# Mergers and Acquisitions: Their Role in the Process of Diversification of an Enterprise

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*SUMMARY*

*This article aims to present the possibilities of using mergers and acquisitions (M&As) in diversification. Its theoretical part contains definitions of diversification and a review of literature on M&As in enterprise growth. Next, it analyzes the M&A market in Poland compared to the markets of Central and Southeast Europe. It presents diversification in the light of the main theories of firm growth and contains a review of the research on the subject of diversification as a growth concept of companies. The empirical section presents case study analyses of six Polish companies regarding the ways in which the firms pursue diversification. The research shows that the dairy companies engage in product diversification, while the meat firms implement industrial diversification. The companies examined in the course of research exemplify the phenomena connected with the use of M&As in diversification.*

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## INTRODUCTION

The subject of mergers and acquisitions (M&As) has been discussed in the literature for many years and from various perspectives, both theoretical and empirical. Many scholars (Manne 1965; Walking & Long 1984; Allgood & Farrell 2000; Brigham & Houston 2001; Domadaron 2002; Gaugham 2002; Krug & Aguilera 2005; Arthaud-Day et al. 2006; Frąckowiak 2009) emphasize the role of M&A deals in enterprise expansion. They make it possible to access new organizational resources and markets, and frequently lead to diversification.

The issues concerning diversification are primarily connected with the growth concept of an enterprise (Ansoff 1957). Diversification is also analyzed on the grounds of the theory of firm growth as well as on the basis of the resource-based theory of a firm: Penrose (1959), Wernerfelt (1984) or Geroski (1999). Firm growth through diversification received attention also from Marris (1963, 1964) and Coad (2007). Other scholars such as Douma (1991), Grant et al. (1988), Montgomery (1982), Porter (1987) or Rumelt (1982) analyze the reasons for and methods of diversification and show that the greatest success is achieved by those firms that adopt the strategy of related diversification. This view is confirmed by the latest research (Jarosiński 2002, 2004; Romanowska 2004; Ferris et al. 2010). However, the theoretical studies that have been conducted so far leave a research gap. They do not go deep enough into the role of mergers and acquisitions in the methods of diversification. There is insufficient research regarding the use of mergers and acquisitions in the process of firm growth as well as the market-product character of diversification.

The objective of this article is to present the possibilities of using mergers and acquisitions in the strategy of diversification. The first part of the paper contains a survey of the literature. Firstly, the main definitions of the term ‘diversification’ are presented. Next, the article discusses M&A related issues and analyzes the M&A market in Poland, as opposed to the markets of Central and Southeast Europe. On the basis of the literature on the aforementioned subject, diversification is described in the light of the main theories of firm growth. Furthermore, the paper presents a review of the most important studies on diversification. It also cites research results concerning the use of M&As in two key branches of the Polish economy, namely, the dairy and meat industries. What is more, it identifies the top transactions that took place on the analyzed markets.

In the available studies concerning the use of M&As in diversification, the issue of the relation between them is only one element of given research, if it is at all discussed. Therefore, there is a need to conduct deeper analysis of this subject.

The second part of the paper presents the research methodology. It describes the methods adopted to carry out the study and carefully explains why given firms were selected for the purpose of the research. In order to illustrate the role of M&A deals in diversification, the case study method was employed. It was used to perform an in-depth analysis of two firms operating in the dairy industry *(SM Mlekpol* and *SM Mlekovita)* and four firms from the meat industry *(GK Animex, GK Sokołów SA, PKM Duda SA GK,* and *GK Farmutil HS SA)*. The aforementioned companies exemplify the phenomena connected with the use of M&As in diversification.

The analyses made it possible to identify the biggest firms first in the dairy industry and then in the meat industry. The model perspective presents the deals that were closed and the profiles of activity of the firms acquired by the companies from the discussed industries.

The third part of the article presents the results of the research as well as the author's final remarks. The results of research on diversification presented here are consistent with the world trends described in the literature. They also confirm the findings of previous studies on diversification. The dominant form of diversification is external development with particular emphasis on acquisition.

The novelty of the paper lies in the fact that it describes the market-product character of diversification. The analyses of the dairy firms present possibilities of growth achieved through product diversification, while the studies concerning the meat firms point out the opportunities brought on by industrial diversification. The research conclusions and final remarks may trigger discussion about the methods of diversification of companies as the deliberations presented in this article confirm the assumption that there is a need for further and more detailed research on these matters.

## LITERATURE REVIEW

Globalization forces firms to cope with a growing number of competitors. Organizations of all sizes must combine effectiveness and competitiveness with being sensitive to the needs of their local customers. Such a situation poses new challenges to managers and necessitates dynamic adaptation. Contemporary firms are in the center of revolutionary transformations. The literature on management lists ten so-called megatrends in the changing environment of a firm. They are the following: strong growth impulses and recession processes, liberalization of economies, accelerated internationalization and globalization, increasing competition, technological advancement, shorter life cycle of products, new IT processes (virtual revolution), demographic changes, new values in the society and increasing awareness of the significance of ecology (Romanowska, 2001).

The megatrends enumerated above exert a strong influence on the economic system as well as on the concepts and methods of management. We can also observe continuous increases in the specialization, size and market value of contemporary firms. There is also a tendency to limit the scope of vertical integration and to create "slim" or even virtual firms. These changes increase the role of M&As as a method of enterprise expansion.

When analyzing the causes of M&As, Gaughan (2010: 18) directs his attention to liberalization of barriers to trade, expansion of capital markets and markets of the financial sector and development of new technologies, as well as increasing global competition. With the use of M&As firms gain access to new organizational resources and markets. They also introduce the strategy of diversification by means of investing in new sources of competitive advantage.

The literature on this subject defines diversification as a strategy involving setting up new, additional activity. This is the point of view on diversification expressed by Miller & Dess (1996: 42). Rue & Holland (1986: 124-125) emphasize that we can talk about diversification only when a company enters areas that differ considerably from its current activity. Similarly, for Mintzberg & Quinn (1992: 79), diversification signifies starting to operate on a different economic path. Another scholar (Romanowska, 2009: 67) perceives diversification as an expansion of the range of products and services beyond the borders of one sector.

As can be seen, all aforementioned authors associate diversification with the beginning of a new activity, one different than activities currently conducted, or with entering new markets with new products. Moreover, it leads to the creation of new quality in the market-product combination of an enterprise. According to Rajzer (2001: 63), notwithstanding its diversity, the process of diversification may be based on internal financing or on acquisitions and mergers with other firms.

### *M&A Deals and Enterprise Growth*

The intensification of changes taking place in the market creates the need for increasing the potential of an enterprise. Further growth may be achieved in a variety of ways, depending on the possibilities of particular companies. They frequently do not possess enough strategic potential to be able to fully take advantage of the ongoing transformations. *The Economist* (2009) presents an opinion that the process of concentration as well as the growth of large firms is caused by their increasing awareness of the risk connected with sub-suppliers. Unreliable suppliers may indeed frequently affect the production cycle in large concerns in a negative way. So as not to lose their established brands and reputation, big firms must focus on their core competences. Instead of subcontracting particular areas of their operation, the enterprises take control over subsequent links of the chain of value. Through the use of M&As, they incorporate firms considered to be crucial in their growth concept. Actions involving the purchase of an entire firm or its part become alternatives to internal growth.

Frąckowiak (2009: 26-27) defines mergers as "consolidations or combining of enterprises, whereas acquisitions refer to the purchase of stocks or shares". A merger takes place when at least two autonomous firms are combined. This is a mutual agreement as a result of which a new business unit is created. Mergers can take two possible forms. The first one involves the combining of companies of similar sizes. Their economic powers are relatively equal. The firms are liquidated in order to create a new enterprise. The characteristic feature of such a merger is the fact that each firm loses its independence and ceases to be a legal entity. A new company is founded on the existing potentials. In this respect, we should understand a merger as a *consolidation* of enterprises.

In the literature the issue of mergers and acquisitions is analyzed from various angles. For instance, Manne (1965) discusses M&A deals by looking at them from the perspective of taking control over the assets of the acquired company. The author claims that what motivates an acquisition is the price of stocks, which is lower than that which would be possible if a given company was better managed.

However, other scholars (Walking & Long 1984; Allgood & Farrell 2000; Krug & Aguilera 2005; Arthaud-Day et al. 2006 ) turn their attention to hostile takeovers. They stress that such deals are a way of disciplining managers. When a takeover deal is closed, current management is usually replaced with new management that can use a firm's potential in the right way. The risk of being replaced is a very strong motivator for managers.

In the literature, the subject of M&As is also discussed from the perspective of multiplying owner benefit and achieving the synergy effect (Hamrol & Tarczyński 2002). Synergy means *combined work*, which in the context of M&As refers to the benefits brought by combining the operations in two or more business units. The synergy is connected with the fact that firms joined by capital or integrated in terms of organization can generate greater value than a business entity which functions on its own (Hamrol & Tarczyński 2002: 132).

In this context Brigham & Houston (2001) and Domadaron (2002) analyze factors that affect the creation of synergy. The researchers find that synergy can be achieved though: operational activity (an increase of sales revenues), financial activity (lower transaction costs, reducing the cost of capital, tax benefits), diversified effectiveness of operations conducted by the merging firms and the increase of market power.

When discussing M&A-related issues it is also worth quoting Wernerfelt (1984: 175). The scholar is of the opinion that M&As provide an opportunity to trade resources that would be unmarketable in a different situation, and also offer a chance to buy or sell resources in *bundles.* This signifies that in a given *bundle* one can sell or buy a combination of technological capabilities and business contacts. The author stresses, however, that the imperfection of these transactions stems from a relatively small number of buyers and sellers as well as from the diversity of firms. As a consequence, a given firm has different value for different buyers. It is crucial for the acquiring company that the *bundles of resources* make it possible to achieve synergy between resources that a firm already possesses and those that are bought.

As has already been mentioned, M&As are one of the ways of developing a firm. They are an alternative for growth based on the internal method involving the use of a firm's own resources and skills or traditionally understood capital investment. Moreover, M&As are processes which are of great interest for modern companies. They exert an enormous influence on the competitiveness and growth of not only firms but also entire sectors, or even economy.

In the course of discussion about M&As it should be noted that these transactions carry great risk and generate additional costs. What is more, M&As are connected with the change of organization culture, management or laying off some of the employees. Therefore, they are transactions that cause a number of various effects in firms and their environment. The motives for M&As notwithstanding, these deals frequently do not lead to the expected increase of the values of the companies. Thus, they are difficult and complicated processes. It ought to be emphasized that in many cases M&As end in failure and a definite identification of the factors determining their success is not simple.

In the literature on the subject matter of this paper scholars such as Sudarsanam (1998: 234-245) analyze the consequences of M&As and carry out an extensive survey of the world research. A common feature of these studies is the conclusion that M&As frequently fail, which means that the value of a given business drops in comparison to its value before the transaction. For instance, the findings of research conducted by the consulting company Coopers & Lybrand (1993) concern the experience gained during takeovers of British firms. On the basis of this research, Sudarsanam points out the causes of the failures or successes of the transactions. The most common factors contributing to failure include: the attitude of the managers of the company that is taken over and cultural differences (85%), lack of plans concerning integration (80%), lack of knowledge about the industry or about the target company (45%), bad management of the company that was taken over (45%), lack of experience in the area of acquisitions (30%). On the other hand, the factors contributing to the success of a merger or acquisition enumerated by Sudarsanam include: the creation of detailed integration plans and the pace of their implementation (76%), a clear objective of the takeover (76%), a cultural match between both companies (59%), good cooperation with the management of the company that was taken over (47%), knowledge about the taken-over company and its industry (41%).

A similar viewpoint on the factors conditioning the M&A processes is proposed by Korpus (2014). The author is of the opinion that successful combining of firms which contributes to the increase of their value does not take place very often. Moreover, Korpus notes that a great number of successful transactions largely depend on the skills and attitudes of the managers that conduct them. When analyzing the factors influencing M&As, the scholar emphasizes the importance of *due diligence*. According to her, *due diligence* serves to investigate the target, identify its potential problematic areas in the entire transaction as well as sufficiently prepare for integration. Therefore, *due diligence* minimizes the risk carried by M&As and is one of the factors determining their success.

*Due diligence,* also called *investment audit,* is an investigation of the current condition of a given firm, the aim of which is to identify its strengths and weaknesses as well as to point out potential opportunities and dangers. Such an examination involves every aspect of the potential transaction and its result has a significant influence on the decision to take over a firm and on its price. Generally, *due diligence* concerns commercial, financial, legal, environmental and technical aspects. Particular elements of the investigation ought to identify the main risks carried by the basic activity of the target company as well as the opportunities the transaction may create. More information on the subject of *due diligence* can be found in Gąsior (2005: 177–187) or Bernhardt (1994).

The discussion presented so far shows that M&A deals involve purchasing the entire company or a part of it. Their essential element is the expectation that the combined companies are going to be worth more than the sum of their individual values would be if they functioned independently. Synergy refers to the benefits which can be obtained only when firms become one and which lead to the increase of the value added. However, it should be emphasized that M&As are difficult and complicated processes and in numerous cases they result in failure.

## *The M&A Market in Poland Compared to the Markets of Central and Southeast Europe*

The report *Poland compared to Central Europe – 2010 Edition* concludes that in the period from January 1to December 31 2009 firms in Poland closed 556 M&A transactions worth over €8.5 bn. The data concerning transaction values includes the value of operations disclosed, which make up about 72% of the total. The combined value of all the M&A deals in Poland closed in this period amounted to €12 bn. Among the 556 transactions, 36 involved restructuring within corporate groups and their value amounted to €1,827 m (KPMG & DEALWATCH, 2010). In comparison, in 2008 Poland recorded a total of 548 transactions worth almost €8.54bn.

When comparing the Polish M&A market in 2009 and 2008, we should notice that it was stable. The number of transactions rose by less than 1.5%. Moreover, the market comes out well when contrasted with the regional data. In 2009 in Central Europe 1,663 M&A transactions were concluded. Their total value (as the sum of transactions whose value was disclosed) amounted to almost €25 bn. The combined value of all the transactions was €43 bn. The data demonstrates that Poland's share in the M&A market made up about a third of all deals closed in Central Europe (KPMG & DEALWATCH, 2010).

When analysing the M&A market it is also worth quoting research results included in another report called *Central and Southeast Europe - M&A Barometer 2012.* The study was conducted by Ernst & Young in 11 countries: Bulgaria, Croatia, the Czech Republic, Greece, Hungary, Poland, Romania, Serbia, Slovakia, Slovenia and Turkey. The study revealed that only in five countries did the M&A market grow in 2012. These countries were the Czech Republic, Greece, Poland, Slovakia and Turkey. In the entire region the value of the transactions decreased by 17.6%. What is more, the findings show that in 2012 in Central and Southeast Europe 1,108 deals were closed and their value totalled $41.8 bn. In 2012 the highest number of transactions (297) was recorded in Turkey. As for the volume of closed deals, the second position belonged to Poland (276 transactions), while the third to the Czech Republic (155 transactions). As for the value of the deals, however, in 2012 Poland was in the third position with deals worth $8.02 bn. The first position belonged to Turkey, the second one to the Czech Republic. In 2012 in Poland, in comparison to 2011 ($22bn), the value of transactions decreased (EYGM, 2013).

The aforementioned research shows that in the whole region the highest number of M&As took place in the industrial, services, mining and energy sectors. Transactions of the highest value were carried out in the banking, food, and mining and energy sectors. Most of the transactions involved strategic investors. In Poland they made up 90% of the total. 59% of all the deals concerned firms operating in Poland, 30% were M&A deals involving foreign investors, while the remaining 11% were conducted by Polish firms operating abroad. The most active foreign investors in Poland were the USA, Germany and the UK.

When analysing the M&A market it is also worth quoting research results included in another report called *M&A Barometer H1 2014. Central and Southeast Europe* (2014). The report states that the total value of M&A deals in Central and Southeast Europe in the first half of 2014 amounted to US$18.5 bn. This is a rise by over a third compared with the same period in 2013. Turkey was the country that held the first position in terms of the value of transactions. It was followed by the Czech Republic and Poland. Turkey was the top country in terms of the volume of closed deals as well (153 transactions). The second position belonged to Poland (112 deals), while the third to the Czech Republic (111 deals). What is more, the report states that 629 transactions were completed in the first half of 2014 in the entire Central and Southeast Europe area (11 countries). The value of the transactions in the respective period was $18.5 bn. This is a 35.9% increase compared to the first half of 2013. Moreover, the research found that in the whole region the major target of transactions was IT companies (16%). Further targets of takeovers were manufacturing companies and service firms, which made up 13% and 10% of the deals, respectively. Other sectors in the region in which acquisitions took place were energy and mining (7%), pharmaceutical industry (7%) and real estate (7%). In Poland a majority of the M&As (63%) were closed by strategic investors, whereas financial investors completed 37% of all the transactions. The main sector of economy undergoing ownership transformations was IT (EYGM, 2014).

The analyses presented above allow one to conclude that, despite the changes in the number and value of the transactions, Poland is still an attractive country in terms of mergers and acquisitions. Over 50% of all the deals closed in Central and Southeast Europe were domestic. This signifies that both the buyer and the target company originated from the same country. In Poland, 32% of investors were foreign investors from countries such as Germany, the USA, Sweden, France and Greece. In 17% of the transactions Polish companies took over foreign firms. For instance, in June 2014 *PKN Orlen* acquired the Canadian mining company *Birchill Exploration* for over $200 m. This was the largest transaction in the oil industry. It is also worth remembering that at the end of 2013 PKN Orlen from Płock acquired *TriOil*, a Canadian company listed on the Toronto stock exchange. At the same time *Grupa Azoty* purchased the exploration rights for deposits of phosphate rock in Senegal for about $29 m. Further Polish mergers were carried out by the company *PZU*. They included the acquisition of *Link4* as well as insurance companies in Lithuania and Latvia for about €350 m. The examples of transactions mentioned above demonstrate that Polish companies are becoming more active in the international M&A market.

## *Diversification in the Light of the Theories of Firm Growth*

In the theory of strategic management the classic model of the strategy of growth of an organization was designed in the 1950s by Ansoff (1957). Primary growth strategies based on this model involve investing in product and market development. Investing in product development entails modification of existing products and introducing product innovations, but most importantly, investing in new products. Investing in market development, in turn, involves competing in geographically new markets, which leads to internationalization. According to Ansoff (1957) the next step in the process of growth of a firm is diversification, which consists in abandoning not only the current technologies of product manufacturing but also the current market structure. According to Ansoff, diversification involves relocation of resources possessed by an enterprise to actions significantly different from those that the firm carried out in the past. He also emphasizes that diversification requires involvement in industries, technologies and markets that are new for the company, with products that are also new. Therefore, diversification is an undertaking leading to growth in new fields.

In the literature the issues connected with firm growth are explained in the *theory of the growth of the firm* developed by Penrose (1959). The central issue constituting the core of the theory is the optimal growth rate of a firm as well as the determinants and limits to growth. When analyzing the mechanisms of firm growth, Penrose stresses the role of resources. On the grounds of the theory of the growth of the firm, the author treats a company as a collection of physical and human resources. The scholar claims that a firm's directions of expansion are determined by its physical resources, skills and experience of the managers as well as by its unused resources. Thus, Penrose develops the *resource-based theory of the firm*. The author also believes that a firm is not only products and markets, but also particular internal resources which are indivisible, specialized and unique for a given company. She also emphasizes the role of possessing resources and, in particular, the importance of the services which these resources may provide. According to Penrose, a firm's success is determined not only by such resources as labor or capital, but also by the quantity and quality of the services which these resources introduce into the manufacturing processes. Penrose identifies the following fundamental strategies in the process of firm growth: internal expansion, diversification, expansion through mergers and acquisitions, and innovations.

Also the work of Wernerfelt (1984: 172-173) is in agreement with the resource-based theory of the firm. In his view, a company's resources can be both tangible and intangible. Examples of such resources include the brand, accumulated knowledge, technology, qualified personnel, business contacts, buildings and machinery, effective procedures, and capital. According to Wernerfelt, all the elements connected with a company which can be perceived as its strengths or weaknesses can be called resources.

Geroski (1999: 16-30), in turn, believes that when a firm is created it possesses some particular ability or knowledge that it develops later in a unique way. This signifies that on the basis of its current knowledge, a firm learns how to develop new skills and expand its knowledge. Similarly to Penrose, Geroski perceives a firm through its resources and emphasizes that internal resources are an individual matter and firms can possess stocks of underused resources that push them to grow. As for diversification, Geroski analyzes the organizational capabilities of a company. The scholar believes that the choice of the right diversification strategy is connected with the issue of core competences, and claims that diversification should be based on an understanding what a given firm is able to do to acquire particular skills.

Diversification is also of interest to Coad (2007: 34-35), who makes reference to the managerial growth model developed by Marris (1963, 1964). From the perspective of the aforementioned model, Coad assumes that firms grow only due to diversification. Above a certain level of growth, further diversification generates lower profit. This is confirmed by observations of the events taking place on the stock market. According to Coad, the reactions to diversification announcements as well as subsequent analyses of the profits of diversified firms show that diversification tends to exert a negative influence on a firm's financial performance. Conversely, diversified firms that decide to refocus their activities improve their financial results.

Diversification entails launching new activity, different from that or those currently conducted, or entering new markets with new products. However, before a decision to diversify is made, a company should thoroughly analyze its capabilities. According to Penrose (1959: 136), it ought to take into consideration if further growth is possible in the current field of operations. What should also be thought over is whether the resources and skills of a firm are sufficient to allow it to keep its position in its field and enter new areas at the same time, as well as whether the new fields are profitable and can be conquered. Penrose believes that the diversification strategy of a company should focus on the most effective use of the resources that are already possessed. The author stresses that growth by diversification is the most effective if the new activities are related to the existing resources.

In the professional literature the issues concerning the decisions to diversify are frequently connected with M&As. At this point it is again worth mentioning the words of Wernerfelt (1984: 175, 179) who points out that potential buyers tend to limit their search for firms they would like to take over to those that fulfill some simple criteria. The scholar's opinion is that in the process of managing the buyer's resource portfolio, the candidates for product or resource diversification must be evaluated both in terms of the short-term effects as well as in terms of their long-term capabilities for further expansion.

The discussion presented so far leads to the conclusion that diversification may be an attractive form of development for many firms that have reached considerable maturity. Moreover, it leads to the creation of new quality in the market-product combination of an enterprise, because it goes beyond the current processes in the chain of value added. Diversification may be connected with the processes currently taking place in a company or be conducted in fields completely new to a given firm.

When we look into growth from the perspective of products, it can be seen that companies expand their range of goods and services as well as cover new market segments. In this aspect, product development entails broadening their product portfolio. In a situation when investment in a product is done in a firm's current sector, we speak about product diversification. Therefore, *product diversification* means expanding the range of products by adding goods coming from new market segments of the current sector of operations.

Product development leads to the expansion of the range of products offered by a given company. In a situation when investing in product development involves products from outside a firm's current sector, with time we can speak of *industrial diversification*. This means entering new areas of operations understood as new sectors of the economy. In this case a sector is defined as a group of companies producing goods or services of similar purpose and using the same supply sources. Therefore, the market character of growth entails investment in products from new sectors or industries and signifies *industrial diversification*. In this sense, diversification is understood as broadening the product development strategy.

## *Diversification – a Survey of Selected Research*

In the literature on the subject matter of this article the issues connected with diversification are viewed from various perspectives, both in the theoretical and the empirical sense. As it has already been mentioned,, they particularly concern issues related to mergers and acquisitions and the possibilities to find more beneficial conditions of operation. For instance the researchers from the field of strategic management – Ferris et al. (2010) point out growth opportunities brought on by industrial diversification and stress that it is a strategy which lets a firm use its resources effectively and achieve synergy. Wiersema & Bowen (2008) in turn, turn their attention to the process of globalization of markets and industries. The scholars also mention opportunities of diversification in the international sense.

The professional literature contains an entire branch of research on the connection between the methods of diversification and company performance. Studies carried out by Rumelt (1982) found that the firms which develop through related (industrial) diversification perform better than specialized companies (not diversified) and than those which developed through conglomerate (unrelated) diversification. However, another study (Montgomery, 1982) proved that the differences in the performance of firms that diversified their operations in different ways were a result of the type of sector structure rather than of a given type of diversification. Similarly, Grant et al. (1988) found that related diversification does not ensure better performance than unrelated (conglomerate) diversification.

Nevertheless, research conducted at the beginning of the 21st century confirms the previously widely-held opinion that initial increase in the level of diversification causes fast growth in company performance, but at the same time a too high level of diversification leads to a drop in performance (Palich et al. 2000; Gary 2005; Miller 2006). The research cited above demonstrates that for every company there exists an optimal level of diversification, and after crossing this limit a firm's profitability begins to fall.

Investigation of the relationship between the level of diversification and the economic performance of a company has been conducted in Poland as well, for example by a group of scientists from the University of Lodz (Bohdanowicz et al. 2010). Their research dealt with the subject of the strategies of public companies. The analyses demonstrated that the higher the level of diversification of a company's activities, the higher its return on assets.

In the context of the effectiveness of the diversification strategy it is worth mentioning the research conducted by a team led by Romanowska (2011). The scholars analyzed for instance the influence of the level and character of diversification on the economic performance of corporate groups. Their studies regarded three categories of enterprises: specialized groups, groups with a dominant share in one sector, and diversified groups. The findings revealed very weak dependence between the degree of diversification and financial performance measured e.g. with ROE and ROA. The comparison of economic performance of the groups that adopted the strategies of related and unrelated diversification found no relation between the type of diversification and the amount of revenues generated by the examined corporate groups.

From the perspective of designing a growth strategy for a firm, however, the earlier studies of the team of Romanowska (2004) are of crucial importance. The research *Strategic Behaviours of Polish Enterprises in Global Sectors* investigated various aspects and areas of strategic behaviors of Polish firms. In the context of directions of company development, the scholars present different strategies following the model created by Ansoff. They point out that the opportunities arising from industrial diversification allow a firm to achieve synergy.

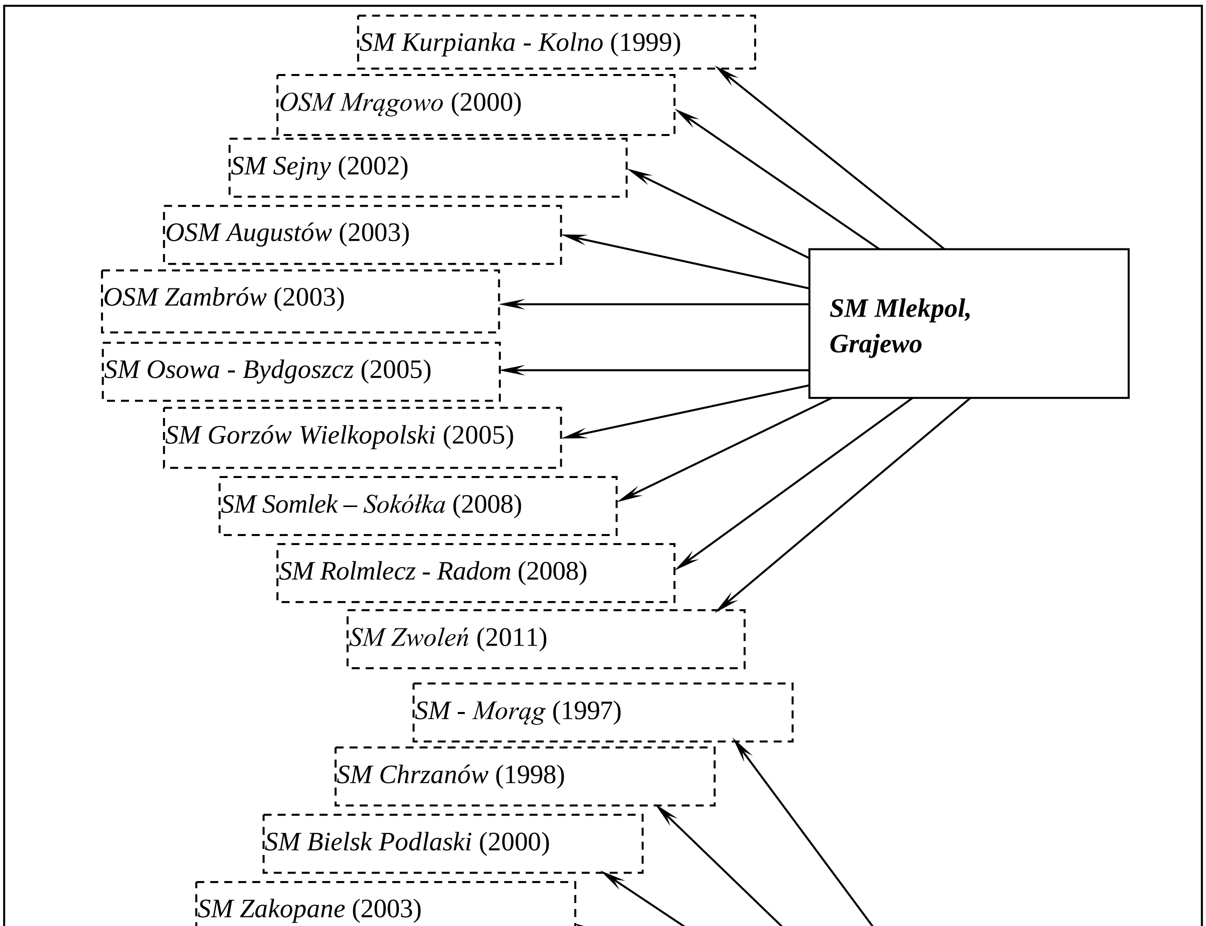
As for the methods of implementing the strategy of diversification, it is worth quoting the research conducted by Jarosiński (2002). His study examined the reasons and motives behind the Polish entrepreneurs' decisions to venture into the strategy of diversification, the methods of carrying out the process as well as the level and type of diversification. The conclusions of Jarosiński's study demonstrate that the main motive for undertaking diversification by the analyzed companies was the need for growth, while the dominant reason was the risk of losing their traditional markets. The most common way of pursuing the strategy of diversification was internal development. The dominant methods of diversification included purchasing shares in other companies, which should be understood as acquisitions usually leading to related diversification. The analyses also show that the examined enterprises were fully diversified at the time of the research.

Another study carried out by Jarosiński(2004) confirms the interest of Polish entrepreneurs in related diversification. The research investigated the changes in the level of product and industrial diversification of companies from the following five sectors: household appliances, paints and varnishes, brewing, chemical fertilizers and shipbuilding. The examination of these changes in the years 1990-2002 concluded that in the group of diversified companies the percentage of those that adopted the strategy of related diversification and those that chose unrelated diversification declined. Moreover, the research demonstrated that firms diversify their operations in a mixed way only marginally. Jarosiński also concludes that among the total of diversified companies in the analyzed period the dominant form of diversification was related (industrial) diversification.

In the context of ways of diversification, as has already been mentioned, a firm can become involved in both internal and external growth. Porter (1987) and Douma (1991), however, showed that companies tend to choose external development, with particular emphasis on acquisition. What is more, Porter concluded that as many as 74% of acquisitions in unrelated sectors ended in failure. Similarly, Douma found that 81% of entries into unrelated sectors failed, while in the case of entries into related sectors the failure rate was only 41%. The latest studies demonstrate that the greatest success is achieved by those companies that adopt the strategy of related diversification.

The issues connected with adopting the strategy of diversification also appear in the research on capital and organizational concentration of companies (Janiuk 2011, 2014). This type of study shows that, in their growth concepts, the companies pursue diversification through involvement in M&As.

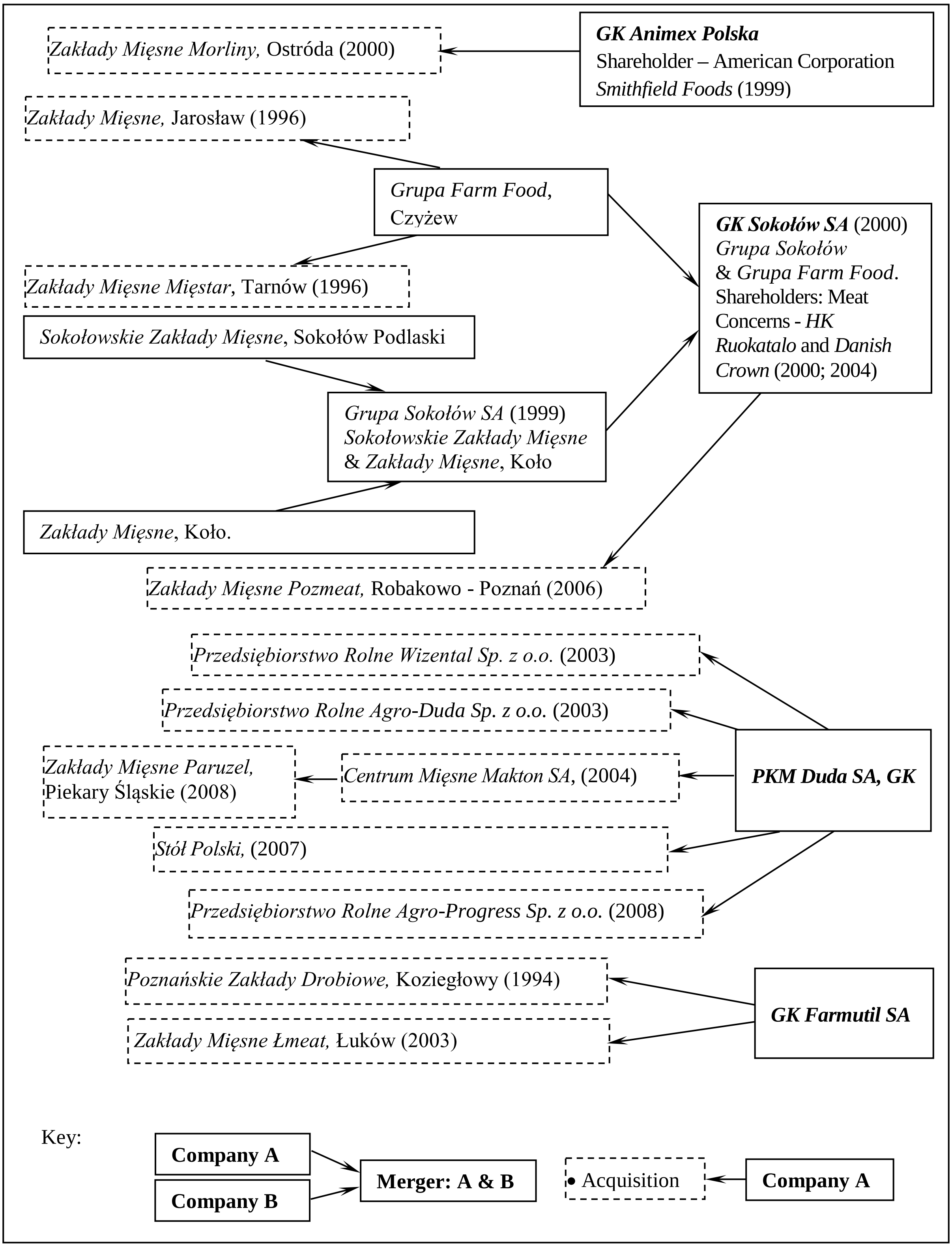
The research on the subject of concentration of the dairy industry in Poland (Janiuk 2014) identified the largest dairy companies: *SM Mlekpol – Grajewo* and *SM Mlekovita – Wysokie Mazowieckie.* These firms diversify through takeovers of smaller businesses with a similar profile. The top deals on the dairy market are presented in Figure 1.




Source: Author's own work on the basis of Janiuk (2014)

*Figure 1. Top transactions on the dairy market in Poland*

Moreover, the research dealing with the meat industry in Poland (Janiuk 2011) shows that firms strive to diversify. The study also found that the companies incorporate M&As in their growth concepts. The top deals on the meat market are presented in Figure 2.




Source: Author's own work on the basis of Janiuk (2011)

*Figure 2. Top transactions on the meat market in Poland*

### *Research Gap*

Research shows that in their pursuit of diversification, companies use mergers and acquisitions. However, the theoretical analysis conducted in this article reveals a research gap. The insufficiency of research regards the use of M&As in enterprise growth as well as the market and product character of diversification. In the available studies, which regard M&As and diversification, the issue of the relation between them is only one of the elements of the research, if it is discussed at all. Therefore, there is need to conduct a deeper analysis of the subject of the role of M&As in the methods of diversification of enterprises. Such research would make it possible to provide the answer to the following questions:

- What is the role of M&A deals in the diversification of enterprises?
- In what way do M&A deals enable a company to take control over subsequent elements of the economic path?
- How do M&A deals make it possible for companies to enter fields related in terms of technology, market or organization?

The answers to the questions posed above will make it possible to identify the opportunities which stem from the use of mergers and acquisitions in the strategy of industrial diversification of an enterprise.

## METHODOLOGY

The study uses the data gathered in the course of previously conducted analyses regarding capital and organizational concentration of companies in the two key industries of the Polish economy, namely the dairy industry (Janiuk 2014) and the meat industry (Janiuk 2011). Next, unobtrusive research was carried out. The method adopted was content analysis involving the examination of recorded texts such as books, magazines or website information (Babbie, 2008).

On the basis of previous analyses and the information from websites an in-depth analysis of the largest M&As in the dairy and the meat industry was performed. The previously carried out quantitative analyses served as a basis for the identification of the enterprises which most frequently make M&A deals parts of their growth concepts.

The next step of the study concerned the analysis of opportunities to use M&As in the strategy of diversification. The analysis of the enterprises took the form of case studies. In line with the Grounded Theory, a case study is a research tool enabling the researcher to fully understand phenomena observed in a real-life context (Babbie, 2008).

The case studies investigated the most active entities on the M&A market in the dairy industry (2 firms) and the meat industry (4 firms). The cases studied in the dairy industry are *SM Mlekpol* and *SM Mlekovita*, whereas in the meat industry the analyzed firms are *GK Animex*, *GK Sokołów SA, GK Farmutil HS SA* and *PKM Duda SA GK.* The use of case studies as a research method allowed for formulating extensive conclusions concerning the methods of diversification. In order to investigate the role of M&A transactions in the growth concepts of companies, analyses of each of the six cases was performed. The aforementioned companies exemplify the phenomena connected with the use of M&As in diversification.

The firms chosen for the study are the most active entities in their industries in terms of engagement in M&As. Therefore, considering the highly uncertain chance of success of M&A deals, which was pointed out in the theoretical part of the article, it can be generally assumed that in the cases of the firms selected for the study the transactions positively affect their growth process. The companies mentioned above have for years been actively participating in the consolidation process of their industries. Preliminary observations allow one to conclude that the analyzed firms pursue the strategy of diversification. They gradually increase their sales revenues as well as their market share (Janiuk 2011: 94; 2014: 39). However, in terms of the market-product character of diversification, dairy firms differ from meat companies. Therefore, the selected business entities are worth attention with regard to the way they use M&As to diversify their activities.

In accordance with the growth model created by Ansoff, the research presented in this paper follows its assumptions regarding the market-product character of diversification. Growth of the product character is understood as the broadening of the range of products by adding goods coming from new market segments but targeted for the current sector of operations – this means *product diversification*. Growth of the market character, on the other hand, is understood as the widening of the product portfolio, which involves entering new fields of operation perceived as new sectors of the economy – this means *industrial diversification* (related).

In-depth analyses made it possible to identify the biggest firms first in the dairy and then in the meat industry and present them in a comprehensive way. The model presents the deals that were closed and the profiles of activity of the firms acquired by the companies from the discussed industries. As a result, it was possible to formulate detailed conclusions on the subject of the role of M&As in the process of diversification of companies. Comprehensive presentation of the research results leads to the answers to the research questions posed above.

## RESEARCH RESULTS AND CONCLUSIONS

The analysis of the dairy industry demonstrates that *SM Mlekpol* and *SM Mlekovita* are enterprises which diversify their activities in the process of slow concentration of their industry. They are domestic capital companies which in the process of their growth take over smaller entities operating on the market. The takeovers they performed involved firms with a similar profile of activities and led to the widening of the firms' range of products. In the context of diversification the acquisitions allow the companies to expand their product portfolio by goods coming from new segments of the dairy market. The target entities operate in the same sector of economy (dairy processing). This signifies that, by investing in product development and increasing the variety of their products, *SM Mlekpol* and *SM Mlekovita* are involved in product diversification. Product diversification of dairy companies as well as the profiles of activities of the taken over firms are presented in Table 1.

*Table 1*

*Product diversification of dairy companies and the profiles of activities of the acquired firms*

| Acquiring company<br>Enterprise functions | Acquired company | Profile of activities after the acquisition |
|---|---|---|
| ***SM Mlekpol, Grajewo***<br>Purchase of raw milk;<br>Milk processing plants:<br>Manufacture of dairy products;<br>Distribution and sales of dairy products; | *SM Kurpianka - Kolno* (1999) | Production: ripening and smoking cheeses, cheese spreads.<br>Sales of dairy products. |
| | *OSM Mrągowo* (2000) | Production: fermented products, kefir, milk drinks, whey powder, hard cheeses.<br>Sales of dairy products. |
| | *SM Sejny* (2002) | Production: ripening cheeses, spiced cheeses |
| | *OSM Augustów* (2003) | Sales of dairy products. |
| | *OSM Zambrów* (2003) | Production: UHT milk, quarks, whey powder, powdered milk.<br>Sales of dairy products. |
| | *SM Osowa - Bydgoszcz* (2005) | Production: milk and flavoured milk, quark<br>Sales of dairy products. |
| | *SM Gorzów Wielkopolski* (2005) | Production: powdered milk.<br>Wholesale outlet of dairy products. |
| | *SM Somlek - Sokółka* (2008) | Production: yoghurts, fermented milk.<br>Sales of dairy products. |
| | *SM Rolmlecz - Radom* (2008) | Production: UHT milk, UHT cream, butter, quark, cream cheese, bio-yoghurts, full and skimmed milk, powdered milk<br>Sales of dairy products. |
| | *SM Zwoleń* (2011) | Production: powdered milk. |
| SM Mlekovita,<br>***Wysokie Mazowieckie***<br>Purchase of raw milk;<br>Milk processing plants:<br>manufacture of dairy products;<br>Distribution and sales of dairy products; | *SM - Morąg* (1997) | Production: ripening cheeses.<br>Wholesale outlet of dairy products. |
| | *SM - Chrzanów* (1998) | Production: ripening cheeses.<br>Distribution Center. Sales network of dairy products. |
| | *SM Bielsk Podlaski* (2000) | Production: ripening cheeses.<br>Wholesale outlet, Distribution Center, Sales network |
| | *SM Zakopane* (2003) | Production: mozarella cheese, smoked ewe's milk cheese (oscypek).<br>Sales of dairy products. |
| | *SM Lubawa* (2007) | Production: cottage cheeses, quark.<br>Cheese Packing Plant.<br>Sales network of dairy products. |
| | *SM Działdowo* (2007) | Production: hard cheeses, butter.<br>Wholesale outlet, Distribution Center. Sales network of dairy products. |
| | *SM Kurpie – Baranowo* (2008) | Production: Cheddar cheese, butter.<br>Sales of dairy products. |
| | *OSM Pilica* (2008) | Production: cheeses, whey.<br>Sales of dairy products. |
| | *OSM Kościanie* (2011) | Production: flavoured cheeses, cream.<br>Wholesale outlet, Distribution Center. Sales network of dairy products. |
| | *SM Susz* (2011) | Production: cheeses, whey.<br>Sales of dairy products. |
| | *SM Biała Podlaska* (2012) | Production: cheeses, whey.<br>Sales network of dairy products. |
| | *OSM Sanok* (2014) | Production: cheeses, whey.<br>Wholesale outlet of dairy products. |
| | *SM Tomaszów Lubelski* (2015) | Production: cheeses, whey.<br>Wholesale outlet, Distribution Center. Sales network of dairy products. |

Source: author's own work on the basis of the conducted research.

The subsequent stage of the research regards firms operating in the meat industry. The investigation concluded that the largest meat companies are *GK Animex, GK Sokołów SA, GK Farmutil SA* and *PKM Duda SA GK.* When we look into the methods of diversification of the studied firms, what should draw our attention are the specific conditions in which the companies were set up.

*GK Animex* is a link of a foreign international corporation, *Smithfield Foods.* In Poland *Animex* has developed on the basis of the assets of state companies. In the processes of privatization and abolishment of monopolies in Polish economy, the firm went througha series of ownership transformations. It acquired stocks and shares in domestic fodder manufacturers, meat processing companies and meat product manufacturers. The target companies are specialized firms operating in the agricultural and food industry. In the case of *Animex,* restructuring involves for example incorporating independent businesses. The acquisitions tend to involve former partners and competitors on the meat market. One of the key transactions in line with this tendency was the acquisition of *Zakład Mięsny Morliny* in Ostróda. Apart from the development of *Animex's* production potential, the deal entailed gaining another well-known brand on the market.

*GK Sokołów SA* is also a company with a share of foreign capital. It was set up as the result of a merger between *Grupa Sokołów SA* and *Grupa Farm Food* (2000). The analysis reveals that the origins of these companies lie in the processes of ownership transformations of former state-owned manufacturing plants as well as with earlier M&As in the industry. *Grupa Sokołów SA* was created as a result of a merger between *Zakłady Mięsne SA* and *Zakłady Mięsne* in Koło (1999), whereas the genesis of the development of *Grupa Farm Food* involves the acquisitions of *Zakłady Mięsne Jarosław* in Jarosław (1996) and *Zakłady Mięsne Mięstar* in Tarnów (1996).

*PKM Duda* and *Farmutil,* on the other hand, are firms based on domestic capital. They have established their positions in the agricultural and food industry predominantly by exploiting the transformations of private companies. On the basis of their principal area of operation, the companies enter new fields with which they are related technologically, organizationally or in terms of market. In the process of natural investment of their financial surplus, they gradually expand their industrial and market scope of operations. They are aware of the opportunities arising from consolidation of the industry; therefore, they purchase shares or stocks of business entities functioning in the areas creating a chance of further growth. They pursue investment in technological development.

The studies of the cases of the meat companies allow one to conclude that diversification of their activities is based on M&As involving entities that are for example their suppliers, partners or competitors. The investigated companies take over firms operating in the broadly-defined agricultural and food industry by performing partial or full buyouts. They undertake forward or backward vertical diversification. These processes are called backward vertical diversification and forward vertical diversification, respectively. When the companies enter new areas of operation they also assume control over comparable phases of the creation of value on other economic paths. These types of activities are characteristic of industrial diversification. Industrial diversification of meat companies as well as the profiles of activities of the taken over firms are presented in Table 2.

*Table 2*
*Industrial diversification of meat companies and the profiles of activities of the acquired firms*

| **Acquiring company**<br>Enterprise functions | Acquired company | Profile of activities after the acquisition |
|---|---|---|
| ***GK Animex Polska:***<br>Agricultural production: Production and processing of fodder, livestock farms.<br>Meat processing: animal slaughter and meat processing. Operations on the market of pork, beef and poultry.<br>Manufacturing of meat products.<br>Manufacturing and sales of down and feathers.<br>Distribution and sales. | *Zakłady Mięsne Morliny,* Ostróda (2000) | Production department: pork and beef processing. |
| ***GK Sokołów SA:***<br>Production of raw materials: agricultural and livestock farms;<br>Meat processing: animal slaughter and meat processing. Operations on the market of pork.<br>Manufacturing of meat products.<br>Distribution and sales. | *Zakład Mięsny Pozmeat,* Robakowo - Poznań (2006) | Production department: pork processing. |
| ***PKM Duda SA:*** | *Wizental Sp. z o.o.* (2003) | Livestock farming: trade in livestock. |
| | *Agro-Duda Sp. z o.o.* (2003). | Livestock farming: trade in livestock. |

| | | |
|---|---|---|
| Agricultural production: production and processing of fodder, livestock farming; Meat processing: purchase of cattle and pigs for slaughter, slaughtering, processing and distribution of meat, purchase and processing of game. Operations on the market of pork, beef and game. Manufacturing of meat products. Distribution and sales. | *Centrum Mięsne Makton* (2004) | Production department: meat processing. Wholesale outlet. Meat distribution center. |
| | *Stół Polski* (2007) | Network of sales of meat and meat products. |
| | *Agro Progress Sp z. o.o.* (2008) | Livestock farming: trade in livestock. |
| | *Zakłady Mięsne Paruzel,* Piekary Śląskie (2008) | Meat processing and cold cuts production. |
| ***ZRP Farmutil SA:*** Agricultural production: processing of fodder, farming of pigs, poultry and cattle. Meat processing: purchase of livestock, slaughter and meat processing. Operations on the market of pork, beef and poultry. Manufacturing of meat products. Distribution and sales. | *Zakłady Drobiarskie,* Koziegłowy (1994) | Production department: poultry processing. |
| | *Zakłady Mięsne Łmeat,* Łuków (2003) | Production department: pork and beef processing. Wholesale outlet. Network of sales of meat products. |

Source: author's own work on the basis of the conducted research.

The research demonstrates that when the examined firms undertook and carried out diversification, in various respects they behaved in a way similar to that described in the literature. Although the motives and ways of diversification were formulated in a slightly different way, they still fully correspond to those cited in the references. The dominant form of diversification of the aforementioned companies is external development with particular emphasis on acquisition. The results of the case studies described above made it possible to formulate particular conclusions that lead to the answers to the research questions posed above.

The analyses of the dairy firms found that *SM Mlekpol* and *SM Mlekovita* perform takeovers of firms with profiles of activities similar to theirs, which leads to product diversification. The acquired companies are local competitors specialized in production for particular segments of the dairy market. The acquisitions create chances of benefitting from the incorporated assets and divided competences. In the process of research it was discovered that the transactions enable the companies to quickly strengthen their positions on the market. The observed acquisitions ought to be understood as incorporations as a result of which new branches or plants are created and function within the structures of the buyer. From this point of view, diversification concerns these entities which possess complementary resources in the product or market areas. These complementary resources and competences strengthen the core activity of the buyer. Such a form of product diversification contributes to the modernization of the production potential, optimization of the use of particular links of the chain of value and limits industrial risk. As a result, the number of unnecessary production factors is reduced, while product specialization of given businesses increases. Product diversification enables a firm to reduce costs as well as expand its product portfolio and distribution network. This empowers companies to become leaders in the dairy industry. It may be assumed that in the process of their future growth *SM Mlekpol* and *SM Mlekovita* are going to establish their positions with regard to their core activity and go beyond the borders of dairy industry later on. As a consequence, further investment in related areas of operation is going to lead them to industrial diversification.

Also the case studies of the meat companies presented above demonstrate that they have been using the strategy of diversification for years. However, in their case, it is industrial, not product diversification. *GK Animex*, *GK Sokołów SA, GK Zakład Rolniczo-Przemysłowy Farmutil HS SA,* as well as *Polski Koncern Mięsny Duda SA GK* are involved in mergers and acquisitions. When diversifying their activities, the companies take over businesses functioning in areas treated as crucial for their further growth. They pursue investment in technological development. Moreover, they purchase shares or stocks of firms that are their suppliers, partners or competitors. They adopt the strategy of industrial diversification by means of entering new areas of operation related to their core activity. The examined companies display interest in both backward and forward industrial diversification. In their growth concepts they create entities joined by capital connections. On the basis of their principal area of operation, they take control over new areas with which they are related technologically, organizationally or in terms of market. The M&As contribute to functional improvements and to changes in the involvement in the market. The firms' strategic decisions lead to the achievement of synergy as well. Their functioning in related fields makes it possible for them to expand their areas of operation to cover new elements of the economic path – this means industrial diversification.

Diversification is a strategy which determines investment priorities on given markets and points out directions of expansion. It decides to what extent a company is going to focus on particular areas of its operations. What is also noteworthy in this context is that in both the dairy and the meat industry the process of production concentration is of key importance. This creates the need to increase the scale of investment directed at modernizing the processing potential and at the construction of new production plants. Managers are aware that in such conditions success cannot be achieved solely by means of internal growth. Therefore, the role of M&A deals as means of enterprise expansion is growing. Through the use of these transactions firms gain access to new organizational resources and to new markets. As a result, initially small corporate groups emerge and gradually increase their revenues. This brings on a steady intensification of consolidation processes in the sectors as well as technological concentration of production.

The basic limitation of this research is its lack of representativeness. The case studies presented above exemplify the phenomena regarding the use of diversification. The findings presented here can be of use only to entities possessing sufficient organizational potential to allow them to diversify their activities. In addition, the results may serve managers in the process of making decisions about the directions and methods of diversification.

The analyses also carry implications for further research, which can examine the optimum level of diversification and its types or investigate the relation between diversification and the economic condition of companies.

## FINAL REMARKS

The discussion presented above confirms that advancing globalization involves sectors of the economy, industrial markets, enterprises and competition. The fact that foreign firms are gradually entering the Polish market intensifies internationalization of the economy. In order to adapt to the changing conditions, enterprises must become actively involved in the changes. The pressure generated by globalization and increasing competition forces them to adjust to the new conditions. A characteristic feature of such adjustment is the act of setting ambitious goals. The completion of the tasks stemming from these goals leads to fast growth and sometimes also to expansion. It is expressed in the willingness to catch up with the best or assume the position of a leader.

M&As can be observed in various sectors of the economy. The motives behind these ways of combining of enterprises are diverse. They stem from the evolution of the environment, diversification of activity or the resources possessed by a given company. The interest in M&A transactions is also triggered by the need to accelerate growth and strengthen market positions. As a result, firms gain the possibility to complement their resources and competences. The transfer of knowledge and technology makes it possible to achieve synergy, economies of scale and to expand the scope of operations. However, M&As frequently fail. Only in a few cases do they lead to cost reduction and an increase of market share. The most common mistake made during M&As is insufficient analysis of such important aspects as risk, price and integration. The discussion presented so far in this paper indicates that *due diligence* minimizes the risk carried by the M&A transactions. It is treated as a factor determining their success.

Diversification entails launching new activity, different from that currently conducted, or entering new markets with new products. The study demonstrates that in their pursuit of diversification companies get involved in M&As. From the perspective of diversification it is crucial that the transactions ensure synergy between the resources that a firm already possesses and those to be purchased.

The results of research on diversification presented in this article are consistent with the world trends described in the literature. They also confirm the findings of Polish studies on diversification reviewed earlier in this paper. The dominant form of diversification in the cases of companies described here is external development with particular emphasis on acquisition. The investigated transactions make it possible for the companies to enter fields related in terms of technology, market or organization. As a consequence, the firms develop and strengthen their enterprise functions. Their brands become recognizable and their industrial and market scope of activity grows. This strengthens their competitive position on the market and helps them reduce the risk carried by cooperation with suppliers.

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## DATA SOURCES

ANIMEX POLSKA: http://www.animex.pl/

FARMUTIL S.A.: http://farmutil-hs.pl/

PKM DUDA S.A.: http://www.pkmduda.pl/

S.M. MLEKOVITA: http://www.mlekovita.com.pl/

S.M. MLEKPOL: http://www.mlekpol.com.pl/

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