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Promote transformation of resources through merger & acquisition – case review from coal mining enterprises in Shanxi province

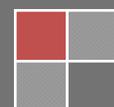
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ABSTRACT

The merger and acquisition of coal companies are inevitable results of transformation of resources. It's spurred by market competition and is an effective way to better use the social resources. Shanxi has made a significant progress since the region launched China's largest-ever restructuring campaign in an effort to improve work safety conditions and production capacity of the industry in April, 2009. The innovations in the fields of investment scheme of energy sector, the comprehensive use of resources, production security and management institutions have provided valuable experience for the updating and transforming of coal industry of the nation. In light of this, the thesis proposes five strategies for the industry to push forward merger and acquisition process and achieve successful transformation of resources.

KEYWORDS

Transformation of resources; Coal companies; Merger and acquisition; Shanxi Province.



THE IMPORTANCE OF MERGER AND ACQUISITION FOR COAL INDUSTRY TO PUSH FORWARD RESOURCES TRANSFORMATION

Theories related to merger and acquisition of coal industry

Neoclassical Economists believe that enterprises could achieve the ideal state of scale economy through merger and acquisition. Merger and acquisition may bring concentrated production of individual products and make full use of the productivity by reducing the costs that are generated by separation of different specialized sectors. The giant corporation formed could take focused measures and collect abundant capital on research and development of new technologies in a particular area. In this way, the company may enjoy command of its costs, prices, production, financing and even customer behaviors and thereby enhance the relationship between enterprises and government as well as sharpen the competitive edge of the business.

Chinese scholars Zhang Hongjiang and Chen Xuehua (2004) claim that merger and acquisition is a kind of capital that an economic entity exerts on another one in order to create the conditions for resource integration and produce added value. As a special form of capital, merger and acquisition takes the corporation entity or its stocks as the operating subjects, aiming to maximize the added value of total capital through coordination. First, the core subject in the process is the stock of the company. Capital could be integrated without limits of time and space by share purchase. Second, the values added in this process are gained through the indispensable integration of resources. It is because of the change in production function that is triggered by the reform in production factor structure that the efficiency is improved and the capital is enhanced. Therefore, the merger and acquisition capital is not a simple factor involved in production activity but a driver for the transforming of other resources. The integration of resources becomes possible just because of such kind of capital.

The importance of merger and acquisition for coal industry to push forward resources transformation

With the development of society and economy, shifts of economic growth modes have become a strategic focal point for the future improvements. In doing so, importance should be attached not only to the increase of quantity but also to the quality and efficiency of production factors by advancement in technology and managerial expertise. The economic structure and operational control are as important as the expansion of total output. Meanwhile, due attention should also be paid on harmonious development of society, economy and environment.

Characterized by relatively lower concentration ratio, larger amount of small businesses, lower output and disorderly competition, the coal industry in China has an outlook of inferior scale economy and is lack of specialized expertise and skills. The large coal corporations have an average annual output over 10 millions tons but the percentage is still less than 10% of national production. The current development of China's coal industry as a whole still lags far behind that prevailing in the international arena. By the end of 2004, the number of large coal corporations only accounts for 2.5%. The year 2006 saw an annual coal output topping 2.35 billion tons in China but the amount of coal mines is close to 20000. In comparison, the United States yields 1.2 billion tons of coal annually with only 1100 mines. Moreover, Australia produces 0.3 billion tons each year by 100 some mines.

The main coal producer nations all feature with large-scale powerful corporations with the prevailing trend of merger and acquisition in coal industry all around the world in recent years. Only with advantageous giant corporation as the core, capital as the link to establish multinational enterprises could Chinese coal companies further enhance their operational capacity and financial strength in order to sharpen the competitive edge in the global market and to lay a solid foundation for China to get involved in coal exploration global wide.

The coal industry in China is in the stage of resource integration and enterprises restructuring and will step forward into capital integration in the future. An important strategic transition is facing the coal industry, which would call for a shift from 'passive adaption to the market' to 'active participations in cooperation and establish internationally competitive energy and chemical corporation'. Therefore, the merger and acquisition of coal companies are inevitable results of transformation of economic development pattern. The faster the transformation is, the frequenter merger and acquisition will happen. Meanwhile, as a byproduct along with socialized production, the restructuring of coal industry will in turn facilitate the efficiency of social resource consumption.

ANALYSIS ON THE MERGER AND ACQUISITION OF DOMESTIC COAL COMPANIES AMID TRANSFORMATION OF RESOURCES---ILLUSTRATED BY THE EXAMPLE OF SHANXI PROVINCE

Background for the merger and acquisition of coal companies in Shanxi Province

Shanxi enjoys the advantage of abundant coal resources and coal industry is naturally the pinpoint business in the province. According to the statistics, Shanxi has produced about 12 billion tons of coal since the 1949, accounting for a quarter of the total national output. Over 70% or 8 billion tons are transported to other provinces. Shanxi has made great contribution to the economic construction of China. However, the benefits do not come free of expenses. Owing to the limited productivity in certain historic phase, an industrial structure featuring numerous small coal mines with low yield has come into shape and hard to proceed further without thorough reform. Therefore, Shanxi province need to push forward restructuring and resources transformation via dedicated efforts to explore new modes of development, upgrade the industry, step up resource-oriented strategy, improve efficiency and pursue a low-carbon economic growth. The large-scale merger and acquisition launched in 2008 is believed to be the first step.

Measures to carry out merger and acquisition of coal companies in Shanxi Province

Shanxi has made a significant progress since the region launched China's largest-ever restructuring campaign in an effort to improve work safety conditions and production capacity of the industry in April, 2009. In accordance with the advanced productivity and the modern management concepts, integration and scientific control have been adopted among local coal enterprises. With the support of giant coal corporations both inside and outside the province as well as that of other fields such as electricity, metallurgy and chemical industry, giant businesses have been created through selection and restructuring process of the small and medium companies. Fully tap the combined role of government regulation and market competition, reasonable structure has come into for with involvement of mechanization, capitalization and enhanced production safety. The coal-abundant province has achieved huge leap to a region with organized and powerful coal industry.

The merge could help private companies to survive as it introduces advanced production technologies and management methods. Shanxi plans to step up the consolidation of its coke mining sector through the restructure, a process that will include the closure of smaller miners, improving production standards and eliminating outdated production capacity. There have been a lot of innovations in the process and has provided a good example to follow for other regions around the nation.

Achievements of current stages

Prominent increase in industrial level

The structure of numerous small businesses with low output has been changed radically. By merger and acquisition, the level of scale economy, mechanization, informatization and modernization has been significantly improved into a new stage of development. 70% of the mines averages at an annual output over 900000 tons. Those producing less than 300000 tons have all been washed out. The annual yield of single mine has risen from 300000 to over 1 million tons. All the mines reserved have adopted modern machines in exploitation. The increased level of coal industry has become a driver for the economic growth of the whole province.

Huge leap in concentration ratio

Amount of coal enterprises has reduced from 2200 to around 130, 4 (Pingshuo Coal company, Tongmei Coal, Shanxi Coke, Shanxi coal transportation and sale co.) of which has an annual production capacity of hundreds of million tons and another 3(Yangmei Coal, Luan, Jinmei Coal) of over 50 million tons. Meanwhile, 11 enterprises have an output over 10 million tons annually and another 72 local companies around 3 million each yearly.

Largely optimized scheme for mine opening

Shareholding system has been introduced as the main organizational form with cooperation between public and private sectors. Of the total, public investment accounts for 30%, private 30% and mixed finance 50%. As is shown in Chart 1, 46 companies are fully owned or majorly controlled by the state, 86.79% of the total number; 5 enterprises or 9.43% are under collective ownership; one joint-venture and one private company. The set of Figures are drawn in Yangquan, Shanxi province after the merger and acquisition process. Ownership Structure of Shanxi Coal Industry in 2010 shown in Figure 1.

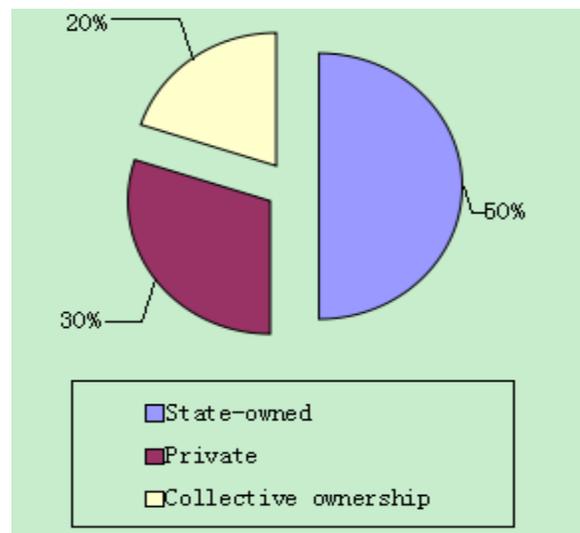


Figure 1 : Ownership structure of Shanxi coal industry in 2010

Significant strengthened production security

The retained mines after merger and acquisition will be constructed in line with the safety standards and the level of mechanization and informatization will be enhanced, which will also serve to facilitate a secured producing activity. The year

2010 saw 63 incidents with 139 deaths, a decrease of 11.27% in terms of case amount and 31.19% in respect to death toll. Death rate per million tons is reduced by 42.86% to 0.1876.

Salient improvements in sustainable development with more contributions to the industry

Environmental indicators including recycling rate, rate of reusing, coal washing and processing rate, major pollution control rate and coal bed gas exploitation have all been significantly enhanced. The effects become more and more explicit with the further promotion of merger and acquisition works in coal industry. In the year 2010, revenue of coal reached to 544.1 billion Yuan, a 44.48% growth over 2009, 2 times higher than that of 2005. Industrial added value of coal industry is up to 240 billion yuan, a 45.28% growth over 2009, accounting for 55.8% of value added of the whole province. Coal enterprises contributed 81.6 billion yuan to the tax revenue, an increase of 22.4 billion yuan or 37.84%.

STRATEGIES FOR THE INDUSTRY TO PUSH FORWARD MERGER AND ACQUISITION PROCESS AND ACHIEVE SUCCESSFUL TRANSFORMATION OF RESOURCES

Speed up the merger and acquisition process for resource transformation

Pushing forward merger and acquisition is a strategic project for scientific development of coal industry

Development is the primary point in scientific outlook on development. In order to develop in a scientific way, the mode of production must be reformed and structure be optimized. Related departments should take effort to speed up infrastructure construction with focus on giant corporations encouraging multi-fields cooperation beyond limits of geographical locations and pursue an integral operation involving areas such as coal, electricity, railway, port, chemical and architecture. Myriad problems of small businesses such as the low quality, safety threats, waste of resources and lack of order should be duly addressed by planned guidance, government support and institutional guarantees.

Stepping up merger and acquisition is a key measure in response to the current financial recession

The global financial crisis has brought both opportunities and challenges for coal industry of China. Coal companies should draw upon the favorable situation and avoid the disadvantageous elements to deal with the current situation properly. Amid the hard time for small businesses owing to the falling demand, measures should be made to intensify merger and acquisition. Practices and experiences have shown that stable and reliable coal supply is an indispensable foundation for the thriving of national economy and the healthy situation of coal industry cannot exit without strong support from giant corporations. Therefore, it's a call of the times to further step up merger and acquisition process in coal industry and cultivate a group of large companies as the main supplier for both domestic and international markets.

Carrying out merger and acquisition faster is a vital measure for a stable development of national economy

Giant corporations, unified mine developers, scientific planning, reasonable layout, modern machines, large-scale mines, higher recovery rate, lower energy consumption and recycled economy are all indispensable factors to achieve an economical development with secured production safety and optimized industrial structure. Only in this way could China's coal companies become more influential and competitive in the international arena.

At present, China has been fully equipped with the conditions required by merger and acquisition with increased level of modernization and a batch of enterprises achieving international advanced standards. Some technological indicators ever hit the international records. All of these have provided a favorable environment for merger and acquisition.

Introduce strategic investors from abroad and pursue a reasonable structure of shareholding system

In the above-mentioned merging and restructuring campaign, the whole coal industry has over relied on the government-lead allocation and focused on the state-owned enterprises, which has resulted to high debt with big challenges in the aspects involving compensation funds and further investment in mines. All these have posed higher operational risks brought about by the market changes and thereby external investors are in urgent demand. Approving strategic investors to bid for mining rights and introducing share reform in the corporations would be feasible ways to establish a scientific and sound enterprise system as well as to pursue reasonable and sustainable managerial decisions.

The reform of Shanxi coal industry has been practiced consistently in line with the principle that "providing more for the advanced companies and ruling out those left behind". Whether state- or individual- owned, as long as the company represents advanced productivity and matches its scale to the resources, it could be the mainstay in reform and restructure process. The government has emphasized the importance to break through boundaries in three fields, namely the ownership system, different industries and regions, in order to develop both state- and individual- owned in equal terms.

Therefore, the government should make the state-owned and private enterprises the center of reform as well as support on a policy basis for private ones joining in the progress. Meanwhile, it is also suggested that all the coal, electricity, metallurgy and chemical corporate, no matter what its ownership system is, should be linked by property right and actively take part in the merge and restructure in the form of shareholding. With the wider and further opening-up, the foreign investment will complicate the reforming process. Related departments should introduce the overseas funds selectively and gradually with the premise of state-ownership.

Tap new pillar industries on the foundation of coal industry

The concept of sustainable development is of great significance for energy enterprises. Because of the resource-oriented characteristics of coal industry, companies would enter a bottleneck phase with gradual growth. Therefore, life cycle

should be taken into consideration when companies try to tap the overseas markets. For example, enterprises could extend their industrial chains and broaden products lines via merging or acquiring coal chemical or coking businesses. Another viable way is to enhance market share via merger of coal transportation companies.

Therefore, the enterprises should stick to the principles of “promote industry and production by multi-development of coal-based enterprises” with a two-side extension with upside and downside industries so as to achieve the leap towards diversification and to establish a new structure focusing on three-dimensional energy.

In the progress from single production to diversification, the subjects should concentrate available resources, cultivate core competitiveness and spare no effort to expand, deepen and optimize the coal industry. The companies should avoid developing quantity in the expense of the quality. Therefore, they need to foster a strong coal business before going into other fields such as electricity, metallurgy or coal chemical area. Only with powerful core production line can the process of diversification press forward smoothly.

The key to diversification lies on solid technological base. As the main profit source, coal industry should maintain its own competitive advantages by concentrated effort on self-development which will provide the foundation for diversification.

Nowadays, this operational idea has been substantially adopted in the process of restructuring process. Myriad arms of coal industries have been initiated, which could be seen in TABLE 1.

Speed up international merger and acquisition of giant coal corporation in order to enhance global competitiveness

With the rising competition in the global coal market, multinational companies have carried out a strong wave of share purchasing in order to secure their leading role in terms of market share and to enhance their control in coal production. Further speeding up the establishment of multinational giant coal corporation with higher productivity and better managerial expertise becomes an immediate concern to the Chinese companies.

In recent years, Chinese government has attached great importance to cultivate strong powers in coal industry and encourage the involvements into the international markets. In the “11th five-year plan on Coal industry development” issued by the State development and reform committee in January, 2007, multinational strategy has been given top priority. A few of Chinese coal enterprises have successfully gone out to Australia and Mongolia for mining investment.

Shandong Yanzhou Coal Corporation is the first business tapping the overseas coal resources of China. In the adoption of international strategy, Yanzhou has accumulated more resources, expanded market scale, broadened channels and ultimately enhanced competitive strength. The company has listed on stock markets of Hong Kong, New York and Shanghai in 1998. In October, 2004, Yanzhou bought an Australian coal enterprise by 32 million Australian dollars with total investment up to 113 million U.S dollars. In 2010, Yanzhou, again, spent 3.333 billion Australian dollars (18.95 billion RMB) on the full acquisition of Felix Resources Company Limited, another Australian business.

In the perspective of international development, the coal giants such as Peabody Energy Corporation (USA) and Ruhl Group (German) are on their way to internationalization with their business expanding all the continents. The coal giants mentioned above even do better in foreign land than in their home lands. The capability of multinational production has been a decisive standard for having international competitiveness. Therefore, the coal corporations should open wider to the outside world; foster their strength to compete in the global market along with the reform practices.

TABLE 1 : The development directions for the first 5 companies of China’s coal industry in 2010

Ranking	Enterprises	industrial development directions
1	Shenhua Corporation	coal, railway, electricity, port, coal chemical
2	Shanxi Coal Transportation and Sale Corporation	coal transportation and sale, production, coal chemical
3	Henan Coal Chemical Corporation	coal, chemical, nonferrous metal, equipment manufacturing, logistics trade, mine construction, practical businesses
4	Shanxi Coke Corporation	coal, coke, machine, mechanical electricity, chemical, construction material, electricity
5	China Coal Energy Corporation	coal production and trade, coal chemical, pit power generation, mine construction, coal equipment manufacture

Re-establish modern giant coal corporations by integration in the wake of merger and acquisition

Merger and acquisition is just the first step for development. The decisive section is the integration process after. With successful completion of merger and acquisition, the following points need to be kept in mind in integration activities so as to lay scientific and stable foundation for a strong company.

Carry out corporate transformation in accordance with demand and standards of modern entrepreneur institution

The modern enterprise institution which includes “Clearly established ownership, Well defined power and responsibility, separation of enterprise from administration and scientific management” is the inevitable choice for the reform of SOES and is also required in the restructuring process of resource-oriented companies. By combining large enterprises into giant power together with technological cooperation, capital restructuring, merging of bankrupted companies and private funds introduction, the targeted industries could further promote the transition of operating mechanism on the basis of internal reform and capital reorganization.

Management structure innovation

The coal enterprises should follow a sustainable path of modernization and standardization by enforcing institutional innovation. Reform and management are the two pinnacles in the development of enterprises and the achievements must be consolidated by innovations. With the establishment of a comprehensive managerial institution in the areas of human resources, finance, production cost, technology, marketing and safety, the coal industry would maximize its benefits through optimizing the allocation of internal resources.

Organized human resource scheme

Normally speaking, the employees of the company that has been acquired tend to have negative attitude, which may bring passive impact on the development of the corporation. Based on the analysis of surveys done by human resource department, companies should enhance the morale by cultivate encouraging business culture, set up reasonable structure and initiate related training to make clear the responsibilities and authorities of different positions.

Integrated organizational culture

Cultural conflicts and confrontations are inevitable owing to the different background of companies involved in merger and acquisition activities, therefore it's the duty of managers and executives to reduce the negative impact to the minimum level by cultivate shared values and encouraging atmosphere.

Intensified ability of independent innovation

The management layer staff should be fully responsible to the plan and supervision work with specific research and development tasks assigned to individual departments. More should be invested into innovations of crucial technologies. Coal industry should rely on a strong technological basis with practical research as its priority in the process of transition. The enterprises need to pursue a sound technological innovation mechanism, select the focus reasonably, promote construction of larger mines and further the mechanization drive. A series of powerful corporation with modern competitiveness would be set up through innovation.

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