INTEGRATIONS AND HOSTILE TAKEOVERS

Research Paper

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Abstract

By merger or acquisition, companies are merged into one company, in such a way that the assets of all companies included in the merger or acquisition are merged and that after the procedure there is only one company. That company becomes the universal legal successor of companies that cease to exist due to integration. The basic difference between a merger and an acquisition is that in a merger the acquiring company already exists and will continue to exist, and the acquired company ceases to exist. Although there are differences between the terms merger and takeovers, they are sometimes used in the same sense, but the laws clearly distinguish them. Takeovers can be friendly or hostile, depending on the attitude and willingness of the management of the target company. In general, when the participating companies are approximately the same size, the notion of consolidation applies, and when the companies differ in size, the notion of merger applies. In practice, this distinction is blurred, and the term merger is used in companies of the same, but also different sizes. The paper analyzes the four most important approaches to integration processes with special emphasis on takeovers of a hostile nature.

Keywords: Integration, Hostile Takeovers, Strategic Planning.

1 Introduction

Mergers, acquisitions and takeovers are phenomena that have attracted the attention of professional economists, entrepreneurs, the general public and legislative and control bodies in the economies of many countries in the last hundred years. The economic reasons for mergers and acquisitions lie in the need to concentrate capital, technology, professionals, labor, and resources in general. Most merger and acquisition transactions occur in telecommunications, television networks, the pharmaceutical industry, computer software manufacturing, banking, and retail. Experience to date has shown that a large number of integration processes, especially takeovers, end in failure because they are high-risk transactions with potentially high returns, but whose failure has a long-lasting negative and sometimes devastating effect. The paper analyzes the theoretical approaches of integration processes and provides relevant facts for the development and implementation of a strategic plan for enemy takeovers. The authors point out the asymmetry of information and the risks that occur in hostile takeovers, and propose criteria for making decisions about starting such integration processes.

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2 Relevant features of integration processes

2.1 Mergers, Acquisitions and Takeovers

A merger or acquisition is a process in which at least two companies form a new company to which they transfer all their assets and thus cease to exist without liquidation, and the members of the merged companies receive shares in the new company in exchange for their ownership shares. When merging, entire companies connect and create a new, joint company, and the former independent companies cease to exist. The name of the newly created business entity usually takes over the names of previously independent companies. Mergers most often occur between existing competitors in the market, ie companies in the same industry merge (Haistor Ramić, 2021; Lazibat et al., 2006). Mergers or consolidations are business combinations by which two or more companies merge to create a completely new company. All merging companies disappear, and only the new entity that has formed continues to operate.

A merger is a combination of two companies where only one company survives and the merged company disappears. In a merger, the merging company takes over the assets and liabilities of the merged company. It is a process in which one or more companies transfer all their assets to another company and thus cease to exist without conducting liquidation proceedings.

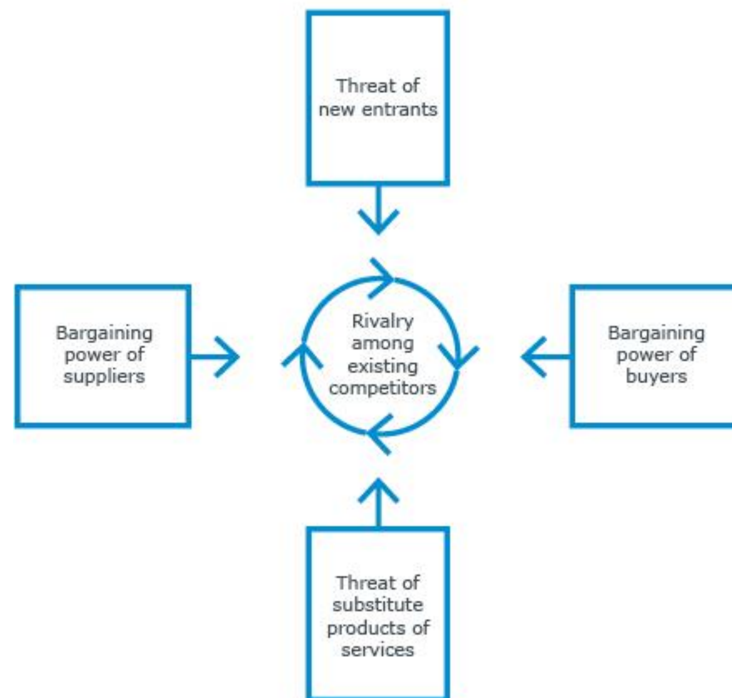
Another term that is often used is acquisition. This term is less specific, so it is sometimes used only for hostile takeovers, and sometimes for friendly or hostile takeovers of other companies by an acquirer (Novak, 2000). In the broadest sense, an acquisition or takeover of a company means any acquisition of another company or a significant share in the equity of another company by an acquiring company, regardless of whether the acquisition was made by purchasing the assets or ownership interest of the acquired company or pooling ownership interests. It does not matter whether the acquired company ceases to operate or whether it continues to operate under its own company but under the control of the acquiring company.

2.2 Features of managerial and organizational approach

In accordance with the approach of the industrial organization, the basic explanation and reasons for the implementation of the merger and acquisition process in companies stems from the positive effect on the volume and structure of organizational costs as well as the positive effect on market position and strength of companies. Integration processes of mergers and acquisitions contribute to reducing costs and increasing the market power and position of integrated companies within the entire economic sector. Integrations in the form of mergers and acquisitions generate long-term profitability of firms through the impact on changes in the industrial structure in which firms operate (Church and Ware, 2000).

The analysis of the competitiveness of enterprises is conducted in the context of the entire industrial sector and key sectoral stakeholders. Relationships in the structure of the economic sector determine the degree of rivalry among competitors, influence the decision-making on strategic guidelines in the growth and development of enterprises and affect the way business processes are performed. A strategic tool that analyzes the position of companies within the industry is the model 5 of competitive forces. Competitive forces that shape the position of companies within the industry are (Rašić Jelavić and Brkić, 2016):

- Strength of industrial rivalry, ie strength of competitiveness among companies within the observed industry
- Danger from competitors
- Bargaining power of the customer
- Bargaining power of suppliers
- Danger from substitute products (substitutes).



Scheme 1: Porter's model of five competing forces (Rašić Jelavić and Brkić, 2016)

The five competing forces influence the shaping of the profit potential in the economic sector as well as the degree of attractiveness of investments in that sector. The basic preconditions for long-term profitability in the economic sector are a favorable position in relation to suppliers and customers and substitute products. A stable competitive structure is also an important factor in the profitability of the sector, and the integration process is the most significant factor influencing changes in the existing competitive structure at the industrial level (Buterin and Blečić, 2013; Hackbarth and Miao, 2012).

Barriers to the entry of new competitors into the economic sector affect the degree of stability and survival of existing competitive relations. The absence of barriers to entry into the economic sector attracts new competitors and causes changes in the existing balance within the sector, and in particular changes in terms of potential lower prices of products and services. The described price movements can cause a decline in business profitability of all stakeholders involved, and therefore businesses are increasingly turning to integration processes to strengthen their market position and strength and to rationalize operating costs (Sudarsanam, 2005).

By taking over and merging in a particular industry, companies strengthen their bargaining power whether they are in the position of buyer or supplier. If a customer company takes over or merges with its competitor, the company will be in a situation to influence the price of the services or products it buys. Strong industrial rivalry can initiate price struggles that can limit an industry’s profitability by lowering prices. A takeover or merger with a competitor enhances the bargaining power of the acquirer if the takeover results in a reduction in the number of competitors. Strong substitutes reduce the market power of the industry, further limiting the influence of firms in the industry on prices. By taking over companies that offer replacement products, the market position can be strengthened and thus the profitability of the acquirer can be improved.

Before explaining the managerial theoretical approach to merger and acquisition processes, it is necessary to define two key theories in corporate governance, namely agency theory and service theory. These theories describe the relationship of contradiction and compliance of managerial goals with the goals of owners and shareholders, which is an important factor and affects the success of the implementation of the process of enterprise integration.

Agency theory is an organizational and economic theory that attempts to explain the relationship between principals (owners) and agents (managers) when delegating the management process to professional managers. The theory emphasizes that the interests of principals and agents are inherently conflicting, and managers will act opportunely to maximize their own interests and goals, which may be to the detriment of the owners and shareholders in the firm. If the harmony of the goals of managers and business owners is successfully achieved, then the relationship between agents and principals is understood in the context of the theory of courtesy (Panda and Leepsa, 2017).

Consistent with the managerial theoretical approach to mergers and acquisitions, many integration processes are characterized by a high degree of failure because the decisions made by managers are not in line with the interests of other stakeholders in the company. Such decisions do not create the necessary newly created value for owners and shareholders. When there is no possibility of effective discipline of managers by shareholders and competitive forces in the market, integration processes cannot result in an adequate degree of success.

The opportunistic approach to mergers and acquisitions by managers is based on the realization of their own interests, which gradually lead to a decline in the value of the company. Decisions on mergers and acquisitions should not be made on the basis of the amount of managerial tangible and intangible incentives and rewards, as this creates managerial myopia or nearsightedness that leads to long-term loss for all stakeholders.

In addition to the amount of tangible and intangible incentives, the objectivity of decision-making on integration processes of mergers and acquisitions may be affected by the desire of managers to maintain control over management processes. In such situations, various trade-offs are possible that negatively affect the interests of owners and shareholders, such as selling shares at a lower price in order to retain management positions. Contracts between agents and principals should therefore be designed in a way that minimizes the possibility of opportunistic action by managerial structures during the implementation of mergers and acquisitions (Filipović, 2012).

As part of the managerial theoretical approach to mergers and acquisitions, the so-called hypothesis of managerial arrogance is also important. This hypothesis was developed to explain the fact that managers of the organization that is the target of the takeover process often have a high level of subjectivity in terms of assessing the value of the company. A rational approach to the decision to take over a company should be based on determining and comparing the real book value and market value of the company. Nevertheless, managers often rely on subjective assessments of a company's value, which means that takeover decisions are sometimes not made on rational and fact-based analyzes. In such situations, the acquirer tends to overestimate the value of the firm and generate additional value for the acquirer's enterprise based on its own subjective evaluation (Boone and Mulherin, 2008; Roll, 1986). Relying on the subjective assessment of the value of the company that is the target of the takeover in the management literature is also called the *winning curse*. It points out the importance of careful and detailed planning and preparation of integration processes and the importance of implementing due diligence processes in order to determine the real situation in the company and an objective assessment of its value.

2.3 Financial approach and human resources theory

The financial theoretical approach to mergers and acquisitions is significant because it provides a response to problems that may arise from the discretionary and opportunistic behavior of managers when implementing integration processes (Sisek and Strahonja, 2012). Unlike entrepreneurial business ventures in which the ownership and management function is united in one holder of these functions, the growth and development of the company results in the separation of management and ownership function and control over the decision-making process is not in the hands of owners or shareholders, but primarily in management structures (Vinšalek Stipić, 2020). The task of managers is to rationally engage the necessary factors of production to generate new value, and the ability to generate new value is also

a fundamental measure of the success of managerial performance and therefore the incentive system of managers must be aligned with the results (Štefulić Radman Peša, 2012).

The most significant contribution of the financial approach to the processes of mergers and acquisitions arises from the theory of free cash flow. Free cash flow is the liquid cash available to an enterprise after investing in projects that have resulted in a positive net present value. The decision on the distribution of free funds may be conflicting from the point of view of management and the owners or shareholders. If the owner decides to pay a dividend, it reduces the amount of free cash, and thus the degree of control of the manager over the company's operations. Managers will be more motivated to invest free cash flows than to pay dividends because in this way they increase the volume of their own power and control. The decision to take over a company often arises in response to the conflict situation described. Managers of companies with a surplus of free cash often decide to take over other companies, and if this process is not carefully planned and based on facts, it will certainly result in negative effects on the interests of shareholders (Ayash, 2020).

The development of the knowledge society and economy is increasingly analyzing the impact of individual organizational processes from the point of view of human resources as the most important resource in creating a competitive advantage of modern companies (Boras et al., 2000). Decision-making on integration processes of mergers and acquisitions needs to be considered very precisely given the advantages and disadvantages and the impact of integration processes on human resources, which can be twofold and is conditioned mostly by leadership style after the integration process (Filipović, 2011). During the process of mergers and acquisitions, conflicting interests of certain interest groups related to human resources management, and especially the retention or dismissal of certain teams of employees, may come to the fore. Downsizing or dismissal of a part of employees is necessary to apply only as a last resort because it has a very negative effect on organizational culture and morale and on the attitude of employees about the merger and acquisition process (Kemal and Shadid, 2012).

Merger and acquisition processes certainly require the successful implementation of organizational changes with the aim of establishing cohesion in the new and wider business system. Organizational changes are very often accompanied by fear and resistance among employees. Successful management of the transition process in which ethical and transformational leadership is applied with an emphasis on employee participation, is the key to successful and effective adaptation to the inevitable organizational changes, but also for the creation of a solid and stable organizational culture that is oriented towards the realization of strategic goals due to which the processes of mergers and acquisitions were carried out (Gotal, 2013). Transformational leadership is a factor that minimizes the problems that can arise due to mismatches between previous organizational cultures of companies that are integrated. This style of leadership can strengthen the sense of belonging to a new organizational culture and avoid the problem of fragmentation and feelings of insecurity among employees after the implementation of the process of mergers and acquisitions.

3 Strategic plan of hostile takeover

Knowing that mergers and acquisitions are among the activities characterized by a high level of risk, it is extremely important that companies adhere to these rules when implementing them (Lazibat et al., 2006):

- Selection of a suitable target partner
- Detailed research of the market position of the potential partner
- An attempt to determine the compatibility of company culture and their management
- Determining the new structure of the organization after the merger or acquisition
- Protection of key resources of the target company
- Valuation of shares
- Integration planning.

Acquisitions are a more common form of integration than mergers, and their advantage over mergers is that the parent company still exists and retains its existing name and most market relations, which has its economic value. The advantages that merging can give are:

- Growth of the company's strength, increase in market share and expansion of production lines
- Helps diversify and thus reduces cyclical and operational impacts
- Makes it easier for a company to lend finance when it merges with a company that has significant liquid assets and low indebtedness
- Gives a good return on investment when the market value of the acquired company is significantly lower than the cost of its replacement
- In some cases it increases the market price of the stock because the shares of a larger company may be perceived as more marketable, safer and more stable
- Opportunity for better development management
- Achieving a synergistic effect, which means that the result of the combination is greater than the sum of the parts.

Disadvantages of merging are (Novak, 2000):

- Reverse synergy that reduces the net worth of the combined entity, for example due to adjustments in the method of payment of employees, the cost of servicing the debt incurred by the takeover, the shortcomings of key people in the acquired company
- Adverse financial effects because the intended benefits were not realized, for example, no cost savings were realized
- Antitrust activities that prevent or delay the proposed merger
- Problems due to disagreement of minority shareholder

All mergers and acquisitions are explained by numerous goals, but there is one basic one that lies behind all these goals - to increase value for shareholders. Mergers and acquisitions are high-risk transactions, but the potential returns on such transactions are high. Some transactions are successful, others are not. Economic values are expected to grow, and accelerated growth is projected. However, very often the challenges in meeting these expectations are underestimated. Unsatisfactory results are visible in a number of large mergers. As takeovers increasingly accept declining productivity, low morale, internal competition, the departure of executive staff as a result of takeovers, shareholders become dissatisfied. Cost reduction is always far more expensive than anyone anticipated. It rarely materializes as quickly as expected.

Data on management support for mergers and acquisitions policy from the research of Lazibat et al. (2006) support the claim that mergers and acquisitions are an insufficiently known term. As many as one third of the respondents did not know the answer to the question whether the management in their companies supports integration processes or not. Also, with as much as 64.5%, the claim of the great importance of mergers and acquisitions for inclusion in the process of globalization was accepted.

Implementing a hostile takeover of a company requires detailed planning and preparation of the takeover process. Planning for such acquisitions is a key step in achieving the goals. The enemy takeover planning process can be divided into expected and unexpected aspects. The expected aspects of the hostile takeover are the analysis of the external and internal environment of the company and the analysis of the market position of the company in accordance with the model of the five competitive forces. Based on the above analyzes of the situation, it is possible to derive a realistically achievable vision, mission and business strategy (DePamphilis, 2010).

In the process of planning hostile takeovers, it is very important to take into account unexpected aspects and factors that cannot be predicted before the takeover process due to information asymmetry or the fact that the acquiring company often does not have all the necessary information about the target company. This is also the biggest reason for failure in the integration process of the takeover, especially

if it is hostile (Cao et al., 2005). For this reason, it is important that the strategic takeover plan includes both a detailed identification as well as a way to manage the potential risks that may arise from not knowing certain key information about the target company.

The takeover plan should include the results of the external and internal environment of the company and market analysis as well as an assessment of the target company's resources. Based on these data, strategic issues in the company's operations are determined, and the top management of the acquiring company makes decisions on optimal strategies or ways of implementing a hostile takeover. The overall hostile takeover plan should include a business takeover financing plan, a timeline, and the persons responsible for carrying out individual activities as part of the hostile takeover plan (Kaplan and Stromberg, 2008).

The strategy or method of implementing a hostile takeover should be optimally aligned with the financial and non-financial goals that are planned to be realized by the takeover (DePamphilis, 2010). As part of the financial goals that need to be realized, it is important to mention the minimum rate of return on investment in the target company and the minimum level of income and operating profit that is planned to be realized. Taking into account non-financial goals when developing a strategic takeover plan is important because of gaining a long-term sustainable competitive advantage in the company's operations after the takeover. Of greatest importance in terms of non-financial goals is the possibility of acquiring rights arising from intellectual property such as patents, access to technology and know-how, and increasing specialized resources for investment in research and development processes.

The disadvantages of hostile takeovers stem from the fact that it is not possible to negotiate the management of the takeover company and the target. While friendly takeovers develop strategic management contacts between both companies and share business status information based on data confidentiality agreements, this process is not present in hostile takeovers. Lack of communication and inability to negotiate make it impossible to check in detail the financial performance and credibility of the company. The difference between the implementation of the friendly and hostile takeover process also stems from the fact that a hostile takeover does not send a letter of intent to take over, which contains a proposal for the share price and takeover volume and information on takeover restrictions.

As part of identifying and developing a risk management plan for a hostile takeover, it is crucial to define operational and financial risks and the effects of these risks on the success of the takeover process as well as overpayment risks that may result from overestimating the company's value. As part of operational risk, it is necessary to assess the ability to successfully manage the company, especially in the integration process phase. The ability to timely finance debt is at the core of financial risk management, and this risk is directly related to the ability to objectively assess the value of the company, ie the desire to avoid overpayment in relation to the real value of the target company.

The takeover plan should also contain detailed information on the criteria on the basis of which the target company is selected and the ways in which the takeover of the target company contributes to the realization of the strategic goals of the acquiring company. Common criteria for selecting a target company are the amount of financial resources that the company can invest in the takeover of another company, the industrial sector from which the company is the target, as well as geographical restrictions related to the selection of the target. Data on the financial operations of companies in the form of corporate and financial reports and their detailed analysis should be the basis for making a decision on the implementation of a hostile takeover. Business profitability, target markets in which the company operates and the specificity of production processes are relevant criteria when making a decision to take over the company.

4 Conclusion

Merger is a process in which at least two companies form a new company to which they transfer all their assets and thus cease to exist in their previous form, but their members receive the corresponding shares in the new company. Upon merger, the former independent companies cease to exist by merging into a new, joint venture. All merging companies disappear, and only the new entity that has formed continues

to operate. Unlike a merger, an acquisition is an integration process in which only one company continues to operate and the merged company disappears. In acquisition, the acquiring company takes over the assets and liabilities of the merged company. It is a process in which one or more companies transfer all their assets to another company and thus cease to exist without conducting liquidation proceedings. If the management of the target company recommends acceptance of the takeover bid, the offer is considered friendly, and if the takeover bid is officially rejected, it is considered hostile.

The process of hostile takeovers is particularly evolving under the influence of globalization and market liberalization And it can be observed that historical waves of takeovers are very similar to business cycles of expansion. However, in order to gain a more stable market position in the global market, the total number and value of integration processes is constantly increasing. Acquiring companies should plan in detail the process of hostile takeovers in accordance with their own strategic development goals, especially bearing in mind the danger arising from the potential overpayment of company values. Furthermore, in a hostile takeover, there is a high possibility that the target company will seek to defend itself, with its management having a number of strategies at its disposal to defend itself against unwanted takeovers. This can greatly increase the cost of the takeover project or impoverish the target company to such an extent that the purpose of the takeover becomes questionably profitable. In this sense, strategic planning is set as a necessity to protect the financial and other interests of the acquiring company.

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