

*First draft, comments welcome*

**IMPACT OF MERGERS AND BUSINESS GROUPS ON THE STRUCTURE OF  
RUSSIAN TRANSITION MARKETS AND COMPETITION**

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### **Abstract**

Post-privatization reallocation of ownership, wave of mergers and emerging of business groups in Russia became important feature of industrial organization after 1999. The common knowledge is that new business groups enhance restructuring of the enterprises but at the same time prevent competition in Russian market. But are the new integrations in the Russian industries as bad as their reputation is?

The goal of this paper is to demonstrate the impact of mergers on the market concentration in the Russian transition economy in 1997-2004, and to analyse the impact that groups of companies, also known as business groups, have on competition. The industry-level analysis showed that, in spite of the significant volume of mergers, the exceptionally high concentration of businesses is attributable, first and foremost, not so much to mergers, as to the high costs and/or low incentives to entry.

According to the results of sample surveys of the enterprises, Russian business groups that emerged as a result of mergers, despite their exceptionally bad reputation, are hardly capable to limit competition in the target markets significantly.

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## **IMPACT OF MERGERS AND BUSINESS GROUPS ON THE STRUCTURE OF RUSSIAN TRANSITION MARKETS AND COMPETITION**

*(Private Business Groups - how significant is impact on the concentration and competition in the Russian industries?)*

### **MERGERS, BUSINESS GROUPS AND STRUCTURAL CHANGES IN THE RUSSIAN INDUSTRIES**

In the past twenty years, the key factors that influenced the development of the Russian market structure have been privatization of Russian companies and post-privatization ownership reallocation. The key form that post-privatization ownership reallocation took have been mergers, which became especially popular in the period of economic growth. Certain mergers attracted the attention of the expert community, – both domestic and international, - not only because they were large-scale, but also because they involved numerous corporate conflicts.

Might the mergers (in this paper all the forms of amalgamations including mergers, acquisitions, takeovers both friendly and hostile will be seen as merger) be expected in Russian economy? Intuitively, one can suppose that, upon completion of the mass privatization, the Russian economy had to undergo a period of large-scale structural changes. Structural changes had to take place at different levels. In the production sector, the two levels of structural change are reallocation of the overall industrial output among different industries, and reallocation of output in the given industry among the market participants. An indicator of the latter process is change in concentration of production. Change of the production concentration is to have two forms - (i) market entry and exit by the sellers, and (ii) reallocation of the industry among the sellers. According to the World Bank report (World Bank, 2007, p.17), the role of the first type of market reallocation is minor: firm entry and exit rates in Russia are significantly lower than in the developed market economies, and than in most economies in transition. The more noticeable should be the role of market reallocation among the existing sellers.

In turn, market reallocation may take two forms: change of relative shares of the *existing* sellers, and mergers of two or more sellers. Upon completion of mass privatization, mergers became a way in which large Russian *business groups* grew. Combinations of several previously independent companies under common private control, known as business groups, play an important role in the Russian economy. At the beginning of this decade, two dozens of largest business groups employed about 40% of all industrial workers, and had about the same share in the total industrial output (Gurieva, Rachinsky, 2005)<sup>1</sup>. However, large shares of some business groups in the Russian industries can be attributable to two alternative reasons. The first reason is that the new private owners acquired control over the largest companies in respective industries during the mass privatization, including transactions that were regulated by special decisions (loan-for-shares auctions, first of all). The second reason is that private

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<sup>1</sup> It should be noted, that this data is still too conservative, since the information on the largest Russian business group formed around Gazprom is not included.

business group owners acquired privatized companies after the completion of mass privatization. It is important to distinguish between these two processes, in order to assess the role of mergers in the market shares allocation among the sellers. Mergers can be considered the most important factor of the Russian market structure evolution, only if a significant share of large business groups evolved in the process of post-privatization ownership reallocation. Contrariwise, if such a significant share of business groups is attributable to the initial allocation of ownership, then the high market concentration has not to be explained by mergers, but is an inheritance of resource allocation in the socialist period and discretionary allocation of assets among the new owners in the course of privatization.

The question of the mergers' role in the development of Russian markets is related to another issue – assessment of the impact that mergers, and respective business groups, have had on the competition in the Russian markets. It is generally recognized that, in the low-entry markets, increase of concentration reduces the incentives for competition among the sellers. In this context, the more significantly mergers affect market concentration, the more limits of competition are attributable to mergers. And contrariwise, the more market structure retains pre-privatization features and characteristics, the less responsibility lies with mergers for the competition in the Russian markets.

It is important to analyse the impact of business groups' expansion on competition in both static and dynamic framework. Competition is important not as its own, but as a driving force for more efficient use of resources. Complete elimination of competition by business groups in their target markets has an adverse effect not only on customers, and not only at that specific moment in time. Weakened competition among the market players results in long-term losses through less effective use of resources.

Finally, understanding of mergers' impact on market concentration allows to ex-post assess the results of public policy towards mergers in Russia. In the past decade, the Russian antitrust pre-merger control has been criticized for combining too large a scope (i.e. too many transactions controlled) with the favourable regime provided for the largest transactions (i.e. lack of detailed control and absent remedies designed to defend competition). If concentration in the Russian industries significantly grew because of the mergers, and became very high by the end of this decade, then the criticism of the Russian antitrust is fully justified.

The goal of this paper is to demonstrate the impact of mergers on the concentration in the Russian industries and the abilities of business groups as a result of mergers to restrict competition in the Russian markets.

I used two types of data in our analysis. Type one comprises data on the Russian industrial concentration annually collected by the Russian Federal Statistics Agency. Dataset includes output of fifty largest enterprises in the industry. Unfortunately observation unit is enterprise as a legal person but not a company: special adjustment of the dataset is necessary to show the true level of concentration. Compared to other databases available in Russia and focusing on specific companies, the data provided by the Russian Federal Statistics Agency are very limited – information on the company owners, structural relations, or the number of employees is not provided. However, the reports prepared on an annual basis ensure a rather high degree of representation, unlike many other, more detailed datasets, which are highly representative only with respect to the years immediately following the survey year.

Type two is the data of sample surveys of the enterprises, which were arranged by the SU-HSE in 2005-2006. These sample surveys include survey conducted in the framework of

‘Corporate Governance and Integration in the Russian Economy’ joint project with the Hitotsubashi University, Japan, in 2005, and the sample survey conveyed as part of the joint project of World Bank and the Higher School of Economics “Investment Climate Assessment in Russia”. In both surveys, enterprises were asked questions about the industry structure, organizational structure, and the size of their respective business groups. The methodology of both surveys defines business groups as a combination of legally independent entities united under a single control. This definition is in line with the business groups definition given in the modern literature, “a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action” (Khanna & Rivkin 2001: 47–48). Although Russian authors sometimes differentiate between business groups and holdings<sup>2</sup>, in this paper I will use these terms as synonyms. Furthermore, I believe that most business groups may be characterized as companies comprising independent legal entities, but nonetheless, employing a hierarchical type of business coordination.

In this paper I analyse only business groups operating in non-regulated industries. The reason for this is that concentration, organizational structure, and decision making process in regulated industries' companies are largely determined by the state, as a regulator. Despite the large-scale structural changes in these industries (e.g., telecommunications and electric power generation), impact of mergers as the form of post-privatization asset reallocation initiated by private owners on competition was minor.

When citing in this work the results of ‘Corporate Governance and Integration Processes’ project (HU-SU\_HSE, hereafter), I use only data relating to companies in non-regulated industries (i.e., respondents other than those representing electric power generation and telecommunications industries). This reduces the sample by about 15%, considering the number of respondents. In turn, the ‘Competitiveness of Russian Manufacturing Industries’ project (WB\_SU\_HSE, hereafter) included only companies in non-regulated sectors - including metallurgy, machinery manufacturing, wood processing, textile, sewing, and food processing industries.

The paper is structured as follows. The second section contains the review of literature on the volume of mergers in Russia, and on the impact of business groups on the market structure and competition. More precisely, the results of recent studies are interpreted in terms of market structure and competition. Section three deals with the assessment of the mergers impact on concentration in some industries. Section four summarizes the data of sample surveys on the Russian industries' shares of companies controlled by the new business combinations. The conclusion contains the results of the analysis.

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<sup>2</sup> Some researchers, - in Russia, it is Pappé (Pappé, 2000), first of all, - identify business groups only with conglomerates of independent companies, while holdings are viewed as business combinations with deliberately designed internal structure, – horizontally or vertically integrated. In this context, evolution of Russian business combinations is viewed as an evolution from business groups to holdings.

## MERGERS, BUSINESS GROUPS AND COMPETITION IN THE RUSSIAN MARKETS: SUMMARY OF THE RECENT SURVEYS

According to statistics, the increase of mergers volume in the Russian economy is noted starting in 1999. At the same time, objectively, the Russian mergers' indicators do not look super high, against those of other countries (fig.1). We can say that, although mergers, as an instrument of structural market change, play a more important role than the entry/exit processes, they are still less intensive than could be expected.

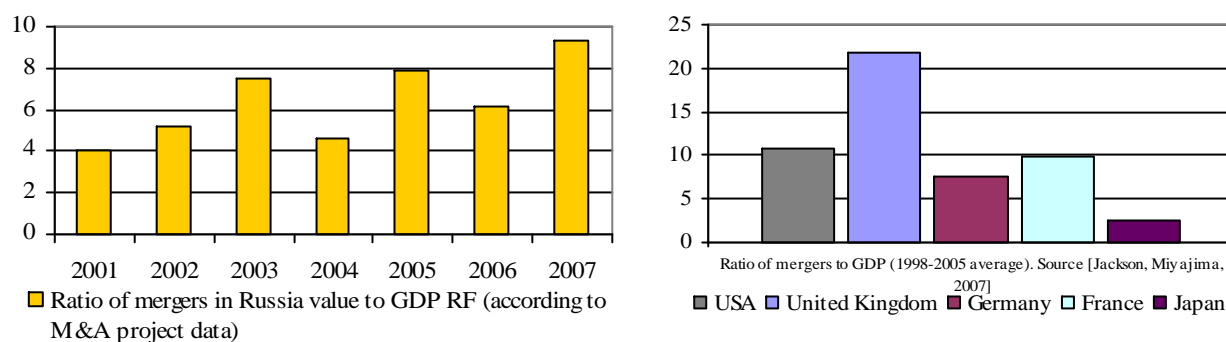


Figure 1. Volume of mergers in the Russian industry: international comparison (ratio of the mergers value to GDP, %): Russia (left) and other countries (right)

The results of recent studies on Russian business groups can be summarized as follows:

*Business groups in different industries.* Business groups are large owners of most attractive assets. In particular, the breakdown of business groups by industry testifies to that fact. At the beginning of this decade (Guriev, Rachinsky, 2005), the share of business groups surpassed the average indicator in the most profitable industries – 72% in the oil industry, 78% in the ferrous metallurgy, 92% in the non-ferrous metallurgy, 80% in the aluminium production, and 46% in the production of mineral fertilizers. Notwithstanding the industry structure, inclusion of export companies in a business group is viewed as a guaranty of its sustainable development (Pappe, 2000).

*Business groups and effective use of resources.* Business groups are at least as good owners as owners of independent companies. There is an evidence of business group's competitive advantages in restructuring and improving the financial performance of the enterprises. Sample surveys of companies showed that companies within business groups are more active in modernization (Yasin (ed.), 2004; Avdasheva, 2005). Membership in a group facilitates investments on the enterprise level (Frye, 2004, 2005). Assessment of comparative resources effectiveness in business group companies and in independent companies provided interesting results. Guriev and Rachinsky (Guriev, Rachinsky, 2005) discovered that oligarch-owned enterprises (i.e., enterprises within business groups) outperform independent enterprises in the increase of total factor productivity. At the same time, so far, there is no evidence that enterprises in the business groups demonstrate more efficient use of resources in the given date (year).

The project 'Corporate Governance and Integration in the Russian Economy' provided similar results (Dolgopyatova, Iwasaki, Yakovlev (eds.), 2007). Enterprises within business groups more often take modernization measures, enterprise becoming part of a business group improves productivity in 2001-2004 with higher probability than non-member enterprises. At the same time, in 2004, companies that joined groups after the mass privatization did not demonstrate statistically significant advantages, as compared to independent enterprises.

In contrast to Russia, business groups in Ukraine, for instance, are definitely more efficient owners (Gorodnichenko et al., 2006): in 1993-2002, companies controlled by the Ukrainian oligarchs demonstrated both higher growth rates of the scale of production and productivity, in comparison with independent enterprises.

*Internal structure of business groups.* In the past decade, business groups evolved by improving their internal structure. Ten years ago business groups were viewed as amorphous structures, where the role of the decision making center was hard to identify. Groups seldom specialized in certain areas, and conglomerate type of organization prevailed. These were, first and foremost, the results of privatization environment: access to the privatized assets was very discriminative; this is why new owners often purchased companies not in line with their strategic plans, but just because they could buy them much cheaper than any alternative buyer. Corporate diversification in Russian business groups was very far from related diversification. Typical group structure in the second half of the 1990-s was characterized by a high diversification level. But after the mass privatization was completed, most groups began reducing corporate diversification and building more logical organizational structures with higher level of specialization (Pappe, Galukhina, 2006).

*Decision-making and corporate discipline in business groups.* Immediately after privatization, group companies encountered a rather serious agency problem. This was due to significant autonomy that CEO-s of Russian companies traditionally had, and to the significant corporate diversification, that considerably enhanced the cost of governance. The ways of solving the agency problem between the group owner and the company CEO do not differ much from the ways of solving the agency problem between the owners and managers of private Russian companies. The key means of solving the issue are using the "do it yourself option", and an active participation of owners in the management of group companies, directly or via parent company (Dolgopyatova, Iwasaki, Yakovlev (eds.), 2007). As the results of the 'Corporate Governance and Integration in the Russian Economy' project show, this option is used by nearly half of the groups under private control. Another option of the owner participation in the corporate governance process is high centralization of decision making process, and in particular, – of all financial decisions. There is evidence that, in the past decade, centralization of financial decisions has been growing. Along with replacing group companies management and replacing incumbent CEO's (CEO's that have been in office for too long) with new hired managers loyal to the new owner, centralizing of decision-making significantly improves management discipline in the group companies.

*Business groups and rent extortion.* It is generally assumed that the Russian government and business are very closely connected by informal ties. Testing of alternative hypotheses regarding the nature of such ties, - whether business is capturing state, state is capturing business, or it is a "mutually profitable exchange" between the state and business (Yakovlev, 2007), – leads to the conclusion that the third described type of relationship prevails. Decisions affecting business are made under the pressure of influential special

interest groups, largely represented by business groups. In turn, business groups demonstrate "social responsibility", and therefore fulfil their obligations before the state. It is believed that informal relations and ability to obtain privileges from the state have been important incentives for companies to join groups.

*Concentration in the Russian industry.* Fifteen years ago, the relatively low concentration of production in Russia became a surprise for foreign researchers of the Russian economy. Nonetheless, a number of surveys (Brown, Ickes, Ryterman, 1993, Brown and Brown, 2001, Ruehl 2004) reconfirmed the conclusion that, despite the fact that distribution of the total population of Russian enterprises shifted towards larger ones, production concentration in Russia, at the beginning of the period of reforms, was lower than the respective indicators in the countries with developed market economies.

No special research of Russian business groups' impact on concentration and competition has been conducted. However, the results of the studies cited may be interpreted to assess this influence as well.

1. Business groups are especially active in the industries where target markets are global. Even when the competition among the Russian exporters reduces, they continue to be exposed to the global market competition. Therefore, we can hope that effectiveness of resource usage by business groups will be improving, affected by the global competition. In this case, industrial concentration in the Russian domestic market does not play an important role as the competition driver.

2. Modernization and more effective use of resources are indirect signals that group companies are most likely exposed to competition (if not on the domestic, then on the global market). What is known about Russian business groups companies does not comply with the notion of a "lazy monopolist".

3. Conglomerate mergers, as opposed to horizontal and even vertical ones, present least significant obstacles for competition. Contrariwise, it is the improvement of internal structure of Russian business groups that we have witnessed recently, when core business operations are identified, that may somewhat enhance the threat that business groups present for the competition.

4. In some industries, mergers may be an anticipated process. If there is a certain equilibrium level of concentration, then, in the situation of an exogenous allocation of industries among the sellers (in the Soviet economy), the concentration change trends must be attributable to the difference between the initial and equilibrium concentration. The lower the concentration indicators are at the beginning of the transition, as compared to the equilibrium, the more should concentration grow in the transition period.

5. The evidence on intra-group managerial discipline suggests they are not extremely dangerous for competition. The fact that, in the past decade, member enterprises still have had certain autonomy means that they are able to independently make market decisions, and therefore, compete. In some cases, even competition between companies in the same group is possible. Internal group restructuring that has been going on in the recent years, along with the change of corporate governance, make businesses more profitable, but at the same time they can generate restrictions for competition.

6. A key reason for groups' negative impact on competition lies in informal liaisons with government and discretionary state support of certain companies. In this context,

mergers present a basis for specific leverage of market power, which becomes possible due to the rent extortion.

## IMPACT OF MERGERS ON CONCENTRATION IN SELECTED RUSSIAN INDUSTRIES: 1997-2004

Concentration of producers is an important indicator of the market structure which reflects both conditions and results of competition. The fewer sellers there are in the market, and the more evenly market is shared by the sellers, the lower incentives sellers have to compete. Increase of concentration resulting from mergers may be viewed as a threat for future competition in the Russian markets. At the same time, change of concentration indicators characterizes the processes of industries and markets reallocation among various types of participants. In this context, the merger activity is an important indicator of the intensity of the structural changes.

Assessment of concentration change trends resulting from mergers allows to answer the following questions:

1. How much did the concentration grow because of mergers?
2. Can concentration ratios resulting from mergers be considered exceptionally high?
3. Have mergers changed the concentration indicators in Russia in comparison with other market economies?

To answer these questions, we used the information on the production concentration provided by the Russian Federal Statistics Service (Rosstat) for the period of 1997-2004. Since, for the purposes of concentration indicators assessment, the observation unit is an enterprise as an independent legal entity, and not company as an economic firm, we independently modified the data by relating an enterprise to the company. The source of information on mergers in the period under analysis was the analytical database "Mergers and Acquisitions Market" maintained by the AK&M agency and encompassing the period from 1996 to 2006. Our analysis includes only the years through 2004, because in the following year, a change of the industry classifier of statistical monitoring took place (All-Russian Classifier of Industries (OKONH Industry Code) was replaced with All-Russian Classifier of Types of Economic Activity). In the majority of cases, comparison of industry concentration indicators by different classifiers is impossible.

As the concentration indicator, we used Herfindahl-Hirschman index calculated as:

$$HHI = \sum_{i=1}^n s_i^2$$

where  $s_i$  is the share of company  $i$  in the total production in the Russian Federation.

Change of this indicator reflects very well the impact of market share reallocation on the intensity of competition. It is not by chance that this very indicator is used for pre-merger control in most countries. The method of analysing mergers impact on competition reproduces the approach used by antitrust authorities in different countries.

Assume that

$s_1$  – share in the industrial output of the merger target company (group of companies);

$s_2$  - share in the industrial output of companies (other than merger target company) owned by the seller at the time of deal;

$s_3$  - share in the industrial output of companies (other than merger target company) owned by the buyer at the time of transaction.

If the companies' share in the industry output does not change after the merger, then Herfindahl-Hirschman index, affected by a given merger, will change as follows:

$$\Delta HHI^m = [s_2^2 + (s_1 + s_3)^2] - [(s_1 + s_2)^2 + s_3^2] = 2s_1(s_3 - s_2)$$

The impact of transaction on concentration is proportional to the target company's share in the industry, and to the buyer's industry share excess over the seller's share. Sum of the effects of deals represents the overall estimated effect of mergers during the period under analysis. Of course the estimation presented is very rough since it does not count the post-mergers changes in the share of the merger participants. At the same time for the purposes of analysis it is interesting to delineate “merger itself” effect on concentration from other effects including changes in cost, decisions of merger participants on output etc.

Merger transactions effect is analysed with respect to six industries – aluminium production, production of nitrogen fertilizers, tire production, cement production, confectionary and brewing industry. All these industries in Russia were among those demonstrated the highest volume of mergers in the period under analysis.

The concentration ratio of USA was chosen as benchmark. This is explained by a number of reasons. First of all, the few benchmarking studies of concentration of production in Russia were done against the USA. Secondly, during the period in question, the USA industry classifiers used for the calculation of concentration did not change.

Table 1 summarizes indicators of mergers impact on concentration (value HHI in 1997 and 2004, HHI change due to mergers, HHI change due to other factors, HHI in the comparable USA industry in 2002, the number of Russian companies in 1993 and 2004, and in the USA in 2002). The equivalent industries chosen for comparison are listed in the Appendix. The presented data provide a basis for assessment of the impact of mergers on concentration of production in the Russian industries.

First, the effect of mergers was significant in all industries. In some cases, HHI grew as much as three times. By the end of the reviewed period, production concentration in most industries is high enough. At the same time, only a few industries seem over-concentrated due to mergers, especially if we pay attention on the relative size of the Russian industry. Keeping in mind that all industries in the sample are exogenous entry cost industries, the concentration should negatively depend on market size (that is value of shipments here). So for alumina&aluminium production, tire manufacturing and cement production we could expect higher concentration in Russia than in USA.

Table 1. Impact of mergers in selected industries on concentration of production and comparison of concentration in RF and USA

Industries	HHI RF 1997	HHI RF 2004	$\Delta HHI^m$	HHI USA 2002	# enterprises RF 1997	# enterprises RF 2004	# firms USA 2002	Value of shipments RF2004/US 2002*
Alumina&aluminium production	1828	3901	2073	1185	17	27	435	0.41
Tire manufacturing	1897	2858	1405	1631	12	21	545	0.19
Nitrogenous fertilizer manufacturing	603	1167	374	977	16	25	116	2.27
Cement manufacturing	737	1700	1463	569	48	49	131	0.12
Confectionary manufacturing	662	815	71	1474	274	258	1008	1.06
Breweries	460	850	220	2500	205	189	349	0.72

Note: Comparison of the value of shipments is *PPP adjusted*

Source: for data on RF author's estimation based on Rosstat data, for USA – (Concentration Ratios, 2005)

However, other effects affecting concentration were also quite noticeable. In some industries, other factors - entry of new sellers and market reallocation among existing sellers, - had the same sign as mergers, and in some industries the sign of other effects was the opposite. However, the important thing is that, in absolute terms, the other factors had a significant impact on concentration.

To conclude, in most industries the impact of Russian business groups on concentration of production till now is not so bad for competition as reputation of Russian business groups is. Industrial concentration in the industries leading by the number and volume of deals during 1997-2004 in general seems to be not so high as one could expect.

But even if it is so, - for example, in the cement industry, - one can doubt that high concentration is explained by merger deals. Small number of not only producers but also plants remains to be the characteristic feature of industrial organization in RF, indicated long time ago (Brown et al., 1993, Brown and Brown, 2001). Let us mention that, in eleven years from 1993, in Russia emerged only three new cement producing plants<sup>3</sup>, - and this is despite the fact that during the past decade the demand for cement has demonstrated fast growth, and experts believe that cement prices grow faster than prices of any other product or service in the construction industry. In this context, the reasons for high concentration should be sought not in the large volume of mergers, but in the lack of incentives for entry and/ or high entry costs.

## PORTRAIT OF RUSSIAN BUSINESS GROUP BASED ON SAMPLE SURVEY: IMPLICATIONS FOR COMPETITION

The possible negative effect of mergers on competition is identified not only by the change of concentration due to mergers, but also by the market environment and decision making the companies adopt after the merger. The more influential business groups as a special interest groups are, the higher threat of competition due to merger is. The same is true for level of centralization of pricing decisions in the group: only tough discipline in the group insure the ability to collectively raise prices.

Although most sample surveys carried out by the State University Higher School of Economics in the recent years have not focused on the impact of business groups on the market structure or the amount of competition among the sellers, the results of such sample surveys provide answers to a number of interesting questions:

1. Which type of mergers prevails in the Russian industry recently? Among the three typically identified types of business combinations, - horizontal, vertical, and conglomerate, - the most dangerous for competition are mergers of the first type. The more business combinations are performed as horizontal mergers, the stronger their negative impact potential for competition.

2. How many members (subsidiaries) are in a typical business group? Some of the leading Russian researchers described mergers in post-communist economy as "the process of reconstructing Soviet ministries" (sited by to Dolgopyatova, 2003:81). In this case, the very number of companies participating in a business combination, - especially in a horizontal one, - may indicate that there is a possibility of a unilateral impact on competition.

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<sup>3</sup> Currently, a number of big companies have announced their plans for building new cement plants; however, this happened only at the end of the decade that demonstrated a continued growth of demand for this product.

3. Is there a difference between assessment of the intensity of competition by business group companies and independent companies? Considering all the problems related to interpreting subjective assessment of competition (Avdasheva et al., 2007), a systematic difference of opinions in favor of independent companies could prove that business groups are really able to unilaterally control target markets.

4. How centralized is decision making in business groups? The more centralized is the process of decision making, – in particular, marketing and pricing decisions, - the less probable is competition among sellers that are members of the same group. And contrariwise, the fact that companies within a group retain a certain degree of independence can be a sign of a lesser degree of coordination of pricing decisions and therefore of saving a competition.

5. Which are the main incentives for the enterprises to join the business groups? Which are the main gains the enterprises-subsidiaries expect and receive in comparison with independent enterprises?

Sample surveys provide more or less complete answers to such questions. Out of 324 enterprises that are members of business groups, according to the WB-SU\_HSE project, about one half are the members of horizontal business incorporations, one quarter are members of vertical combinations, and one quarter are members of conglomerate combinations. Industry-related differences are statistically insignificant for the purposes of companies' allocation by different combination types. Similar results were received in the HU-SU\_HSE project. However, the HU-SU\_HSE project data also demonstrate that the share of conglomerate and vertical mergers in the total volume of deals increased during the whole reviewed period and the share of horizontal mergers respectively decreased.

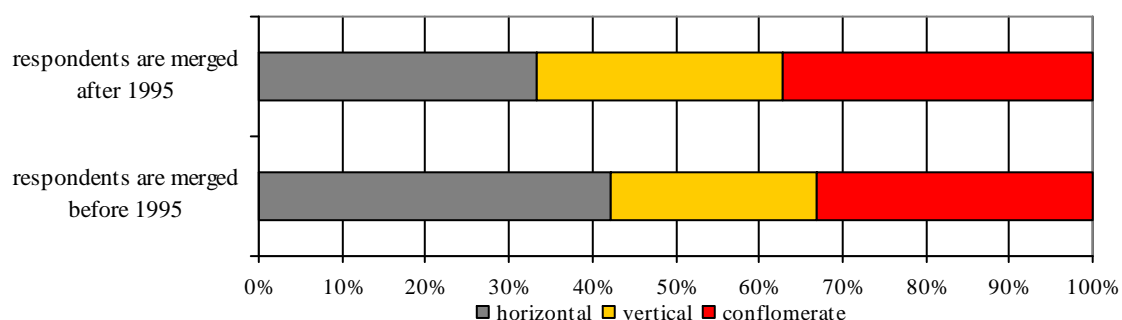


Figure 2. Share of horizontal, vertical, and conglomerate business groups in the number of enterprises-group members, by period of group establishment (source: HU-SU\_HSE), %

The data of survey are supported by other available sources. According to the Russian Federal Antitrust Service (FAS), in 2006, the share of horizontal mergers did not exceed 40% of the total transactions reviewed by FAS (FAS RF, 2008, p.63). Most mergers, not being horizontal, should not be so serious threat for competition.

A typical number of enterprises-subsidiaries in a group is not very large either (fig.3). And we can see that the number of enterprises in conglomerate combinations is significantly higher than the number of companies in horizontal combinations. Of course conglomerate integrations can include industry sub-holdings with a large share in the target market.

However, judging by the cited data, Russian business groups are far from "reconstructing Soviet ministries" as many experts expected in the early 2000s (Dolgopiatova (ed.), 2003: 81). Moreover, new groups emerged after 1995, include fewer enterprises than the older one. Interestingly, the sample survey results coincide with information on some groups that were formed as a result of mergers, which we discussed in paragraph 3. Groups in the eight surveyed industries comprise from two to fifteen companies, but a typical number of enterprises in a group (those are horizontally organized) is four to five.

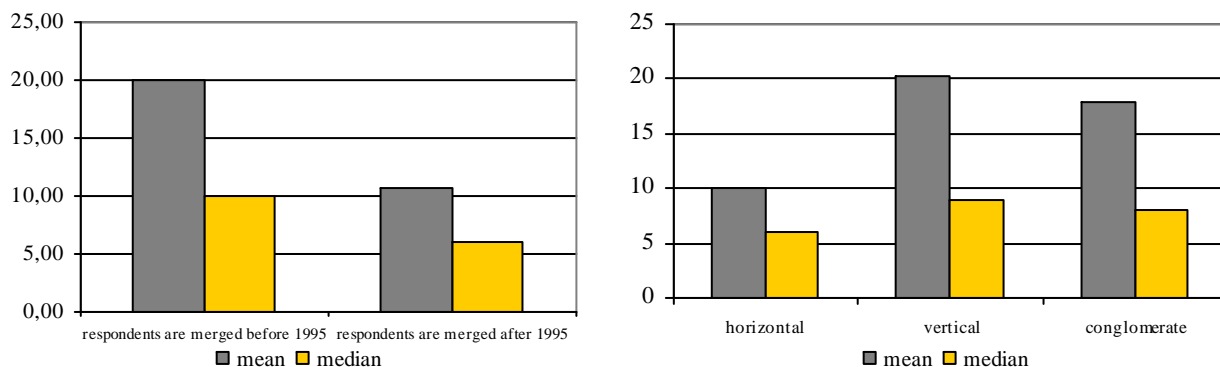


Figure 3. The number of enterprises in the groups (left – by time of formation, right – by type of production system) (source: HU-SU\_HSE)

According to the HU-SU\_HSE, assessment of the intensity of competition by group companies and by independent companies does not differ much.

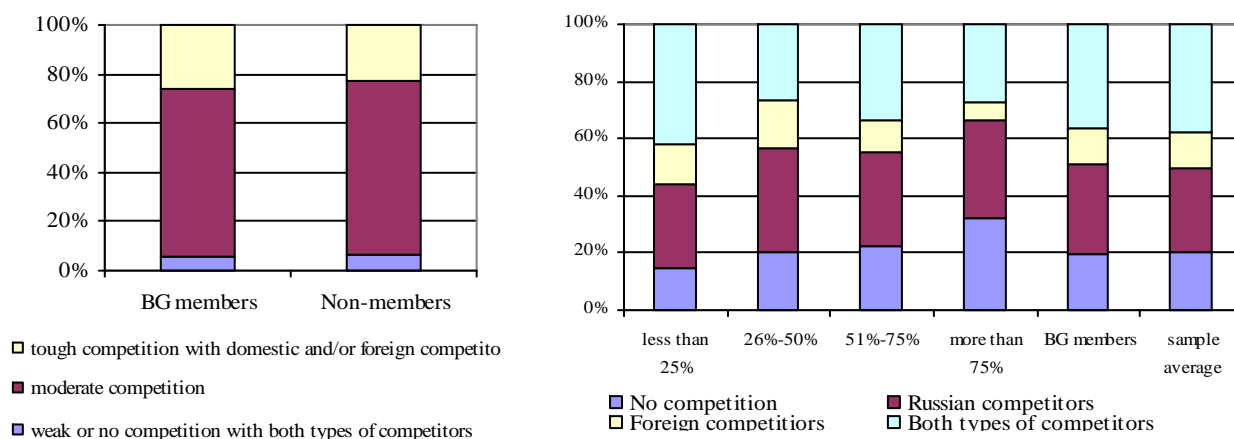
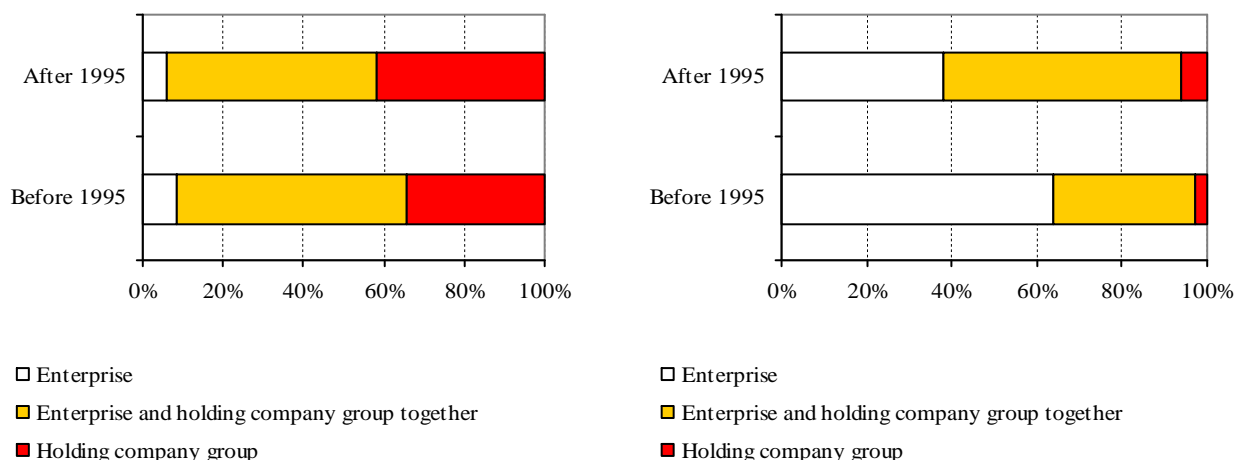


Figure 4. Assessment of the intensity of competition by group members and independent companies: HU-SU\_HSE survey (left) and WB-SU\_HSE (right, , grouped by share of intra-group sales, source: (Kuznetsov, 2006)

About one quarter of enterprises are in tough competition with both domestic and foreign companies. About 6% feel weak or no competition. The WB-SU\_HSE data give a still better notion of the competition pressure on the group members. Figure 4 (right) shows assessment of competition depending on the share of production sold in the same business group (i.e. in the same company). Enterprises that are members of business groups assess

competition as low only if they sell a significant share of their output to the subsidiaries of the same business group. And contrariwise, those companies that sell their products mostly to external customers assess competition even somewhat higher than independent enterprises which are non members of any groups.

Decision-making centralization in the business groups according to respondents is not extremely high (fig.5). Directors of enterprises enjoy significant independence and have a consultative vote not only in routine decisions, but also in management strategies decisions. They make a significant portion of routine decisions independently. At the same time the level of centralization is higher for the enterprises merged after 1995. This is especially sought for routine management decisions. In the new private business groups internal discipline is more tough than in the groups survived from the Soviet time and first years of liberalization. New members experience more radical transformation from independent entities into production unit of the broader company. For the sake of competition, it means that the potential adverse effect on competition is higher for the recent mergers.



Answer on the question "Who takes strategic management decisions related to enterprise?"

Answer on the question "Who takes routine management decisions related to enterprise?"

Figure 5: Centralization of strategic and routine management decisions in subsidiaries of business groups: HU-SU\_HSE survey

Typical gains for the enterprises from merger is important to know if the business group helps in deep restructuring using entrepreneurship ability or it helps to receive gains as a member of special interest group. In the first case, merger does not necessarily lead to the restriction of competition, and in the second case it most probably does.

In both surveys the assessment of advantages of being part of a group by the directors of the enterprises corresponds with the idea of business groups as a form of restructuring privatized companies. Key function of business groups is concentration of marketing and finance competences, which are used to adapt privatized companies to the global competition. A large portion of respondents (fig.6) points out better marketing position ("strengthened our market position," "obtained access to the global market") and investment advantages. Many

respondents view groups as a form of protection against hostile takeovers (fig.6). Reason of better relationship with authorities (federal and/or regional) is important for considerable part of the respondents but fortunately for much less portion of respondents in comparison for the share of those enjoined improvement of market competitiveness and investment opportunities. Additional advantages of group companies are, most likely, attributable to the improvement of their competitive advantages, and not to extortion of rent generated through special relations with state. The surveys do not support the hypothesis that business groups include all their new members in the informal ties with the state.

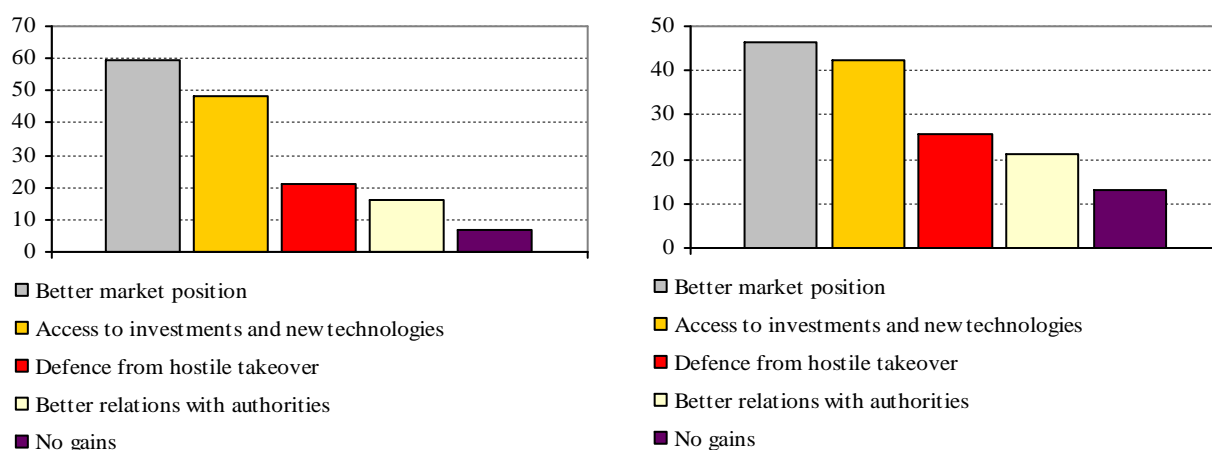


Figure 6: General directors of enterprises about gains from the membership in the business groups HU-SU\_HSE (left) и WB-SU\_HSE (right).

Data on the modernization rate and labor productivity dynamics (Dolgopyatova, Iwasaki, Yakovlev (eds.), 2007) support the positive assessment of group company performance by their directors. Compared with independent companies, most group companies have modernized their production, marketing, and corporate governance system. Most part of subsidiaries in the four years preceding the survey, achieved productivity growth. More often than independent companies, enterprises subsidiaries in the group achieved productivity growth through reduction of employment.

## CONCLUSIONS

Statistical and survey data do not allow to identify mergers and Russian business groups as a main threat of competition in the markets. The volume of mergers in Russia, - despite its continuous growth that started at the beginning of the period of economic upturn, - is not exceptionally high compared to other countries. The hypothesis that, in the situation of low market entry by sellers, the volume of mergers in a transition economy must significantly outpace that in the majority of developed countries was not supported by the survey data.

Mergers did have a significant impact on the concentration of production in some Russian industries. At the same time, resulting level of industrial concentration in many

industries is still not so extremely high, in some other industries high level of industrial concentration can be explained at least partially by relatively low demand etc. It is worth noting that the impact of factors other than mergers on concentration also appeared to be quite noticeable. Even in the industries with the largest amount of mergers, 25-30%, concentration change resulted from re-allocation of markets among existing sellers. At the same time entry rates are really low. High concentration is attributable however not only and not so much to mergers, as to low incentives and high costs of entry.

According to the results of sample surveys, business groups' impact on companies' behavior and position is hardly related to obtaining and abuse of extremely high market power. Increasing centralization of decision-making in the groups represents the most important threat for competition: new group members retain less autonomy than old ones. Recently merged enterprises are subjects of more tough control by parent company.

A significant portion of business groups are conglomerates that are most neutral as far as market power is concerned. Typical Russian business group contains not so much enterprises: the least number of members is in horizontally organized groups and rather new groups. Most subsidiaries in the business groups feel competition as intensive as independent companies do. Most part of directors of the enterprises those are merged by business group seek not for close relations with authorities as special interest group but deeper restructuring aimed at improving of market competitiveness. Reason of rent extortion is important for relatively small portion of the subsidiary in the group.

Therefore, neither the data on mergers and their impact on concentration, nor the data on composition, organizational structure, and operations of Russian business groups, provide evidence that economic concentration in Russia is the most important factor that limits the market competition.

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Appendix 1. Industries chosen for comparison of concentration ratios in RF (2004/06) and USA (2002)

<b>Russian Federation (Rosstat data): OKONH, Industry</b>	<b>USA (Concentration ratios, 2002), NAIC, Industry</b>
12212 Proizvodstvo aluminiya, glinozyoma i fluoridov (alumina, aluminum and fluoride production and processing)	33131 Alumina and aluminum production and processing
13351 Proizvodstvo shin (tire manufacturing)	326211 Tire manufacturing (except retreading)
13111 Azotnaya promishlennost (nitrogenous fertilizer manufacturing)	325311 Nitrogenous fertilizer manufacturing
16112 Proizvodstvo cementa (cement manufacturing)	327310 Cement manufacturing
18114 Konditerskaya promishlennost (confectionary manufacturing)	311330 Confectionary manufacturing from purchased chocolate
18144 Pivovarennaya promishlennost (breweries)	312120 Breweries