M&A Market Efficiency in Russia: Problems and Prospects

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ABSTRACT

The **aim** of the article is to study the effect of M&A transactions in Russia for shareholders and investors of an acquiring company. The **objectives** of the study were to develop methods for efficiency evaluation, to conduct a general analysis of the M&A market in Russia, to develop recommendations based on the results. **The framework of the study** was the market-based approach to the analysis of transaction efficiency. The authors investigated the key indicators: the value of the company EV (Enterprise Value) and the market value of the company MV (Market Value). They analyzed three time points for each transaction and the change of the indicators in-between: six months before the transaction, at the time of the transaction and six months after the transaction. The data obtained allowed for calculating the growth rates of stock prices, the values of the companies and the average values for the market. Based on the study results, the authors **concluded** that the M&A market has a weak effect on the Russian economy as a whole, but at the same time there is a decreasing effect for shareholders. The majority of M&A transactions aim to expand corporate finance, to increase the company's capitalization, and to maximize business value. The **results** are of use to predict the further dynamics of the company's value, a key indicator for portfolio and institutional investors, as well as to analyze the efficiency of acquisitions followed by evaluation of investment attractiveness of the company.
Keywords: mergers and acquisitions; M&A market in Russia; corporate finance; tender transactions; hostile takeover

INTRODUCTION

Globalization of economic relations, significant changes in regulating financial and economic activities of companies and digital forms of cross-border capital flows create new opportunities for free financing of international mergers and acquisitions. The global economic space provokes companies to transform dynamically by quickly modifying economic processes and activating the processes of cooperation in the capital market. Here, business reorganization is one of the effective tools to survive. It has many various forms: from reengineering of internal processes to modernization, technical re-equipment and company restructuring. In Russia, reorganization of a company is usually a merger where a new legal entity arises based on previous companies-participants [1].

The Russian legislation defines five forms of business reorganization: merger, accession, transformation, division and spin-off. Internationally, reorganization is understood as mergers and acquisitions. The overseas term "merger" focuses on emerging a new company, and Russian "merger" is a "termination of one or more companies" [2].

Merger and Acquisition (hereinafter — M&A) is a radical but effective way to increase the value of an acquiring company. It gained

ground in the 1990s. M&A transactions play a dual role in corporate finance. On the one hand, it is an effective way to increase the enterprise value, and on the other, it displays unfair competition. According to Chinese colleagues, the success or failure of an M&A depends on whether both parties in the transaction have a consistent understanding of the quality and risks of the assets being merged, which is specifically manifested in the ability of both parties to reach a consensus in terms of valuable consideration and payment guarantee [3].

The M&A market in Russia is not well studied, and it is very difficult to determine its role for the national economy, since most of the transactions are tender offers. These are merger transactions, characterized by special hostility and direct intention to take over another's business [4]. It is important to understand what effect the acquiring company and its shareholders will receive from this transaction.

Devoted to the analysis of the reasons for expanding a business, the need to diversify a business and the problems of entering new markets, the fundamental work by Patrick Gaughan "Mergers, Acquisitions and Corporate Restructurings" puts a special emphasis on achieving a synergistic effect from complete M&As and various types of operating and financial synergies [5].

Post-announcement market prices reflect beliefs about both merged and standalone firm values, and the likelihood of either outcome. Acknowledged expert Paul Borochin writes: "Stock prices alone do not contain sufficient information to identify these latent beliefs." By adding exchange-traded stock option data, he delivers a clear decomposition of observed value change into two parts: 1) value creation and 2) new information about standalone value. Previous research has struggled to disentangle the two. This decomposition provides a strong and practical measure of the market's expectations about value creation in a merger [6].

The key parameter of business performance is a constant increase in its stock value. Therefore, the questions arise: what effect does the tender offer have on the stock value? do tender transactions attract potential investors? is investing appropriate at this point? how does the total market value of the company change after transactions?

The relevance of this work is confirmed by the need to consider the M&A market characteristics in Russia based on statistical data, which will allow for a more detailed study of this problem.

DEVELOPMENT OF RESEARCH METHODS

M&As are the mechanisms to form alliances and new companies influenced by competition and changes in macroeconomic conditions. M&As should be considered as an opportunity for strategic development of the company's business. While developed countries are used to M&A transactions, the Russian M&A market has such initiated the practice [7]. It is not surprising: in Russia, M&A processes started in the mid-90s of the last century [1, p. 122]. The M&A market in Russia is relatively young and developing. However, during this time, many efficient and inefficient transactions took place. Efficient transactions are the transactions that showed a positive synergistic effect or increased the company's value in the market, which turned out to be beneficial for the owners. There are two basic approaches to determine the efficiency of M&A transactions. In the first approach the efficiency evaluation of the of M&A transactions is based on the analysis of stock value and return on equity. In this case, ROE is calculated separately for the shareholders of the merged company and for the shareholders of the acquiring company. In reality, the acquiring company, as a rule, may end up with both a positive and a negative result. The second approach is the analysis of financial indicators calculated based on the published official financial statements of the

company before and after the M&A transaction. This study used the first approach and evaluated the efficiency of M&A transactions from the perspective of increasing the value of the company's equity. Evaluating economic benefits from a transaction is very important to determine the M&As relevance. Economic benefits may result in economies of scale, vertical integration, increased efficiency, better use of tax considerations, a combination of complementary resources, etc. [8].

In Russia, M&A transactions are characterized by significant government participation in creating new corporations in the oil and gas and financial sectors of the economy. An important aspect of the activities of international financial and production corporations, states, transnational corporations and private investors is a reliable efficiency evaluation of reorganization transactions and market development monitoring. There are three basic approaches to evaluate efficiency of transactions [9]: accounting, market and the combined one. The authors used the market approach, which involves analyzing quotes for a certain period before and after the transaction, as well as analyzing changes in the EV (Enterprise Value) and MV (Market Value) indicators during and after the transaction. Since the data for the evaluation by the accounting method is not available and the publication frequency of accounting reports is low, the market approach is the most appropriate.

It is generally accepted that stock value[1] changes immediately after the transaction is announced and considers all investment decisions of market participants regarding a particular security in a short term. However, we should note that all investment decisions have already been made by the time of the

transaction, and the stocks do not show any obvious movement. Time alone is not enough to obtain a synergistic effect. According to the synergetic theory, M&A transactions transform companies into a new business with a number of advantages, whose effect exceeds the total of companies' capabilities. Moreover, the merger leads to an increase in the value of the business, and the acquiring company acts to gain the welfare of the owners [10].

The financial and policy implications of M&A are varied. From an investor's perspective, the long-term adjusted gain from M&A depends not only on the immediate growth of wealth, but also the fact that such a growth would accompany reduced rate of volatility persistence [12]. Since the current stock price considers the expectations of investors regarding further price movements [12], it can be assumed that in an efficient market, stock prices take into account all possible expectations from a synergistic effect in the future [13]. We investigated the moment of the transaction, when the key changes are taking place in the target company. The strategic development of the business and its investment attractiveness will depend on how the merger will go.

The transaction effect is not immediate, so we observed it over a six month-period. During this period, the insider information is completely distributed, and all investment decisions regarding further price movements are made.

Donald DePamphilis claims that the stock price of the acquiring company for a certain period before the transaction declines, and the target company's stock price increases. We tested this statement for Russia and made conclusions about the similarity of the domestic and foreign markets. We did the measurements six months before the transaction and analyzed the data obtained.

For the study, we identified 15,643 M&A transactions, of which 6979 were selected with a change in the ownership of the target company (a transaction with a majority stake). Then, we

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[1] There is a difference between a stock value and a stock price. Value and price are two different categories. Analysts form the stock price on the stock market. This is a certain value, based on which stocks are traded in the short term. In the long run, the stock value is important for investors. They should correctly determine the stock value, which will affect their decision to buy or sell.

selected the companies that completed more than 5 M&A transactions during the study period. We also picked 72 companies that met the selection criteria. The analysis of quotes required that the research units were listed on the stock exchange and were functioning at that moment. Therefore, we did a re-sampling and selected 30 companies. We took all data on transactions and companies from Bloomberg[2] and EMIS[3] information databases.

ANALYSIS OF M&A MARKET IN RUSSIA

E. A. Fedorova, P. I. Rybalkin, N. R. Mikhelashvili evaluated the efficiency of transactions in the Russian market and the stability of the company after the transaction [14]. In the work "New financial technologies change our world", the authors substantiate the need to study M&A banking transactions [15]. The authors draw attention to factors that influenced the volume of the M&A market and the main trends in its development [16]. At the same time, stock evaluation as the main indicator of business performance remains aloof.

Various foreign studies prove the impact of M&A transactions on the company value [17–21]. In particular, the authors examined the impact of the transactions on shareholder capital and the abnormal return on their implementation. They evaluated the impact on the type of transaction: friendly or hostile [22]. The results of the study showed a return of about 20% for shareholders in the case of friendly acquisitions.

According to Thomson Reuters, in 2016, the announced M&A transactions volumes involving Russian assets amounted to 39.2 billion US dollars. According to AK&M agency, in 2016, the market size amounted to 41.76 billion US dollars [23]. According to the Deloitte annual research, the Russian M&A market almost doubled in the first half of 2019 compared to the same period in 2018 — up

to 33.8 billion US dollars [24], i.e. it declined compared to 2016. In 2019, the number of transactions slightly increased and amounted to 169 (in the first half of 2018, there were 153 transactions). Nobody has yet conducted a major study of the Russian market. This is most likely because it has been functioning not so long ago. Yet, the volume of transactions conducted in Russia is sufficient for a statistical study.

Along the analysis, it turned out that not all companies were listed on the stock exchange when the transactions took place; therefore, some companies were withdrawn from the sample, and we used the largest transactions for the analysis. As a result, we selected 50 transactions to analyze price changes and 40 transactions to analyze changes in enterprise value.

From 2000 to 2018, over 16 thousand transactions with a total amount of $ 603.66 billion took place, of which we identified 6916 transactions of a tender nature. *Fig.1* and *2* show the dynamics of the volumes of tender transactions and their total value, considering inflation. Here, we should note two large M&A waves in 2008 and 2011. Now, the market is in a recession, and the growth in transaction volume is unlikely.

It is also worth noting that large purchases were made at the peak of stock market growth, a year before the crisis. This is due to the need for company development. At the same time, companies often overpaid at such moments. For example, in 2011 the EV/EBITDA multiplier (the ratio of Enterprise Value to Earnings before interest, taxes, depreciation and amortization) was 51.26 times, which indicates an overvaluation of the market.

A large transaction volume does not always involve large investments to buy a company. The largest investments into the M&A market were in 2007 and 2012. First of all, these data are due to mega transactions (over 10 billion US dollars) in the market.

The analytical information agency EMIS provides data on the average indicator "Enterprise

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[2] Access obtained in the laboratory of the Financial University.
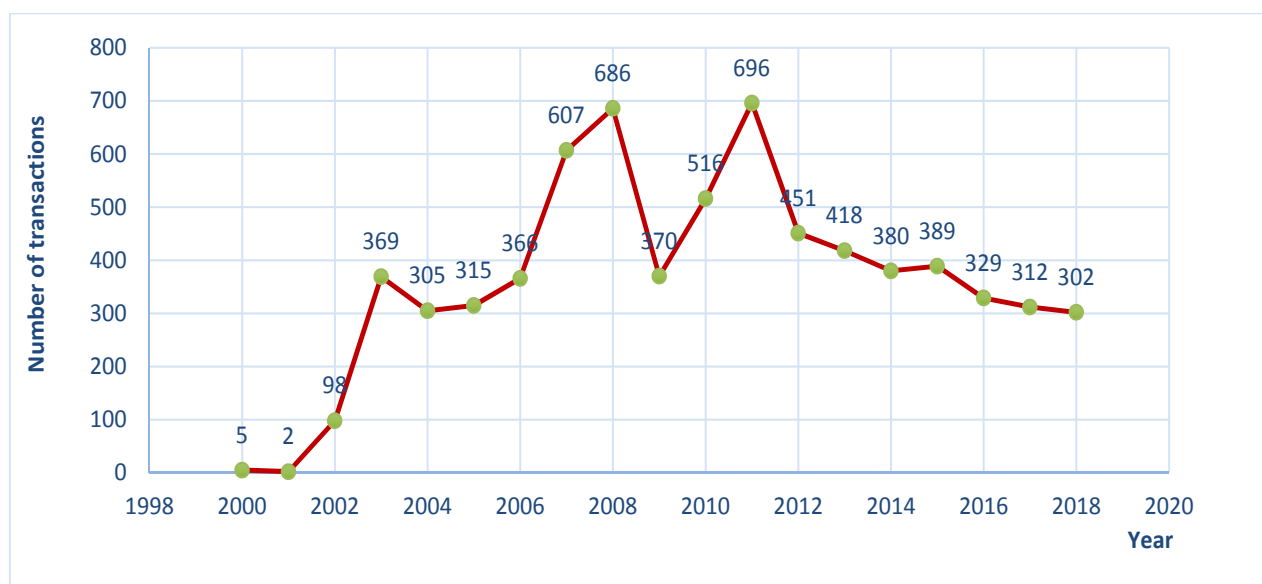[3] Analytical agency. Access obtained in the laboratory of the Financial University.

Fig. 1. **Dynamics of the volume of M&A transactions in the Russian Federation for 2000–2019**
Source: compiled by the authors based on data from the analytical agency EMIS.
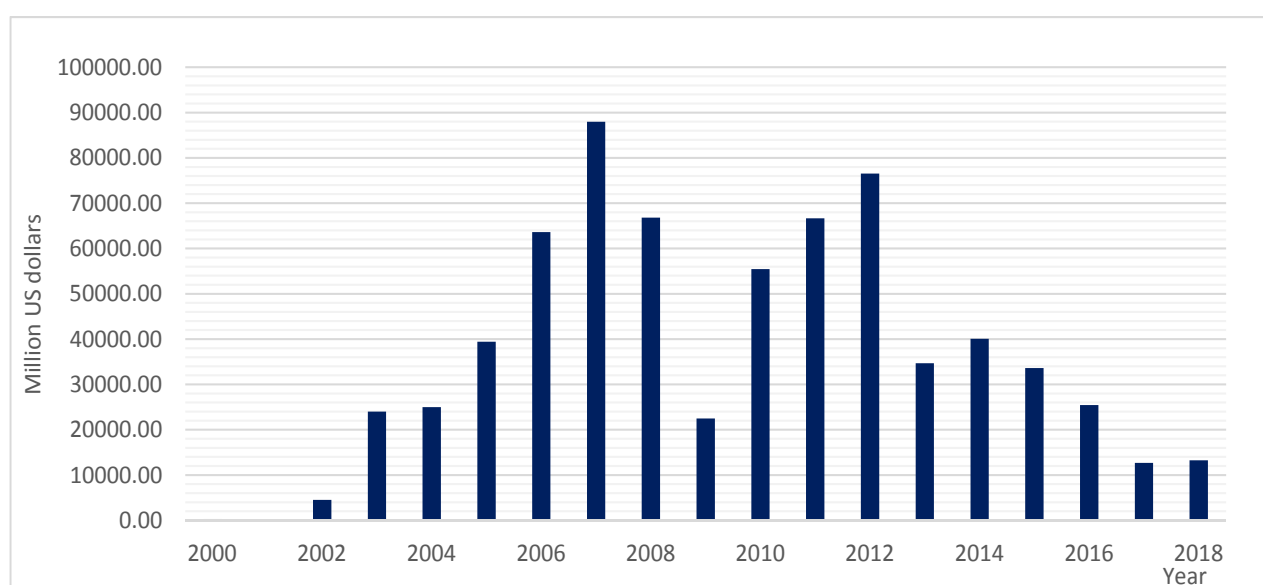

Fig. 2. **Dynamics of M&A transactions adjusted for dollar inflation in Russia in 2000–2018**
Source: compiled by the authors based on data from the analytical agency EMIS.

Value / Sales" and "Enterprise Value / EBITDA" over the past 19 years. These indicators show how much the buyer overvalued the transaction. On average, business value was estimated at 59 revenue indicators of the target company and 12.57 EBITDA indicators represented in *Fig. 3*.

Thus, we can conclude about the high value of target companies in relation to the income that they generate. This can be caused either by a high revaluation of target companies by investors, or by overconfidence in the future profitability of a business.

There are large players in the studied market, as elsewhere. Based on the sample received, we identified ten largest companies by the number of transactions, and diversified the acquiring companies by industry (see *Table 1*).
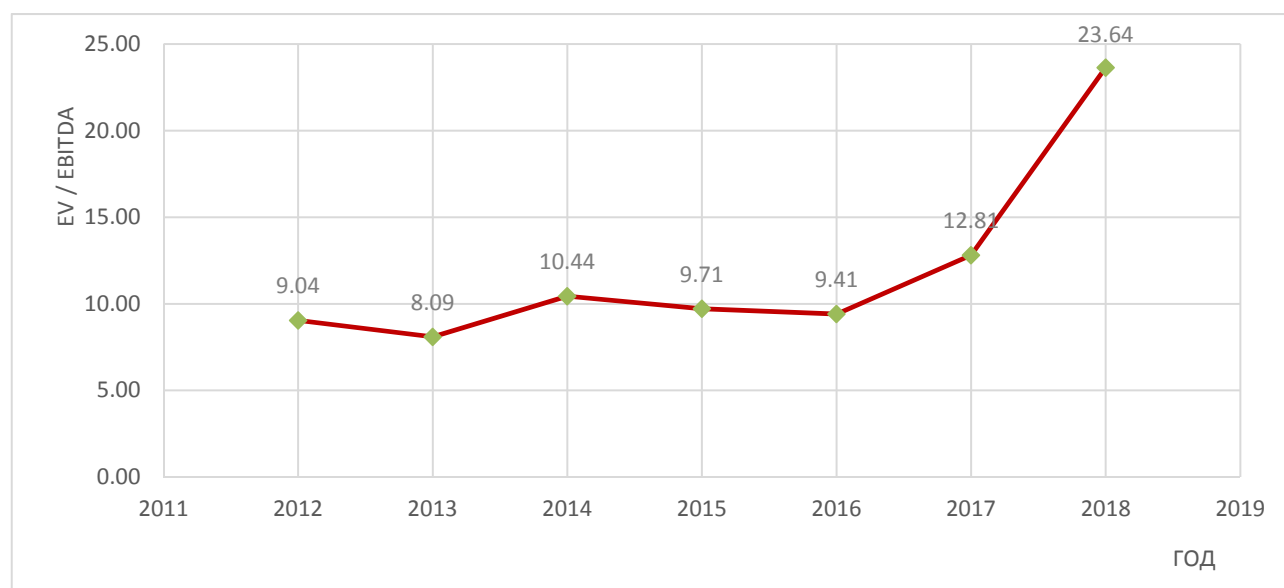
Fig. 3. **Dynamics of the average EV / EBITDA value for M&A transactions in Russia in 2012–2019**
Source: compiled by the authors based on data from the analytical agency EMIS.

Table 1

Ten largest companies in Russia by the number of transactions in 2000–2019

No.	Company	Number of transactions
1	Mobile telesystems (MTS)	40
2	Rosneft	37
3	Sberbank	23
4	AFK Sistema	21
5	Lukoil	19
6	Mechel	19
7	Severstal	19
8	X5 Retail Group	19
9	Gazprom	17
10	VTB Bank	17

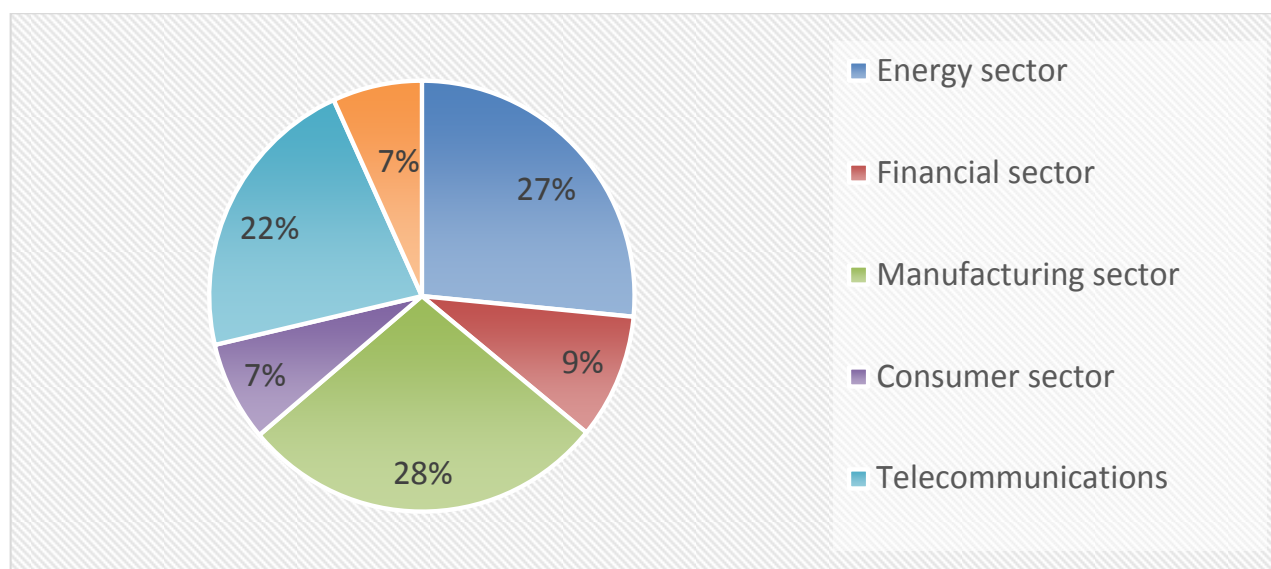*Source:* compiled by the authors based on data from the analytical agency EMIS.

Fig. 4. **Share of M&A transactions by sectors in the Russian Federation in 2000–2019**
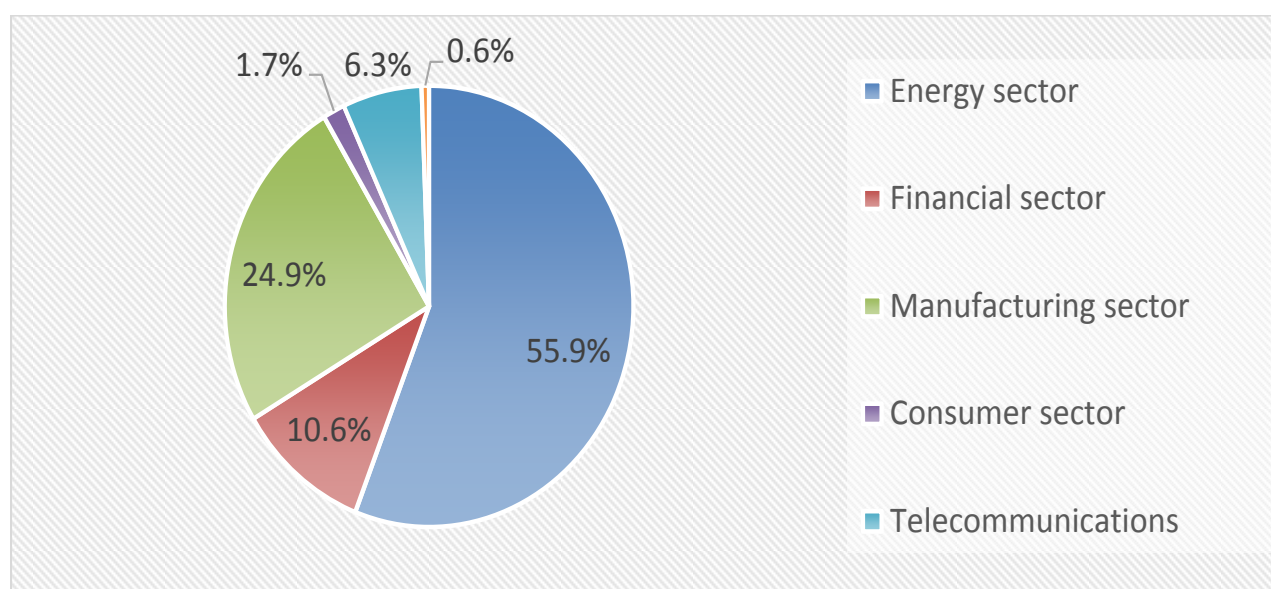*Source:* compiled by the authors based on sample observation.

Fig. 5. **Cost of M&A transactions by sectors in the Russian Federation in 2000–2019**
Source: compiled by the authors based on sample observation.

The largest number of transactions was carried out by MTS, which is a special case for the Russian economy. Most transactions took place in the manufacturing sector. The energy sector leads by the investments in transactions, with PAO "Rosneft" leading in this sector. It conducted 37 transactions; the largest is worth $ 27,730.00 million.

The industry differentiation of transactions allows us to conclude about the most frequent sectors for the M&A market, as well as the distribution of investments by these sectors. *Fig. 4* and *5* show the shares of the number and volume of investments in M&A tender transactions by industry based on the selected sample of companies. The data indicate only transactions conducted by public companies, and do not consider transactions by state and private non-public firms, therefore, the findings represent only the public sector of the economy.

Results of the study of market prices, EV and MV 6 months before and 6 months after the transaction

Indicator	Before the transaction	After the transaction
Stock Price Research		
Average stock price change	−3.20%	−2.95%
Negative changes	29	24
Positive changes	21	26
Enterprise Value Research (EV)		
Average change in EV	5.13%	2.27%
Negative changes	18	19
Positive changes	22	21
Company Market Value Research (MV)		
Average change in MV	5.19%	0.14%
Negative changes	18	16
Positive changes	22	24

Source: compiled by the authors.

RESEARCH RESULTS

After the market research, we analyzed the overall performance of transactions based on price dynamics and changes in enterprise value (see *Table 2).*

The study revealed the following results:
• on average, stock prices of companies decline by 3.2% for 6 months before the transaction. Stocks of companies also decline 6 months after the transaction by 2.95%;

• 58% of transactions showed negative dynamics of price changes 6 months before the transaction. At the same time, 52% of transactions showed positive dynamics in prices;

• the enterprise value increases by an average of 5.23% 6 months before the transaction. After the transaction, it also grows by an average of 2.27%;

• the market value of stocks increases by 5.19% 6 months before the transaction. 6

months after the transaction, the market value grows by an average of 0.14%;

• in 55% of cases, the enterprise value grows 6 months before the transaction and in 52% of cases it increases 6 months after the transaction.

It is important that the data on the market value (MV) showed a positive dynamics when stock prices were declining. First of all, this is due to the fact that the MV indicator consists of two components: the market value of equity and debt. Therefore, the rate of change of the MV indicator and stock prices do not match.

CONCLUSIONS

The research results allow for the following conclusions.

The M&A market in Russia is still developing and has already experienced two major waves of acquisitions. They result in a slowdown of the market value of the company after the transaction, as well as the EM indicator. This may be due to low-quality transactions or goals that selected for the acquisition.

Before the transaction, the company value grows at fast rate. It is likely due to generating additional funds to purchase another company, since in Russia LBO[4] is not widespread.

Despite the steady development of the M&A market in Russia over the past decades, we can hardly call it established. The 2008 crisis and the political transformations of 2014 led to certain shocks and made significant adjustments to its development. Based on the research results, as well as other studies on investments and capital markets in Russia[5], we can assume that the market is not yet ready to increase transactions due to the current economic situation. State transformations in the tax segment, changes in inflation and a decrease in FDI (foreign direct investment) in the Russian economy reduce the likelihood of an increase in transactions in 2019–2020. The volume may fall to the level of 290–300 transactions.

In addition, the study results provide a brief description of the Russian M&A market. Thus, the market is characterized by:

• high level of overpayment for target companies;

• a decrease in the volume of transactions over the last 7 years, as well as a decrease in the total investment in transactions;

• an increase in the value of companies before the transaction and at the same time a decrease in the stock price of these companies;

• low efficiency of transactions from the point of view of shareholders.

This study has revealed issues and problems that may be considered in the future. In particular, it identified the reasons for the decrease in the growth rate of companies after the transaction compared to the growth rate before the transaction. The study analyzed opportunities for the market development and what additional benefits these efforts can bring to the economy; it compared the Russian market and the M&A market of developed and developing countries, including features, trends, key differences and many other things.

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[4] LBO, Leveraged Buy-Out, is a type of activity of the private investment sector companies, in which the company is purchased at the expense of borrowed funds.

[5] Overview of the M&A market in Russia. KPMG Investment and Capital Markets Research in Russia and the CIS. M&A market in Russia in 2018, KPMG. 2019. URL: https://assets.kpmg/content/dam/kpmg/ru/pdf/2019/02/ru-ru-ma-survey-feb-2018.pdf (accessed on 15.09.2019).

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