



International Economy

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**TNC STRATEGIES:
MERGERS AND ACQUISITIONS**

Abstract

The paper presents the essence, the prerequisites of mergers and acquisitions; it singles out modern trends of mergers and acquisitions, namely the development of the social component of enterprise integration; also the operations are analyzed in merges and acquisitions throughout the whole world and in Ukraine, in particular.

Key words:

Merges and acquisitions, integration.

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«There is a «gin rummy school of management» ... you pick up a few businesses here, discard a few there. The sad fact is that most acquisitions display an egregious imbalance – they are a bonanza for the shareholders of the acquiree; they increase the income and the status of the acquirer's management; and they are a honey pot for the investment bankers and the other professionals on both sides. But alas, they usually reduce the wealth of the acquirer's shareholders, often to a substantial amount».

Warren Buffet,
Chairman Berkshire Hathaway

Relevance. Increased interest in cross-border transactions of mergers and acquisitions as a form of internationalization recently became a crucial prerequisite for M&A research. In recent years there has been observed a growing intensity of consolidation both, in Ukrainian and world market of mergers and acquisitions. At the same time, current market challenges form the new requirements for those operations to succeed. With this aim in view, mergers and acquisitions as the integration processes should be implemented on the integrated approach for assessing the economic and social efficiency.

The aim of the article is to study the nature and purposes of merger and acquisition strategies in today's business world and, on this basis, to distinguish the current trends in the market of merges and acquisitions throughout the world in general and Ukraine, in particular.

To meet this goal, the *following objectives* were determined: to investigate the nature and causes of mergers and acquisitions; to analyze current trends of mergers and acquisitions operations both, in the global and in Ukrainian markets; to distinguish current urgent issues of mergers and acquisitions strategies; to assess the mergers and acquisitions in Ukraine.

Considerable number of researches, both of domestic and foreign scientists and researchers was devoted to the problems of merges and acquisitions, namely by: O. Kuzmin, R. Shuliar, I. Tomashevskaya, Yu. Brihkhem, R. Brrail, S. Mayyers, O. Bilorus, A. Halchynskyi, V. Heyets, B. Hubskeyi, A. Kredisov, D. Lukianenko, V. Kuryliak, Yu. Makohon, S. Mochernyi, O. Mozhovyi, V. Novytskyi, B. Panasiuk, Ye. Panchenko, Yu. Pakhomov, A. Poruchnyk, O. Rohach, V. Rokocha, L. Rudenko-Sudareva, M. Rubtsov, A. Rumiantsev,

Ye. Savelyev, V. Sidenko, S. Sidenko, N. Tatarenko, A. Filipenko, O. Shnyrkov, I. Shkola and others.

Mergers and acquisitions (M&A) is a popular way to ensure a company's growth, and a prerequisite for the creation of new organizational forms of international companies. By implementing strategies for mergers and acquisitions the companies provide on the one hand, the protection of their interests, and on the other – the actualization of competitive advantages.

In the broadest sense of the concept, merging means the integration of two or more organizations into the new one, providing for a complete transfer of assets and liabilities from one company to another, or uniting of two companies into one economic unit (Weston and Weaver, 2001).

Acquisition is purchasing of shares or assets of the company to strengthen control over it (the European Central Bank, 2000; Hagedoorn and Duysters, 2002).

When a company establishes control over another company and announces that it has become the new owner of the latter, that transaction is called absorption. Legally the acquired company stops its existence, the buyer absorbs all business, and the shares of the buyer still are listed on the market. The merger, in its turn, is called the process when two companies, often about the same size, decide to continue their business as a new company rather than to remain different companies owned and managed by different people [7].

Mergers and acquisitions (M&A) of the companies are a set of actions aimed at the growth of total assets at the expense of synergies, i.e. and the benefits of common activities. In other words, the mergers and acquisitions describe the transformation of the two companies into one. Merges is the emergence of a new company as a result of uniting of the two equal companies, and acquisitions is buying a company that is absorbed by the absorbing company, resulting in the absorbed company ceases to exist, while the absorber extends [8].

All transactions of mergers and acquisitions (by Hubbard) are divided into two kinds of corporate acquisitions: (1) friendly mergers and acquisitions (accepted by the Boards of Directors of companies), (2) hostile, organized by the competitors (non-accepted).

The main reasons for M &A include the following:

- M&A as a response to the need for shocks in specific areas, either redistribution of assets (Harford, 2005);
- saturation of domestic markets in goods and services, or seeking expansion into new markets, promotion of new researches and developments (Bower, 2001).

Due to merging the companies hope to benefit in the following:

- economies of scale actualization;
- absorbing of new technologies through the acquisition of both, big and small companies with advanced technologies;
- increase of market share (Dela Mano, 2002).

International practice in formulating and implementing strategies for mergers and acquisitions tends to distinguish two main reasons for their implementation, namely, the diversification and development of organizational structures.

Considering the first prerequisite, that is, diversification, we can observe that it takes place under condition when:

- the company develops and implements the growth strategies related or focused on implementing the principle of geographical dispersion of production, that is, «shredding» of the production process at the supranational level;
- the company develops and implements the strategies by using Ansoff matrix. Ansoff argued that the company should choose diversification as a vector of growth, when the target and goods produced are new for it. He identified four main reasons for diversification, including:
 - the set goals do not match the scale of the existing portfolio of produced products;
 - retained earnings exceed total costs within the existing portfolio of products;
 - diversification strategy is more profitable than the strategy of expansion;
 - the corporation is governed by the principle of «in the garden of a neighbor the grass is greener» [9].
- the diversification discounts occur;
- one of the two following measurements for categorization is present:
 - concentric (concentration), horizontal, vertical, conglomerate;
 - passive (protective) or active (offensive) position.

The organizational structure as a key element for building the organization plays an important role in the formation and implementation of strategies for mergers and acquisitions: its definition, dimensions of organizational structure; organigramme (block diagram of the organizational structure (system) forms of organizational structure.

In international business the following forms of building structures are distinguished:

- U – form;
- M-form;
- H-form;
- X-form;
- matrix structure.

Organizational structure as a «skeleton» of any organization requires keen attention in the process of its formation. The organization, regardless of whether its operation is only planned, or it is already functioning, should have a clear idea of competence, duties and responsibilities, their boundaries in order to build or improve an effective organizational structure. So, we know the following dimensions of the organizational structure of the economic entities that position their business outside the country of origin. These include: specialization, standardization, formalization, centralization, configuration flexibility, etc.

As for the organigram, it allows to schematically showing the structure of the organization and thus, to facilitate the perception and understanding of communications, the required number of workers as well as their competence, authority and responsibility. In its turn, this enables to determine the direction of the authority delegation to ensure higher quality and efficient operation of the entire organization.

The probability of M&A succeeding is a very important issue. Not only scientists and researchers are interested in it, but also managers who make decisions on further activity of the company. Typically, a potential buyer in making a final decision on the choice of the acquiree, assesses its assets, inventory of contracts and agreements with suppliers and so based on the principle of *due diligence*. This assessment is intended to provide further probable synergies.

However, the companies often do not include the analysis of such components as evaluation of human resources (organizational knowledge, technical ability, creativity, experience, etc.). More sophisticated and statistically minded companies carefully pay attention to the assessment of corporate culture and organizational compatibility. In practice, human capital assessment is often conducted only after the contract of sale has been signed or in case of the first problems of integration have arisen. As noted by Schuler and Jackson (2001), the cause of unsuccessful mergers and acquisitions is a failure of integration, in fact, because of incompatibility of organizational cultures as a result of their inadequate analysis.

In modern scientific literature on strategic management the evaluation of intangible resources and the knowledge transfer becomes more and more urgent. Designing of organizational culture and policy of human resources is one of the main problems when creating a new organization. Also, it is important to cre-

ate favorable social, cultural, technical and economic conditions for successful organizational design or, in other words, building of effective / efficient organizational structure.

Stages of a merger or acquisition integration are usually carried out at several levels: (1) operations (2) business (businesses), and (3) cultures.

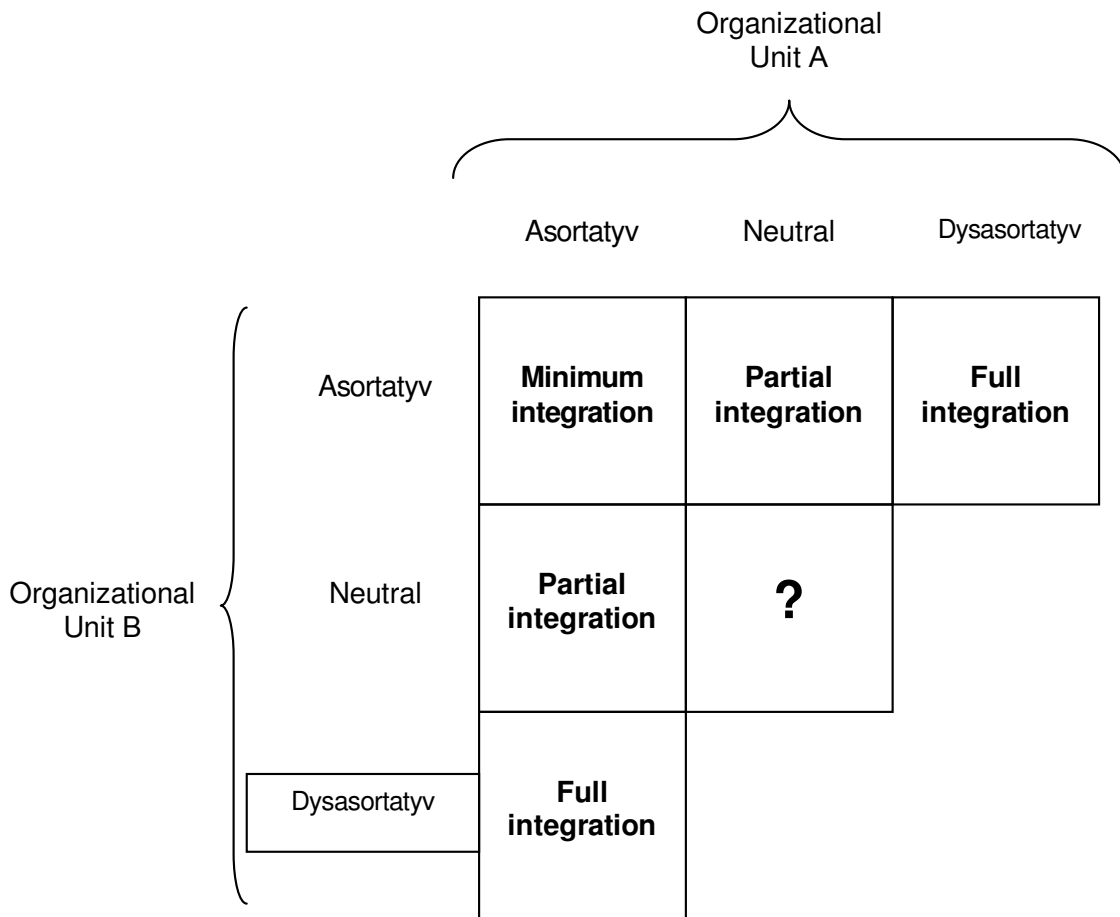
In the scientific literature, there are the following types of integration distinguished depending on the set goals:

- full integration: in this case, all kinds of counterparty enterprises are integrated according to the agreement; the introduction of the management models of the parent company at the acquiree, i.e, the management system is fully integrated in the acquired company;
- partial integration: as a result of the adoption of this kind of integration, some economic functions are combined, the control over certain areas is performed by the buyer, but the economic activities of the organization remains independent; some elements or a different degree of integration of the management system of the acquired company, for example, accounting and methodology standards are integrated with the acquiring company, and in product development the acquiree's approaches are used , that is, it independently performs the developments;
- minimum (zero) integration: some functions of enterprises are combined, first of all, to have certain economies in workers' wages; the target organization takes administrative decisions independently, but for a defined reporting to the acquiring company; the acquiree, still operates as an independent company portfolio; the company-buyer affects only some minor elements of the control system.

One more problem concerning M &A is determining the actual value of the contract object. Because of the subjective factors, vision or assessment of the actual cost of the acquiree is different, though there are different methods of assessing the value of the company which has to be purchased, such as comparative figures, the method of discounted cash flows, balance sheet analysis, method of liquidator's assessment, and others. As mentioned before, none of these methods evaluates human capital, rather than characterizing the organizational culture.

As a result of the M&A social component study, Fabac, R., Schatten, M., Đuričin, T, offered their organizational model of integration (see Fig. 1).

Figure 1
Integration model based on associativity [1]



The model presents two M&A participating enterprises: A and B, and distinguishes three degrees of similarity between counterparty enterprises of M&A transactions. If the companies can be called «similar», then according to this model, they are identified as *asortatyv* organizational units, if they are partially similar – *neutral*, if dissimilar – *dysasortatyv*. The similarity in this model should flow not only from economic analysis, but, first of all, in the systems of management, levels of organizational cultures (especially on the management system’s priority values) and its function approaches, and the availability and potential of human capital.

This model is focused on social inclusion of the capabilities formation to maximize the network cohesion.

Indeed, many statistical data indicate that successful cultural integration is necessary for the company's operation. The studies show that 80 percent of international M&A risks are associated with poorly managed cultural integration. Managers tend to focus on assets such as finance, at the same time neglecting the problems of culture. In today's multicultural business environment, executives and managers face the problems of cultural integration needing, which is very important, a comprehensive action plan [2].

There some changes have occurred in the volume and geography of M&A implementation in a global scale. Thus, in 2012 the total amount of claimed and made M&A agreements in the world fell by four percent compared to the previous period.

Thomson Reuters Agency estimated that in 2012 worldwide, it was announced that mergers and acquisitions amounted by 2.4 trillion. USA dollars. The most active were the US companies, where the economy is not so much under the effects of the European debt crisis. Thus, the transactions involving the U.S. companies accounted for 49% of total M&A, and the European companies made 28%. However, the observed decline in transactions was observed in both markets: the United States announced the agreements amounting to \$ 881 billion. (-8%), and the decrease in Europe was 3%. Although, in the IV quarter there was a revival, The M&A global volume of transactions amounted to 660 billion dollars, which is 15% more than in the III quarter, and 16% more than in the IV quarter of 2011 (see Fig. 2, Table 1). [10]

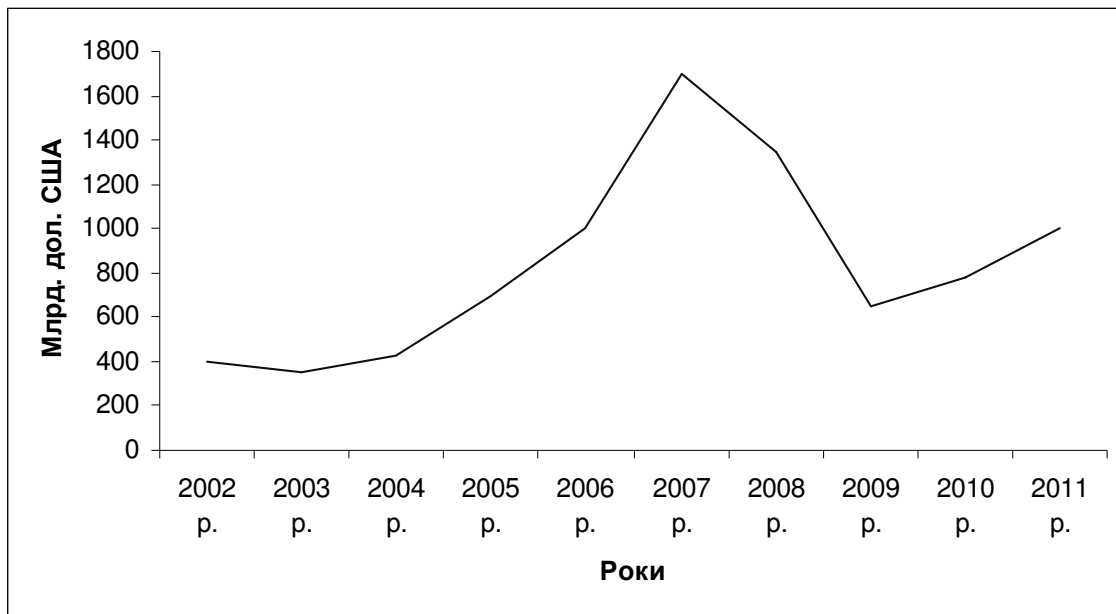
Concerning the developing countries, there is also a decrease in M&A observed by 16% and made 12% of the total global volume. The leader among these countries is China, whose companies took part in 37% of M&A transactions on the emerging markets. China is followed by South Korea (12%), Brazil (10%) and Russia (9%). It is worth noting that within two last years China has become one of the main sources of foreign investment into the Latin American and the Caribbean States (ECLAC).

As far as the sector of M&A direction is concerned, the largest number of M&A occurred in energy (19%), finance (11%) and manufacturing sectors.

Another feature of the market was that the greatest deal (55.3 billion. U.S dollars.) was not a merger, but a division of American Pharmaceutical Holding Abbott Laboratories: Abbott is the production of medicines and medical equipment; AbbVie is the research activities. In general, the volume of transactions in the distribution of the companies into a part of operations, either separation of operations into separate structures was 1.1 trillion. US dollars accounting for 47% of total M&A transactions. A record high starting from 1992, share of transactions in the division can be explained by the desire of enterprises to simplify corporate governance and increase efficiency [10].

Figure 2

Cross-border M&A worldwide



Source: [4].

Consequently, international M&A is a demonstration of investment stability under condition of instability against the background of crisis escalation of sovereign debts in Europe, and weakening of the economy in the United States. Most international investments continue to come either from North America or Western Europe. However, the emerging markets have become a new important worldwide source of foreign investments in recent years, including these due to the M&A.

China (including Hong Kong, China), in particular, became a major international investor, ranking the fourth-largest source of international M&A in 2011, with 7% of the world total volume. In 2010 it took the second place with 10%.

Although the M & A declined in the global market, it is forecast to increase by 2014 (see Fig. 3).

As for Ukraine and its place in the global M&A, it should be noted that Ukrainian companies have intensified their activities in foreign markets. In particular, as it is presented on the forbes.ua site the largest Ukrainian M&A transactions made abroad include the below (Table 2).

Figure 3

Methods of entering foreign markets

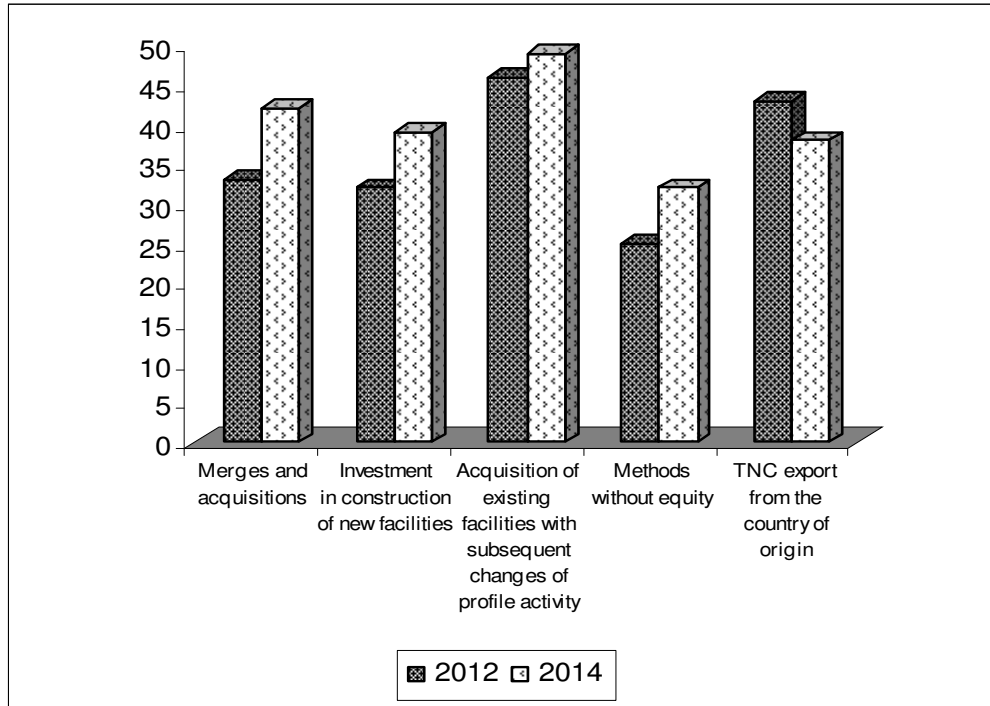


Table 1

Foreign companies M&A, 1996–2011 (Number of deals and their value)

Years	Gross international M&A				Net international M&A			
	Number of transactions		Costs		Number of transactions		Costs	
	Number	Share in total volume, %	Billion US dollars	Share in total volume, %	Number	Share in total volume, %	Billion US dollars	Share in total volume, %
1996	932	16	42	16	464	13	19	14
1997	925	14	54	15	443	11	18	10
1998	1089	14	79	11	528	11	38	9
1999	1285	14	89	10	538	10	40	6
2000	1340	13	92	7	525	8	45	5
2001	1248	15	88	12	373	9	42	10
2002	1248	19	85	18	413	13	28	11

Years	Gross international M&A				Net international M&A			
	Number of transactions		Costs		Number of transactions		Costs	
	Number	Share in total volume, %	Billion US dollars	Share in total volume, %	Number	Share in total volume, %	Billion US dollars	Share in total volume, %
2003	1488	22	109	27	592	20	53	29
2004	1622	22	157	28	622	17	76	33
2005	1737	20	221	24	795	16	121	26
2006	1698	18	271	24	786	14	128	20
2007	1918	18	555	33	1066	15	288	28
2008	1785	18	322	25	1080	17	204	29
2009	1993	25	107	19	1065	25	58	23
2010	2103	22	131	18	1147	21	65	19
2011	1900	19	156	15	902	16	77	15

Source: [5].

Table 2

Six Major Transactions Ukrainian Companies Made Abroad

No	Year	Buyer	Transaction cost	Size of package	Object
1	2008	«Metinvest»	€ 1150 mln.	100%	Trametal SpA (Italy) Spartan UK (Great Britain)
2	2009	«Metinvest»	US \$ 900 mln.	100%	United Coal Company (USA)
3	2007	Palmary Enterprises	US \$ 600 mln.	60%	Consolidated Minerals (Australia)
4	2009	EastOne	US \$ 361 mln.	100%	CK «Rossiia» (Russia)
5	2012	СП Kernel Glencore	US \$ 265 mln.	100%	Terminal «Taman» (Russia)
6	2008	Mickiland	US \$ 66 mln.	75%	OAO «Ostankino Dairy Plant» (Russia)

Source: forbes.ua.

In comparison with the world market, some buoyancy is observed on the national market (see table 3).

Table 3

Ten Largest M&A Occurred in Ukraine in 2012 (excluding privatization)

No	Buyer	Transaction cost	Portfolio size	Object
1	CKM	US \$ 480 mln.	80%	«Lemtrans»
2	Feedobank	US \$ 83 mln	100%	ErsteBank
3	Smart-Holding	US \$ 80 mln	96%	Bank «Forum»
4	???	US \$ 80 mln	100%	Pharmaceutical group «Zdorovia» («Health»)
5	Glencore	US \$ 80 mln	100%	PAT «Kolos» «Ear»
6	Kernel	US \$ 70 mln	100%	«InterAgro»
7	???	US \$ 70 mln	100%	Kramatorsk ferroalloy factory
8	Smart-Holding	US \$ 60 mln	10%	Frunze NPO
9	«Urozhai» («Harvest»)	US \$ 60 mln	80%	«Korovai» («Loaf»)
10	Ostchem	US \$ 34 mln	58%	UkrAgro-NPK

Source: forbes.ua.

Ernst & Young on the basis of the criteria of conditions simplicity (conditions are evaluated according to 23 factors, including regulatory, political, financial and economic conditions, technological development of the country, the development of labor market, infrastructure and so on.) for making M&A deals formulated ratings of the countries by level of their market «maturity» for M&A transactions (see Table 4) [6].

The higher maturity (max = 100) is, the lower risks of M&A transactions made in the country are, and the more actively are implemented such processes as both, between «home» and foreign companies.

The competitive advantages of the Ukrainian market for foreign investors are a skilled labor force, presence of potentially profitable assets. However, it is difficult to identify either foreign capital actually inflows into Ukrainian economy, or it outflows abroad to be registered there in the economic entities.

¹ Information on the buyer is absent.

Table 4

Country	Rating	Market maturity for M&A, %
South Korea	5	81
China	9	79
Thailand	17	73
Malaysia	18	73
United Arab Emirates	20	72
Czech Republic	21	71
Russia	28	68
Poland	30	66
Chile	32	66
Brazil	34	65
Turkey	37	64
India	38	63
Kazakhstan	40	62
Mexico	41	62
Qatar	45	61
South Africa	49	60
Vietnam	50	60
Indonesia	51	60
Ukraine	52	59
Saudi Arabia	59	58

Source: author's development based on forbes.ua.

In conclusion, we can say that mergers and acquisitions is the integration, when agreement signing is not a final, but rather initial stage, and includes activities aimed at adjustment of the organizational structure, business processes and goals of the firms merging. Proper organization of human resources is an important step in the integration process. And really we can not help agreeing with the idea that mergers and acquisitions is a kind of card game of «rummy», when you can buy and raise business in one country and «discount» (sell) it in another one.

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