

TRENDS IN CONCENTRATION OF PRODUCTION AND THE CAPITAL BY MEANS OF MERGERS AND ABSORPTIONS IN THE POST-CRISIS MARKET ENVIRONMENT

DARIA BELYAEVA

Saint Petersburg state university of economics and finance, Russia

ABSTRACT

Processes of technological production concentration basis and capital centralization become the characteristic feature of general economic dynamics of the post-crisis period and transformation of the market sphere. Such processes dynamically develop in all developed countries of the world. Their trend depends on a lot of circumstances: market conditions, the constructive help of the state (state corporation), development of financially-bank system and etc. The author considers only the mechanism of processes of merge and absorption among all this system of concentration and characterizing their positive and negative influence on the general market conditions.

JEL CLASSIFICATION & KEYWORDS

■ O16 ■ Competition ■ M&A ■ Absorption ■ Association ■ Stimulus ■ Concentration ■ Scale effect ■ Monopoly ■ Market share ■ Labor productivity growth

INTRODUCTION

The transformation of economic system post-crisis economy of last decade dynamically occurs all over the world on the basis of large-scale use of mechanisms for realization of a structural, investment, financial, innovative policy at all levels of functioning economy and social sphere. Unfortunately, these processes develop in Russia not so dynamically as it would be desirable and it is necessary.

Without concerning many reasons of such rather slow dynamics, we will notice that they basically are connected with prevalence of sectors of power resources extraction and their realizations abroad, weak growth of mechanical engineering branches, metal working, use of knowledge and experience of a modern science and foreign practice.

However, in our opinion, delay of a trend of the economy general growth also is caused in many respects by the reasons which are connected with incomplete use of market mechanisms of scales consolidation, volumes, the sizes of enterprise structures and competition possibilities as organizational mechanism of management, competitiveness and, in this case, absence of workings out of priority market strategy on the nearest and remote prospect. The majority of the Russian corporations try to find the ways of extensive growth for mobilization of interval reserves. And such companies poorly use possibilities of technological and economic concentration of productions and the capital as for stimulation of its own production, and adjacent kinds of manufacturing of the goods with the high added cost on the basis of cooperation and association.

Processes of M&A and the choice of strategic policy

Corporate associations at the given stage of economic growth undoubtedly promote decrease in expenses, increase of culture of production, and the main thing, create the material-economic basis of a constructive competition development.

Such integrations which are carried out by various methods, ways and forms, undoubtedly, promote the general economic growth of post crisis economy.

The most widespread form of these integrations are merges and absorption.

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The competitive environment is always objective condition of merges and absorption, or to be exact – changes which it brings in technology and structurization of branches. Competitiveness allows, and here we can say even compels the companies and organization to involve the investment more likely, to find a new strategic approaches in management, to use and reduce production costs more effectively, without reducing thus quality of let out production.

For this reason merges and absorption with a view of creation of corporate associations after an economic crisis of 2008 can be considered as one of possibilities of a successful exit of the Russian companies and the organizations on the world competitive market. According to the Analytical portal Mergers.ru (Merges and Absorption in Russia) 58 similar transactions with cost volume in \$4,2 billion have been fixed only for the period of 2008-2010 years.[1]

So, in our opinion, merges and absorption in the market sphere should be considered as one element of an overall strategy for enterprise development, aimed at ensuring the competitiveness growth mainly due to incomplete use of the business, appearance of the effect of production scale, monopoly and the possibility of entering new markets. Under these conditions, the very effectiveness of merges and absorption is one of the mechanisms and factors determining the competitiveness of production, primarily by reducing production costs, to some extent affects the competitiveness of the economic system.[2]

Any business integration occurs when you create a corporation or stock companies which are merged separate economic units [3]. And here the organizations may use different methods and mechanisms for its development. For example, in the post-crisis development, they have to enlarge the capital for more efficient use and further gains in the market. All this leads to an increase in the monopolization of the economy. In actual practice, there were two main forms of scaling up production and capital growth:

- The concentration based on the accumulation and expanded reproduction, when the process of capital investment "in the business." Some authors call this process the actual concentration,
- the strategy and tactics of merges and absorption of competitors.

In the study of the market of merges and absorption we have identified the most common types of merges and a few basic types of merges [2].

These are horizontal merges, which represent one industry association of companies producing similar products or engaged in the same stage of the production process. In transactions of this type is important to note that such merges occur frequently combining competing companies.

In this case, there is a strengthening of market power of the newly established company, and this in turn may raise antitrust authorities, as well as market power means that a company can influence the economic situation in the market. When the horizontal integration of the newly established company size increases, proportionally

increases the proportion occupied by the market and, consequently, increased market power, the ability to raise prices for the products and generate more revenue.

As the examples of the mergers on the Russian market of this type we can lead the merger "LUKOIL" and "KomiTEK" in 1999, in February of 2011 holding "Wimm-Bill-Dann" announced the purchase of JSC "Holding Company "Opole" in Central Russia, in USA - «Hewlett Packard» and «Compaq».

There are also vertical mergers, an amalgamation of companies operating in different industries and represent a single technological chain. This integration is usually characterized by large enterprises for industry (metallurgy, machinery, petroleum, etc. on). In the case of vertical integration of the expansion can take place by the addition of both companies involved in previous stages of the production process, as well as companies engaged in sale of goods by the consumer. As an example of this type of association may be noted Holdings, formed in the Russian market in the industry (e.g., "Russian Aluminum" and "Severstal").

The literature notes, and other form of integration, called conglomerate mergers. They represent the integration of companies working in different industries that are not competitors, buyers or sellers of products to each other. Among conglomerate mergers sometimes produce varieties. For example, a merger with the expansion of product line (connecting non-competing products, sales channels and manufacturing process which are similar) or a merger with the expansion of the market (in this case is acquired additional channels of sales). Also observed and pure conglomerate mergers - an association of companies that do not have any community.

Vertical and horizontal integration - a typical example of direct centralization of production in which the object of investment in the form of mergers and absorptions are the means of production. As a rule, all the integrations cause the transformation of the market sphere.

Distinguish mergers depending on the nationality. [2]. We say that among them are:

- National mergers - the merger, operating in the territory of a state,
- transnational mergers - mergers, located in different countries. In the Russian market in recent years, the prevailing trend is to implement these types of mergers, as evidenced by the growth of capital investments in January-June 2011, which increased by 2.7% versus the same period the previous year [5].

In practice of the Russian business today there are deals like mergers and absorptions of companies. By kinds of absorptions are the following:

- Absorption, which results in the acquisition of a controlling stake,
- bankruptcy of the company, followed by the acquisition of assets,
- establishing control over the management of the enterprise entity representing the interests of the owner of a large block of shares.

It must be stressed that at fulfillment of transactions M&A are conducting thoughtful integration process. It is always a guarantee of achieving the goals as well as mergers and absorptions can lead to success as well as to large adjustment costs, as well as financial losses. Companies seeking to rapid growth, it is escalated through mergers,

expecting significant cost savings and increased speed. In this case most likely to occur synergistic effect, meaning that the value of the combined company will be higher than the sum of the costs of companies before the merger. As a rule, it is declared as a primary objective in mergers / absorptions in most cases. The synergistic effect may occur for various reasons: economies of scale of activity, a combination of complementary resources, increase market share, cost savings, etc. Managers of organizations must be borne in mind that part of the reason may lie in the erroneous financial calculations and estimates of the market or in the wrong strategic choice of partner for a merger or absorption [6].

By analyzing the concentration of capital and production through the implementation of transactions M&A, it is important to emphasize that such transactions are not always effective and do not always bring profit to companies undertaking integration. Among the main reasons for the ineffectiveness M&A at the present stage of development of Russian business, in our opinion, are the following:

1. Establishing priority of the process of M & A on getting the result as a synergistic effect (financial, technological, marketing, etc.) - the desire of top managers and major shareholders to participate in public, public interest, big deal, get positive PR and the satisfaction of personal ambition,
2. lack of clear targets of M & A,
3. error in determining the potential effects of integration on all levels of planning (often in a strategic point of view),
4. incorrect choice of a particular object in the transaction (the discrepancy of actual characteristics participating companies to the characteristics which are planned),
5. change guideline and resource prosperity transaction participants in the implementation process,
6. changes in the macroeconomic situation,
7. lack of expertise of specialists, organizing and executing the transaction, including the stage of integration sites.

Changes of the situation on the M&A market in Russian Federation

By analyzing the transactions in the country of the last year on the market of mergers and absorptions it can be noted a tendency to increase passing transactions of this kind, although their volume is not yet the same extent as in the international practice. The leaders of the Russian companies tend to the enlargement of the amount of its capital to enhance the competitiveness of both the local and international level. So, in May 2011, the total capacity of the Russian M&A market has changed markedly. Experts of analytical group of M&A-Intelligence Magazine "Mergers and Absorptions" recorded 21 deals worth 3, 51 billion. This is more than in April 2011 by 17.4% and by 22.3% more than in May 2010 (see Table 1.) [7].

In May 2011 on the Russian market recovered several major transactions. Thus, in the middle of June this year, "Uralkali" announced the completion of the transaction to merge with "Silvini" and created a new structure of the share capital of the company, but the transaction is not included in the rating of M&A-Intelligence, because she was wearing, essentially, technical in nature.

The largest transaction was the signing of the agreement with Sberbank and shareholders of "Troika Dialog" to acquire 100% stake in the investment company. In the future, the transaction will take place in several stages and the parties still need to obtain regulatory approval in Russia and other countries in which the "Troika Dialog" is active.

Table 1: Changes of the situation on the M & A market in Russia (2010-2011)

Month	The volume of transactions, billion dollars	Change from previous period, %	Number of trades	Trend
2010				
January	1,78	-76,0	13	↓
February	3,35	88,2	21	↑
March	2,04	-39,1	20	↓
I quarter	7,17	-43,1	54	↓
April	2,42	18,6	23	↑
May	2,87	18,6	15	↓
In total January–may	12,46	-19,9	92	↓
June	9,97	247,4	28	↑
II quarter	15,26	112,8	66	↑
July	0,91	-90,9	14	↓
August	3,34	267	25	↑
September	3,54	6	25	↓
III quarter	7,79	-49,0	64	↓
October	4,88	37,9	25	
November	2,44	-50,0	24	↓
December	6,77	177,5	23	↓
IV quarter	14,09	80,9	72	↑
In total	44,31	3,6	256	↓
2011				
January	1,76	-74,0	17	↓
February	2,02	14,8	19	↑
March	3,94	95	24	↑
April	2,99	-24,1	23	↓
May	3,51	17,4	21	↓
In total, January–may	14,22	14,1	104	↑

Source: Experts of analytical group of M&A-Intelligence Magazine "Mergers and Absorptions"

Company "VimpelCom" has issued the second-largest deal, agreeing to purchase 100% of the seaside "New Telephone Company" (NTC), a member of the top ten mobile operators in the country. "NTC" as one of the last major operators, for sale, and in purchasing are also interested competitors of "VimpelCom" by the "big three" MTS "Megaphone", and "Rostelecom" and Tele2.

In the third by the cost of the transaction this year, Russia sold at auction a controlling stake port operator "Vanino Commercial Sea Port" to company "Seltehsstroy" at a cost far exceeding the initial value.

The data which are presented in table 1 shows that in 2011 is the dynamic growth of M&A transactions both in monetary and quantitative ratio compared to 2010. Of course, there are trends of rising and falling, but in general M&A market for the first half of 2011 indicators over the same period in 2010.

Review of mergers and absorptions in Russian market for the third week of September 2011, prepared by the analytical group «ReDeal», shows the trends of growth and development of this market. According to a survey for the period recorded 14 completed transactions; 8 deals in the process of registration and 8 deals being negotiated.

Conclusion

It should be noted that the Russian market of mergers and absorptions is considered one of the largest and most dynamic in Eastern Europe, but in terms of specific processes occurring on it is very different from the U.S. and from European markets. In the European market a top priority when buying a company is given to the new technologies available to the acquired company, ie, there is actually acquired knowledge, while Russia is still a tendency in transactions only beginning to emerge and grow.

When acquiring companies in the Russian market of mergers and absorptions more prevalent speculative tendencies, above all a desire to acquire material gain. The most attractive target company absorptions are a major industry with access to natural resources, as well as companies that own large real estate, which is typical for large cities such as Moscow.

A distinctive feature of the Russian market is also the presence of hostile mergers and absorptions, which of course does not contribute to its further development. This is due to many aspects, including a large or lack role of government in regulating these processes, as well as the imperfection of legislation.

According to many authors, for the success of M&A market in Russia, corporate leaders need to clearly work out a strategy of the upcoming merger or absorption, to assess all possible angles and losses that may result from the transaction. Also at the present stage of market transformation companies need to move on to the lines of innovative development and the path of post-industrial growth, relying not so much on the industrial sector but on the technologies that are used in industries, as well as the social aspect.

At this stage, "since the revolution in information technology," the question of preparation of highly qualified staff who are able to generate, manage and effectively use information based on knowledge, it becomes very relevant. This implies no reduction in the concentration of capital and production in the real economy, but rather increases its growth as a result of new technologies, which corresponds to the general positive trend of growth of capitalization of the post-crisis economy.

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