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MERGERS AND ACQUISITIONS DURING THE ECONOMIC-FINANCIAL CRISIS

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***Abstract:** In terms of the modern economic and financial crisis, mergers and acquisitions occur as vehicle of the internationalization of business. The accumulated effects of the crisis on the processes of mergers, acquisitions and other forms of restructurings have become one of the important areas of economic analysis. This paper is concerning with current issues surrounding the process of mergers and acquisitions, and suggests the special features of the restructuring today. On that basis, the intensity and trend of merger and acquisitions, in the conditions of modern economic and financial crisis, are primarily analyzed. In addition, the paper discuss specificities of the due diligence analysis and the evaluation process of mergers (acquisitions) during the economic-financial crisis.*

***Keywords:** mergers, acquisitions, economic-financial crisis, due diligence.*

1. Introduction

From a holistic perspective, mergers and acquisitions (M&A) have multiplicative effects on the economic trends and the behavior of economic agents. Accordingly, the effect of implementing the strategy of mergers and acquisitions should not be considered *a priori*, independently of the experience of other countries, but only in the comparative analyzes. The global economic and financial crisis has significantly altered the market conditions where transactions of mergers and acquisitions are carried out. Crisis conditions, which include high level of risk, require additional efforts of potential investors in making investment decisions.

The accumulated effects of the global crisis caused macroeconomic instability, economic decline, recession and pessimism in investment. Skepticism regarding the availability of funding sources, particularly equity capital, is one of the important determinants of decrease in the volume of mergers and acquisitions in the global level. The resulting post-crisis changes in tax regulations, legislation in the field of competition and the difficulties that arise in the field of finance and the evaluation of these complex investments at the same time, are additional restrictions on M&A implementation.

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The crisis has affected M&A processes in different fields and from different aspects. The crisis has driven down the volume of transactions and hindered the ability of many companies to pull off deals. Lower profits, a gulf between buyers and sellers when assessing a company's value, greater difficulty in getting financing and lenders' demands for more equity up front are the main factors in this decline. "The expectation value gap" (between what a buyer is willing to pay and what a seller is willing to accept.) has widened because of the economic-financial crisis. As a result, the number of completed M&A transactions has fallen sharply. This has led to changes in the structure of transactions due to the changes in the value of deals. One of the consequences of the current recession is a decrease in mergers and acquisitions.

The paper deals with current issues surrounding the process of mergers and acquisitions, and points out the specific features that are observed in the area of restructuring nowadays. The paper aims to identify the impact of current economic and financial crisis on M&A activity which is widespread in the economic realities of the national economies.

The remainder of this paper is organized as follows. The second part of the paper is devoted to the analysis of the intensity and trend of merger and acquisitions in the period before the current economic and financial crisis. In the Section 3, we give an overview of the consequences of the current economic and financial crisis on M&A activity. Section 4 is devoted to the specificities of the due diligence analysis of M&A strategies, since a comprehensive analysis of the overall position of the target company during the crisis requires additional expertise and time. Section 5 concludes the paper.

2. The Intensity and Trend of Merger and Acquisitions in the Period before the Current Economic and Financial Crisis

The consequences of the present economic crisis demonstrated the global level. Practice has proved that the M&A processes are not resistant to exogenous disturbances, but the negative effects that come from the global environment and reflect on these processes. On the beginning of the XXI century M&A activities take an impressive volume by the number and value of transactions.

From the beginning of the global economic and financial crisis, the market in which the processes of mergers and acquisitions taking place, has significantly changed its characteristics. Downturn in global financial markets, recession, macroeconomic instability is growing concern regarding indebtedness, demand a high level of uncertainty faced by business entities and determine the environment in which mergers and acquisitions are carried out.

The table 1 shows a global deal boom that began in 2004. and reached new highs in both value and volume in 2007. In the second half of 2007., the line is set to decrease in 2008. Empirical research shows that despite volatility in global financial markets in the second half of 2007, overall M&A was fairly stable throughout the year, particularly in terms of deal volume. In 2007, the majority of deals were announced in the Finance sector (21%). Real Estate/Property (14%), Utility & Energy (12%) and Telecommunications (10%) were also were also attractive sectors for the implementation of the strategy of mergers and acquisitions of companies. It is interesting to mention that the existence of some country specificities have influence to average size of transactions. There are more than 100 000

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transactions in the United States in period 1997-2007. Although M&A transactions are much more numerous in the UK than in other European countries, France is the place where large scale operations occurred most frequently. During the period 2000-2005, the average value of transactions was \$1.2 bn in France compared to \$1 bn in Germany and \$500 m in the UK. (Financer Worldwide 2008, 38-40)

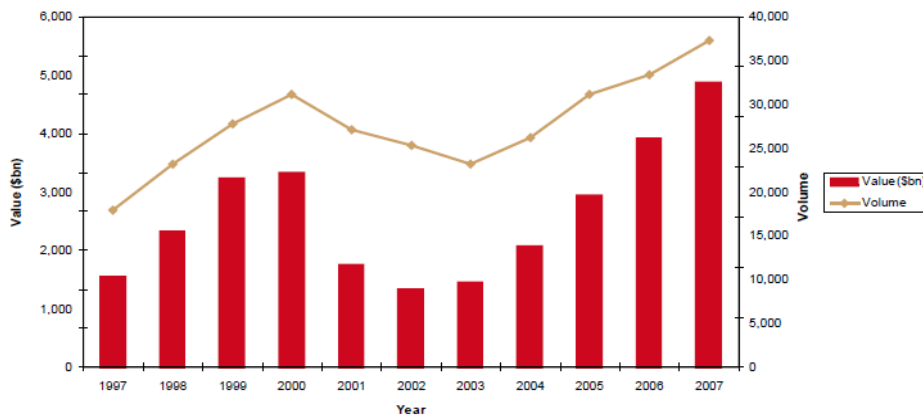
Table 1: Global M&A 1997-2007

Year	Deal Value (\$bn)	Volume
1997	1.548.3	17.910
1998	2.3175	23.224
1999	3.222.0	27.756
2000	3.335.5	31.196
2001	1.775.0	27.065
2002	1.322.4	25.359
2003	1.452.8	23.164
2004	2.061.2	26.244
2005	2.937.4	31.122
2006	3.916.8	33.429
2007	4.873.0	37.267

Source: International mergers & acquisitions, Creating value in an increasing complex corporate environment. (2008) Birmingham, United Kindom: Financier Worldwide. pp.20

In 2007, global M&A reached historic levels with \$4.83 trillion in announced deal volume (Figure 1). This surpassed the 2006 record of \$3.91 trillion by 23 percent. Emerging market targeted M&A volume reached \$909 bn in 2007, up 43% from \$643 bn in 2006 and became the highest annual total on record. Emerging market cross-border inflow increased 43% to \$ 371 bn in 2007 from \$260 bn in 2006. (Financer Worldwide 2008)

Figure 1: M&A activity at the global level during the period 1997-2007



Source: International mergers & acquisitions, Creating value in an increasing complex corporate environment. (2008) Birmingham, United Kindom: Financier Worldwide. pp.20

Merger and acquisition activity has a cyclic character. As presented in the figure 1, periods of intense activity of mergers and acquisitions, are usually followed by periods of low use of external growth strategies. Some authors emphasize that in the past, two-thirds of M&A transactions have destroyed value. In this context, the key question today is: Will the new wave of M&A create more value than the previous one?

There are some main reasons driving value creation and value destruction in M&A deals by analyzing 2500 M&A transactions that took place over the past 15 years in Europe. (Financer Worldwide 2008, 40-41) First, there are no statistical correlation between the value creation and the size of the transaction. However, large scale transactions (more than \$1bn) tend to destroy value whereas small scale transactions (less than \$50m) tend to create value. Second, an acquirers' previous M&A experience has an influence on value creation. On the one hand, frequent buyers (involved in one or two acquisitions a year) are more likely to create value. On the other hand, a company which carried out less than one M&A transaction over the past 15 years risk to destroy value. As a matter of fact, previous experience will allow a company to better evaluate potential synergies with its target. A more realistic approach on future synergies will be translated into appropriate pricing. Third, M&A can act as a catalyst in uncovering significant savings which were previously concealed. Finally, value creation depends on how the merger preparation and the post-merger integration process is managed.

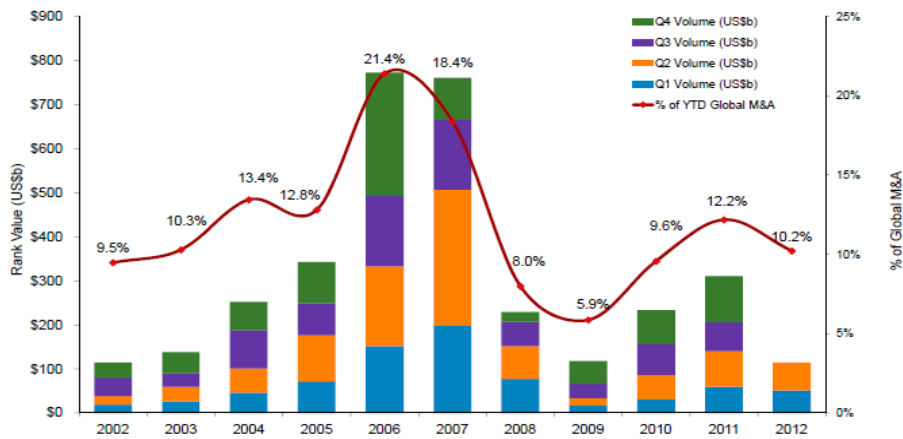
3. Consequences of the Current Economic and Financial Crisis on M&A Activity

Skepticism about the availability of funding, particularly equity capital, is one of the important determinants of decrease in the volume of mergers and acquisitions at the global level. The main feature of M&A activity during the crisis period is a material decrease of activity and a "quiet period" in the field of M&A. This decrease in M&A activity is just temporary, it does not mean the complete interruption of activity, but only a decline in volume and number of M&A transactions. The value of worldwide M&A totalled US\$1.1 trillion during the first half of 2012, a 22% decrease from comparable 2011 levels (Figure 2). By number of deals, M&A activity fell 17% compared to last year with fewer than 18,000 announced deals. Compared to the first quarter of 2012, the value of announced mergers & acquisitions rose 18% during the second quarter of 2012, but decreased 12% compared to the second quarter of 2011.

Empirical research (Thomson Reuters 2012) shows that emerging markets account for 28% of M&A. Accounting for over one-quarter of worldwide announced merger activity, M&A involving companies located in the emerging markets totaled US\$315.3 billion during the first half of 2012, a 12% decrease from 2011. Cross Border M&A activity totaled US\$462.5 billion during the first half of 2012, accounting for 42% of overall M&A volume and down just 5% compared to the first half of 2011. Cross border M&A was driven by the energy & power, consumer staples, materials and financial sectors, which comprised 50% of cross-border deal volume during 2012. Private equity in M&A transactions was going down 19% over 2011. Worldwide private equity-backed M&A activity totaled US\$113.7 billion during the first half of 2012. Private equity deal making in the high technology, energy & power and retail sectors accounted for nearly 50% of activity during the first half of 2012. Accounting for 10% of worldwide M&A during the first half of 2012, private equity-backed M&A decreased 19% compared to 2011 levels.

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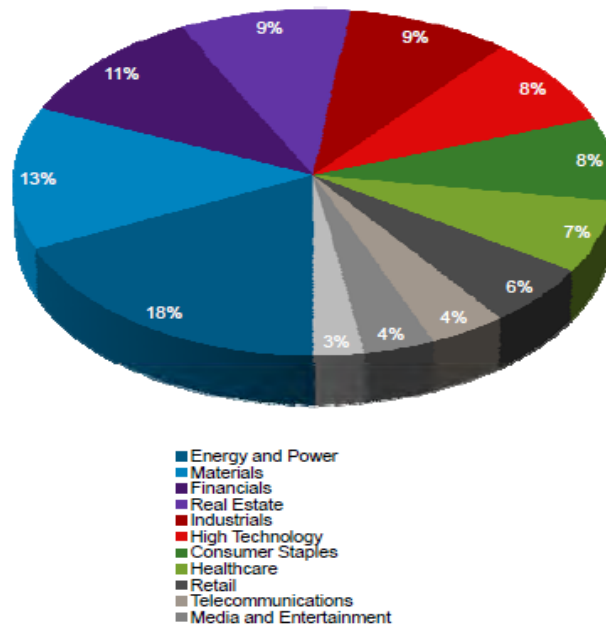
Figure 2: Worldwide Announced Financial Sponsor Activity



Source: Mergers & acquisitions review, Legal advisors, First half 2012, Thomson Reuters. pp.1

In the conditions of constrained capital environment, management is seeking for alternative funding options. In value terms, state-backed and financial investors accounted for the largest proportion of M&A deals during 2012. In addition, the state-owned enterprises and sovereign wealth funds, which are primarily looking to secure the strategic supply of materials, other financial investors are seeking for the pure financial returns from anticipated future transactions. (Ernst&Young 2013,7)

Figure 3: Worldwide Announced M&A by Target Industry



Source: Mergers & Acquisitions Review. (2012) Thomson Reuters. pp.1

The energy and power sector was the most active during the first half of 2012, commanding 18% of announced M&A, while the materials and financial sectors accounted for 13% and 11% of M&A activity, respectively (Figure 3). Just two sectors, retail and consumer staples, have registered year-over-year gains compared to the first half of 2011. Media and entertainment and consumer products deals led the decliners, down 46% and 45%, respectively, during the first half of the year. (Thomson Reuters 2012)

One of the consequences of the current crisis was manifested in the change of the volume in M&A transactions. Actually, according to data from Thomson Reuters, there were 36% decrease from 2008 to 2009 when volume totaled \$1.14 trillion. Financials, healthcare, and energy and power deals accounted for 63% of worldwide M&A volume in 2009 according to the same data source.

Until the second half of 2009, merger volume in the Americas dropped 30%, while in Europe it run down 47%. Asia Pacific volume fell 34%, while in Japan eased it 11%. The only bright spot was Africa and the Middle East, where M&A volume was up 4%. (Thomson Reuters 2012)

Two main themes dominated M&A across mining and metals sector in 2012: (Ernst&Young 2013, 19)

(1) Low risk M&A. Low risk M&A transactions were pursued to achieve synergies in shared facilities, infrastructure, blasting etc. Alternatively, low risk deals were aimed at gaining greater control over an asset where a stake was already held.

(2) Strategic M&A. Another emerging trend in 2012 was the increase in the number of deals done for minority stakes rather than full-takeovers, which were very much the domain of the debt-financed consolidation phase that took place between 2005 and early 2008. Consequently, these minority stake acquisitions increased options for juniors, be it exit through an outright sale, or funding via a strategic investment that lends confidence to a project and enables future financing to be arranged. This trend is likely to continue as financing options remain tight and large-cap producers look to recycle capital -both being factors that will drive the pursuit of juniors, as well as strategic partners on projects.

4. Specificities of the Due Diligence Analysis

Variability of operating conditions and a high level of uncertainty in terms of the current crisis, imposed the need to anticipate the complex economic activities. Particular challenges arise in the field of evaluation strategies mergers (takeovers) and due diligence analysis. Quality of makroeconomic environment is one of the most important factors which determines realization of the due diligence analysis.

Due diligence is an indispensable part of the process M&A. Due diligence is one very important process, which may not be applied in the same way throughout different market conditions. Due diligence is an effective tool to enable decision makers to evaluate the risks and benefits of the potential transaction. The advantages of the properly constructed due diligence process, however, do not end simply at the competition of the transaction. The due diligence process and integration planning should go hand in hand to ensure a successful acquisition. (Financer Worldwide 2008, 146)

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Diligence enables companies to meet their growing complex transaction needs. Diligence has gone from solely financial diligence to encompass other business areas such as benefits, insurance, operations and others. Additionally, diligence expands to the commercial aspect when companies question the sustainability of the target's growth and sell-side diligence when deal makers are ready to harvest their investments or part with non-core assets as their business strategy changes. Diligence enables deal makers to make confident decisions which may entail substantial reworking of a transaction prior to close.

Implementation of the due diligence process in the crisis requires additional expertise and time. Comprehensive analysis of the status and position of the target company, if the companies have experience in the implementation of M&A and can provide all the necessary information for due diligence analysis, usually takes at least several weeks. Business conditions during crisis extend this period, because the additional effort spent on analysis of the most important long-term liabilities (the structure of the creditor, the possibility of debt restructuring, restrictions on taking action/assets) and risk analysis of bankruptcy.

Legal due diligence can be tailored to focus on the material elements of the buyer's business plan in order to confirm whether the target is a potential fit before ramping up a more comprehensive due diligence. Additionally, the diligence should not only dictate whether the deal gets done and at what price but, as important, it should drive the drafting and negotiations of the transaction documents to allocate the inherent risk among the parties. (Financer Worldwide 2012)

Capturing value from a merger, acquisition or divestiture continues to be one of the most significant challenges deal makers face. As companies become increasingly global and regulations evolve, diligence becomes more sophisticated and encompasses so much more than financial performance. Financial diligence alone does not uncover the wide range of risks associated with a transaction; especially if it is a cross-border deal where foreign jurisdiction, culture, labor, transfer pricing, foreign market conditions and financial reporting come into play. (Financer Worldwide 2008, 129)

Due diligence process covers the deal continuum to include commercial diligence which accesses the size of the market and critique the target's business plan; total performance diligence which evaluates not only financial statements, accounting and tax but also operations, systems, governance, vendor relations, internal controls, management integrity, human resources and insurance; and sell-side diligence which helps sellers present the business to be sold from a buyer's perspective. To maximize deal and shareholder value, companies need to be aware of and anticipate deal risks while formulating an action plan to address them. Performing diligence on the entire operations of the target and its market strengths, weaknesses and risks will enable deal makers to make informed business decisions.

Regardless if you are a buyer or seller or whether the transaction is domestic or foreign, early identification of potential deal issues leads to informed decisions and better financial modeling.

Commercial diligence enables companies to address the appropriate questions such as: What are the risks inherent in a business strategy? What strategy and market-related value creating opportunities exist? What is the sustainability of the company's competitive advantage? How big is the market? Commercial due diligence is the best used when the

buyer has reservations about key business plan assumptions. Often transaction risk arises from inaccurately assessing market growth drivers, industry trends, competitive positioning and supplier relations. Deal value will diminish if the commercial capability of a deal cannot be supported. Both commercial and total performance diligence continue to provide dealmakers value after the deal close.

Additional restrictions on the implementation of mergers and acquisitions are the post-crisis changes in tax regulations, legislation in the areas of competition, and the difficulties that arise in the field of financing and evaluation of these complex investments.

Although understanding the financial and tax position of the target is important, they are only two of many factors that could derail a transaction. Other factors impacting the value of the deal are often more important. Compensations and retirement programs are getting more complex when country specific regulations are involved. Tax diligence has evolved from the assessment of tax compliance issues to include the evaluation of potential deal structures and movement of cash. Areas of taxation which may have an impact on deals include proposed restructurings and valuation of goodwill, know-how and other intangibles. Also, different countries have their own tax regime and understanding the tax implications on deals enables buyers to choose the right tax structure and move cash to the appropriate territory to service debt as well as a tax efficient return to investors. Considering the fact that companies face many risks, deal makers should expand their traditional diligence to include insurance to ensure the target has adequate self-insurance reserves and coverage, and assess the impact on the buyer's insurance programs in terms of change in control, insurance program structure, collateral and cost allocation. Asset valuation and methodologies used can have a significant impact on deal value. The accounting principles used may also have a bearing on the perception of value of the business or the assets. In particular, identifying the differences between US GAAP (Generally Accepted Accounting Principles) and IFRS (International Financial Reporting Standards) is becoming more important as more countries adopt IFRS. (Financer Worldwide 2008, 130)

Due diligence process helps companies to verify the current business of the target company and potential acquisitions in order to minimize risk in the process of takeover. Due diligence process is implemented by acquirer enterprise for the monitoring of all segments of the target company, as well as assess the benefits, obligations and responsibilities related to retrieval. Inadequate conducted due diligence process increases the risk level and can make specific acquisition unsuccessful.

5. Conclusion

Only the appropriate reviewing the causes and consequences of a particular phenomenon can draw relevant conclusions about the same, in this paper the focus is placed on the analysis of the consequences of the current crisis on M&A activity.

In times of crisis there is no privileged countries and sectors. The current financial and economic crisis has affected different intensity processes of mergers and acquisitions of companies in all countries, regardless of their level of development and the structure of the economy. Since the time of the crisis took on more serious proportions, and the deviations

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of the macroeconomic projections regarding mergers and acquisitions the company was growing.

Current crisis has confirmed the long-term sustainable model of development that is based on the mergers and acquisitions of companies. This is supported by the fact that the basic characteristics of present and future trends of development of M&A activity indicate that implementation of this strategy is often the only way to market success.

An empirical studies verify that intense takeover activity has a cyclic character. After a period of intense activity of mergers and acquisitions businesses, usually followed periods of low use of external growth strategies. Increased acquisition activity is associated with periods characterized by unexpected changes in economic conditions and greater diversity of market participants' views on the future development of the company such as current crisis has confirmed. Based on numerous studies conducted in the first decade of the twenty-first century, it was confirmed that the waves of mergers and acquisitions of companies present in all sectors of economic systems. Their dominance was observed particularly in the financial sector where the implementation of the M&A strategy, as a method of external growth, causing dramatic changes in the financial market.

The due diligence process and integration planning should go hand in hand to ensure a successful acquisition. Due diligence is one very important process, which may not be applied in the same way throughout different market conditions. Due diligence, which during the crisis requires additional expertise and time enables companies to meet their growing complex transaction needs.

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SPAJANJE I PREUZIMANJE PREDUZEĆA U USLOVIMA EKONOMSKO-FINANSIJSKE KRIZE

Rezime: U uslovima savremene ekonomsko-finansijske krize merdžeri i akvizicije se javljaju kao nosioci internacionalizacije poslovanja. Akumulirani efekti krize na procese spajanja, preuzimanja i drugih oblika integracije privrednih društava, postaju jedno od važnih oblasti ekonomske analize. Rad se bavi aktuelim pitanjima koja prate procese spajanja i preuzimanja preduzeća, i ukazuje na specifičnosti koje se na ovom području restrukturiranja uočavaju danas. Na toj osnovi, prvenstveno su analizirani intenzitet i trend aktivnosti spajanja i preuzimanja preduzeća u uslovima savremene ekonomsko-finansijske krize. U radu je posebna pažnja posvećena specifičnostima dju dilihens analize i procesu vrednovanja strategije spajanja (preuzimanja), budući da sveobuhvatna analiza stanja i položaja ciljnog preduzeća u uslovima krize zahteva dodatnu ekspertizu i vreme.

Cljučne reči: Merdžeri i akvizicije, ekonomsko-finansijska kriza, due diligence.