ARGUMENTA OECONOMICA
No 1-2 (19) 2007
PL ISSN 1233-5835

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POLISH CAPITAL GROUPS DURING TRANSFORMATION

Capital groups have become known in Poland only after 1989. Since then, they have come across a significant evolution – they grew in size, they consolidated, they expanded abroad. The specific feature of the Polish capital groups is their low level of internationalization and a high degree of centralization resulting from the fact that they typically have chosen a form of a concern. The studies of Poland's largest capital groups listed on the Warsaw Exchange show their growth strategies and make it possible to assess whether the forms and management methods are consistent with the chosen strategy.

Keywords: Capital group, holding company, concern, growth strategy, diversification, internationalization, centralization of management, acquisition

INTRODUCTION

The research of an enterprise in Poland has mostly neglected a problem of corporate structural changes, particularly related to the changes in corporate strategies. The process of transforming companies into capital groups as a consequence of the increase of their sizes and of their degree of complexity is particularly interesting. This paper presents the results of studies aimed at the examination of the relation between the type of growth strategy followed by a capital group and its inner structure (Romanowska 2006).

Modern complex business organizations are no longer dominated by hierarchical links typical for organizational structures, instead, capital and contractual links are regarded as more capacious and flexible. A. Chandler was first to emphasize the relation between growth strategy and organizational structure which should allow the introduction of strategic changes (Chandler 1990). A. Chandler has defined just one dimension of strategy – a degree of product diversification. Chandler's proposition implied that product diversification increase should be accompanied by a structure centralization decrease. Hence, for one-product companies, he suggested a functional specialization based structure, whereas companies

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following concentric diversification should apply a more decentralized structure, and split into more independent divisions according to a product criterion. For conglomerates, or horizontally diversified companies, Chandler proposed a holding company structure, with divisions obtained according to either a product or a branch criterion, and transformed into separate capital companies.

Today, Chandler's assumption that strategy should necessarily be adjusted to structure remains valid, but the number of parameters describing strategy and differentiating structures has increased. Chandler's model does not consider the variation of structure depending on whether the company operates in a single country, in many markets abroad, or follows a global strategy. The model does not take into account structural revolution brought about recently by the use of the Internet in various business functions. Trends towards globalization of companies as well as the application of advanced Internet technologies generate a demand for strongly centralized structures with considerable capital and contractual relations. With company operations more complex due to its product and spatial diversification, the hierarchical links become less capable and more restricted, therefore contractual and capital relations are more needed.

Capital groups emerge as a structure best adapted for large diversified and globally active business organizations. They are an attractive option among complex organizational structures existing since the 19th century, and have become widespread in the middle of the 20th century. M. Trocki identifies the following essential arguments in favour of such rapid propagation of capital groups (Trocki 2004, p. 21-22):

- aiming at economies of scale and diversification effects,
- the need to focus operations on core competencies, and to reduce risks,
- aiming at optimization of total effect of activities and at stimulation of local entrepreneurship.

Capital groups in developed countries have significant political and economic power. Their turnovers often reach tens of billions of dollars, and their market value exceeds multiples of budgets in many European countries. Large companies in developed countries have been accumulating capital and improving their operations for many decades. The beginnings of large Japanese concerns such as Mitsui or Sumimoto reach back to the 17th and 18th centuries, and the Swedish Stora from the Wallenberg group is 700 years old. Mitsubishi and Suzuki date back to the 19th century, also DuPont, Kodak, Siemens and Royal Dutch/Shell are over 100 years old. The average lifetime of the Fortune 500 list is estimated to about 50 years. Therefore, in order to build a strong capital group, time and good capital investments are needed. In Poland, as of 2006, capital groups represented about 30% of the largest 500 Polish companies, however, the average lifetime of those groups does not exceed 10 years.

There have been various attempts to identify and to study peculiarities of Polish capital groups. The research carried out at the beginning of the transition period shows the directions of development of Polish capital groups, and explains why they are special (Romanowska 1998).

The research presented in this paper aimed at analysing the relations between selected attributes of a company strategy and the structure of its operations. Two dimensions have been selected: a range of branch diversification in company operations, and a range of market diversification defined as a geographical range of operations.

Each capital group under study has been characterized by means of the following parameters:

1) A method of company formation:
   - by acquisition of existing companies;
   - by separation of divisions from the parent company and transforming them into companies;
   - the parent company forms new companies;
   - by the ownership consolidation.
2) Links of operations: vertical, horizontal, conglomerate, and mixed.
3) Location of companies: domestic and international.
4) The type of a group as regards the role of the managing company:
   - concern (operational holding company);
   - strategic (managerial) holding company;
   - financial holding company;
   - mixed group.

The research was carried out on all Warsaw exchange listed companies whose market capitalization exceeded PLN 1 billion at the end of October 2006. Financial sector companies were excluded from the study because their diversification is restricted by legal regulations; also several other entities were excluded because they failed to submit essential information. Thus, a list emerged of 36 most valuable production and trade companies which were capital groups.

1. EARLY EXPERIENCES OF CAPITAL GROUPS IN POLAND

As regards the degree of company concentration, Poland is still far under the US or even Europe’s levels. Unlike in the West, Poland’s capital groups have not been formed over decades of capital accumulation and ongoing concentration of activities. They emerged suddenly in 1989 as a response by enterprises to radical change in circumstances of operations and to freedom of business decision making. The primary impulse for the formation of Poland's first capital groups have been, on one hand, the lost possibilities to operate in existing markets, and on the other hand, the change in legal and systemic regulations which allowed to form such groups. Antimonopoly regulations have been crucial, as well as the possibility to acquire companies and to cooperate with foreign investors. The strongest Polish capital groups today reach back to socialist enterprises. These are particularly the companies which succeeded in building up a huge business potential in the centrally planned economy, and after 1989 they were capable of being totally restructured and shifted towards the requirements of the market economy.

In the new reality there were no cooperative linkages, no former markets, no technologies, no good products or money for their development, and there were antimonopoly regulations. Such reality forced state-owned enterprises to seek new methods to survive and to grow. They were seeking the methods to sustain, and even to expand, their potential without being accused of re-establishing a monopoly. That group of enterprises was interested in an attractive growth option by means of branch diversification, i.e., entry into new sectors of activities with the existing common management of the entire company.

Another path of capital groups formation based on former state-owned enterprises has led to new independent entities being separated by the centrally managed process of transforming state-owned enterprises into State Treasury companies. A number of large state-owned enterprises have been transformed in this way to branch holding companies.

The large Polish banks have experienced a completely different process of capital groups formation. The process of bank consolidation by takeovers of weak banks or mergers of strong banks was accompanied by their entry into new types of activities, not only financial services.

The last path of capital groups formation is based on the former state-owned enterprises who followed the Mass Privatization Programme. That unique way of privatization of several hundreds of state-owned enterprises has led to the emergence of fifteen National Investment Funds, which were large capital groups relative to Poland's circumstances.

The common feature of the presented paths of capital groups formation was their strong relationship with the processes of privatization and demonopolization of Poland's economy. This way of Polish capital groups formation can be referred to as the way of transformation.

In addition to those distinctively Polish paths of capital groups formation, there has been a normal process of capital group formation since the beginning of the transition period, and even earlier, similar to other countries in the world. I mean Polish private enterprises formed after 1989, and enterprises founded by Poles and foreigners, which have been developing and transforming into capital groups. Newly created private enterprises have been seeking possibilities to place their financial surpluses in new markets and in new sectors. The privatization process was creating many options of attractive purchases of enterprises. A big share in many new capital groups belongs to foreign capital.

Young capital groups started at the same moment in time, but under various legal and systemic regulations, and with a different economic situation, thus, they followed different directions and paces of growth. After several years, significant differences between groups development strategies and ways of their functioning were evident. Polish capital groups differ from each other as regards the level of branch diversification (diversified groups and branch specialized groups), the method of formation (by merging or by separating), and also the activeness in the group's enlargement and selection of ways of growth (acquisitions, alliances, new agencies of own enterprises).

The research carried out in the mid 1990s suggests that the strongest influence on the diversity of strategies among capital groups had the way of their formation and the economic situation of enterprises initiating the groups creation. The differences in the way of thinking by management, and their managerial skills are also important. Each of the above listed paths of capital groups formation was peculiar, and was creating, at least at an early stage, diverse conditions for the development of capital groups.

The origins of Polish groups, the importance of restructuring and privatizing reasons will be influencing the shape and the character of Polish capital groups for many years to come, which is evidenced by the results of our research presented in the remainder of the paper.

2. POLISH CAPITAL GROUPS IN 2006 – RESULTS OF RESEARCH

The examination of 36 capital groups resulted in the identification of two dimensions of their development strategies – the level and character of branch diversification, and the level and character of internationalization. Table 1 presents the variants in strategies of companies under study as regards the level and character of branch diversification.

Table 1

The types of diversification in companies under study

Diversification strategy	Number of companies
Specialization in one sector	11
Weak concentric diversification – several sectors in one or several branches	15
Strong concentric diversification – many related sectors and branches	6
Mixed diversification – concentric and horizontal	3
Lateral diversification – conglomerate	1
Total	36

Source: author's elaboration based on own research

Table 1 proves that a clear majority of the largest capital groups either specialize in one sector or diversify concentrically in one or several branches. A few companies are horizontally diversified, and only one company is a typical conglomerate. This can be explained by the opportunity to simultaneously realize economies of scale and of synergy as well as that extensive scope of activities facilitates a strategic and operational control by the managing company.

Table 2 presents the strategy diversification as regards the character and degree of internationalization.

Table 2

Types of international strategies in companies under study

International strategy	Number of companies
Domestic operations exclusively	10
Import and export carried out by a parent company	3
Import and export carried out by foreign agencies	11
Own production units abroad	12
Total	36

Source: author's elaboration based on own research

An amazingly large proportion of the examined groups is either active only in Poland or carries out export by their headquarters in Poland. This is not because of their aversion or inability to operate in a sector, but rather because those companies belong to multinational corporations and have been assigned a task to operate in the local market. Half of the groups follows an advanced international strategy and carries out operations in their agencies abroad.

By means of a well-known model of growth strategy by H. I. Ansoff, I tried to discover a correlation between the two dimensions of growth strategies in companies under study: the product development (product diversification) and the market development (geographical diversification). The results are presented in Table 3.

Table 3

Growth strategies in companies under study according to Ansoff's model

		Market development				**Total**
		A Local market	B Domestic market	C Multinational market	D Global market	
Product development	4. Unrelated branches		3	–	–	3
	3. Related branches	2	6	–	–	8
	2. Several or all sectors in a branch	6	8	–	–	14
	1. Several or all products in a sector	3	10	–	–	13
Total		11	27	–	–	38

Source: author's elaboration based on own research

Contrasting the two dimensions of strategy shows that they are substitutes to a limited degree only. The majority of less branch-diversified companies operate on a global scale, but the correlation is weak. The most frequent model of growth strategy in the largest Polish capital groups consists of one sector specialization and in the global scope of operations.

The research shows that large Polish capital groups are typical concerns. In the sample of 36 groups under study, with capitalization greater than PLN 1 billion, only 3 groups were strategic holding companies. Table 3 compares the structures of large capital groups in Germany and in Polish groups under study.

Table 4

The structure of capital groups in Germany and in Poland

Types of capital groups	**Germany**	**Poland**
Operational capital groups	56.4%	88.9%
Managerial capital groups	34.5%	11.1%
Financial capital groups	9.1%	–

Source: M. Trocki, Grupy kapitałowe…, op. cit, p. 73 and own elaboration based on research

The analysis of capital groups origins shows that the typical methods of their formation were: new companies formation (24 cases) and acquisition, i.e., additions of newly purchased enterprises to a group (23 cases). In 18 capital groups, companies have been formed by separation of departments or divisions from a parent company and by their transformation into subsidiaries, usually with 100% shares owned by a parent company. Consolidation as a method to create a capital group was pursued only in 3 cases, and was accompanied by a takeover of a company under pressure from another capital group.

A hypothesis was formulated and verified that a method of capital group formation depends on the past of an enterprise: groups from the transformation of state-owned enterprises have been mainly created through separations, whereas those emerged after 1989 have been created through acquisitions and de novo formation. Table 5 presents the results of the research.

Table 5

The origins of companies under study vs. typical method of subsidiaries formation

Origins of a company	**Typical method of subsidiaries formation**				**Total**
	A	S	N	C	
It existed before 1989 as a state-owned enterprise	9	11	1	–	21
It emerged after 1989 or existed before as a private enterprise	3	3	8	1	15
Total	12	14	9	1	36

Source: author's elaboration based on own research

Notes:
A – acquisitions of existing companies;
S – separation of divisions from the structure of a parent company, and their transformation into companies;
N – new companies formation by a parent company;
C – ownership consolidation.

The correlation between the origins of companies under study and a typical method of subsidiaries formation seems significant. Those companies which were state-owned enterprises before privatization typically formed groups by separating departments or divisions from their own structures, and also by transforming acquired entities into own subsidiaries. Those enterprises which emerged after 1989 or existed earlier as private firms typically created new companies by founding new entities.

CONCLUSIONS

The research over the relationships between corporate strategies and their structures allow to formulate many cognitive and methodological conclusions.

The cognitive conclusions are the following. There is a significant influence of a strategy pursued by a company on the structure of its activities. The most influential factor is the size of a company and its growth expansion. All large public companies operating in Poland are more or less developed capital groups. Moreover, motivations towards accelerated growth and pursuit of capital mainly contribute to the transformation of enterprises into capital groups. The research proves that the internationalization of a company is also a significant motivation. Large exporting companies and those which locate abroad other than trade operations tend to found foreign chapters as subsidiaries or associated entities. Internationalization usually requires that joint venture companies must be founded with local entrepreneurs or foreign entities must be purchased, which is only available for capital companies. We also found that an advanced internationalization compels enterprises to form separate entities operating abroad, i.e., to decentralize this corporate function.

The relationship between product diversification strategy, the type of capital group, and level of centralization in group management is less evident because the sample under study included both specialized as well as strongly diversified groups. All companies are capital groups, and their character as regards management centralization is not significantly different. It seems that notwithstanding competency factors which encourage the decentralization of managing strongly diversified groups, the ownership's reasons prevail – i.e., the general unwillingness to decentralize power and control.

The analysis of how new subsidiaries emerge in a group has some interesting findings. A correlation with the origins of groups has been proved. Old, post communist groups more often were founding companies by separations, whereas new groups preferred acquisitions and creation of new companies. Consolidation was found relatively seldom, which may result from the young age of capital groups under study; consolidation will follow with time.

The research assumed that we study one-sided influence of some attributes of strategy on the method of capital groups formation. One may hypothesize that in many cases there is a reciprocal relationship. For example, knowing that an enterprise is a capital group increases the probability of horizontal diversification, because it is easy: within a group, with no need to acquire competencies in a new domain, it is possible to acquire a company from an unrelated sector, and to successfully manage it. Choosing a form of a capital group is also a significant factor in persuading an enterprise to expansion through mergers, acquisitions and strategic alliances. It also facilitates the strategic reorganizations through easier outsourcing and smaller range of vertical integration in a company.

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Received: May 2007