

## Study on the Deviation of Policy of Merger and Acquisition of Steel Industry

Jidong He

Shangqiu Normal University, China

### Abstract

Policies of iron and steel industry of China are issued to encourage merger and acquisition which improve industry concentration and industry competitiveness. But because of the difference of the government behavior, ownership, regional market and behavior of decision makers industrial merger and acquisition cause deviation. In order to promote the industrial merger reasonably, government should make reasonable adjustment in management of government, related industry policy and government of enterprise.

### Keywords

Deviation; Policy, Merger And Acquisition, Steel Industry.

### 1. Introduction

Iron and steel industry is an important basic industry of China's national economy in the industrialization stage, whose rapid development has led and supported fast development of related industries. However, in the development process of iron and steel industry, the industry concentration is not high, excess capacity, market competitions are excessive, innovation ability of enterprise research and development is not strong, the consumption of relevant resource and energy are too large, environmental load pressure increase, international competitiveness is not high and a series of questions, which has become obstacle of the further development of the iron and steel industry. In order to promote the rational and stable development of the iron and steel industry, China formally proposed to adjust the industrial organization structure promulgated in "Development Policy of Iron and Steel Industry" in 2005, implement the merger and reorganization, enlarge scale of enterprise group with comparative advantages and improve the industrial concentration. The subsequently issued "Adjustment and Revitalization Planning of Iron and Steel Industry"(2009), "Opinions of the State Council on Promoting Merger and Reorganization of Enterprises"(2010), "Rules and Regulations of Production and Operation of Iron and Steel Industry" (2010), "Twelfth Five-year Development Plan of Iron and Steel Industry" (2011) and other policies and regulations, successively put forward merger and reorganization of iron and steel industry. But since 2005, the policy of reorganization and merger have been officially put forward, although the reorganization and merger of iron and steel industry have made progress in China, but the effect is not obvious, the reason lies in the following several main factors, which make the mergers and acquisitions policy of iron and steel industry deviate, thus the actual effect of policies are not ideal.

### 2. Differences of Governmental Action Make the Implementation of Merger and Acquisition Deviate

In the merger and reorganization aspects of iron and steel industry, the policy emphasizes the principle of the operation of the market, the enterprises as the main body and government guidance, and association between strong enterprises, improves industrial concentration. Because the iron and steel industry has different contribution to the local economic growth in different regions, the transfer of benefit distribution will inevitably occur in the process of mergers and reorganization, which will have an impact on the local fiscal levy and employment and other aspects, and the attitudes that local governments on trans-regional mergers and acquisitions are naturally different. The treatment of the internal mergers and acquisitions within the region, because of the vertical administrative leadership relations, coordination among the various levels of government are convenient, mergers and

acquisitions proceed more smoothly. For example, Wuhan Iron and Steel (Group) Company purchase Egang in 2005, and Hebei Tangshan iron and steel group co., LTD integrate Xuansteel Company, Chengde Iron and Steel Company etc. For trans-regional mergers and reorganizations, there is no affiliation relationship among the governments at all levels, coordination is difficult, merger and reorganization will encounter the governmental obstacle, and the progress are slow or fail, for example, acquisition of Baosteel for Han-Steel fail in 2006 and so on.

The mergers and acquisitions of iron and steel enterprises except that the intergovernmental fiscal levy and employment are influenced and make the governmental actions different, more likely, it is invisible benefit that relevant government departments and officials obtain. For the iron and steel enterprises within the jurisdiction, fiscal levy and employment not only contribute to the economic development of the whole district, it is the opportunities and ways that part government officials create rent-seeking. For the enterprises within the jurisdiction, especially the state-owned enterprises, the benefits of creating rent-seeking may be far greater than the benefits of fiscal levy and employment for certain officials, and if the outcomes of the mergers and acquisitions make the opportunity for rent-seeking income disappear or decrease, it can be imagined that part officials' attitude for mergers and acquisitions .

Another reason for the differences of government action is that the marketization process is still not completed and the structural reform of the government is not yet in place. Industrial mergers and acquisitions have been market-oriented enterprise behavior, the governments only play a guiding role in mergers and acquisitions, but the government was the only investment subject and ownership agents of enterprise for historical reasons, the government guide enterprises to develop the economy by way of planning. In the marketization process, in the case that the government are still the ownership agent of the state-owned enterprise, the government often promote enterprise mergers and acquisitions in a dominant way in the implementation process of merger and acquisition policy of the iron and steel industry, rather than guiding enterprises' mergers and acquisitions in the case of considering the enterprise's strategy and ability and so on, this will make the effects of mergers and acquisitions are not obvious, the policy effects are deviated.

### **3. Difference of Ownership Make Merger and Acquisition Policy Treat Public and Private Enterprises Differently**

Historical reasons, for the property right structure of current iron and steel industry, the existence of state-owned enterprises is prior to private enterprises. Market-oriented reform and promotion make the property rights diversified in China; there are state-owned enterprises, collective enterprises, private enterprises and foreign-funded enterprises in most industries. etc., the diversification of enterprise property rights can make every property rights subject effectively compete in the market, and can compare the market efficiency of enterprises with different property rights, which is consistent with the purpose of China's market system construction. After the restrictions that private capitals enter into the China's iron and steel industry are cancelled, a large number of private capitals enter into iron and steel industry to meet the market demand, and promote market competition. However, compared private iron and steel enterprise and the state-owned enterprises, most of the scale are generally smaller, which means when the iron and steel industry policy promote mergers and acquisitions, there are inherent shortcomings and difficulties in private iron and steel enterprises: under the condition that the capital market is not perfect and credit crunch is impacted by policy, the smaller scale means weak financing capacity, the mergers and acquisitions cannot get the financial preferential taxation, so that the required fund amounts for mergers and acquisitions are difficult to meet, but if mergers and acquisitions are not made, they will be face the danger that expelled from the market or purchased by state-owned enterprises.

On the contrary, for the state-owned iron and steel enterprises, in order to promote mergers and acquisitions, industrial policy not only require financial support for the mergers and acquisitions of important iron and steel enterprises, offer the preference in tax revenue, and establish special funds to encourage enterprise' mergers and acquisitions. Policy supports make state-owned enterprises and

private enterprises in an unequal position in the mergers and acquisitions, state-owned iron and steel enterprises or state-owned iron and steel stock companies can get enough financial support, even if the two enterprises can raise the same amount of money in mergers and acquisitions, the cost of capital that they undertake is not equal, so that state-owned enterprises are in a favorable position in mergers and acquisition compared to private enterprises.

When the industrial policy promotes merger and acquisition, encourage private capital to participate in state-owned restructuring and reorganization, and trans-ownership mergers are encouraged. However, under the condition that the above-mentioned state-owned iron and steel enterprises obtain support of preferential policies, private enterprises unilaterally participate in the acquisition, which cannot match state-owned iron and steel enterprises with enough financial support, private capital cooperate to participate in the mergers and acquisitions of state-owned, which is only not indispensable, but the private capital is disguisedly excluded from the mergers and acquisitions of state-owned enterprises. On the other hand, state-owned enterprises compared with private enterprises, the property rights of state-owned enterprises are owned by the whole people, but the actual owners of property rights are absent, and the relevant government departments and personnel are only involved as managers, if the private enterprise purchase state-owned enterprises in the process of trans-ownership mergers and acquisitions, the high and low of asset valuation means that face the loss of state-owned assets and the risk of bearing responsibility, and what is the agency or staff do not want to face, and for the mergers and acquisitions between state-owned enterprises with state-owned nature, there is a lower risk in the current mergers and acquisitions mode. Therefore, for the same merged state-owned enterprises, the private enterprises and state-owned enterprises which want purchase, the relevant government agencies and personnel tend to mergers and acquisitions between state-owned enterprises, rather than private enterprises purchase state-owned enterprises. Finally, the takeover target is the private enterprise, because the absence phenomenon of property owner does not exist, mergers and acquisitions are operated in full accordance with the market, there is less problem of asset loss.

In a word, regardless of cooperation in mergers and acquisitions or separate participation in mergers and acquisitions, the problems that private iron and steel enterprises are difficult to compete against state-owned iron and steel enterprises exist, so that the trans-ownership mergers and acquisitions that policy advocated have changed into state-owned enterprises purchasing state-owned enterprises or state-owned enterprises purchasing private enterprises, there are deviations from the intentions of policy and market efficiency rather than the opposite.

#### **4. Different Regional Market Make Scales Deviation in Mergers and Acquisitions Policy**

Each iron and steel enterprise is the result of different technical scale choice that different investment subjects based on the financing ability and the consumption demand in their area. Large enterprises are decisions that early government investment layout made and according to the needs of large space market, small enterprises are that private investment subjects or local governments make technical choices based on small space requirements possibly. So the scale structure of China's current iron and steel industry, both large-scale iron and steel enterprises with ten millions of tons and small iron and steel enterprises with hundred thousands of tons. There are three preliminary results in investment decisions of investment subjects in the regional space: first, market space boundary of the same product of different enterprises mutually contact; second, market space boundary of the same product of different enterprises overlap in small part; third, market space part of the same product of different enterprises overlap in most part. In reality, the initial investment form first ideal situation which rarely occurs, the second and third case are the normal of layout, excessive competition will not appear in the second case, competition balance evolve to the first condition; third, the investment result forms overlap of product space market of different enterprises, logistics and freight costs are rarely considered in the competition, the market are in stiff competition based on production costs. If the merger and acquisition occurs under the policy incentives, for the third case, mergers and acquisitions

can avoid excessive competition; for the mergers and acquisitions in first and the second case, if the production is concentrated in one place, and then sold to the market, the enterprise assume more freight costs, unless the reduction of scale cost of factory after merger and acquisition is more than the total freight of the production cost before the merger and acquisition; if the freight is borne by the purchaser, the expenditure of some consumers are increased compared with before merger and acquisition; if the productions are still simultaneously produced in original place, the space market did not change compared with the original, but the enterprise's property rights have shifted, the scale effect of enterprise's production technology has not improved. On the contrary, in order to occupy a larger market, the main mergers will expand the scale of merged enterprise of after mergers and acquisitions, and compete more intensely with other enterprises. For example, Baosteel purchase Bayi Steel in 2006, after the merger and acquisition, Baosteel increased the capital injection for Bayi Steel, Baosteel further expand the scale of production; Similarly, one of the conditions that Cold Steel is merged into of Valin in 2009 is the increase investment of cold steel scale, and both Valin and Cold Steel' benefit is not very good, expanding production will only more compete with other enterprise after the merger and acquisition. These mergers and acquisitions case illustrates the deviation occurred in industrial policy through mergers and acquisitions to improve concentration and control scale. Because if the enterprise' scale basically remain unchanged after the merger and acquisition, it is shown that enterprise' scale basically meet the needs of regional markets, and the scale is reasonable; if the enterprise scale enlarge after the merger and acquisition, then it is shown that the enterprise scale do not meet the needs of regional space market, even if no mergers and acquisitions, enterprises should also expand the scale in the future. Of course, after the merger of enterprises the enterprise expand the scale, it can be explained the mainly merging enterprise adjust strategic layout within the group, but in the current trans-regional merger and acquisition cases, after mergers and acquisitions the enterprise scale has not scaled back, but some enterprises enlarge the scale in the requirements of technical policy standards, which result in more intense market competition, it can be said that the f enterprise scale deviate under the incentive of merger and acquisitions policy.

## **5. Behavior Differences of Decision-Makers Make the Merger and Acquisition Policy Deviate**

Usually, strong stock holders and managers have significant impacts on enterprise' decision-making in the production and operation of enterprises, and the strong stock holder make judgments on decision of enterprise managers through the board, the results of shareholders' decentralization and information asymmetry make enterprise' decision-making power mainly controlled in the hands of managers, the managers become the enterprise's "internal controller." However, the dominant position of our country's state-owned economy decided although the management decisions of state-owned enterprises are independent; the government departments are still the major decision-influencers and even the one of decision-makers, therefore, in addition to strong stock holders and enterprise managers, the government departments and personnel has a decisive role in enterprise' management decision in our country.

Differences of decision-makers include the following aspects in the implementation process of merger and acquisition policy of the iron and steel industry:

The first is the difference of the decision-makers' ability. In the development process of iron and steel enterprises, the size of enterprise scale, the theoretical researchers of institutional economics usually are concerned about the size of the transaction costs, if the transaction cost of enterprise market is thought to be too large, the organization cost within the enterprise is smaller (or internal transaction costs), then the enterprise can scale up; if the market transaction cost is less than the internal organization cost, the enterprise should scale down, and ultimately the equilibrium point of enterprise scale is the equal place of transaction cost and organization cost. However, the enterprise is fundamentally a producer, whose basic attribute is profitable, the size of enterprise' profitability is related to the enterprise' capability, enterprise capability theory is concerned about the allocation capability of enterprise resources; allocation of enterprise resource is decided by enterprise

decision-makers. The enterprise decision-makers' analysis ability of market forecasting, risk-taking ability, internal management and coordination ability and so on are different reflections of their ability. In the development process of enterprise, decision-makers with strong ability mean that they can control larger-scale enterprises; decision-makers with weak ability manage smaller-scale enterprises. If the property rights of enterprise are consistent with benefits of enterprise decision-makers, the decision-makers with strong ability will scale up through the merger and reorganization in the market changes and policy incentives; if the ability of decision-maker is weak, the enterprise scale remains unchanged or scales down in the market changes and policy incentives.

The second is the utility difference of decision-makers. The decision-makers pursue personal utility in the pursuit of expansion process of enterprise scale, but the cost of personal efforts must be paid. The decision-makers are subject to internal supervision and external constraints in the effective corporate governance structure, the decision pursue the maximization of personal utility and the optimization of enterprise scale, which may be compatible with the incentive. However, for the mergers and acquisitions of state-owned iron and steel enterprises under the policy incentive, there is an asymmetry between the utility pursuit and the effort cost of decision-makers. On the one hand, the state-owned enterprises have relatively low constraints for decision-makers due to the governance structure; decision-makers have the impulsion to expand, their own utility can be enlarged through the expansion, but they are subject to the internal and external constraints to some extent. The governmental relevant departments and personnel' actions and internal decision-makers' expansion impulsion are the same under the policy incentives, internal and external constraints further relax, enterprise decision-makers can increase personal income through scale expansion after the merger, the current cost of mergers and acquisitions are undertaken by the enterprises and government together, and the current policy encourages mergers and acquisitions, which has become excuse for qualitative loss of enterprise under uncertain conditions in future, and it further possibly becomes an excuse for bargaining with the government.

It can be found from the data of listed iron and steel enterprise that the association of the scale and the performance of listed iron and steel companies is not large, they did not change significantly before and after mergers and acquisitions, the general trends of enterprise performance are consistent with changes of market demand, decision-maker's ability does not reflect the objective demands of mergers and acquisitions currently. At the same time, the salary of enterprise decision-maker has a certain correlation with the enterprise scale, which shows that the utility maximization of the decision-maker has promoted the expansion of enterprise scale. This shows that under the condition that the ability of decision-makers is limited and the maximization pursuit of utility, the results of policy incentives of iron and steel industry' merger and acquisition can make the scale of iron and steel enterprises expanded, but it does not help to improve the benefits and help to improve the competitiveness of enterprises, the policy roles are deviated.

## 6. Policy Suggestions

Because governmental action differences, ownership differences, differences of regional market and decision-makers' behavior differences make the deviation happened in merger and acquisition policy of China's iron and steel industry from the formulation to the present. If the relevant industry policies and system aspects will not adjusted in future promotion process, the mergers and acquisitions of iron and steel industry will not achieve the desired purpose of the policy. In order to promote the effective implementation of merger and acquisition policy of the iron and steel industry, and achieve the desired effects, the policy and system and other aspects should focus on the following three aspects of work in future:

(1) Governmental management innovation. The leading role of the state-owned economy is reflected by the market competition, and it should not always rely on the governmental support to develop; relying on governmental support and preferential policies is not conducive to the equal competition of market entity, and ultimately not conducive to the development and improvement of the market system. Mergers and acquisitions of iron and steel enterprises are the market behaviors of enterprises;

the governments often unduly lead in reality and deviate from the enterprise's own behavior. In order to prevent the governmental intervention and deviation of the policy implementation, on the one hand, the ownership agent of state-owned enterprises further merge into superior departments, reduce the rent-seeking opportunities that local government created due to local ownership and management of state-owned enterprises. On the other hand, establish local governments, including supervision institutions and mechanisms of unreasonable intervention of mergers and acquisitions and other enterprise behavior, supervise and prevent the local government from intervening in mergers and acquisitions for local interests. In addition, fundamentally change the local government officials' performance evaluation system which focuses on the economic growth.

(2) Policy Adjustment of Relevant Industry. First, the preferential policies of mergers and acquisitions of iron and steel industry are cancelled; whatever state-owned enterprises and private enterprises have the same roles in fiscal levy, employment and enhancement of international competitiveness aspects and so on, so the implementation of preferential policies should give the same treatment to private enterprises as well as state-owned enterprises. Second, the mergers and acquisitions policy and layout policy of industry should mutually combine well, so that after the mergers and acquisitions, the space market layout of enterprises have competition, but not overlapping, and avoid evolvement from excessive competition to excessive competition after concentration under the condition of decentralization of industry. Third, it is necessary to coordinate the mergers and acquisitions policy and technology policy of industry, technical options of iron and steel smelting are not single, and requirements of each kind of factory scale can be different in accordance with the technology. The purposes of mergers and acquisitions policy are centralization, large-scale, requirements of technical policy are energy conservation, efficiency and environmental protection, the coordination of the two require enterprise scale are optimized in technical efficiency, and the total amounts of environmental load are minimized.

(3) Micro governance. Although mergers and acquisitions of enterprises are autonomous behavior, but the agency commission problems caused by separation of ownership and management are more and more obvious, the objective of enterprise managers usually deviate from the goals of owners, the state-owned enterprises are all the more so. In the mergers and acquisitions of iron and steel, in the short term, the SASAC and the board of directors make appropriate adjustments for managements in accordance with the ability in the process of mergers and acquisitions; in the long term, the construction and implementation of modern enterprise system are the key, strengthen the responsibility of board of directors, the board of supervisors and shareholders' meeting in the construction process, form effective internal control for enterprise management personnel, meanwhile the market constraints more need regulation and perfection of the relevant laws.

## References

- [1]. Ping Xinqiao. Motive and effect of government protection-an empirical effect [J], Finance & Trade Economics, 2004 (5): 3-11.
- [2] Xu Kangning, Han Jian. China's iron and steel industry concentration layout and structure optimization research-remarks on development policy of iron and steel industry [J], China Industrial Economics, 2006 (2): 37-44.
- [3] Zhang Yuanzhi, Ma Mingxiao. Enterprise scale-scale economy and industrial cluster [J], China Industrial Economics, 2004 (6): 29-35.
- [4] Zhang Weiyong. Non-compensability of control loss and property right barriers of in merger and acquisition of state-owned enterprises [J], Economic Research Journal, 1998 (7): 3-14.
- [5] Yan Bangquan. Discussion on enterprise scale and scale economy [J], Academic Exchanges, 2003 (11): 86-89.
- [6] He Jidong, Shi Zhongliang. The demand and restructuring effect analysis of iron and steel industry [J], Review of Industrial Economics, 2011 (3): 142-150.
- [7] Fan Linkai, Li Xiaoping. The practical basis and formation mechanism of excess capacity under the background of progressive reform [J], China Industrial Economics, 2015 (1): 19-31.

- [8] Gan Chunhui, Zou Jun. The term of office local officials, enterprise resource access and excess capacity [J], *China Industrial Economics*, 2015 (3): 44-56.
- [9] Cheng Junjie. The industrial policy and excess capacity during the China's transition period [J], *Journal of Finance and Economics*, 2015 (8): 131-144.