COMBINING COMPANIES – A SOLUTION FOR OVERCOMING THE ECONOMIC CRISIS EFFECTS

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Abstract:
The aim of this paper is to present the concept of combining businesses as a possible solution for companies to overcome the effects of the economic crisis. Combining companies is approached from the point of view of accountancy, therefore presenting the accounting method, the modality of identifying of the acquirer, the evaluation and allotment of the costs of the operation.

Keywords: combining companies**,** acquisition cost, acquisition method, trading fund

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INTRODUCTION

Economic entities perform their activities in a dynamic environment due to: the sharpening of the economic, educational and technical-scientific competitiveness; the expansion and increase of communication opportunities and media; the multiplying and diversifying of consumer needs; the promotion of certain requirements and new quality criteria for goods and services; the spectacular profusion of technical and technological innovations; the reevaluation of the man-nature relationship and the start of wide programs aiming at ensuring the ecological balance; the alteration of forms of organization and management; the limitation of classical resources of raw materials and energy; the deepening of economic and technical-scientific cooperation (Tiron Tudor A., 2005).

Under such economic circumstances, companies are compelled to focus their efforts on self-protection activities, survival, adaptation to the fluctuations of the market and conjunctural as well as, not least, development modifications. At the same time, in order to reduce the possible risks related to business it is necessary to ensure a control of provisioning, marketing and, possibly, to anihilate competition, all these determining the reorganization of companies.

The reorganization operations that enable a company to maintain control over another or to develop are mergers and acquisitions, in short, the combining of companies can offer this facility.

COMPANY COMBINING – REASONS AND BENEFITS

The need to survive, to adapt to the circumstances of the market, to obtain competitional margin compells companies to act so as to benefit from control over other companies with a view to reach the objectives pursued.

Company combining enables companies to:

- *control the entire production cycle*:
  - upstream – suppliers, thus ensuring the regularity of provisioning, and a steady level of cost and quality;
  - downstream – customers, thus being able to eliminate rival products and exploit new outlets;
- *eliminate rival companies*, which will offer a consolidated position on the market by the merger of distribution networks and combination of the production techniques with a view to reduce unitary costs;
- *the diversification of activity fields and maximization of the profit*.

The obtaining of competitional margin urges companies to develop either internally by means of acquiring new assets, financed from the profit non-distributed to shareholders or associates and from external resources, or externally by taking over the control of a company that already owns the equipment necessary with a view to use them.

A combination of companies represents the grouping in one reporting entity of other entities or companies, with lucrative purpose and separately. In most cases, *the result of the combination* is that one of the companies, *the acquirer, obtains control over net assets and the exploitation of another company, the one acquired*, in exchange for the transfer of assets, debt assuming and issuing of shares and other securities of the company (Ristea M.,2004).

Control represents the power to govern the financial and company exploitation strategies, with a view to obtain benefits from the activity undertaken.

Company combination may imply:

- the acquisition of all assets and debts of an entity;
- the acquisition of assets, debts and privileges regarding the activities of an entity;
- the setting up of a new legal entity that will take over the assets, debts and business of the grouped entities.

Company combining can be achieved:

- by means of mergers, by fusion or absorbtion;
- by means of setting up company groups through maintaining exclusive control

The group of companies is a system made up of the parent company and its subsidiaries, each having their own legal status, but having only one decision center (the parent company).

The parent company is a company that has one or more subsidiaries.

A subsidiary is a company under the control of another company (called parent company).

Exclusive control implies that the parent company would hold, directly or indirectly, by means of its subsidiaries, more than 50% of the voting power.

Company combining can take effect as a result of the issuance of instruments of capital, cash transfer, cash or other assets convertible, or a combination of these. The transaction can take place between the entities participant to the combination or an entity and the shareholders of another entity (Ristea M., 2004).

THE EVALUATION AND ALLOTMENT OF THE COMPANY COMBINING COST

All ***company combinations*** are considered, with accountant purposes, acquisitions and are accounted for by applying the ***acquisition method***.

The application of the acquisition method implies following the steps below:

a) identifying the acquirer;
b) evaluating the cost of the company combination;
c) alloting of the costs of the company combination to the acquired assets, contingent debtors and assumed debts.

a) Identifying the Acquirer

The acquirer is represented by the entity that obtains the control over the other entities participant to the company combination. Therefore, in most cases, a company that is combining obtains more than half the voting power of the other company, is the acquirer. Under exceptional circumstances, the buyer does not possess half of the voting power, but the acquirer will be the party that obtains the power if it:

- owns more than half of the voting power of the other company by virtue of an agreement with the other investors (for example, fiduciary vote conventions or other contract terms);
- has control over the financial and exploitation policies of the other company, according to a statute or contract;

- can assign and revoke the majority of the Board or other counterpart leading body of the other company;
- exercises the majority of the votes in the meetings of the Board or other leading body.

Other aspects that can attest the acquirer in a company combination:

- the just value - the entity of the just value significantly larger than the just value of the other combining entity, is considered to be the buyer;
- the combination takes effect by an exchange of voting rights with cash - the entity that pays in cash is the acquirer;
- the management of a company is able to dominate the selection of the leading team of a combined entity – the dominant entity will be considered to be the acquirer.

b) The Evaluation of the Company Combining Costs

The company combining cost or the acquisition cost *is the aggregate amount of the just values of the assets yielded, the debts incurred and the capital instruments issued by the buyer in exchange of the control over the entity acquired.*

The assets yielded and the debts assumed by the buyer are evaluated at their just value.

The just value is the value in exchange of which an asset could be exchanged or a debt paid in the framework of a transaction held under objective circumstances between willing and conscientious parties.

If the transaction is remunerated by the issuance of shares, these are evaluated at the market value on the date of the exchange.

Acording to the reviewed version of the IFRS 3 ”Companies Combinations”*, costs that are directly attributable to the acquisition affect the profit and loss account and represent expenses of the period.* Costs directly attributable to the acquisition refer to costs of the fees of the accountants, legal counsellors, evaluators and other consultants participant to the operation. At the same time, general administrative costs, the ones pertaining to the acquisition department, the costs of the issuance of securities used as exchange instruments represent expenses of the period.

Example

At the beginning of the financial exercise N, company A acquires company B. The transaction is remunerated by the issuance of 1.000 shares A at the price of 20 m.u. and the amount of 10.000 m.u. paid to the shareholders of the acquired company. The expenses for the fees of the legal counsellors and evaluators participant to the operations amount to 5.000 m.u. The acquisition department of company A generated expenses amounting to the total value of 2.000 m.u. in the month when the acquisition took place and it used 20% of its time in order to do the operation.

Acquisition cost = number of shares issues × issuance price + cash payment =
= 1.000 × 20 + 10.000 = 30.000 m.u.

The other expenses, including the fees of the legal counsellors and evaluators, the expenses of the acquisition department are expenses of the period and do not affect the acquisition cost.

In some cases, contract terms stipulate a supplementary counterprestation depending on certain subsequent events related to the performance of the acquired entity and the market value of the securities issued in exchange for obtaining control. The value of the supplementary counterprestation affects the cost of the acquisition upon combination date if it is probable to be supported and if it can be credibly evaluated. If subsequent events do not take place or if the value of the counterpreatation has to be modified, the acquisition cost will be adjusted.

Example

In the month of March of the financial exercise N, company A acquires 70% of the capital of company B, for the price of 500.000 m.u., following to pay a supplementary counterprestation of 100.000 m.u, if the profit of the acquired company surpasses 5.000 m.u. in the first year after the acquisition date. During the financial exercises previous to the closing of the operation, company B has recorded anual profits of around 4.000 m.u. and 6.000 m.u.

Taking into account the annual results obtained by company B previous to the acquisition date, it is probable that that event, exceeding of the profit after the first year, of 5.000 m.u., may take place and consequently, the counterprestation is contingent and is included in the acquisition cost.

If, after the first year, the profit of company B is smaller than 5.000 m.u., the acquisition cost will be decreased accordingly, together with, implicitly, the trading fund resulted after the combination.

c) The allotment of the cost of the company combination to the acquired assets, debtors, and contingent debts assumed

Upon acquisition date, the buying company will allot the cost of the company combination onto the just value of the assets, the debtors and the identifiable contingent debt. There will be exempted from the rule of just value evaluation the assets that are to be resold and that will be recorded at their just value minus the selling costs according to IFRS 5.

Assets, debts and contingent debts of the acquired company are acknowledged, upon acquisition date, by the buying company if they fulfill the following conditions:

- in the case of the assets, other than intangible ones, it is probable for all the subsequent economic benefits to go to the buyer and their just value to be reliably evaluated;
- in the case of intangibles, debts and contingent debts– it has to be possible for the the just value to be reliably evaluated.

If the cost of the combination exceeds the just value of the acquired net assets, the surplus is considered to be a trading fund.

CONCLUSIONS

Combing businesses can be a solution for companies with a view to overcome the economic crisis effects. From the accountancy's point of view, company combinations are considered as acquisitions and they imply the identification of the buyer, the evaluation of the acquisition cost and its allotment onto assets and debts acquired while taking over the business.

The acquisition cost, according to IFRS 3, is represented by the just value of the asets yielded, of the debts assumend and capital instruments issued for the taking over of another company, to which one can add the value of the supplementary counterprestation as provisioned by the contract.

With respect to the allotment of the acquisition cost, this will be attributed to the net asset (assets minus debts) acquired as well as any possible debts. If, as a result of the act of attributing, there appears a surplus, it will be acknowledged as trading fund in the accounting of the acquirer.

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