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Can the Audit Opinion Influence the Portfolio Investment Decisions?

The Case of Listed companies

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Abstract

As a part of their strategic transactions, corporations often acquire stakes in other companies that do not grant them control, but allow them to use their resources to increase their profitability, access technological progress and innovation, develop products, or obtain dividends. The main objective of this paper is to identify the factors influencing the behavior of acquirers who buy securities in the capital of the target companies, listed on Bucharest Stock Exchange, without intending to control them. The study aims to describe two dimensions of the buyers' behavior, when they buy shares that do not lead to the control of the target companies (below 50%). The first dimension refers to the buyer's decision to invest in a certain share of capital, influenced by the profitability of the target company and its market capitalization (dimensions of their performance), but also by the audit opinion on the annual financial statements. The relationship is positive and significant. The second dimension focuses on the decision of the acquirers to invest or not in a blue-chip company (top companies, considered the most efficient and stable on the financial market), with the main purpose of obtaining dividends or trading the respective securities on the capital market, in order to generate cash flows. The result shows that investors buy small shares in blue chip companies, compared to other companies, taking into account their performance and the audit opinion on the annual financial statements.

Key-words: *audit opinion; portfolio investments; blue chip companies; stock market capitalization; Return on Equity, Bucharest Stock Exchange;*

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

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1. Introduction

Globalization and rapid economic growth have led to a new strategic approach for companies, which have begun to look for investment opportunities in emerging economies. As a result, the volume and number of mergers and acquisitions (M&As) involving resident companies in emerging markets has increased significantly, becoming comparable to developed economies (Zhou et al., 2016). Some papers pay particular attention to companies' external growth strategies, with a focus on those in and from developed economies (Yang and Deng, 2017; Lin et al., 2009; Cheng and Yang; 2017; Caiazza et al., 2017), given that they are involved in most of these strategic transactions (Aevoae et al., 2019; Lucas, 1990).

Known in the 1980s as *newly industrialized countries*, applied to several rapidly growing Asian and Latin American countries, emerging economies have their origins in the widespread liberalization and the adoption of market-based policies by most developing countries. Hoskisson et al. (2000) identified, in their study, a list of 64 emerging economies, including Romania, based on criteria related to GDP, GNP per capita and inflation rate. Given their attractive economic conditions, these economies have become, on one hand, focal points for global expansion, providing opportunities for corporate strategies. On the other hand, emerging economy governments have adopted market-based policies related to the strategic decisions of private enterprises, such as alliances, mergers and acquisitions, adapting Western practices to national conditions. Thus, as part of their strategic transactions, corporations often acquire stakes in other companies that do not grant them control, but allow them to use their resources to increase their profitability, access technological progress and innovation, develop products or to simply get dividends.

Considering the case of Romania, as an emerging economy, the main objective of this paper is to identify the factors influencing the behavior of the acquirers who buy securities in the capital of companies listed on the Bucharest Stock Exchange, without intending to control the target companies. Also, their intention to prefer blue chip companies over others is analyzed. As influencing factors, the performance of the target companies is considered (reflected in the return of equity and the market capitalization), but also the audit opinion on their annual financial statements.

The results of the study show that the financial performance negatively and significantly influences the share acquired in the target company, in the conditions of an unqualified opinion of the auditor. Considering the second part of the study, buyers buy small shares in blue chip companies that perform well, financially and on the capital market. Therefore, the intention to improve cash flows is correlated with the investment in profitable companies, while the high shares are acquired in unaudited companies, for which we consider that there is an intention to keep them on a medium and long period of time.

2. Literature review

As a result of its 30-year history of being a free market economy, Romania is considered by many authors (Albu and Albu, 2012; Filip, 2010; Albu et al., 2013), as well as by financial institutions (IMF, 2019) an emerging economy. Romania is a country that has gone through several stages to achieve, in September 2020, the status of secondary-emerging economy, granted by FTSE Russell (FTSE Russell, 2020; Dicu et al., 2019), despite its controversial evolution and various privatization methods proposed by the Romanian government, which stimulated market for corporate control like nowhere else in the Central and Eastern Europe (Pop, 2006).

Market for corporate control is a theory specific to M&As, which considers that, if the owner of a company is not able to add value to the business, then the assets generate economic benefits below the standard level, the business tends to be undervalued and, eventually, becomes a target company (Robins and Wiersema, 1995). An example in this regard is the case of OMV, which completed, on 14 December 2004, the takeover of the 51% stake in Petrom. The Austrian company paid the Romanian Ministry of Economy and Trade the amount of 669 million euros for the direct acquisition of a package of 33.34% of Petrom shares and participated with another 830 million euros to increase the capital, which led to a majority stake. After the completion of the transfer of 51% of the shares to OMV, the participation of the Ministry of Economy and Trade decreased from about 93% to 40.74%. The European Bank for Reconstruction and Development also became a shareholder of Petrom, with a 2.03% stake, by converting a sum of 73 million dollars from a loan granted to the Romanian company.

Given the evolution of Romania, after the fall of communism in 1989, it was mainly characterized by a very high inflation rate (256% in 1993) (World Bank, 2019). The 2000s were influenced by NATO membership in 2004 and the accession to the European Union in 2007. After a robust annual GDP growth of 21.64% between 2000 and 2005 and a major increase of 42,42% in the year of EU accession, the effects of the global economic crisis began to manifest in Romania as well, leading to the decrease of GDP in 2009 (19.19%) and again in 2010 (3.45%).

In recent years, Romania's GDP has grown steadily (World Bank, 2019). In 2020, according to the Index of Economic Freedom, Romania ranks 38th in the world with a score of 69.7, being placed between Cyprus (a largely free economy with a score of 70.1) and Kazakhstan (also considered a moderately free economy, with a score of 69.6 points). In 2021, Romania fell to 43rd place, with a score of 69.5, between Thailand (score 69.7) and Uruguay (score 69.3).

One of the symbols of the market economy is the Bucharest Stock Exchange, after its reopening on April 21, 1995. Since then, it has reached a number of 84 companies listed on the main brand, 281 listed on the alternative market AeRO (Alternative Exchange in Romania) and 15 companies listed on SMT International, dedicated to financial instruments admitted to trading on a regulated market or on a market equivalent to a regulated market, in a third country (BVB, 2021). Many of them were involved in M&As, as targets or acquirers. Of these, acquisitions that did not lead to the control of target companies are at the main point of our study.

There is plenty literature on the reasons for M&As to take place (Calipha et al., 2010; Nguyen et al., 2013). When discussing M&As which have involved a stake leading to controlling the target company, the reasons can be reduced to three main aspects that characterize these inorganic growth operations: synergy, agency and hubris (Seth et al., 2000; Hayward and Hambrick, 1997; Berkovitch and Narayanan, 1993). When research focuses on non-controlling acquisitions, the reasons that lead acquirers to buy shares that do not allow them to take over target companies are related to sharing the acquired company's profitability, sharing technology or developing common products (Nain and Wang, 2018). Used to improve operational efficiency, acquisitions that do not lead to control of the target company can reduce costs, alleviate financial constraints and facilitate innovative activities (Fee et al., 2006).

Regarding the reasons given by the acquiring companies to get involved in M&As, numerous empirical papers have tried to identify *external factors*, related to the sector and the environment, as well as *internal factors*, related to the companies involved in the process, which influence different aspects of the M&As. External factors are usually related to cross-border M&As and include the influence of the quality of the legal and institutional environment and market capitalization on M&A flows (Hyun and Kim, 2010), the size of the stock market and corporate governance (Chen et al., 2009) , the positive and significant influence of GDP per capita, relative geographical distance and GDP (Byun et al., 2013), the money supply, stock prices and the effective exchange rate (Boateng et al., 2014)). Economic, legal, institutional environmental factors in a country mainly influence M&A flows, inside and outside, but do not explain a specific behavior of the acquirers or target companies, in terms of transaction price, investment volume, method of payment and so on.

Company-specific factors include, but are not limited to the financial constraints of the target company (Chen et al., 2009), the technological and market connection between the companies involved (Cassiman et al., 2005; Hussinger, 2010), the financial information (Kiymaz and Baker, 2008), sustainable approach (Hu et al., 2020; Sarabia et al., 2019) etc. Recent scientific papers are also sometimes focused on the connection between M&As and related accounting procedures (Sedláček et al., 2012).

3. General research hypothesis and working hypotheses, proposed for testing and validation

Starting from the existing research, our study aims to test and validate the following general hypothesis:

General research hypothesis*: The opinion in the auditor's report significantly influences the decisions of investors in trading the shares of companies listed on the regulated capital market.*

Given this general hypothesis, the study considers the following two working hypotheses:

Working Hypothesis 1: The opinion in the audit report accompanies the informational content of the financial statements in substantiating the investors' decisions regarding the stake acquired in the target companies listed on the regulated capital market.

Working Hypothesis 2: The opinion in the audit report accompanies the informational content of the financial statements in influencing the probability of acquisition of stakes in blue chip companies.

The hypotheses will be tested and validated, using SPSS 25.0.

4. Research methodology

In order to test and validate the proposed research hypotheses, the study follows a positivist, logical approach. Thus, we start from the target population and argue the analyzed sample, and, with the help of advanced statistical methods of data analysis, the parameters of the regression models proposed in the study are estimated. In order to validate the proposed research hypotheses, generalized linear models, logistic regression, and ANOVA are used (Grosu et al., 2015; Jaba, 2002; Jaba et al., 2012; Robu, 2012) will be used.

4.1. Target population and analysed sample

For testing and validating the research hypotheses, the target population is represented by the companies listed on the Bucharest Stock Exchange, involved in M&As in the period 2010-2019, For this purpose, we will consider a number of 710 M&A. The study included only transactions that include an acquiring company and a target company, the latter being located in Romania and listed on the Bucharest Stock Exchange.

4.2. Proposed models for analysis, variables used and data source

The study analyzes a series of factors that influence the acquired stake by an acquiring company in the target company, as well as the decision to invest in blue chip companies, considering the target companies listed on Bucharest Stock Exchange, for the period 2010-2019.

The proposed variables are presented in **Table no. 1**.

Table no. 1. The proposed variables

Variable (symbol)	Representation	Description	Explanation
Stake (S)	%	Dependent variable	The stake represents the purchased capital in the listed target company.
Return on Equity (ROE)	%	Independent variable/ numerical	Return on equity is calculated as a ratio between the net income and the shareholders' equity of the target company.
Market capitalization (Mkt)	Numeric	Independent variable/ numerical	The value of the target company on the capital market, proportional to the stake acquired in the transaction.
Audit opinion (Audit)	1. Qualified opinion 2. Unqualified opinion 3. Unaudited company	Independent variable/ nominal	The audit opinion issued for the annual financial statements of the target company, according to the legal regulations in force.
Category of the company (Blue_chip)	1. Blue chip 2. Non blue chip	Independent variable/ nominal	The companies considered top, which are the strongest, most efficient and most stable on the market.

Source: Authors' own projection.

For the first hypothesis, the model considers the factors Capital Stake *(S)*, as a dependent variable, and Return on Equity *(ROE)*, Market capitalization *(Mkt)* and Audit opinion *(Audit)*, as predictors. Since we intend to see if the predictors have a significant influence in estimating the share of capital acquired in the target company, we consider the model presented in Ec. (1):

$$S = \beta_0 + \beta_1 \cdot Audit + \beta_2 \cdot ROE + \beta_3 \cdot Mkt + \varepsilon \qquad (1)$$

where,

S represents the stake purchased by the acquirer in the listed target company;

$\beta_{i,\ i=0,\dots,3}$ represent the parameters of the regression model;

ε represents the error.

For the second hypothesis, we consider the probability of acquirers to invest in blue chip companies, as it can be seen in Ec. (2):

$$ln(p/1\text{-}p) = \gamma_0 + \gamma_1 \cdot Audit + \gamma_2 \cdot ROE + \gamma_3 \cdot Mkt + \varepsilon \qquad (2)$$

where,

p represents the probability that the acquirer will choose to invest in the shares of a listed company, in the blue chip category, and *(1-p)* represents the difference, i.e. the probability that the investor will not choose to invest in the shares of a listed company;

$\gamma_{i,\ i=0,\dots,3}$ represent the parameters of the regression model;

ε represents the error.

The proposed third model uses *logistic regression* and interactions between the *Audit* categorical variable and other influencing factors.:

$$ln(p/1\text{-}p) = \theta_0 + \theta_1 \cdot Audit + \theta_2 \cdot ROE + \theta_3 \cdot Mkt + \theta_4 \cdot Audit \cdot ROE + \theta_5 \cdot Audit \cdot Mkt + \varepsilon \qquad (3)$$

For the period under review, data on M&As were collected from two databases, namely from the Zephyr database (country of target company, country of acquiring company, deal value, NACE Rev.2 primary code for both and acquiring target companies) and the financial information was collected from the Orbis database (equity, market capitalization, return on equity, audit opinion).

5. Results and discussions

Following the analysis of the data collected, the study presents a series of descriptive statistics for the analyzed variables (by total and categories considered in the analysis), ANOVA results for capital share according to Audit variable, as well as model parameters estimates proposed regression.

In **Table no. 2**, are presented a series of descriptive statistics on the numerical variables on the sample, considered for testing the working hypotheses.

According to the information in **Table no. 2**, the lowest investment is 0.03% of the capital of the target company, with a maximum of 21.20%. Also, there are negative values for the ROE variable, which means that there are target companies, listed on BVB, which are inefficient in using equity in order to record profit.

Table no. 2. Descriptive statistics of the sample – numerical variables

	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
S	.03	21.20	3.2933	5.78432	2.084	.092	3.311	.183
ROE	-15.30	21.20	7.3612	7.36654	-.371	.092	.021	.183
Mkt	.03	708.54	139.8276	130.36818	1.663	.092	3.384	.183

Source: Authors' own projection using SPSS 25.0.

In **Table no. 3**, the descriptive situation of the target companies is presented, considering the audit opinion on the annual financial statements or its absence thereof.

Table no. 3. Descriptive statistics of the sample – categorical variables

Audit_	Mean	Std. Deviation	N
Qualified opinion	5.2310	7.01864	7 (1%)
Unqualified opinion	2.5517	5.06878	615 (86,6%)
Unaudited company	8.3222	7.62716	88(12,4%)
Total	3.2933	5.78432	710 (100%)

Source: Authors' own projection using SPSS 25.0.

Regarding the situation of the target companies, taking into account the audit opinion or its absence, we notice that the vast majority of them have an unqualified audit opinion on the financial statements (615 companies, representing 86.6% of the sample). The number of companies for which the opinion expressed by the auditor, regarding the annual financial statements, was qualified is only 7 (representing 1% of the sample). There are also 88 unaudited companies, listed on the alternative market AeRo, representing 12.4% of the sample.

The results of ANOVA show the testing of the existence of significant differences between the averages of the capital stakes acquired by categories, depending on the categorical variable Audit, using the post hoc LSD test (Jaba, 2002). Presented in **Table no. 3**, the results indicate a significant difference between the averages of the capital stakes acquired in the target companies, taking into account the audit opinion regarding the financial statements of the target companies listed on the Bucharest Stock Exchange.

Table no. 4. ANOVA results, considering the acquired share and the audit opinion

(I) Audit	(J) Audit	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
					Lower Bound	Upper Bound
Qualified opinion	Unqualified opinion	2.67929	2.07811	.198	-1.4007	6.7593
	Unaudited company	-3.09125	2.14700	.150	-7.3065	1.1240
Unqualified opinion	Qualified opinion	-2.67929	2.07811	.198	-6.7593	1.4007
	Unaudited company	**-5.77054***	**.62310**	**.000**	**-6.9939**	**-4.5472**
*. Significant at a level of 0.01						

Source: Authors' own projection using SPSS 25.0.

Based on the results obtained following ANOVA from **Table no. 4**, we note that there is a significant difference between the capital stakes purchased in unaudited companies, compared to those purchased in companies for which the audit opinion on the annual financial statements was unqualified. The acquiring companies buy higher shares in the unaudited companies, compared to those that have the correct annual financial statements (sig. = 0.000), which means that the acquirers are interested in the correctness of the data published in the annual financial statements if they want to improve their cash flows. If they buy higher shares, they are not interested in the target company being audited.

Table no. 5. The estimated parameters for the model in equation (1)

Parameters	B	Std. Error	t	Sig.	95% Confidence Interval	
					Lower Bound	Upper Bound
Intercept	9.430	.561	16.820	.000	8.329	10.530
[Audit = Qualified opinion]	-4.732	2.031	-2.330	.020	-8.721	-.744
[Audit = Unqualified opinion]	-4.192	.613	-6.843	.000	-5.394	-2.989
[Audit = Unaudited company]	0[a]	.	.	.	.	.
ROE	-.212	.028	-7.646	.000	-.267	-.158
Mkt	-.006	.002	-4.071	.000	-.009	-.003
Audit = Unaudited company is the reference category R Squared = 0,213						

Source: Authors' own projection using SPSS 25.0.

Considering the parameters from **Table no. 5**, we note that all predictors have a significant influence on the share of capital acquired in the target company. The results show that acquirers buy higher shares in unaudited companies compared to those which are audited. This aspect underlines the fact that investors who buy shares on the Bucharest Stock Exchange and have in mind the security of their investment will take into account the auditor's opinion on the annual financial statements issued by the target company. Buyers also consider the performance of the target company in the case of low quotas, as they are interested in improving their cash flows. In the case of the acquisition of high shares, the intention is to accumulate a significant share of capital. Therefore, in this case, the takeover intention takes precedence over the performance, whether financial or manifested on the capital market.

Table no. 6. The estimated parameters for the model in equation (2)

	B	S.E.	Wald	df	Sig.	Exp(B)
Audit = Unaudited company			39.534	2	.000	
Audit = Qualified opinion	6.369	1.296	24.154	1	.000	583.726
Audit = Unqualified opinion	3.596	.622	33.475	1	.000	36.461
ROE	.072	.013	29.855	1	.000	1.075
Mkt	.006	.001	39.258	1	.000	1.006
Constant (for category Unaudited company)	-4.406	.639	47.487	1	.000	.012
a. Variables considered in stage 1: Audit, ROE, Mkt. b. Cox & Snell R Square = 0,287						

Source: Authors' own projection using SPSS 25.0.

The data presented in **Table no. 6** reflects the fact that, in choosing a blue-chip company, the considered predictors have a positive and significant influence. Thus, the probability of the acquirers to invest in a blue-chip company is positively influenced by the existence of an audit report, but also by the financial and capital performance of the target companies. The intention to invest in blue chip companies is not accompanied by the intention to take over or influence their activity, but by the objective to improve the cash flows of the acquiring company, as a result of the collection of dividends or speculative transactions carried out on the regulated market.

Table no. 7. The estimated parameters for the model in equation (3)

	B	S.E.	Wald	df	Sig.	Exp(B)
Audit = Unaudited company			12.657	2	.002	
Audit = Qualified opinion	22.519	10765.528	.000	1	.998	6026556763.166
Audit = Unqualified opinion	**2.575**	**.724**	**12.657**	**1**	**.000**	**13.128**
ROE	-.088	.106	.688	1	.407	.916
Mkt	.005	.006	.808	1	.369	1.005
Audit = Unaudited company * ROE			2.408	2	.300	
Audit = Qualified opinion * ROE	-8.101	2645.856	.000	1	.998	.000
Audit = Unqualified opinion * ROE	**.167**	**.107**	**2.408**	**1**	**.121***	**1.181**
Audit = Unaudited company * Mkt			.048	2	.976	
Audit = Qualified opinion * Mkt	-.004	192.923	.000	1	1.000	.996
Audit = Unqualified opinion * Mkt	.001	.006	.048	1	.826	1.001
Constant	-3.461	.702	24.332	1	.000	.031

a. Variables considered in stage 1: Audit, ROE, Mkt, Audit * ROE, Audit * Mkt.
b. Cox & Snell R Square = 0,299
c. * significant for a 0,15 risk level

Source: Authors' own projection using SPSS 25.0.

Considering the combined influence of the considered predictors, we notice a change in the influence of financial performance on the probability of choosing a blue-chip company, compared to other companies. If the target company proves inefficiency in using its equity, then the loss has a negative influence on the probability of choosing an investment in the best listed companies on the Romanian capital market.

Conclusions

The acquiring companies, which are involved in acquisitions on the Bucharest Stock Exchange, show a behavior dictated by two directions of action. On the one hand, they buy high stakes in target companies, preferring companies that are not audited. In our opinion, this leads to the conclusion that the intention is to involve in long-term investments and to influence the activity of the acquired companies. The fact that the acquirers are not interested in the existence of an audit report indicates that they are not interested in the quality of the information reported by the target company, but its object of activity and how its assets and activity may influence the financial situation of the acquiring company in the future. In this sense, we have in mind future studies that will follow the influence of the core activity and its relation with that of the acquiring company on the share of capital acquired on the regulated market in Romania. On the other hand, low capital shares are acquired in companies that show a high financial performance on the capital market. Proof of this is the return on equity and the market capitalization, which significantly and also negatively influence the share of capital purchased in the target companies listed on the Bucharest Stock Exchange. The results of the study also show that the audit opinion, whether qualified or unqualified, positively influences the option for blue chip companies, but only the unqualified opinion has a positive and significant influence in this regard. If we consider the combined influence of predictors, we see that financial profitability has a positive influence on the decision to invest in a blue-chip company, given that the opinion on the annual financial statements is unqualified.

In conclusion, the behavior of the acquirers on the Bucharest Stock Exchange is oriented either to buy securities in unaudited target companies, in order to keep them, or to invest in audited companies, in order to improve their cash flows through dividends. or speculative actions.

As future research directions, we consider the analysis of the influence of the core activity of the two companies involved, in order to conclude whether or not it has a significant impact on the investment decision of the acquiring companies, which are involved in acquisitions on the Bucharest Stock Exchange.

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