

# GERASYMENKO ANZHELIKA<sup>1</sup>

## Social capital influence on firm's competitive strategy<sup>2</sup> (ukrainian experience)

The article is about the role of social capital in an economy. Using Ukrainian economy as a favorable field for social capital manifestation the author tells about the ways of its influence on firm's competitive strategy developing process. Such factors as corruption level, complexity of regulatory system, multimarket contacts prevalence are discussed to be crucial in this way. To ground this point of view author presents the results of empirical analysis of Ukrainian business groups' multimarket contacts existence. On the one hand such contacts simplify a mutual forbearance between business groups, which is a form of tacit collusion, while forming a base for transaction cost reduction on another hand. It forms a need to consider the social capital influence on firms' competitive strategies and the way of economy's development in the process of economic policy elaboration.

Institutional economic theory raises the problem of social capital influence the competitive strategies of firms. Before speaking about it let's make a small theoretical excursion to definition of the social capital. Up to P. Bourdieu social capital is a sum of real and potential resources created by the existence of reliable nets and less institutionalized relations that are the result of mutual conversance and recognition. J. Coleman's determination of social capital is more detailed. It's just relations that are created by repeated interaction of entities or persons because of accumulation of mutual expectations and liabilities. Both definitions tell us about creation of specific kind of relations that decrease the level of uncertainty and risks. It lets make involved companies competitive strategies more definite and expectative. There are two different effects of such capital manifestation: 1) positive – as a way transactional costs decrease and 2) negative – as a way of market or even economy's monopolization.

Let's look both of them, realizing that social capital is immanent for any economy, while transition economies (like Ukrainian one) are more receptive for its effects.

Firstly, it's because of high level of corruption in such economies<sup>3</sup> that creates a special environment of powerful, but artificial leaders and their competitive fringe. The position of every player in such environment is defined. Their strategies are predictable and mostly anticompetitive. But let's don't speak about a corruption now. This topic has been already highly discussed and not very pleasant.

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<sup>2</sup> The article is based on the presentation given by the author in the international conference „Conference on Sustainability and Maintenance” organised by the Budapest Business School on Nov 9. 2011. Budapest.

<sup>3</sup> For example, Ukraine occupies the 134-th place among 178 countries by Transparency International's Corruption Perceptions Index.

The second reason is a complicated regulatory system that don't let new, first of all foreign companies enter a market easy, change its structure and the way of companies' interaction, and change vectors of its development. On the slide you can see an Easiness of doing business ranking for Ukraine. The integral country position is 145-th among 183 countries in the world. Starting a business here it's a quite difficult task. Just registration takes 27 days here comparing with 1 day in New Zealand. Getting construction permits take almost 350 days more. It complicates entering of potential competitors (inter alia foreign ones) into the market, while incumbent companies are really hung upon each other. Created in such way social capital doesn't let them cheat each other by selling bad goods, minimizing transactional costs on the one hand and doesn't let them cheat by ruining anticompetitive collusion on the other hand.

*Table 1*  
*Ukraine's ranking on doing business indicators*

<b>Doing Business Indicators</b>	<b>2009 rank</b>	<b>2010 rank</b>	<b>2011 rank</b>
Easiness of Doing Business	145	142	145
Starting a Business	128	134	118
Dealing with Construction Permits	179	181	179
Registering Property	140	141	164
Getting Credit	28	30	32
Protecting Investors	142	109	109
Paying Taxes	180	181	181
Trading Across Borders	131	139	139
Enforcing Contracts	49	43	43
Closing a Business	143	145	150

The third reason of huge role of social capital in Ukrainian economy's development, in its companies' decision making process, is a widespread familiarity between top level businessmen, politicians etc. This kind of social capital manifestation generates two way questions. How had that familiarity been created in Ukrainian economy? How does it influence the economy, markets and the process of companies' competitive strategy elaborating?

In the early 1990-s the mass privatization was in Ukraine. Despite the certification kind of privatization not everybody could compete for attractive state assets. All of them had been privatized by small group of people that were richer (money had been needed for buying-up certificates), more enterprising and closer to public state than others. But the big speed of privatization process at that time didn't let even them choose what an asset to merge. They were buying everything they could buy. As a result – Ukrainian economy is appeared under control of few big business groups (let's call it BG), which were integrated into many different businesses. That wave of M&As is called conglomerate one.

Conglomerate ownership structure of Ukrainian economy we can see even now notwithstanding last years' tendency of arranging BG's structure. Table 2 consist information of main BG/ industries' breakdown in Ukrainian economy. Shown in color cell testifies about presence of certain BG in the industry. So, as we can see from the table average BG operates in more than 9 industries and much more markets, while every industry meets about 5 BGs. So, there are tight multi-market contacts between the biggest Ukrainian BGs.

What does it mean? Multi-market contact is a special way of companies' simultaneous functioning and interacting on some separate markets. It allows firms to draw on additional information about their rivals and give them further opportunity to predict rivals behavior, to accord it and retaliate in the case where a rival is found to have deviated from coordinated behavior, which was previously established on the market. So, multi-market contacts enrich social capital; raise its capitalization, which can be measured by the sum of transactional costs' economy; make companies' behavior more transparent and markets development more predictable, while causing and sustaining a tacit collusion on the involved markets.

Operating for a long time together (in some same industries, on some same markets) Ukrainian BGs have become really familiar to each other. They have formed great social capital that manifests into three ways:

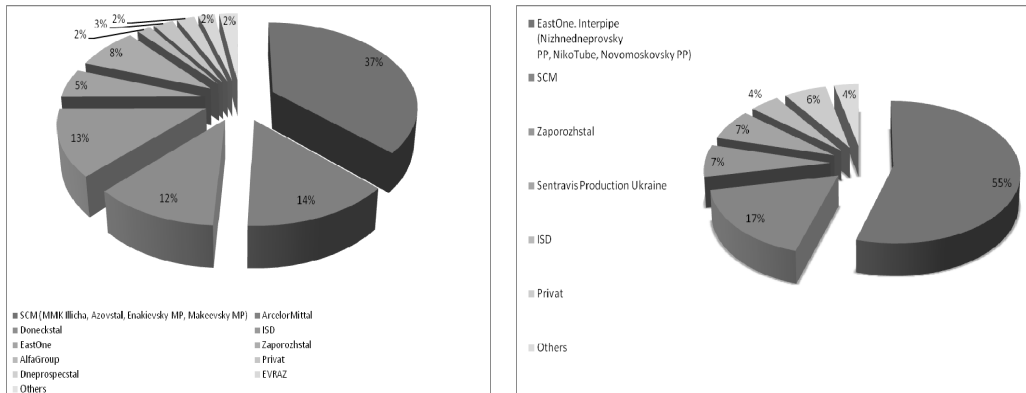
- 1) ability of quite a correct prediction of competitors' behavior on the mutual market that is based on knowledge about previous business practice;
- 2) capability to expand unified competitive strategies' cliché of some BGs on their new products, markets etc.;
- 3) likelihood of "mutual forbearance". The basis for this form of collusion and the firms' approach can be summarized as: "I will not compete hard in your market if you do not compete hard in my market."

*Table 2*  
*Matrix of main BG/ industries' breakdown in Ukrainian economy*

	SCM	Privat	TAS	Doneck- stal	ISD	East- one	UIG	Ukr- prom- invest	Finance & Credit	Zapo- rozhstal	Group DF	Illich- Stal	Smart- Group
Agriculture													
Chemical													
Coke													
Construction													
Energy													
Finance													
Food & beverages													
Insurance													
Management & consulting													
Machinery													
Media													
Medicine													
Metals													
Mining & processing													
Oil													
Pipe													
Real Estate													
Retail & wholesale trade													
Telecom													
Transport													
Others													

Among the evidence of using mutual forbearance as a dominant competitive strategy of Ukrainian BGs on many domestic markets is their structure. Let's look, for example, Ukrainian steel market. For years four of ten biggest steel producers – MMK Illicha, Azovstal, Enakievsky MP, Makeevsky MP – have been operating under the control of one BG, named “System Capital Management (SCM)”, while five other BGs just have been following SCM's dominant strategy. The same situation is on the

pipe market. Three of five biggest pipe producers (Nizhnedneprovsky PP, NikoTube, Novomoskovsky PP) are concentrated under control of other Ukrainian BG – “Eastone” (the total market share is 55 %), while other four BGs are also operate on this market. Among them is “SCM”, who are let be dominant on the metal market,



where “Eastone” also operates. It’s just one example of widespread using the mutual forbearance strategy in deep entwined U others.

*Figure 2.*  
*Structure of Ukrainian tube market*

*Figure 1.*  
*Structure of Ukrainian metal market*

Summing up need to notice that inadequate ways of privatization of early 1990s had created great social capital that has become a heavy background for collusive behavior of incumbent Ukrainian BGs. It lets them monopolize a range of Ukrainian markets, obtain cartel profit and so on. Today company’s collusive behavior is one of the most popular anticompetitive violations that took more than 12 % of all anticompetitive violations in 2010. Herein most of them (almost 29 %) were concentrated in fuel and power sector that is mostly involved into multi-market conduct of Ukrainian BGs. But at the same time I have to say that these very industries are the main donors of Ukrainian budget and creators of the biggest part of Ukrainian GDP. So the role of social capital as a defining factor of firms’ competitive strategy development is rather significant. It causes the way of company and the whole economy development.

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