

Market failure in the light of practice of unsuccessful mergers and acquisitions of companies in Poland

Key words: market mechanism, market failure, welfare economics, open economy, capital structure, mergers and acquisitions, due diligence

Summary

The subject of economics research is the economy itself and the behaviours of the subjects observed within it, whereas the object of the research is the attempt to describe the effects occurring within the economy as well as forming the rules which govern it. The results of this research were reflected in the market model, which in principle describes the behaviours of business entities, taking into account the role of the resources, including capital and difficult to predict human behaviours.

Each of the economic theories had different assumptions regarding efficient functioning of the market mechanism within the social and economic system, at the same time pointing to the imperfections of the other approaches. The analysis of the attitude of the economic theories to the market pointed to the welfare economics as the one that treats the market mechanism in a way that seems to be a complete set of assumptions which attempt to describe the efficiency of resource allocation (including capital by the means of mergers and acquisitions) in the best possible way. It proves that the market mechanism is more effective and allocates resources more efficiently in the open economy but can fail due to the occurrence of the external effects, social preferences, imperfect market competition or incomplete information. According to the welfare economics, these market failures are the reason why governments should interfere in the market economy.

Polish economy underwent the transition from closed to open economy. National enterprises were transformed into single-member State-owned companies or private companies, capital market was developing. New economic order, based on the supply and welfare theories, was introduced. However, the programme of system transformation, based on a double shock with regard to macroeconomic liberalisation and stability, involved high social costs. The implementation of the set of structure reforms was supposed to bring the

synergy effects, trigger market forces, stimulate competition and improve the functioning of the capital markets. In fact, in the macroeconomic scale, what occurred was the drop in production, rising unemployment, unsatisfying progress in defending inflation. Whereas, in the microeconomic scale, the companies were condemned to accelerated privatisation, within the conditions of the open market, struggling with the issue of operational effectiveness and low capital potential. At the same time, they were becoming visible as a target for foreign capital, which based on the assumption that Polish companies were active on a competitive market in the open economy, which at the same time implied the free flow of capital in the global scale. This flow could and can happen through mergers and acquisitions, which can mean more complex overseas expansion, higher level of risk and require significant capital involvement. Mergers and acquisitions were conducted under the conditions of incomplete information, which is a manifestation of market failure, but nevertheless, the companies were and are still treating it as a chance to survive, adapt or develop by obtaining new sources of financing and forming capital structures that are unique and adjusted to its needs.

The aim of this thesis is to understand the reasons for failed mergers and acquisitions under market failure conditions as the incomplete information, which accompanies these processes, and at the same time constitutes the manifestation of market failure, does not seem to fully explain the failure of the processes. For this purpose a suitable method had to be assorted, which would allow to examine the processes of mergers and acquisitions, paying special attention to their potential effectiveness, extracting possible paths of restructuring or identifying and evaluating risk of failure factors. The most suitable method turned out to be a method associated with mergers and acquisitions but used for a different purpose, and that is *due diligence*. Its flexibility and versatility allowed for the necessary modification and choice of research areas, and as a result a variation of this method was created, which allowed for its innovative implementation. The author of this thesis assumed that restructurings through mergers and acquisitions are above all decisions – not only the most crucial one whether to merger with this precise entity or not, but also a number of smaller decision processes supporting the final decision. That is why by the assortment of the research aspects of *due diligence* of mergers and acquisitions processes the decision making theories were used. Four aspects of *due diligence* were distinguished, which joint analysis allowed to state that there are more than the two ways of restructuring – mergers and acquisitions. These terms used together are often meant to generally describe all the capital restructuring processes leading to concentration. When being used separately, they are interpreted

variously, and in the worst case they are used interchangeably with reference to the same process. A separate analysis of the theoretical aspects of merger and acquisitions processes by the mean of a modified *due diligence* allowed to quite precisely isolate not two but five possible paths to undergo the process of restructuring within the general set of merger and acquisition processes.

The outcome of the empirical research conducted with the use of *due diligence* method confirmed the occurrence of the isolated paths, that being share deal, asse deal, hostile takeover, incorporation and merger sensu stricto. However, above all, it confirmed that the reasons for unsuccessful mergers and acquisitions lays beyond the incomplete information. The reasons for market failure with reference to capital allocation within the practice of mergers and acquisitions should be sought in the process of conducting them, above all in the economic and financial aspect, formal and law aspect, behavioural aspect, and less in the organisation and process aspect. The analysis of the unsuccessful mergers and acquisitions and their outcomes allowed to propose a set of rules, which would aim at minimizing the risk of failure of the merger and acquisition process, and as a result to ease the signs of the failure of market functioning mechanism.