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Fakulta informatiky a managementu

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FOREWORD

The Faculty of Informatics and Management, University of Hradec Králové, The Department of Economics organised on 4. - 5. 2. 2014 12th international conference Hradecké ekonomické dny 2014 (Hradec Economic Days, HED 2014).

The aim and intention of the conference are to present the results of scientific research activities in the fields of economics, business economics and management, creating a platform for regular encounters of experts of related fields, strengthening relationships and research, establishing personal contacts so important for submission of joint research projects and creation of space for presentation and publication of young teachers. The HED 2014 conference meets all these requirements.

Five parts of the reviewed HED 2014 conference proceedings include 184 papers in Czech, Slovak and Polish, another part of the proceedings presents 116 papers in English. Most papers were registered in the section of Business economics and management and of Economy and Management of Enterprises and Regions.

The papers were divided thematically and discussed in eight sections.

1. Latest issues in the banking and financial markets
2. Regional development macroeconomic context
3. Tourism economics
4. Business economics and management
5. Economy and management of enterprises and regions
6. Ekonomia i zarządzanie regionów i przedsiębiorstw
7. Mathematical models in economics
8. Modern trends in management

I would like to thank all those who contributed to the preparation of the conference, members of the scientific, organisational and programme committee. Many thanks go to the reviewers and editor for the preparation and publication of the proceedings.

I believe that the Hradec Economic Days conference contributed to the exchange of professional knowledge, establishing and strengthening collegial relationships.

Significant achievement and appreciation for the Department of Economics, Department of management and the entire team was the inclusion of the Hradecké ekonomické dny conference proceedings of the years 2005-2011 **in the CPCI database** (Conference Proceedings Citation Index) on the Web of Science. We will also strive to implement the HED 2014 conference proceedings in this database.

Hradec Králové of 13. 1. 2014
Ing. Jaroslava Dittrichová, Ph.D.
Head of the Department of Economics
Faculty of Informatics and Management
University Hradec Králové

INTEGRATION POLICY TOWARDS M&A IMPLEMENTATION IN KAZAKHSTAN

Jan Lojda, Lyudmila Davidenko

Banking Institute Prague, Innovative University of Eurasia

jlojda@bivs.cz, davidenko1m@rambler.ru

Key words:

corporate management – mergers – acquisitions – antitrust policy – economic integration

Abstract:

This paper summarizes the best practices in corporate management, law and integration management based on merger and acquisition transactions. The analysis of modern integration policy of the Republic of Kazakhstan from the perspective of expanding economic ties with Europe has been carried out. A retrospective and contemporary assessment of integration processes in the most attractive sectors of Kazakhstani economy has been given. The recommendations on the formation of process-oriented concept of the company's growth based on merger and acquisition transactions have been developed.

Introduction

The analysis of Kazakhstan's practice in mergers and acquisitions shows that the most common type of M&A is "acquisition", where the target company maintains its existence, and the result of the transaction is only a change of shareholders (participants). This is due to the fact that Kazakhstan's experience in market relations, including the transactions of mergers and acquisitions, has launched since the independence in 1991. Currently, when making corporate transactions in Kazakhstan, managers often draw on the experience from Russia and countries of the European Union, including its positive features and negative consequences.

The retrospective evaluation of stages of development of M & A market is shown in Table 1. The basis of the typology is the annual periodicity with singling out the sectors - leaders in the number of transactions.

TAB. 1: Periods of Formation of Kazakhstan’s Market of Mergers and Acquisitions

Period	Sectors – leaders of M&A market	Characteristics of a period
1990-1996	Sectors of economy in general	Privatization with giving the document proving the right of ownership.
1996-1998	Mining and smelting complex, machine-building, oil and gas, petrochemistry	Gaining the control over the enterprises of state sector through the realization of collateral bonds on state loans.
1999-2003	Mining and smelting complex, machine-building, oil and gas, petrochemistry, estate property	Redistribution of property after crisis to increase the effectiveness of companies. The rise in role of administrative resource and companies of high capitalization.
2004 - 2007	Mining and smelting complex, machine-building, oil and gas, petrochemistry, estate property, power industry, telecommunication, financial sector	Aggressive policy of companies’ growth to diversify the manufacture and to penetrate into new markets.
2008 - 2010	Mining and smelting complex, machine-building, oil and gas, petrochemistry, estate property, power industry, telecommunication, pharmaceuticals, financial sector	Strengthening the activity of the state at the market of mergers and acquisitions as a forced measure to overcome the consequences of the world financial crisis.
since 2011	Mining and smelting complex, machine-building, oil and gas, petrochemistry, estate property, power industry, telecommunication, pharmaceuticals, financial sector	Horizontal and vertical mergers and acquisitions, withdrawal of the state from the controlling interest, subsidiary companies of Sovereign Wealth Fund Samruk – Kazyna JSC. Entrance of national companies to the domestic stock market within the program “People’s IPO”.

Source: own compilation

The analysis of trends in the formation of M & A market in Kazakhstan showed that its formation was determined largely by external factors. The significant ones include the impact of two financial crises in 1998 and 2007. During these periods the role of large corporations and government increased. Most leaders, who appeared in the period of M

& A market activity, which occurred in 2004-2007, still use mergers and acquisitions transactions as a tool for corporate growth.

1. Characteristics of modern integration policy of the Republic of Kazakhstan from the standpoint of expanding economic ties

The world community has large, medium-sized and small firms that are usually seen as social and economic systems forming systems of a more complex level, such as industries, regions, states and other social formations.

The main problems, business entities in Kazakhstan face, can be described as follows:

- an innovation breakthrough and the commercialization of knowledge;
- organization of relations with the research and consulting centers;
- modernization of production;
- introduction of a process approach of management of the resource base, production and sale of products (labor, services);
- combination of several business entities for the purpose of constructing a single technological chain for products and services with high added value.

It can be stated that the integration processes at the macro level entail the need for a mechanism of integration at the level of organizations of both representatives of the real economy and educational institutions (*see Figure 1*).

A progressive example of integration at the macro level is the Shanghai Cooperation Organization (SCO), which originated in 1996 and includes Kazakhstan, Russia, China, Kyrgyzstan, Tajikistan and Uzbekistan. According to the President of Kazakhstan Nursultan Nazarbayev (2011) the share of the SCO member states is at least 25 percent of world oil reserves, 30 percent of world gas reserves and 50 percent of explored reserves of uranium [10]. The priority of the SCO is economic cooperation. The specific features of the economies of the SCO countries are the development of real industrial production, construction of market infrastructure and job creation. The positive effect for domestic businesses from Kazakhstan's participation in the SCO is specified by the possibility of a business combination with China's growing companies.

Describing the economic integration within the framework of the Eurasian partnership, it is useful to note the influence of global trends in the vertical and horizontal companies' growth. The rich information base required for potential partners for joint

FIGURE 1: Content of Contemporary Integration Policy of the Republic of Kazakhstan

Integration policy at the macroeconomic level
with states-members of the European Union, the Shanghai Cooperation Organization within common economic space, the Eurasian Economic Community
Target points:
<ul style="list-style-type: none"> • sustained development and innovation breakthrough; • implementation of joint projects in gas sphere, metallurgy, oil production and processing; in the sphere of space technologies, nanotechnology, microbiology; machine-building and agriculture; • ensuring the equal access to the unified energy and transport systems.
Mechanisms of economic integration:
<ul style="list-style-type: none"> • cooperation, formation of joint companies, transnational corporations; • purchase of solid assets and holding of shares of the enterprises – partners (mergers and acquisitions transactions), outsourcing on mutually profitable agreements; • formation of joint working groups, selection of specialists in the sphere of assessment, development of schemes of purchase of holding of shares and consolidation of capitals through the management companies; • introduction of business – processes in the spheres of advanced technologies.
Innovation prerequisites of integration processes:
integration of educational and scientific space through the Eurasian associations of universities, Eurasian club of scholars, International center of high technologies, consulting centers; entering the international market of innovation projects in the sphere of renewable sources of energy, research of problems of climate changes.

Source: compiled by authors.

management of business appears in the “World Investment Reports” of UNCTAD (United Nations Conference on Trade and Development), reports of the International Finance Corporation and World Bank “Doing business in a more transparent world”.

According to the annually changing method of calculation Kazakhstan in 2012 improved its position in the ranking “Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises” by 7 points (in 2011 according to the method of calculation of 2013 Kazakhstan ranked the 56th place) and took the 49th place. Kazakhstan entered the list of countries demonstrated significant improvements in facilitating business for the last year [8]:

-the rating “Registration of companies”: Kazakhstan rose for 30 positions (from 55 place to 25 place), the simplified procedures of the foundation of enterprises and removal of a claim for payment of minimum capital for three months after registration contributed it;

- the rating “Resolution of insolvency” (55th place): the reforms on introducing the accelerated rehabilitation proceedings, prolonging rehabilitation period, extension of powers and increase of qualification requirements for the trustee of bankruptcy were

conducted; the requirements to provide information on bankruptcy, creditors' rights expansion, changes in the position of continuing operations, the introduction of the period for the adoption of the rehabilitation plan, and addition to the requirements of judicial supervision changed;

- the rating “Getting Credit” (from 97 place to 83 place): the rights of secured creditors through the introduction of new grounds for relief from automatic stay in rehabilitation procedures were strengthened.

Growth of rating position allows judging the improvement of investment climate, mitigation of taxation burden for manufacturers. So, on March 1, 2011, the Law of the Republic of Kazakhstan “On making amendments and additions to some legislative acts of the Republic of Kazakhstan on issues of state property” (2011) came into effect that made changes and additions to some legislative acts of the Republic of Kazakhstan on issues of mortgage lending and protection of rights of consumers of financial services and investors [3]. Such conditions are beneficial to attracting foreign direct investment and integration processes in general.

2. Characteristics of the integration processes in the most attractive sectors of Kazakhstan economy

Economic concentration may serve as an indicator of M & A market. The analysis of the current situation of competition development in Kazakhstan shows that some sectors of economy are over concentrated. In particular, such sectors as railway, communication, air transportation, oil and gas, fuel and energy, pharmaceuticals, as well as the spheres with state participation. The “Program on the Development of Competition in the Republic of Kazakhstan for 2010-2014” (2010) reports about the presence of threats from the monopolies’ side in the country's economy, even if the companies operating in these markets now are competitive.

The growth of the size of a functioning enterprise is equated to the strong side of business, economies of scale, market leadership. The borders of growth are regulated by law. According to the analytical data of the Agency of the Republic of Kazakhstan on Competition Protection (Antimonopoly Agency) it is possible to trace the dynamics of numbers of mergers and acquisitions among the market entities for the period of 2007-2011, *Table 2*:

TAB. 2: Information about the state of economic concentration (according to the Antimonopoly Agency of the RK)

Indicator of economic competition	2007	2008	2009	2010	2011
Number of petitions about granting the consent to economic concentration	360	387	308	313	286
Number of granted permissions	210	224	134	150	120
Number of entities which are in the public register of market entities taking a dominating or monopolistic position (on the state of affairs for the beginning of the period)	754	969	945	612	600

Note: compiled by authors to the source Statistics and reports “On the petitions for the economic concentration” of the agency of the Republic of Kazakhstan on the competition protection (2012).

As compared with 2007 in 2008, the number of permissions for economic concentration has increased by 7%. According to data for 2009 the Antimonopoly Agency (2012) received 308 petitions for consent to economic concentration. Among them, in 110 cases transactions were made in industry, agriculture and other sectors, 106 - in the sphere of fuel and energy complex, 64 - in transport and communications and 28 - at the financial markets. Out of 308 petitions, 134 petitions were agreed, 140 petitions were not taken into consideration. In connection with the transactions within the same group of persons consent was not required for 21 petitions. The data presented show that, despite the expansion of customs borders, the total number of application for merger in 2011 is lower as compared with 2010. On the basis of official data one can state that the number of mergers over the past three years is below pre-crisis indicators, but there is a tendency to increase. Moreover, transactions concluded with foreign firms are supported which increases the international status of the state before the potential investors.

The confirmation of this serves the example of the transaction at the end of 2010, made in the banking sector according to the resolution of the Board of the Antimonopoly Agency of November 28, 2010 № 295-OD “ On granting the consent to economic concentration of the company” Punjab National Bank” (PNB), New Delhi, India. According to the Kazakhstan Stock Exchange KASE (2011) that is now JSC “DanaBank” renamed to JSC “Subsidiary bank “Punjab National Bank “JSC” SB

“PNB” – Kazakhstan” is a subsidiary of Punjab National Bank. The Indian Bank acquired 3500000 common voting shares of JSC “Danabank” which is 63.64% of all issued shares. According to analysts of “BATT” Investment Company (2010) (the owner of approximately 10% of shares of JSC “Danabank”), for several years, the bank plans to take place among the top ten banks in Kazakhstan, and with further expansion in the CIS Kazakhstan bank will be the basic structure¹.

In 2011 permission for the merger by acquiring shares in the authorized capital and acquiring assets, the following market participants received: “Mineral Resourcez BVBA”, “Soldesa Indonesia BV”, “Pepsi-Cola (Bermuda) Limited”, “Laybridge limited”, “Gemini Oil & Gas Investments BV”, “Medeu Holdings BV”, LLC “Eurasia leasing”, LLC “SBS Trade”, LLC “Technocentre Ltd”, LLC “KazPetroDrilling”, LLC Tivit Energy Kazakhstan”, LLC “Allur Tech”, LLC “CNPC International”, LLC “SDB Group”, “Cisco Systems”. The sectoral belonging of these firms is different, but all participants have a chance to enter new stage of development, entering the capital of other market entities, or acquiring new types of assets. From this list you can single out one company that has chosen a strategy of integration and business diversification through mergers and acquisitions as a basic way of development.

According to reports “The People's IPO” (2012), Beginning since 2012 Kazakhstan launched the program “The People's IPO” in accordance with the draft of Government of RK. The Commission has carried out the selection of companies whose shares will be placed at the Kazakhstan Stock Exchange KASE step-by-step in over several years. The companies of the first echelon will enter the market first: JSC “KazTransOil” (oil transportation, export and import of petroleum and petroleum products); JSC Kazakhstan Electricity Grid Operating Company “KEGOC” (electrical power engineering).

The second echelon of companies approximately includes: JSC “KazTransGas” (gas transportation systems and main pipelines); JSC NMSC Kazmortransflot (sea freight); JSC Samruk-Energo - Holding on Management of power assets in Kazakhstan (heat power engineering and electrical power engineering).

¹ “BATT” Investment Company (2010): Working Paper “*Investments DanaBank*”. 2010. Available at: <http://www.batt.kz/en/investments/bank>.

The third echelon: JSC “NC” Kazakhstan temir zholy” (passenger, transit, cargo transportation); JSC “Kaztemirtrans” (freight rail); National Company KazMunayGas JSC (exploration, production, processing and transportation of oil and gas); NAC Kazatomprom JSC (import-export of uranium, rare metals, nuclear fuel for nuclear power plants, special purpose equipment, technologies and dual-use materials).

Considering Kazakhstan's M & A market across sectors, analysts note that the most universal is still oil and gas sector. The other sectors of the economy, which large M & A transactions were concluded from 2009 to 2012 became the banking, mining and metallurgical industries.

As an example of a corporate strategy realization based on business scale growth in the mining industry, we will consider the corporate strategy of major Kazakhstan’s corporation Eurasian Natural Resources Corporation PLC (hereinafter ENRC). The basic acquisitions of ENRC Group are described in *Table 3*. Objects of transactions, investment items, are characterized from the position of investment attractiveness.

TAB. 3: Characteristic Features of the Investment Management Strategy of the Group ENRC

The ENRC Group's mission	
achieve growth as a leading natural resources group and to enhance overall value for its shareholders	
Strategy of Investment Management	
entry into the world economy by expanding the boundaries of business	
Stages of Implementation Strategy: forecasting the responses of market and competitors' actions - creating conditions for the company’s growth of - assessing and forecasting of cash flows - determining the cost of capital - carrying balanced assessment of the acquired business - a comparative analysis of the data	
Responsible executives : Chairman, members of the Investment Committee of the Board of Directors of ENRC, consultants - Heads of the Group	
Company - aim	The motive of M & A transactions
99,44% JSC “Serov Ferroalloy Plant”; 98,8% JSC Saranovskaya mine “Rudnaya”	Access to the chrome ore, processing and sale of ferroalloys (medium - and low carbon ferrochrome).
50% Xinjiang Tuoli Taihang Ferro-	Entering the Chinese market of high carbon

Alloy Co. LTD (China)	ferrochrome production.
ENRC PMP LLP, which owns 100% of shares of JSC “Pavlodar Machine-building Plant”	Savings on payment of outsourced services, meeting the large domestic needs of the Group in overhead cranes.
25% of JSC “Shubarkol Komir”	Strengthening of an integrated business - model through getting a reliable and cost effective supply of coal char and relatively high quality thermal coal.
75% of JSC “Shubarkol Komir”	
95% Central African Mining and Exploration Company (Africa)	Access to the growing market with the presence of transport operations, projects of the asset portfolio development in coal, bauxite, fluor spar, and platinum in the DROC.
90% Chambishi Metals PLC (Zambia, Africa);	Integration of mining and smelting enterprises for extraction and processing of copper and cobalt in Zambia and the DROC.
100% Comit Resources FZE (Dubai, UAE)	
50,5% of shares of company Camrose Resources Limited	Acquisition strategy, which is based on raw material assets of copper and cobalt, potential opportunities for synergies.
100% Mineracao Minas Bahia SA (“MIBA”)	Expansion of the Iron Ore Division which is able to increase the value of the Group as well as the growing commitment to work in Brazil.
51% Mineracao Peixe Bravo SA (“MPB”)	

Note: compiled by authors from source²

The strategy of ENRC is based on its mission “achieving the growth as a leading group in the sphere of extraction and processing of natural resources and improving the overall value for its shareholders. ENRC operates in Kazakhstan, China, Russia, Brazil and Africa (the Democratic Republic of Congo, Zambia, Mozambique and South Africa). The successful implementation of this strategy is directly linked to the Investment Committee of the Board of Directors of the Group. Of course, the decision-making process to expand the boundaries of business leaders considers the professional opinion of the functional departments, independent experts. Therefore, the implementation of mergers and acquisitions (hereafter M & A) is a complex process that requires strict

² Official site of ENRC / <http://www.enrc.com/about-us/our-strategy>

regulation and analysis. An important component of the growth strategy is the risk - management program.

ENRC has made a number of acquisitions. Geographically, these are the companies in Brazil and Africa. The enterprises are divisions of other non-ferrous metals. The division produces and refines copper and cobalt ore, and also includes a road transport business operating in Central and Southern Africa and a number of projects for the development of coal, bauxite, platinum, fluorspar across Africa. CAMEC's acquisition in November, 2009 was the beginning of the Group's diversification in Africa. In April, 2010, a 90% share of Chambishi Metals PLC was acquired. In June, 2010, 12.2% share of Northman Platinum, one of the largest producers of platinum in South Africa was purchased. Subsequently the share was increased and now it makes up 14.35%. In August, 2010, 50.5% share of Camrose Resources Limited, the world's largest independent producer of cobalt concentrate, which produces about 10% of world demand, was acquired.

The newly entered into the corporation businesses require funding of projects on modernization of production. It is possible that some sources will not be available to use in connection with reduction in assessments of credit rating agencies. To improve the financial positions the following functions of the Treasury, the Audit Committee and the Investment Committee under the Board of Directors have been stepped up, namely:

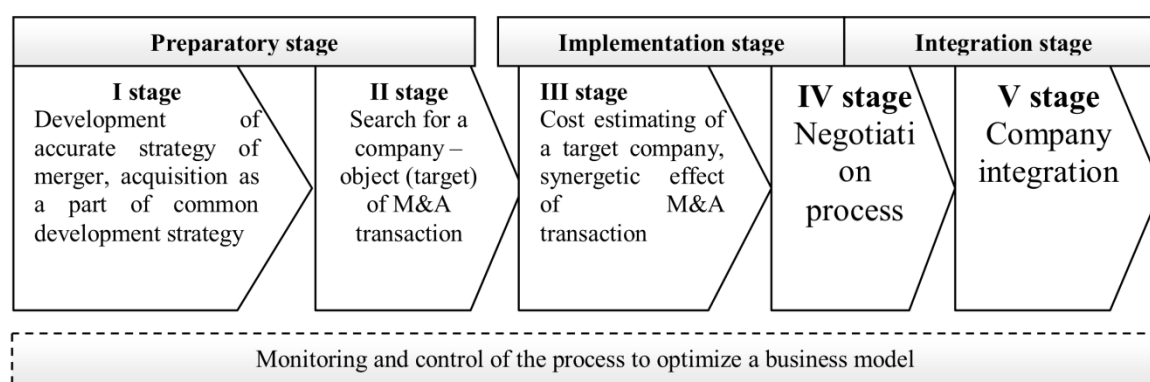
- monitoring and reporting are improved;
- relationships with providers of finance and credit rating agencies are established and maintained;
- the cash flow projections are regularly prepared and submitted to the Board of Directors;
- the annual budget with the inner process of quarterly reports is drawn up;
- the financial plan for a period of five years, which is designed to orient the ENR finance system development has been developed;
- the control over the financing of operating and investing has been strengthened.

These measures should reduce the probability of failure to perform its payment obligations, limited opportunities for the Group to obtain financing. In addition, there will be sources of funding available to complete the project and make further acquisitions.

3. Conclusions - Recommendations for the development of process-oriented concept of the company's growth based on mergers and acquisitions

The concept is based on a process approach to managing the integration of companies in M & A. The concept is informational - analytical framework consisting of the description of the M & A transactions of domestic companies over the past three years. Using the concept will allow firms to create a real process model strategy of growth through mergers and acquisitions. The process of implementation of the company's growth strategy through M & A is expedient to split into five main stages inherent in the various stages of mergers and acquisitions, *Figure 2*.

FIGURE 2: **Process of implementation of Strategy of Company Growth through M&A**



Note: complied by authors

The preparatory stage of M & A

At the initial stage it is necessary to identify the quantitative and qualitative parameters of growth, the time horizon, which will match the plans for business expansion and development of the company in whole.

The condition of Kazakhstan business environment is reflected in the reports of Interfax-Kazakhstan News Agency, information-analytical service of centre Business Resource Central Asia (BRCA), “BCC Invest” JSC, “Halyk Finance” JSC, Financial portal PROFINANCE, “Aibn Asset Management” JSC, “Asia Capital” JSC, “Greenwich Capital Management” JSC, Group of companies Resmi, “Sayat Zholshy & Partners” a law firm, “GRATA” law firm and others.

The stage of M&A implementation

The most significant and responsible stage is connected with estimating the cost of a target company, defining synergetic effect of transaction of M&A. Approaches to business estimation are multidirectional since many-sided nature of the transaction “purchases – sales” must be taken into account. According to group of experts in the field of an estimation of investment appeal led by Novikov AB (2009), to increase the probability of a reliable estimate, experts - appraisers traditionally use the set of three directions [10]: the profitable approach (capitalization-of-earnings method and discounting method); the market approach (method of public company - analogue and method of transactions M&A); the approach on assets (adjusted book value method and liquidation value method).

Experience shows that exactly at an evaluation stage there may be miscalculations which can turn out to be serious problems and even a negative outcome of the whole operation on merger of firms. The reasons of such errors lie in the following: poor quality of the information received at the previous stages of “due diligence”, unduly overestimated evaluation of the synergetic effect; change of the external factors little depending on participants of transaction M&A; in particular, consequences of financial crisis when strategy of the companies’ growth by means of mergers and acquisitions have undergone serious adjustments.

The analysis of materials on the perfect and successfully conducted transactions shows, that synergies can be reached in such functional areas as personnel, marketing, engineering business - processes, optimization of resource provision, qualitative and quantitative parameters of production (services) produced by newly established or expanded in the course of M&A firm.

Review of M&A of public Kazakhstan corporations, such as Eurasian Natural Resources Corporation PLC (ENRC), KAZAKHMYS, allows drawing a conclusion on necessity of using the following criteria when estimating the expediency of the future transaction: growth of a correlation of market capitalization of the estimated company (“P”) and proceeds from sales of production, services (symbolic representation “N”); indicator growth of earnings per share “EPS”, or net income per share, as correlation of the total net profit of the united companies and total quantity of shares of the united companies.

Integration stage

At this stage social aspects and human values since merger of the companies demands an individual approach to workers of the firms which are subject to merger or acquisition are important. The success of integration will be defined by continuity of corporate traditions, observance of the rights and duties of the people occupied in given firms.

In the conclusion, we can emphasize that the process approach to organization of mergers and acquisitions allows minimizing all types of risks that accompany M&A transactions.

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