IMPACT OF MERGERS AND ACQUISITIONS ON CORPORATE PERFORMANCE: A CASE STUDY OF SILKNET COMPANY

Olga PACHULIA

Sokhumi State University, 0192, Georgia

Olgapachulia@gmail.com

Abstract

In this paper, we examine the impact of mergers and acquisitions on corporate financial performance in Georgian company using data from financial reports. The paper suggests literature overview of mergers and acquisitions and shows Georgian company example. Our article represents and analyses JSC Silkne's merger and acquisitions strategy, industry selections and aim of the new acquisitions. Based on the portfolio analyze, mergers and acquisition benefits are find out, as a consequence product diversification is one of the strategy used to broaden business portfolio in the case of JSC Silknet. Moreover, our research suggests financial performance trends, based on return on Equity, Return on Assets, return on Sales. The results show, if the financial performance changed positively to the company's favor while the company was merging and acquiring new firms.

Key words: *mergers and acquisitions; diversification; strategy; performance;*

JEL Classification: *G3, G30, G34, L1.*

I. INTRODUCTION

New challenges are distinguished for companies, they have to increase their abilities to compete in a global market, expand and generate incomes. Companies are struggling to expand their business and one of the way to merge and acquisition of another company.

This paper has the objective to investigate whether mergers and acquisitions increase corporate performance. The focus is on mergers and acquisitions as the way to improve corporate financial revenues and profitability. Generally, mergers and acquisition is a new opportunity for the company, it can benefit by creating a new market access for products, improving financial performance, acquire new skills, new technologies, know-how, and all together gain competitive advantage. At the same time it can be associated with risks for management.

Acquiring a new firm and mergers strategy needs delicate analyses before making decision. Selecting a new firm means expansion of business portfolio, which may be associated with risks at the same time. Discussing the mergers and acquisition, we conclude, that it is a corporate strategy that impacts company performance positively. This strategy mentioned above, is used frequently by companies, which want to enlarge business and show better financial performance. Lars Bengtsson and Rikard Larsson (2012), suggest to use case study method is a powerful, yet much underutilized method in M&A research, as M&A are unique and complex events that highlight both value-creating and value-destroying organizational processes. So, in the end we will show case of mergers and acquisitions on the example of the company. Financial data are available only for 2014-2017 years. Based on the period, core financial trends are studied in section IV and conclusions are suggested in final section.

II. MERGERS AND ACQUISITION LITERATURE OVERVIEW

Mani Arora and Anil Kumar (2012) discusses 4 types of mergers, such as:

- Horizontal merger is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor, so in the case of horizontal mergers, firm expands operations in the same industry. "Horizontal mergers are designed to produce substantial economies of scale and result in decrease in the number of competitors in the industry";
- Vertical merger is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier and producers of raw material, then it may result in backward integration of its activities. On the other hand, Forward integration may result if a company

decides to take over the retailer or Customer Company. Firms implementing vertical merger may result in economies, as for operating level and financial level.

- Company implementing Co generic Merger involves the following: the acquirer and target companies are related through basic technologies, production processes or markets. The acquired company represents an extension of product line, market participants or technologies of the acquiring companies. These mergers represent an outward movement by the acquiring company from its current set of business to adjoining business. The acquiring company derives benefits by exploitation of strategic resources and from entry into a related market having higher return than it enjoyed earlier. The potential benefit from these mergers is high because these transactions offer opportunities to diversify around a common case of strategic resources;
- Conglomerate mergers involve firms engaged in unrelated type of business activities i.e. the business of two companies are not related to each other horizontally (in the sense of producing the same or competing products), nor vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these common factors.

According to the study of Deloitte center (2018), main drivers for the mergers and acquisition strategies are technology acquisitions, expanding customers, expend and diversify products and services, talent acquisition. Acquiring technology assets now ranks number first as a strategic driver of M&A deals, and is also a major factor for industry. Besides, over the past two years, 65 percent of corporate respondents said their cash reserves have increased more than 58 % after merging and acquiring, and the primary intended use of that cash is for M&A deals. It should be remarked, that corporations primary intended use of their cash reserves is for M&A deals. Deloitte center report concluded that “the deal making process will look dramatically different as innovations in diagnostic tools continue to develop. The introduction of new technology for M&A transactions has moved deals out of the spreadsheet age both for companies that have adopted the tools and those that are considering using them. These developments comprise just some of the many indicators that M&A transactions have evolved in meaningful ways” (Deloitte Development LLC, 2018).

Craig Furfine and Richard Rosen (2011) research suggests, that managerial motivations may play an important role while merging and acquiring another firm. In their opinion, “the increased default risk can be arises from aggressive managerial actions affecting risk enough to outweigh the strong risk-reducing asset diversification expected from a typical merger. Besides, an acquisition not only affects a firm’s potential return stream but also changes the firm’s risk, including its chances of going bankrupt.”

Chui (2011), represents risks that managers should take into consideration: minimize the risk of implementation, stuff, culture, different legacy system (while merging and acquiring foreign company), business disruption. The author also, suggests most “successful factors that should pay attention to are time, quality and cost of the processes”. Andrey Golubov, Dimitris Petmeza and Nickolaos G. Travlos (2012), suggests that as the mergers and acquisitions activity becomes more global, more interesting tests are exploiting the different institutional characteristics of various countries. The authors concluded that “even for the wellresearched markets, our understanding of M&A-s will improve as new and finer data become available. Meanwhile, mergers and acquisitions continue to be an integral part of the business world, a hotly debated issue for board members and policy makers, and a fruitful area for further research”.

Reuben Badubi (2017), research suggests, that a problem with limited due diligence, over estimate of potential synergies, lack of plan indecision problems are find out after mergers and acquisitions. The author shows some cases, where stake holders are not even consulted on processes, but the major challenge with acquisitions by the government is political appointments to key positions that require expertise and quality experience. Besides, research results of Badubi shows, that local enterprises tend to fail and the reason is lack of experience and capacity to handle risks.

III. CASE OF MERGERS AND ACQUISITIONS: JSC SILKNET

JSC Silknet, which represents Silk Road group's subsidiary is the leading company in Georgia, which offers a wide range of telecommunications products. It includes: Internet, TV, fixed telephone services and business telecommunications services. Important business associations

The Silknet was created by its original founders JSC United Telecom, Ltd. Adjara Electricity Union and Ltd. Vanex, by entering their share property in Silknet's capital. From December 2010, Rinestream Holdings Limited is registered company in Malta, as a 100% owner of Silknet. The final beneficiary owners of the company are Giorgi Ramishvili - 61.9%, Aleksi Topuria - 28.58% and David Borger - 9.52%.

In 2011, Silknet acquired Novus Ltd, which owned by TV channels for broadcasting rights. In 2011, Silknet found a new company named NNN NG Georgia. The aim of the company was publishing the National Geographic magazine in Georgian and supporting international National Geographic activities.

In 2014, the company acquired Weimax Georgia, which provided wireless fixed Internet service through WiMax technology. In the same year, the company acquired 85% share in LTD Georgian Media Network, which was broadcasting on TV. Since 2014, the company owns 51% of shares in LLC "Amber". On June 30, 2014, the Group acquired 85% of the share of ownership in Georgia Media Network, which is one of the IPTV content providers of the group (Prospectus, 2017).

In December 2015 LLC Silknet merged with VTEL Georgia Ltd. VTEL Georgia Ltd implemented wireless fixed internet service with WiMax technology. As a result of merger the F48 and F53 licenses were owned by Silknet.

In 2016, the company acquired another 15% of Georgian media network and also merged with it, which became an authorized person in the field of broadcasting in December of the same year (financial statement, 2015).

Table 1. Mergers and acquisitions list with periods and industry

	Name of the company	Year	Industry/ activity
1	Novus Ltd	2011	
2	WiMax Georgia	2014	
3	LLC "Amber	2014	Digital service
4	VTEL Georgia Ltd	2015	internet service
5	LTD Georgian Media Network	2016	Media Network
6	LTD “Geocell”	2018	Mobile services
7	“Caucasus online”	Dealing Failed	telecommunication
	Sanet and Georgia Online		dial up technology
	Caucasus Network		dsl Technology
	Talenet		fixed wireless technology

According to the head of the board George Ramishvili, company is going to make an investment in LTD “Geocell” 100 million Gel for the next 4 year. This will be aimed for modernization techniques. While talking about oligopoly, he said that having two strong companies in the market will develop competition.

In the telecommunication industry merging mobile and digital webs is a world tendency. The representative of regulatory commission says, that we will not have monopoly, as we also have such nets like “Magticom”. Oligopoly may arise, but it does not contain threats for customers. So, Co generic Merger was used by Silknet. By merging and acquiring these companies discussed above, it extended production line and technologies. Silknet should get benefits by maintaining of strategic resources, besides entry into a related market having higher return than it enjoyed earlier will be also another benefit for the company. Moreover, diversification of products and strategic resources diversificationa are another benefit from these mergers.

After acquiring “Geocell”, the whole spectrum of telecommunications company will be created. The final acquisition will be in the first part of 2018 year. The united company provides a wide choice of innovative products and services for Georgian consumers and increased access to international exclusive content. After merging Geocell on March 27, 2018 year, Silknet became the largest fixed-line operator in the country and now offers mobile service to customers. "Silknet" became the 100% shareholder of Geocell. The value of the deal was 153 million US dollars.

Merging “Caucasus online” was another challenge for Silknet. These dealing could be very beneficial for the company as Caucasus Online in the local and regional market is the important player in telecommunication industry and direct competitor, which has more than 3000 km own optical fiber infrastructure. In 2008 year, under the brand of Caucasus online several companies have merged: Sanet and Georgia Online (dial up technology), Caucasus Network (dsl Technology), Talenet (fixed wireless technology). Unfortunately, regulation commission denied and merging with Caucasus Network failed. This would be a horizontal mergers, which would help Silknet to expand its services and operations in the same industry, decrease the number of competitors in the industry, it would be the opportunity to grow market share in internet providing market importantly as “Caucasus online” and Silknet provide internet services 41 and 41% appropriately.

To sum up, after merging and acquiring several companies, Silknet implemented product diversification strategy and enlarged its business offering customers different services. Moreover, as we see above in Table 1, Silknet acquired and merged with companies that provide internet service and mobile services, which point out using related corporate diversification strategy. As a result of mergers and acquisition, company enlarged its business and diversified business portfolio, which help it to gain competitive advantage, strengthen business and opportunities to show better financial performance. The next research question is what financial results did the company got after merging and acquiring the companies discussed above.

IV. FINANCIAL PERFORMANCE OF JSC SILKNET

JSC Silknet financial conditions are interesting to discuss. Company is awarded to B+ rating by FITCH. By customer-centric approach and high emphasis on delivering valuable telecommunications services, due to GNCC, by 2017 year, Silknet has achieved 41% of Internet market share in Georgia. 30% of Georgian families enjoy Silknet's cutting-edge IPTV service with its exclusive content. Company holds 48% of the fixed telephone market. Silknet began functioning by merging assets of several local telecommunication company in 2010 year. According to the member of board Leqso Tofuria, company got Fitch B+ rating in 2016 year.

Based on our calculation and results return on assets (ROA), return on equity (ROE) and return on sales (ROS) from 2014-2017 has growing trend. In 2014, ROA increased importantly by 90%, ROE increased by 52% and Return on sales by 8% only. In this year Silknet merged with Weimax Georgia and LLC Amber.

In 2015 ROA increased by only 6%, ROE by 29% and ROS increased by 14%. The merging period was in the end of the year, it was in December 2015, when LLC Silknet merged with VTEL Georgia Ltd. With the merger Silknets net assets increased with VTEL by 6,242.

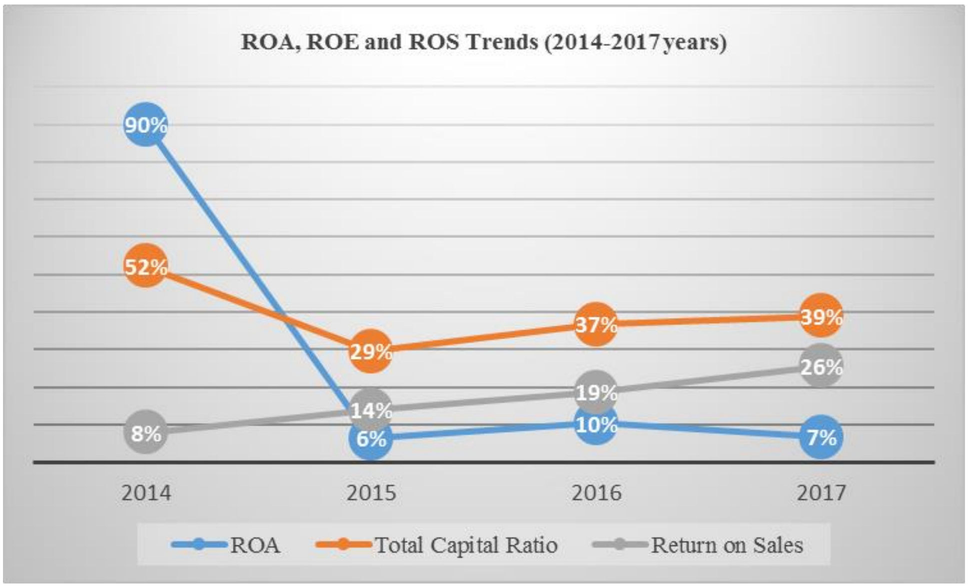

Fig. 1. ROA, ROA and ROS Trends for Silknet from 2014-2017 years.

In 2016 company merged with LTD Georgian Media Network. In this period ROA increased by 10%, ROE by 37% and ROS by 19%. As the total capital increased by 21% compared to previous year, total assets only by 1% growth was fixed in this period. With the merger Silknets net assets increased with LTD Georgian Media Network by 2223.

In 2017 year, ROA increased by 7%, ROE increased by 39% as a result of 11% growth of capital and 6% growth of total assets. As for ROS, it increased by 26%.

Each year revenues of Silknet consisted of its activities and changed. They include Internet services, internet television, fixed telephone service, interconnect service, facility rental service, wireless telephone service and other. As we found out in 2014-2016 internet services are 43-44% of company's revenues, but in 2017 share or internet services revenues increased to 61%. Revenues from internet television is on the second place, in 2014-2016 it was 20-24%. Internet television revenues share in total revenues decreased in 2017 and was 14%. Fixed telephone service revenues share in total revenues was 12% in 2014, but it increased in 2015-2016 and was 19%. Again in 2017 fixed telephone service revenues share in total revenues decreased to 12%. Interconnect service revenues share in total revenues is about 5-7% during 2014-2017 year. As for facility rental service revenues share in total revenues in 2014 it was 10% but than it decreased to 4% in 2017 year. As for wireless telephone ("CDMA*") service it is from 2-4% in total revenues (see fig. 2).

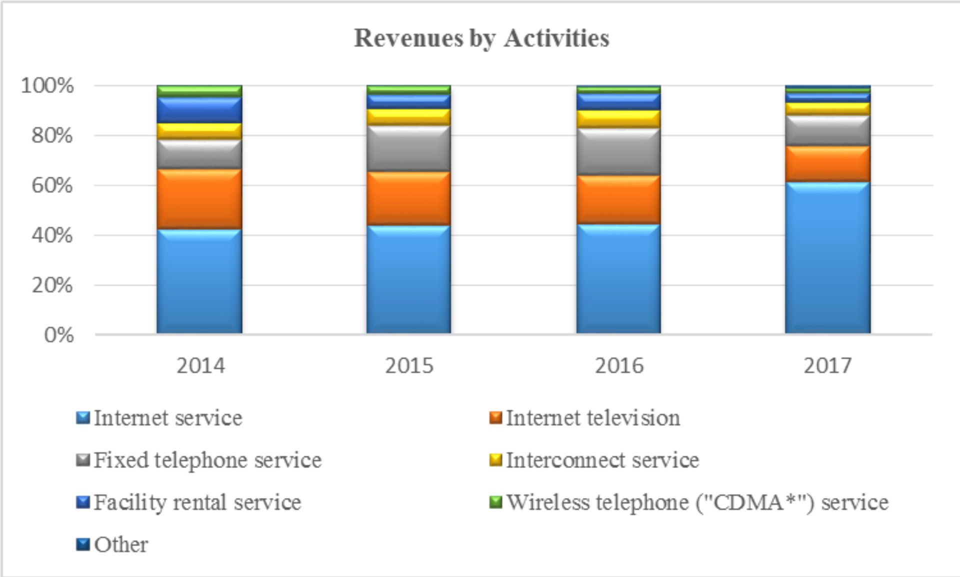

Fig.2. Revenues of Silknet by Activity

V. CONCLUSION

In this paper, we discussed the benefits and risks of mergers and acquisitions. As a result of literature overview we find out that main drivers for the mergers and acquisition strategies are technology acquisitions, expanding customers, expend and diversify products and services, talent acquisition. While implementing M&A strategy firms should minimize the risk of implementation, stuff, culture, different legacy system, business disruption. Acquiring technology assets became the main motivation for M&A deals. Mergers and acquisitions may require expertise and quality experience, in the absence of which firms can fail. It should be remarked, that corporations primary intended use of their cash reserves is for M&A deals. Based on the research, we concluded that the mergers and acquisitions are strategies that help companies to enlarge business activities. Besides, it helps to grow market share, decrease in the number of competitors in the industry, result in many operating and financial economies, diversify around a common case of strategic resources, to diversify business portfolio.

In the case of Silknet, we found that it only merged with companies in the same industry but with different products. So, Silknet used mergers and acquisition strategy together with related corporate diversification. In our opinion, by merging and acquiring the companies, Silknet can gain competitive advantage over competitors, where market is oligopolic and even in the long run it can get monopoly. However, we found out, regulation is one of the threats which can disturb company's plans, but still it worth to continue develop and grow business on the favor of the corporation, so legacy is remained as the main threat and risk for M&A decision.

Based on our trend analyses of company's financial performance, ROS, ROA, ROE continue to grow from year to year for Silknet, while it was merging and acquiring new firms. That means that merging and acquiring strategy help the company to get financial benefits. As it helps to get cash reserves and additional revenue, firms can make investments and new opportunities and markets will be available for them.

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