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# Analyzing the Dynamics of the Romanian M&A Market.

## Empirical Evidence Regarding the Premiums Paid in Transactions

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### Abstract

Corporations often acquire stakes in other companies. These stakes do or do not grant them control but they definitely allow the acquirers to use target companies' resources to increase their profitability, access technological progress and innovation, develop products, or obtain dividends, as a part of their strategic transactions. The main objective of this article is to assess the stake purchased in acquisitions, based on information related to the size of the target companies and the premium paid, based on a sample of 2.565 acquisitions which involved at least one Romanian company, for the 2010-2018 period of time. The result show that the influence is negative and significant for the entire sample. When considering the accounting practices of the target companies, large stakes are purchased in companies which apply local GAAP, compared to IFRS. The second part of the study focuses on Romanian mergers, which are regulated separately by the OMPF no. 897/2015. In the case of these transactions, the target companies, in most cases, report a negative book value of equity.

**Key words:** mergers and acquisitions; premium; purchased stake; Romania; FDI;

**JEL Classification:** E22, G32, M42, M48, O16

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## Introduction

Global foreign direct investment (FDI) flows in 2021 were 1.58 trillion dollars, up 64% from the level of 2020, which was an exceptionally low year, given the Covid-19 pandemic and the fact the world economy just stopped for a period. The recovery of the economies has asked for massive investment and showed significant rebound momentum, which included a significant increase of the M&A market (UNCTAD, 2022). The 2021 growth momentum is unlikely to be sustained, given the triple food, fuel and finance crisis in many countries, as a result of the Ukrainian war. In this context, the M&A market must be stimulated, and the involved companies must consider one of the three motivations found in the literature: synergy, agency and hubris (Seth *et al.*, 2002).

The wealth effects of mergers and acquisitions on acquirer and target company's shareholders are of interest for both academics and practitioners and they are analyzed from managerial, financial, accounting or cultural perspectives. One of the most important aspects that is treated in many papers is the mechanics of takeover markets, which includes the division of M&A-driven wealth between the involved firms (Mulherin and Simsir, 2014; Weber *et al.*, 2011; Schoenberg, 2006). The last topic, regarding the value created by M&As, is one of the most discussed paradoxes, given the fact that the number and value of these business concentrations have increased over the years, despite the low or lack of performance recorded by many acquiring companies. Mergers and acquisitions (M&A) specialists analyze and commensurate the wealth effects especially on the target firm shareholders, to assess whether they receive fair or oversized premiums from the proposed transactions (Antoniou *et al.*, 2008; Mulherin and Simsir, 2014; Laamanen, 2007).

In the literature, wealth effects of M&As are typically measured by abnormal stock-return patterns of the target or acquired firms and by the premiums paid in transactions. The economic significance of abnormal returns and the length of time for abnormal returns to subside may differ between advanced and emerging economies due to differences in the efficiency of their capital markets, the quality of their institutions, the size of their human and capital stocks, and the speed with which information is disseminated to market participants (Arik and Kutan, 2015). The premium captures expected synergies resulting from the deal (Gomes and Marsat, 2018) and convey information about the way acquirers

assess the risk of market manipulation by target insiders (Cumming *et al.*, 2016). Aktas *et al.* (2011) show that more synergistic deals occur with targets that exhibit better performance regarding their corporate social responsibility.

In the acquisition-related literature, the premium is the first manifestation of the expected synergy, assuming that the managers conclude the transactions considering that the added value to be obtained exceeds the amount paid in addition to the shareholders of the target company.

Cho and La (2014) compares the premium with the expected synergy to get from the acquisition operations, of course, taking into account the influence of the time factor: premiums are paid immediately, while synergies are expected to occur after at least one-year transaction date. Most authors believe that they occur even after three years after that date (Damodaran, 2005; Schosser and Wittmer, 2015; Rao *et al.*, 2016). In fact, the size of the premium payable to the target company's shareholders may, in some cases, exceed the value of the stock market capitalization of the target company and is not correlated with the expected synergies for several reasons: insufficient understanding of the concept of synergy, presentation of the expected synergy without being identified specifically the sources for obtaining it without specific calculations or a presentation of the steps to be taken to achieve it.

On the other hand, over time, there were authors who put into discussion the proper ways of measuring the deal premium, arguing about the target share price which should be considered when calculating it (Eaton *et al.*, 2019; Masulis and Simsir, 2018; Schwert, 2000; Schwert, 1996). What is interesting about these studies, analysed in evolution, is the fact that, along the years, the unaffected stock prices which are compared with the stock prices when the deal is completed are considered for a longer period prior to deal announcement (from 20 to 105 days in present days). The justification is simple. In nowadays, the information is at arm's length and, by trading day -20, for example, the stock prices already incorporate a substantial amount of deal related news.

From a different perspective, Ang and Ismail (2015) and Ismail (2011) argue that a 10% increase in the 52-week high is associated with a 3% increase in the offer premium, because both the target and the acquirer's shareholders must form an estimate of target value when deciding whether to accept/propose the offer. Lacking time, information, and ability to accurately compute

present values of future cash flows etc., some of them will consult the 52-week high as a reference. Targets seek and attempt to justify the highest possible price (Baker et al., 2012).

In the case of mergers, on the other hand, the premium is a result of the takeover of the absorbed company by the bidder, resulting from the comparison of the value of the securities issued to the shareholders of the target company with the value of the contribution brought into the concentration by the latter. These issues will be further exemplified on the case of Romanian transactions.

The normative act that legislates the mergers in Romania is the Order of the Minister of Public Finances (OMPF) 897/2015 - Accounting rules regarding the merger, division, dissolution and liquidation of companies, withdrawal or exclusion of some associations. The economic entities, those that apply the order in the event of a reorganization operation, also use the accounting regulations regarding individual/consolidated annual financial statements, approved by OMPF no. 1.802/2014, with subsequent amendments and additions. In the case of economic entities that apply the Accounting Regulations

in accordance with the International Financial Reporting Standards (IAS/IFRS), regulated by OMPF no. 2.844/2016, proceed to the accounting using the mentioned regulations, in compliance with the legislation for reorganization operations (OMPF no. 897/2015, art.2).

In the case of acquisitions, the premium appears as an anticipation of the synergy effect that is expected to be recorded, in at least three years from the date of completion of the transaction (Damodaran, 2005). In the case of mergers, the premium appears as "the difference between the value of the contribution resulting from the merger and the value by which the social capital of the absorbing company increased", according to OMPF 897/2015. In other words, determining the premium from merger operations involves mathematical calculation. In this sense, Eq.1 presents the calculation of the mathematical value of a share (MV), the parity ratio (R) in Eq.2, the number of shares issued by the absorbing entity for the contribution of the absorbed entity in Eq.3 and, in Eq.4 the method of calculating the merger premium (P) is presented.

$$MV = \frac{Net\ Assets_{absorbed}}{No\ of\ shares\ issued} \quad 1$$

$$R = \frac{MV_{absorbed\ company}}{MV_{absorbing\ company}} \quad 2$$

$$No\ of\ new\ shares = No\ of\ shares\ of\ the\ absorbed\ company * R \quad 3$$

$$P = No\ of\ new\ shares * (MV_{absorbing\ company} - NV_{absorbing\ company}) \quad 4$$

or

$$P = Net\ Assets_{absorbed\ entity} - (No\ of\ new\ shares * NV)$$

where:

NV – nominal value

A bidder has every incentive to see that the amount paid for a target or for a part of it, in an M&A transaction, is a true reflection of its net worth, so the premium would match it (Jory et al., 2016). The objectives of the paper are twofold. On a side, using a multinomial logistic regression, we analyse the probability for an acquirer to choose between controlling, being an associate or purchasing minority acquisitions in a target company, based on the same

influence factors. Also, we want to analyse if the premium paid in Romanian acquisitions is a determinant for the purchased stake, next to the dimension of the target company and the accounting practices. The results will show that the three variables are significant in the choice, but also in estimating the purchased stake. Based on this premises, in case of Romanian M&As, we propose the following hypotheses to be tested and validated:

- **H<sub>1</sub>: In Romanian acquisitions, the probability of purchasing a specific stake in the target company is significantly influenced by the premium paid, the size and the accounting practices of the target company.**
- **H<sub>2</sub>: In Romanian acquisitions, the premium paid, the size and the accounting practices of the target company have a significant influence on the purchased stake in transaction;**
- **H<sub>3</sub>: In Romanian acquisitions there is a significant difference between the premiums paid considering the accounting regulations applied by the target company;**
- **H<sub>4</sub>: In Romanian mergers the target companies report negative book value of equity.**

## 2. Research methodology and design

### 2.1. Target population and analysed sample

Considering the above, we present a study of 2,565 acquisitions involving at least one Romanian company in the 2010-2018 period of time, which aims at describing the generic characteristics of the premium paid in the transactions concluded in Romania. One must note that domestic and cross-border purchases involving a single target company and one or more acquiring companies were considered.

The chosen period is significant for Romania. 2010 is the year when GDP and GDP per capita started to grow, after the 2008-2009 financial crisis (World Bank, 2021). The year 2018 marked a historical moment for the European Union, because, on 14 November, the Brexit Withdrawal Agreement was published, and endorsed on 25 November by 27 EU member states. The act, covering matters such as money, citizens' rights, border arrangements and dispute resolutions, had great impact on the economy of the EU, including Romania.

Starting in 2019, there has been a reorganization of the European Union, at least from a financial perspective, by moving the financial center from London to other locations within or outside the Union (Hall and Wójcik, 2021; Kalaitzake, 2021). These movements have led to changes in the structure of financing and financial services (Donnelly, 2023; Lavery et al., 2019) and, consequently, in Foreign Direct Investment (FDI) within the member countries (Kalaitzake, 2021; Baier et al., 2019). The year 2020 was atypical due to the influences of the Covid-19 pandemic, while 2021 marked a year of resumption of activities worldwide under exceptional conditions (Fu et al., 2021). Therefore, we consider that the recent years deserve a distinct study as there is no comparability with the years proposed within the scope of this study.

### 2.2. Models proposed for analysis and data source

The variables proposed for the study are presented in **Table no. 1.**

Symbol	Representation	Explanation
<b>P</b>	Numerical	Premium paid in acquisitions
<b>StakeInt</b>	1- Shares in jointly controlled entities; 2- Shares in associates; 3- Controlling interest.	We consider the following intervals: 0-20% (1); 20-50% (2); >50% (3).
<b>StakeVal</b>	Numerical	The stake purchased in acquisition (%)
<b>DC</b>	Ln(Total assets)	Size of the company
<b>AccP</b>	1 – IFRS 2 – Local GAAP	Accounting practices – target company
<b>Year</b>	Year of the acquisitions	For 2010-2018 period of time.

Source: Own processing

For our first hypothesis, we propose the following model:

$$\ln \left[ \frac{P(\text{StakeInt}_j)}{1 - P(\text{StakeInt}_j)} \right] = \alpha + \beta_1 \cdot DC + \beta_2 \cdot P + \beta_3 \cdot \text{AccP} \quad 5$$

In order to capture the relationship between the purchased stake and the numerical variables, the function is as follows:

$$\text{StakeVal}_t = f(\text{DC}_t; P_t, \text{AccP}_t) + \varepsilon \quad 6$$

Using GLM, we propose the following model:

$$\text{StakeVal}_t = \delta_0 + \delta_1 \cdot \text{DC}_t + \delta_2 \cdot P_t + \delta_3 \cdot \text{AccP}_t + \varepsilon_t \quad 7$$

Hypotheses will be tested and validated using SPSS 25.0.

**Table no. 2**, in 2007 transactions were acquired a capital share of up to 20%, in 177 transactions securities were purchased that allowed the acquirer to have a significant influence on the target company, and in 381 acquisitions a share of capital was purchased that allows the company to acquire control. These transactions are divided into the same table in industry and service transactions.

### 3. Research results

#### 3.1. Descriptive statistics

Descriptive statistics for the sample under analysis are shown in **Tables 2&3**. Thus, according to the data in

Range			Main activity		Total
			Industry	Services	
0-20	AccP	IFRS	522	1120	1642
		Local GAAP	251	114	365
	Total		773	1234	2007
20-50	AccP	IFRS	22	10	32
		Local GAAP	107	38	145
	Total		129	48	177
50+1	AccP	IFRS	17	9	26
		Local GAAP	227	128	355
	Total		244	137	381
Total	AccP	IFRS	561	1139	1700
		Local GAAP	585	280	865
	Total		1146	1419	2565

Source: Own processing using SPSS 25.0

Given that the premium was calculated by reference to the value of the target company's equity, weighted by the share of capital acquired, as the difference between the value of the payment made and the value of the capital, its value can be positive or

negative. Given the average in **Table no. 3**, we conclude that, in the acquisitions in Romania, on average no premium was paid, the payment being below the level of the value of the net accounting asset related to the purchased share of capital.

	Minimum	Maximum	Average	Std. Deviation	No.
Premium	-1,539,691.11	599,412.557	-982.649	50,564.759	2565
DC	-0.88	16.693	12.747	3.581	
StakeVal	0.010	100.00	16.715	31.338	

Source: Own processing using SPSS 25.0

**Table no. 4. Pearson Correlation**

Indicators	Premium	DC	StakeVal
Premium	1.000	-.042***	-.020***
DC		1.000	-.600***
StakeVal			1.000

Significance level: 0.01\*\*\*

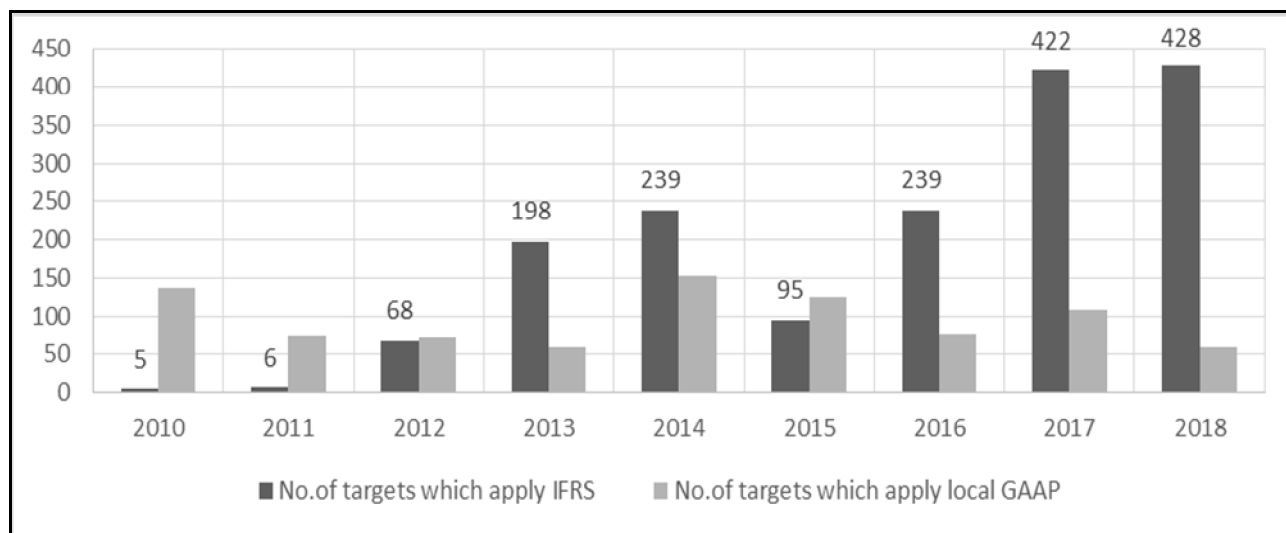
Source: Own processing using SPSS 25.0

There is a negative correlation between the size of the company and the premium paid in acquisition: the smaller the company, the bigger the premium. The same correlation can be observed between the size of the company and the acquired stake in the target company, which signifies that small stakes are acquired in large companies and vice versa. The correlation also holds between the premium and the acquired stake, from which

we deduce that large premiums are paid for small companies, while reduced premiums are paid in the case of acquisitions in large companies (Table no. 4).

In Figure no. 1, the graphical representation of the target companies according to the applicable accounting regulations in the year in which the acquisition took place is presented.

**Figure no. 1. Accounting practices for the target companies**



Source: Own processing

The 2,565 target companies, related to an equivalent number of transactions, apply IFRS in proportion to

66.28%, the rest of 33.72%, applying national accounting regulations (Table no. 5).

Table no. 5. Descriptive statistics for nominal variables			
Accounting practices	No.	Mean	Std. Deviation
IFRS	1,700	-2,550.295	53,779.148
Local GAAP	865	2,098.273	43,426.599

Source: Own processing using SPSS 25.0

### 3.2. Results and discussions

The overall effectiveness of the model was evaluated using the Chi-square ( $\chi^2$ ) test.

According to the information presented in **Table no. 6**, the proposed regression model

is significant ( $p < 0.01$ ), indicating a significant relationship between the ranges of acquired stakes and the selected independent variables (company size, premium paid, and applicable accounting regulations).

**Table no. 6. Models fitting information**

Outcomes	Model 1				
	Model Fitting Criteria		Likelihood Ratio Tests		
	-2 Log Likelihood		Chi-Square	df	Sig.
Intercept Only	585.738				
Final	554.971		30.767	6	.000

Source: Own processing using 25.0

All variables proposed for analysis have a significant contribution to the proposed model (company size, sig. = 0.000; premium paid, sig. = 0.014; accounting regulations, sig. = 0.000). Considering that, in this regression model, the analysis revolves around the acquiring company and the factors that can influence its decision to purchase

within certain intervals defined by accounting regulations, as presented in **Table no. 1**, these stakes determine a certain influence on the target company. We believe that our choice of variables is appropriate and significant, considering the pseudo  $R^2 = 35.5\% - 48.5\%$ .

**Table no. 7. Parameter estimates**

StakeInt <sup>a</sup>		B	Sig.	Exp(B)	95% Confidence Interval for Exp(B)	
					Lower Bound	Upper Bound
0-20 (1)	Intercept	-1.587	.000			
	DC	.186	.000	1.204	1.129	1.284
	P	.000	.001	1.000	1.000	1.000
	[AccP=IFRS]	3.042	.000	20.957	11.949	36.754
	[AccP=Local]	0 <sup>b</sup>	.	.	.	.
20.1-50 (2)	Intercept	.697	.042			
	DC	-.205	.000	.815	.749	.886
	P	.000	.577	1.000	1.000	1.000
	[AccP=IFRS]	2.375	.000	10.746	5.053	22.857
	[AccP=Local]	0 <sup>b</sup>	.	.	.	.

<sup>a</sup>reference category is 3 (control)

Source: Own processing using 25.0

According to the data from **Table no. 7**, acquirers are more likely to purchase shares representing 0-20% of the target company than the controlling percentage. In fact, when the company size increases by 1 unit, the chances of the acquirer purchasing minority shares increase by 18.60% in the proposed model, compared to the reference category 3 (control), while keeping other effects constant. Additionally, the premium paid is significant ( $B = 0.0002$  and probability rate = 1.002), meaning that acquirers have

a 0.02% higher chance of buying shares representing less than 20% of the target company compared to the reference (category 3).

When comparing acquisitions of shares in associate entities (representing 20-50% of the target company) with the reference category, we can observe that the size of the target company remains a significant and positive influencing factor. Consequently, the chances decrease by 79.5% for an acquiring company to purchase shares in

associate entities, compared to the reference category, and the premium paid is no longer an influencing factor in this decision.

We notice that the categorical variable "Accounting Practice" is significant, and the fact that the target company applies IFRS (International Financial Reporting Standards) compared to local GAAP (Generally Accepted Accounting Principles) increases the chances of acquiring minority interests and shares in jointly controlled companies, relative to the reference category. The

conclusion drawn from the analysis is that acquiring entities tend to purchase smaller stakes in companies that apply IFRS and stakes that lead to control in entities that apply national accounting regulations.

**Table no. 8** presents the parameter estimates for the regression model proposed for testing and validation, taking into account all transactions (2,565 acquisitions). The chosen independent variables explain only 41.7% of the variation of the dependent variable ( $R^2 = 0.417$ ).

Model	All acquisitions			Acquisitions - industry			Acquisitions - services		
	Beta	t	Sig.	Beta	t	Sig.	Beta	t	Sig.
<b>Constanta</b>		3.377	.001		.404	.686		4.443	.000
<b>DC</b>	-.083	-3.420	.001	-.038	-1.122	.262	-.143	-4.106	.000
<b>Interval</b>	-.069	-2.867	.004	.033	.978	.328	-.160	-4.594	.000
<b>Significance</b>	Sig. = 0.002, F (2,2562)			Sig. = 0.124, F (2,1143)			Sig. = 0.000, F (2,1416)		

Source: Own processing using SPSS 25.0

With a significance level of 0.000 and an F value = 611.552, the ANOVA test indicates that the model is significant for all 2,565 transactions. From the values recorded in **Table no. 8** we observe that both the size of the company and the premium paid in the acquisition are significant for the acquired stake in the target company and both have a negative influence on the dependent variable. These results show that acquirers tend to purchase smaller stakes in larger companies and vice versa, which is consistent with the

Romanian economy. The large companies in the sample are those listed on the Bucharest Stock Exchange, and the acquired stakes in these companies typically fall within the first category (0-20%). The same influence is observed in the case of premiums, which have lower values for high-stake acquisitions and higher values for minority stakes.

**Table no. 9** shows the number of entities that report and that do not report premiums in merger projects, considering the period 2014-2017.

Year		Premium		Total
		Yes, it records	No, it does not record	
The year of the merger project	2014	86	152	238
	2015	90	144	234
	2016	83	163	246
	2017	70	121	191
Total		329	580	909

Source: own projection

In the 2014-2017 period, out of a total of 909 mergers involving Romanian companies, 329 registered a merger premium and 580 did not. Of those that recorded a premium, 28 recorded a negative premium, which will be

recorded in the records of the absorbing company as a loss from the cancellation of its own securities following the merger. In cases where no premium was recorded, the net book asset of the target company was negative, which



did not allow the acquiring entity to issue securities to the shareholders/associates of the acquired entity.

**Table no. 10** shows the number of premium reporting/non-reporting projects grouped by merger type.

Merger type	Projects with premium		Projects without premium		Total	
	Nr.	%	Nr.	%	Nr.	%
Horizontal	117	35.6%	215	72.7%	332	100.0%
Vertical	135	41.0%	213	77.7%	348	100.0%
Conglomerate	77	23.4%	152	49.6%	229	100.0%

Source: Own projection

Thus, in the case of horizontal mergers, in a number of 117 transactions, a premium was registered in the merger project, compared to 215 cases in which this element could not be registered. In the case of vertical mergers,

the ratio is 135 cases with a premium compared to 213 cases without a premium, and in the case of conglomerate mergers, the ratio is 77 projects with a premium to 152 projects without a premium.

Merger type	Horizontal	Vertical	Conglomerate
Mean	3.926.420,900	9.250.452,123	13.460.512,600
Median	455.600	996.656	866.570
Minimum	-234.588.921	-9.146.450	-1.021.998
Maximum	289.450.000	236.230.163	359.851.240

Source: Own processing

According to the information in **Table no. 11**, on average, in Romania, in the period 2014-2017, for 909 merger projects an average premium of 3,926,420.90 lei was recorded in the case of horizontal mergers, 9,250,452 lei in the case of vertical mergers and 13,460,513 lei in the case of conglomerate mergers.

Considering the way the merger premium is calculated in Romania, we believe that the descriptive analysis is the most appropriate means of analytical presentation of their situation.

## Conclusions

Emergent economies can be characterized by many and rapid changes in the business environment and Romania became part of this group of economies, due to some key indicators with favourable evolution (GDP, HDI etc.). These changes are generated by the need of developing up to a maturity level, and by the need of compatibility with the developed economies. M&As are part of this evolution due to their potential of increasing the investment in an economy, as external growth operations.

Acquirers usually pursue a merger to cut costs and create opportunities for increasing their wealth. The aim is to establish or broaden their presence in high-growth markets, so they are constantly on the lookout for acquisitions with growth prospects or for mergers which generate synergies for the involved parties. Another reason could be to gain access to production and new technology. This strategy pushes expansion plans by broadening the customer base and increasing market share. All these motivations come with a price acquirers want to pay and target companies' shareholders want to accept and the premiums paid in M&As in an important part in this decision.

In the case of Romanian M&As, purchases of minority stakes (0-20) and purchases in associates (20-50) targeted the IFRS-applying entities, while in the case of purchasing a controlling interest (50+1) the entities applying local GAAPs were preferred. Also, the choice for minority acquisitions and for acquisitions of stakes in associates is positively influenced by the target companies' dimension, calculated reposed to total assets. When considering the premiums paid in transactions, they

influence the choice for minority acquisitions but do not have an influence in the choice for investing in associates. All these conclusions are reported to the choice of investing with the main purpose of controlling the target companies. The first hypothesis is partially validated.

Given the influences in Romanian acquisitions, the size of the company and the premium paid in transaction have a negative influence on the purchased stake which means that the acquirers pay high premiums for small stakes bought in small sized entities.

Thus, in Romanian acquisitions, *the premium paid in transaction has a significant negative influence on the purchased stake*. The smaller the share of capital purchased, the higher is the premium paid to the shareholders of the target company. Also, *the size of the target company negatively influences the stake purchased in transactions*. The acquirers purchase participations

which grant control, in small local companies. The second hypothesis is validated.

In the case of Romanian mergers, the target companies, in most cases, report *negative book value of equity*. According to our findings, in average, in 63% percent of the merger cases, the premiums are not recorded, due to this financial situation and as a result of applying local regulations. The third hypothesis is validated.

Strategies for growth are part of the fundamental spectrum of strategic management business development. In the case of Romanian companies, there are specificities due to the state of the institutions, the rapid change of legislation in key industries and the economy level and the quality of the political environment. The limits of the study arise from the lack of financial data, the small number of companies listed on Bucharest Stock Exchange, thus leading to the impossibility of collecting supplementary data.

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