Possibilities of business restructuring under the condition of recession

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ABSTRACT

The decrease in business activity and the fall in the production volume in the sectors of economy relying on long-term crediting is characteristic feature of the modern recessions. The pessimistic expectations of entrepreneurs concerning product demand leads to falling direct investment into business despite unlimited investment opportunities due to the developed capital markets nowadays. As a result it has created the opportunity for the development of such business restructuring types as mergers and acquisitions. Potential investors are different and their investment motivation is different, but the goal is the same – to increase the value of the business and its efficiency as a result of mergers and acquisitions. Utilizing borrowed capital for acquisitions of enterprises has many advantages. However, purchasable enterprises are exposed to several financial risk factors.

The biggest problem in the Baltic states and therefore also in Latvia is the fact that government institutions do not monitor constantly the enterprise merger and acquisition deals. There are merger and acquisition deals in Latvian market, but they are basically related to selling stocks to foreign investors. Foreign investors seldom consider Latvia as a separate region for investment Mostly they consider the whole Baltic market or even the Baltic Sea region. Such a division of regions shows that often the acquisition of an enterprise in Latvia is only a part of the implementation of a larger plan.

Key words: recession, business restructuring, mergers, acquisitions, M&A cycles.

INTRODUCTION

The economic development in one country depends on the economic situation in other countries in the modern business world. Therefore the crisis in the banking sector and real estate market in the USA, which is recognized to be the leading country in the global economy, was the accelerator of recession in many countries. Consequently, according to the opinion of the experts of the international rating agency “Fitch Ratings” such largest industrialized countries in the world as USA, Great Britain, the countries of the euro zone and Japan in 2009 and 2010 will experience the most substantial GDP downturn since World War II.

The author of the article suggests that the complicated situation as regards the availability of crediting combined with the decrease in demand and the volume of corporate investments leads to the uncharacteristic simultaneous recession in the EU countries.

On the ground of inconsistent economical environment consideration of ensuring market positions and future development potentialities is required of entrepreneurs. Restructuring is one of the most common scenarios in order to develop company. For example, initiating restructuring process is a frequent choice of entrepreneurs aimed to increase their market share or amount of customers, expand the circle of suppliers or adopt new experiences. For company’s management or potential investors to understand with what kind of company they are supposed to operate with, detailed researches of financial performance and project of reorganization in company are often performed nowadays. Respectively – various data of the examined company are being surveyed, analyzed and inspected, thereby the risks peculiar to the company are made recognizable.
The decrease in business activity and the fall in the production volume in the sectors of economy relying on long-term crediting is characteristic feature of the modern recessions. The pessimistic expectations of entrepreneurs concerning product demand leads to falling direct investment into business despite unlimited investment opportunities due to the developed capital markets nowadays.

The objects of research, the results of which are presented in the article are the merging and acquisition of enterprises, known as M&A in business environment, as one of the most attractive ways of business restructuring and investments nowadays.

The goal is to prove that business restructuring under the conditions of recession compete quite successfully with other types of investment in attracting free funds.

The paper attempts to present the analysis of business restructuring and investment process nowadays.

The main methods of research were the analysis of statistic data, quantitative and qualitative comparison of M&A process in Latvia and other EU countries, based on expert’s opinion and on personal observation.

**DISCUSSION**

Everything is in a close correlation in the business world. The economic development in one country depends on the economic situation in other countries. The experts believe that the complicated situation as regards the availability of crediting combined with the decrease in demand and the volume of corporate investments leads to the uncharacteristic simultaneous recession in the developed countries.

The "compression" of production results in reduced demand in labour market which leads to the growth of unemployment rate and decrease of real wages. During recession appears the tendency of fast decrease in the prices for energy and raw materials. The pessimistic expectations of entrepreneurs concerning product demand leads to falling direct investment into business. The merging and acquisition of enterprises, known as M&A in business environment, is one of the most attractive ways of investment which under the conditions of recession competes quite successfully with other types of investment in attracting free funds.

Due to impact of inconsistent economical environment and processes of globalization life cycle of companies has shrunken and business has become more dynamic, which has encouraged processes of restructuring companies. Motives of restructuring vary significantly, still the target is one – increase of company's market value and raise of efficiency in a result of implementing company's restructuring program. Thereby these processes are crucial both for stimulating entrepreneurship and development of national economy in general.

Currently significant restructuring processes in Latvia are performed in the financial sector, concerning both monopolies (Latvenergo, Latvijas Gāze) and small and medium enterprises. Thereby within the research impact of internal and external factors on improving company's financial state is analyzed – restructuring is considered as one of the determinant factors of ensuring company's financial stability.

Restructuring is a composite of numerous interrelated activities – from diagnostics to restructuring organizational structures and business processes based on modern management approaches, and one of the most attractive ways of business restructuring and investments nowadays is the acquisition of enterprises. Potential investors (buyers) are different and their investment motivation is different, but the goal is the same – to increase the value of the business and its efficiency as a result of the acquisition. Therefore these transactions are vital both for the encouraging of entrepreneurship and the development of national economy. As
any investors they are interested not only in the processes at the microeconomic level, but also the investment environment on the whole – macroeconomic indicators and favorable conditions for the business development. There is not only high risk, but also the necessity to think strategically and to act flexibly during recession.

The acquisition of the enterprise from the point of view of the investor requires careful analyses of the processes looking for the optimal solution. The business success of the investor depends on it. The acquisition of the enterprise involves high risk and uncertainty, but also high return in case of success.

Business restructuring is a process aimed at maximization of company's market value by implementing activities of improving company's activity. During the process of enacting successful financial strategy the following targets are gained by restructuring the company:

1) increase of company's equity value as an obligatory condition to increase the competitiveness,
2) company's financial performance is improving due to strengthening of its solvency, liquidity, financial stability and profitability,
3) attraction of long-term investments in form of direct investments or long-term debt commitment is accomplished.

Reorganization is considered as the main stage of restructuring company to implement further activities of attracting investments and establishing optimal owner structure. However it is important to remember that positive result of restructuring company can be accomplished with the following conditions: production and investment programs are developed; ground of financial and economical determination is established in order to create new structures; potential investors are found; legal rights of movable property and real estate are executed; chosen alternative of reorganization is supported by the owners of company. The key factor of company effectiveness is the increase of equity's value.

Matters of business restructuring and financial strategy are poorly examined in Latvian scientific literature, only several authors are published (J.Averina, V.Jerošenko, J.Pinnis, I.Voronova, K.Ketners, N.Saksonova) who have summarized traditional approaches for implementing company's financial strategy reflected in foreign literature.

Financial problems of restructuring companies have been studied by such world famous scientists as Van Horne J., Vachowicz J., Brigham E., Gapsenski L., Burshard Bongart, Gerd J., Korner J., Dicken A.J., Buehner R., Penzel H.G., Muller - Stewens J. However their researches are performed in the field of corporations, while in Latvia the possibility of restructuring small and medium enterprises is more interesting.

Alternative of preventing company's financial difficulties developed by the author, concerns companies in a position of financial difficulties. The matter of the complicity of activities related to preventing the difficulties is dependent on the complicity of the problems – starting with technical insolvency and concluding with bankruptcy.

During the stage of owner's crisis financial performance of the company worsens, which initially does not influence the payments to creditors. The criterion chosen is the limitation of interests of the owner, respectively, the real loss of owners investing. Theoretical ground of offered criterion and numeral measurement is completely possible, despite of apparent abstractness. For owners the company is an object of investing financial resources, allowing to increase the value of the resources invested. In order to compare the effectiveness of investments, alternative investments with the same risk level can be used as the ground. Therefore, to determine the direct loss to owners, present market value and present initial investment value of the equity capital should be compared, considering that they will be used as alternative investments with the same risk level.
Thereby the following inequality can be used as the criterion of the first stage which is the owner's crisis:

\[
\frac{TV_{pa}}{TV_{pam}} + D > 1, \quad \text{where} \quad (1)
\]

\(TV_{pa}\) – company's market value;
\(D\) – owner's dividends;
\(TV_{pam}\) – present initial investment value of the equity capital with the possible alternative use of the resources invested with the same risk and liquidity level.

The insolvency of the company can be described both as episodic and chronic. In the latter case a huge possibility of bankruptcy may arise, which is understood as legally admitted or announced by debtor as inability to satisfy creditor's financial demands in full and/or inability to meet their obligatory payment.

Therefore to avoid situations of crisis, company's financial performance has to be evaluated in a good time, so in case of instable situation composite of actions can be enacted in order to recover it. One of the key elements of the activity's system is restructuring of the company.

During development of the paper the author made a conclusion that together with integration in European Union the competition became more intense in several areas of entrepreneurship in Baltic states, so new requests for entrepreneurship methods were brought forward. Restructuring as a method of increasing market value of the company is common in industrial countries. However it is characteristic for Baltic market that bulk of small and medium size companies often uses irrational methods of financing. Therefore managing structure of financial sources and financial flow is irrational in these companies.

Considering the company as a complicated system, dependent on external and internal factors business restructuring is defined as changing the structure or as changing the business units. Considering the impact of both external and internal factors, restructuring includes improvement of company's management systems, financial, economic and strategic activities, marketing systems, personnel management, quality management and innovation management.

Low efficiency of the company's economical activity can be considered as the main cause of restructuring, which is reflected by poor financial indicators, scarcity of current assets, huge debtor and creditor debt amount and arriving at situation of crisis.

Performing successful restructuring requires set of targets emerging from the overall strategy of the company.

During development of the paper several researches were analyzed where different targets of restructuring are mentioned. Mostly these researches are fragmentary and not classified, without defined boundary among different motives of the restructuring, and the determinant phase, which defines the success of the restructuring process, is often activities of integration. Matters of company's restructuring and their importance in the viability of companies in transition economies are studied by Dockery E., Herbert W.E., Crum R.L., Goldberg I. Scientists have united opinions about the relevance of the integration activities to overcome different barriers. The speed of the activities is often mentioned as the key factor. In general the scientists consider that the optimal speed of restructuring is dependent on desires of employees, culture barriers and existence of competitors desiring for addition of the company. Therefore the optimal speed of restructuring differs in every particular case. External environment's factors are also reviewed in the studies: development of market economy and safety of national currency.
With following to strategic and tactical targets, majority of the motives of restructuring company can be classified in following groups:

- Decreasing the outflow of company's resources (mainly the money);
- Increase or stabilization of company's inflow of resources;
- Motives leaving out the movement of resources.

By summarizing the motives of restructuring, a conclusion can be made that the managers and investors traditionally enact two targets: increase of company's competitiveness and further increase of company's value. Depending on targets and company's strategy one of the types of restructuring is chosen – operative or strategic.

EU financial markets have expanded rapidly during last years, thus new financing alternatives for acquisition of enterprises have developed, for example, second lien debt. It is characterized as combination between bank financing and mezzanine financing with regard to loan term and conditions. Concerning security second lien debt is subordinate to bank loan – if the guaranty becomes required, gained resources initially are shifted to extinguish the bank debt completely and only remaining amount is spent to repay the second lien debt.

Admittedly, to finance acquisition of enterprises there is a great amount of different secondary financial instruments in market that can be used. Wide range of financial instruments allows flexible cash flow of the purchasable company, therefore it is possible to customize repayment schedule in accordance with resources of acquired company. According to Figure 1, European LBO’s (acquisition of enterprises, utilizing significant proportion of borrowed capital) structure of transactions is following: bank loans are dominant (50%), followed by equity (20%) as well as owner loans (12%), which is possible together with equity.

**Figure 1:** Financial sources of European LBO (leverage buyout) operations in 2006 (%)
to come to terms of syndicate credit, thereby loan is provided by several banks and the credit-risk is divided accordingly.

Eligible leverage depends on a range of factors – total growth of national economy, industry represented by purchased enterprise, perspective, seasonality, expanding potential, market fluctuations, stability of company’s economic activities and other significant factors.

It is relevant to mention that each project of purchasing an enterprise is evaluated accurately by associates, i.e. investors. Assessment of purchasable company’s credit standing in the future is the key factor potential investors are considering.

If bank makes a decision to participate in financing the operation, specific conditions or covenants are included in credit agreement as an instrument to determine difficulties in enterprise timely, since repayment of LBO credit is based solely on purchasable enterprise’s future cash flow. Thus freedom of action of new owners is restricted by covenants in relation of such transactions as selling assets or paying dividends, and operations that are not related to ensuring economic activities have to be coordinated by investors. Moreover, banks have postulated to keep some previously defined financial indicators at certain level. Inability to meet the specific conditions may lead to bank’s request for repaying the loan immediately.

Utilizing borrowed capital for financing acquisitions of companies has following advantages:
1. “Debt discipline”. Due to liabilities assumed by company, it stimulates management to focus on arranging economic activities, which might have been canceled or delayed. Thereby increase of liabilities is not only financial strategy, but also an instrument to accelerate changes in the level of management.
2. It is possible for investors to obtain an enterprise for undersized capital necessary, for as the commitment proportion grows, equity proportion decreases. Saved funds can be invested for financing other operations.
3. Income chargeable with corporate income tax can be reduced by the amount of the interest costs.
4. Company can boost its value by increasing the burden of liabilities up to level with the highest profitability of equity.
5. Equity often includes managers together with investors, thus inspiring (or even requiring) higher management to invest a remarkable amount of their personal funds in to the transaction. Thereby equal motivation is guaranteed for both investors and management.

However, the big number of unsuccessful restructuring deals does not decrease the amount of performed restructuring deals because of their potential advantages when compared to the traditional methods of business extension.

Analysis of the failures is made and the factors are identified:
1. Increase of labor fluctuation.
2. Absence of strategy.
3. Insufficient evaluation of the costs.
4. Willful non-objective evaluation.
5. Scarcity of the necessary control.
6. Slow decision making and uncertainty of the competition limits.
7. Barriers of cultural differences.
8. Scarcity of managerial experience.

The performed researches enable to make conclusion that the company's restructuring is related to high risk level. Moreover the amount of unsuccessful transactions do not decrease, therefore the companies with negative experience should be more careful in the future, while
the participating specialists and consultants have to obtain the necessary experience in order to succeed with consideration of the mistakes made. Unfortunately statistics does not confirm the assumption. One of the explanations could be that the external conditions change constantly, and consequently the experience obtained can not be used because of the changes in general conditions. The second reason – the experience obtained previously is not being systematized and accumulated.

Unpredictable events such as recession, litigation or changes in legal environment can lead to inability to cover fixed interest, non-fulfillment of technical obligations (by breaking covenants), or even complete liquidation of enterprise – in this case shareholders lose all invested capital. Value that financial buyer expects from the LBO transaction is related to increase of sales and profitability, as well as appropriate management of working capital and capital investment. Success of LBO operation can be threatened both by weak management of purchasable enterprise and differences in motivation of managers and owners. Furthermore, if increase of interest scales up fixed costs, capability of enterprise to endure through business and economic recession decreases.

Mergers and acquisitions of companies as main types of corporative restructuring have historically formed cyclically (undulant). Especially it appears in 20th century. There were five emphasized cycles of merging of companies in this time period.

1. Wave of mergers in 1897 – 1904
2. Wave of mergers in 1916 – 1929
4. Wave of mergers in 20th century's eighties
5. Mergers in late 1990s and the first decade of 21st century

The last cycle in 1990s was special as regards the volume and geographical boundaries. First the European (except British) entrepreneurs actively participated in acquisitions and mergers as it was done earlier by their USA and British colleagues. The acquisition and merger market in Europe reached the size of the USA market which had already been the most developed. Since the middle of 2003 the merger and acquisition market has experienced growth after the sudden gap in 2001. It seems that the global recession has already allowed to experience the end of the sixth cycle of the enterprise acquisitions.

Though the end of the sixth cycle has not been mentioned in literature yet, still it is possible that 2007 could be marked as a period which could refer to the end of the current cycle of enterprise mergers and acquisitions. As the main precondition of such an opinion serves the collapse of the financial market, which started in 2007 in the USA and in 2008 reached also Europe.

The following tendencies are expected in the world enterprise merger and acquisition market in the nearest future:

- The conditions of financing will become stricter – the recent events in the capital markets, future uncertainty will make the creditors (especially banks) return to stricter covenants. Besides the cost of capital will remain high.
- Financial investors will adapt to the new environment that will make them give up aggressive financing structures. The total loan capital proportion in financing transactions will shrink. As a result the financial investors will be forced to invest more their own funds. In some recent deals financial investors’ contribution in their financing was nearly 50%.
- The number of large deals with a purchasing price above 300 million dollars continues to decrease. Financial investors will turn to smaller enterprises that will allow to diversify the investors’ portfolio thus spreading the risk.
- The common opinion is that the price of enterprises should continue to fall because less financing is available and very often it is impossible to finance the deal, but if it takes place, it takes more time.

- The global economy does not grow as quickly as it has been recently, even a long phase of recession is possible therefore the financial investors will have to prove their professionalism in increasing the value of the enterprise and improving the cash flow to maintain high profitability from investments because up to now the clue to the investors’ success was the favourable economic environment and the fact that the average enterprise price indicators increased what allowed after some time to conclude the deal with profit even without improving financial indicators. Financial investors more often will follow the investment strategy “buy and build” that allows to achieve much faster growth of the enterprise value through the merger of several enterprises:

- Strategic investors will become more competitive because they will be able to compete with financial investors as regards the price because the latter will face difficulties in attracting capital.

- Companies with large burden of liabilities which they are not able to settle or so called distress enterprises will become potential investment objects if the investors see the possibility to restructure the enterprise. Some of the venture capitalists have already founded special funds which will specialize in acquisition of the enterprises which are in financial difficulties.

- The possibility of more serious governmental regulation of the deals concerning enterprise acquisition cannot be excluded. For instance, after the tremor in financial markets in autumn 2008, European Commission has announced the decision that suggests implementing a stricter supervision of venture capital funds because according to the present procedure their activities are not sufficiently regulated.

The biggest problem in the Baltic states and therefore also in Latvia is the fact that government institutions do not monitor constantly the enterprise merger and acquisition deals. Therefore there is no statistical data about the number of deals and their value. There are merger and acquisition deals in Latvian market, but they are basically related to selling stocks to foreign investors by local entrepreneurs and not buying them from foreign enterprises as well as there are few acquisition deals in territory of Latvia. There are more large size concerns in Lithuania, therefore they are more active in acquisition of enterprises and attracting foreign capital for development. Estonian enterprises are rather active in acquisition deals and attracting of capital, they have more developed capital market. Foreign investors seldom consider Latvia as a separate region for investment Mostly they consider the whole Baltic market or even the Baltic Sea region. Such a division of regions shows that often the acquisition of an enterprise in Latvia is only a part of the implementation of a larger plan.

According to the research of Deloitte Latvia which evaluated the attraction of the Baltic States for financial investors or venture capital funds, it was concluded that the most favourable investment environment is in Latvia in comparison to other Baltic States. The results of the research show that taxation and legislation in Latvia is very favourable for the deals related to the acquisition of enterprises which are financed by crediting LBO or leveraged buyout. As one of the most attractive factors for investing in Latvia is mentioned the low corporate income tax rate, which is one of the lowest in Europe.

The forecasts are that in 3-5 years financial investors (Private Equity funds) who have invested successfully and developed enterprises in Latvia are going to sell their activities. After that a new wave will come and investors are going to attract major strategic investors from Europe and Scandinavia. Also there are investors practicing “buy and build” strategy –
they purchase an enterprise in Latvia and then observe and buy companies in other Baltic states in order to merge then into one enterprise.

There are micro-enterprises according world standards in Latvia, thus value of transactions is insignificant compared to global scales. According to data of corporate finance consultant company Behrens Corporate Finances, there has been 31 acquisition operations in 2008 made by foreign investors. Total amounts of acquisition transactions in Latvia is unexplored, but it could similar, assuming that domestic investors are relatively inactive. As summarized in Table 1, information about investors’ country of origin reflects that the most active buyers of enterprises are Estonians by acquiring 8 companies in 2008. In following table all types of investors are summed up, without marking out strategic and financial investments or how many operations are involving foreign risk capital funds.

Table 1: Number of acquired companies in Latvia by investor’s country of origin

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>CEE*</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Denmark</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>France</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Germany</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Estonia</td>
<td>8</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Ireland</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Iceland</td>
<td>5</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Russia</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Great Britain</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Luxemburg</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Norway</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Finland</td>
<td>1</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Turkey</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ukraine</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Sweden</td>
<td>3</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total:</td>
<td>31</td>
<td>21</td>
<td>18</td>
</tr>
</tbody>
</table>

* CAE - Central and East-Europe

Table shows that there is the largest number of transactions in 2008, it has increased by 48% compared to 2007 and by 72% compared to 2006. Remarkable take-off in increasing amount of deals was Latvia’s alignment to European Union in 2004, which resulted in increase of confidence about Latvia’s macro- and microeconomic environment from strategic and financial investors. Nordic countries maintain the top position in purchasing enterprises. Investors from Iceland have been particularly active in last years, however investors from other countries have paid special attention to Latvian enterprises in last 2 years.
In due to raise investment funds the most attractive industries are financing and insurance area, as well as food and alcohol production and merchandising. In 2008 there have been 3 deals closed between Latvian media enterprises and foreign investors, and the same in building industry. Areas with the greatest number of acquisition transactions are displayed in Table 2. Conclusion is that capital is being invested in companies with considerable added value and prospective cash flow.

**Table 2:** Acquisition operations of Latvian companies in industry perspective (buyers are foreign investors)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor-car Industry</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Gambling</td>
<td>2</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Office Furniture, Manufacturing and Selling</td>
<td>4</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Construction</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Building Material Selling</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Finances and Insurance</td>
<td>1</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>IT, Communication</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Wood, Metal Processing, Building Material</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Media</td>
<td>3</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Food, Catering Industry, Alcohol Production and Selling</td>
<td>8</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Tourism, Air Transport</td>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Room Maintenance</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>31</strong></td>
<td><strong>21</strong></td>
<td><strong>18</strong></td>
</tr>
</tbody>
</table>

Latvian companies which changed their owners to foreign investors in 2008 are reflected in Table 3. There is tight information available about the transactions in the public space. Purchasing of Inc. “Lode” lately has been one of the most notable public-to-private acquisitions, as the enterprise has been removed from stock market and is being administrated as company of private capital. Purchasing price for 82,8% shares attains 23,9 million euro, furthermore former shareholders received twice as the price of stock exchange. Another significant event in 2008 was inability to close one of the most pricy deals in Latvian economics, i.e. privatization of state telecommunication enterprise Lattelecom. Approximate value of the deal was calculated within 380-440 millions euro, and one of the world’s major investment companies Blackstone Group was attracted as potential buyer. The deal was expected to be arranged as MBO or management buyout, which means that the shareholders buy out the company and are supported by financial investors. The deal was not closed and now is put off indefinitely, without explaining the obstacles to society.
Table 3: Most notable acquiring deals in Latvia in 2008

<table>
<thead>
<tr>
<th>Purchased enterprise</th>
<th>Industry</th>
<th>Buyer</th>
<th>Country</th>
<th>Type of Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latcharter Air Transport</td>
<td>Icelandair</td>
<td>Iceland</td>
<td>Strategic Investor</td>
<td></td>
</tr>
<tr>
<td>L.I.O.N. &amp; Ko Alcohol Selling</td>
<td>Liviko</td>
<td>Estonia</td>
<td>Strategic Investor</td>
<td></td>
</tr>
<tr>
<td>FFL Food Wholesale Premia Tallinn Cold Store</td>
<td>Estonia</td>
<td>Strategic Investor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kolonna Trade Douglas</td>
<td>Great Britain</td>
<td>Strategic Investor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BM Auto/ Baltic Motors Motor-car Industry Inchape Group</td>
<td>Great Britain</td>
<td>Strategic Investor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vika Wood/ Vika Timber Wood-processing Norvik finanšu holdings</td>
<td>Iceland</td>
<td>Financial Investor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEC Building Alta Capital</td>
<td>Estonia</td>
<td>Financial Investor</td>
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Activity of Latvian investors purchasing companies in domestic market is insignificant. In 2008 one of the leading telecommunication companies Baltcom Ltd. expanded by obtaining seven small internet providers, and in 2007 the major local transaction has been merger between building companies Aile and Tapex. Industries with common local merger deals are following: pharmacy, gas retail, dairy industry. In these operations it is basically acquisition of particular products, not the whole company with its concept.

Several local venture capital funds are founded in Latvia, e.g. Zaļās Gaismas Investīciju Fonds, Eko Investors. The core specialty of the enterprises is to promote use of venture capital in entrepreneurial environment, and they are supported by institutions of European Union, however some leveraged buyout has been performed by local funds. It has to be admitted that venture capital investment funds in Latvia are in their early stage of development, for example comparing to Estonia where venture funds are expanding and purchasing enterprises in neighbor countries.

If the economic situation in the country gets worse, we can forecast even larger invasion of foreign investors in Latvia because the local investors will have even less opportunities to finance deals from their own funds and attracting them from local financial institutions.

**CONCLUSIONS**

- Unlikely the temporary recession of economic activity following the development cycles and rotating with the rising phases, the crisis causes significant failures of the company's activity that can even completely change the company concerning its property, management, personnel and technical matters.
- In order to eliminate the crisis, the financial performance of the company has to be evaluated in a good time, and in case of instable situation set of activities has to be enacted to recover the company. One of the key elements of the system is company's restructuring.
• Considering the company as a complicated system dependent on external and internal factors, the restructuring can be defined as structural changes or business unit changes. Considering the impact of external and internal factors, the restructuring contains development of management systems, financial economic and operative activities, marketing systems and management of personnel, quality and innovations.

• Low effectiveness of company's economic activity can be considered as the main cause of the restructuring. It is reflected by poor financial indicators, scarcity of current assets, huge amount of debtors and liabilities.

• Restructuring is not simultaneous changes in company's capital structure or production. It is a process during which several obligatory restrictions and the specifics of the company restructured have to be considered. Enactment of restructuring is possible only when the targets are clarified, the restructuring concept is justified and all the stages and methods are clear.

• The great amount of unsuccessful restructuring cases does not decrease the amount of performed restructuring projects because of their potential advantages when compared to the traditional methods of business extension. Therefore the causing factors of failures should be identified during the restructuring and the risks of enacting the restructuring have to be evaluated.

In the light of all stated above utilizing borrowed capital for financing acquisitions of enterprises has the following advantages:

• “Debt discipline”. Due to liabilities assumed by company, it stimulates management to focus on arranging economic activities, which might have been canceled or delayed.

• Company can boost its value by increasing the burden of liabilities up to level with the highest profitability of equity.

• Equity often includes managers together with investors, thus inspiring (or even requiring) higher management to invest a remarkable amount of their personal funds in to the transaction.

The analysis of M&A in Latvia shows the following tendencies in acquisition and selling market in Latvia:

• The acquisition market in Latvia is developing successfully in spite of the economic recession that is reflected in the negative GDP growth and the budget deficit.

• If the economic situation in the country gets worse, we can forecast even larger invasion of foreign investors in Latvia.

• Crises attract investors because then you can buy company at a good price. Still many financial investors wait because they hope that it will be possible to buy a company at a still lower price than at present.

• Now we have a buyers’ market because there is uncertainty about the near future, the shareholders have less illusions about the value of the company and they tend to think more about selling the enterprise than a year ago.

• During recession buyers in the area of company’s mergers and acquisitions have a new challenge because of the more complicated and more expensive availability of the resources. Therefore we can forecast that the deals will be for smaller sums, but their number will be larger.

• Up to now the companies have not been forced to consolidate in order to optimize costs and to make production more efficient. Therefore in the further periods probably we can anticipate consolidation processes in the Baltic States.
Before initiating the restructuring the company's historical data and former performance should be evaluated. During this process the strategic financial analysis system could be used. It compares the information obtained with the data of closest rivals and determines the company's position in the industry by performing the analysis of company's external environment. All activities mentioned above must be performed with a target of studying the activities that can be improved by more qualitative and professional management.

As one of the most critical restructuring stages the forecasting of future activity may be considered. Based on how qualitative and objective the future forecasts are formed, the investment decision will be made about selling the company. In order to expected cash flow being objective, the assumptions made should be based not only on company's future perspectives on micro level, but also on the statistics of country's macroeconomic indicators and the expert opinions about country's development. Thus the expected data would be more reasonable and it would include the positive and negative consequences of the economic cycles. As another improvement element of the predicting quality of company's future activity, a new business process – the “Budgeting” – is offered, which would allow the planning and analyzing the costs and incomes of the company, and forecasting financial indicators as well. That would raise the possibilities to increase company's managing quality.

By determining the company's market value and analyzing the equity and borrowed capital's price as well as the increasing financial risk, it is concluded by the author that the most used method by Latvian financial analysts – the adapted CAPM model or the cumulative method – does not reflect an adequate price of increasing financial risk. In order to determine adequate equity price correlating with the increasing financial risk along with more aggressive funding structures, the author offers using CAPM method.

BIBLIOGRAPHY


