Value Creation through Company Merger in the Financial Sector: Empirical Evidence from Slovenia

Laura JUŽNIK ROTAR
Faculty of Economics and Informatics
University of Novo mesto[1], Slovenia
laura.juznik-rotar@uni-nm.si

Boštjan BUTOLEN
Sparkasse Leasing S d.o.o.[2], Ljubljana, Slovenia
bostjan.butolen@s-leasing.si

Article's history:

Received 1st of February, 2021; *Received in revised* form 27th of February, 2021; *Accepted* 19th of March, 2021;
Published 30th of March, 2021. All rights reserved to the Publishing House.

Suggested citation:

Južnik Rotar, L., Butolen, B. 2021. Value Creation through Company Merger in the Financial Sector: Empirical Evidence from Slovenia. *Journal of Applied Economic Sciences*, Volume XVI, Spring, 1(71): 43 – 56.

Abstract:

The paper explores value creation through company merger in the financial sector. The merger took place at a time when, due to the past financial crisis, the demands of regulators and central banks were aimed at abolishing leasing companies and integrating them with banks.

The aim of the paper is to identify the basic areas necessary to assess the feasibility of the merger and to ensure the safe and profitable operation of leasing companies. The present study provides evidence on the integration of business resources and human resources. Moreover, the impacts scenarios on provisioning and profit of a company with credit ratings and the IFRS 9 standard are introduced. Simulations of the possible scenarios calculations are based on different parameters such as probability of default, loss given default, credit rating. Based on empirical research we find that the establishment of credit ratings is essential for the provisioning process. The latter are also a key factor in making impairments, which directly affect the balance sheet results. The projection of the merged company's business operations brings acceptable returns and corresponding growth, which guarantees a long-term existence and a competitive position of the merged company.

Keywords: merger; financial sector; post-merger integration; managerial decision-making; economic environment.

JEL Classification: G34; G32; C53.

Introduction

To address the issues of the merger process, post-merger activities and to provide in depth analysis in the context of a concrete merger this paper investigates a Slovenian case of the merger of Company A and Company B[3] which operate in the financial sector and are owned by banking groups.

The main reason for the merger of the two companies was to combine best practices and knowledge of different areas. In the light of improved financial sector stability and macroeconomic environment study of a concrete merger is motivated by providing strategic direction for ongoing creation of value (see, for example, Sysoyeva 2019). In reaching the potentially promising financial results some main areas have to be researched, namely the business plans of the merged company, the acquisition transaction, the establishment of customer credit ratings, the introduction of the IFRS 9 standards with six possible post-implementation scenarios, and thin capitalization. Therefore, the following research questions were asked to examine this merger case:

[1] Na Loko 2, 8000 Novo mesto, Slovenia
[2] Cesta v Kleče 15, 1000 Ljubljana, Slovenia
[3] Due to data confidentiality, the companies' names are not disclosed.

Q_1: How were credit ratings finished in Company B up to the day of purchase?

Q_2: What were the basic parameters of credit ratings formation in the compared companies?

Q_3: How were impairments calculated up to the day of purchase?

Q_4: What are the differences between methodologies of establishing impairments of Company B and Company A?

Q_5: What will be the projection of the balance or business plans of the merged company over the next five years?

This study represents a contribution to science in the area of mergers and acquisitions presenting a concrete study of the successful practice of merging financial firms, challenges and opportunities, filling gaps in managerial decision-making and creating opportunities to increase societal benefits with new knowledge.

1. Literature Review

Companies nowadays operate in a completely different business environment due to globalization of business, speed of communication, the rate of change within markets and technology. Gaining a competitive advantage through company merger is therefore seen as an opportunity to create value and to grow (see Bukalska and Król 2020, Pinshi 2020).

There were virtually no mergers and acquisitions in the Republic of Slovenia during the global financial crisis and a great majority of companies were fighting for their existence. Banks and leasing companies were faced with a high level of provisioning in their balance sheets and the implementation of additional risk assessment methods due to increasing inability of debtors to repay debts. The amount of money in circulation decreased during the financial crisis, with interest rates rising. Some banks, especially those owned by the state, had to be further recapitalized (IMF 2019). All the mentioned had an impact on the degressive economic environment, and many companies ceased their operations. Mergers and acquisitions were not undertaken by companies during this period, as they mostly needed capital for their provisions and their existence on the market. After 2016, the economic situation began to stabilize again and the positive economic climate also created new opportunities in the area of mergers and acquisitions. The positive climate in this area was also due to the fact that the companies, which survived the global financial crisis, were mostly cleared of bad investments and represented a good opportunity for expansion and growth in the future. This was mainly noticed by foreign investors who, at relatively favorable prices, entered the ownership of Slovenian banks. According to the given research gap, we will explore this area in greater detail.

Mergers represent a mutually desired connection of companies, where two or more companies form a single entity. These are transfers with universal legal succession, transfers of assets and liabilities. Mergers are usually non-cash transactions in which the owners of two or more companies exchange their shares or holdings (Doukas and Zhang 2015). The most important advantage of mergers is the simplicity of transferring ownership of the company's assets, which, by formal merger, is actually automatic. On the other hand, the disadvantage is the automatic accession of all known and unknown, contentious and uncontested obligations of the target company. Although a business merger presents a unique business event, the merging process itself usually follows a certain sequence of steps (see Nnadi and Tanna 2013). Firstly, strategic goals are defined, followed by a search and a thorough inspection of candidates, strategic and financial evaluation, negotiation, search for funding sources, agreement and obtaining approval, and the conclusion of transaction (Fiorentino and Garzella 2015).

However, the mere conclusion of the transaction does not end the merger process. It is followed by post-merger integration and activities that need to already be planned and negotiated in the pre-merger period, as this will enable integration to be fast and efficient (Yang *et al.* 2019, Lauser 2010). Successful integration means effective business integration and satisfied employees, and by contrast, failure of integration leads to poor realization of planned synergies and dissatisfied employees. Excessive emphasis on one component of integration at the expense of another, as a rule, adversely affects the success of the acquisition (Bansal 2019, Chang-Howe 2019). In order to achieve the intended effects of integration, many adjustments are required in the organizational system, which does not only imply a simple fusion of two companies but an imaginative and creative integration of resources, organizational cultures, systems, structures and processes (Schönreiter 2018).

According to the ECB (2000), mergers and acquisitions have changed the structure of the European banking sector. Due to changes in highly competitive global market mergers and acquisitions are sometimes seen as a solution (see, Menicucci and Paolucci 2016). Pazarskis *et al.* (2019) examine the Greek banking sector during the period of economic crisis 2008-2014 and find improvements in capital and loan structure in post-merger

performance of Greek banks. By using the data envelopment analysis econometric approach, Sompolos and Mavri (2018) investigate the efficiency of the Greek banking system and highlight the effect of the economic crisis with a downward trend in operational and profitability efficiency between 2010-2013 period. A similar approach and conclusion for the Czech and Slovak banking sector can be found in a study by Paleckova (2019). On the other hand, Tampakoudis *et al.* (2019) evaluate Greek bank mergers and acquisitions during the period 1997-2018 on wealth effect using univariate and multivariate quantitative approaches. Such a long analysis period consequently includes different shocks the Greek economy has faced (banking crisis, sovereign debt crisis and economic crisis). The results indicate that the stability in the economy has been reached at the expense of taxpayers and shareholders while Ferro and León (2018) also add the role of regulators and competitive authorities to increase merger efficiency.

Credit risk management plays an important role in bank performance. Knapp and Gart (2014) examine the impact of bank merger on credit risk using the standard Markowitz procedure and conclude that there is significant change in the credit risk profile after a merger. By applying the matching strategy, Alam and Lee Ng (2014) examine the determinants of bank mergers in the Asian region. Bank growth, profitability, asset quality and liquidity play an important role in bank mergers while economic and financial crises influence and change the determinants.

The success of a merger strategy depends heavily on the process of bridging the cultural differences between businesses and the challenges faced by employees (Harikkala-Laihinen *et al.* 2018). The management of the parent company must therefore take into account the differences in organizational culture as it is very difficult to change (Caiazza and Volpe 2015). The blending of two organizational cultures is termed acculturation. Constructing an organizational culture must begin with an honest and thorough evaluation of both cultures and needs for the future. This allows the company to identify areas that can be managed relatively smoothly, areas where friction might occur, as well as positive areas where companies show strong similarities (Panibratov 2017). Such circumstances provide the new organization with the opportunity to take advantage of these strengths and create new value that will move the company forward (Srivastava and Prakash 2014). The manner of acculturation directly affects the long-term success or failure of a merger strategy. It is more successful if the characteristics of the two organizational cultures are considered and the assessment of the organizational culture is already part of a comprehensive analysis for the purpose of the merger. Thus, significant differences between existing cultures are identified early enough (Savović 2017). Evaluation is difficult, but once it is determined which differences should be overcome and what the merged company's culture should be like, then that culture should be appropriately supported, strengthened and encouraged by new norms and procedures (Cui *et al*. 2016, Carvalho and Ogasavara 2017).

2. A Merger Case Study

2.1. Presentation of Company A

Company A is a subsidiary of the Financial Institution. Company A was established for the purpose of selling leasing services on the market of the Republic of Slovenia. The Company may enter the market together with the Financial Institution A for the purpose of offering additional services to its clients or independently, thereby assisting in the acquisition of clients within the group. The mission is also to cross-sell products within the Financial Institution A's group and directing customers to conduct business via transaction accounts at the bank. The leasing sales channels are bank advisers and direct sales. The financing strategy covers the financing of movable property by legal entities. Company A does not finance real estate. The company is committed to complying with the Financial Institution A's guidelines. Predominantly, Company A offers financing for the following equipment:

- vehicles - personal, combined, freight, buses, cargo trailers;
- agricultural machinery and equipment;
- metal and woodworking machines, textile machinery, printing machinery and equipment, plastic and glass processing machines, industrial metalworking lines;
- construction machinery, excavators, forklifts;
- medical equipment.

The SWOT analysis of Company A is shown in Table 1.

Table 1. SWOT analysis of Company A

Strengths	Opportunities
▪ strong relationship with Financial Institution A and its group; ▪ own sales and sales via the banking network; ▪ leasing know-how; ▪ connection with the group; ▪ combined sales of banking and leasing products; ▪ recognizable brand in SE European countries; ▪ transfer of knowledge between bank and leasing; ▪ reputation of the Financial Institution in SE Europe.	▪ market entry with supply of passenger cars for natural persons; ▪ increasing cooperation with equipment suppliers; ▪ increasing cooperation with clients of group; ▪ increasing cooperation with insurance companies.
Weaknesses	**Threats**
▪ financing only legal entities, without population; ▪ relatively short financing periods: ▪ no cooperation with suppliers.	▪ refinancing is for relatively short periods; ▪ thin capitalization; ▪ increased regulations and implementation of demanding policies by the group that are not adapted to the Slovenian market.

Source: Authors.

2.2. Presentation of Company B

Company B is a subsidiary of the Financial Institution B. Company B is a universal leasing company that deals with modern forms of financing real estate and movable property, which include financial and operational leasing. Financial and operational leasing are competitive in price and quality with traditional forms of financing and an increasingly important and sought-after form of financing for legal as well as for natural persons. Company B actively markets financial leasing of movable property to legal and natural persons (94%). As a form of financing, it also offers operational leasing of vehicles to legal persons, but to a lesser extent (6%). The main objectives of the company are:

- operating in all leasing segments with a focus on vehicle financing;
- reducing credit risk by carefully assessing customer credit rating;
- maintaining the existing level of financing;
- efficient organization and optimization of work processes in all areas of work;
- investing in staff in terms of motivation and additional professional education; and
- actively participating in the company's sales process.

The SWOT analysis of Company B is shown in Table 2.

Table 2. SWOT analysis of Company A

Strengths	Opportunities
▪ quality business relations with suppliers and end customers; ▪ own know-how, knowledge of employees; ▪ quality and profitable investment portfolio; ▪ promptness and flexibility; ▪ risk management; ▪ defined business processes; ▪ Consumer Lending License for all three units by the Ministry of Economic Relations and Development.	▪ increasing business in the used vehicle segment; ▪ acquisition of at least one global brand for financing new vehicles; ▪ the possibility of financing fixed assets for companies; ▪ expanding business with existing suppliers of agricultural machinery, freight vehicles and equipment; ▪ credit risk reduction by selecting clients with better credit ratings.
Weaknesses	**Threats**
▪ low volume of new business; ▪ low balance sheet total; ▪ a gap in advertising; ▪ expensive refinancing.	▪ expensive refinancing; ▪ business constraints due to EU measures; ▪ concentration on the used vehicle financing market.

Source: Authors.

2.3 Reasons for the Merger

The main purpose of the merger is to increase the volume of leasing business performance and to offer leasing business to consumers. The merged company will offer all leasing services in one place, while providing better quality service to existing customers and the potential for increased collaboration and growth. By merging companies, there will also be a better controlled segmented risk, which means that the company will achieve greater

diversification of its investments, which will provide additional stability for the merged company, as well as more easily accessible sources of financing for the merged company. Thus, enabling cost optimization with sources of financing with the Financial Institution A's owners where the interest rate is lower than that paid by Company B. The merged company offers more favorable leasing terms on the market and consumers benefit from the merger as well. Not only has the offer improved for the consumers, but they also benefit financially, which is reflected in cheaper leasing services.

Both companies are present on the leasing market, with horizontal overlaps on the markets in the Republic of Slovenia in which they are present, only in the leasing market for legal entities, namely in the context of leasing service for freight transport and equipment and machinery. There is no vertical overlap, as the two companies do not provide each other with financial resources to finance activities on the retail leasing market.

The Financial Institution A estimated that the concentration would have a positive impact on both companies, since the two companies were mainly active in different areas - Company A in the field of legal persons and freight financing and Company B mainly in the field of financing natural persons and passenger vehicles. As Company A created its entire realization by financing legal persons, mostly freight programs and machinery and equipment, and since Finance Institution A did not offer leasing products for natural persons in Slovenia, they estimated that the merger with Company B would have a positive impact on the operations of the entire group, as this would enable the Financial Institution A to complete its current product range in Slovenia, thus providing customers with a more comprehensive range of financial services. Namely, Company B created the majority of its realization by financing natural persons and passenger cars. The merger of the two leasing companies was considered positive and reasonable precisely because of their complementary activity.

Table 3 shows the market share of leasing companies in Slovenia, cost and financed value in EUR in million. As can be seen from the information presented, Company A and Company B are ranked 10th and 11th, respectively, by market share measured by the cost of the financed objects. The data in the table do not include the volume of leasing transactions concluded with banks.

Table 3. The market share of leasing companies in Slovenia, cost and financed value in EUR in million

	Cost value	Market share %	Rank	Financed value	Market share %	Rank	Number of contracts	Market share %	Rank
Leasing company 1	306.97	23.20	1	272.56	25.50	1	15,544	18.00	2
Leasing company 2	254.37	19.20	2	188.29	17.60	2	11,348	13.20	3
Leasing company 3	228.77	17.30	3	183.02	17.10	3	42,304	49.00	1
Leasing company 4	113.99	8.61	4	89.87	8.41	4	2,181	2.53	6
Leasing company 5	109.92	8.30	5	85.01	7.96	5	4,721	5.47	5
Leasing company 6	86.22	6.51	6	60.00	5.62	6	5,387	6.24	4
Leasing company 7	57.88	4.37	7	42.89	4.01	8	1,316	1.53	8
Leasing company 8	56.65	4.28	8	56.65	5.30	7	176	0.20	12
Leasing company 9	36.24	2.74	9	30.63	2.87	9	474	0.55	10
Company A	23.59	1.78	10	19.00	1.78	10	395	0.46	11
Company B	23.27	1.76	11	17.06	1.60	11	1,329	1.54	7
Leasing company 12	9.21	0.70	12	9.21	0.86	12	762	0.88	9
Leasing company 13	7.12	0.54	13	5.63	0.53	13	168	0.19	13
Leasing company 14	3.59	0.27	14	2.64	0.25	15	166	0.19	14
Leasing company 15	2.84	0.21	15	2.84	0.27	14	1	0.00	18
Leasing company 16	2.20	0.17	16	2.20	0.21	16	6	0.01	15
Leasing company 17	0.93	0.07	17	0.93	0.09	17	1	0.00	18
Leasing company 18	0.05	0.00	18	0.05	0.00	18	3	0.00	16
Leasing company 19	0.03	0.00	19	0.02	0.00	19	3	0.00	16
Total	1,323.84	100.00		1,068.52	100.00		86,285	100.00	

Source: Authors.

The merged company is expected to take 9th place after implementation of the financed value and 7th place based on the number of contracts. The realization of all leasing transactions with banks is in the fifth year in its growth phase in volume of services. Given the small market shares of Company A and Company B in the Slovenian leasing market, it is estimated that the merged entity will increase the number of clients and leasing transactions.

2.4. Obtaining Appropriate Consents for the Merger

Obtaining consents, which are required to complete the transaction, can be divided into two parts: obtaining consents arising from internal acts of the Financial Institution A and obtaining consents and permissions arising from legislation and approvals that are of business nature. Obtaining both types of consents was necessary for the transaction to be successful. Immediately after the approval of the Slovenian Competition Protection Agency and the Bank of Slovenia and/or the European Central Bank was obtained, the completion of transaction was foreseen, after which the notify became a 100% owner of business interest and was able to begin integrating and reorganizing the business of the merged company.

2.5. Calculation of Purchase Price and Purchase Transaction

The purchase price is the last step before the change of ownership, when all conditions for its realization are fulfilled. Following the transaction, the consolidation and reorganization of operations continued and all relevant permits were obtained. The total planned consolidated assets already include effects due to recapitalization, mutual adjustments due to refinancing with the bank, and other effects dictated by the Capital Requirements Regulation. The planned additional volume of the merged company's weighted assets is consistent with its medium-term financial plan or with the growth of its balance sheet total.

2.6. Policy Implementation and Internal Control Process

Following the merger, the merged entity was divided into sections relevant to the company's operations. The Company's management and area managers are thus tasked with providing all the necessary infrastructure for strategically important areas. A supervisory board was established and the management board consists of two members. The management and the way of work is implemented in the merged company, which ensures compliance of both the legislation and the standards of the group.

The established internal control system operates on the basis of documented rules and procedures and covers (i) compliance of operations with the regulations, standards and internal acts of the bank; (ii) compliance of investment monitoring against risk limits; (iii) supervision of the implementation of prescribed procedures set in internal rules by employees; (iv) checking various reports; (v) safeguarding assets of the bank; and (vi) security of information systems. The effective internal control system ensures: effective and correct implementation of the bank's business strategy and risk management strategy in all areas of operations as well as the implementation of planned business activities; improving the quality of operations in terms of economy, efficiency and effectiveness; reliability of information on the financial and operational performance of the bank for internal and external use; compliance of the bank's operations with applicable laws and regulations and internal decisions and procedures; clarity, transparency and documentation of the internal control system's decision-making process, which limits and prevents conflicts of interest; functional and organizational separation of employees operating within the functions of the internal control system, from business areas that they must monitor and control due to professional obligation; the immediacy of internal reporting between the head of each internal control system function and the management and/or supervisory board, *etc*.

The internal control system operates on the basis of interaction of the following systems, namely internal control; risk management functions; internal audit services and the bank's compliance function and information security function. The internal control process is conducted through the management of the bank, senior management and staff in order to reduce risks and provide reasonable assurances that the objectives of the organization will be achieved. The operation of the internal control system is focused on daily integrated operations and regular management controls. Internal controls are set up within the framework of individual processes for which the owners of the performing processes, inspections or controls are responsible, in addition to the internal audit. The operation of the risk management function, ensuring compliance of operations and internal audit, however, is focused on guidance-control and information operations.

2.7. A Brief Overview of the IFRS 9 Standards

The International Financial Reporting Standard introduces new criteria for the classification of financial instruments into categories based on the Company's business model and the characteristics of the instrument. At the same

time, it introduces a model of expected losses for impairments. As a result, the new standard has the main impact on the financial statements of financial institutions. Simultaneously, it is expected from companies, for the sake of simplicity in accounting treatment of hedging, to opt for its use. According to the classification and measurement of financial instruments, three groups are available in accordance with the IFRS 9: amortized cost model; fair value through statement of comprehensive income with subsequent transfer in the income statement (debt instruments) or without transfer in income statement (equity instruments); fair value through profit or loss (FVTPL). The definition is made according to the business model of the company and the substantive characteristics of the instruments. The most significant change in accordance with IFRS 9 relates to impairments that relate to expected losses and no longer to historical or past losses (*incurred loss model*) In addition to past losses and recoveries data, estimates of future events and environmental impacts should be included in the assessment. Banks have felt the biggest impact for several years, as the new standard requires a lot of data modeling and processing.

2.8. The Impact Scenarios on Provisioning and Profit of a Company with Credit Ratings and the IFRS 9 Standard

The following paragraphs show simulations of the possible scenarios calculations by considering the impact of IFRS 9 on the operations of Company B, which did not have this standard in place by the acquisition. The introduction of the standard can have a significant impact on the formation of impairments of the company's portfolio and, consequently, on the overall result. The possible scenarios calculations are based on the following parameters: default options by credit rating (*Probability of Default* - PD), assumptions about possible future losses (*Loss Given Default* - LGD), credit rating, due date, type of product, customer type, past days of delays, amount of delays and interest rates.

Six possible scenarios have been constructed, with tables 4-9 showing the number of contracts in each rating, the sum of exposures, the percentage of impairments (% CLA), which is calculated for each rating and the total impairment result (CLA sum). The tendency is to minimize the amount of impairments or to maximize exposure in the so-called "Level 1". "Level 1" means the rating where the collective impairments formed are the smallest and do not significantly affect the result in the balance sheet, while "Level 3" means practically fully formed adjustments or impairments and has a material impact on the balance sheet result.

The first simulation is based on past days of delays. All amounts overdue for more than 30 days are rated "Level 2", all exposures rated with the credit rating R (R is assigned to all defaulters who owe more than 2% of their total exposure and reach a materiality threshold of EUR 200) or are classified to "Level 3". A credit rating of R represents the worst possible risk class and is given to defaulters that exceed 90 days of delays and reach the materiality threshold of minimum EUR 200 or 2% of overall exposure. Rating "Level 1" covers all exposures with a risk class better than R and delays of less than 30 days. The exposure of "Level 1" is EUR 31,564,946.38 which is a favorable scenario. The results of the simulation are shown in Table 4.

Table 4. Simulation 1

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	31,564,946.38	52,988.15	0.17%	4,154
Level 2	2,299,930.60	36,587.79	1.59%	311
Level 3	133,993.14	20,421.99	15.24%	38
Total	33,998,870.12	109,997.93	0.32%	4,503

Source: Authors.

In the second simulation, there are all missing credit rating classes (referring to credit ratings of natural persons, Company B's customers who did not have certain credit rating classifications due to the former owner's policy) are sorted by Company B's portfolio by days of delays, the same as in the first simulation. Exposures with delays greater than 30 days are classified as "Level 2" and exposures with a risk class R and defaulters above 90 days are classified as "Level 3". Rating class "Level 1" covers all exposures with a risk class better than R and delays of less than 30 days. The shift of 22 clients is thus visible from class 2 to class 3 compared to simulation 1. The level of exposure in "Level 1" is practically the same as in the first scenario, the sum of impairments is slightly higher, the overall result is still favorable. The results of the simulation are shown in Table 5.

Table 5. Simulation 2

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	31,564,946.38	52,988.15	0.17%	4,154
Level 2	1,921,986.71	33,773.53	1.76%	289
Level 3	511,937.03	77,113.57	15.06%	60
Total	33,998,870.12	163,875.25	0.48%	4,503

Source: Authors.

In the third simulation, all missing credit rating classes in the Company B's portfolio are sorted by days of delays, the same as in the first simulation. Compared to the first two simulations, an additional criterion was used. Given the fact that the portfolio lacks both current rating classification and historical rating information about credit rating classification, in this scenario we simulate what would happen if all customers - as well as those with delays of more than 90 days and rated R - were reclassified into class 3. It can be seen that 4,154 contracts, which were otherwise classified in class 1, in the second simulation, are now classified in class 2 and result in a total of 4,443 contracts. This leads to an additional impairment design of 204,413 compared to simulation 2. This scenario already shows a slightly higher risk level, which would be negatively reflected in the result by the impairment result of EUR 315,300.28. The results of the simulation 3 are shown in Table 6.

Table 6. Simulation 3

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	0	0	0	0
Level 2	33,486,933.09	238,186.71	0.71%	4,443
Level 3	511,937.03	77,113.57	15.06%	60
Total	33,998,870.12	315,300.28	0.93%	4,503

Source: Authors.

In simulation 4, all assumptions remained the same as in simulation 3 except the PD curves. Using the more pessimistic PD curves drawn from the hierarchy of credit rating classes from class 3 onward, therefore credit rating classes 1 through 3 were eliminated. Simulation 4, after a visible impairment of EUR 551,890.18, would already be a serious risk to the result. It should be pointed out, however, that simulation 4 does not reflect the real situation, since the vast majority of the portfolio is placed in "Level 2" as if no credit ratings and historical data were identified. The results of simulation 4 are shown in Table 7.

Table 7. Simulation 4

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	0	0	0	0
Level 2	33,486,933.09	474,776.61	1.42%	4,443
Level 3	511,937.03	77,113.57	15.06%	60
Total	33,998,870.12	551,890.18	1.62%	4,503

Source: Authors.

As an upgrade of simulation 4, for the expected losses in class 3, the PD parameter is set to 100%, and LGDs determined by Company B are used. In simulations 5 and 6, a pessimistic approach is used for the still allowed calculations in class 3, and the CLA is set at 100% of exposure. Simulation 5 presupposes the same assumptions as simulation 1, hence the missing Company B's credit ratings were determined based on the days of the delays. Exposures with delays of more than 30 days are classified in class 2 and exposures in class R, while delays of more than 30 days are classified in class 3. In class 1 are exposures with days of delays of up to 30 days and credit rating classes other than R. Class 3 is impaired by 100%. The results of simulation 5 are shown in the Table 8.

Table 8. Simulation 5

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	31,564,946.38	52,988.15	0.17%	4,154
Level 2	2,299,930.60	36,587.79	1.59%	311
Level 3	133,993.14	133,993.14	100.00%	38
Total	33,998,870.12	223,569.08	0.66%	4,503

Source: Authors.

In simulation 6, all assumptions are the same as in simulation 2, hence all missing Company B's credit ratings are classified based on the days of delays, just like in simulation 1. Exposures with days of delays of more than 30 days are classified in class 2 and exposures with a credit rating class of R and delays of more than 90 days are classified in class 3. Class 1 is reserved for ratings other than R and delays of up to 30 days. The LGD for class 3 is set to 100% and therefore 100% impaired. The results of scenario 6 are shown in Table 9.

Table 9. Simulation 6

Level	Sum of exposures	CLA sum	% CLA	Number of contracts
Level 1	31,564,946.38	52,988.15	0.17%	4,154
Level 2	1,921,986.71	33,773.53	1.76%	289
Level 3	511,937.03	511,937.03	100.00%	60
Total	33,998,870.12	598,698.71	1.76%	4,503

Source: Authors.

Based on the above simulations, we can conclude that the lowest portfolio impairments are the lowest in simulation 1 and highest in simulation 6. In the calculations, the amount of calculated impairments varies between 0.32% and 1.76% of the total exposure, which in nominal terms ranges from EUR 109,997.93 to EUR 598,698.71. Simulation 2 or simulation 5 are rated as the most probable simulations, since they represent the most realistic situation, mainly due to the fact that the bad investments were eliminated as a condition of the SPA (sale and purchase agreement) before the portfolio merger.

2.9. Projection of Operation Outcomes of the Merged Company over the Next Five Years

Table 10 shows the projection of operations of the merged company in the forthcoming years (in EUR 1000). A simplified form of profit and loss account is used to plan the most important rates. Over the years, an increase in profits and other rates is visible, including costs, which should not exceed the revenue growth ratio, otherwise costs are not justified. Normally, the cost/income ratio is measured by the CIR factor (*cost income ratio*).

Table 10. The projection of operations of the merged company in the forthcoming years (in EUR 1000)

Items	2018	2019	2020	2021	2022
Net interest income	3,245	3,611	3,902	4,793	5,201
Risk provision for loans and receivables	-360	-486	-558	-576	-562
Net fee and commission income	70	74	75	69	75
General administrative expenditure	-3,413	-3,727	-4,049	-5,001	-5,544
Labor costs	-1,178	-1,243	-1,294	-1,344	-1,396
Other administrative expenses	-1,257	-1,370	-1,489	-2,267	-2,621
Depreciation	-978	-1,114	-1,266	-1,390	-1,527
Other operational results	1,268	1,443	1,644	1,808	1,981
Profit before tax	810	915	1,014	1,093	1,151
Deferred tax	53	58	63	67	69
Income tax	-158	-181	-203	-219	-227
Net profit / loss	705	792	874	941	993
Operating income	3,315	3,685	3,977	4,862	5,276
Operating costs	-3,413	-3,727	-4,049	-5,001	-5,544
Business result	-98	-42	-72	-139	-268

Table 11 shows the planned balance sheet of the merged company (in EUR 1000). The balance sheet shows the estimated growth of the balance sheet total, which mainly derives from liabilities by acquiring new sources of financing in the form of loans or equity and assets from placing leases on the market.

Table 11.The planned balance sheet of the merged company (in EUR 1000)

Items	2018	2019	2020	2021	2022
Money resources	344	802	814	733	305
Loans and receivables	2	0	0	0	0
Loans and advances to customers	88,760	98,780	107,599	113,407	117,898
Risk provision for loans and receivables	-1,756	-2,221	-2,750	-3,300	-3,843
Funding	0	0	0	0	0
Other assets	5,949	6,912	8,125	9,225	9,964
Intangible assets	390	415	441	470	501
Land and buildings	3,544	4,530	5,509	6,506	7,540
Deferred tax assets	360	361	486	554	624
The rest	1,655	1,606	1,689	1,695	1,299
Funds	93,299	104,273	113,788	120,065	124,324
Bank deposits	85,275	95,715	104,685	110,385	114,335
Client deposits	0	0	0	0	0
Other liabilities	1,823	2,044	2,265	2,490	2,422
Reservations	42	44	46	48	50
Tax liabilities	144	157	176	194	186
The rest	1,637	1,843	2,043	2,248	2,186
Subordinated liabilities	0	0	0	0	0
Capital	6,201	6,514	6,838	7,190	7,567
Attributed to owners with no controlling share	0	0	0	0	0
Attributed to owners with controlling share	6,201	6,514	6,838	7,190	7,567
Liabilities	93,299	104,273	113,788	120,065	124,324

Source: Authors.

In order to achieve higher profit margins, it will be necessary to increase customer financing on the market, while ensuring sufficient profitability of new business and investment security. In the years prior to 2021, with the achievement of the before mentioned results in the previous tables, an increase in return on equity is projected, stabilizing at approx. 13%, which represents a sufficient level of capital for the merged company. The group's projected minimum return on equity is also 13%. Due to the limitations of the operations of both companies in the past, we plan and assume that the merged company has sufficient potential to grow its business volume in the forthcoming years.

3. Discussion and Implications

Company B established credit rating classes only for legal persons, as was the requirement of the regulator. There were no credit rating classes set for natural persons, although they were assigned by the former owner for reporting purposes to the regulator, which were not otherwise disclosed. The establishment of credit rating classes is essential for the provisioning process and in the standardization of two determination methodologies, there were in fact many different options. The main guideline was that the newly assigned rating classes met at least the minimum standards, which are followed by the Financial Institution A's group operations. Credit ratings are also the key factor in establishing adjustments that directly affect the shown result in the balance sheet.

Company B did not specify the lessee's credit rating for the portfolio of natural persons, which represents the majority of the portfolio. Company A established adjustments and impairments based on the following criteria: the lessee's credit rating; customer behavioral pattern and a software tool is used to determine the credit rating. A software tool, which is used in the Financial Institution's group covers both, soft and hard credit rating factors and has been developed within the company for all companies, considering that minor deviations as local specifics are also admissible, which each company must argue and gain approval for at the owner and group level.

Corrections or impairments in Company B were formed on the basis of the scale of days of delays. Moreover, a methodology is mentioned, which simply presents or predicts the characteristics of the company's portfolio, however, the model is not sufficiently precise to predict the future more accurately or to provide information on the current state of affairs. Ultimately, the IFRS 9 standard was introduced for similar reasons.

Company B established revisions and impairments based on the number of days of delays and the hedged share of the investment. Company A established adjustments and impairments based on the number of days of delays; customer credit rating; potential for decline based on the customer's rating (PD); potential for decline in terms of portfolio calculations (LGD) and the hedged share of the investment. By comparing the two methodologies, we can conclude that Company A had more detailed definitions and it can also be said it had stricter criteria for the formation of revisions. As a result, it was decided that Company B had to sell all its bad investments before the sale, as only this could eliminate the dilemma that arose, what would happen if the implementation of Company A's methodology showed a negative result for the company.

The balance sheet projection shows acceptable returns for the owner and corresponding growth for the next five years. The projection shows that sales growth and balance sheet total are still achievable. The desired target market share is 5%. The potential of Company B has not been exploited as a result of EU measures to which it has been subjected in recent years has also been considered, as well as the potential that Company A has not been able to achieve due to product limitations. The realization of the plans enables a long-term existence of the merged company on the market.

Many of the previously mentioned studies highlight the importance of post-merger activities for achieving long-term success which managers ought to take into consideration. In the present case, the post-merger activities are those which lead to the most unknowns, in addition to the before mentioned determinations of the unified credit rating classes and the introduction of the IFRS 9. Numerous adjustments are required to achieve the goals of integration, as merging two companies is anything but easy. In its operations, Company B focused primarily on retail banking, was very much bound by consumer law, and focused on used vehicles with lower values to which all their operations, processes and policies have been adapted to. Company B also had its own accounting department, whereas Company A used an external partner for accounting. Cooperation with the bank was quite low at Company B or rather included occasionally mediated clients, more often, the employees between leasing and bank felt like competition. The quickness of approval was felt to be a key asset. Company A, however, was focused on corporate banking, with relatively high amounts of financing, especially of freight vehicles and equipment. The cooperation with the bank was at a high level, on a daily basis, and the employees experienced the comprehensive offer as synergy and a competitive advantage. In fact, it was a unique cooperation between the leasing company and the bank on the Slovenian market, which actually brought many advantages and took precedence over the competition. The focus was on investment security, which is considered one of the important points in investment approval decisions. It is also important that Company A has been a part of a rather important banking group in Europe and due to this, it is subject not only to Slovenian legislation, but also to European and internal ones, delegated by the banking group.

Managerial implication is also emphasized by the importance of human capital in the pre- and post-merger process. The companies were faced with the decision how to retain all the benefits of both companies and, of course, follow their employees and their way of coping with changes. Coping with changes was seen as more successful with Company A's employees, as they had been preparing and regularly communicating throughout the year prior to the merger. The changes were presented as positive, plenty of energy was invested in collaborative problem solving and open communication. Company B's employees only perceived the ownership change as positive, as it ended the period of uncertainty about the unclear future of the company. However, considerable restraint was observed in introducing new approaches to financing, aligning with the policies of the banking group, moving corporate headquarters and connecting with the bank, as it was perceived as a competition mainly due to past experience, and the Financial Institution's group is a synergy.

A new organizational structure was established inside the merged company, all processes had to be unified, policies that were in place within the group had to be implemented, and a new merged company strategy was required. The merger process, which lasted about two years, also saw an increase in audits at both companies. Of course, this meant a great deal of employee involvement in the audit procedures and, consequently, less market activity. After all, audits are also related to costs burdening the company. There were also discrepancies in the field of sales methods and in presenting proposed financing to decision makers. Given that quickness was crucial at Company B, the suggestions were fairly poorly met, with insufficient data. It was often observed that consultants quickly placed themselves in a subordinate position with the supplier who referenced the customer, and for the most part they did not obtain enough information to decide regarding financing. A shift of responsibility from sales

to risk management was also noted. On the other hand, the approval of Company A was already essentially bank-oriented in minimizing the risk, in customer and group ratings, even with smaller clients, a too detailed explanation of certain information was required. The procedures were lengthy, which was acceptable for the corporate sector but not for the retail sector.

The two had to be united in a unified and effective process, however, when encountering different cultures, dilemmas and different feelings of employees naturally arose. As the acculturation method directly affects the long-term success of the merged company, considerable attention was paid to this. Among other things, employees attended in-depth training in the fields of change management and acceptance, sales training for interactive field sales, emphasizing basic sales skills and the importance of gaining information early in the negotiations. In order to achieve competitiveness and long-term success, the merged company will continue to focus on key success factors and employees.

Conclusion

This paper presents the case of merging Company A and Company B as well as researching the most important areas of the merger. Although a business merger presents a unique business event, the merger process itself usually follows a certain sequence of steps. Firstly, strategic goals are defined since a good advanced analysis significantly helps to identify and overcome potential problems while reducing the risk of failure. The definition of objectives is followed by the search and careful examination of candidates. Candidate analysis is important in terms of seeking information on legal, financial, tax, personnel, operational and other important business areas. The fundamental task of due diligence is to evaluate the strengths and weaknesses of the planned investment, and to obtain information from which a final merger decision can be made. If the company chooses to continue the merger process, a strategic and financial evaluation is based on the expert team's selection, collection of data and evaluation. Evaluation is followed by negotiations, where the fundamental element is determining the value and price of the target company. The acquiring company must determine, under the price agreement, the amount of funds required to complete the acquisition transaction. In doing so, it must find the optimum source of financing, which is the most cost-effective in terms of maturity of assets and project risk. This decision is mainly influenced by the volume of required resources, credit rating and cash flow at its disposal. The determination of financing sources is followed by an agreement, obtaining the necessary approvals and the conclusion of the transaction itself. However, the mere conclusion of the transaction does not end the merger process. It is followed by post-merger integration and activities that need to already be planned in the pre-merger period, as this will enable integration to be fast and efficient.

Every financial institution owned by banking groups should undergo the described procedures. It is true, however, that this is not a united or only recipe for all mergers, as each industry has its own requirements and specifics, and each can represent its own project. The procedures outlined, however, indicate the right direction in researching and creating the subject area, especially for companies that are a part of banking groups in Slovenia. The main areas which have or had the most significant impact on the merger are presented, namely the business plans of the merged company, the acquisition transaction, the establishment of customer credit ratings, the introduction of the IFRS 9 standards with six possible post-implementation scenarios, and thin capitalization. In addition, it shows how tightly regulated banks and related companies are and what requirements they have to meet, either when it comes to legislative or reporting regulations. We determined that the distribution of newly introduced credit ratings is appropriate and acceptable to the customer. We also found out that the introduction of the IFRS 9 standard did not result in unexpected new impairments. Moreover, every financial institution, especially companies that are part of financial groups, are faced with thin capitalization as they are mostly financed by their parent companies and/or by companies within their own group. Of course, this is a dilemma, because in order to maximize profits, which is also one of the basic missions of all companies, these companies provide their companies with the cheapest sources of financing. On the other hand, there is a limitation called thin capitalization, which prevents the companies in the group from excessive depletion. Thin capitalization is a fact and must be considered.

A limitation of the study is the confidentiality of data and, consequently, the availability of data treated as a business secret. As a result, the details are not fully disclosed. The research could be supplemented by recent findings in the field of mergers and acquisitions in financial institutions in the Republic of Slovenia that have emerged in recent years, especially in the years following the financial crisis, which were significantly more intense than in the years during the crisis. The latter is seen as a possible orientation for future research.

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