

## How the legislation influenced the M&A transactions in Romania

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**Abstract.** *We know that there is a close connection between the mergers and acquisitions and the legislation in every country. The M&A market is usually governed by commercial codes and other special laws in order to enhance business performances but maintaining proper competitive environments for improving business performances.*

*The aim of this study is to analyze whether the M&A market in Romania was influenced in time by the specific legislation that was regulated for this purpose. Our analyze will include data for mergers and acquisitions between 2000 and 2014 and different types of mergers and acquisition processes which happened both on the stock exchange market and on a counter-to-counter basis.*

*We will also discuss about the political decision that had an effect on the M&A market in Romania mainly in cases of privatisation processes. We will take into account the EU accession when Romania had to align its legislation to the European one (The European Community Merger Regulation Law) to see if this affected the M&As.*

**Keywords:** M&A legislation, takeovers, regulation, tender offers.

**JEL Classification:** E22, G34, G38, K22, N40.

## 1. Introduction

Large companies are constantly looking for entering new markets, to increase their financial performance or to increase market share and shareholder wealth. As we all know, mergers and acquisitions (M&A) are the tool for the rapid development of companies with financial resources. A good example is the European market which has been in continuous development especially after the transformation of centralized socialist economies of east and south-east.

Companies in developed countries use M&A operations to enter into emerging economies regions because here they can find insufficiently regulated market, a workforce not so well paid as in developed countries and also numerous opportunities for development. Political changes in Eastern Europe that led to the removal of communist regimes had major effects on the economies, many large state companies, which until recently were sustained even if they didn't recorded profits, were forced to restrict their activities or even to close their gates. In this way privatizations appeared and state companies were taken over by foreign investors. For example, in Romania the main privatization period was between 1996 and 2000. From the legislation point of view, in this period Romania had still an unstable legal framework and major deficiencies in the trading rules compared with the Western European states.

So, in a world with developing economies and continuous globalization (Stiglitz, 2003), more and more states have considered necessary to maintain fair competition between companies that act on the same market in order that the final consumer does not have to suffer. This resulted in the establishment of a set of "game rules" which in Europe are called competition laws, while in the U.S., antitrust laws. Since on the M&A market there are large companies pursuing a permanent conquest of new markets and increase in market share as we already said before, transactions can often violate the fair market competition and therefore more attention was given to this area in the last decades.

This is why the aim of this article is to study if the M&A market in Romania was influenced by the specific legislation. Once Romania joined the European Union, European regulations have been included in national legislation mainly affecting the former commercial code, civil code and capital market law. However, as in every member state, there are some particularities that investors must take into account before they decide to invest in that country and the dynamics of these particularities can be observed in the evolution on the number and value of the transaction.

Further, the article is organized as follows: next section will come with a brief overview of literature review, in section 3 we focus on the database and methodology, then we have the results and comments and the last section will be dedicated to conclusions.

### Literature review

In the literature there are more and more studies that analyze the relation between law and legal regulations in different economies and the financial development of the state or companies operating in its borders. One example can be La Porta et al. (1998, 1999, 2000)

who believe that civil law states have an important role in regulating business more than the states with common law.

In the European Union, the Community law governing M&A market is called the European Community Merger Regulation Law (ECMRL law). Even if the EU states have their own internal M&A law, the general trend is the same. The ECMRL only regulates only those transactions that are considered, by some criteria, at the union level. There are three main types of transactions, defined as “concentration”, that require regulation. They occur only where there is change in control or change in ownership in that company and may result in mergers, acquisition of sole control or association of companies (joint venture).

Another study which analyzes the M&A payment choices of European bidders for publicly and privately held targets in the 1997–2000 concluded that corporate governance concerns, debt financing, institutional settings, laws, and regulations have a large influence on the bidder's payment choice (Faccio and Masulis, 2005).

Even if studies do not have a main interest in analysing the relationship between law and M&A transactions, the conclusion take into account this aspect also. In a study on the influence of family ownership on the acquiring shareholder M&A valuation, there were also analysed the aspects of firm returns under different legal environments when a merger and acquisition (M&A) is announced (Feito-Ruiz and Menéndez-Requejo, 2009). The conclusion is that a weaker legal and institutional environment in the target country has a positive influence on acquiring shareholder valuation. Another study of the authors aimed to analyze the influence of the legal and institutional environment on bidder firm returns around the announcement date of cross-border Mergers and Acquisitions (M&As) (Feito-Ruiz and Menéndez-Requejo, 2011). The results showed that shareholders of acquiring firms place greater value on cross-border M&A announcements than on domestic ones. The stronger (weaker) the legal and institutional environment of the acquirer firm country in comparison with that of the target firm country, the more positive (negative) the effect on acquiring-firm shareholders' valuation of M&As.

There are many studies on the US market with this topic, but many of them focus on cross boarder M&As. In one study the aim was to see to which extent cross-listing in the US leads to legal and regulatory bonding, and/or whether reputational bonding proxies by financial intermediaries monitoring is an important factor in US investors decision to hold shares in cross-listed firms (Schneper and Guillén, 2009). The results were quite interesting because many of the cross listing decision are based on the legal aspects.

Studies made on a multinational level show that law and finance quantifies differences in the laws governing the business enterprise in various countries. The conclusion is that many legal institutions matter for financial development (Siems and Simon, 2010).

To sum up, governments have developed M&A laws in order enhance business performances and to maintain a proper competitive environments for improving business performances (Lin et al., 2011).

## 2. Databases, results and discussion

The study analyze the data on M&A between 2005 and 2014 (estimation), the aim being to see the trend of the number and value of the transactions. The data was taken from several sources the most relevant was Zephyr database (1). The database includes the number of transactions made and their global value all relevant areas in the world: North America, Western Europe, Asia, Africa, Eastern Europe, Middle East and South and Central America.

As we know, in the past decade, the world economy suddenly went from a situation of continuously growth to a rapidly recession that is still felt in both Europe and America. So, the global economic shock was also felt in the M&A market. So the M&A market is reacting to a lot of factors, in many cases being quite hard to analyse the impact of one particular one.

In Romania, the M&A market had the same trend as the one of the word data (Table 1). The development of this market started with the appearance of many foreign companies. Acquisitions and mergers in Romania have been preferred by investors to the implementing of its own subsidiaries. A possible reason can be that the acquired company has already established a relationship with different costumers and so is able to adapt rapidly to the economic environment or simply the buyer wanted to benefit from the know-how of the acquired company.

**Table 1.** *Number of M&As in Romania between 2005 and 2014*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
Number of M&As	239	256	281	210	191	270	212	324	443	589

**Source:** Zephyr database.

The table present the number of M&A transaction on the Romanian economy between 2005 and 2014. The data for 2014 is an estimation based on the values recorded by September.

We can see that the number of transaction is lower in 2008 and 2009 due to the world economic crisis and also to the political and social instability in that period. Frequent changes to laws are directly affecting the economy, especially those changes related to the tax code and excessive political involvement among state-owned companies, which are discouraging investors to invest in the economy.

**Table 2.** *Aggregate deal value (mil USD) in Romania between 2005 and 2014*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*
Aggregate deal value (mil USD)	12,758	4,939	3,031	6,783	2,270	1,951	993	1,323	3,134	7,852

**Source:** Zephyr database.

The table presents the number of M&A transaction on the Romanian economy between 2005 and 2014. The data for 2014 is an estimation based on the values recorded by September.

As a result of the significant increase in the number of mergers and acquisitions, in the period before and just after the EU accession, Romania has experienced a major decrease in the mergers and acquisitions market both in terms of size, and volume, while the number of mergers increased. This was caused mainly by the difficult economic conditions that made it more difficult to access funds to finance further deals. High expectations of sellers on final earnings are in contradiction with the fact that investors hope to conclude transactions more convenient in financial terms, which lead to

prolonged negotiations and the completion of only a smaller number of transactions. Investors have shown caution against potential targets and completed only those transactions that can offer them maximum capital revenues.

The legal framework for transactions related to mergers and acquisitions is rather limited, including the Company Law 31/1990 and Order 1376/2004 (on the recognition of the main operations of merger, division, dissolution, liquidation of companies, and the withdrawal or exclusion of shareholders and their tax treatment). Mergers and acquisitions involving at least a listed company must comply with Law 297/2004 on the capital markets and the regulations issued by the National Securities Commission of Romania (NSCR).

Over the time the political decision and legal regulations have a decisive influence on the number and value of the transaction. For example, the privatization of state companies back in the 1990s represents an important moment in Romania's M&A market. This process has offered foreign investors a wide range of investment opportunities in Romania through the acquisition of shares or assets, and by setting up joint ventures with state-owned companies. In addition, strategic investors were offered numerous incentives just to invest in the Romanian economy.

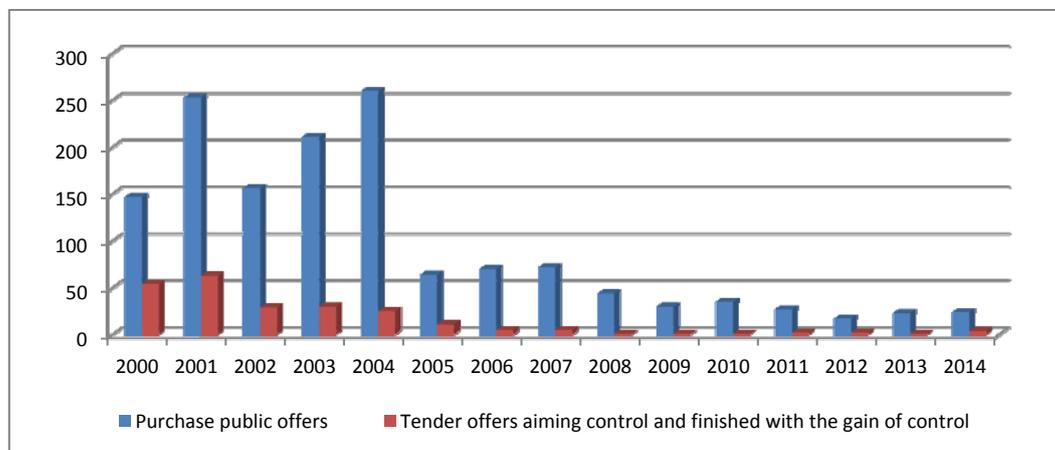
Privatization Act was amended several times in order to increase the attractiveness of the companies offered for sale. A revised Law on Privatization (Emergency Ordinance 88/1997, approved by Law 44/1998) and was recognized as the only law governing the privatization process. This was part of the Mass Privatization Program (MPP) which was started by the government in order to take the Romanian economy to a market orientated one.

The program involved the transfer of shares of several thousand companies to citizens in exchange for coupons. In order to do this, any company entering into this program was forced to get listed on the Stock Exchange, although they neither intended nor met the criteria to be listed on the stock market. This lasted until 2004 when the capital market law appeared and changed that. The effects on the number of the public purchase offers can be observed in the tables below.

**Table 3.** Number of Public Purchase Offers and Tender Offers on the Romanian Capital Markets between 2000 and 2014

Year	Purchase public offers	Tender offers aiming control and finished with successful buy of a controlling position
00	147	43
2001	253	38
2002	156	22
2003	211	22
2004	260	19
2005	64	8
2006	70	3
2007	72	4
2008	44	1
2009	30	0
2010	35	0
2011	27	2
2012	17	2
2013	23	1
2014	24	4
Total	1433	169

**Source:** update of Dragotă et al. (2013).



Next we will analyze if the success of the public purchase offers on the Romanian capital market is influenced by the 2004 capital markets regulation, the political regime of the Romanian government or the accession to the European Union.

The database for this analysis consists of 344 public purchase offers from the Romanian capital market between 2000 and 2014 (August). A percent of 49% are successful public purchase offers, offers where the acquirer succeeded in gaining the controlling position at the end of the transaction. In order to do that, we used a Probit model and we based on the assumption that the probability for an event to occur is linearly related to a set of explanatory variables. We considered that the sign of the estimated coefficient for the independent variables with this model will describe a change in the probability for the dependent variables. In Table 4 we present the variables used in the model to explain the probability of success of a takeover bid offer.

**Table 4.** Variables used in the model

Indicator	Explanation
PBA	The percentage of share from the company being target of the public purchase offer owned by the bidder from the before the transaction (Ciobanu, 2014).
PSP	The percentage of share from the company being target of the public purchase offer purchased by the bidder.
CAP	The target company capitalization.
CMLAW	The existence of the capital market regulation – dummy variable (1 for existence, 0 otherwise).
EUA	Romania situation in the time of the transaction – dummy variable (1- if it was a member of EU, 0-otherwise).
LIBGOV	Liberal government period – dummy variable (1- if is true, 0-otherwise).
SOCGOV	Social government period – dummy variable (1- if is true, 0-otherwise)

Using these variables we tested, using the Probit model, which of these influence the success of the public purchase offer. We must also remind that we analysed only to public purchase offers that happened on the Romanian capital between 2000 and 2014. The results of the model are presented in Table 5.

To estimate the probability of a public purchase offer we used the probit regression model. The regression uses 344 observations of a public purchase offers on the Romanian capital market between 2000 and 2014. We consider a public purchase offer successful if there is a change in the target's controlling ownership. We did not consider in the same

regression the variables correlated at a higher level than 0.3. Z-statistics are in parentheses. The symbols \*, \*\*, \*\*\* represent significance levels of 10%, 5% and 1%.

**Table 5.** *The model estimated results*

Variable	(1)	(2)
PBA	1.31***	
	(3.31)	
PSP		4.41***
		(10.94)
L_CAP	-0.01	-0.008
	(-0.51)	(-0.17)
CMLAW	0.67*	0.91**
	(1.78)	(2.02)
EUA	-0.81**	-0.23
	(-2.58)	(-0.61)
LIBGOV	-0.26	
	(-0.81)	
SOCGOV		0.23
		(0.58)
Intercept	0.07	-1.57**
	(0.15)	(-2.05)
Mcfadden R-squared	26.55%	44.82%
Probability (LR stat)	4.03*E(-6)	1.23*E(-9)

These results show that the probability of a successful purchase public offer is higher after the introduction of the capital market law in 2004 than before. This result can be explained by a higher investor's confidence because of the law regulations.

Another positive influence on the probability is obtained with a higher percentage of shares owned before the transaction. This is because it is simple for an active shareholder of a company to convince the others to sell him shares of the company, and with the higher the percentage of shares already owned the higher the change is to obtain a controlling position. The same situation is with the percentage of shares purchased during the transaction. The higher the offer is, in terms of number of shares, the higher is the probability for the offer to be successful.

Also, we recorded a negative influence on the probability of success of a purchase public offer after Romania EU accession. This can be explained by the higher number of regulations due to the European Community Merger Regulation Law directives. The explanation for this result is that there are more offers recorded for the same company, due to a higher investor's confidence, so it is simple to understand that only one of those will be successful.

## Conclusions

The most important conclusion of this study is that the changes in the M&A regulations have affected the number and the average value of a transaction. This is because a new regulation comes with new notification, control and intervention procedures which are designed to raise the investor's confidence.

We can say that investors are likely to invest more in a well regulated market. Not only that many regulations can better protect the investors' money, but also they can provide an excellent environment for development and capital gains. Therefore, the business

environment does have a positive influence over the M&A market and for a future study we can use some indicators like the number of days required to start a business or the indicators that determine the how friendly business is the economy in order to explain more the changes in the number and value of the M&A transactions.

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### Note

- <sup>(1)</sup> Zephyr is a database of M&A, IPO, private equity and venture capital deals with links to detailed financial information on companies.

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