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Polish corporate groups in network industries. The development, restructuring and characteristics

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Agenda

- Corporate groups
  - Growing interest in management literature
  - Definition
- Corporate groups worldwide
  - Theoretical framework and dimensions of corporate groups
  - Comparative analysis
- Research on Polish corporate groups
  - Aim and methodology
  - Results
- Conclusion

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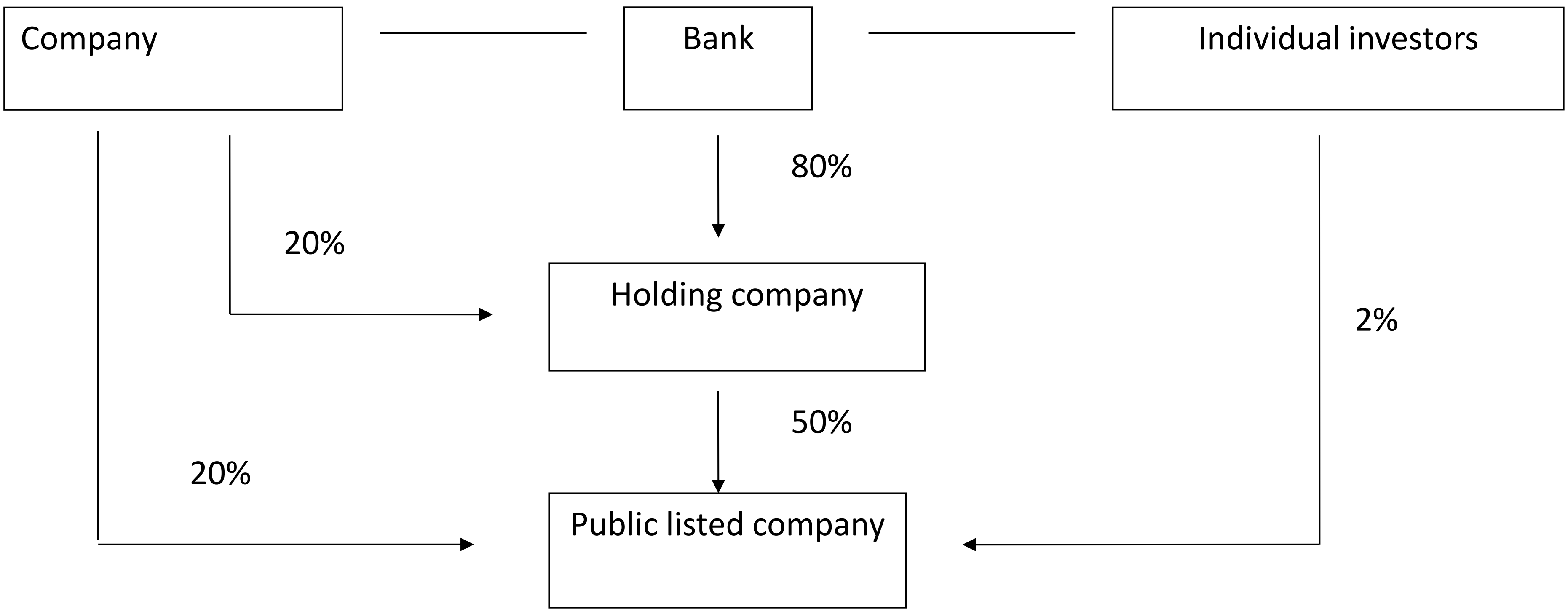
Corporate groups in management literature

- Growing interest in corporate groups in the management and finance academic literature
- One of the most popular organizational form of economic (Heugens and Zyglidopoulos, 2005)
- Comparative analysis of corporate groups reveals many advantages of these structure
- The latest methodological developments allow to use advanced statistical and econometric tools controlling for the specificity of the sample companies (Villalonga, 2000, 2004; Emms and Kale, 2006; Sanzhar, 2006)

Definition

- Corporate groups (groups of companies) are the separate form of economic activity and depict significantly different characteristics (Zattoni, 1999) as compared to stand alone companies
- Corporate group is usually defined a set of legally separate and independent firms tied with stable relationships and operating in strategically unrelated activities and under common ownership control (Heugens and Zyglidopoulos, 2005; Cuervo-Cazurra, 2006)
- Terms used: business/ corporate group, financial and industrial group, chaebol, business house, keiretsu, grupo, conglomerate
- Narrow approach (ownership) vs. wider approach (informal or social relationships)
- Industry specificity – network industries (synergy, know how, capital requirements, regulations, state influence)



Source: Becht and Roell (1999), p. 1052.

Theoretical framework

- The economic perspective
  – The transaction costs theory - the diversification scope and integration between the affiliated companies analyzing the external (market) and internal determinants
  – The principal-agent theory - the problems of delegating tasks to executives by shareholders and the conflicts between minority and majority investors
- The legal approach relates the formation and functioning of business groups to the conditions and framework provided by regulation
- The political perspective perceives organizations as tools for economic policy and analyzes the interaction between business and politics
- The sociological approach views corporate groups as products of cultural and social systems and studies the role of cultural determinants and their impact upon the groups' characteristics

Aspect/ research perspective	Economic		Legal	Political	Sociological
	Transaction costs	Principal-agent			
General assumptions	Markets vs. hierarchies	Tasks delegating lead to the principal-agent conflict	Organizations as legal units	Organizations as tools for economic policy	Organizations as products of cultural and social systems
Elements of the analysis	External (market) and internal conditions	Motivation of dominant and minority shareholders and executives	Regulation of economic, social and political processes	Role and functions of the government, business-politics interactions	Organizations as social units
Contribution	Analyses the impact of external and internal determinants on firms' diversification and integration	Identifies principal-agent and minority vs. majority shareholder conflicts	Explains the interdependence of economic, social and political systems	Analyses the interaction between business and politics	Analyses the role of cultural determinants upon heterogeneity of groups
Limitations	Does not explain the existence of corporate groups in developed economies	Does not explain motives of executive and organizational behavior	Specificity of national legal provisions	Does not explain the existence of corporate groups in countries of low governmental intervention	Numerous elements in the analysis, neglecting globalization process

Dimensions of corporate groups

- Diversification – the scope of corporate groups strategy and encompasses a number of identified segments where subsidiaries/ business units operate (Campa and Keida, 2002; Lamont and Polk, 2002; Villalonga, 2004)
- Internal market - rules for cooperation, boosts coordination and assures for the development for suppliers and customers of certain goods/ services (Khanna and Rivkin, 2001)
- Internal capital market refers to the investment policy exerted by corporate groups and more specifically addresses the amount of funds allocated between group members and the directions of this investment (Scharfstein, 1998; Maksimovic and Phillips, 2002; Lamont and Polk, 2002)
- Ownership structure points at the process of separating control and cash flow rights via the adoption of preferred shares and/ or building multilayer pyramidal structures that allow the dominant shareholder (founder, family) to exert full control over the group (Demsetz and Lehn, 1985; Morck, Wolfenzon and Yeung, 2004)

Corporate group	Diversification scope	Internal market	ICM	Ownership pattern
American conglomerates	Mostly related	Low importance, external market dominates	Very important, used as a tool for improving efficiency	Dispersed, no pyramidal structures
European pyramids	Mostly related	Medium importance	Important, used for lowering cost of capital	Concentrated, pyramids mostly in Italy, Sweden, Belgium, France, Spain
Russian corporate groups	Related and unrelated,	Medium to high importance as contract enforcement may be a problem	Rather important	Concentrated, pyramids created by oligarchs or the state
Indian *business houses*	Unrelated	High importance – compensation for weak institutional order	Rather important	Concentrated, pyramids created by families
Japanese *keiretsu*	Unrelated	High importance – close relations within the group	Rather important	Dispersed, stable investors
Korean *chaebols*	Unrelated	High importance – close relations within the group	Rather important	Concentrated, pyramids created by families
Chinese corporate groups	Related and unrelated	High importance – close relations within the group	Potential not expoited	Concentrated, pyramids created by the state
Latin American *grupos*	Unrelated	High importance – close relations within the group	Rather important	Concentrated, pyramids created by families

The importance of internal market

	Dispersed	Concentrated
High (internal market dominates)	*Keiretsu* (Japan)	*Chaebols* (Korea), *business houses* (India), *grupos* (Latin America), Russian and Chinese groups
Low (external market dominates)	Conglomerates (USA)	European pyramids (Sweden, Belgium, Italy) and Canadian groups

The most common ownership type

Polish corporate groups

- Stages: the monopoly phase (until 1989), transformation shock (1989-1991), privatization (1991-1994), capital accumulation (1994-1997) and restructuring (since 1998) and further development (Trocki, 2004)
- Development within four main scenarios such as: 1) mergers and acquisitions, 2) outsourcing, 3) organizational development and setting up new companies for new market segments and 4) owner's consolidation (Trocki, 2004)
- 1996 corporate groups which include 9823 non-financial companies making for 0.6% the overall population, 28% in terms of employment, 52% in terms of income, 39% in terms of profits (GUS, 2010)
- The scope of diversification is identified as relatively low with 36% of groups operating within the dominant segment and 26% fully focused on one market, 15% pursuing focused diversification and 23% adopting unrelated diversification (Romanowska, 2011)
- The research reveals that 40% of Polish groups actively engage in the mergers and acquisition transactions while 35% prefer the organic growth (Romanowska, 2011)

Research

- Motivation
  - Scarce research, significant dynamics, focus on strategy, the lack of the reference to comparative analysis
- Aim
  - To trace the development of Polish corporate groups within the comparative analysis and to place them on the proposed matrix
  - Reference to network industries as the perfect environment for corporate groups
- Questions
  - Patterns for the diversification scope, ownership structure, use of internal market and internal capital market
  - Differences depending on the origin
- Methodology
  - Sample of the 30 largest corporate groups – 15 privatized, 15 founded after 1990, year of observations – 2010
  - Data hand collected from consolidated financial statements and the interviews with executives as well as directors of corporate groups

The general characteristics of the sample companies

- Significant differences in terms of the market capitalization between nearly 41 billion PLN to slightly over 1 billion PLN
- Significant difference in the number of affiliated companies ranging from as many as 90 to as few as 1
- The largest groups are those initially set up as state owned enterprises to support the centrally planned economy and then privatized after 1989 mostly via IPO with the remained control of the state
- They operate in various sectors however vast majority of 20 of them originate from sectors which often are viewed as network industries either known as heavy industries (gas extraction, petrochemicals, coal mining) or high tech infrastructure related sectors (telecommunication)
- 23 of analyzed groups are the domestic units with the parent companies located in Poland, while 7 groups are the part of the international business groups

Research results (1)

DIVERSIFICATION SCOPE

- Majority of sample corporate groups adopt the related diversification strategies followed by the vertical integration
- The unrelated diversification appears to be less popular (adopted by 5 corporate groups) and probably too costly
- 17 out of 30 analyzed corporate groups pursue internalization strategies, targeting mostly European markets

INTERNAL MARKET

- The sample corporate groups seem not to take the advantage of internal market (support, supply shared services centers)
- The analysis shows the dominance of the parent company in the group operations (50-90% of the overall turnover – the form of operational holding dominates
- It is most likely due to the early stages of the development of the groups

Research results (2)

OWNERSHIP STRUCTURE

- 25 of 30 analyzed corporate groups reveal ownership concentration measured at the stake of the dominant shareholder at the level of 30%
- The majority shareholder is most likely to be the strategy (industry) investor or the state
- Only 5 companies use preferred shares while the pyramidal structure was adopted by 13 companies usually formed by industry investors

INTERNAL CAPITAL MARKET

- All analyzed companies take advantage of the internal capital market the scope of these practices remains relatively limited
- ICM used the issuance of corporate bonds for affiliated companies, guarantee bank loans or coordinate accounting and tax policies, this appears to be particularly important in the case of network industries
- ICM is most likely related to the early stages of the development of the groups and the dominance of the parent company in the group operations

Concluding remarks (1)

- The groups differ significantly in terms of size – they usually encompass 20 companies, operating as national groups or being a part of a larger international holding
- The groups originate from the former state owned enterprises which were privatized or from companies founded after the transition which developed organically or via M&A
- The groups reveal significant ownership concentration exerted mostly by strategic (industry) investors or the state
- The groups take advantage of the use of ICM mostly providing the issuance of corporate bonds for affiliated companies, guaranteeing bank loans or coordinating accounting and tax policies,
- The groups pursue the related diversification and vertical integration strategies,
- The use of internal market appears to remain limited most likely due to the early stages of the development of the groups and the dominance of the parent company in the group operations.

Concluding remarks (2)

- Polish corporate groups appear to resemble more these structures found in continental Europe and the North America (related than unrelated diversification observed in Latin American grupos or Asian holdings)
- Polish groups due to their early stage of development reveal a conservative use of pyramids, internal market and internal capital market as compared to their longer operating peers
- The post transition environment as well as the current market pressure contribute to the intensive development of significant restructuring processes in Polish corporate groups indicate string dynamics both in terms of the changes in their structure and the directions of adopted strategies

Limitations

- Short time frame – 2010
- A very dynamic structures, substantial changes
- Small data set, hand collected
- Insufficient transparency
- No statistical analysis
- No reference to efficiency and financial performance
- The research shall be continued:
  - With the larger sample
  - With a more dynamic perspective
  - With the use of more variable