

Transaction Costs of Large and Mid-sized Corporations in Russia

Assoc. Prof. Dr. Ekaterina Nikolaeva (Chelyabinsk State University, Russia)

Assoc. Prof. Dr. Dmitri Pletnev (Chelyabinsk State University, Russia)

Stanislav Lushnikov (Chelyabinsk State University, Russia)

Abstract

In the times of economic instability in most developed countries, a decrease is experienced in the effectiveness of many large public corporations. Such corporations are facing high expenditures (transaction costs mostly) and extremely low return on invested capital. Medium-sized businesses, on the contrary, prove to be more efficient: they show an acceptable level of profitability and total cost savings. The purpose of the present study is to calculate and analyse transaction costs of medium and large corporations and identify an impact of these costs on the performance of companies. Within the the framework of a neoinstitutional approach a complex of institutional factors influencing a company's development is being explored. The efficiency of institutional forms is determined through studying such factors as transaction costs. In line with this theory, the transaction cost level of corporations is estimated, which enables one to make their comparative analysis in economic sectors. The analysis has revealed that the relative level of transaction costs with large corporations is two times higher than that in the event of middle ones. A comparative analysis of return on sales in two groups of companies has pointed to a fact that after 2010 the margin of middle-sized companies exceeded the profitability of large companies. The relationship between the level of transaction costs and return on sales in two groups of companies is being quantified as well. We have proved that middle-sized corporations have shown a direct relationship. On the contrary, transaction costs negatively affect profitability in large corporations.

1 Introduction

An insufficient attention in economic literature is being paid to the issue of the ratio between the efficiency of a firm and its transactional expenses. Besides, it is necessary to note that this aspect of the analysis is, as a rule, one-sided. The majority of theorists studying transactional expenses and the institutional nature of a firm speak about a need of decreasing transactional expenses for the purpose of increasing the efficiency of a company and of transactions carried out by it. However, it is possible to adduce a set of examples when a company that increases the transactional component of its expenses and achieves thereby a considerable expansion of sales markets, an elimination of competitors and an access to cheaper resources. And in this regard, according to some authors, there arises a question of a correlation of obtained benefits and expenses incurred.

In papers devoted to the research of transactional expenses, these expenses are classified as a set of methods. Among them there are the following: a division into internal and external, constant and variable, obvious and implicit costs. In addition, at least 10 types of transactional expenses preceding or following a transaction are singled out. Therefore, in our opinion, a choice of a variant of optimising transactional expenses should be made separately with respect to their specific kind.

Many authors in their articles examine the key questions relating to transaction costs in modern companies. They considered the problem of transaction costs in the industry, time and intercountry context (Langlois, 2005; Schmitz ve Patrick, 2006; Pessali, 2006; Bylund, 2013; Powell, 2014).

2 Methodology

Modern corporations are characterised by a variety of forms and ways of conducting economic operations, which, in its turn, also defines a variety of expenses of transactional nature. The types of transactional expenses which have been the most fully described above, are represented in large and average corporations. Big transactional expenses, as a rule, arise in large corporations characterised by big turnovers and considerable profits. In modern economy, high expenses of transactional nature are mainly external and they themselves are subsequently accompanied by considerable benefits for a corporation (for example, costs of lobbying in the interests of a corporation). Internal transactional expenses associated with ensuring the effective functioning of intra-corporate institutions also take place, but most commonly not in such a volume, and a corporation does not expect such considerable benefits from them (for instance, expenditures on the simulation and creation of the most optimal organisational structures).

Nowadays, in Russia and abroad a considerable attention is being paid to the research of medium and small business. In the period of the recession in economies of the majority of developed countries a decrease in the efficiency (often resulting in losses) of large public companies is being observed. Such corporations are becoming unable to meet expectations of investors, quite often showing an extremely low profitability on invested capital. In this regard, large companies, even during especially difficult periods, see a growth of expenses on remunerations of top managers, on advertising, as well as on financing illegal operations and

projects, which allows lobbying interests of corporation in political circles. In connection with this driver, an escape of economy from the crisis situation and a further sustainable development is seen by many economists in the development of medium business.

Large corporations are, as a rule, highly integrated companies which, apart from this fact, widely utilise outsourcing, network structures, which fact, unlike smaller structures, enables them to get additional benefits, including those obtained from decreasing transactional expenses. However, parallel to this, such companies bear a high burden of transactional expenses connected with the maintenance of corporate structure.

Thus, K. Verner and G. Weiss's book (Verner ve Weiss, 2007) describes the largest and most effective multinational corporations, such as Adidas, Bayer, Coca-Cola, Deutsche Bank, The Walt Disney Company, Kraft Foods International, McDonalds Corporation, Procter&Gamble and many others. Most charges brought against leader corporations are economic and social nature, such as: evasion of tax payment, use of child labour, violation of rules of commodity sale, environment destruction, speculative transactions, carrying out experiences on animals, repressions of members of trade unions, setting obstacles to sale of vital medicines in developing countries, extreme forms of exploitation at Chinese factories, dumping, etc. Apart from that, political charges are brought against a number of corporations working mainly in the sphere of production and sale of oil products, banking services, political: financing military operations in developing countries, cooperation with military regimes, granting credits for roguish projects, lobbying against actions aimed at protecting climate, etc.

Whatever violations may be considered, it is quite obvious that the majority, if not all the largest corporations, commit them for the purpose of capitalising on the following: expansion of sales markets, suppression of competitors, cost avoidance. Owing to this the efficiency of these corporations increases. A conclusion suggests itself that illegal economic, social and political actions allow corporations to remain competitive in the world's markets. And those who are not members of this "club" of shadow economy players are compelled to be content with the least they have or withdraw from the market.

From the description of transnational corporations, given above, it follows that the majority of actions (of illegal character) is directed towards an expansion of sales markets and a decrease in production expenses, for which purpose corporations endow huge amounts of money (transactional expenses) in the form of bribes, penalties, financing investigations, etc.

An empirical analysis of data of western transnational corporations has showed that while having huge turnovers these corporations get a rather low margin of profit. That is to say, when deciding on employing illegal measures for the sake of achieving their goals, by no means all corporations achieve considerable benefits.

Medium business is represented by closed (nonpublic) companies, often family ones, with one or several owners. The main advantages of such companies, which favourably distinguish them from large business, are as follows: ability to discern a long-term prospect, a high level of responsibility, and trust, and flexibility in decision-making. In the period of a crisis, the least-effort principle becomes predominating in such companies, which helps them not only remain "afloat" under conditions of competition, but also show quite a good profitability. It is necessary to note that economising occurs largely at the expense of a constant component of expenses, to which a considerable part of transactional expenses exactly relates.

An analysis of medium business in countries of Europe has showed that there is a multitude of quite effective companies, part of which has an access to the world's commodity markets, and parallel to this they do their legal business. G. Simon's books "Hidden champions" (Simon, 1998, 2007) describes middle-scale companies which are world leaders in their areas and which are successful and profitable thanks to their high intellectual concentration in their work with clients, a lack of extensive expenditures on promotion and advertising. These companies possess unique structures and principles of management. Among them there are Baader, Webasto, Stihl, Brita, etc. One of the most important characteristics of these companies is their narrow specialisation and concentration in a certain grocery niche. It enables companies occupy upto 70-80% of the market, which can be comparable only to large transnational giants. As a rule, these are companies with a turnover of upto 300 thousand dollars, having specialised business in various branches – mechanical engineering, metal working, chemical, food, electronic industry, etc.

Unlike large corporations, average ones avoid joining alliances and use of outsourcing in their production and research activity. Production depth (the percent of production operations carried out by firms) makes up about 60%. A share of a value added in revenue is more than 50%, and companies note that a profit level is above an average.

Thus, medium corporations actively use factors of economising on transactional expenses and demonstrate their high efficiency. Having refused that institutional structure which the largest leader corporations have and having victimised part of their turnover, a company can entirely switch over to a more effective model of doing business. In this respect, probably there will be no need in using shadow schemes and companies will be exempted from huge expenditures on making illegal transactions.

3 Results

Russian medium business has some features which, unfortunately, do not testify to its advantage. The historically formed features of Russian economy and of the private sector disclose a number of problems about which it was stated in a report by the PWC company regarding an investigation of private and family business (PWC, 2012). Among them the following challenges are noted: an insufficient support from the state, disinterest of the state in such companies (as small taxpayers), a lack of tax privileges, an existence of high administrative barriers (checks on the part of various agencies, complications faced during registration, etc.), an absence of highly qualified specialists in a number of branches. However, despite the above-said difficulties, there are many highly effective and successful representatives even among Russian companies of medium business.

As already noted, transactional expenses are capable to have an impact on the efficiency of a company. As a rule, it is considered that there is a reverse interrelationship between these indicators: the higher are transactional expenses, the lower is efficiency. However, the author believes, what not all transactional expenses equally “adversely” influence the efficiency of an enterprise. Thus, Popov E.V.’s works (Popov, 2010) prove a direct dependence between transactional expenses and profit by means of a transactional function.

In the course of the research of transactional expenses, we employed indicators of accounting reports of some companies of Russia’s food industry, which are sufficiently presented both by large and medium-sized enterprises. For the purpose of analysing the influence of transactional costs on efficiency of companies, a level of transactional expenses was defined, profitability of sales was calculated, and an analysis of their interrelation was carried out, using an authorial technique. In the course of the research, of companies were attributed to two groups – large and medium, according to a disposal of goods indicator.

An indicator of the level of transactional expenses does not reflect their actual volume in a company - the accounting of all arising transactional expenses is extremely difficult - but is an aggregated relative indicator enabling one to compare transactional expenses of certain economic entities. In order to assess the level of transactional expenses, the author uses data of accounting reports of companies. Out of these records the calculation includes both factually incurred expenses (for example, business and other expenditures, etc.) and relative indicators which indirectly indicate an existence of transactional expenses (the duration of a turnover of assets, a share of reserves in assets). In greater detail, one may read about the technique of assessing the level of transactional expenses in Nikolaeva E.V.’s works (Nikolaeva and Pletnev, 2009).

As a result of the analysis, a proposed hypothesis stating that the level of transactional expenses in large corporations is higher than in medium-sized companies was confirmed. This testifies to high expenditures on the part of large companies on the implementation of their operations. Besides, it was revealed that the level of transactional expenses decreased with the majority of companies in 2009, and after that medium-sized companies demonstrated an increase of the level, while large ones showed a decrease of the same. However, despite this fact, the level of transactional expenses of large companies throughout the whole studied period (2004-2012) practically twice as much exceeded this indicator in the event of medium-sized companies.

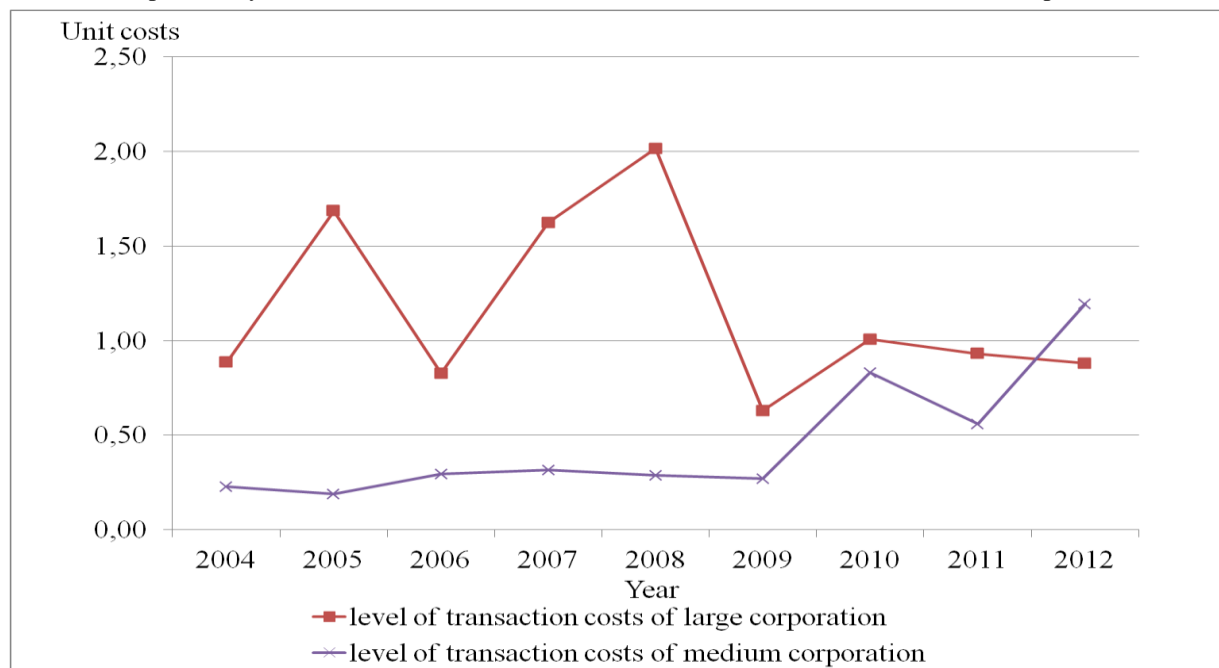


Figure 1. Levels of transactional expenses of large and medium-sized corporations in the food industry branch during 2004-2012 (unit costs)

Further, we have compared efficiency indicators (profitability of sales) for the studied companies from the two groups. The value of profitability of medium-sized companies was insignificantly lower than the similar indicator in the event of large companies (by 2-3%). And on the average, this indicator did not exceed 9% for the branch in the studied period. After 2010, profitability of medium-sized companies somewhat exceeded that of large companies, which may testify to the fact that medium-sized companies got out of the crisis more successfully.

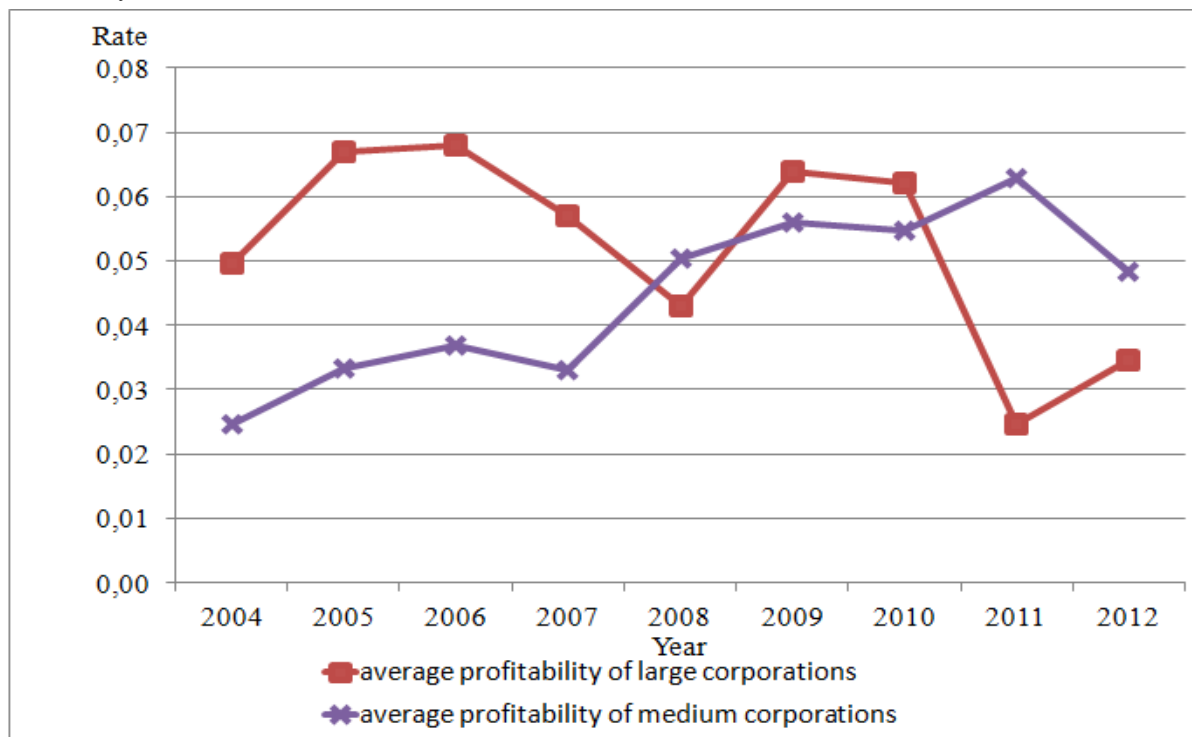


Figure 2. Levels of profitability of large and medium-sized corporations in the food industry branch during 2004-2012 (Rate)

In the paper, the interrelation between the level of transactional expenses and profitability of sales in two groups of the studied companies was quantitatively determined. As a result of a regression-and-correlation analysis, it was revealed that in case of large corporations – leaders in their branch – the interrelation between indicators is reverse, that is to say a growth of transactional expenses has an adverse effect on profitability indicators. In the group of medium-sized companies, some reverse results were obtained – a growth of transactional expenses is accompanied by a profitability growth. Thus, it is impossible to draw an unambiguous conclusion regarding the necessity of decreasing transactional expenses of companies. Possibly, with a reduction of part of similar expenses the efficiency of a firm’s activity will decrease too. And if one takes into account the fact that medium-sized companies generally incur only the most necessary expenses, then it is probable to assume that these are the very transactional expenses without which the efficiency of a company will fall. On the other hand, large corporations often “inflate” the budget of their expenses on non-productive needs, which tells negatively on their results.

In our opinion, the very form of ownership and the size of a company play an important role in the formation of the structure of expenses, which further determines the size of profit. In companies, where property and supervision are not separated (as a rule, in medium business), the existence of market competition stimulates managing directors to economise on expenses. But in large corporations (especially public companies) a lack of rigid supervision on the part of owners demotivates managers to decrease expenses. As a result, such corporations show efficiency at the level of medium-sized companies, in this case they bear twice as big transactional expenses alone (and this is so even without considering that share of incomes, which hired managers stow away “in a shadow”). Barkhatov V. and Pletnev D.’s works are devoted to the study of the theory and practice of the development of institutional environment in Russian corporations, as well as to the issue of their efficiency (Barkhatov, 2011, Pletnev, 2013).

4 Conclusion

By way of summarising, we have singled out a number of factors influencing the volume of transactional expenditures of large and medium-sized corporations in Russia and abroad.

In large corporations, considerable transactional expenses arise due to a need of implementing the following expenses:

- enormous expenses on marketing and advertising;
- expenses associated with an entrance of companies to stock markets;
- high costs of maintaining institutions of corporate governance;
- high expenses on hiring and personnel training;
- costs of making illegal transactions (by managers both in relation to a corporation, and with regard to the state and society).

Unlike large corporations medium-sized companies economise on transactional expenses for a number of reasons:

- companies incur rather low expenses on marketing;
- companies do approach the stock market and have no expenses connected with it (besides, this reduces risks of unfriendly take-overs);
- companies strive to draw highly qualified specialists and maintain low turnover rate of personnel, therefore expenses on hiring and training of personnel are low;
- low costs of corporate governance.

Thus, representatives of medium business actively use economising factors with respect to transactional expenses and demonstrate an efficiency at the level of large corporations which, in their turn, are compelled to bear a huge burden of expenses for maintaining this level.

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