

Problems of the Russian Market of Merger and Absorption Transactions

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Abstract: *Importance:* Nowadays mergers and acquisitions, in addition to the organic growth, act as a tool for achieving competitiveness of the organization in the long run. While determining the strategic objectives of mergers and acquisitions, managers of the participants of transaction are driven by motives associated with obtaining synergetic effects, which require from the stakeholders concentration of resources, managers with sufficient experience and reasonable approaches to transactions at all stages. Thus, the complex of factors determines whether the transaction is successful and points out reasons for a failure.

Objective: Develop the factors contributing to the failure in mergers and acquisitions at stages of implementation. Evaluate the necessity of measures, preventing failure of transaction and minimizing negative effects of it.

Methods: Theoretical analysis, synthesis, systematization of scientific literature on the subject; structural analysis of mergers and acquisitions process, logical analysis of causes of unsuccessful transactions.

Results: Determined the groups of factors weakening the ability to achieve success in mergers at stages of their implementation. Evaluated the necessity of measures, preventing failure of transaction.

Conclusions and Relevance: It is concluded that mergers and acquisitions, despite their attractiveness for increasing business value even in times of deteriorating financial situation, carry many risks. In order to achieve desired effects, the parties involved in transaction must anticipate internal and external factors that can destroy the success of transaction on stages of preparation, closing the deal and in integration period, which determines the necessity of developing measures, minimizing negative effects of unsuccessful outcome of transactions.

Keywords: Reorganization, a synergistic effect, the success of the transaction, strategic goals, mergers and acquisitions.

In today's economy, one of the most important tools for increasing the value of business and improving the efficiency of the organization's financial activities, as well as achieving competitive advantages, is the successful implementation of a merger or acquisition transaction. However, the experience of European and American studies on the effectiveness of mergers and acquisitions of different years makes it possible to reveal that as a result of mergers and acquisitions, the efficiency of business does not automatically increase, and according to various estimates, no more than 40% of transactions lead to increased profits and lower costs (Tichy G., 2001).

Restructuring of the business requires maximum efforts, extensive experience, in-depth knowledge, and a well-thought-out strategy for using financial resources from each participant in the transaction at every stage of its implementation - from pre-investment and pre-integration analysis to the negotiation process and closing the deal, assessing the synergistic effect from it (Ponomarev, A. A. 2012).

Of all the variety of goals and reasons that motivate organizations to deal with mergers and acquisitions, the main reason can be the desire of businesses to obtain a synergistic effect in the form of increasing the overall efficiency of the activity from reducing the level of uncertainty, achieving the effect of complementary resources, production capacities and managerial personnel.

Before taking concrete actions on mergers and acquisitions, the organization, in addition to defining the strategic goals of reorganization and transformation, should conduct preliminary work on the analysis of the attractiveness of the transaction from the standpoint of corporate strategy in the form of the following activities:

- audit of the corporate strategy and future opportunities of the new organizational structure for their compliance with the objectives of mergers and acquisitions;
- study of documents and assessment of legal considerations of stakeholders, analysis of regulatory aspects, analysis of tax consequences;
- comparison of the projected costs of the transaction and the forecasted effect (aggregate

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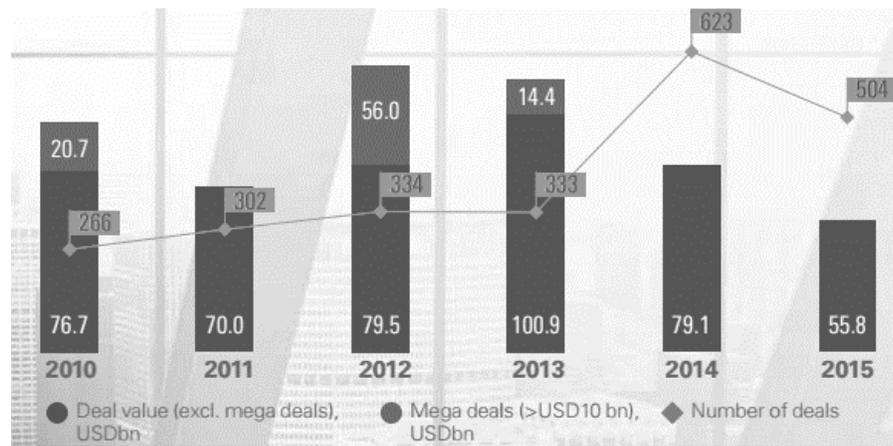


Figure 1: The Russian market of mergers and acquisitions in 2010-2015.

Source: URL: www.kpmg.com Russian M&A Review 2015 –February 2016.

returns) from it: management, operating, trading, financial synergies;

- assessment of the organization's risks related to reputation, human resources, customers, business operations, finances and management activities (Fedorova T.A., 2013).

The success of M & A mergers and acquisitions is influenced by many different factors. In practice, even if the seller really intends to part with his business and is satisfied with the price, and the buyer has the means and strategy for implementing the "purchase", everything can collapse at one point. To avoid these consequences, the deal participants pay due attention to the stage of the transaction evaluation - Due Dilligence, namely:

- assessment of the degree of correctness of the established transaction price taking into account the expected synergistic effect and risk;
- covering, controlling and managing risks;
- assessing the parties' assumptions regarding synergies and their efforts to implement synergistic goals;
- preliminary valuation of the transaction value (Romanenko O.A., 2012).

If, following the results of this stage of considering the prospects for business restructuring, the parties have not abandoned the intention to reorganize, then the transaction is subject to proper registration and closing, taking into account the requirements of the state, higher authorities, as well as changes in business or key personnel.

A large number of difficulties and problems for transaction participants arise not only at the stages of organization of the merger or acquisition process, but also in the integration of pre-existing business units that imply planning integration activities in the spheres of management, personnel policy, financial resources, marketing and sales; monitoring integration processes and smoothing conflicts of interest; assessment of the actual transaction value and synergies, as well as the cumulative impact of the consolidated business on existing stakeholders (Aleksandrov I.N., Fedorova M.Yu., 2014).

Thus, the immediate success of mergers and acquisitions directly correlates with the ability to eliminate factors that adversely affect the process of business reorganization at its various stages.

Currently, mergers and acquisitions have become an integral part of the Russian economy, but statistics on mergers and acquisitions shows that after the transaction less than a third of the newly created organizations realize the synergistic effects inherent in the plans and increase the actual shareholder value of the company (Verdiev D.O., 2015). Beginning with 2015, the Russian market for mergers and acquisitions, there is a reduction in the total amount of transactions (see Figure 1) by 29% to \$ 55.8 billion¹.

This trend is caused by two main factors:

- extensive - a decrease in the number of transactions by 19% to 504 transactions, due mainly to a reduction in activity in the segment of

¹www.kpmg.com Russian M&A Review 2015 –February 2016

internal transactions due to instability of the national currency and imbalance in price expectations;

- intensive - continuing reduction in the average amount of the transaction by 11% to \$ 157 million.

The share of Russia in the amount of transactions in the world market of M & A fell to a minimum of 1.3%, which is significantly lower than the average of 4.3% over the past decade.

As a rule, mistakes that lead to failures in mergers and acquisitions arise because of the lack of careful study of the organizational process. In addition, the reasons for failures are often fairly obvious and repeated from case to case - from their common complex one can single out the reasons that arise before the conclusion of the transaction and after (Nekrasova E. A., 2013). The first group includes the following factors:

1. The absence of a well-thought-out acquisition strategy - the management of corporate compliance, the non-acceptance of risks hinders the consistent achievement of strategic goals and the creation of additional value.
2. Counteraction of state bodies, shareholders, creditors and other stakeholders;
3. Overestimation of the investment attractiveness of the target company and the expected synergetic effects from the merger - incorrect evaluation of the attractiveness of the market or the market position of the partner in the transaction; reassessing the value of the company being integrated can lead to duplication of core activities, powers leading to failure to achieve the desired diversification of the business;
4. Top management pressure - insufficient caution in making long-term decisions due to impatience, deviations from the optimal transaction schedule due to the desire to achieve immediate positive results and a predisposition to conclude a transaction due to personal motives of top management, shareholders of participating companies (Arnautova L. I., 2015).
5. Inadequate thoroughness of the personnel policy with regard to the team that organizes transactions is manifested in the lack of experience, qualification, training of employees, ineffective use of available resources, information, reducing the effectiveness of the reorganization strategy;
6. Inadequate risk assessment - expecting too much synergies relative to, not taking into account the negative effects of activities caused by the closure of individual production facilities, underestimating one-time costs of transformation and further investment, lack of reserve resources for unforeseen cases (management does not include the cost of the transaction prevention and minimization of risks). A small number of organizations successfully apply the methodology of risk assessment and management, which can prevent and reduce the impact of most of the factors that adversely affect the integration of companies in the planning of mergers and acquisitions. This trend is associated with increased uncertainty of the external environment and unpredictability of the economic situation, as well as the laboriousness of risk management activities (Bazhanova M.I., 2015).
7. Lack of proper documentary support for the transaction, violation of legislative regulation;
8. Excessive slowness in deciding on a transaction - can lead to a sharp decline in the fair market value of the organization, an "omission" of the moment when it is necessary to quickly part with assets that shake the financial situation of the organization,

Among the reasons for the second group, arising after the conclusion of the transaction, the following are most important:

1. Lack of strategic management of the target company;
2. Failure in the implementation of the synergistic effect - is conditioned by the conflict of interests of the participants in the transaction, the desire by each organization to gain controlling powers, to concentrate the key power in their hands;
3. Inability to quickly implement integration and post-integration measures - the inability to quickly integrate the acquired firms, indicating the main goals and responsibilities of each new unit (Lenichenko I., 2010);

4. Diversion of financial resources from the core business in order to maintain business reputation, financial stability;
5. the excess of the price paid for the sale of the transaction over the present value of the expected future cash flows, the effect of dilution of shares - in the international appraisal practice, mergers and acquisitions use the concepts of fair value of the business, reflecting the interests of the parties' mutual interests, and in Russia the notion of a market value, which is not entirely correct to use for this purpose, since it involves an assessment for a subject not burdened by subsequent participation in a merger transaction or ingestion (Michurin O.Yu., 2016);
6. Withdrawal of key management personnel (due to contradiction of interests, resistance to changes, psychological incompatibility of leaders and top management of the transformed enterprises);
7. Underestimation of the complex of differences between organizational cultures and management systems of integrated companies;
8. Mistakes in the process of key personnel appointments - when executing a transaction, organizations need to rely on the effectiveness of senior management, even if it requires hiring new employees (Nesterenko N. Yu., 2016);
9. Discoordination of working interaction of different levels and units;
10. Instability of the market situation at the time of the conclusion of the transaction, etc.

An important criterion for a successful M & A transaction is the cost for which the target company is acquired. Allocate fair market and investment value. Obviously, a transaction is advisable when the price paid for the target company is between its fair market value and investment value. The final price is negotiated. The difference between the paid price and the fair market value is called the control premium, that is, it is that part of the synergistic effect that the buyer of the company-target gives to the seller. The higher the premium, the less the buyer will benefit. As a consequence, it can be seen that the premium to synergies ratio shows when the buyer company overcharges for the target company.

Evaluation of synergy is important for determining the optimal price of the company before its purchase to assess the feasibility of the transaction. In this case, a promising method will be used for the calculation (it helps to estimate the synergistic effect before the merger).

The following sources of synergistic effect stand out:

- Market power, increased due to reduced competition;
- Savings received as a result of increased activity;
- R & D cooperation;
- sharing of facilities, infrastructure and resources;
- Diversification of risk.

Consider synergetic effects on examples of transactions involving Russian companies.

- 1) The merger of the holding company "Tele2 Russia" with the mobile division of "Rostelecom".

The largest transaction in 2014 was the merger of the mobile division of "Rostelecom" with the holding company "Tele2 Russia". The value of the merger transaction was \$ 3.50 billion. Due to this transaction, the telecommunications sector became the most demanded sector of the market, and its indicators accounted for 34% of the total market volume. As a result of this transaction, "Rostelecom" received such synergistic effects as:

- Marketing benefits - the company "Tele 2" has almost completely switched to using the lines of the company "Rostelecom". As the top manager of "Rostelecom" noted: "To reduce our costs, we agreed on the location of the joint equipment, and also began to buy together the advertising time"²;
- Complementarity in the field of R & D – "Tele2 Russia" has built a high-quality 3G / LTE network in Moscow ("Rostelecom" did not have GSM frequencies in the capital), and "Rostelecom" started working on the Tele2 network as a virtual operator (MVNO).

²<https://www.vedomosti.ru/technology/articles/2017/05/03/688567-rostelekom-tele2>

- Market or monopoly power. The merger of the mobile cellular companies "Rostelecom" with "Tele2" increased the company's influence, which made it possible to compete more seriously with the Big Three operators.

2) Association of Unilever and the "Kalina concern".

In 2011, Unilever and the Kalina concern merged.

Unilever is a British-Dutch company that is one of the world leaders in the market of household chemical products and food products. In Russia, Unilever owns eight enterprises. Russia is among the twenty largest markets for Unilever.

The main brands of the concern "Kalina" are the following brands: "Clean Line", "Black Pearl", "Velvet Hands", "One hundred recipes of beauty", the men's Ultimatum line in skin care products, "32" and "Forest Balm" in means for oral care³.

As a result of the transaction, the following most possible operational synergistic effects were identified:

- Financial savings due to lower transaction costs - the synergetic effect resulting from savings in the purchase of raw materials; synergetic effect resulting from lower transport and fuel costs;
- Internationalization of transactions - the merger transaction allowed Kalina's products to enter the world market;
- Marketing benefits - for example, the synergistic effect resulting from the pooling of media services;
- Savings on a scale - a synergistic effect by reducing duplicate staff;
- Complementarity in R & D - Kalina can achieve savings through the introduction of the innovative Micro Motion unit that Unilever uses.
- Increased market power due to reduced competition - the transaction allowed to increase the influence of Unilever in Russia.

3) Accession of the Morton Group of Companies to the PIK Group of Companies

One of the largest deals in 2016 was the purchase of a 100% stake in Morton by PIK. As a result of the transaction, the company Morton ceased to exist, all the assets of Morton moved to the company PIK. Both companies at the time of the transaction were the largest developers in the territory of Moscow and the Moscow region. In 2016, Morton Group took the first place, and PIK Group was the third largest construction company in the territory of Moscow and the Moscow Region. The purchase of the company Morton cost PIK in 11.7 billion rubles, excluding debt. Dmitry Trofimov, head of the valuation department at the MEF-Audit, assesses the fair value of the entire Morton business at 165 billion rubles. Without taking into account the debt, which in autumn 2015 was 20 billion rubles.

As a result of the transaction, the following synergistic effects were identified:

- Increased market power due to reduced competition - PIK Group has become Russia's largest developer in terms of construction. Also, thanks to this transaction, PIK Group got access to the rich land bank of Morton Group of Companies, which is the most important reserve in the development of the construction company, which will allow PIK to significantly expand the geography of its projects.
- Savings on a scale - PIK Holding Sergey Gordeev fired a thousand people from the state of the development company Morton after the merger, Kommersant writes. As the analyst Sberbank CIB Julia Gordeeva said, in total 3 thousand people from the number of Morton employees will be reduced.

4) Megafon acquired a controlling stake in Mail.ru Group.

In January 2017, Megafon completed the acquisition of a controlling stake in Mail.ru Group. The total amount of the deal was \$ 740 million.

Mail.ru Group was established in 2010 on the basis of the DST holding, which bought shares in various Internet assets. The company's shares are quoted on the London Stock Exchange. The group of companies Mail.ru Group includes: the portal Mail.ru, social networks "My Mir", "Odnoklassniki" and "Vkontakte", the developer of mobile games Pixonic, a division of online games, aggregators for the delivery of food from restaurants Delivery Club and ZakaZaka, as well as

³<https://www.unilever.ru/brands/our-brands/kalina.html>

other companies. All these services and resources will be managed by MegaFon.⁴

In the company "Megafon" the need to acquire Mail.ru Group is explained by the fact that at present the mobile communication market in Russia has faced "zero growth". The average revenue per subscriber falls, as well as competition for high-margin subscribers. In this regard, the company Megafon intends to bet on "digital" users who are actively using mobile Internet, and the deal with the company Mail.ru Group provided the operator with a "natural" opportunity for expansion in this direction.

It can be concluded that the creation of value added is the main motive for most M & A transactions, manifested in the implementation of a synergistic effect.

Thus, in order to minimize the possibility of unsuccessful confluence of circumstances and the negative effects of the transaction, the management of the organizations participating in it must take the following measures, depending on the stage of the reorganization process:

1) Before the transaction is announced (preparatory stage):

1. Search for answers to key complex questions about the reasonableness of the transaction, the degree and type of integration, the level of financial dependence between organizations, the level of risks and timing of the reorganization in order to minimize uncertainty in the external environment and determine a clear direction for the organizations participating in the transaction. Practice shows that the best results are achieved by integrators, not just following the merger slogans resonating with the markets, but also seeking answers to these strategic questions in advance (Annema A., Bansal R., West. A., 2015).
2. Awareness of the specifics of the transaction and an exceptional approach to it - one of the most important conditions necessary to minimize possible negative consequences of the transaction is the recognition of the fact that "typical" transactions do not exist: the whole

array of transactions can be differentiated according to classifications, but apply a single approach to their analysis without taking into account the specifics of a specific situation is ineffective. As a result of the generalization of various studies, the following conditions are singled out, under which the objectives of the transaction, as a rule, become more achievable:

- Horizontal transactions are often more effective because of growing market power and rising prices;
 - Payment of cash transactions is less risky than other methods of financing the transaction, reduces the weighted average cost of capital, increasing the overall efficiency of the transaction;
 - The implementation of strategic mergers, other things being equal, shows greater efficiency by achieving synergies from integration in various spheres (Alekseenko A.G., Zyza V.P., 2014).
3. Defining a specific strategic vision for the future of organizations in the form of a detailed and convincing set of plans to address the root cause of unsatisfactory financial condition, strengthen the market position and increase the value of business, as well as activities to achieve the stated goals.
 4. Diagnostics of cultural differences: one third of mergers and acquisitions fail because of the inconsistency of the organizational cultures of the merged companies. Even before the deal is announced, the culture can be assessed with the help of so-called "cultural markers" - values, guidelines, principles and working conditions; as well as targeted interviews of current and former employees, to establish the types of specific management practices in both companies. Using this knowledge, you need to establish a vision of the future culture of your company, built on the strengths of both organizations, as well as focusing on "bottlenecks" (Rehm W., West A., 2016).
 5. Evaluation of the attractiveness of the transaction from the perspective of key stakeholders, such as owners (investors), the board of directors, employees (including trade unions and working councils of relevant

⁴<https://corp.mail.ru/ru/company/mission/>

programs), clients, suppliers, government agencies and communities, and the development of programs of consistent persuasion them in the potential benefits of the transaction.

2) Between the announcement of the transaction and its conclusion:

1. Substantiation of a merger or acquisition strategy, identification of optimal timing for its implementation: companies that failed to achieve their goals from integration in the first two years are unlikely to achieve them at all, that is, the ability to realize synergy is crucial, and too long planning and preliminary the study of the transaction leads to delays in its implementation and the loss of potential benefits (Ivanov A.E., 2015).
2. Isolation of the work on integration planning and risk management before the closing of the transaction, the means stabilizing the company - for this purpose a team of highly qualified objective leaders focused directly on the transaction and monitoring the progress of its implementation from day to day is assigned.

3) After the closing of the transaction:

1. Do not start to fundamentally change the principles of joint business on the same day: too often, companies overload workers on the first day with information about operational and strategic changes that will be better absorbed and implemented over time, so it is necessary to implement smoothly and smoothly the changes in order to avoid psychological pressure on the collective, mass resistance to reforms (Singer S., 2016).
2. Restoring trust and cultural integration in key areas of business, communication, role modeling (responsibility allocation) and deciding on the question of "who is in charge" (which leadership is above) - often this process is very laborious, complex, requires sufficient time and competent legal clearance, as well as distracting employees from operating activities, preventing them from concentrating on the future of the company as a whole. Having restored confidence, it is possible to demonstrate openness and transparency, to inspire confidence that managers know what they are doing. The new management team has an excellent opportunity to confirm all past

mistakes and start activities "from scratch" (Nasyrova S.I., 2012).

3. Evaluation of the degree of achievement of synergies: often in the short term there is a certain gap between planned and actual synergies - in order to avoid such consequences, organizations need to compile and implement a system of goals at different levels, as well as a set of control measures and incentive measures. The goals to be set should be consistent with the principles of SMART: be clear, measurable, substantial, achievable, time-limited (Kengelbach J., 2013).
4. Maintaining a positive business reputation - for many managers branding events seem to be only additional marketing costs, but they can serve as an effective way to increase customer and employee loyalty, geographical expansion and business diversification.
5. The interests of other interested parties can not be ignored - given the transaction costs, most managers ultimately create a single plan for communication with employees, fewer leaders give considerable attention to other stakeholders: trade unions and human resource councils (in general have clear ideas about what needs to be changed in the focus of employees); customers and suppliers; regulators and other branches of government (the concern of this group is centered around health, product quality and safety, although the loss of job potential and their impact on the local economy will also be significant); board of directors, etc. (Merzlikina G.S., 2011).

The main reason for the stagnation of the Russian mergers and acquisitions market is the fears of potential investors about the geopolitical situation in the country and the uncertainty about the termination of sanctions against Russia.

To resume activity growth in the Russian market of mergers and acquisitions, it is necessary to stabilize the geopolitical situation in the country and pay more attention to economic growth. Provide state support to domestic and foreign investors who are interested in long-term investments in the Russian market. Thanks to the Banking Sector Consolidation Fund (FCCS), experts created by the Central Bank of Russia to improve the Russian banking system expect growth in

transactions in the mergers and acquisitions market. The banks themselves, sanitized by the Central Bank, are becoming very interesting assets for investors.

To increase the effectiveness of mergers and acquisitions, the following should be done:

- Reduce the time of merger or acquisition. Delays in the transition slow growth, reduce profits, reduce the level of trust in the company, reduce productivity, which leads to missed opportunities and a decline in market share. On the contrary, the acceleration of the merger or acquisition process can lead to a faster return on investment, the opportunity to better exploit new opportunities for business growth and reduce the risks of uncertainty of the company;
- Ensure prompt communication with all stakeholders: investors, customers, suppliers, employees, business partners, the public. It is important to provide for all forms of dissemination of information to inform all stakeholders and to establish an effective feedback mechanism;
- Create a clear integrated management structure. It is necessary to timely determine the organizational structure for the period of the merger or acquisition transaction, clearly understand the roles of all the interacting participants in the process. At the same time, the structure of integrated management should be consistent with the objectives of each stage of the transaction;
- Ensure that there is a clear long-term merger or acquisition strategy. The ability to quickly translate strategic objectives into tactical ones is a prerequisite for achieving the economic benefits of a merger;
- Identify priorities and focus on key tasks. It is necessary to identify potential sources of effectiveness for assessing the likely economic effect from each source of synergy, the possibilities and time to achieve this effect, and only after such an analysis - to provide the necessary resources;
- Use a systematic approach to managing a merger or acquisition transaction.

Thus, when planning a merger and takeover transaction, one can not exclude from consideration

possible reasons for the failure of business reorganization, potentially capable of arising at various stages of the transaction, both internal and external. To prevent minimizing the factors that negatively affect the outcome of the transaction, organizations need to follow a certain integration algorithm developed individually, taking into account the specifics of the organizations being merged, available financial, production resources, human resources and available technologies, business reputation. as well as the size of the business, strategic development plans and many other factors, that is, measures are needed to compare the expected synergistic effect from the transaction and the costs of its implementation, as well as subsequent changes in the integrated companies.

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