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**Article**

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# MERGER OF TRADING COMPANIES, A CHANCE OF SALVATION DURING THE CRISIS

Anca-Simona Hromei\*

**Abstract:** *Mergers are transactions often used as growth strategies by companies that are trying to gain a competitive advantage, or in order to fulfil their objectives. In this period, marked by uncertainty and risk, mergers can be an effective way to enhance the competitive power on the market, or a way to save, restore the declining companies.*

*Given the emphasis on mergers in recent years, this article tries to offer a theoretical approach on mergers, with a highlight on the conceptual framework and the advantages that can be obtained by mergers. Some advices that any manager should take into consideration before completing the merger and, also, in the afterwards period, in order to ensure the success of this process, are presented.*

**Keywords:** mergers; financial performance; advantages of mergers; success.

**JEL Classification:** M41; G34.

## INTRODUCTION

The economic and financial situation at the European level, characterized by uncertainty and lack of liquidities, determines companies to approach different strategies in order to consolidate their business or to maintain it at a competitive level on the market.

The reorganization operations of trading companies are alternatives that can be taken into consideration when a change in the organizational structure is intended, but also to a productive or staff level. Among these operations it is also included the merger of trading companies, process through which two or more companies decide to associate, continuing their activity by means of a single economic entity.

## 1. THE CONCEPT OF MERGER BETWEEN TRADING COMPANIES

At the origin of the idea of merger, stands the concept of increasing the value, starting from the premise that “1+1=3”. In other words, it is considered that the plus of value brought by a company resulted after the merger is superior to the sum of individual values offered by each participant companies, if they would not have merged.

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According to the Explanatory Dictionary of the Romanian Language, the merger represents the fusion of two or more organizations in a single homogenous unit. In fact, after the merger of two or more companies results a single one, usually stronger, having a higher potential of development and a patrimony which comprises elements of assets and liabilities from the all companies involved in its process of formation.

The Romanian law refers to two types of merger, depending on the way they are done. Therefore, *merger by absorption* is presented as the operation through which one or more companies transfer its/their entire patrimony (assets, debts and shareholders' equities) to an absorbing company, in the exchange of distribution to their owners, of some titles within the absorbing company, and sometimes of an amount of money which cannot exceed 10% of the nominal value of those ceded titles. The second alternative is the one of *merger by reunion*, a procedure after which two or more companies are dissolved without entering in liquidation, transferring all patrimonial elements to a newly-established entity, in exchange of some shares or equity interests of the new company, which will be distributed to the existent shareholders or associates and sometimes of an amount of money paid to them.

From the very beginning, it is important to highlight that this process is not a limitative one in terms of the type or the size of companies which can be involved in merging operations. Any trading company, irrespective of its legal form of organization or size, can initiate a merger project.

The merger must not be confused with the acquisition of all titles of a company. If in the case of acquisition, the company that sells its titles continues its activity, in the case of merger the absorbed company or the merging one, stops existing from a legal point of view after the transaction. For a better understanding of the concept, if we were to relate to interpersonal relations, merger might be associated with marriage, a freely consented union between two parties, in the purpose of establishing a family, obtaining favourable results for both parties, and even for the society, while the acquisition of titles might be associated with a consensus-oriented union, a common living but without forming an integer.

## 2. EVOLUTION OF MERGERS IN ROMANIA

The idea of mergers initially occurred in the United States of America and then in Great Britain. In time, these operations developed and became more and more popular, showing significant increases in the last decades, both as regards to the number of operations and the transacted values.



But this momentum was slowed down starting with 2008, when the effects of the economic crisis started being felt, and the actors from the financial markets became more reserved, attentively reasoning before coming to a decision.

In our country, merger operations occurred in a later period compared to other states, especially because of the communist regime which allowed the patronage of the economic sector only by the state. The phenomenon of privatization that manifested itself at the beginning of the '90s can be considered the premise of the subsequent development of the merger market. Hardly since the year 2000, had the merger and acquisition market in Romania started developing, taking place a higher number of such transactions.

The stabilization of the Romanian business environment, the adherence to the European Union and the ascending trend where our country was situated before the economic crisis, made Romania an attractive alternative for foreign investors, especially during the period between 2005 and 2007, which can be considered the top period for mergers. The intensification of mergers in our country during the period between 2005 and 2007 was obvious, these operations being considered by investors as useful instruments in achieving different strategic objectives.

But, starting with 2008, when the effects of the economic crisis were felt in Romania as well, a slowing down in the enthusiasm regarding investment and getting involved in merger operations has been noticed.

At the level of 2009, a decrease of the market for mergers is registered, up to the minimum point, due to the fact that companies adopted a cautious attitude, avoiding risk-taking actions.

The period between 2010 and 2011 was characterized by the same descendent trend in terms of number and value of merger transactions achieved at national level. Although towards the end of 2011 and the beginning of 2012, a certain revitalization of the merger market have been noticed, there is much more to go until reaching transaction levels during 2005-2007 period.

Neither the year 2012 represented a significant evolution for the market of fusions at national level. The strong recovery previously forecasted was delayed because of the unstable political climate. The political uncertainty manifested in the period prior to elections, determined investors to manifest a reserved attitude, significant transactions not being realized in terms of mergers. For 2013, the perspective is still an optimistic one, several transactions of this type being predicted at a national level. It is still necessary to recover from the crisis, restore investors' confidence in the Romanian market and the disappearance of risk factors associated with the period of recession.

In terms of national law regarding mergers, the main regulatory documents are: the Trade Code, the Law on Trading Companies no. 31/1990, Order no. 1376/2004 for the approval of

methodological regulations concerning the reflection in the accounting of the main operations of merger, division, dissolution and liquidation of trading companies, as well as the retirement or exclusion of some associates within trading companies and their tax treatment, Law no. 571/2003 regarding the Tax Code, Accounting Law no. 82/1991, as well as Law no. 26/1990 regarding the Trade Register.

It is also important to notice the fact that, at a legislative level, significant amendments regarding mergers in 2012 were registered. These amendments, introduced at the beginning of the previous year through the *Emergency Ordinance no. 2* from February 28<sup>th</sup> 2012\* target the simplification of mergers, the decrease of costs related to the achievement of this process, as well as the creditors' interests' protection of trading companies involved in such operations. Moreover, in October 2012, an *Emergency Ordinance*<sup>†</sup> was approved and published, which amends and completes the Tax Code, in which a *new facility* is provided, granted to companies which decide to get involved in merger operations. More precisely, the company which results after the merger has the possibility to *recover the tax loss* transferred from the company/companies which took them over after merger. Therefore, it has the possibility to decrease the tax on income that is to be paid, an important fiscal advantage.

Consequently, the current legal and tax conditions are favourable for the achievement of merger operations, and this alternative should be taken into consideration by managers and shareholders or associates of trading companies who wish and feel the need of a change.

When mergers are preceded by well documented studies and analyses, the procedures are done correctly, quickly and in an advantageous manner for all parties involved, these operations might have as result the refreshing and increasing in the efficiency of enterprises activities, supporting the achievement of objectives of economic development and, indirectly, can contribute even to the recovery of the national economy.

### **3. ADVANTAGES WHICH CAN BE OBTAINED BY MEANS OF MERGER**

The subject of mergers can be of interest both for companies with a good financial situation, which can acquire at very low price a company in difficulty, but also for some companies with

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<sup>1</sup>*Emergency Ordinance no. 2* from February 28<sup>th</sup> 2012, published in the Romanian Official Journal, Part I no. 143 from March 02<sup>nd</sup> 2012.

<sup>2</sup>*Government Ordinance no. 15* from August 23<sup>rd</sup> 2012 for the amendment and completion of the Law no. 571/2003 regarding the Tax Code, published in the Romanian Official Journal 621 from August 29<sup>th</sup> 2012.

decreased performance, which consider merger in order to access resources, to increase their efficiency, competitive position or to gain from new opportunities.

As merger means the transfer of the entire patrimony of a company to another company, or having in common the assets and liabilities of some companies for establishing a new one, this operation can be mentioned in the category of strategies of growth or development.

Consequently, the companies interested in the *increase of the market share* or in the *diversification of the range of products or services offered* can and should take into consideration the alternative of a merger.

For companies which do not have enough funds to invest in new lines of production, one of the few chances of success is the merger with a company having a better position and useful (technical or human) resources.

Taking over a company with an increased technological level by another company which does not have enough liquidities to invest in technology, presents the advantage that it *does not imply a direct cash payment*, but the transfer of shares of the absorbing or newly created company to the shareholders of the absorbed company or the one involved in merging. Consequently, it is more advantageous to take over a company with an increased technological level, in whose exchange would be granted shares, than a proper acquisition, which would imply substantial cash payments.

If a company will decide the merger with another company having the same activity, or which develops similar products or services, the main advantage will be a *more efficient exploitation of the managerial and technological resources* the company has in that sector. Positive effects will be found in the achievement of *scale economies*, through the decrease of 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 an effect the decrease in the average cost of production when the capacity of production develops. These can be approached under two aspects, namely technical and financial.

From a technical point of view, the economies of scale are achieved when, after the merger, the production volume increases, ensuring a *better specialization of tasks*, as well as the *technological endowment with important and high-performance equipment* at a more reduced cost, whose purchase would not have been justified if the production volume was not increased enough. The *more efficient use of the working time of specialists* is also ensured, as well as the possibility to establish new departments dedicated to the activity of research and development, in order to *ensure the technological progress*.

From a financial point of view, the achievement of economies of scale implies *obtaining some price discounts* from the suppliers in the case of a large volume of orders, offering an extended warranty as the quality of products is concerned, *the creation of some more advantageous conditions of getting a credit*, and *the decrease of costs with marketing per unit of product*.

From the perspective of the decreasing expenses, a very useful alternative to approach is the merger with a client-type company, or a supplier, the so-called *vertical integration*. The part of the profit that would have belonged to suppliers or clients remains in the company, increasing its financial performance. Also, by taking over the activity of a supplier or client, it can be ensured a better quality of raw materials, as well as of the final goods offered to the consumer, at the same time with the decrease of costs.

But if the intended objective is the production diversification, the merger with a company that has a distinct activity can prove efficient for a long term. Despite the additional costs that might have been entailed by the adaptation and information regarding the new field, the *refreshing of the company's image* can directly influence the level of sales and implicitly the obtained results. Another alternative, the one of merging with a company having a different activity, but somehow related, presents the advantage of attracting *some clients from the market of the company which was taken over*, and determining them to purchase the products or services of the other company involved in merger.

Another advantage of a merger transaction is that after the merger, the resulted company will detain in the patrimony a higher number of assets, necessary to develop the activity. The increase of the financial power by merging patrimonies *will facilitate contracting credits* and *will increase the power of negotiation* of the company with the banking institutions, in terms of the possible costs of indebtedness. Furthermore, due to its new dimension, the company has the possibility to participate in some auctions, where previously it had no access.

Consequently, depending on the objectives and results that are intended, there are multiple forms and alternatives to achieve a merger, and the current legal and tax conditions are not doing anything other than encouraging such operations.

#### **4. PIECES OF ADVICE FOR A SUCCESSFUL MERGER**

When deciding the involvement in a merger, there are certain aspects that must not be disregarded, while achieving the transaction, and also afterwards, so that the operation to be considered a success.





Usually, mergers initiated by large and well-known companies are preceded by a process of “*due diligence*”. Through it, is examined the commercial health of the candidate for merger, ensuring that the company is not exposed to unwanted or unforeseen risks. In order to achieve the process of due diligence, chartered accountants must be contracted to revise financial statements, tax experts for controls of tax nature, as well as jurists to check the risks of exposure to certain obligations towards third parties, provided in the previously concluded contracts.

*Analysing the opportunity* of the merger, *by studies, analyses and forecasts* is perhaps the most important procedure that must be done before starting the operation. Along with economic and financial calculations, there must be analysed the structure of the staff from both companies involved, the level of education and their degree of specialization, but also certain opportunities that might derive from the achievement of this transaction.

Irrespective of the type of merger, it must always be considered the main elements that ensure the success of such an operation, namely: *a previous information*, as detailed as possible, realized by each participant company, in respect of the situation of other companies involved, *establishing some clear objectives* that are to be obtained from the process of merger, *knowing the field of activity of the new company*, achieving some studies and analyses concerning the results that can be obtained after merger, *a very careful planning of all stages* of development of this operation, as well as the *permanent communication* between those involved. The communication with employees is very important, both before and while achieving the process of merger because in its absence a state of fear can be created, the uncertainty of the working place causing mass resignations or a decrease of productivity of employees. It must be considered the fact that employees feel safe when their roles are clearly defined and their rights of decision are clearly delimited.

The period which follows immediately after the merger, when the proper adaptation and integration of all elements made common by the involved companies takes place, is very important. It is recommended to give this stage the same attention and importance as to the period of planning and analysis, prior to merger. In the stage of adaptation and integration, strategies must be revised, business plans must be established, and all components of the organization and business systems must be assessed, optimized and partially reconstructed.

Planning must be started in the period of due diligence, and the implementation immediately after the transaction is completed from a legal point of view. When the merger becomes certain, the attention must be focused towards the post-merger integration. *Involvement and attention* of the managers in this period must be maximized.



It is recommended a quick integration, having at its base the *early identification of synergies*, in order to get the expected results. On the contrary, if the period of instability and confusion which accompanies the news of reorganization is extended, it directly affects the employees. Nevertheless, the duration of achieving the complete adaptation and integration after merger will also depend on the previous relations between companies, as well as on the similarities between them.

The persons in the managing boards of merging companies must be aware of the organizational culture differences between companies, and must avoid the eventual conflicts, by means of frequent communication with all parties involved, starting from employees and up to clients or suppliers. Integration will take place in well-established stages, considering collaboration and communication between different hierarchic levels, as well as checking the results of every intermediary stage of the process.

Models should be found to integrate or make compatible the organizational cultures of the participant companies, starting from their common elements. Moreover, attention must also be given to the problems of emotional, political and rational nature, which might influence the good development of the activity, both in the present and for long term.

Furthermore, it is important to *clearly establish the directions of the new business*, depending on the intended objectives, but also depending on the condition of the economic environment where the company activates. It is necessary to permanently verify whether the activity and results do not deviate from the initially-established plans, as well as the occurrence of certain risk elements which could not have been foreseen prior to merger. When deviations are noticed, immediate measures of redressing must be taken.

Moreover, for the success of a merger, is recommended that everything be approached from *a more flexible manner*, taking into consideration as many options and alternatives as possible, in order to discover the best solution. Managers must be perceptive and open to change and, in a certain measure, even creative, in order to offer the organizational conditions necessary to the most efficient post-merger integration.

During the merger and afterwards, *the attention granted to company's clients must not be decreased*. In a great measure, the performance of the merger and the possibility to successfully continue for a long term, depend on the degree of client satisfaction. Consequently, the new company must find solutions to offer the most attractive products and services at a reasonable cost, in order to gain back the existent clients and to attract new ones.

To synthesize, the essential elements for the success of the company in the post-merger stage are: the style of leadership, a clear vision, the involvement of all staff, the engagement to offer the best value for clients, and especially the open and honest communication with employees.

## CONCLUSIONS

To conclude, one can state the fact that mergers, irrespective of the reasons underlying their achievement, are strategies more and more often implemented by the companies in the entire world. Due to these operations, companies can achieve objectives of external growth, with the condition to know precisely the legal, financial, accounting and tax aspects that characterizes them, which make the difference between a successful transaction and an unsuccessful one.

In the current economic and legal conditions, Romanian companies should also analyze the alternative of merger, both for the purpose of consolidating the power on the market, but especially for the diversification of activities or for getting a higher chance to continue the activity on a long term.

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