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FEASIBILITY OF ENTERPRISE CONCENTRIC DIVERSIFICATION UNDER THE ECONOMIC CRISIS CONDITIONS

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ДОЦІЛЬНІСТЬ ВИКОРИСТАННЯ ПРОЦЕСУ КОНЦЕНТРИЧНОЇ ДИВЕРСИФІКАЦІЇ ПІДПРИЄМСТВОМ В УМОВАХ ЕКОНОМІЧНОЇ КРИЗИ

The article analyses the influence of concentric diversification and synergetic effect as the profit increasing instruments on the activity of leather goods producing enterprises in Ukraine during the crisis of 2014–2017. It also proves the feasibility instruments of enterprise crisis management done by means of contrastive analysis. The strategy of enterprise management in the crises period is grounded, its results are estimated, and the influence of the country's fiscal policy on the company's strategy of development is shown. The article demonstrates the enterprise's new market segment entry as one of the most important crisis management instruments. Besides, the detailed description of the enterprise's three-year production of goods with the elastic demand is provided in this article.

У статті здійснено аналіз впливу процесу концентричної диверсифікації та синергетичного ефекту як інструментів для підвищення прибутку на діяльність реального підприємства з виробництва шкіряної галантереї під час економічної кризи 2014–2017 років в Україні. Шляхом порівняльного аналізу визначено доцільність використання цих інструментів у розробках антикризового менеджменту підприємства. Також надано стратегію управління виробничим підприємством під час кризи, здійснено оцінку її результатів та показано вплив стратегії розвитку країни на стратегію розвитку підприємства через фіскальну політику. У статті продемонстровано один із випадків вимушеного виходу підприємства на новий сегмент ринку як одного з найнеобхідніших заходів антикризового менеджменту. Окрім того, представлено детальний опис діяльності підприємства з виробництва товарів з еластичним попитом протягом трьох років.

Key words: concentric diversification, synergetic effect, crises management, development strategy, fiscal policy, elasticity of demand.

Ключові слова: концентрична диверсифікація, синергетичний ефект, антикризовий менеджмент, стратегія управління, фіскальна політика, еластичність попиту.

PROBLEM DEFINITION

Private enterprises have to choose the most effective methods of their development and to work up crisis management to survive under the market conditions in the period of economic instability. Often the Ukrainian entrepreneurs (representatives of small and medium — size businesses) try to save money by reducing the output and redundancy instead of expanding production in order to stay in the market under the economic

crisis conditions. From the authors' view point diversification and synergetic effect are the most efficient integral parts of the enterprise's crisis management.

ANALYSIS OF THE LATEST RESEARCHES AND PUBLICATIONS

The question of diversification and synergetic effect of enterprises' activity was repeatedly analyzed by foreign

authors such as Kotler F. [1], Thompson, A. [2], Striklend A. [2], and Druker P. [6]. But all of them considered these concept in general or on the examples of large enterprises and did not pay enough attention to the work of small or medium- size businesses which are, by the way, the most widespread in the world.

TASK DEFINITION

The aim of this article is to analyze the influence of diversification and synergetic effect on the activity of the Ukrainian small private enterprises under the crisis conditions of 2014—2017; to analyze of the enterprises' activity before and after taking these measures; and also to give the information about the enterprises' possibility not to include diversification and synergetic effect in the list of crisis management and the circumstances under which the enterprises would stay. The novelty of our research consists not only in a contrastive analysis of economic condition of enterprises before and after realizing diversification and synergetic effect, but also in providing the information about the crisis management influence on the enterprises activity.

MAIN MATERIAL STATEMENT

F. Kotler considers diversification growth as one of the ways of transition from one branch to another for the purpose of further development. He distinguishes three types of diversification: concentric, horizontal and conglomerate. Concentric diversification lies in production of new goods, which are similar to the already existed ones for the purpose of new clients' attraction [1, pp. 531—532].

From the Kotler's point of view, concentric diversification is an instrument of profit increase and client base expansion, but the auther does not take into account the possibility of enterprises retention in already mastered branches and present enterprises preservation under the conditions of economic instability.

The enterprise, which is the object of our research, uses the process of concentric diversification to stabilize the financial position and avoid bankruptcy.

It is necessary to give the general characteristic of the enterprise before going over to its detailed analysis.

A private enterprise "Style Line" (Kharkiv), which produces leather accessories, was based in 1998. At first, the material and technical resources consisted of one cutting out table and one sewing machine, but in 2013 the material resources consisted of 15 professional equipment units and 24 employees. "Style Line" cooperated with the wholesale buyers of leather accessories, who had shops in the shopping centers of Kharkiv and all over Ukraine. The production was also demanded by the owners of leather footwear shops. Leather products made 100% of gross output of the enterprise. This fact shows that the main clients were representatives of middle and well-to-do classes.

It is also necessary to notice that at the beginning of 2013 the enterprise actively cooperated with wholesale buyers from Russia (about 15% of the total amount of production were sold abroad) and considered the possibility to set up a company outlet and to design its own brand as a higher stage of development.

Thus, it is possible to draw a conclusion that in 2013 a private enterprise "Style Line" was in a stage of an active development, but a question of carrying out any type of diversification to increase profits had still existed, because the enterprise needed funds for further plans realization.

In other words, at the beginning of 2013 carrying out of diversification was based on classical reason — the desire to expand clients' base. In that case, diversification in a related branch would take place. Thompson and Striklend

wrote about this kind of diversification in their book "Strategic management". Diversification in a related branch allows changing the elements of a strategic compliance into a competitive advantage [2, p. 299]. This means that the enterprise might work on the adoption of new technologies to create new production on the already existed base.

At the beginning of 2014—2017 crisis economic and political situation had changed in Ukraine. The deterioration of economic conditions of the country affected the work of large, medium- size and small businesses. The rate of national currency towards dollar went sharply down (in September, 2013 1\$=8 hrn (≈8, 18 hrn) [3], but in April, 2014 hryvna's rate towards dollar had fallen down to 3,32 units — 1\$≈11,5 hrn [4]). It was a reason of prices increase. The suspension of the country's economic development caused the origin of simultaneous growth of cyclic unemployment and inflation lowered purchasing power of consumers.

At that time the enterprise production was presented by the goods with elastic demand released to representatives of middle and well-to-do classes, who began to buy less and prefer cheaper production under the crisis conditions (because of Pigou or well-being effect the curve of demand pulled down). The firm lost the possibility of entry into the Russian sales markets, because of the political conflict between Ukraine and Russia and because of imposing sanctions against Russia.

The possibility of the enterprise bankruptcy became a consequence of these events. So, the administration of the enterprise made a decision to carry out concentric diversification in the frame of crisis management to adapt the enterprise to unstable economic situation in the country.

Otherwise, the enterprise management resorted to strategic planning, which was defined as an elaboration of strategy with formalized procedure assigned on stages, techniques and methods [5, p. 231].

Nevertheless, it is also necessary to create the right structure of crisis management to achieve the desirable results. One of the most important requirements the enterprise had to meet was providing maximum efficiency of the whole teamwork [6, p. 146].

Carrying out of concentric diversification consisted of five stages:

1. The transition to cheaper working stock. As far as 100% of production was made of natural leather before the crisis, after carrying out of diversification, 80% of gross output of the enterprise was made of artificial leather and only 20% were natural leather products. The firm decided not to refuse fully from leather production, because it might have lost the rich consumers. The enterprise could manage to lower the price of a commodity unit by the use of cheaper raw materials.

2. Purchase of new equipment. Four sewing machines were bought in China to increase output (unlike available Italian and German sewing machines, Chinese machines were cheaper. One Chinese machine cost ≈ 1100€ as far as German machine cost ≈ 2000€ Two German presses were for ≈ 1400€ each and two Italian painting machines cost ≈ 1200€ each and were bought to improve the quality of production. The firm also changed the suppliers of the materials: natural leather was bought in Italy before the crisis, while artificial leather was bought in Kharkiv after diversification. Natural leather was bought in Kharkiv too but in a smaller quantity.

3. Due to the loss of possibility to enter into the Russian sales market the enterprise was forced to look for new sales markets in Ukraine, basically wholesale buyers who had shops of leather accessories as the enterprise had no company shops.

Table 1. The comparative analysis of the "Style Line" enterprise activity in September, 2013 and April, 2014

Determinant	September, 2013	April, 2014
Gross revenue	43 680 uah	50 540 uah
Net profit	13 104 uah	15 162 uah
Units of production	91 units (leather goods)	23 units of natural leather goods 136 units of goods made of artificial leather
Price	60\$=480 uah	1 unit of natural leather goods 60\$=660 uah 1 unit of goods made of artificial leather 260 uah
Stock item	6 samplers	8 samplers
Staff	24 persons	27 persons
Number of equipment	15 items	23 items (+8)
Taxation	229,4 uah	243,6 uah
Dollar exchange rate	1\$=8 uah	1\$=11 uah

4. The staff increased on 3 persons to work with new equipment and to serve it.

5. Also the stock item increased from six to eight samples.

It would be desirable to pay attention to the fact that the enterprise refused to introduce innovative technologies not only because of the crisis. As P. Druker said, it was impossible to carry out diversification and to introduce new technologies at the same time because of complexity of these processes, which required attention and had disadvantages [7, p. 176].

Taking into account the detailed description of changes in the structure of the enterprise, we can come to conclusion that the enterprise management decided to choose diversification of real goods, in order to expand the range of goods by producing a considerable number of their modifications [8].

The results of carrying out concentric diversification in view of external factors can be presented in table 1.

*According to what the owner of this enterprise said, the net profit equaled 30% of gross revenue.

It should be noted, that after diversification, which was carried out in 2013, the net profit should be divided into two categories:

1. Gross revenue and net profit (net profit 1), which the enterprise gained from realization of leather production and which made 30% of total amount.

1. Gross revenue and net profit (net profit 2), which the enterprise gained from realization of artificial leather production and which made 70% of total amount.

The enterprise came to a new market segment when it had begun to make production of economy class (the artificial leather goods). However, the fact that the enterprise didn't refuse of leather production, gave the possibility to work for the consumers of middle class and reserve an insignificant part of the market.

The powerful argument in favor of carrying out concentric diversification under the conditions of economic instability is an opportunity not only to preserve the existing quantity of employees but also to increase it.

According to the analysis of the received results, it is possible to draw a conclusion that diversification helped the enterprise not only to survive but also to increase the gross income and net profit, in spite of tax assessment increase and fall of hryvna exchange rate towards dollar.

It is also necessary to make the contrastive analysis of the enterprise's activity results in September 2013 and September 2016 in order to assess how long the enterprise could work after carrying out concentric diversification without repeated restructuring of the industrial process and to give more complete description of the enterprise's activity.

According to the data derived from table 2, we can come to the conclusion that thanks to concentric diversification, the "Style Line" manufacturing enterprise can properly function under the significant fall of national currency and taxation increase.

Furthermore, one should not forget that, according to the official results of the Ukrainian statistics, index of the industrial output in leather and leather goods production came to 98,2% (was 1,8% off) in the period from September 2016 to October 2016 [9].

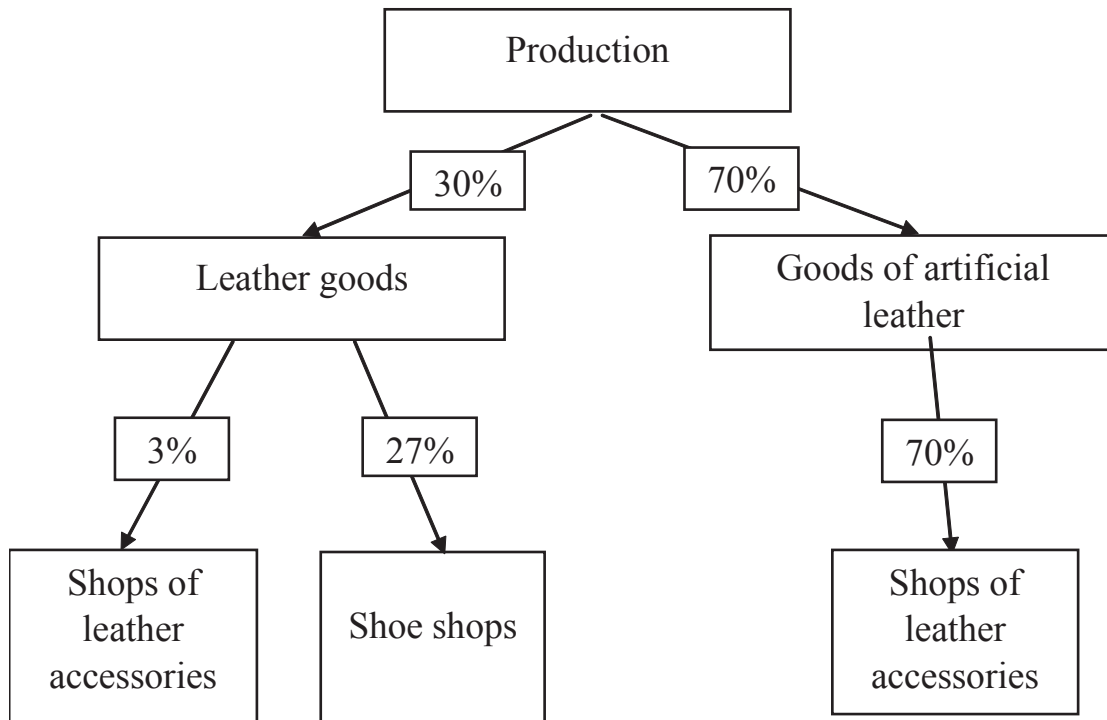
It demonstrates that the situation became worse in this branch of industry, but as we can see in table 2, this fact didn't influence the results of the enterprise's activity.

In this part of the article we should focus on the role of synergetic effect in carrying out the enterprise diversification and see how this effect influences its results.

The synergetic effect during the amalgamation of two companies was analyzed in the article "Diversification: synergetic effect or the complementary multiplier?" The author of this article focused his attention on the fact, that "the criterion of a complementary production and services is the necessary condition to carry out diversification" [10].

Table 2. The comparative analysis of "Style Line enterprise's activity in September, 2013 and September, 2016

Determinant	September, 2013	September, 2016
Gross revenue	43 680 uah	91 500 uah
Net profit	13 104 uah	27 450 uah
Units of production	91 units (leather goods)	31 units of leather goods 150 units of goods made of artificial leather.
Price	60\$=480 uah	1 unit of leather goods 60\$=1500 uah 1 unit of goods made of artificial leather 300 uah
Stock item	6 samplers	8 samplers
Staff	24 persons	27 persons
Number of equipment	15 items	23 items (+8)
Taxation	229,4 uah	594 uah
Dollar exchange rate	1\$=8 uah	1\$=26 uah



Picture 1. The sale structure of "Style Line" enterprise production during the first two quarters of 2016

In our case, the enterprise's management decided to use the influence of synergetic effect on additional profit by signing the agreement with the owners of shoe shops.

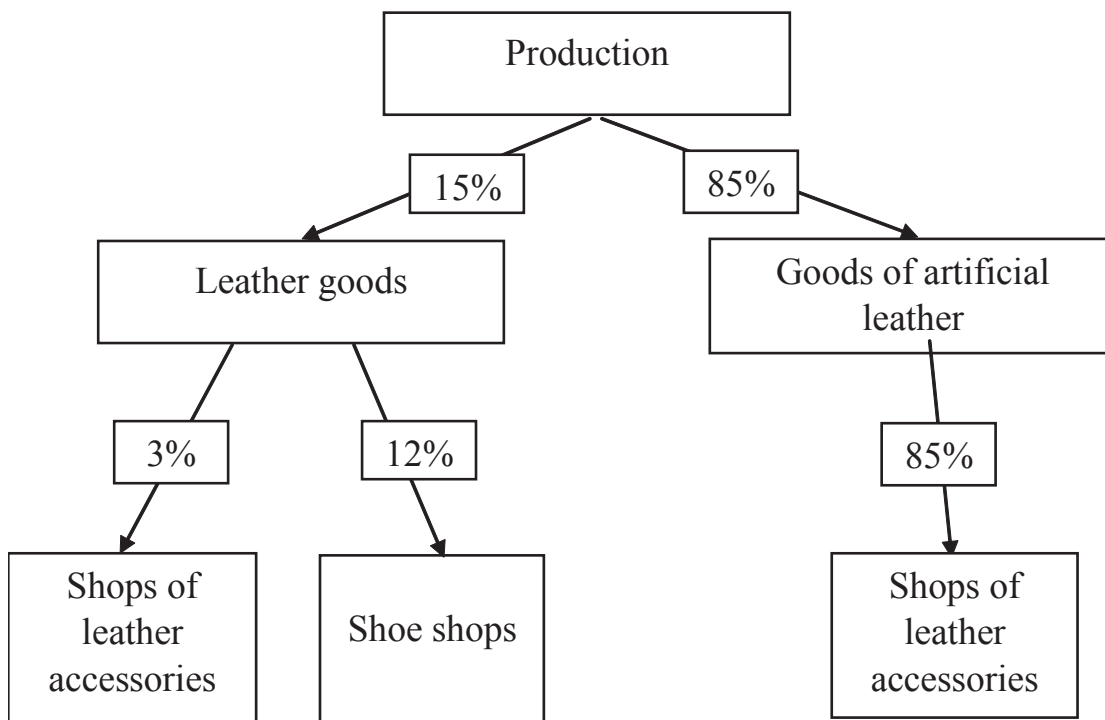
Leather footwear and leather accessories can be defined as complementary products because the use of one of them implies the use of another.

During the crisis of 2014—2017 the majority of leather accessories shop owners had to refuse from the production

of nature leather and turn to the production of artificial leather. Thus the shoe shops owners became the main buyers of leather goods.

In other words, in this case, synergetic effect can be observed not as a consequence of two firms' amalgamation but as a consequence of complementary products realization.

If after diversification we divide the net profit into the net profit which the enterprise gains from realization of



Picture 2. The preliminary results of 2016 sales structure of "Style Line" enterprise production

leather production (net profit 1), and the net profit, which the enterprise gains from realization of artificial leather production (net profit 2), 90% of the net profit 1 is received from selling in the shoe shops and only 10% from selling in the shops which sell only leather accessories.

The sale structure of "Style Line" enterprise production during the first two quarters of 2016 is presented in picture 1.

As we can see at picture 1, 27% of total amount of production were realized in shoe shops. That is 27% of goods were sold thanks to synergetic effect, which is a consequence of complementary goods placement in shoe shops.

Also it should be mentioned that carrying out diversification is a very long process, which consists of several stages. A number of these stages is caused by both exogenous and endogenous factors.

The fiscal policy, political and economic situation in the country refers to the important exogenous factors. The endogenous factor is the strategy of the enterprise, which is chosen by its management.

In fact, the consumer price index was made 101, 8% in general and for "Clothes and footwear" category in particular. The enterprise producing leather accessories referred to it and its index equaled 99, 5% in November 2016 [11]. According to this fact, we can conclude that the prices of leather accessories and the personal income of households remained approximately at the same level.

Therefore, the enterprise management decided to continue diversification hence its first results were quite successful. That is why the decision to increase the volume of artificial leather goods output on 15% and to expand its production was made.

Thus judging by the preliminary results of 2016, the sales structure of "Style Line" enterprise production looks like that:

Thus the influence of synergetic effect decreases because of the reduction of natural leather goods production. In September 2016 27% of leather products were sold thanks to the influence of synergetic effect, now only 12% of leather goods are sold. It shows that diversification doesn't always lead to synergetic effect, but sometimes it forces to refuse it if the influence of this effect does not correspond to the chosen strategy of the enterprise's development.

CONCLUSION

The use of diversification and synergetic effect is not only the rational but necessary under the conditions of economic instability. On the example of the real Ukrainian private enterprise, we have proved that:

1. Diversification helps the enterprise not only to survive under the crisis condition, but also to increase the output and the number of employees.

2. Synergetic effect can work to the benefit of the enterprise thanks to increase in volume of production and diversification of its sale.

From our view point, the carried out analysis gives the detailed information about the influence of diversification and synergetic effect on a small business enterprise activity under the conditions of 2014—2017 crises in Ukraine.

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Стаття надійшла до редакції 24.02.2017 р.