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DO ROMANIAN MERGERS REALLY CREATE VALUE?

Empirical study

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Abstract

The realities of our modern society demonstrate that businesses operate in a competitive environment, which requires continuous improvement and development of production and sales. In this context, for financial, economic and fiscal reasons, companies resort to a process of concentration, through the merger of all the factors involved in the fulfilment and diversification of their activities. Often, the reasons for engaging in a merger refer to the fact that two merged companies create, in terms of value, an entity that exceeds the individual values of the two participants if they were to continue to activate separately.

This paper aims at analysing whether the well-known relationship '1+1=3', which describes merger synergies, applies at the Romanian level.

For this reason, each of the values of 77 merged companies were compared with the sum of the individual values of the firms that initially created them. It was found that 56% of the mergers analysed generated added value for shareholders.

Introduction

When approaching the subject of mergers and acquisitions, it is most likely to find the famous relationship '1+1=3' used to define one of the results of such transaction, namely the value creation.

A very important aspect is the way these values are calculated, nowadays being developed specific methods for companies' assessment. These valuation methods are grouped into three distinct approaches, namely: the assets approach, the income approach and the market comparison approach, each of these having their own specific valuation methods.

From these valuation methods, the assets approach, namely the net assets value method, is the simplest to apply, for this reason, but not only, being the most popular and used valuation method for merging companies especially at the level of Romania (Lazăr&Avram, 2011).

Although, in general, mergers are said to create value, numerous cases failed to achieve this objective, being identified situations when the merger decision led to greater losses than if the companies were not to merge.

For this reason, this paper aims at identifying whether for Romanian companies the decision to participate in a merger process led to a higher return value for shareholders or not.

The Net Assets Method and the Added Value Resulting from a Merger

As mentioned previously, the value of a company calculated through the method based on the Net Assets is easy to be determined, this involving calculating the difference between total assets and total liabilities for each of the companies that will merge. The level of assets and liabilities is the one included in the financial statements prepared for the moment when the merger is decided. Therefore, the net asset value represents the surplus assembly of goods and receivables of a company on its total liabilities, or the total shareholders' equity and the net financial result (Toma, 2009).

This valuation method is preferred especially by merging companies with low resources, which are not willing to invest in contracting a certified assessor. In addition, because accounting rules require the assets and liabilities to be inventoried and reviewed yearly, it can be considered that the balance sheet and the financial statements prepared for the merger include relevant and updated values. Therefore, the result obtained by applying the net asset valuation method can be accepted as being close to the market value.

When describing advantages that result from mergers, one of the first to be mentioned is synergy, or added value.

The International Valuation Standards define the synergy as that extra element of value that results from the combination of assets or rights, deciding which of the value of the combined rights are greater than the sum of the values of the individual rights.

The first to synthesize a formula for expressing synergies was Ansoff (1965), who explained this merger advantage using the relationship '2+2=5'.

After Ansoff, researchers and also business advisors or managers developed two other formulas to express synergies, namely '1 +1= 3' or '1+1>2', with the purpose of highlighting the added value which can be generated from combining two different businesses.

Another explanation for synergies is given by Lubatkin(1983), who states that synergies occur when two companies are run more efficiently and effectively together than apart, due to a better allocation of scarce resources.

The popularity of the Net Assets valuation method and the synergy formulas mentioned above were the ones to trigger the idea of verifying whether Romanian mergers conduct to value creation or, on the contrary, they destroy value and generate losses for shareholders.

Research Methodology

In this paper, we considered interesting and appropriate the analysis of the benefit that results from mergers.

With regard to researches conducted at national level, there cannot be identified any studies which have as main purpose the determination and comparison of the post-merger value of the company with the existing value before the merger, both in the absorbing and the absorbed companies. The need to measure that value is important in order to demonstrate one of the reasons frequently stated in the merger projects, namely value creation for shareholders in companies involved in such a restructuring transactions. From this perspective, if the studies conducted internationally converge on the idea of increasing the value of the company in the post-merger period, at the national level literature addresses this topic less.

It is therefore obvious that the purpose of the analysis is to identify if the sum of values for the individual merging companies is below the one of the company created through merger.

All companies whose merger projects have been published in the Romanian Official Gazette during the year 2011 represent the population on which the analysis will be conducted.

From these, there were selected the ones activating in the wholesale and retail sector, resulting a total sample of 93 merger cases.

This activity sector was chosen as being more representative, considering that the highest number of mergers took place in it. (Hromei, 2014)

Of the 93 mergers identified, there were removed the ones for which the input value or the net asset value was not stated in the merger project, nor could be determined, in the end, resulting a final sample of 77 merger cases.

To achieve the established purpose, the following steps were conducted:

- Calculating the individual values of the companies included in the merger project, namely their net asset value;
- Summing the individual values of the companies participating in the merger;
- Determining the value of the company resulting from the merger in its first year of activity after restructuring;
- Comparing the sum of the individual values with the net asset value of the company resulting from the merger;
- Determining the plus or minus of value generated as a result of the merger.

Results and Interpretations

After conducting the steps previously described, the study obtained a total number of 43 merged companies with a superior value than the summed values of the absorbed and absorbing companies that activated separately in the previous period.

As shown in Figure No. 1, 56% of the mergers analysed managed to create added value for shareholders, while 44% of them generated zero added value or even destroyed or reduced the net asset value at the disposition of shareholders, the variant of individual functioning being more favourable.

This phenomenon can be explained by the fact that the specific of activity of the companies selected for the study does not involve holding the heritage of many fixed assets, as in the case of production firms. Companies activating in the wholesale and retail sector usually focus on stocks and ensuring their circulation as quickly as possible, therefore it is normal for the level of assets to be relatively low. In addition, it is possible that the merger generated several redundant assets, which were not integrated in the operational activity, therefore not creating value.

It should also be mentioned that the first year following a merger is the most critical one, the entire integration of human and technological resources being conducted. The entire activity is restructured and remodelled in order to suit the new dimensions, needs and goals of the recent created company.

Instead, it is possible that among the reasons that led to the decision of merger, there was retrieved the salvation of the business, this explaining the high debt levels registered by the companies from the sample.

A low level of increase in assets, namely low investments, together with a higher debt level could generate reductions of the net assets.

However, the fact that the number of merger cases that generated synergies is higher, allows us to conclude that participating in a restructuring through merger was a good strategy for the companies analysed.

It should be clarified that the results may vary when the assessment methods used would fall into other approaches. This analysis was not possible because, as highlighted in earlier studies, Romanian companies are not interested or not able to contract an authorized assessor. This certified evaluator would be able to apply more complex procedures, such as those based on discounted cash flows, which involve both estimates and projections, and calculations with a high level of difficulty. Therefore, the only way of measuring the value of the companies was through the net asset value, a financial indicator also presented in the financial statements.

Conclusions

The results of the study conducted lead to the conclusion that the Romanian mergers have the tendency to create added value for shareholders, namely to generate synergies, when assessing the value through the net assets approach, suggesting the fact that the international trend applies also at the national level.

Both shareholders of the absorbed and the absorbing company will be satisfied of these results, part of the company's value transforming, in the future, into dividends at their disposal.

Although the percentage of mergers generating added value isn't highly superior to the one of companies which lowered their value after the merger, chances are that, in the next year following the completion of the integration phase, the value of the merged company would increase significantly.

Considering that the analysis on the medium-term evolution of the absorbent company's value compared to the time prior the merger might offer more relevant and interesting results, future studies will address this issue.

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ANNEXES

Figure No. 1