

THE INTERNALIZATION OF TNC'S PRODUCTION: FINDINGS FOR UKRAINIAN BUSINESS

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Abstract. The article deals with mergers and acquisitions as modern strategies of TNCs internationalization. The positions of Ukrainian capital on international mergers and acquisitions' market are explored. The peculiarities of foreign investors' activity in the different sectors of the national economy are determined. The factors preventing national companies from gaining competitive advantages on the world market are outlined.

Keywords: TNC, mergers, acquisitions, Ukrainian, national economy, investors, competitive advantages.

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Introduction

In today's development of global economy its internalization is a distinctive trend, resulting in convergence of economic development of different countries, enhancement of industrial relations, rapid growth of international trade, migration of capital, expansion of international relations in banking and insurance spheres, intertwining of financial and stock markets, etc. Large companies, functioning in the form of transnational corporations (TNC), play a particularly important role in these processes. Industrial associations, integrating technologically related enterprises, emerge in the international business. The active process of creating financial and industrial groups, holdings, strategic alliances, etc. takes place. It means that it is not just involvement of additional resources, finances, bank capital, but also optimal diversification of activities, acquisition and application of the best practices, know-how, advanced machinery and technology in order to gain competitive advantage, which become the sphere of common interests, and here the mechanism of internationalization and its active use in competitive strategy becomes the crucial factor.

Mergers and acquisitions are firmly established on the national market as a special form of transnational business internationalization. However, Ukrainian business consolidation is carried out contrary to the global trends in the development of merger and acquisition. As a result of unstable political and economic situation as well as imperfection of institutional environment, domestic companies are in difficult circumstances, taking into consideration an opportunity of foreign investment attraction or increase in the value of business. Therefore, more and more often merger and acquisition are a critical tool and, sometimes, even the only way to increase capitalization.

The merger and acquisitions as modern strategy of Ukrainian companies

In Ukraine the activities of enterprises, related to mergers and acquisitions, including foreign entities, are legally regulated. Thus, pooling of capital, purchase of equity stake or arrangement of any other activities, focused on increase of the market share, are impossible without authorization of the Antimonopoly Committee of Ukraine (AMCU). In 2016 the Committee reviewed 547 applications for approval of entities concentration (in 2015 – 774 applications). At the same time, about 76.2 percent of applications were received from foreign investors. In comparison with 2015, a proportion of such applications declined by 7.4 percent.

Most of the applications for concentration approval were submitted by the entities in 2008, and 47.4% of applications were received from foreign investors or enterprises with foreign investments. It demonstrated the growing interest of investors to domestic enterprises, which had a reduced value due to the global economic crisis. Within the period between 2009 and 2013 there was a trend towards increasing in the number of applications for concentration approval. Within the period between 2014 and 2016 the indicators slightly fluctuated, but without any dramatic changes. It should be mentioned that such trends, on one hand, can be explained by the increasing financial and economic indicators of not just Ukrainian and foreign economy, but also individual enterprises, which are gradually stabilized. However, on the other hand, it is worth to agree with the experts in merger and acquisition market of Ukraine that the majority of large-scale agreements were concluded using behind-the-scene approaches or owing to compelling economic or situational circumstances.

At the same time, the above-mentioned figures confirm the revival of interest in domestic assets, represented by the growing number of requests in respect of potential objects for acquiring or partnership. Investors perform activities, focused on study of the industry and preliminary selection of investment objects, preparation for entering into merger and acquisition agreements, which can be implemented since the favorable environment is formed owing to stabilization of the situation in Ukraine.

The most prevalent forms of entity concentration that the Committee has issued approvals for within the analyzed period are acquiring shares (stakes, interest), which is shown in the Table 1.

Table 1

Distribution of the approvals of entities concentration, issued by the Antimonopoly Committee of Ukraine between 2000 and 2016, by types (compiled from the source: Antimonopoly Committee of Ukraine)

Year	Type of concentration					Total
	Merger	Joint venture	Acquisition of control	Purchase of shares (stakes, interests)	Others	
2000	10	5	5	250	33	303
2005	31	12	16	249	51	359
2010	21	131	227	2833	136	3439
2011	13	18	136	417	1	585
2012	31	32	106	576	5	750
2013	20	23	73	655	8	779
2014	17	22	36	418	8	501
2015	14	23	50	563	8	658
2016	3	8	69	357	8	441

The growing dynamics was demonstrated by all types of concentration within the period between 2000 and 2011. Dramatic decline in the amount of concentration approvals in 2009 was resulted by general drop in economic activity due to the global economic crisis. Within the period between 2012 and 2016 most of the types of concentration showed unstable and sometimes downward dynamics.

During 2016 the Committee issued approvals for 441 cases of entities concentration. In 106 cases the applications were returned to the applicants without consideration or the participants of concentration abandoned an idea of its implementation before the decision is taken by the Committee. The return of applications without consideration was mainly caused by lack of sufficient information, contained in the submitted materials, and a refusal to implement concentration – over the risk of its potential banning due to adverse consequences for competition, found in the course of the respective application review. At the same time, the majority of approvals were issued in such industrial sectors as agriculture, machine building, pharmaceuticals, construction and real estate, chemical industry, IT technologies and communications.

It should be noted that it is almost impossible to count the number and scope of merger and acquisition agreements in the Ukrainian realities as the reporting and information, which have to be official public sources, are not published and often hidden by the owners of assets or counterparts. Therefore, in this paper we are bound to handle the data, published by analytical agencies and mass media. In particular, according to the information and analytical resource in the sphere of mergers and acquisitions titled “Mergermarket”, the largest increase of value and number of agreements was recorded in 2012 (Fig.1).

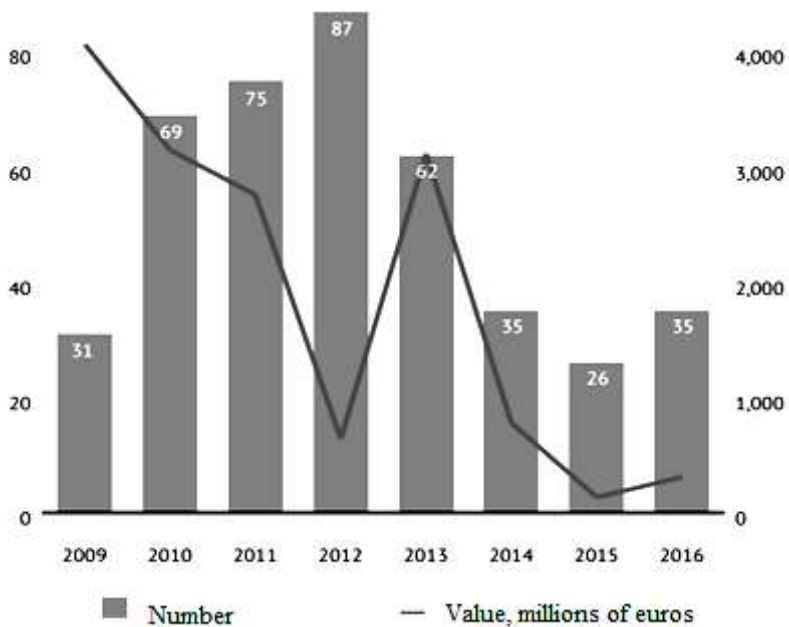


Fig. 1. Dynamics of value and number of merger and acquisition agreements with participation of Ukraine (as a seller, purchaser or the country of assets origin), 2009-2016 (*Rising to the challenge: M&A in Ukraine, 2017*)

2014 should be defined as the most disastrous year in respect of mergers and acquisitions for the last 10 years. Even during global economic crisis and decline of Ukrainian economy within the period between 2009 and 2010 the indicators were less disastrous. We can consider that the major cause of this situation consists in unstable political situation, created by two extraordinary elections during a year as well as the armed conflict in the east of Ukraine. This happens even notwithstanding the fact that within the period between 2012 and 2013 the market demonstrated positive trends. Thus, in the peak after-crisis year of 2012 the overall scope of transactions amounted to about 5 billion US Dollars, and in 2013 these indicators increased to 6.5-7 billion US Dollars. This period should be characterized by a considerable outflow of Western capital from Ukraine, resulted by social and political uncertainty in the country as well as by strengthening the positions by Russian corporations, which extended their presence in the sectors of strategic importance for Ukraine. It should be noted that the capital of Western countries demonstrated reluctance to bear risks of Ukrainian financial sector, particularly, in unfavorable social and economic situation. This was evidenced by decrease in proportion of foreign capital in banking system from 41.9% in 2012 to 33.7 % at the end of 2013. It was partially caused by change of trends in the European banks capital flow. Significant sovereign and operational risks, which can be covered just by large TNC, dominated in the energy and raw material sectors. At the same time, before drop of merger and acquisition market in 2014, Russian companies had been particularly active. Transactions, related to Russian capital, demonstrated different vectors on the territory of Ukraine. It is purely real investments, which are not of speculative nature. Russian strategies were mainly focused on real production sector in order to act as a competitor and take part in distribution of income jointly with financial and political elite of Ukraine. Concerning the agreements, concluded between domestic enterprises, before 2014 the driving forces of market were represented by banks, IT companies, retail agencies and corporations of agro-industrial complex. Enlargement of Ukrainian pro-government financial and industrial groups on account of new assets was quite dynamical in 2013, despite shortage of special-purpose circulating capital for mergers, low ratings of Ukraine in international comparison, high political risks, etc.

Thus, until 2014 the scope of mergers and acquisitions with participation of Ukraine has demonstrated more than double growth, even provided three-year drop that took place before 2013. Mainly, it was the agreements with involvement of Ukrainian assets, where the sales quickened due to replacement of foreign owners of local assets by the Ukrainian ones and enlargement of national business. However, in 2014 even intention of foreign investors to abandon Ukraine almost failed to keep the market afloat. A lack of demand on national assets caused decrease in the average cost of transactions with Ukrainian participation down to 12 million US Dollars for three quarters of 2014, if we compare it with the same period of 2013. As for the market itself, it has lost almost three-fourth of its size, having been reduced to 895 million US Dollars for nine months of 2014.

An aggregate effect of the above-mentioned factors made 2014 a disastrous year for development of merger and acquisition market in Ukraine, which consolidated agreements that had been negotiated before and just were brought to logical conclusion, or forced agreements. It should be noted that 2015 renewed the Ukrainian merger and acquisition market owing to investors' activities in agricultural sector, energy sector and IT industry, which are of interest for a potential purchaser, notwithstanding the political and economic hardships in the country.

In 2015 financial sector and telecommunication market were the most interesting for investors. A share of these two sectors in total amount of agreements was about 57%, and the most significant agreements included acquiring of Ukrainian startup “Looktery Inc” – developer of photo applications for smartphones, by the American “Snapchat” (132.7 million Euro) and the agreement between Turkish “Turkcell AS” and Ukrainian “Astelit” (TM Life) on purchase of 44 % of shares of the latter at the price of 89 million EURO.

2015 was marked by so called ‘package agreements’, e.g., an equity stake was granted in exchange of funding (credit for replenishment of circulating capital or other needs). Such agreements are less risky for investors as far as such investments ensure guaranteed income or security, or an equity stake is considered as a mechanism to guarantee repayment of debt funds. Moreover, most of the investors were determined to enter into small-size agreements – around 10-40 million US Dollars, that was caused by not only economic factors, but also domestic policy related to risk management.

Western capital displacement by the domestic one, in particular, reduction in the number of international agreements in contrast to the national ones, became one of the most significant trends of 2015. During this period foreign players acted primarily as sellers. There was quite small amount of real buyers; therefore, in most of the cases of agreements with involvement of foreign capital, this capital left Ukraine. Besides, we should also mention an exit of certain Russian companies from the domestic market. Thus, let us remind you the sale by Russian company “LUKOIL” of the network of 240 petrol stations and six petroleum tank farms, which were on balance of the subsidiary company “LUKOIL-UKRAINE” (300 million US Dollars). After numerous cases of boycotting their petrol stations, Russian company performed highly skilled transaction, which enabled them formally to change the owner and rebrand the company. Due to the Ukrainians’ hostility towards Russia producers in the heat of the confrontation between these countries, Russian Kama Automobile Plant (KAMAZ), which sold its sales network and technical maintenance to Ukraine, leaves Ukraine. Russian company “Rosgosstrakh” also got rid of the insurance company “Providna”, having sold all shares to the Ukrainian subsidiary of West European investors.

According to preliminary results of 2016, the scope of merger and acquisition agreements in Ukraine increased by 20% and reached 605.3 million Euro, and their number increased almost by 2.5 times – up to 84 agreements, in comparison with 2015. Total amount of public agreements also increased by 131 % and amounted to 310 million Euro, at the same time, major part of this indicator growth stems from the sale of “Ukrsotsbank” by “UniCredit” bank of “ABH Holdings” at the price of 281 million Euro.

The largest number of agreements was concluded in the following sectors: bank services (25 agreements, including 12 agreements where the buyers are the residents of Ukraine), construction and real estate (9 agreements, including 6 – national investors) and agricultural and industrial complex (8 agreements, including 3 – Ukrainian investments). Table 2 shows the most significant agreements.

In the context of the global amount of merger and acquisition agreements, Ukraine has a portion of just 0.09 %, and the largest investors in the geographical structure of Ukrainian M&A market are Cyprus (7.1 %), Russian Federation (6.0 %), Canada, Switzerland and Austria (3.6 % each) (Fig.2).

Table 2

**The largest merger and acquisition agreements with involvement of Ukrainian capital,
2015-2016**
(Rising to the challenge: M&A in Ukraine, 2017)

Company, which is acquired	Company, which acquires	Sector	Cost of the agreement, million US Dollars	Share
2015				
Solar energy stations (10) (Ukraine)	CNBM International (China)	Energy	168 million Euro	100%
Rozetka.ua (Ukraine)	Horizon Capital (USA /Ukraine)	Trade	36.4 million Euro	-
Savyntsi-Agro, LLC (Ukraine)	Agro-Holding Astarta (Ukraine)	Agricultural and industrial sector	462 thousand Euro	99,98%
Astra Bank (Ukraine)	AgroHoldings (Ukraine) Limited / NCH Capital (USA /Ukraine)	Bank sector	92.1 million UAH	100%
Euroasia Telecommunications Holdings B.V. /Astelit, LLC (Netherlands /Ukraine)	Turkcell (Turkey)	Telecommunication and Mass Media	100 million USD	44,96%
2016				
Barvinokretail network (Ukraine)	National Grocery Stores Chain ATB (Ukraine)	Trade	5-6 million Euro	100%
Pharma company Marifarm (Slovenia)	ArteriumPharmaceutical Corporation (Ukraine)	Pharmaceutics	6.8 million Euro	100%
BorshchahivskiyChemical-Pharmaceutica l Plant (Ukraine)	Pharmaceutical Firm Darnitsa (Ukraine)	Pharmaceutics	207. 4 million UAH	25%
Trimob, LLC TOB (Ukraine)	MTC Ukraine (Vodafone) (Russia)	Telecommunication and Mass Media	3 billion UAH.	100%
Oil-Extraction Factory Ellada (Ukraine)	Kernel (Ukraine)	Agricultural and industrial sector	95.8 million USD	100%

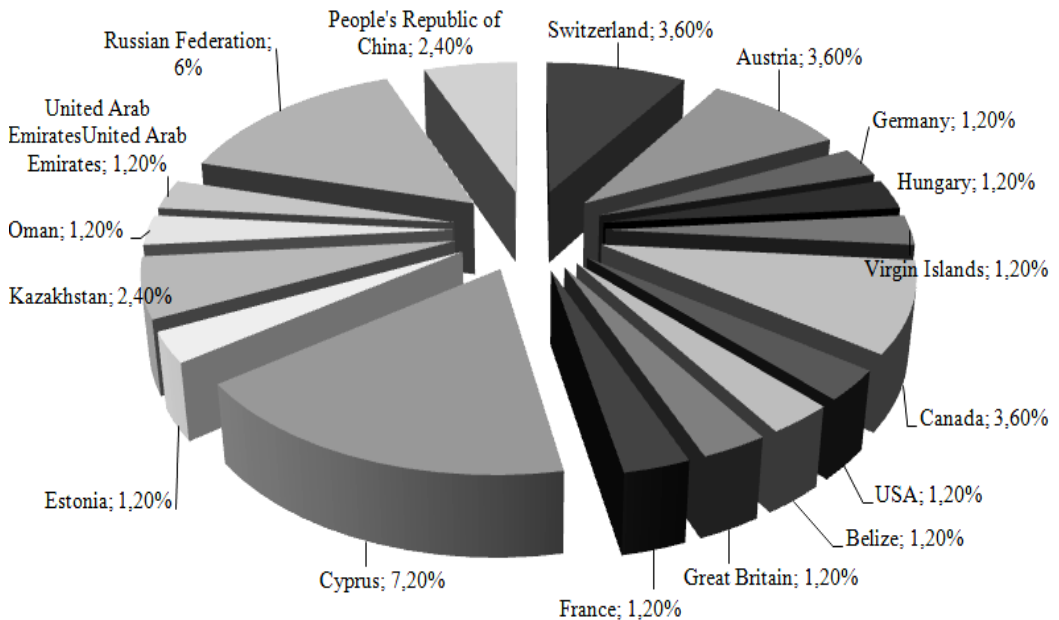


Fig. 2. Countries-investors to merger and acquisition market of Ukraine, 2016
(*Ukrainian M&A market 2016: Results*)

We can assume that the investments from Cyprus are repayment of domestic capital. In 2016 one agreement has been concluded in every of the following sectors: machine building, pharmaceuticals, metallurgy, agricultural and industrial complex, IT and insurance. Investors from Russia preferred bank sector (3 agreements), telecommunication and machine building (one agreement in each of the sectors). Investments from Canada were made in agricultural and industrial complex as well as metallurgy, from Austria – bank sector and insurance, from Switzerland – oil and gas sector as well as financial services. We should also emphasize that Chinese investors entered the market: in 2015 – Chinese company “CNBM International” (alternative energy sector, 168 million Euro), and in 2016 – “Bohai Commodity Exchange Co. Ltd” and “China Tian Yuan Manganese Ltd”. Moreover, there is still present a share of Russian capital.

Similar indicators were also recorded for dynamics of changes in cost of agreements. In particular, the leaders are financial services (13 % for the period of 2013-2014 and 81% during 2015-2016), energy (8 % and 6 % respectively) and communication sector (83 % and 3 % respectively).

So, foreign companies, Ukrainian financial and industrial groups and other Ukrainian capital systematically develop and increase their assets, despite of shortages in monetary liquidity, economic and political uncertainties, and limited access to Western markets of debt and equity capitals.

The scopes of cross-border M&A for the period between 1998 and 2015 demonstrated instable dynamics. For the period between 1998-2005 the amounts of M&A cost increased by 359.9 million US Dollars, i.e., almost by 16 times. In 2010 there was an abrupt decline, which almost reached the amounts of cost in 1998, however, starting from 2011 we have seen a growth, reflecting the increase in cost of global M&A agreements with participation of

Ukraine by over 2.5 times, amounting to 65.3 million US Dollars. In 2014 the cost of cross-border mergers and acquisitions with involvement of Ukrainian capital reached negative value -121.3 million US Dollars, owing to economic instability and complicated political situation in Ukraine. The improvement was achieved in 2015 and the cost of agreements was recorded at the level of 460.1 million US Dollars. Similar trends of instability were also common to a number of cross-border mergers and acquisitions with participation of Ukraine.

As has already been pointed out, the financial service and banking sectors became the leaders among the mergers and acquisitions agreements with involvement of Ukrainian capital. Among the most significant agreements we can emphasize that Bulgarian “Euroins Insurance Group” has obtained approval of AMCY to purchase shares of “HDI Strakhuvannya”, Public JSC in the amount, which provides them with over 50% of votes in the company’s supreme management body. “Fairfax Financial Holdings Limited” (Canada) announced a conclusion of agreement with “QBE Management (Ireland) Limited” (Ireland) and their Ukrainian partner for the acquisition of 100% of the insurance company “QBE Ukraine”. A consortium of West European investors as a part of the private investment fund from Luxemburg and a number of private investors acquired 100% of the Ukrainian Insurance Company “Providna”, belonging to the Russian Insurance Company “Rosgosstrakh”. Moreover, the Insurance Company “Universalna” announced their intention to join the insurance group “Vienna Insurance Group”, the approximate amount of transaction is 25 - 30 million US Dollars. Thus, the financial service sector is the most developed on the market of mergers and acquisitions and the most attractive for foreign investors.

The sphere of banking services is also characterized by special kind of dynamics. In particular, “Eurobank Ergasias S.A.” (Eurobank) announced entering into agreement with the Ukrainian “Delta Group Bank” for sale of their branch in Ukraine at 95 million Euro. The shareholders of “Alfa-Bank” (Ukraine) signed an agreement with the “Bank of Cyprus Group” for purchase of 99.77% of shares of the “Bank of Cyprus”, Public JSC as well as the credit portfolio, issued by the Bank of Cyprus Group to the Ukrainian borrowers. Total amount of transaction was 202.5 million Euro. A group of companies “Group DF” purchased 100% of shares of “Pravex-Bank” from “Intesa Sanpaolo” at 75 million Euro, where the direct purchaser was represented by “Centragas Holding Gmb”, being a part of “Group DF”, which combines the assets of Dmytro Firtash.

The Ukrainian industry became an attractive field of activity for foreign TNC, including by the way of mergers and acquisitions, which implement their own strategies through subsidiaries. Notwithstanding the fact that high level of energy dependence of Ukrainian industrial enterprises considerably reduces their attractiveness for financial investors, who expect gaining the profit within the shortest period, we could most likely anticipate expansion into national chemical industry on the part of strategic western investors and Russian companies, who will try to take advantage of the current situation in Ukraine aiming to get a significant price discount.

Agricultural and industrial complex holds a special place on the Ukrainian market of mergers and acquisitions. Establishment of holding structures in agrarian sphere makes it possible not just to develop production capacities, but also to obtain additional competitive advantages, both on national and international markets. As, generally, huge agricultural companies encompass almost full production cycle – from growing of raw materials to its processing and manufacturing of finished product. Global financial crisis as well as political and economic instability in Ukraine caused ambiguous implications for activities of international and Ukrainian agricultural holdings. Some companies increased their own land

fund on account of purchase or acquisition of medium-sized and small enterprises. Reduce of the cost of leasing the land contributed to this situation as far as lack of free money for agricultural works and significant rise in price for material and technical resources has adverse impact on financial state of multiple enterprises that led to considerable decrease in value of their assets. Ukrainian and other world banks actively credited agricultural holdings to perform such operations as purchasing the assets of other enterprises and renewal of fixed assets.

As a result of active efforts, taken by agrarian companies on mergers and acquisitions market, the German Company "OSI Group" decided to sell two agrarian companies in Ukraine, belonging to them – "Agrobeef", LLC (Kyiv) and "Agrosolutions" (Kyiv); Yuriy Kosyuk, the largest shareholder of "Myronivsky Hliboproduct" sold 100% of shares of Berezan Poultry Farm to five Cyprian companies "Proscar Trading Limited", "Digomax Limited", "Sitate Limited", "Gresley Holdings Limited" and "Pentamorfo Limited", which previously owned securities of Berezan Poultry Farm.

A group of companies "Terra Food" is going to purchase 8.016 of shares of "Trostanets Milk Plant", Closed JSC (Vinnytsa Region) or 86.0981% stake. According to the announcement of "Terra Food Milk Ukraine Limited" in the disclosure system of State Commission for Securities and Stock Market, they plan to purchase the above-stated block of shares from "Milk Alliance", Closed JSC; Vinnytsa company "Vinfort" was allowed to concentrate more than 50% of Odessa Sparkling Wine Factory, included into "Gruppo Campari" since 2009. Agricultural "Holding Industrial Milk Company" (IMC) additionally purchased 60% of "Agrocom", LLC, having a land bank of 16 thousand ha and capacities for storage of grain and oil crops in the amount of 195 thousand tons. Total amount of the agreement is 18 million US Dollars. Earlier, in August, 2013 the agricultural holding purchased 40% of "Agrocom", LLC, at 12 million US Dollars. Moreover, the leading diversified agro-industrial company "Kernel" sold Oil-Extraction Factory in Nevinnomyssk, Stavropol Krai, Russian Federation. Sunflower seeds processing capacity – 100 thousand tons per year, and a price of Oil-Extraction Factory made 10 million US Dollars.

Trade industry occupies special positions on the market of mergers and acquisitions. For today, retail trade is the most dynamic and rapidly developing focus of business. More and more often the factors of the Ukrainian market investment attractiveness are represented by the growth of retail goods turnover, low degree of retail facilities saturation, high degree of unorganized retailing, which make retail trade an attractive sector for activities of holding structures.

At present, almost all retail chains consider an option to sell a package of entire business. Medium-sized regional retail chains with highly developed system of sales attract more interest of foreign investors today.

So, among the most significant agreements we should highlight the sale of Ukrainian chain of building materials hypermarkets of German group "Praktiker" to "Kreston Guarantee Group Ukraine" Auditing Firm; moreover, negotiations on merger of "Spar" and "Bacon chains" (about 20 outlets) with the retail chain "Varus" took place between Sergiy Kasyanov, the owner of agro-holding "KSG Agro" and retail chain "Varus", in particular, they discussed renaming of all "Spar" stores as "Varus" in exchange of allotting a stake in the parent company "Omega" to Sergiy Kasyanov.

During the last years the activities of Ukrainian enterprises in the sphere of consumer services on mergers and acquisitions market have been considerably activated. Thus, Ukrainian logistic company "Meest Express" purchased Postman, the largest courier service

in Ukraine. The Unified State Register of Legal Entities and Individual Entrepreneurs states that 95% of Postman now belong to Rostislav Kysil, the President of “Meest Express”, and the remaining 5% - to “Meest Group”. The Investment company “Concorde Capital” and Oleg Kalashnikov, the shareholder of the Ukrainian chain “Luxoptica”, closed a deal to buy 80% of “Dobrobut” clinics chain.

The agreements in the sphere of communications and IT technologies deserve special attention. Thus, “Concorde Capital” closed a deal to buy 50% of “OMP-13” company, operating on the market of money transfers and payment systems of Ukraine. Chicago-based company Intersog with software development office in Odessa announced purchase of Odessa developer “SoftTechnics”. This transaction is estimated in the amount of 2.5 million US Dollars. Internet-provider from Dnipro “Fregat” claims the status of nationwide provider and announced buying up Internet-providers all over Ukraine.

Therefore, participation of domestic enterprises in mergers and acquisitions, both on the domestic market and in cross-border agreements, is a special tool for business development, providing large corporations with an opportunity not just to raise value of business, but also to strengthen competitive positions on the market, to enhance efficiency of using combined resources and the level of the companies’ internal integrity as well as to diminish risks and increase the level of business sustainability. At the same time, to achieve the full-fledged development of merger and acquisition market in Ukraine, including with involvement of foreign capital, we need to overcome a number of obstacles pertaining to insufficient transparency of business and irregularity of consolidation procedures, non-compliance with the requirements of company law and ethics, violations in the sphere antimonopoly legislation, availability of the factor of “informal arrangements” at the moment of planning and implementing agreements, insufficiently developed infrastructure of stock market and imperfection of legal regulation of merger and acquisition processes.

Conclusions and suggestions

At the same time, in consequence of political instability and confrontation in the eastern regions, which considerably worsen investment environment, it is difficult to speak about sustainable development of merger and acquisition market of Ukraine. We should outline the following key factors, determining modern specifics and dynamics of the market:

- driving motives towards sale of share in the company or full package, connected with inability to control activities of this company due to replacement of political elites;
- interest in purchasing Ukrainian assets, which are impaired to a certain extent and can be profitable in future, provided that the political and economic situation is improved and in context of the perspective for EU;
- capacities of the large Ukrainian corporations to raise and use additional funding for merger and acquisition agreements, and further diversification of their own activities.

The uncertain geopolitical situation complicates the process of introducing by the government of so needed reforms, which could help Ukraine to attract international investors in the long run. In future, apart from political stabilization, settlement of political confrontation and economic stabilization, a lot of other factors can have a positive impact on development of mergers and acquisitions market in Ukraine. In particular, International Monetary Fund supports restructuring of state enterprises, including a number of energy distribution companies.

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