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REASONS FOR MERGERS AND THEIR IMPACT ON COMPANIES

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Abstract

Given the emphasis in recent years on reorganizing operations, as strategies for achieving the medium and long term objectives of the companies, this paper aims to enable a theoretical study on the subject of mergers between companies, by analyzing the recent literature regarding this subject, both national and international, focusing on mergers' evolution in Romania, the reasons which determine their achievement as well as on outlining the state of knowledge regarding subsequent performance of the companies involved in these transactions.

A need for further research on the topic of mergers' performance has been identified, particularly on the medium and long term, as existing studies have not provided enough information in order to formulate a principle regarding the impact of mergers on a company's performance.

INTRODUCTION

The unstable situation of the current economic environment, globalization, the lack of liquidities, the rapid technological advances, and the competition becoming more and more aggressive, create among managers the need of continuous adaptation, by identifying the most appropriate strategies for saving the business or to strengthen its position on the market.

Among the measures envisaged is included also the merger, as a mean of internal restructuring of a company, through which occurs either a full takeover of assets from another company in exchange for a remuneration, usually made with shares within the company that initiated the operation, either by pooling the assets of two companies to create a new one.

The advantages that can be obtained as result of merger represent factors for the decision to merge. Among them, in the literature, have been identified mainly the followings: market power enhancement, synergies, which determine both a increase of size and cost reduction, fiscal advantages, control over new assets without direct payment in cash, diversification, easier access to credits, a refreshed image of the company, or access to new markets. In other words, mergers can contribute to the survival of a company in difficulty or to increase competitiveness and the financial or non-financial performance.

THE CONCEPT OF MERGER BETWEEN COMPANIES

According to the Explanatory Dictionary of the Romanian Language, the merger operation consists in the fusion of two or more organizations in a single homogenous unit. The result of a merger between two or more entities is a single company, usually stronger, having a higher potential of development, in whose patrimony will be found assets and liabilities from all companies involved in its process of formation.

Romanian law, especially the Law of Trading Companies no. 31/1990, with the subsequent amendments and additions, refers to two types of merger, depending on the way they are achieved. The first type, the merger by absorption, is presented as the operation through which one or more entities transfer its/their entire patrimony to an absorbing company, in the exchange of distribution to their associates or shareholders of some titles of the absorbing company, and sometimes of an amount called balancing payment, of maximum 10% of the nominal value of those shares.

The second alternative is the one of merger by reunion, a procedure after which two or more companies are dissolved, without liquidation, transferring all their assets and liabilities to a newly-established company, in the exchange of some shares of the new company, which will be distributed to the existent shareholders and sometimes of an amount of money paid to them.

The literature sometimes creates confusions, by superimposing the concept of merger over the one of acquisition (researchers generally refer to mergers and acquisitions operations –M&As). It is necessary to make the distinction between the operations of merger and acquisition of a part or all titles of a company. In the second case, although is detained the control over the patrimony of the entity from which titles were purchased, the operation does not represent a merger, as the transfer of all assets and liabilities from a company to another did not take place and the number of companies involved had not been reduced, by dissolution without liquidation.(Toma, 2003).

EVOLUTION OF MERGERS AT A NATIONAL LEVEL

In Romania, mergers started being used quite lately, hardly after the middle of the'90s. The period between the years 2002 and 2004 was marked by a continuous increase of the number and values of mergers, as well as of an increase of attractiveness of the Romanian economic environment for foreign investors (Bădulescu & Vancea, 2012).

A significant evolution of their number had been notices starting with the year 2003, when cross-border mergers began to be used. Their volume was influenced by the favourable evolution of some macro-economic factors such as the GDP, the exchange capitalization and the volume of credits granted to the private sector, which created the adequate premise to initiate such transactions (Jurcău, Andreicovici& Matiș, 2011).

Although it is considered that the number and value of transactions within mergers depend on the economic environment's situation, the national studies conflict with the theory that in periods of crisis, the number of operations of this type reduces. If comparing the market of mergers in the period after the settlement of the economic crisis, with the previous years, an increase of the number of transactions can be noticed. Consequently, one can deduce the fact that companies decided to merger in order to „save" the business or to consolidate its position on the market, in conditions of economic instability (Cernat-Gruici, Constantin& Iamandi, 2010).

If analyzing the values of the transactions, the year 2009 represented a breakdown on the market of mergers and acquisitions at a national level. The factors which contributed to this decline were the lack of liquidities, the difficult access to credits, as well as the decrease of attractiveness of investors towards risks (Vancea, 2011).

This descending trend continued also in 2010, when the value and number of mergers was with 5% under the level of the previous year (Ernst&Young, 2011). Starting with the first quarter of 2011, a tendency of refreshing the market of mergers and acquisitions was noticed, but the national rhythm of redressing is slower than the one for other European developed markets (Ernst&Young, 2012).

Neither the year 2012 represented a significant evolution for the national market of mergers. The strong recovery previously forecasted was delayed because of the unstable political climate. The political uncertainty in the period prior to elections determined investors to manifest a reserved attitude, significant transactions not being realized.

For 2013, the perspective is a more optimistic one, being forecasted several transactions of this type at a national level (CMS&DealWatch, 2013).

REASONS UNDERLYING THE ACHIEVEMENT OF MERGERS

The reasons that might determine the managing board of a company to initiate a merger are multiple, depending on the medium and long term objectives intended.

Usually, at the base of each merger operation underlies the desire of development, an activity improvement or the achievement of better results. When companies activate in the same field, the alternative of merger can be chosen, in order to eliminate the competition and to strengthen the market position. In certain situations can be invoked as reasons different organizational or managerial advantages, especially when those companies have either one or more common associates, or the same managing board.

The main reason why a company decides to merge consists in the desire of a business reconfiguration, by increasing the resources and the productive capacity. Along with taking over a company, it obtains the control both on its assets and on its know-how, also with the possibility to develop a very important element, namely the specialized human resource (Ferreira, 2007).

Another reason why companies can decide to get involved in mergers is the access to certain information or strategic assets. A study realized on the Chinese market of mergers and acquisitions highlighted the fact that companies usually see merger as a possibility to increase the competitive advantage, by taking over some assets that might favour the technical and productive development, with reduced costs (Deng, 2010).

From a strategic perspective, the reasons for achieving mergers can have an offensive nature, when is intended the entrance on a new market, the gain of new resources, the increase of the influence level and the refreshing of the business, or a defensive nature, when is intended the consolidation or defence of the market position, looking to reach a critical size, adaptation to technological evolutions or eliminating competition (Masulis, Wang, Xie, 2007).

The fiscal advantages could represent another factor with significant impact on the decision of merger. In the planning stage must be analyzed the possibility to obtain tax advantages, and also a tax planning for the future must be considered, taking into account the deductibility of interests and the tax regulations specific for each country of which the participant companies come from. (Ianca, 2008)

In Romania can be noticed a tendency of merger encouragement, the last legislative amendments creating favourable legal and fiscal circumstances for this type of operations. Within the Ordinance no. 15 from August 23rd 2012 for the amendment and completion of the Law no. 571/2003 regarding the Tax Code, published in the Official Journal no. 621 / August 29th 2012, is provided a new advantage granted to companies involved in mergers, namely the possibility for the company resulting from merger, to recover the tax loss transferred from the company/companies taken over. Consequently, it has the possibility to decrease the tax on income that is to be paid.

In the conditions of this economic crisis, the merger of trading companies, as form of concentration of companies' capitals, can provide the technical and financial resources necessary to continue the activity. By creating a single company, usually stronger, there is a chance to increase the market share and the sales. Moreover, after improving the degree of technological endowment, by gaining new assets, a company can increase its productivity level, the quality of products, as well as the efficiency of using resources. The merger can be the best solution in the case of a deficient management of the absorbed company, as well as a way to “refresh a business” without additional investments, only by pooling together the assets and liabilities of two or more companies (Uher, Nagy, Cotleţ B. & Cotleţ D., 2010).

Both in the case of large companies, listed at the stock exchange, as in the case of small companies, a merger with a company having a similar or related activity has as effect the achievement of some economies of scale, by decreasing the production or personnel costs, as well as those related to the payment for certain goods or services which were previously purchased from the outside. The economies of scale have as effect the decrease in the average production cost, when the productive capacity extends.

Risk diversifications, as well as the extension towards new geographic areas are also considered elements that influence the decision to merge. (Kwaasi Adjei&Ubabuko, 2011)

THE MERGER PERFORMANCE – SUBJECT OF DEBATE

The performance of mergers and acquisitions is a frequently approached subject in the literature, both at national and especially at international level, but recent studies referring to this aspect reached inconsistent results. Moreover, there are so many ways to appreciate the performance of a company in the period after merger, that in certain situations, different approaches may create confusions.

These operations can have significant implications on the performance of the participant companies, as well as on the value that belongs to title owners within these companies. When a firm decides to take over by merger or acquisition of titles a firm from other country, it will get full control on that unit, therefore obtaining a strategic advantage from a geographical point of view (Laamanen& Keil, 2008).

The performance of mergers can be approached under two dimensions, respectively the financial performance and the non-financial performance. At its turn, the financial performance can be appreciated by means of indicators provided by accounting (evolution of costs, results, economic and financial indicators), of those used in marketing (market share, evolution of sales, client portfolio, etc.)(Pierre, Devinney, et.al, 2009), or based on the evolution of the company’s securities on the capital market (Mogla&Fulbag, 2010).

The non-financial performance is determined based on non-financial indicators, among which must be mentioned the degree of innovation, adaptation to the market requirements, the success, the reputation, etc. (Meglio&Risberg, 2011).

The decrease of costs and the achievement of economies of scale can be considered another way to measure the performance of a merger. According to the analysis of cost evolution in the period prior to merger and afterwards, certain differences were recorded depending on the age of the company and its activity field. For example, in the case of sanitary institutions, the merger determined a decrease of costs, but significant economies were achieved only in the first years after merger, thereafter costs increased gradually up to the level previously recorded (Harrison, 2011). In the IT sector, there have been significant savings and increased short-term financial performance as a result of the merger, provided that attention was paid to the compatibility of the software offered, trying to achieve a complimentarity between them. (Leger, Quach, 2009)

The analysis of mergers’ performance realized between companies from different countries has shown an increase of their productivity with up to 9%. But this favourable result was recorded only after three years following the merger, so it is considered that a certain period of time is necessary to pass, in order to obtain the expected results (Karpaty, 2007).

The same favourable results were obtained within a study realized by the researchers Bertrand and Zitouna. They analyzed the evolution of profit and productivity of companies involved in mergers and acquisitions, and reached the conclusion that these types of operations significantly improve the level of productivity, but do not increase the profit of the company resulted after merger. Furthermore, it was noticed the fact that in the case of mergers between companies from different states, the increase of the productivity level was superior to the one recorded in case of mergers between companies from the same state (Bertrand&Zitouna, 2008).

If the non-financial performance is analyzed from the perspective of significant advances in development capacity and innovation in the period following the merger, studies show that these operations usually have a beneficial effect on the degree of innovation in the productive process. An increase of the performance and innovation were noticed after merger, especially in IT and telecommunications fields, both due to the activity of the R&D department within the absorbing companies and as a result of taking over the developed technological and human resources from a company with a similar activity (Gantumur& Stephan, 2012).

When studying of the performance of companies involved in mergers, the period when the analysis was conducted is very important. Although most of the studies focused on the short-term performance(Zollo&Meier, 2008), these show certain limitations, as the effects of merger cannot be noticed immediately after ending the operation, but later, after the stage of post-merger integration. In many cases, the short-term positive signals were followed by significant long-term decreases, being registered also inferior results to those obtained by the companies in the years prior the merger (Oler, Harrison&Allen, 2008).

Although opinions are different regarding the impact of mergers and acquisitions on the companies' performance, there can be synthesized certain factors which can positively or negatively influence the performance reported by companies after merger. These are: the payment modality (cash or titles), the ratio accounting value/market value of titles, the type of merger (by absorption or reunion) or if it was realized between affiliated or independent companies, if the involved companies are from the same state or from different states, if the merger or the sale of all titles was decided, the size of involved companies, the macro-economic conditions, as well as the duration of the transaction (Ismail, Abdou& Annis, 2011).

In an unstable business environment, mergers and acquisitions can be considered strategies to consolidate the financial power of companies. Despite all these, in certain situations, such operations proved to be a failure, especially when the management board concentrated mainly on the economical and financial aspects, neglecting the needs of the human capital. Therefore, in order to avoid an eventual failure, it is recommended that the managing style orients towards change, giving attention to the economic aspects, the staff-related ones and to those of organizational culture (Brătianu& Anagnoste, 2011).

The failure of mergers can be determined by a series of factors, among which can be mentioned the followings: the lack of experience at the managerial level, the lack of a process of due-diligence, the incompatibilities from the strategic management level of involved companies, the cultural differences between employees from the merging companies, or the defective or incomplete communication between different hierarchic levels. Any merger should be preceded by a process of due-diligence, through which is evaluated the condition of the company that is to be taken over. The managing board of the company should contract several specialists (jurists, economists, financial analysts, auditors, tax consultants, specialists in marketing and management) and only after that decide if the financial situation, the image of the company, as well as the organizational culture show the advisable conditions for merger (Chiriac, 2011).

Another factor that can determine the failure of a merger is the high degree of indebtedness of the absorbed company, which may have a negative impact on the profitability of the absorbing company. In order to avoid the failure of a merger by absorption is recommended an analysis of the return on equity ratio of the company that is to be taken over. It is considered acceptable a level of minimum 15% of this ratio; for a lower level of the mentioned limit, those who want to invest in a company, or to absorb it by merger should reconsider their option (Georgescu, Chiriac, 2012).

Other factors that might determine the failure of a merger consist in informational asymmetries that flow from the period before merger, as well as in the problems of cooperation and coordination from the period after the merger. If a company decides to get involved in a merger, but in the post-merger period will count only on the managing board of the partner company, without actively participating in the process of integration, the merger will be completed, but will be doomed to fail. (Banal-Estañol & Seldeslachts, 2011)

The stage that follows immediately after merger, the one when the effective combination of resources takes place, is essential for the success of the transaction. Often, the failure of mergers is caused by the inappropriate administration of this period of transition, especially in terms of cultural differences and of the human factor, whose influence will reflect in the economic and financial results obtained by the company (Marks&Mirvis, 2010).

The same negative influence of mergers was also identified at a national leve1; a study on 31 companies participating in mergers between 2007 and 2009, shows that the short and medium terms results were lower than the ones predicted. This unfavourable evolution was also assigned to the high degree of indebtedness registered by the absorbed companies, which transferred by merger the payment obligations to the absorbing company (Georgescu&Chiriac, 2012).

Therefore, it is noticed the necessity for further research in terms of merger performance, especially for medium and long term, as the current studies do not offer enough relevant information and do not create the foundations of a principle referring to the impact of mergers on the results of the company.

CONCLUSIONS

Due to the increasing interest regarding mergers, both at national and international level, it is interesting to approach this theme within further research studies. A merger represents a complex and challenging way to realize the strategy of a company. In order to increase the chances of success of these operations, a very good documentation and analysis before starting the operation are necessary. Furthermore, an intense effort must be invested afterwards, in order to adapt the company's activities to the new conditions, as well as for the integration of resources and organizational cultures of the merged companies.

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