MERGERS AS WAYS OF INCREASING EQUITY FOR SHAREHOLDERS ON THE LONG TERM

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Abstract

Mergers, as reorganization options, have emerged from the continuing need of companies to adapt to market demands, as well as from the desire to identify the most appropriate solutions for business continuity and capital adequacy, becoming increasingly popular nowadays.

Considering that the reasons most frequently invoked for a merger are achieving synergies and increasing shareholders' value, we considered it appropriate to carry out a long-term analysis of the added value generated by these restructuring transactions. Since the examination of the evolution of a company's value has a higher significance and level of interpretation after a certain period of time once the completion of the merger process and the integration phase, the study was conducted for a period of eight years from the time of the merger.

This paper seeks to analyse whether, in the long term, the well-known relationship "1+1 = 3", which describes the merger added value or the generated synergies has applicability at the level of the Romanian economic environment.

For this reason, for each of the 65 Romanian merger cases analysed, the sum of the individual values of the companies' prior the merger was compared with the value recorded by the absorbing company for a period of 7 years after the completion of the merger. It was found that in 77% of the cases the merger had a beneficial impact on the equity value of the participating companies, therefore the capital restructuring by merger can be considered an adequate option.

Keywords

Mergers and acquisitions, long-term synergies, value creation, equity valuation, net asset method

JEL Classification

G34, M40

Introduction

In recent years, at national level, there has been an increase in companies' interest in restructuring and reorganization operations such as mergers and acquisitions. This practice of mergers, particularly discussed and analysed internationally, gradually grew a place on the Romanian market. The media is presenting more and more such transactions, the reasons for their completion being the vertical or horizontal development of business, the increase of equity and of the value returned to the shareholders, or, in some cases, the hope of rescuing those companies found in an impasse.

The majority of studies conducted on the evolution of the companies after the merger operation focused on their short-term results. However, the medium- or long-term effects of these transactions have not been detailed, nor if the objectives stated in the merger projects were actually achieved in the post-merger phase.

Regarding these aspects, Gregorieva and Petrunina (2015) concluded that mergers conducted on emerging markets are value-destroying deals. Also, a recent study conducted by Bianconi and Tan (2019) found that due to the merger process, the firm value can increase in the short-term, but in the medium-term, the company value is expected to decline.

At the level of Romania, it was found that at the end of the merger year, 56% of the cases examined showed an increase in the value of the companies, while in 44% of the cases the decision to merge had a negative impact on the value of the companies, the individual operating mode being a more favourable one. Therefore, the major influence of the mergers on the creation of added value for the shareholders could not be confirmed at the end of the first year after completion of the merger. (Hromei, 2015)

Since we believe that the results obtained after the first year of the merger could have been influenced by factors related to the period of integration of each company's resources and adaptation to the new structure and activity, we decided to conduct our analysis over a longer time horizon considering the results obtained more relevant for identifying a national trend.

Research Methodology

The purpose of this research is to determine, in the long run, the impact the merger has on the value of the companies that have decided to restructure by this method, namely the identification of synergies resulting from the merger process, in term of company value.

A first definition of synergies phenomenon was given by Ansoff, who explained the benefit resulting from the successful completion of a merger operation through the "2 + 2 = 5" formula. This way, he tried to point out that, by continuing the activity through a single entity, two companies can obtain higher values than in the situation when they would have decided to activate individually (Ansoff, 1965).

Over time, Ansoff's formula has been adapted; nowadays the relationship frequently used to define the plus value of the merger is generally "1 + 1 = 3".

This research seeks to identify the long-term concordance between this formula and the economic reality at the level of the Romanian merger market.

For this purpose, we analysed the evolution over a period of 8 years of the value of the company resulting from the merger, compared to the sum of the individual values registered before the reorganization, for the companies that combined their patrimony, aiming to determine the synergies, respectively the long run generated added value from these transactions.

There are many approaches and valuation methods for merging companies, from simplistic asset-based approaches to the most complex ones like revenue-based, cash-flow, goodwill, and stock indices, each of these methods having advantages and disadvantages depending on the specific of the evaluated companies (Petitt and Ferris, 2013).

International literature and practice consider the income approaches best suited for estimating the value of merging companies, among which more popular are the cash-flow or dividend-

based methods. Also frequently used, the modern methods based on market comparisons are relatively simple to apply and provide a more relevant value for companies, according to the ever-changing economic reality (Shapiro et al., 2013).
Nevertheless, at the level of the Romanian business environment, it was found that the most preferred are the asset-based methods, the most commonly used method being the accounting net asset value (Lazăr and Avram, 2011; Hromei, 2014).
This method takes into account the book value of the company's assets and liabilities, in order to determine the book value of equity, which is considered a global value or net contribution for each of the companies at the moment of the merger (Georgescu et al., 2019).
The Net Asset Valuation Method assumes the determination of a company's value only on the basis of the information presented in the last balance sheet, the owner's equity being determined by reducing the level of total assets with the total debts of the company. Therefore, the net asset value represents the total equity of a company (Poniachek, 2019).
Given the frequency of the valuation method based on the net asset value and the fact that for the sampled companies, this same method was used to determine their value at the time of the merger, we considered it appropriate to maintain the same method when determining the value of the companies for the years following the merger.
The analysed sample consists in all the wholesale and retail companies whose merger projects were published in the Official Gazette of Romania during the year 2011. Both the absorbent and the absorbed companies have their main activities under the section G: wholesale and retail commerce, according to the NACE classification, considering this a better way to observe value evolution if merging companies activate in the same or related field.
The decision on the selection of mergers that took place in 2011 can be explained by the need to access the financial data published for the years following the merger, the time range being, as mentioned above, of 8 years.
Of the 93 merger cases identified, we eliminated those for which the value of the contribution at the time of the merger or the net asset value was not stated and therefore the value at the time of the merger could not be determined, as well as those companies which in the subsequent years after the merger date, either dissolved or ceased to publish their financial statements. In the end resulted a sample of 65 cases of merger by absorption to be studied.
We consider interesting to mention that the total number of companies, which, within the period of 8 years after the completion of the merger ceased to exist, being dissolved and radiated, or their financial information ceased to be published, amounted to 12, these details suggesting a negative influence of the merger on the activity of those respective companies on the long run. However, not knowing other information or factors that could have influenced the dissolution and eradication decision, we consider more important to focus on the evolution of the ”surviving” companies that make up the selected sample.
The time horizon observed refers to the period 2011-2018, the results included in the analysis being related to the year of the merger and the next seven years after the completion of the transaction.
In order to achieve the proposed goal, it was considered, in the first stage, the determination of the individual values of the companies, based on the information included in the merger projects, documents which were consulted in the database of the Official Gazette of Romania, part IV.
As above mentioned, the valuation approach was through the Net Asset Valuation Method, one of the arguments being the fact that all the companies included in the sample, used at the time of the merger, this method to determine and present their net contribution in the merger project. Some of the reasons invoked in the mergers projects for opting for this method included the fact that none of the companies were listed at the stock exchange, the difficulty

of making estimation for cash flow assessment, and the accuracy of data from the balance sheet, consistent with the economic reality.

After establishing the individual values, we proceeded to determine the value of the newly created entity, by summing the individual values of the absorbed and absorbent companies.

Taking into account our objective, namely the analysis of the long-term value evolution, the next step was to determine the value of the company resulting from the merger for a period of 7 years after the completion of the merger process. For this, the database of the Ministry of Public Finance was consulted, where the annual financial statements submitted by the economic agents are published, the database query being possible using the unique registration code of each absorbent company. Information regarding the net assets or net equity was collected for the years following the mergers, namely the period 2012-2018.

After collecting the information regarding the total equity or the net asset value for the period under study, we continued with the calculation of the annual growth rate of the value of each of the merged companies included in the sample.

The final step implied the calculation of the average growth rate of the company's value for the period under review, thus determining whether, on average, the merger has led to an increase in the value of companies or to its diminishing.

For each of the companies included in the study, the growth rate of the value from one financial year to another was determined, as well as the average growth rate for the analysed period.

By observing the average growth rate, we were able to identify the number of merger cases for which, in the long term, an increase in the value of the company could be identified, as well as those cases that did not show a favourable evolution after the merger.

Results and Discussions

After completing the above described steps, we proceeded to group and separate those mergers that determined, in the long term, a difference of positive value from those that led to the destruction of the value of the companies, respectively the reduction of the shareholders equity level.

The results of the study suggest that mergers can be directly associated with an increase in the value of the company and, indirectly, with an increase in the benefits to its owners.

Out of the 65 mergers analysed, in 50 of the cases, there was an increase in the value of the company resulting from the merger over the sum of the individual values of the companies that formed the basis for its creation, and in the years following the restructuring. Therefore we can state that intended for 77% of the companies included in the sample, the decision to merge has proved to be beneficial, generating synergies at the level of the shareholders on the long term, and increasing the book value of the equity.

These companies have managed to overcome the difficulties they faced before the merger and at the stage immediately following the completion of the transaction, integrating favourably both their shared assets and their organizational cultures.

Compared to the short-term results, it is noted that a larger number of companies register, in the long term, an increased value, this trend being explained by a better integration of resources in the next financial years. Another reason could be the implementation of a medium and long-term strategy to increase results and benefits, as well as a more efficient activity than in the first year, considered critical and focused, in particular, on adapting to change.

It can be stated, therefore, that at the basis of creating synergies lays the company that absorbs or the absorbent, but there may also be situations where synergies result precisely from the absorbed company, due to the assets or knowledge it has transmitted to the absorber. It is important for the leaders in the field to be able to identify the elements that can add value, as well as to quantify the value of synergies generated. Good integration mechanisms and communication plans implemented after the merger process are the main ways of ensuring

the success of such restructurings. (Baker and Kiymaz, 2011)
Participating in a merger with a partner in the same industry, as it was the case in our study, could lead to a decrease in production and personnel costs and in costs of goods or services previously purchased from outside, all of these benefits being translated by the phrase economies of scale, often referred to as main motivation in merger projects.
However, as can be seen in figure no. 1, there were also some less favourable situations in terms of value recorded by companies after the reorganization by merger. In 15 of the analysed cases, respectively for 23% of the absorbent companies from the sample, in the years following the merger, there were found decreases of value, respectively decreases in the shareholders equity.

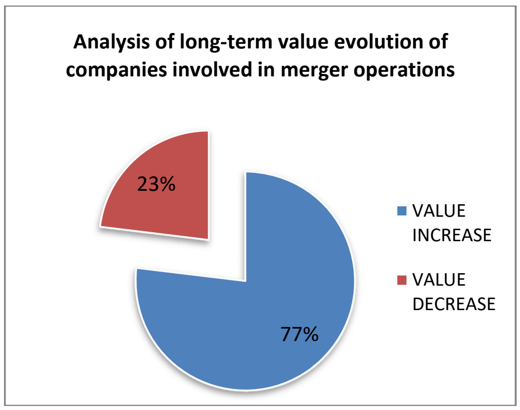

Fig. no. 1 The analysis of long-term value evolution for companies involved in mergers

This phenomenon can be justified by the complexity of an efficient organization of the merger process, the difficulty of making realistic forecasts on the future evolution of the company, establishing the post-merger strategy and activities, so that the initial objectives and the main purpose of the reorganization would be achieved.
The failure of a merger operation is often due to an overestimation of the benefits that could be obtained, as well as to the insufficient information collected about the company being acquired or took over, referring to its resources and its strengths or weaknesses. A faulty initial assessment can lead to a failed transaction.
It should also be pointed out that it is difficult to accurately measure the value added that can be attributed, in the long run, to the merger, since other factors, internal or external, may interfere, as time passes, in the economic and legal activity of any company. These factors might directly alter the company's financial results.
However, if proper planning and close follow-up of all phases and steps during the integration period are taken into account, merger operations can have a real positive influence on businesses previously in difficulty, as well as a significant growth of capital, and of the benefits to their owners.

Conclusions
The results of the study lead to the idea that Romanian mergers succeed, in the long run, to create added value, or to lead to synergies.
When the value of the companies participating in the merger is determined on the basis of the accounting net asset method, namely the book value of equity, a tendency to increase this value in the long-term, respectively in the next 7 years after the transaction was completed, was identified, the majority of the companies included in the study registering increases in value in the period following the completion of the merger process.

This favourable evolution of the value of companies can be translated by an increase in the benefits of shareholders, which is often invoked when deciding to participate in merger restructuring operations.

An analogous analysis would be interesting, but based on company valuation by other methods, since the accounting net asset method is the simplest but also the least adapted to the specifics of each company and field.

Also, the measurement of the value added and of the synergies generated by the Romanian merger operations through modern assessment methods already applied internationally can represent future research directions.

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