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THE INFLUENCE OF MERGERS ON THE MEDIUM-TERM FINANCIAL PERFORMANCE OF ROMANIAN COMPANIES

Empirical study

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G34, M40

Abstract

At the level of Romania, very few studies approach the issue of how mergers can influence the medium-term financial performance of the participating companies. International studies often obtain contradictory results when measuring the impact of mergers on the financial performance. This study aims at analysing the merger transactions that took place in Romania during the year 2011, in the trading sector. A total of 87 companies involved in merger deals were included in the sample. As measurements for the financial performance, the net turnover, the net profit and the return on sales rate have been chosen. The results show that mergers din not have a positive impact on the financial performance of the absorbing companies for the three years following the reorganizing operation. It has been identified a decrease in terms of profitability for the absorbing companies, only the level of net turnover recording significant increases in the medium term.

Introduction

The success of mergers is a very debated and controversial topic, different studies conducted on this topic often offering contradictory results.

The reasons for these differences are related not only to the space-time factor, i.e. the location of the companies surveyed, the number of years taken into account, neither to the period under review, nor to the sector of activity in which the company operates. Rather, it can be stated that studies on the impact of mergers offer distinct results because they are based on different indicators to assess the success of the merger.

In recent years, mergers began to receive more attention in the Romanian business environment, being often considered as ways of strengthening businesses or of salvation in critical situations.

Despite this increasing interest, the studies regarding the reorganization operations through mergers, and in particular, those regarding their performance, are relatively small in number.

Therefore, the possibility of analysing the appropriateness of making such a transaction, based on previous studies, is quite difficult to achieve. There is thus the need for research of this type, in the short, medium and long term. Managers or shareholders need information of this kind, based on empirical studies conducted at a national level, before deciding on involving in a merger. Given that even at the European and international level there cannot be outlined a unified view of the success of mergers, opinions being often divided, it is even more necessary to conduct analysis based on data from the national level.

This paper aims to investigate the changes occurred in the financial performance of Romanian companies, subsequent to their participation in a merger transaction.

Previous studies

As previously mentioned, opinions regarding the impact of mergers on the financial performance can often be quite opposing.

While some of the international studies identified an increase of the financial performance after the merger ((Linn & Switzer (2001); Heron & Lie (2002); Gugler, Mueller, Yurtoglu & Zulehner (2003); Moeller & Schlingeman (2004); Rahman & Limmack (2004);Powell & Stark (2005)), there are also many researchers who support the idea that the financial performance has decreased due to the participation in a merger transaction (Clark & Ofek (1994); Dickerson, Gibson & Tsakalotos (1997); Yeh & Hoshino (2001); Kruse, Park & Suzuki (2002)).

A recent study conducted in Romania analysed the short-term performance of companies involved in mergers, based on financial data for the previous year before the merger and the results from the year the merger was completed. It was found that in 72% of cases examined, the merger had a beneficial impact on the financial performance of the absorbing companies (Chiriac, 2013).

However, there is the possibility that, in the medium or long term, the analysis on the financial indicators of performance could provide different results.

Therefore, it was considered appropriate to conduct a research on the evolution of the medium-term performance of companies participating in mergers.

Research methodology

This study mainly aims at identifying the impact that participation in a merger by absorption plays, in the medium term, on the financial performance of the absorbent company.

In terms of spatial-temporal landmarks, it should be noted that the study refers to the national business environment, namely focusing on the companies that merged in Romania during the year 2011. The research aims at analysing the evolution of some financial indicators, comparing their values for the year prior the merger with the ones obtained in the next three year after the merger was completed.

Thus, it was decided to collect data on all merger projects published in the Romanian Official Gazette during the year 2011. The access to the archive of the Official Gazette has been possible through a subscription for the "expert-monitor" application, which allows viewing different parts of the publication.

There has been identified a total of 301 merger projects published in 2011, all of them achieved through the absorption method.

Given that sometimes a company's activity can influence its evolution, and overall conclusions may differ considerably from those formulated for a single activity sector, we considered suitable partitioning the merger transactions depending on the main classes of activity of the absorbing companies.

It was found that, in 2011, mergers were mainly completed in the activity Section 'G: Wholesale and retail', according to the NACE classification. Table no.1 highlights the activity sectors in which mergers took place and the share of each sector in the total number of transactions.

It can be stated that, according to the number of mergers recorded, the companies operating in the wholesale and retail trade sector are more opened to the idea of restructuring through a merger activity. A total of 93 companies, representing a share of about 31% of the primary sample, considered merger as an adequate strategy to streamline the business. The next sectors of activity in which a considerable number of mergers took place are manufacturing, with a total of 52 mergers completed in 2011, and the real estate sector, with 31 completed mergers.

Since we consider more appropriate the study of the financial performance's evolution depending on the main activity of the participating companies, this paper will continue with analysing the domain in which has been recorded the highest number of mergers. Future studies will address also to the other domains.

Therefore, after the separation of the 93 merger projects from the wholesale and retail trade sector, we proceeded to collect financial data for each of the absorbing companies. Accounting data was available online on the website of the Romanian Ministry of Finance.

It has been decided to select the indicators for the year before the completion of the merger, namely 2010, and those who followed after the operation, the latest available financial data being published for the financial year ended at 31st of December 2013.

Of the 93 absorbent firms selected, there were eliminated the ones for which data could not be obtained for all the analysed years, the final sample being composed of 87 companies.

Given that it is intended to analyse the impact of mergers on the financial performance of the selected absorbing companies, this study will focus on the evolution of the following indicators: *net turnover, net profit, commercial return (the return on sales).*

For each of the performance indicators mentioned above, it has been determined the growth rate from one year to another and the average growth rate for the three years analysed.

To ensure a more relevant image, we considered appropriate to compare the evolution of these financial indicators of the companies from the sample, with the average national values of these indicators for the trading sector. Information on the medium values of turnover, Net Profit and Return on Sales was collected from the database of the Ministry of Public Finance.

Results and interpretations

a) Evolution of the net turnover after the merger

A first analysis of the absorbing companies' financial performance targeted the evolution of the net turnover.

Thus, based on the accounting data for the financial years 2010-2013, it can be stated that, in the medium term, the companies showed an increase in the level turnover, the average growth rate annually recording values above the threshold of 100.

As showed in Figure no.1, in about 75% of the cases, there was registered an improvement in the level of turnover for the period after the merger. This trend can be translated into a strengthening of competitive position in the market in which the companies operate.

Furthermore, when analysing the evolution of the turnover at the national level, it was found that in the reviewed period, in the analysed sector, the indicator decreased from year to year, registering an average decrease of approximately 2.24%, as showed in Table no.2.

Comparing the evolution at the sectorial level with the evolution of the annual turnover of the companies from the selected sample, it can be stated that most absorbing companies were located in a favourable position compared to the sector's average. Figure no. 2 shows a summary of the comparison between the results of the sample and the sectorial average from the national level.

Results highlight that, out of the 87 companies analysed, 69 of them have developed medium-term turnover higher than the sector level, suggesting that they have improved their strategic position in the market, relative to their competitors.

b) The net profit evolution of the merging companies

The second measure of performance analysed was the *net result* of the absorbing companies, taking into account its evolution from the year before the merger, and for the next three years following.

Unlike the case of the net turnover, it was found that, in terms of net result, the merger did not have a significant impact. As seen in Figure no.3, only about half of the companies (52%) recorded an average increase in the medium term, compared to the period prior the merger.

To determine whether at the sectorial level things are similar, it has been decided to analyse the evolution of the net result's average obtained by companies operating in the wholesale or retail sector, at the national level. As shown in Table no. 3, it was found that, at the level of Romania, companies working in this field registered, on average, a very small increase of the net result, of just 3.95% in the three years analysed.

Given that a comparative analysis between the results recorded by merging companies and the average ones from the sector can provide a clearer picture of the impact of mergers on financial performance, we proceeded to determine the number of companies that have achieved, on medium term, an increase in the net result which is superior to that obtained at the sector level.

As showed in Figure no.4, it was found that, a number of 44 companies, namely 50.57% of them, showed a higher average growth rate, while 43 companies have achieved an evolution of the net result lower than the sectorial average.

Adding the fact that the net result, as an indicator characterizing the enterprise's profitability has not fared significantly different in the post-merger period with the fact that, in terms of turnover there is a significant positive development, it can be deduced the idea that, with the merger, the absorbing company's costs have increased significantly, negating the effect of increasing incomes resulting from the operational activity of the company.

c) The Impact of Merger on the Return on Sales

After analysing the indicators provided by the financial statements, we proceeded to determine the financial performance of the companies through the return on sales rate (ROS).

As showed in Figure no.5, after observing the average increase rate of the ROS ratio for the reviewed period, it was found that for only 25 of the analysed companies, representing a share of 28.74% of the sample, there was recorded an improvement of this indicator. The remaining 67 companies, representing 71.26% of the selected sample, have recorded a decline of the commercial profitability in the medium term.

Based on the method of calculation of this ratio, the relatively small number of companies that increased their sales profitability is caused due to the fact that, on average, the net result has evolved with a slower pace than the evolution rhythm of the turnover.

Therefore, it can be stated that, for the companies participating in the merger, although their sales have increased significantly, they failed to achieve sufficient economies of scale, in order to ultimately achieve higher results than the ones obtained before the merger was completed. The companies which registered on the medium term, a reduction of the commercial profitability, either failed to properly integrate the distribution system along with the business expansion, or failed to establish a strategy in order to improve the efficiency of costs of the trading activity. In order to obtain a better interpretation of this indicator, additional information regarding the operational incomes would be required, to ensure that there were no financial or extraordinary expenses affecting the net result, and hence profitability. Unfortunately, at the time the study was conducted, access to this information had not been possible.

The next step was to conduct the analysis of the absorbent companies' ROS compared to the average level of ROS from the sector to which they belong.

As it can be seen in Table no. 4, nationwide, companies operating in the wholesale and retail trade recorded an increase of 6.33% of ROS during the period between 2010 and 2013.

Taking as a comparison point the 6.33% average increase of the sectorial ROS, there has been made delineation between companies which passed this reference level of profitability, and those who situated below this level or even registered a decrease of the commercial profitability. It was found that only a total of 20 companies exceeded the average growth level recorded nationwide in the trading sector. The remaining 67 companies, namely 77% of them, failed to fall within the sectorial trend, their profitability being affected in the period under review.

Conclusions and future research directions

It can be stated that, in terms of the indicators analysed, the financial performance of the absorbing companies is negatively influenced by the participation in a merger operation, most companies recording a decrease in the return on sales rate.

Results on the evolution of the net profit couldn't provide a reliable conclusion, being a fairly small difference between the numbers of companies for which this indicator has increased in the period under review, from those who have experienced a decrease in net profit as a result of the merger. The only positive impact of the merger on the performance of the acquiring company was registered on net turnover.

Therefore, as a general conclusion, the merger operations had rather a negative impact which can be justified by an inefficient planning of the transaction, unrealistic projections made regarding the future business performance, inefficient post-merger integration activity at the organizational level, or an inadequate resource management.

As prior stated in the literature, to record post-merger performance not only financial issues need to be addressed. Although most studies conducted on post-merger performance were based on actual or projected financial data, aspects of non-financial performance were usually neglected. Therefore, we believe that considering also the non-financial indicators (degree of innovation, reputation, etc.) is very important, especially in sectors characterized by rapidly evolving technology (IT, telecommunications etc.).

Future research directions will concentrate on analysing the financial performance through other return rates, by stock indicators and non-financial measurements.

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Tables and Figures

Table No. 1

Merger distribution on each activity sector for the year 2011

Activity sector according to NACE	Number of mergers completed	Share in the total number (%)
A - Agriculture, forestry and fishing	9	2.99
B - Mining and quarrying	3	1.00
C - Manufacturing	52	17.28
Production and supply of electricity, gas, hot water and air	6	1.99
F - Construction	28	9.30
G - Wholesale and retail trade; repair of motor vehicles and motorcycles	93	30.90
H - Transportation and storage	22	7.31
I - Accommodation and food	9	2.99
J -Information and communication	9	2.99
K - Financial services and insurance	7	2.33
L - Real estate activities	31	10.30
M - Professional, scientific and technical activities	21	6.98
N - Activities of administrative services and business support service activities	4	1.33
Q - Human health and social support	5	1.66
R - Arts, entertainment and recreation	1	0.33
S - Other service activities	1	0.33
TOTAL	**301**	**100**

Table No. 2

Average turnover at the national level for companies in the trading sector

Level of turnover (lei)	**2010**	**2011**	**2012**	**2013**	**Average increase/decrease rate**
Average sectorial Turnover	1,977,588	1,969,405	1,960,309	1,847,623	
Annual increase/decrease rate		*99.59*	*99.54*	*94.25*	*97.76*

Table No. 3

Average net result at the national level for companies in the trading sector

Level of the Net Result(lei)	**2010**	**2011**	**2012**	**2013**	**Average increase/decrease rate**
Average sectorial Net result	**51.811**	**53.579**	**55.369**	**58.199**	
Annual increase/decrease rate		***103,41***	***103,34***	***105,11***	***103,95***

Table No. 4

Average ROS at the national level for companies in the trading sector

Return On Sales Ratio (%)	**2010**	**2011**	**2012**	**2013**	**Average increase/decrease rate**
Average sectorial ROS	2,62	2,72	2,82	3,15	
Annual increase/decrease rate		*103,82*	*103,68*	*111,70*	*106,33*

Figure No. 1

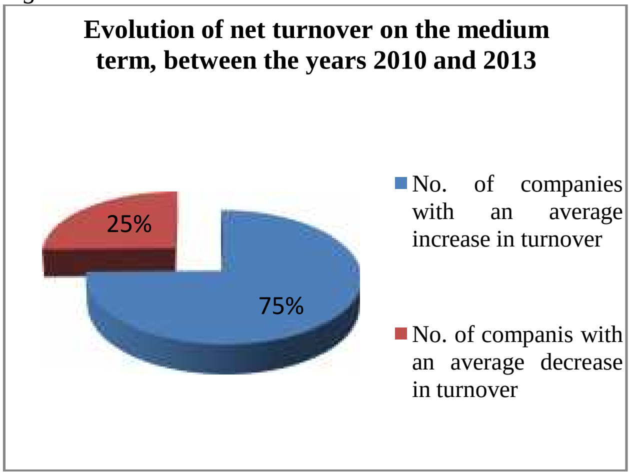

Figure No. 2

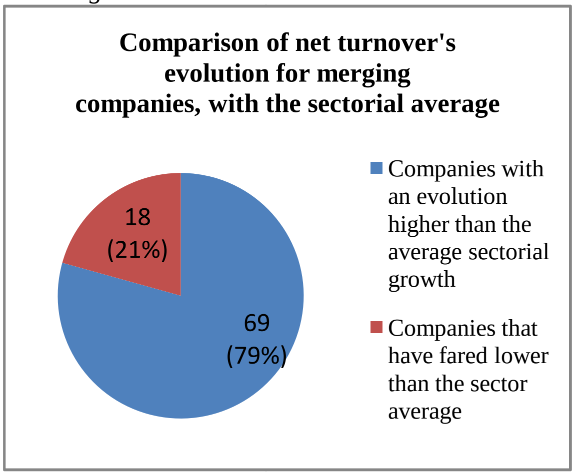

Figure No.3

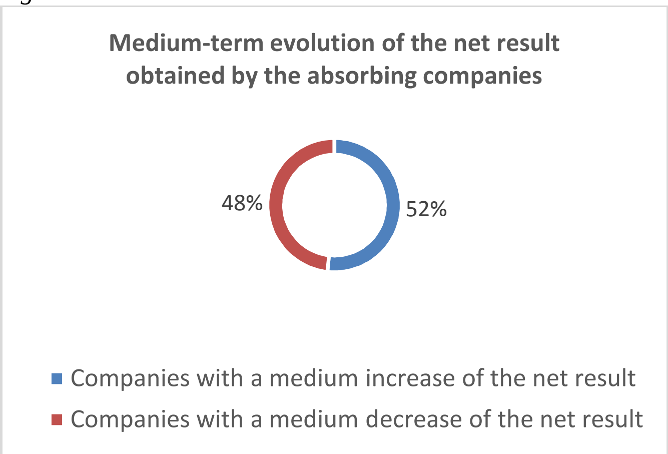

Figure No.4

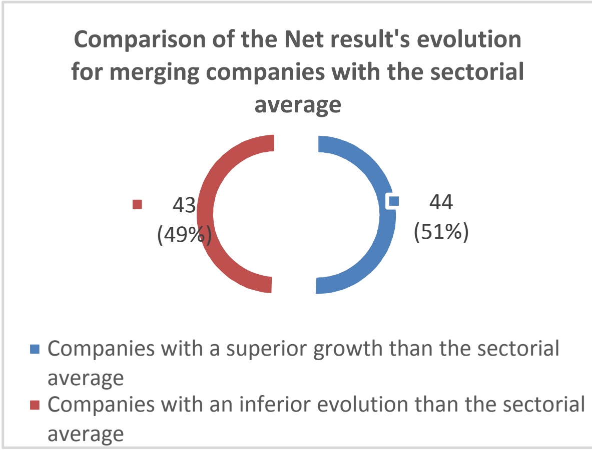

Figure No.5

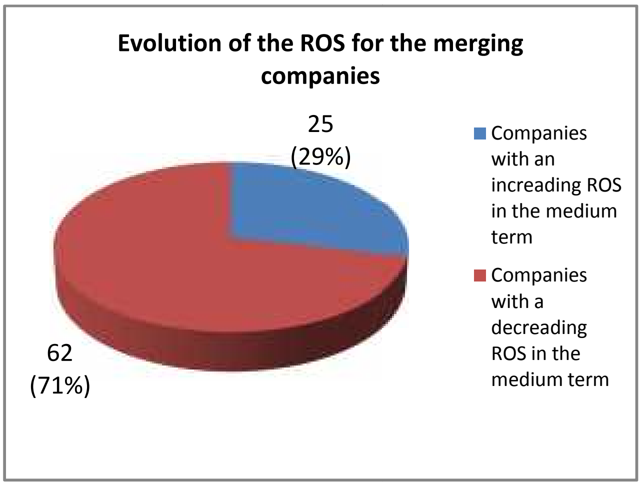

Figure No.6