MERGERS - SUCCESS OR FAILURE?

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Abstract: *Mergers are transactions of great importance, not only for organizations involved, but for many stakeholders. Success or failure of such enterprises may have consequences enormous for the shareholders of an organization, creditors, employees, competitors and community. Empirical evidence indicates a high rate of failure of mergers in terms of create value for shareholders. This study examines the causes of merger failure and offers a possible solution to make the merger successful. The internal audit has evolved from its traditional role to an active advisory. Internal auditors can ensure successful merger process.*

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1. INTRODUCTION

Financial and economic crisis covered the entire world and its consequences are difficult to assess. One thing is certain - the fear of tomorrow, with all its consequences. In this framework of uncertainty and unknown, the only salvation for companies to strengthen a certain position on the market and gain advantages in terms of the transaction tax is to restructure the company by merger. This transaction is a juridical solution for companies in inability to pay, representing one of the juridical and economic arrangements to enable the continuation of financial recovery.

Many writers and business analysts have argued that mergers are doomed to failure and that merger success is somehow in contradiction with the reality of business world. Of the total of merging companies 80% of them do not create value (Freedman, 2010).

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In fact, most mergers are proving a difficult process, with unknown risks that ultimately translate into a loss of sales, and especially with the loss of valuable people in your organization. A fair and disciplined approach to the merger increases the chances of success.

2. MERGERS, ACQUISITIONS AND CONGLOMERATES

Mergers, acquisitions and business combinations are often analyzed as if they are the same, but a clear distinction is needed.

Merger is the operation by which two companies join together to form a single one. This enables the consolidation and increasing competitive capacity of enterprises.

The acquisition is a business combination in which one entity obtains control of the net assets and operations of another, in exchange for a transfer of assets, employment, debt or issuing shares.

Coglomerates are bringing together of separate enterprises into one economic entity as a consequence of an undertaking by the net assets and operations control to another.

3. WARNING SIGNS

The merger decision depends on the outcome of due diligence. To ensure the success of the merger is necessary to take into account the warning signs (Vulpoi, 2010):

- financial warning signals, including termination of collaboration with internal/external auditors, changes in accounting methods, sales of shares by sources inside the company management, employees. These actions may indicate fraud and/or possible insolvency;
- warning signals from the operations area, which covers, among other, the turnover is very high or very low and may indicate instability in the company's activity;
- warning signals on debt, which are related to the company's exposure to potential dispute with State bodies, customers, employees;
- warning signals about the transaction itself, which may relate to potential violations of law resulting from the transaction or tax and accounting objectives diverge on the transaction.

4. CAUSES LEADING TO FAILURE OF MERGER

Previous experience of project managers in the merger is not obligatory but can help a lot to learn from mistakes.

This may be a cause that can explain the failure of mergers but the idea is exaggerated. How many managers have gone through in their lives even a merger ? So the experience of managers in the merger can not be discussed, but managers should consult with a whole team of specialists: lawyers, accountants, tax consultants, specialists in marketing and management.

Another cause of merger failure is the lack of due diligence analysis. Due diligence is a detailed analysis of the company being acquired / acquiring about finances, management, assets.

About the due diligence is to say that the team performing the due diligence at least include accountants to review financial statements, lawyers to investigate exposure to various liabilities to other persons and tax experts. It is important to note that these teams of accountants, lawyers and tax experts must be independent to avoid conflict of interest.

Among the issues examined in the process of "due diligence" are:

- review of financial statements (to confirm the existence of assets, liabilities and equity capital components in the balance sheet to determine the "health" based on the company's financial profit and loss account);
- review and management aspects and the company activity (to determine the quality and reliability that may be made to understand financial statements and any rights and obligations contingent, whose impact is not reflected in financial statements);
- review the degree of conformity with legal regulations (to check the possibility of unpleasant future juridical implications arising from past activities of the company);
- review of transactions and documents (to ensure that documentation is adequate and that the transaction is appropriate to transaction structure);
- fiscal review (to check the compliance of tax regulations and company practices that are outstanding liabilities to creditors budget).

The risk of failure can be avoided if you examine the manufacturing process, characteristics, product design, refusal rate, business advertising, marketing, customer number, employee profile. The decision to buy a company should not be influenced by the fact that the headquarters is located in a building that holds office on the beach or in luxurious buildings.

Cultural differences can create major problems. If a company is conservative and the other company is transparency and open, a contradiction apears. An example is the merger of Daimler and Chrysler.

Usually buyers neglect organizational culture for a more detailed analysis of systems and business processes. This makes them sometimes during the integration process to impose some predefined schemes and thus to be hit by lack of acceptance and resistance to change.

Managers must be aware of cultural differences between organizations so they can avoid conflicts with frequent communications, for employees, customers and other stakeholders interested in post-merger integration success.

There is no good or bad corporate culture. There is only one variety of cultures and it is the duty of those who lead the integration process to seek ways to make them compatible.

Another cause that leads to failure of merger is the lack of communication that creates uncertainty, insecurity among employees, and when employees are needed, it is possible for them to leave.

Often employees complain of uncertainty, conflicting rumors and insecurity. They will ask the questions: Will be restructuring? I will be moved to another department? What will happen with my boss?

I find it shocking that in the majority of restructuring, the message refers to the fact that everything is fine and there is no worry. Rather, I would recommend the message: yes, the integration will not be easy, but it is a great opportunity, not a problem.

Another aspect to note about the causes of mergers failure is that very few companies that have managers who have the ability to control companies in different industries. Over 42% of conglomerate mergers have failed.

Before to achieve a conglomerate merger, managers should evaluate this issue and possibly to receive specialist advice.

Also no less important is that to define roles, responsibilities, incentives and structures clear enough.

Immediately after the merger, most of the functions will be doubled, and the integration team should decide and communicate the responsibility for actions during the transition and after, if they want to support productivity and employee morale. Actual acceptance occurs if people can imagine themselves and their future in the new combined entity - which includes a clear understanding of what is required of them and opportunities for personal development (career, compensation and benefits).

I believe that those causes are relative. It is ignored in the literature that often the decision on the merger has to take into consideration the audit reports. Making the merger should take place only if the auditor expresses an unqualified audit report at the end.

5. INTERNAL AUDIT ENSURE SUCCESSFUL MERGER PROCESS

Internal auditing profession faces many challenges in the new millennium. Driven by minimizing costs and increasing profits or at least maintain a reasonable level, departments of internal audit desperately are seeking ways to add value to an organization and try to prove they can still "do business" for their employers.

Audit role has changed over the years from traditional to a proactive role based business consultancy.

Unfortunately, even if the role of internal audit has extended in the case of mergers, internal audit does not contribute effectively than the due diligence phase. Perhaps one reason is that managers believe that internal auditors do not have the necessary skills to be actively involved in all stages of a business.

In 1998 the Institute of Internal Auditors (IIA) conducted a study and randomly asked auditors to explain what role they had in the fusion process (Davison, 2001). The responses were as follows:

- most of the auditors who responded said that they had only carried out the audit report in terms of mergers;
- audit department heads were involved in preliminary discussions on any new merger;
- most respondents felt that greater value could be added in the merger if the role of the audit department would extend;
- most respondents agreed that cultural differences and poor planning were the first two reasons for merger failure;
- almost all respondents felt that they needed specialized training in merger.

Therefore there is a great need for further study regarding the role of audit in case of merger. The internal audit function can improve the quality of management in the merger process.

Managers often do not understand the importance of internal audit in all stages of a merger. In an international survey conducted (Selim, 2002), it is clear participation of internal audit in various stages of the merger:

- strategic planning stage – 27 %;
- implementation of the merger plan stage - 14%;
- negotiation stage of the exchange ratio - 82%;
- the implementation stage of the merger - 86%;
- post merger stage - 41%.

Internal auditors should try to involve as early as possible in the merger process. To contribute effectively and add value to the strategic planning stage, auditors should follow:

It is important that internal auditors should receive information about possible mergers. Advice on systems and processes for the merger could reduce the risk. The target company in a merger may have different systems. An effective documentation can reduce the costs of integrating those systems and processes within the newly formed company. Auditors can calculate the audit risk for the target company.

Unfortunately, internal audit departments usually have little or no involvement in the merger process when the strategy of merger is elaborated. Company management often believes that the role of internal audit begins after the merger. Compliance with the above make half the battle to be won before.

Internal auditors should consult with specialists in various fields such as finance, human resources and legal departments.

Working with external consultants may increase the chance of successful fusion. External experts may be external auditors or a firm. Internal audit can provide vital information to management about the value of the acquired company, its financial situation and any deficiencies.

So given that often the decision on the merger takes into account the audit reports from the entities involved, we felt that the financial auditor's role is a successful coordinated successful merger process. If the auditor's opinion is with reserves, then there is a reason to reject the proposed merger and the merger will not be a failure.

To reach a position to express an opinion on the merger, the role of the auditor is to verify financial information, that has both utility: internal (management and business management) and an external utility for third party information (shareholders, tax authorities, customers, suppliers, creditors, banks, etc..). This control is exercised in order to protect property and ensure the credibility of information published.

According to ISA 315, "Identifying and assessing risks of material misstatement in understanding the entity and its environment" the auditor should obtain sufficient information about the entity and its regulatory framework. According to the category the entities belongs, in the case of merger, sholud apply other normative acts as shown in Table 1 - Normative acts.

Table 1 – Normative acts

Type of entity	Normative act
Commercial companies	Law 31/1990 concerning commercial comapnies
Banks	National Bank of Romania (B.N.R.) no. 5 / 2000 concerning banks' merger and division
Loan Cooperatives	B.N.R. nr. 6/2003 concering merger and division of credit cooperatives
Insurance companies	Insurance Supervisory Commission (CSA) no. 113111/2006 to implement the Norms concerning approval of the merger or

	division of insurance companies
Insurance and reinsurance brokers	Insurance Supervisory Commission (CSA) no. 113111/2006 to implement the Norms concerning approval of the merger or division of Insurance and reinsurance brokers
Private pension funds	Supervisory Commission of Private Pension System (CSSPP) no. 14/2008 concerning protection of participants in the merger of private pension funds ..
Non-bank Financial Institutions	Chapter. 4 of Law no. 93/2009 concerning non-bank financial institutions.

The decision on the merger must have regard to audit reports from entities involved in the merger.

Making the merger should take place only if the auditor expresses an unqualified audit report at the end.

The auditor should obtain sufficient information about the entity and its framework. The auditor has to provide users of accounting information on compliance with generally accepted accounting principles and internal procedures established by the management company and financial statements, changes of financial position and other information supplied for stakeholders.

6. CONCLUSION

The failure of mergers is determined by a number of factors including: poor experience in merger processes, failure analysis of due diligence, strategy management incompatibility between the companies involved in the merger, the inadequacy of culture workers in the companies, unverify the financial position, lack of communication between manager and employees.

Any merger that "is respected" is that preceded by a process of due diligence process by which the company examines the candidate's health business, ensuring that no unnecessary exposure to risk and unpredictable.

Managers should consult with a whole team of specialists: lawyers, accountants, tax consultants, specialists in marketing and management before the merger procedure.

A coherent and consistent communication plan may lead to the success of the merger or at least employees will not be unsatisfied and hence will not be declining productivity.

Because there are a variety of cultures, managers should seek ways to make them compatible.

Determining the causes of merger`s failure is useful to anticipate a failure. It is ignored in the literature that often the decision on the merger is based on the audit reports. Making the merger should take place only if the auditor expresses an unqualified audit report at the end.

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