

MERGERS AND ACQUISITIONS IN CEE COUNTRIES (example of Poland)

Angelika Kędzierska-Szczepaniak, Ph.D, Gdansk University

INTRODUCTION

The world market economy is currently characterized by the tendency to globalization, which means that companies have to cooperate and tighten their relations.

Companies working on the local market do not have many possibilities for development, so mergers and acquisitions (M&A also called consolidations or takeovers) can be a chance for them to cooperate with companies from all over the world.

Consolidations (M&A) concern the aspect of management, corporate finance and corporate strategy dealing with buying, selling and merging of different companies. The main goal of mergers and acquisitions is usually an improvement of company performance and shareholder value over a long period of time.

Mergers and acquisitions are similar corporate actions - they combine two previously separate companies into a single legal entity. In some cases, terming the combination a “merger” rather than an acquisition is done purely for political or marketing reasons.

In a merger of two corporations, the shareholders usually have their shares in the old company exchanged for an equal number of shares in the merged entity¹.

A merger can resemble a takeover but it results in a new company name (often combining the names of the original companies) and in new branding. A takeover, or acquisition, on the other hand, is characterized by the purchase of a smaller company by a much larger one.

¹ Brigham E.F., J.F.Houston: Fundamentals of Financial Management. Harcourt Publishers, Fort Worth 2001, p.345.

An acquisition can produce the same benefits as a merger, but it does not necessarily have to be a mutual decision. A larger company can initiate a hostile takeover of a smaller firm, which essentially means buying the company in the face of resistance from the smaller company's management².

Unlike in a merger, in an acquisition, the acquiring firm usually offers a cash price per share to the target firm's shareholders or the acquiring firm's shares to the shareholders of the target firm according to a specified conversion ratio. Either way, the buyer essentially finances the purchase of the target company, buying it outright from its shareholders.

The main difference between mergers and acquisitions is the fact that in the former at least one company loses its legal entity, which means that two companies combine and become one larger entity. In the latter, however, neither of the companies loses its legal entity.

There are three main reasons why companies decide to merge and acquire:

- growth – buying a company usually gives a better position on the market, the new company has more assets and more possibilities of financing;
- diversification – when one company buys another one that specializes in another branch, it can reach new markets but also diversify the risk of activity;
- synergy effects - the combined business can cut costs and increase profits, boosting shareholder values for both groups of shareholders.

The main goal of this paper is to present the M&A market history in Poland and other CEE countries.

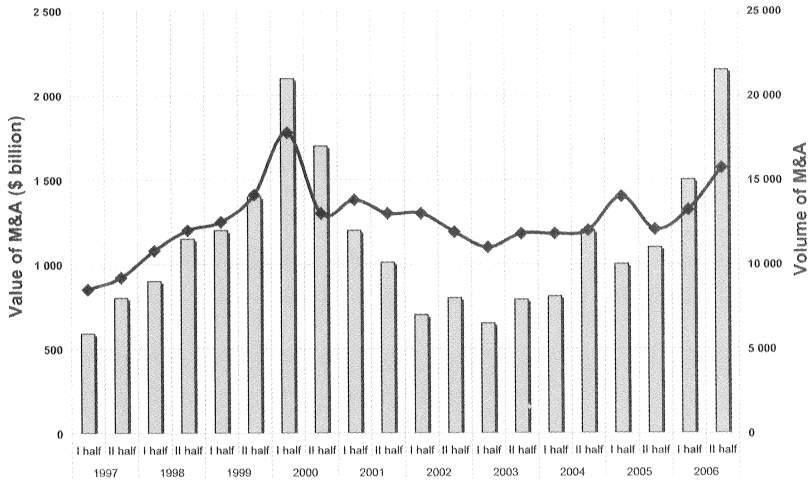
Mergers and acquisitions in CEE countries

Mergers and acquisitions appear serially in the world economy. Those periods are called “merger waves”. They are mostly seen in the economies of the USA, the EU, Japan and Australia. There were four

² S. Sudarsanam: *The Essence of Mergers and Acquisitions*, Prentice Hall, 1995, p.23.

merger waves before the end of the 20th century. Now, we can see the fifth merger wave which includes Poland and other Central and East European (CEE) countries.

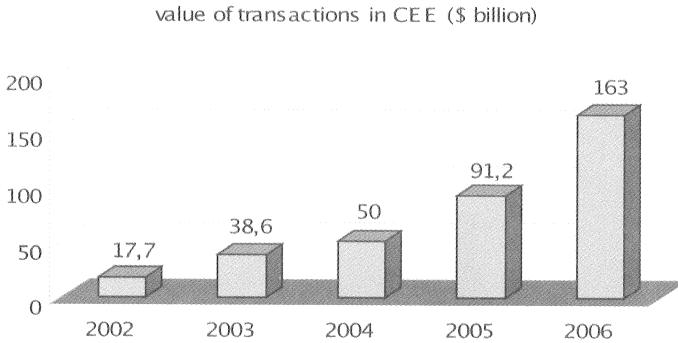
The M&A world market is presented in Graph 1.



Graph 1. Value and volume of mergers and acquisitions in 1997-2006.

Source: own study on the base of KPMG Report: *M&A Market in the World and in Poland*, www.kpmg.com

There was some stagnation in the value and volume of transactions at the beginning of the 20th century. It was caused by many factors such as the war in Iraq, the epidemic of SARS, the stagnation of the world economy and the threat of terrorism. The 2004 marked the end of the stagnation period in the area of M&A transactions. The value of M&A grew from \$1,950 billion to \$ 3,600 billion in the period 2004-2006. The situation on the M&A market in CEE countries is presented in Graph 2.

Graph 2. Value of mergers and acquisitions in CEE countries in 2002-2006.

source: own study on the base of: PwC Report: CEE M&A Survey 2006: Maturity, Momentum and Mega-Deals in Central and Eastern Europe, www.pwc.com

Transaction activity was also extremely buoyant in CEE countries. Robust growth in CEE means that M&A market value almost doubled in 2006 in comparison with 2005 and tripled the aggregate value of the 2004 record. The total value of transactions rose by 79% and reached a record-breaking \$163 billion (compared with \$91 billion in 2005). Deal volume rose by 37% in 2006 compared with 2005.

The main role in mergers and acquisitions of the CEE market was played by privatization. Now, the role of privatization in CEE countries has changed. The total value of privatization dropped from \$22.8 billion (2005) to only \$7 billion USD (2006).

The lower importance of privatization can be a good sign for the investors who perceive the market as more and more mature, which means that more transactions are really market transactions without the State sell-off stage.

There are also changes in the role of inward and outward transactions. The proportion of inward mergers or acquisitions dropped in volume-terms from 40% to 34% of total activity. The most active foreign investors in CEE countries in 2006 were the UK, Germany and Austria³.

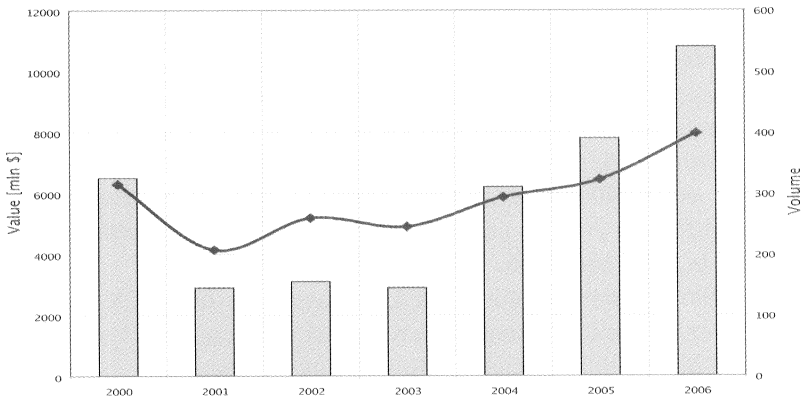
³ PwC Report: CEE M&A Survey 2006: Maturity, Momentum and Mega-Deals in Central and Eastern Europe, www.pwc.com

Mergers and Acquisitions in Poland

The history of mergers and acquisitions in Poland and CEE countries is not very long, and goes back only as far as the beginning of economy transformation in 1989. This transformation was very important for attracting foreign investors' attention. Foreign investment was possible in the way of privatization, greenfield plans and mergers and acquisitions.

Graph 3 presents the value and volume of M&A transactions in Poland.

Graph 3. Value and volume of mergers and acquisitions in Poland in 2000-2006.



Source: own study on the base of: PwC Report: M&A Country Survey 2006, www.pwc.com

The escalation of M&A in Poland and CEE countries depended on the situation on the world market. During the first years of the 21st century there was stagnation. The value of M&A amounted to \$ 2.8 billion in 2001 and was about 60% lower than a year earlier. Poland was the leader of market transparency in the CEE region then. These conditions were visible in over 70% of all realized transactions (at the same time the average in the region was about 40%). German (22 transactions), Dutch and American (over 12 transaction) investors were the most active investors before Poland's joining the EU.

The dynamic growth of the market was in contrast to the 2002 world trends. Altogether, 259 transactions were recorded and the value

of the whole market reached over \$ 3.1 billion, which resulted in an almost 11% growth in value and over 25% growth in the quantity of transactions compared with the year 2001. Local investors participated in the majority of transaction. The significance of foreign investments decreased since local firms administered more and more capital knowing that the period of bad economic conditions is the best time for investments. However, foreign investors were still interested in Polish firms. There were about 90 transactions with foreign capital amounting to the total value of about \$ 1.75 billion. The major potential investors came from Germany, Holland, the United States and France.

The M&A market had a downward tendency again in 2003. On the other hand, there were some clear signs of liveliness observed at the end of 2003. The number of transactions fell by about 5% in comparison with the year 2002. The value dropped by about 6% to the level of \$ 2.9 billion. French companies were the most active investors, who finalized 13 transactions, followed by German, British and American companies (10 transactions).

The role of mergers and acquisitions has been growing in Polish economy since 2004. The value of M&A transactions in Poland rose by about 120% in 2004 in comparison with 2003. The growth was still observed in 2005 and 2006.

In 2006 Poland was one of the key players on the M&A market in CEE countries coming second with reference to the numbers of transactions and third with reference to the value of transactions.

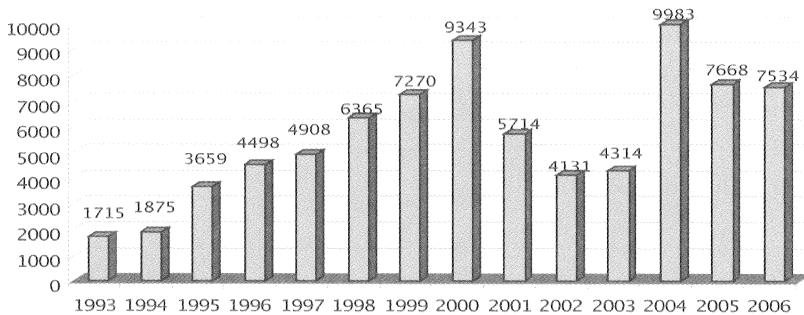
The value of transactions is a crucial factor. At the beginning of the 1990s there were a lot "small" transactions. In 2005 and 2006 the volume of transactions was similar to that in 2001 but the value was much higher. There were many medium (over \$50 million) and large (over \$100 million) transactions. This is a sign of market maturity.

It can be seen that foreign investors are important players on the Polish M&A market. They are interested in buying Polish companies because it is a quicker, cheaper and safer way to join the Polish market. Other reasons usually include the low price of assets and cheaper but qualified workforce.

Foreign investors have few possibilities to join the Polish market. The first one is greenfield, which means that a company starts from scratch, but it is more risky than investing in existing companies, called brownfield (e.g. M&A).

The share of foreign capital in the Polish market has changed. Graph 4 presents the value of foreign investment in Poland till 2006.

Graph 4. Value of Foreign Direct Investment in Poland (\$ million).



Source: own study on the base of data of Polish Central Bank, www.nbp.gov.pl

The largest growth of foreign investors' inflow took place in 1998-2000 when Poland was the CEE leader with respect to the attractiveness to foreign investors. Poland took almost 39% of Direct Foreign Investments located in this part of Europe. Next came the Czech Republic (18%), Russia (11%) and Hungary and Slovakia (about 8%). In 2001 a decline in those transactions (about 6%) was observed⁴.

In 2002 the number of foreign investors' inflow also decreased. It was probably caused by the fact that in 2001-2002 Polish economy showed the slowest development rate among CEE countries. In 2001 GDP increased by only about 1%, and in 2002 by about 1.3 %. Moreover, restrictive monetary policy, unclear tax regulations, uncertain investment climate and a decline in world economy had an influence on foreign investors' decisions. 2003 witnessed the end of stagnation and an acceleration of the dynamics of growth. The animation of the economy and accession to the EU in May 2004 resulted in a larger inflow of foreign investments to Poland. In 2003 the total value of foreign investments grew by about 6% in comparison with 2002 and by over

⁴ PwC Report: The Analysis of M&A in CEE Countries in 2003, www.pwc.com

100% in 2004 (compared to 2003). The most important investors came from France (20%), Holland (14%), United States (12,5 %) and Germany (12%)⁵. In Poland there are also some investors from Portugal. The most famous of them are presented in Table 1.

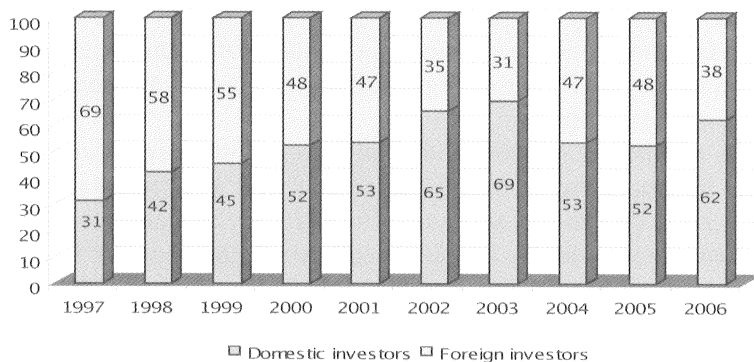
Table 1. Portuguese investors in Poland (data for 30.06.2007)

Lp.	Investor name	Name of the company in Poland	Activities
1.	Banco Commercial Portugues	Millenium Bank	financial
2.	Jeronimo Martins Holding	Biedronka (Ladybird)	retail trade
3.	Martifer	Martifer Sp. z o.o.	production of tubes
4.	Orfama S.A.	Archimode Sp. z o.o.	textile
5.	Simoldes Plasticos	Simoldes Plasticos Polska Sp. z o.o.	production of transport equipment

Source: own study on the base of Polish Information and Foreign Investment Agency, www.paiz.gov.pl

However, it is not only the value but also the role of foreign investors that has changed. At the beginning, they played a very important role on the Polish market and almost 70% of all M&A transactions were made this way. Later, the proportion changed and foreign investors participated in only 38% of the transactions in 2006. The proportion of foreign and domestic deals in Poland is presented in Graph 5.

⁵ PwC Report: CEE M&A Survey 2004: One step higher, www.pwc.com

Graph 5. The proportion of foreign and domestic deals in Poland.

source: own study on the base of PwC country and regional reports, www.pwc.com

In spite of the diminishing foreign investors' role in M&A transactions, they still constitute an essential part of direct foreign investments. M&A amounted to 42% of all foreign direct investment in 2006. The companies whose capital is partly foreign are an important segment of Polish economy.

Perspectives

The accession to the European Union, economic growth as well as the improving moods on the market should stimulate the development of the M&A market in Poland. The law and economic conditions should be favourable to the market liberalization and stimulate the consolidation of the market and the privatization activity. However, Polish investors are also aware of many obstacles such as the growing competition (mainly from foreign investors), obsolete technology and large investment needs. Local companies see their chance in co-operation and joining large international structures, which may increase M&A trends in the coming years.

Poland's membership in the European Union reduces the risk and encourages new investors who appreciate the economic and political stability, decrease of investment risk as well as the guarantees of applying the EU rules. At present, Polish economy is in a dynamic stage,

but at the same time it still offers relatively small labour costs in comparison with other EU countries. Another advantage is the existence of qualified advisory companies. On the other hand, investors also see the negative sides of doing business in Poland, for example, excessive bureaucracy, lack of a stable legal system, corruption and the lack of suitable infrastructure.

The number of mergers and acquisitions will increase in Poland because it is much easier and quicker to take over an existing company than to create it from the beginning. Foreign firms which invest in Poland already will probably be interested in strengthening their financial position and increasing their assets. Moreover, new, especially small and medium investors, will be attracted by the uniform European market which offers the feeling of political safety.

Conclusions

The M&A market is still less developed in Poland and CEE than in fully developed market economies. This results from the weakness of the banking system (which is involved in investment activity to a small extent) and the absence of many types of investment funds. Moreover, there are only a few companies specializing in takeovers on the Polish market. Despite some weaknesses, the Polish corporate control market is one of the best developed in the region. The potential of its growth will be clearly visible within a few years of the accession to the European Union, the end of privatization processes and the improvement the economic situation. These factors will result in an intensive development of the Polish corporate market whose structure will resemble other developed market economies in the world.

Summary

The Merger & Acquisition (M&A) market has a short history in Poland, going back to the beginning of the economic transformation in 1989 when it was based on privatization and foreign direct investment (FDI).

Those transactions were very popular at the end of the 1990s. The value and number of transactions have been increasing each year. There was short stagnation after this period but the economic revival, mem-

bership in the European Union and better atmosphere among investors will probably result in an increase in the number and value of mergers and acquisitions on the Polish market.

Sources:

1. Brigham E.F., J.F.Houston: Fundamentals of Financial Management. Harcourt Publishers, Fort Worth 2001
2. KPMG Report: M&A Market in the World and in Poland, www.kpmg.com
3. Polish Central Bank, www.nbp.gov.pl
4. Polish Information and Foreign Investment Agency, www.paiz.gov.pl
5. PwC Report: CEE M&A Survey 2004: One step higher, www.pwc.com
6. PwC Report: CEE M&A Survey 2006: Maturity, Momentum and Mega-Deals in Central and Eastern Europe, www.pwc.com
7. PwC Report: CEE M&A Survey 2006: Maturity, Momentum and Mega-Deals in Central and Eastern Europe, www.pwc.com
8. PwC Report: M&A Country Survey 2006, www.pwc.com
9. PwC Report: The Analysis of M&A in CEE Countries in 2003, www.pwc.com
10. S. Sudarsanam: The Essence of Mergers and Acquisitions, Prentice Hall, 1995.