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**THE ANALYSIS OF MERGERS AND ACQUISITIONS BASED ON
THE EXAMPLE OF A CHOSEN COMPANY IN EASTERN CROATIA**

**ANALIZA SPAJANJA I STJECANJA PODUZEĆA NA PRIMJERU
ODABRANOG PODUZEĆA ISTOČNE HRVATSKE**

ABSTRACT

External growth of a company is one of fundamental aims and strategies of modern business. Different forms of business combinations, such as acquisition, contribute to better financial and business performance. Eastern Croatia, like other parts of Croatia, has in the last decade been facing economic crisis. Economic inefficiency leads to more complex ways of doing business and demands innovative financial techniques and instruments. The aim of this paper is to identify the importance of mergers and acquisitions in improving business and financial performance of the acquiring and target companies based on the example of the Agrokor Group's acquisition of Belje PLC (together with PIK Vrbovec meat industry). As a result of this acquisition, new products are developed, new markets are entered, new suppliers and distributors are reached and the companies are becoming more competitive in the market. Various quantitative and qualitative methods were used. Both scientific and technical literature and financial reports were analysed. Data synthesis has emphasized the importance of acquisition. By comparing statistical and financial reports before and after the acquisition conclusions on the effects of acquisition were reached. The results show that this acquisition was risky; nevertheless, it was a good business call, good investment and a great step forward for the Agrokor Group. However, the positive effects of the acquisition are a result of changes in management and organization, the use of new technology and knowledge, whereby the key role was played by a change in the market strategy and conducting a new business philosophy. It is predicted that the two corporations will become recognisable force in the Croatian market and will become a serious competitor. Expanding the Agrokor Group into eastern Croatia by acquisitions has proved to be a great external business growth strategy also for entering foreign markets.

Key words: Concern, Merger and acquisition, Business combinations, Financial and business performance, Eastern Croatia

SAŽETAK

Eksterni rast poduzeća predstavlja jedan od temeljnih ciljeva i strategija suvremenog poslovanja. Različiti oblici kombiniranja poduzeća, a time i akvizicija doprinose poboljšanju ukupnih financijskih i poslovnih performansi poduzeća. Kao i ostale regije Hrvatske, istočna Hrvatska se u zadnjem desetljeću suočava s financijskom krizom koja ima za posljedicu iznimno nepovoljna gospodarska kretanja. Ekonomska neefikasnost u cjelini dovodi do kompleksnijih i složenijih oblika poslovanja primjenom inovativnih financijskih tehnika i instrumenata. Cilj rada je prikazati na primjeru ulaska Belja d.d. (zajedno s PIK Vrbovec mesnom industrijom) u okvir Agrokor koncerna, značaj udruživanja i stjecanja poduzeća u poboljšanju poslovnih i financijskih učinaka akvizitorske i ciljane/ih tvrtki kao posljedice razvijanja novih proizvoda i ulaska na nova tržišta, pristupa novim dobavljačkim i distribucijskim kanalima, veće stabilnosti i konkurentnosti te ostalih relevantnih činitelja akvizicije. U svrhu izrade rada koristilo se više metoda kvantitativnog i kvalitativnog istraživanja. Analizira se dostupna znanstvena i stručna literatura te financijska izvješća na temelju kojih se sintezom relevantnih podataka naglašava relevantnost akvizicije. Komparacijom statističkih i financijskih izvješća poduzeća prije i poslije ulaska u akviziciju donose se zaključci o konkretnim učincima akvizicije. Rezultati istraživanja pokazuju da je ulazak u navedenu akviziciju na samom početku bio iznimno rizičan, međutim u konačnici provedena akvizicija bila je znatan dobitak za Agrokor koncern kao rezultat dobre poslovne odluke i aktivnih investicija. Međutim, pozitivni učinci akvizicije rezultat su većinom promjene načina upravljanja i organizacije te primjene novih tehnologija i znanja, pri čemu je ključna bila promjena cjelokupne tržišne strategije i provođenje nove poslovne filozofije. Prema predviđanjima, organizacija poslovanja ove dvije korporacije dugoročno će stvoriti prepoznatljivu snagu na hrvatskom tržištu kojoj će se teško moći konkurirati. Širenje Agrokor koncerna na istočnu Hrvatsku putem akvizicije pokazalo se odličnom strategijom eksternog rasta poduzeća kao oblika nastupa i na inozemnom tržištu.

Ključne riječi: Koncern, Udruživanje i stjecanje, Poslovne kombinacije, Financijske i poslovne performanse, Istočna Hrvatska

1. Introduction

Entrepreneurship in eastern Croatia today is poorly developed; it is the least developed of Croatia's regions. It has a particularly small number of entrepreneurs and the employed, low incomes and negative consolidated financial results, a small number of investors and few investments in fixed assets and generally negative financial performance. Economic inefficiency leads to more complex ways of doing business and demands innovative financial techniques and instruments. Different forms of business combinations, mergers and acquisitions in particular, enable competitiveness in the market, adaptation to market conditions, and other advantages for the acquiring and for the target company.

The aim of this paper is to identify the importance of mergers and acquisitions in improving business and financial performance of the acquiring and target companies based on the example of the Agrokor Group's acquisition of Belje Public Limited Company [Belje PLC]. Scientific and professional sources, financial reports and other relevant sources have been analysed for this purpose. On the basis of synthesis of available data and comparison of statistical and financial reports before and after the acquisition, a conclusion has been drawn regarding the effects of acquisition.

2. Mergers and takeovers – acquisitions

When analysing mergers and acquisitions it is necessary to define the basic terms, such as acquisition. We need to examine the difference between mergers and acquisitions, fusion and

consolidation and the acquisition of assets and the acquisition of property. The cost of and the motive for acquisition, synergistic effect, and other relevant advantages of acquisitions are extremely important for its implementation.

2.1. Defining the basic terms

The term acquisition can be defined as a takeover of a company or a part of a company by acquiring a control package of its shares or by acquiring its property. The term also refers to combining two or more business entities into one business entity. An acquisition can occur when two or more companies join together because of some common interests or when one company takes over another or more companies. The acquiring company can purchase the majority ownership interests or the property of the target company. When it comes to mergers, we can differentiate fusion and consolidation. Fusion refers to combining two business entities into one business entity by merging their ownership interests completely, while consolidation refers to merging the companies into one completely new company. An acquisition, therefore, can be carried out by purchasing a company (its property or a control package) for cash or by means of an exchange for the acquiring company's shares (Orsag and Gulin, 1996, 25-30).

2.2. The motive for and the cost of acquisition

The driving force and prerequisite for an acquisition is the synergistic effect, i.e. the value of two companies combined should be greater than the value of each company before the acquisition. Synergy can be mathematically represented as follows (Orsag and Gulin, 1996, 84-85):

$$V_{AB} > V_A + V_B, \text{ whereby } \Delta V = V_{AB} - (V_A + V_B)$$

V_{AB} - the company's value after acquisition

V_A i V_B - the companies' values before acquisition

ΔV - synergistic value

Combining and merging companies can be financed by using different financial instruments and cash flows, including: cash payment, issuing securities in domestic and foreign markets, taking loans from financial institutions and corporations or issuing shares (where the shares of the acquiring company are exchanged for the shares of the target company). Regardless of the type of acquisition, it is important to set the price of shares, i.e. the company's value. The cost of an acquisition includes the market value of the target company and an acquisition premium. The existence of a premium is very important in order to motivate the majority of shareholders to sell their shares, i.e. to subordinate to the acquiring company (Orsag and Gulin, 1996, 93).

2.3. The importance of acquisitions in business

The basic prerequisite for economic growth and development is the openness of the economy. Entrepreneurs have to be familiar with all the ways of performing in the international and domestic market in order to survive and adapt to market changes. Without mutual cooperation and various arrangements with other companies it would be impossible to be competitive in today's market. This way, we can achieve some benefits, such as unit costs reduction, economy of scale, technological excellence, better research and development infrastructure, and human resources.

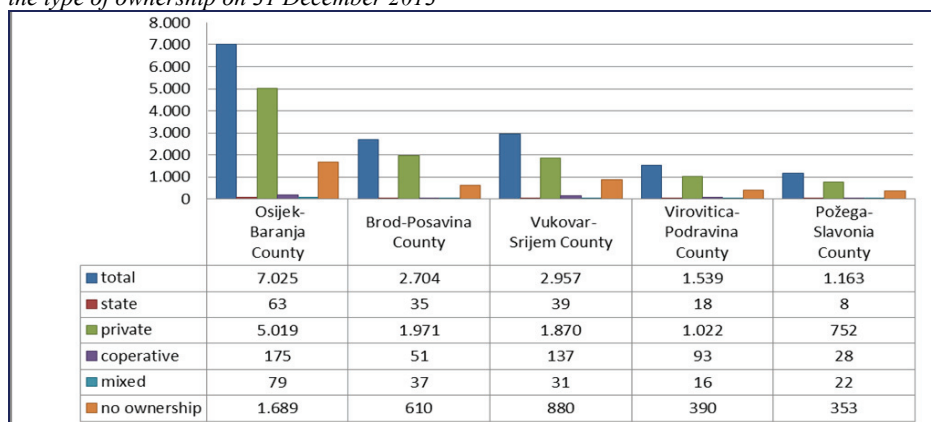
Pervan (2005, 1) emphasizes the following advantages of mergers in relation to internal growth of companies:

- faster growth (since it eliminates the time needed to obtain building and other permits, construction of facilities, procurement and installation of equipment, training of staff and the initial market penetration);
- immediate cash revenues from the acquired company (since the acquired company is already operating in the market and is generating revenues and inflows);
- economy of scale (larger amounts of procurement result in a better bargaining position and inputs procurement at lower prices);
- financial economy (better negotiating position can result in a lower cost of financing);
- reduced business risk (acquiring an already established company is a less risky investment compared to independent market penetration, especially if it is a new and unfamiliar market);
- diversification of business risk (if they acquire companies from other sectors).

3. Entrepreneurs' characteristics and their development in eastern Croatia

According to the Financial Agency ([FINA], 2013, 7) there were 8,351 entrepreneurs in eastern Croatia in 2012, which made only 8.6% of all entrepreneurs in Croatia, significantly less than in Continental Croatia (52%) and Adriatic Croatia (39%). According to the Croatian Bureau of Statistics' (2014) data there were 15,388 active legal entities in eastern Croatia in 2013. The analysis of legal entities in eastern Croatia showed that the largest number of legal entities was recorded in the Osijek-Baranja County with a total of 7,025 legal entities, while the Požega-Slavonia County had the smallest number of legal entities, only 1,163. According to type of ownership, the most common type was private ownership and it amounted for 69.1%, the percentage of entities in cooperative ownership was 3.1%, in mixed ownership 1.2%, in state ownership 1.1%, and for 25, 5% of legal entities there were no records. The National Classification of Activities 2007 data showed that the most common activity was wholesale and retail.

Table/Chart 1: The structure of active legal entities in the counties of eastern Croatia according to the type of ownership on 31 December 2013



Source: Processed by the authors according to the data obtained from the Croatian Bureau of Statistics (2014)

Financial reports on the profit of entrepreneurs of eastern Croatia for 2012 showed that these entrepreneurs generated the least revenues and profit of all Croatian regions, they accounted for only HRK 9.6 billion or 8% of the total revenues, i.e. HRK 1.6 billion or 4.6% of the total profit of the entrepreneurs with positive business results. They also accounted for HRK 3.3 billion or 11% of the total loss of all the companies which had made losses. Consolidated data showed negative financial results – net loss of entrepreneurs of eastern Croatia amounted to HRK 1.7 billion. The number of investors and the amount of investments was the lowest in eastern Croatia than in any

other Croatian region. Less than 8% of investors invested in production capacities in eastern Croatia, only HRK 3 billion or 9% of all investments were made here (FINA, 2013, 8-9). As seen from the aforementioned indicators, eastern Croatia lags behind in the development of entrepreneurship and in the context of using all relevant advantages, business combinations are certainly desirable, acquisition in particular.

4. Analysis of acquisition of the chosen company in eastern Croatia

In the framework of analysing the effects of acquisitions in the region of eastern Croatia, the Agrokor Group's (Concern's) acquisition of the enterprise Belje, a company for agricultural production, food processing and trade of goods, Darda (Belje PLC) was chosen. Financial effects of business operations of Belje PLC before and after the acquisition were analysed.

4.1. Basic information on Belje PLC

The Belje Company was founded in 1697. During the years facilities for agricultural products processing were built. In 1921 it became a state-owned company. After World War II the company was devastated, so after the liberation of Baranja great efforts were made to restore the production. Belje has changed various forms, and in 1953 it was organized as the first state farm in this region – the industrial and agricultural collective enterprise Belje (Belje PLC, 2015.). According to the data published in the Abridged Prospectus of Belje PLC (the Zagreb Stock Exchange [ZSE], 2003, 4) class A shares were issued in 1993 during the transformation of the state farm "Belje" - an industrial and agricultural collective enterprise into a joint stock company Belje PLC. However, since there was no privatization until 2002, these shares were state-owned until then. Class B shares were issued on 12 August 2002 upon the decision of the General Assembly of the Company. Due to the fact that class A and class B shares were of the same type and the same nominal value, in the transfer of shares to the depository of Central Depository and Clearing Company, they were united in one class (5,515,487 class A shares, each with the nominal value of HRK 100). In 2003 the shares of Belje PLC were listed on the ZSE with a share capital amounting to HRK 328,619 480.

4.2. Financial analysis of Belje PLC before the acquisition

Based on the data obtained from the Croatian Competition Agency ([CCA], 2005, 12-13) financial indicators of business operations of Belje PLC before the acquisition were analysed. The current ratio should always be 2.00 or higher (Žager et al., 2008, 249), and in this particular case, it amounted to 1.22 in 2003 and 0.64 in 2004, which means that there was a decrease in value, due to a significant growth of short-term obligations in comparison to short-term property. The financial stability ratio should always be under 1. If we analyse the performance indicators of Belje it becomes clear that its financial stability was significantly disrupted in 2004 when the financial stability ratio was 1.33 compared to the year before when the ratio was 0.94. The debt ratio indicates that in 2004 for every invested kuna the enterprise Belje PLC used HRK 0.62 of external assets. This is a proof of the deterioration of the relationship between total liabilities and total assets. Due to unfavourable cash flow, the debt of the enterprise was above the acceptable level (it is usually considered that the acceptable debt ratio is 0.50) and it rose by 48 per cent. The financial ratio indicated that for every unit of its own capital the enterprise used 1.63 units of external capital, which represented a significant growth in debts in comparison to 2003 (an increase of as much as 126 %). The growth of debt can also explain the growth of illiquidity.

Activity ratio indicates the velocity of circulation of property in the business process. If we want a business to be successful and less risky, it is important that the turnover ratio is the biggest possible number, i.e. that the period of bonding of total and specific asset is as short as possible. In the case of Belje PLC the turnover ratio of total assets recorded almost the same value - 0.45 in 2003 and

0.46 in 2004, while the turnover ratio of current assets decreased by 7 per cent, suggesting current assets bonding demanded more time (CCA, 2005, 12.). Furthermore, from the data gained from the CCA it is evident that the business did not meet the criteria of good business performance. The indicator recorded a value under 1 both years and, in addition, in 2004 there was a 26 per cent decline compared to 2003. From all the existing data it is evident that Belje PLC had worse business results in 2004 than in 2003. The debt and the current ratio increased, and the already bad economic situation got even worse.

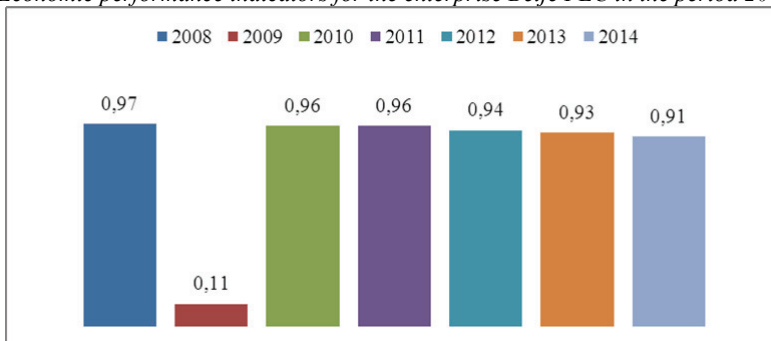
Without further investments and the support of a financially stronger enterprise, Belje PLC would become unsustainable. Business results were becoming worse every year, many years of poor business operations led to a poor market position and without significant investments it would be impossible to sustain the company in the market. The enterprise had significant financial difficulties, the production was reduced, a large number of employees became redundant, out-dated production plant and the impossibility to modernize the production became the main issues. If they had continued to do business that way, their business results would have continued to get worse, so a reconstruction of production process, new organization scheme, new products, new investments and feedback information from the consumers were necessary. In 2005 the Agrokor Concern acquired the agricultural conglomerate Belje PLC together with Pik Vrbovec meat industry.

4.3. Business results of Belje PLC and the Agrokor Group after the acquisition

The data from the Annual Financial Statement (ZSE, 2008, 3-4) shows that in 2008, after the acquisition Belje PLC became the biggest company according to property size with total assets amounting to HRK 2 billion and 392 million and with the capital of HRK 821 million. The investments into fixed assets increased by HRK 275 million. The obligations towards the banks (loans) increased by HRK 100 million. In 2008 the loan debt amounted to HRK 300 million, and the debts towards entrepreneurs amounted to HRK 814 million. The company's revenues increased significantly in the period from 2007 to 2008, from HRK 818 million to HRK one billion and 533 million, while the expenses increased from HRK 778 million to HRK one billion and 481 million. Sales incomes made the largest part of revenues, 83%. In comparison to such a revenue, the profit may seem somewhat small, only HRK 18 million in 2007. The reason for this lies in the fact that all resources were used to increase the production capacities and to expand the business.

This can be confirmed by examining the consolidated and unconsolidated annual financial statements of Belje for the period 2008-2014 (ZSE, 2015a, 2-4), which demonstrate that investments into fixed assets were made with the aim to increase production capacity and to restore old plants. There has been a large increase in revenues and expenditures, i.e. in business activities. However, liquidity is still low, at the edge of insolvency. The business comes down to constant investments in new capacities partly by using financial leverage, and partly by using their own resources, and to maintaining the minimum liquidity necessary for regular operations. By analysing the data from annual financial statements of Belje for the period 2008-2014 (ZSE, 2015a, 2-4), it is evident that both revenue and expenditure increased during the years. In 2009 total revenues of Belje declined by 14.9% in comparison to the year before (Chart 2). The decrease in revenue was influenced by the decline in market prices and the financial crisis in the world market. Economic performance indicators increased from 0.11 to 0.96 in the following year. In 2014 total revenue amounted to HRK 1,936,679,696, while total expenditure amounted to HRK 2,121,363,420. The reason for such a large expenditure is the aforementioned investment in fixed assets, i.e. investments into and expanding of production capacity.

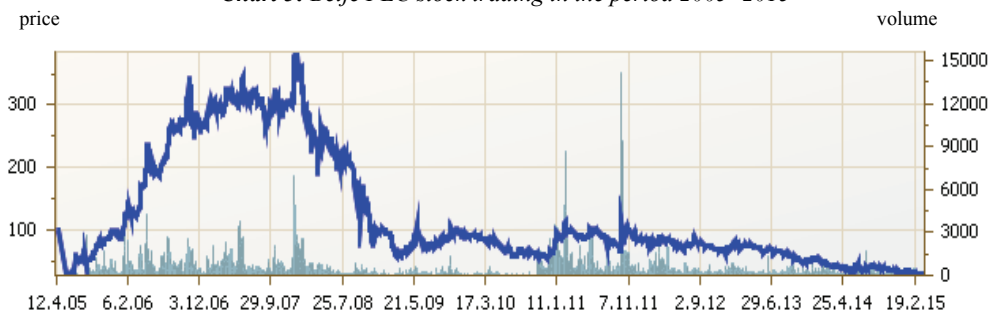
Chart 2: Economic performance indicators for the enterprise Belje PLC in the period 2008- 2014



Source: Processed by the authors according to the data obtained from Annual Financial Statement of Belje PLC, ZSE (2015a, 2-4)

Since joining the Agrokor Group the value of Belje shares has increased rapidly. The lowest share value in 2005 amounted to HRK 30.01, but a year later the share value grew to HRK 346.00. Shares value grew until the beginning of the financial crisis. Chart 3 shows the fall of the value of Belje shares (Moje dionice, 2015).

Chart 3: Belje PLC stock trading in the period 2005- 2015



Source: Moje dionice (2015)

Today Belje PLC has over 8 million listed shares on the Zagreb Stock Exchange. The majority shareholder is Agrokor Concern which owns 53.12% (ZSE, 2015b). This is the largest company in the Republic of Croatia, but also one of the strongest companies in the south-eastern part of Europe. The primary activity of the Agrokor Concern is the production and distribution of food and beverages and retail activity. The Agrokor Group records constant expansion of business through years. The reason for this is a clear vision and a clearly defined business strategy. The ability to review and modify their business calls, in accordance with the rapid changes in the market, is considered one of the main reasons for the success of Agrokor. In general, the anticipation of changes in the environment and the ability of quick adaptation to changing conditions are the basis for success of any business. These abilities are necessary in order to stay on the market and to grow, partly due to the size of the Croatian market, which is basically very small, and partly due to competitive pressure.

In 2006 the Agrokor Group signed a long-term loan in the amount of EUR 40 million with the International Finance Corporation [IFC], the World Bank member responsible for the financing of investments in the private sector (the Agrokor Group, 2015.) This long-term loan has enabled further investments in Pik Vrbovec and Belje. The loan provided for long-term funds needed to

refinance the debt as well as to secure additional investments, thus giving support to continue restructuring and expansion plans, such as: investments in the quality of production, expansion of capacity, efficiency, productivity, and improvement of the cost structure of both companies.

According to the already mentioned data from the financial analysis it can be concluded that thanks to the acquisition some positive results were also achieved for Agrokor. In the first six months of 2005, Agrokor achieved consolidated revenues which were 15 per cent higher than the revenues in the same period a year before, what is primarily a result of increased sales in the retail sector, which makes almost 70 per cent of total sales revenues and other operating revenues. Such revenue growth was primarily caused by the significant growth of retail trade, opening of new stores and external growth of the Agrokor Group by acquiring Belje and Pik Vrbovec.

5. Conclusion

The conducted analysis of financial and economic performance indicators of Belje PLC shows that before the acquisition the enterprise delivered negative financial performance. Financial indicators of liquidity, debt, economic performance revealed a downward trend. Production capacities and the number of employed people were being decreased continually, production plant was inadequate and out-dated, there were no new investments, and the enterprise was losing its competitiveness and its market share. In this context, a support from a financially and economically stronger entrepreneur was indispensable.

After the Agrokor Group's acquisition of Belje PLC, production capacities were increased, old plans were renovated, revenues and expenditures grew, as well as business activities. New investments into fixed assets were made, and all resources are now being used for the expansion of production capacities and business expansion. As a result, profit isn't very high. However, share value grew until the financial crisis emerged. By entering the Agrokor Group, Belje PLC was able to adapt to quick market changes and became one of the biggest Croatian production capacities in food industry. Today they produce a wide range of food and agricultural products from cheese and meat products to wine, flour and animal feed. The enterprise is extremely important for the local and regional economy, in particular for employment.

Expanding the Agrokor Group into eastern Croatia by this acquisition has proved to be a great external business growth strategy also for entering foreign markets. The analysed acquisition indicates some advantages of this kind of business combination, such as the increase of the value of the target company after the acquisition.

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