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Evaluation of Successfulness of Mergers and Acquisitions in the Slovak Republic's Economic Environment[1]

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Abstract: *Integration of companies is a very difficult process consisting of several phases. The complexity of this process highlights the number of unsuccessful integrations of companies worldwide. After completing the integrative process, the evaluation of adjusted results should follow which is in practice very often neglected. The reason is that the process of evaluating successfulness of mergers and acquisitions is challenging and time-consuming. Although the evaluation of successfulness of mergers and acquisitions is a challenging process, enterprises should not neglect it, because it can provide a lot of valuable information and detect serious problems in integrated companies. The presented paper considers the methods of evaluating successfulness of mergers and acquisitions applied abroad as well as the methods used in the Slovak Republic. It also presents results of realised research aimed at evaluating the success of completed mergers of the Slovak companies by means of indicators of financial analysis.*

Key Words: *Mergers; Acquisitions; Financial Analysis; Market Value; Evaluation; Success of Mergers and Acquisitions; Research; the Slovak Republic.*

Introduction

Joining the companies into larger and more competitive units is often a response to the increasing international competition, being realised mostly through basic forms of linking enterprises as mergers and acquisitions. Buying another company is an investment, in which it is necessary to take into account the basic principles of capital investment decisions. Purchases should take place insofar as they contribute to the wealth of the shareholders and to the increase of shareholders' value. However, it is very difficult to assess mergers and acquisitions, to assess

[1] This paper was prepared as outcome of research project VEGA No. 1/0404/16 "Financial Challenges after the Last Global Financial Crisis and Possibility of Development of the Slovak Capital Market", in the Slovak original "Finančné výzvy po poslednej globálnej finančnej kríze a možnosti rozvoja slovenského kapitálového trhu".

all of their benefits and costs. The risk is compounded by the fact that the game is often very high amounts.[2]

All connections share a fundamental objective which is to create value for shareholders or members that is greater than the sum of individual companies, i.e. to maximise the wealth of the owners. Therefore, the basic criterion of success of mergers and acquisitions is to ensure economic profits. In the literature we can meet with different ways to measuring the success of mergers and acquisitions, but in the corporate practice is this assessment quite neglected.[3] One reason is that the process of evaluating the success of mergers and acquisitions is demanding and time-consuming. Another reason is that the managers prefer subjective evaluation of the success of the transaction prior to the official control. The aim of the presented paper is to evaluate the success of mergers from the Slovak industrial enterprises through research realised in the crisis years of 2010 and 2011, based on the analysis of financial situation of the receiving companies during the periods before and after the implementation of transactions and on the analysis of impacts of mergers of enterprises on development of their market shares.

Methodology and research

Post-processing requires the use of more scientific methods, such as logical, empirical, and exact methods. Analysis and synthesis will be applied by the examination of theoretical knowledge as well as financial statements. From other methods the methods of induction, deduction, and comparison will be used. To assess the financial situation of the merging firms we will apply methods of financial ratios, continuing with indicators of profitability, activity, liquidity, and costs.

Method of estimating the benefits of mergers and acquisitions

In the literature we can find a number of views on issues of successful mergers and acquisitions as well as ways to measure resulting effects. Some companies are beginning to analyse the efficiency of mergers' and acquisitions' forecasts of future cash flows of the target company. Some

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[2] See BREALEY, R. A., S. C. MYERS and F. ALLEN. *Teorie a praxe firemních financí*. 2. aktualiz. vyd. Brno: BizBooks, 2014. 1096 p. ISBN 978-80-265-0028-5.

[3] See GAUGHAN, P. A. *Mergers, Acquisitions, and Corporate Restructurings*. 5th ed. New York, NY: John Wiley & Sons, 2010. 671 p. ISBN 978-0-470-56196-6; and SUDARSANAM, S. *Creating Value from Mergers and Acquisitions: The Challenges*. 2nd ed. Harlow: Financial Times Prentice Hall, 2010. 786 p. ISBN 978-0-273-71539-9.

of them increase revenues or reduce costs which can be attributed to the integration and is linked with the development forecasts.

The same opinion is shared by Eva Kislingerová, whereby in any analysis of mergers and acquisitions a direction from the target company should be pursuing. It is always important to have correct answer to the question why the two companies have common value greater than separated. The United States market is, therefore, an average of the views that the acquisition premium pays amounts to the sum of all synergies.[4]

Most common reason for failure of mergers and acquisitions a large number of authors considers with the human factor. Between employees of the merging companies mistrust and suspicion are often spread. When filling management positions, the way for internal lobbying power struggles, personal conflicts, and intrigues opens. Common issues that have been looking as originators for failure of mergers and acquisitions are the lack of awareness of the buyer of target company, results from asymmetry, diversity of information held by the both sides as well as issues of interaction, peer interaction – an insurmountable barrier may represent differences in business management and also in the corporate culture itself. It is important to follow what is accepted by profit from the combination of investors. If the stock price of the company after the notification of intentions to liaise with other company falls, it is a broadcast signal from investors that the benefits are of dubious connections or that the company will not pay too much.

One possible measure of success of a connection rests in investigation of its effects on earnings per share of acquiring company. Implementation of a connection can cause earnings per share growth which may give information to the investors that the companies are doing better, but this may not be the truth. In many cases after completing the transaction an increase in earnings per share occurs, even if integration does not show any obvious economic gain and combined value of the two companies will not increase. Such a situation is referred to in the literature as a bootstrap effect.

As traditional criterion to assess the success of completed mergers and acquisitions the exchange rate of the shares in acquiring companies has been mainly abroad (i.e. in countries with developed capital markets)

[4] See LEVY, H. and M. SARNAT. *Kapitálové investice a finanční rozhodování*. 1. vyd. Praha: Grada, 1999. 920 p. ISBN 80-7169-504-1.

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used. It informs about how the transaction has been admitted by the market and what is accepted by the investors to profit from mergers and acquisitions. Change of course is reflected by change in profitability as well as by changes in other indicators, such as in the status and prospects of the company in relation to evaluation of the strategy and quality management.

In the Slovak Republic, there is used no such access to assess the success of implemented connections because only a few Slovak companies have their shares listed on the stock exchange and also because of the lack of a functioning capital market in the country. For assessing the success of implemented connections we, therefore, applied financial analysis where we saw a clear effect of the transactions on financial situation of the successor companies in the figures, particularly in the financial analysis indicators. By comparing the situations before and after the merger, it could be clearly assessed whether the implementation of the goal had been reached.[5]

Financial analysis comprehensively defines Karol Zalai as an "material which summarises and evaluates results of the company for the period analysed, identifies and quantifies factors that have determined the progress made and results achieved in the future, and prolongs that compresses everything into the draft measures the implementation of which should ensure achievement of business objectives."[6]

To assess the success of transactions, it is possible to use a wide range of financial performance indicators: absolute (indicators of gross profit, net profit, turnover, value added, and net cash flow) or relative (indicators of profitability, activity, liquidity, indebtedness, efficiency, and costs). In addition to traditional performance indicators, modern indicators can be applied. The most well-known is the indicator economic value added (known as EVA) which tracks so-called development over profit that remains in the hands of business owners. In the Slovak economic environment, in intercompany comparisons its modification known as EVA ZERO can be used.[7]

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5 See KUBRIČANOVÁ, E. *Vplyv krízy na proces fúzií a akvizícií ako stratégie rozvoja podnikov v SR*. 1. vyd. Bratislava: Ekonomická univerzita v Bratislave, Fakulta podnikového manažmentu, 2015. 145 p.

6 See ZALAI, K. et al. *Finančno-ekonomická analýza podniku*. 8. preprac. a rozšír. vyd. Bratislava: Sprint dva, 2013. 471 p. ISBN 978-80-89393-80-0.

7 See ŠRENKEL, Ľ. and M. SMORADA. EVA ZERO – skutočná relatívna EVA. *Finančný manažér*. 2014, roč. 14, č. 1, pp. 15-21. ISSN 1335-5813.

Results

To assess the success of transactions, we could apply a wide variety of indicators of financial analysis from the area of selected indicators of profitability which have a high predictive value in business performance indicators as well as indicators of synthesised liquidity, activity, and indebtedness. In addition to indicators of profitability, we focused on calculation and assessment of the development by indicators of activity, since the rate of use of company's property significantly affects its overall profitability and liquidity ratios because solvency is an important characteristic of an enterprise in relation to the business partner in charge of stability. Often is the alleged motive for implementation of mergers cost savings which is also one of sources of the synergy effect, so we decided to examine our sample of enterprises by analysing the development of indicators of costs.

In the literature, one of the key points of implementation of mergers and acquisitions create searches for new markets and struggles for strengthening positions in existing markets. Implementation of merger should lead to an increase in market power and should gain a better position in the market. Thanks to it, companies can quickly take advantage of the new market opportunities and increase the quantities produced, without building additional production capacities. Transposition of the existing establishment will ensure an immediate access to the local network of suppliers and customers as well as access to information and long experience in acting on the market.

Based on the development of percentage of firms surveyed in the market, we can conclude that implementation of mergers led to increased market shares in acquiring firms in eight from the fourteen analysed companies. In contrary, six companies reported decreased market shares in acquiring firms.

When analysing combined enterprises' work, we met with several problems which wasted our analysis. The primary problem we encountered at the outset was that in Slovakia there are available no statistics of completed mergers and acquisitions and that the access to financial data in the form of financial statements is difficult. Although in relation to the market there are available several public databases, they usually contain only selected data from financial statements in compressed forms.

Overall, we analysed the period of years 2008 – 2013 which means that in each of the relevant mergers we reviewed accounts for at least two years before and two years after the implementation of transaction that we considered to be a sufficient period for expression of positive effects of transaction. We were aware of the fact that the number of companies included in our research represented only a small proportion of the total number of the Slovak firms that carried a merger. Our research, therefore, couldn't be generalised for all merged businesses; its results referred only to the sample of businesses investigated.[8]

The analysis results show that implementation of mergers led to increased profitability of transferee companies in only three of the fourteen analysed companies. In contrary, five companies reported decreased profitability and six companies were not able to clearly define direction in the development of analysed indicators after completing the implementation of merger.

Based on fully completed analysis, we can conclude that implementation of mergers led to increased efficiency in the use of assets in all three vertical mergers. In the case of horizontal mergers, two of the four successor firms effectively managed and used assets of the merging company and in two other cases we obtained ambiguous results. A negative impact of the implementation of merger on the activity of transferee companies was reflected in the conglomerate mergers – three of the four were pressed to a reduction in activity, suggesting that the transferee companies failed to effectively use assets of merging companies. Diversification of activities of enterprises led to a deterioration in use of their property and then to fall in their profitability.

Based on results obtained from our realised research, we can conclude that synergistic effect was even the case of horizontal and congeneric mergers where there was reached the greatest achievement of its premise. In financial terms, there were successful only 21 % of monitored transactions which confirms that it presents a very complex process that only a part of businesses successfully manages.

On the basis of developments in liquidity indicators of the surveyed businesses we can conclude that implementation of mergers led to an improvement in the ability to pay only by three of the fourteen analysed

[8] See *Register účtovných závierok* [online]. 2017 [cit. 2017-06-01]. Available at: http://www.registeruz.sk/cruz-public/domain/accountingentity/simplesearch; *Cribis Univerzálny register* [online]. 2017 [cit. 2017-06-01]. Available at: https://www2.cribis.sk/Home.aspx; and Preveriť. In: *Bisnode* [online]. 2017 [cit. 2017-06-01]. Available at: http://www.bisnode.sk/produkty-riesenia/skupiny-rieseni/preverit/.

companies. In the survey sample, enterprises were not experienced with a positive effect of merger to improve the solvency of transferee companies; quite the contrary, in the most cases there was identified deterioration in liquidity ratios. Reasons were either too low or too high levels of liquidity of merging companies.

Another important finding was that implementation of the three monitored vertical mergers led to increased efficiency in use of property. On the contrary, a negative impact of implementation of mergers on activities of transferee companies was reflected in conglomerate mergers – three of the four informed about reduction in activity. Diversification of activities of enterprises led to a deterioration in use of their property and then to fall in their profitability.

Results from analysis of indicators in the area of costs (total cost ratio, cost ratio, and economic) showed that construction of mergers led to a reduction in costs in only five enterprises surveyed. Material and energy intensity declined in the entire group of enterprises which significantly affected in both economic and costly terms. The above-mentioned group consisted of two horizontal mergers, two vertical mergers, and one congeneric merger. None of the four conglomerate mergers reported decrease in costs.

Discussion

Main field of our research focused on analysis of the impact of mergers on solvency of enterprises showed that implementation of mergers had a clear positive impact on improving the solvency of successor companies. On the contrary, in the most cases (in eight of the fourteen companies surveyed) liquidity ratios worsened. This was due to the strong impact of liquidity ratios of merging companies. An important finding was that none of the four conglomerate mergers reported decrease in costs, which was confirmed by the fact that where there was no overlapping, complementary or overlapping activities could arise synergistic effect which was reflected in reduced costs.

When examining the impact of horizontal mergers on the development of market shares in acquiring companies, we concluded that the survey sample enterprises expressed a clear positive impact on horizontal mergers in increasing market shares. Maintaining a higher market share in a long term period is not easy which was reflected in our sample of surveyed enterprises.

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Realised research also confirmed that in cases where there was a merger of two profitable enterprises, profitability successor was rising after implementation of merger despite deteriorating conditions in the sector. In cases where the merging company recorded negative profitability in coming years, this negatively influenced the development of successor company. It follows that the process of evaluating the success of transactions is an essential part of their implementation and businesses in economic practice should not neglect it because in this way they can detect in advance weaknesses of transferee companies that in many cases can be removed or mitigated through early interventions.

Conclusions

Businesses that want to survive in a competitive environment must choose a strategy to achieve set objectives. One of such strategies is represented by mergers and acquisitions. Many businesses neglect them in the process of economic practice. The main reasons for this fact are the complexity, slowness and time preference, subjective opinions of managers on the percentage of transactions as well as on the official controls which refute misconceptions about the success of transactions executed. They would then face the harsh reality of their own failure. Ignoring the negative reality of a failed transaction is not a solution, problems will further increase in company and stepping up the management cannot continue to circumvent unnoticed problems, but this may be too late.

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