

# ANALYSIS OF M & A AGREEMENTS AND THEIR SECTORAL CHARACTERISTICS

Artem Ivanov <sup>1</sup>

**Abstract.** The article analyzes the theoretical foundations of M&A agreements of different companies. The types and forms of M&A agreements were investigated. Due to the conducted analysis on the sectoral distribution of M&A agreements, it was concluded that the industry leader in this area was the mechanical and industrial equipment production, which led the industry rankings in terms of amount and value of such agreements in 2018. The main factors of the increase of M&A processes in the insurance industry in 2018 are introduced in the paper – raise of interest rates, increase of the amount of available capital, improved conditions for the world economy development, tax reform in the USA. Much attention is also paid to M&A banking activities in the USA. The article points out that the healthcare sector has been dominated by the ten largest pharmaceutical companies with the highest return on investments, which spent an average of 35% on M&A of total investment volume in R&D and M&A in recent years.

**Keywords:** mergers, acquisitions, globalization, agreements, M&A.

**JEL:** L16, L24, G34.

## Introduction

With globalization and increased integration processes in the global economy, business restructuring through mergers and acquisitions becomes one of the key forms of its scaling and development. Internationalization of the economy leads to the need for capital appreciation for its effective use.

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The relevance of the chosen topic is conditioned by the fact that international M&A (Mergers and Acquisitions) agreements are a mechanism of economic globalization, which leads to the formation of multinational corporations and the creation of global brands, deserving special attention.

**The purpose of the article** is to identify the major trends in the industry development of M&A agreements in the world.

Such scientists as S. Bragg, F. Evans, D. Bishop, D. DePamphilis, P. Gaughan, etc. have studied this issue. However, a very limited range of studies is devoted to the specific development features of the direction of mergers and acquisitions in the conditions of globalization of the world economy.

### **1. Theoretical and methodological aspects of M&A**

Mergers and acquisitions (M&A) are agreements in which the ownership rights of companies, other commercial organizations or their operating units are transferred or merged with other organizations. As an aspect of strategic management, mergers and acquisitions can enable businesses to grow or shrink, as well as change the nature of their business or competitive position.

From a legal perspective, a merger is a legal integration of two companies into one. In contrast to a merger, acquisition means that one company acquires the rights to shares or assets of another company (Canestri, 2014). From a commercial and economic point of view, both types of transactions typically lead to the consolidation of assets and liabilities within a single organization, and the distinction between "mergers" and "acquisitions" is less clear. A transaction legally registered as an acquisition may result in one party's business being indirectly owned by the other party's shareholders, while a transaction legally structured as a merger may give each party's shareholders partial ownership and control of the merged enterprise. An agreement may be termed a merger of equals if both CEOs agree that the merger is beneficial for both companies. If the administration of the target company opposes the agreement, the merger could be considered as an "acquisition".

Acquisition is the purchase of one enterprise or company by another company or entity. Specific acquisition goals can be defined in a variety of ways, including market research, trade detection, dispatch from internal business units, or supply chain analysis. Such a purchase can be 100% or almost 100% of the assets or equity of the acquired company. Consolidation occurs when two companies come together to form a new enterprise, while neither of the previous companies remains independent. The types of acquisitions are "private" and "public" acquisitions, depending on whether a shareholder company or several companies are listed on a public stock exchange. Acquisitions are considered by some publicly traded companies as a value creation strategy. An additional dimension or categorization is whether the acquisition is friendly or hostile.

World experience suggests that 50% of acquisitions were unsuccessful. That is, it was very difficult to succeed in the acquisition. More successful in mergers and acquisitions are serial acquirers, companies that perform such operations quite regularly, in contrast to other companies that rarely do so (Deng, 2015).

Depending on how the board of directors, employees, and shareholders of the target company perceive the purchase, its definition is largely "friendly" or "hostile". In the case of a friendly agreement, the companies cooperate in the negotiations. Otherwise, the management of the target company is unwilling to be bought or unaware of the offer. It is quite common practice to convert hostile acquisitions into friendly ones, as the acquirer secures the approval of the agreement by the board of directors of the company being purchased. This usually requires improving the terms of the offer through negotiation.

Acquisition usually implies that a big company buys a small one. However, sometimes a small firm acquires management control of a large company or a long-established company and retains the name of the latter in order to merge after the acquisition. This is known as a reverse acquisition.

Another type of acquisition is a reverse merger, a form of transaction that enables a private company to be publicly registered on a short notice. A reverse merger occurs when a privately held company with prospects and willingness to raise financing buys a publicly traded limited liability company that has no prospects for business development (Fogertey, 2018). Most

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often, the shareholders of the acquired firms receive a significant positive “abnormal return”, while the shareholders of the acquiring company are likely to experience a negative welfare effect.

The overall net effect of M&A agreements is positive: in almost all studies, positive M&A returns are reported for investors, which means that M&A create economic value. In the opinion of many professionals, this is done by transferring assets to management teams that administer them more effectively.

There are also many structures used to control the assets of a company. The purchaser buys the stock and therefore controls the acquired target company. Company ownership control, in turn, provides effective management of company assets. However, since the company is purchased as a going concern and a continuous enterprise, this form of transaction entails all the obligations accrued by that entity in its past and all the risks the company faces in its business activities.

A purchaser buys the assets of the target company. The cash received by the target company from the sale is returned to its shareholders in the form of dividends or liquidation. When a buyer purchases all the assets, this type of transaction leaves the target company in the form of an empty shell. The purchaser often structures the transaction as an asset purchase to “pick up” the assets he/she needs and exclude assets and liabilities that he/she does not have. This may be of particular importance in cases where foreseeable liabilities may include future ones, which could not be calculated for damage compensations. The latter include court proceedings, payments of benefits to employees or their termination, environmental damage and so on.

The disadvantage of this structure is the tax levied on the transfer of individual assets. While stock transactions can often be structured as exchange or other non-taxable transactions, both for the buyer and the seller's shareholders (Attila, 2011).

The main advantage of conducting M&A operations is that firms seek to improve financial performance or reduce risk (Cogman, 2015).

In addition to the benefits of reducing risks and improving financial performance, another benefit of M&A can be considered economies of scale.

This means that the merged company can reduce its fixed costs by eliminating individual divisions or operations.

Another benefit of M&A is the economy of scale. This occurs due to efficiency gains, primarily related to changes in demand such as increasing or decreasing marketing and distribution of different types of products.

An increase in revenue or an increase in the company's market share occurs at the expense of M&A. The mechanism of this process is as follows. The purchaser absorbs the main competitor and, thus, increases his/her market power (by capturing increased market share) in order to set prices.

Cross-selling is another positive consequence of M&A processes. For example, a bank buying a stockbroker may then sell its banking products to stockbroker's customers, while a broker may register the bank's clients on brokerage accounts, or the manufacturer may acquire and sell additional products.

M&A processes have a well-defined synergy effect. For example, procurement savings by means of increasing the order size and related discounts on wholesale or increase in number of management specialization opportunities.

M&A affect geographical and other types of diversifications. For instance, an operation that is designed to smooth the results of the company's profits, which smoothes the company's stock price in the long run, giving conservative investors more confidence in investing into the company. However, this does not always provide value for shareholders.

M&A processes have an impact on resource transfer. The resource interaction of the buying firms and the target firms could create value by overcoming information asymmetry or by pooling resources.

Vertical integration during the M&A processes occurs when firms that are very different in size and capacity merge.

Some companies use M&A processes as an alternative to the usual hiring process. This is especially common when a small private company is targeted. In this case, the large company simply hires ("acquires") the staff of the target private company.

M&A may aim to gain access to hidden or non-performing assets (land, real estate).

In the context of globalization and digitization of world economic relations, intellectual property has become one of the core competencies for

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companies. Research shows that the successful transfer and integration of knowledge after a merger or acquisition has a positive impact on a company's innovation capabilities and productivity.

There are additional M&A motives that may not increase the shareholder value (Besley, 2013). For example, diversification. While this may save a company from a downturn in a particular industry, it cannot provide value since individual shareholders can achieve the same hedge by diversifying their portfolios at a much lower cost than those associated with the merger.

Manager's overconfidence in the expected synergy from M&A can lead to overpayment for the target company.

Excessive use of M&A processes can lead to empire building. Therefore, it should be remembered that, along with increasing the ability of large companies' managers, there is a risk of losing influence on certain components of the production process.

The threat of the merging process can be called the effect of "compensation manager". There have been cases where some executive management teams have received payouts based on the total profit of the company rather than earnings per share. This gave a perverse incentive to buy companies for increasing overall profit while reducing earnings per share (which is detrimental to company owners and shareholders).

The process itself is multifaceted and depends on the type of companies that merge. Horizontal mergers typically occur between two companies in the same business sector. This means that synergy can be obtained through many forms, such as increasing market share, saving costs and exploring new market opportunities.

Vertical merger is a purchase of a business provider. Vertical purchase aims to reduce overhead costs on transactions and economies of scale.

The M&A conglomerate is the third form of the M&A process that involves the merger of two companies operating in different markets. The main objective is to diversify goods and services and to invest.

The M&A processes lead to restructuring of business goals, corporate governance and brand identity.

## 2. Analysis of trends of M&A agreements in industry markets

By analyzing the trend of concluding M&A agreements in various sectors of the world economy, we can identify trends in the consolidation processes of leading companies in different sectors of the economy.

Let's look at the dynamics of changes in the volume of mergers and acquisitions in the economic sectors during the period from 2015 to 2018.

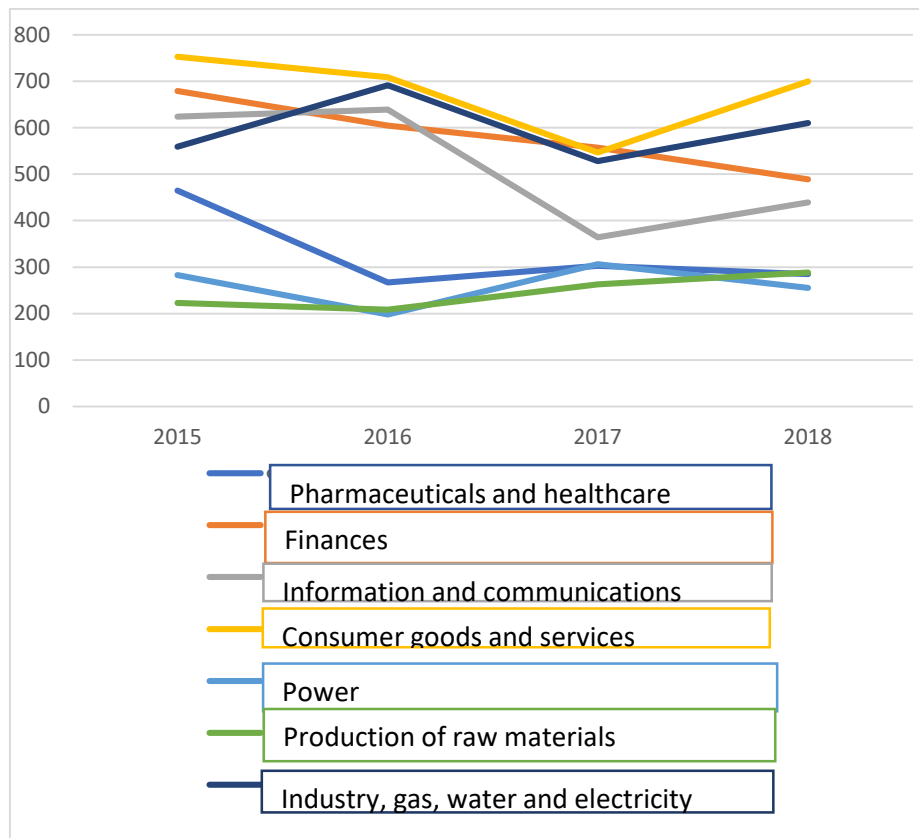


Figure 1. Dynamics of the amount of M&A agreements in the global economy during 2015-2018 (billion USD)

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From the figure above, we can conclude that the negative tendency of development was inherent in such industries as pharmaceutical and financial. For the first sector, the cause of the decline was its high level of risk, however, the development of genetic engineering and the use of advanced technologies such as 3D printers for creating artificial organs can significantly change the development direction. The negative trends in the financial industry development can be explained by the introduction of automated information technology, such as Blockchain and the need to regulate the industry by rebuilding it based on leading technologies.

The most unstable can be considered the field of information and communication technologies. It is the most dynamic sector of the economy and therefore investors are reluctant to risk their funds because of the possibility of unexpected technology updates or, in other words, technological breakthroughs.

The energy and raw materials industries are traditional for the world economy. Sector fluctuations were due to the uncertainty in oil prices.

Also unstable was the industry branch. One of the preconditions for increasing the volume of industry in 2018 was the development of the direction of mergers and acquisitions in the sub-sector of the chemical industry.

The consumer goods industry tends to increase sales and reduce the number of transactions. Japan and India play a significant role in the development of this area.

The M&A sectoral breakdown makes it possible to conclude on the priority of the machinery and industrial equipment and furniture sector, which again led the industry rankings by volume and value of transactions in 2018, having announced 11,274 agreements totaling 625.8 billion USD.

The most valuable deal in the engineering industry was announced in 2018. The transaction was worth 23.6 billion USD and took the form of acquisition. United Technologies has acquired Rockwell Collins, an aircraft cabin manufacturer. In October of that year, L3 Technologies acquired Harris, which was worth 15.7 billion USD.



**Table 1**  
**List of M&A highlights in 2018**

Industry	Object of the agreement	Purchaser	Volume of transaction (%) / share of acquisition (billion USD)
Media	Time Warner (USA)	AT&T (USA)	91,50/100%
Healthcare and pharmaceuticals	Express Scripts Holding (USA) (USA)	Cigna (USA)	68,52/100%
Healthcare and pharmaceuticals	Aetna (USA)	CVS (USA) HealthCorp	67,82/100%
Chemistry and petrochemistry	Monsanto (USA)	Bayer (Germany)	63,87/100%
Oil and natural gas	Energy Transfer Partners (USA)	Energy Transfer Equity (USA)	61,82/97,64%
Media	Sky (USA)	Comcast (USA)	48,41/100%
Transport	Abertis Infraestructuras (Spain)	Abertis Infraestructuras SA SPV (Испания)	41,53/100%
Chemistry and petrochemistry	Linde (Germany)	Praxair (USA)	39,90/92,05%
Media	Altice USA (USA)	Purchased by shareholders	32,14/67,21%
Oil and natural gas		Marathon Petroleum (USA)	31,34/100%
Aerospace industry	Rockwell Collins (USA)	United Technologies (USA)	30,52/100%
Finances	GGP (USA)	Brookfield (China)	27,68/65,96%
Food industry	Dr Pepper Snapple (USA)	Keurig Green Mountain (USA)	26,62/100%
Media	RELX NV (Great Britain)	RELX PLC (Great Britain)	25,63/100%
Real estate	Westfield (Australia)	Unibail-Rodamco (France)	22,03/100%

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In terms of number of transactions, wholesale and retail trade ranked second with 6050 agreements, followed by chemical industry, production of rubber and plastic products (5081 agreements) and publishing and printing industry - 4586 agreements. This trend remains unchanged in the first quarter of 2019.

In total value of transactions, the second place in 2018 is taken by chemical industry, production of rubber and plastic products - 476.6 billion USD. In the first quarter of 2019, this industry became the leader in transaction value.

In order to highlight the key trends in the M&A processes, it is worth exploring the current situation in terms of M&A activity in the major sectors of the world economy: chemical, oil and gas industries, insurance, banking, retail and consumer goods, healthcare.

*Chemical industry.* According to Deloitte, the global volume of M&A in chemical industry declined by 5% in 2018 compared to 2017. However, it remained higher than the annual figures for 2012 – 2015. In 2018, there was an increase in total value and number of transactions, which exceeded 1 billion USD. The largest deal was the 12.5 billion USD acquisition of AkzoNobel, a specialized chemical product company (new name - Nouryon). If the process moves forward, the acquisition of Saudi Aramco (Saudi Arabia's national oil company) by SABIC could be the largest deal in the industry in recent years. In January 2019, SABIC's market capitalization exceeded 90 billion USD.

As one of the leaders in the activity of M&A processes, the chemical industry remained stable in geographic regions with a slight decline in some key markets in 2018. The shrinking of the four largest markets - the United States, China, the United Kingdom and Germany - was partly offset by the growth of traditionally smaller markets such as India, the Netherlands, Japan and Brazil.

India is expected to continue expanding M&A deals in the basic chemistry, agrochemical and construction chemistry sectors. For the Netherlands, 2018 was a record year, which estimated at 14.7 billion USD and is the highest in ten years. However, the uncertainty regarding the UK's exit from the EU has affected the investment climate in Europe.

Against the backdrop of rising interest rates, global trade tensions and slow economic development in 2019, the number of M&A deals is projected to be slightly lower than in previous years. However, activity in the global chemical industry continues to rise, even in an uncertain situation and with potential for strong growth.

*Oil and gas industry.* Despite promising market conditions during 2018, the strong oil and gas industry was not aware of its potential to increase M&A activity as it remained financially constrained in the context of continued prudence.

Two long-standing trends have reached a critical point. First, due to the restriction of production by Russia and Saudi Arabia, the United States has completed a historic transition to become the world's largest oil and gas producer. Second, oil prices rose steadily, reaching a four-year high in early October 2018. The return to price volatility and the fall in oil prices at the end of the year increased the caution that characterized the industry after the downturn in 2014.

Compared to 2017, the volume of transactions decreased in the oil and gas exploration and production service (OFS) segments. The value of transactions in the transportation and processing and sales segments has increased - the last acquisition totaling 35.6 billion USD was made by Marathon Petroleum. It acquired an independent oil refining company Andeavor.

The cost of M&A deals in the US hit record high - more than two-thirds of the total value of oil and gas transactions. Each of the ten largest oil and gas deals in 2018 provided for the acquisition of North American assets. Two deals worth more than 10 billion USD were announced: Marathon Petroleum / Andeavor agreement and British Petroleum's acquisition of shale oil and gas in the US by Australian company BHP Billiton for 10.5 billion USD.

It is generally expected that the processing and sales segment will continue to demonstrate its historical resilience to market changes. Meanwhile, the OFS segment, which is still struggling to recover lost profits, is in the most vulnerable position.

*Insurance.* When it comes to the global insurance market, it should be noted that, the number of M&A transactions decreased (from 1385 to 1257) in 2018, though the total value of the transactions increased by 19%

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(from 177.6 billion USD to 210.4 billion) compared to 2017. This was mainly due to the increase in the number of transactions worth over 1 billion USD.

One of the oldest insurance markets are the United States and the United Kingdom, so the key trends come from there.

As of 2018, there has been a moderate increase in the number of underwriter deals in the United States (from 84 to 87) compared to 2017. However, their aggregate value increased rapidly by 189% (from 14.8 billion USD to 42.7 billion USD). The driving force behind such impressive results were two important property insurance (P&C) deals: the acquisition of XL Group company, based in Bermuda by AXA insurance and investment group for 15.3 billion USD; American International Group (AIG) acquired all common shares in Validus Holdings, Ltd. (Validus) for 5.5 billion USD.

Despite a successful 2017, the volume of brokerage transactions in 2018 continued to hit high growth rates. During 2018, 594 transactions were made, which is 11% higher than in 2017. In addition, there is a 50% increase in the aggregate value of transactions.

In 2018, the interest rate environment was growing fast. This fact has attracted attention of private equity firms in the personal insurance (L&H) sector. The acquisition of Liberty Mutual Group shares by Lincoln Financial Group for 3.3 billion USD has also become a significant event.

Despite uncertainty about the future of the United Kingdom in the European Union, there has been relative activity on the country's market following the implementation of the EU Solvency II Directive. Three multi-billion-dollar M&A deals in 2018 resulted in a large increase in the aggregate and average value of insurer deals compared to 2017.

The main factors behind the increase of M&A processes in the insurance industry in 2018 are following: interest rate hikes, increased capital stock, improved conditions for the global economy, tax reform in the US. According to experts, most of these positive trends will continue until 2019.

*Banking sphere.* Despite the relatively favorable macroeconomic trends during 2018, M&A banking activity has not reached the expected level. The relative decrease in the number of transactions compared to 2017 was 17%, while their total value decreased from 331.1 billion USD to 273.6 billion USD.

In addition, there have been significant developments in the banking sector. Particularly, there were several major deals: the merger of Saudi British Bank and Alawwal Bank worth 4.7 billion USD with an aim to create Saudi Arabia's third largest bank; acquisition of MB Financial by Fifth Third Bancorp for 4.6 billion USD; sale of assets by Chinese conglomerate HNA Group Finance to an investor group for 4.2 billion USD.

Domestic banking agreements continue to dominate, accounting for three quarters of all activity. The target markets are the US, India, China and the UK. China's domestic M&A activity has calmed down somewhat along with economic growth. Instead, there has been a growth of M&A processes in India's banking sector. The number of transactions increased by 22% during 2018, driven by market consolidation and increased investment from private equity firms and government investment funds.

The globalization of the world economy and the processes of digitization have led to some loosening of the market and promotion of e-commerce and e-banking. This encourages others to seek strategic partnerships and invest in new financial technologies. Many companies already have innovative funds.

Global consolidation remains a key topic, especially for small and medium-sized banks, which offers significant opportunities for M&A deals. Overall, M&A 2019 projections remain optimistic, despite the geopolitical tensions and economic situation in certain countries.

*Retail and consumer goods sector.* The total number of transactions in the retail and consumer goods sectors decreased by 13%. At the same time, there is a tendency for other industries to increase the aggregate value of the announced transactions. In particular, the aggregate value of transactions increased by 7% in 2018.

The USA remained the leader of the M&A agreements in the retail and consumer goods sectors in 2018. The country's share was about 20% of the total announced deals. Even more striking is the value of M&A transactions, which exceeds 36% of the total announced deals in 2018 in the industry [8, p. 10]. In 2018, the largest deal was in the food industry - Keurig Green Mountain Inc. acquired Dr Pepper Snapple Group Inc. for 26.6 billion USD.

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China's foreign investment in Europe (by 47%) and the United States (by 33%) declined significantly. Instead, they remain the major investors. Japan's cross-border investment in the European region increased by 57% during 2018, whereas the cross-border investment in the Asian region has grown by 15% at the expense of healthy profits. M&A activity in Europe has increased. During 2018, the number of transactions increased by 16%. Although, the total number of transactions in the Asia-Pacific region decreased by 7%.

India's strong M&A engagement is also impressive. The number of transactions increased by 13% during 2018. This is partly due to the increased interest from cross-border investors. The most important deals of 2018 were the acquisition by Walmart of the most of Flipkart shares (77%) for 16 billion USD. And the acquisition of Unilever by Horlicks for 3.8 billion USD.

It is possible to predict an increase in the activity of M&A processes in such growing categories as: soft drinks (coffee, tea, water, functional drinks); healthy foods and ingredients; skin care; consumer health products and animal products. These categories show particularly high growth rates compared to the rest of the sector and attract investors. However, there are risks of reducing the overall volume of transactions amid growing attractive categories and markets.

*Healthcare sector.* This market is recently dominated by the ten largest pharmaceutical companies with the highest return on investment, which spent an average of 35% of M&A on their total R&D and M&A investments. The biotechnology segment is considered one of the most active in the M&A market.

As well as in other segments, major transformational acquisitions are worth 60-70 billion USD for the healthcare sector during 2018-2019. In January 2019, Takeda Pharmaceutical Co. made its largest acquisition of Irish drug maker Shire in its history. The transaction amounted to 62 billion USD.

The healthcare sector is very risky and, therefore, experiences difficulties in uncertain times. At the same time, prospective developments and globalization processes strengthen the belief in the development of the

industry. Therefore, cell and gene therapy will remain popular with investors. The sales of assets are also expected to increase.

### Conclusion

International M&A agreements is a mechanism of economic globalization that leads to the formation of multinational corporations and the creation of global brands that deserve special attention.

The sectoral distribution of M&A deals gives the opportunity to conclude on the priority of the machine building and industrial equipment sector, which led the industry rankings by volume and value of transactions in 2018. In terms of the number of transactions, wholesale and retail trade ranked second, followed by chemical, rubber and plastic products, along with publishing and printing industries.

The tendency of recent years is the dominance of the largest companies with the highest return on investment, which spend money on the acquisition of small innovative companies working in the field of digital technology and R&D.

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ISSN 0861 - 6604

# BUSINESS management

BUSINESS management 2/2020



PUBLISHED BY  
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OF ECONOMICS - SVISHTOV

2/2020

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Submitted for publishing on 19.06.2020, published on 24.06.2020,  
format 70x100/16, total print 40

© D. A. Tsenov Academy of Economics, Svishtov,

2 Emanuil Chakarov Str, telephone number: +359 631 66298

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**BUSINESS**  
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Year XXX \* Book 2, 2020

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