



Sayabek Ziyadin
D.Sc. (Economics), Professor,
Kazakh Humanitarian Juridical Innovative University,
Semey, The Republic of Kazakhstan
42 Kabanbay Batyra Str., ap.42, Semey city, 071400,
The Republic of Kazakhstan
ertis_economika@mail.ru



Yessenova Gulmira
PhD (Economics), Associate Professor,
Department of Finance, JSC «Financial Academy»,
The Ministry of Finance of The Republic of Kazakhstan
11 Sh. Ualikhanov Str., 010011
Astana, The Republic of Kazakhstan
pavlodarsemey@mail.ru

Prerequisites for development and diversification of production in industry

Abstract. This article describes the process of diversification as a matter of aggregate socio-economic and administrative relations that arise between the subjects of a region, including industrial enterprises on the one hand and regional consumers on the other as well as the participation of authorities and entities of the institutional environment. Diversification through the acquisition and construction of assets in a country is supplemented by diversification through the acquisition of assets abroad. The diversification of industrial activities in a region as a matter of administrative relations that structure the interaction between these relationships is a form of the implementation of corporate strategies and promotes the benefits of diversification. The main obstacle to the direction of diversification is limited financial, information and manufacturing capabilities as well as limited experience.

Keywords: Diversification; Innovation; Industry; Export; Production; Region; Enterprise; Strategy

JEL Classification: D24; F02; F41

Зіядин С.

доктор економічних наук, професор, декан факультету фінансів та економіки, Казахський гуманітарно-юридичний інноваційний університет, Семей, Казахстан

Есенова Г.

кандидат економічних наук, доцент, кафедра фінансів, АТ «Фінансова академія» Міністерства фінансів Республіки Казахстан

Умови розвитку диверсифікації виробництва

У статті розглянуто процеси диверсифікації як предмет сукупності соціально-економічних й управлінських стосунків, що виникають між суб'єктами регіону: промисловими підприємствами з одного боку й регіональними споживачами – з другого, за участю органів влади та суб'єктів інституціонального середовища. У статті зроблено висновок про те, що в сучасних умовах диверсифікація, яка розвивається шляхом придбання й будівництва активів усередині країни, доповнилася диверсифікацією, яка здійснюється шляхом придбання активів за кордоном. Автором виявлено, що диверсифікація діяльності промислових підприємств у регіоні як предмет управлінських стосунків, які структурують взаємодії суб'єктів цих стосунків, є формою реалізації корпоративних стратегій і стимулюється перевагами диверсифікації. Визначено, що основною перешкодою у напрямі диверсифікації є обмеженість фінансових, інформаційних і виробничих можливостей, а також досвіду.

Ключові слова: диверсифікація; інновації; промисловість; експорт; виробництво; регіон; підприємство; стратегія.

Зиядин С.

доктор экономических наук, профессор, декан факультета финансов и экономики, Казахский гуманитарно-юридический инновационный университет, Семей, Казахстан

Есенова Г.

кандидат экономических наук, доцент, кафедра финансов, АО «Финансовая академия» Министерства финансов Республики Казахстан

Условия развития диверсификации производства

В статье рассмотрены процессы диверсификации как предмет совокупности социально-экономических и управленческих отношений, возникающих между субъектами региона: промышленными предприятиями с одной стороны и региональными потребителями – с другой, при участии органов власти и субъектов институциональной среды. В статье сделан вывод о том, что в современных условиях диверсификация, развивающаяся путем приобретения и строительства активов внутри страны, дополнилась диверсификацией, осуществляющейся путем приобретения активов за рубежом. Автором выявлено, что диверсификация деятельности промышленных предприятий в регионе как предмет управленческих отношений, структурирующих взаимодействия субъектов этих отношений, является формой реализации корпоративных стратегий и стимулируется преимуществами диверсификации. Определено, что основным препятствием в направлении диверсификации является ограниченность финансовых, информационных и производственных возможностей, а также опыта.

Ключевые слова: диверсификация; инновации; промышленность; экспорт; производство; регион; предприятие; стратегия.

1. Introduction. The structure of the modern world economy and globalisation impose difficult, new and competitive requirements for all participants. Kazakhstan needs to recognise the realities and challenges of global production, where developed countries and transnational corporations, in pursuit of their objectives, fight for resources to maintain a dominant position in the global production chain. This leads to the situa-

tion where high technology is produced in developed countries, while countries rich in raw materials remain at the bottom.

In recent decades, countries have been attractive to investors due to lower labour costs. Currently, however, investors are interested in the availability of energy resources. China and India, the two rising Asian giants comprising a third of the world's population, are showing a huge demand for energy.

China, for example, has already become the second largest consumer of oil in the world. The dependence of these economies on energy imports (in 2013, India – 70%, China – 50%) has increased their search for reliable sources of oil and gas, including more active investment policies abroad.

Since the beginning of the 21st century, there has been an increasing trend of mergers and acquisitions of large companies, which has led to further consolidation and strengthening of transnational corporations in the world economy. The primary reason for mergers and acquisitions is the struggle for raw materials, labour, and capital, and also to acquire information, knowledge and technologies. In economic terms, the world's largest multinational companies are commensurate with independent states. This process has already begun in the CIS space. For example, in 2013, the market volume of mergers and acquisitions in Kazakhstan and Russia grew by almost half and reached nearly \$8 billion and \$71 billion, respectively, and this trend is expected to continue in the future (Andrew Muhammad, 2012) [15].

In the U.S. and other countries, the process of diversification was accelerated by the adoption of antitrust laws. Traditionally, companies are widely diversified in Japan and South Korea, which is primarily due to the desire for conquest in foreign markets.

World experience shows that in all countries (including France, Germany, South Korea and Japan), the targets of industrial policy are companies rather than industries. For example, in France, every industry has been created with one or two large companies that support small businesses and compete with foreign firms in the world markets. Modern industrial policies in economically developed countries are characterised by the absence of rigid sectoral priorities, primarily due to highly diversified business structures. Therefore, the main results of industrial policy are increasingly corporate structures that are formed to meet the interests of the country. All increased power resources are concentrated in national development: professional staff (marketers, top managers), managerial competence, advanced technology and financial resources.

2. Brief Literature Review. To the issues highlighted in the article were devoted the works on management, marketing and production diversification of Ansoff, H. I., & McDonell, E. J. (1990) [1], Aronov, A. M. & Petrov, A. N. (2001) [2], Assael, G. (1999) [3], Berezin, I. S. (1999) [5], Dobrianskaya, N. A., & Popovich, V. V. (2013) [6], Kono, T. (1987) [7], Kotler, P., & Keller, K. L. (2015) [8], Liouville, J. (1993) [9], Shevelev, S. A. (1999) [12], Thompson, A. A., & Strickland, A. J. (1998) [13].

3. Purpose. To analyze obstacles and propose ways of their overcoming for production diversification as socio-economic and administrative relations between region, including industrial enterprises on the one hand, and regional consumers on the other hand in Europe, USA and Kazakhstan.

4. Results & Discussion. Currently, the world is witnessing the next stage of industrialisation. However, unlike the initial stages of industrialisation of the late 19th and early 20th centuries, where the future world powers evolved under strong protectionism, lively competition for colonies, military build-up and war, the present stage is dynamic. Under entirely different conditions of world globalisation, changes in world trade markets, mobility of capital and labour processes, which once occurred over a period of a decade, are now happening under one government. World experience shows that, in the modern process of industrial development, the decisive role belongs to the state. For example, a decision on the construction of large steel mills is accepted based on macroeconomic and geopolitical considerations. Exploration and development of resource bases are also conducted under the supervision and with the participation of the state. Even when initiatives, such as Tori projects, involve transnational corporations, construction companies are contracted at the national level, which takes into account the needs of the country and is an effective way to reduce risk. Ideally, decisions about industrialisation in the interests of a national economy should be taken at a time when the corresponding manufacturing, export-oriented production is still evolving. Consequently, the development opportunities based on market

mechanisms are very limited and therefore occur with the active participation of the state.

A number of steel companies in the U.S. and Western Europe were combined. They carried out the development of iron ore, coking coal, iron production, steel, rolled products, pipes and other steel products. Additionally, these companies now produce products for domestic consumption: rolls, refractories, ferroalloys, etc. Some companies even have their own fleet and railways. Almost all have extensive distribution networks, both national and foreign.

The greatest degree of diversification has been achieved by companies in Germany and Japan, predominantly in steel production. The priority areas selected for diversification were in engineering and engineering services.

The main indicators of socio-economic development of the country over the past few years confirm the presence of sustainable economic growth and improving living standards. However, the situation in the global economic environment has not reached the Kazakh economy and so dynamic economic growth has not been observed since 2011.

The growth rates of the oil and mining industry (63.2% in real terms over the period 2008 to 2012) have outpaced the growth of processing industries (55.1% for the same period).

However, the commodity structure still predominantly consists of raw materials. Exports mainly consist of a combination of fuel and metals (oil, ferrous and non-ferrous metals) together with corn (90%). In addition, there is a trend of increasing concentration on the commodity nomenclature of raw materials or products of low redistribution. In 2008, the top five groups of exports constituted 82.5% of total exports, while in 2011 this ratio was 88% (the top five exports were mineral products, steel and steel products, and copper and articles thereof).

The fact that the export of non-oil products is growing significantly and outpacing growth in exports of raw materials and products of low added value leads to a steady decline in the share of non-oil products in total exports.

The share of non-oil products in total exports amounted to 11.6% in 2008, and decreased to 6.1% in 2012. In addition, a significant share of non-commodity exports are products with low added value and usually a limited number of items.

These trends demonstrate the need to develop adequate mechanisms of state support for domestic producers and exporters of finished products in two key areas and the resolution of both internal and external issues.

A preliminary analysis of statistical data to consider various factors associated with demand and supply, as well as the contribution of industries to socio-economic development, has shown that there are some industries in Kazakhstan that have a significant potential for withdrawal of their products in foreign markets. A scale index and classification of high, medium and low potential identified the most competitive industries:

- chemical industry - 40.4% of total non-oil products;
- mechanical engineering - 13%;
- food industry (foodstuff) - 4.1%;
- textile industry - 0.5%.

Particular attention should be paid to supporting existing competitive advantages and developing new advantages that would increase the volume of exports of these industries in foreign markets (Ani L. Katchova, 2005) [10].

On the one hand, prospects for access to the WTO and more progressive globalisation of the economy greatly expand the integration of domestic enterprises in the sphere of global business. On the other hand, this increases the likelihood of clotting in already occupied market niches. The current situation shows that the international market has no open market niches. In this situation, it is necessary to define what type of products can be displayed on the international market because of their competitiveness, as well as meeting the requirements of the innovation economy. This factor requires action on the part of industrial enterprises in the direction of diversification. (Dobryanskaya, 2013)

As previously mentioned, the main obstacle in the direction of diversification is limited financial, information and manufacturing capabilities, as well as experience. Industrial enterprises,

in our opinion, should be looking for opportunities to diversify, primarily in the territory where they are located, i.e. in the region, thereby forming clusters of related diversification.

Industry-specific areas have their own specialization. For example, Pavlodar region is an industrial region and, therefore, the management of industrial enterprises will mainly use the experience of diversification of regional enterprises that are similar in structure and purpose in the absence of a unified concept of diversification.

One of the key priorities is the development of modern economic growth through a phased replacement of raw materials in the gross regional product with high-tech products, including exports, to increase the share of processing industries with high added value. Innovation policy is a powerful lever that ensures restructuring and allows saturation of the market with a variety of competitive products.

The Presidential Address to the people of Kazakhstan on 17 January 2014, named «Kazakhstan – 2050», is a fundamental document that describes the long-term development priorities of the state. Prosperity, security and the welfare of all Kazakhs are themes that define the long-term development strategy until 2050 («Kazakhstan's Way – 2050») [11].

In accordance with the President's Message to the people of Kazakhstan, further documents have been developed around this plan.

The main objective of the program of the industrial-innovative development of Pavlodar region is to achieve the sustainable development of the region through economic diversification and the phase of substituting raw materials in the gross regional product with high-tech product exports.

To achieve this goal, the Program involves the following tasks:

- diversification of production and the formation of non-oil sectors of the economy;
- further development of the field of innovation infrastructure;
- stimulation of the creation of high-tech export-oriented industries;
- assistance in the implementation of promising investments and innovative projects through state development institutions;
- involvement in innovative activities of small and medium enterprises;
- assistance of industries in meeting international quality standards;
- preparation of qualitatively new management, engineering, technical and skilled workers for newly developed sectors of the economy.

The program consists of the following main areas:

- research of the competitive advantages of industries and enhancement of the competitiveness of the region;
- development of investment and innovation;
- improvement of the competitiveness of the economy;
- development of innovation infrastructure.

In this regard, the main priority for the region in the coming period is to create new high-tech industries and to increase the competitiveness of their products in domestic and foreign markets.

Due to several factors, the following important strategic diversification benefits would arise:

1. Potential synergies, which would manifest in:

- operational savings as a result of increasing returns to scale production, management, marketing and distribution;
- financial savings through reduction of transaction costs;
- the possibility of efficient control when merging firms;
- the increased market power of the company and reduced competition.

Zhao Jianmei (2014) [14] notes that at the dawn of diversification criteria, synergies manifest mainly with functional departments: the marketing department, R&D and others. However, subsequent experience has shown that the most important criterion of synergy is often in corporate governance.

2. The stability of income and risk reduction.

3. Strengthening information security businesses and the integration of marketing research.

4. Tax benefits.

5. Technological gains from mutual penetration technologies and joint R&D activities.

Promotion of diversification in industrial activities at the regional level is stimulated by the following factors:

- rational external concentration, which is impractical in a particular region;
- reducing the risk of entrepreneurship through renovation and expansion of the range (range) of products;
- reduced risk of structural changes and market fluctuations: the possibility of financing the restructurings of enterprises with a long cycle of circulation of capital through production with rapid turnover of capital;
- legislative restrictions on the growth of the horizontal and vertical integration of production to ensure free competition between manufacturers.

Diversification of enterprises in the region will be successful due to:

- multi-purpose sharing of production capacities;
- lower costs, due to the rational, comprehensive utilisation of production capacity, as well as the concentration of distribution networks;
- formation of channels of information, knowledge, technology and managerial expertise;
- reduction of business risks;
- avoidance of gaps in production goals;
- economies of scale;
- organization of joint activities with regional partners etc.

In analysing the situation at the national and regional levels, we can say that there exist all necessary conditions and prerequisites for the implementation of diversification.

In analysing process control diversification, several authors formulated its principles. Given the regional dimension, we can formulate its principles as follows:

1. The principle of depth of diversification is determined as a proportion of the volume of production of new products in the current period to the total volume of production in the base period. Therefore, the necessary degree of diversification is determined by taking into account the current situation and future goals of the company and the region, as well as the direction of economic development in general.

2. The principle of macro- and micro-economics which take into account the influence of the components and relationships that characterise the separate spheres of the environment (in the region) and affect the performance of the enterprise.

3. The principle of performance suggests that the analysis and development activities in the diversification must be weighed against the costs and results of both businesses and the region.

4. The principle of focus and control is associated with increasing role of heads of the organisation and the region. As the implementation of diversification affects many departments of enterprises and institutions in the region, it needs a body (council, team, etc.) for the coordination and monitoring of the process and outcomes.

5. The principle of calculation of resistance due to the presence of changes introduced in the existing control system, and the availability of the system to counter these changes. Resistance may be a personal character or economic (unforeseen costs, results, etc.). I. Ansoff (1984) [1] gives the following main reasons for resistance: fear of the new, unfamiliar circumstances, and changing relationships. At the regional level, reasons for resistance to diversification are:

- fear of material loss due to the restructuring;
- increased accountability for results;
- loss of status and privileges as a result of changes;
- increase in the volume and complexity of the work;
- lack of awareness;
- display of professional incompetence;
- discrepancy between the old and new culture and power structures;
- duration of the implementation process.

6. The synergy principle focuses on the diversification of collective action at all levels of management and execution.

7. The system's principle is an integrated approach in the management of diversification.

8. The principle of equilibrium involves maintaining a balance between company divisions and structures in the region, according to their relevance to the organisation and the region.

9. The principle of originality directs the company's management and the region to search for and stimulate creative personnel associated often with extraordinary offerings in the area of innovation.

Thus, the diversification activities of industrial enterprises in the region, as an object in the aggregate management relations that structures the interaction of subjects of these relations, stem from my implementation of corporate strategies and are stimulated by the aforementioned factors.

6. Conclusions. Diversification can be successful only when it is beneficial to structural units and increases the competitive status of the company as a whole. To this end, according to Azoev (2000) [4], it is necessary:

1. To implement constant search capabilities for separation of production in existing structures. This may lead to new organic lines of business and simplify the integration.

2. To review the relationships between existing departments. Weak links in process steps and gaps in the life cycle of manufactured products may indicate the direction of diversification.

3. To assess the possibility of a subsequent reorganisation of the new business. According to some researchers, the proposed scope of the business should not be attractive until diversification. It is desirable to enter into a new realm before the full economic potential is visible.

4. To use business experience and knowledge gained during diversification. The main objective in this case is to enhance the overall capacity of a diversified enterprise.

5. To establish the foundation for simplifying horizontal linkages between business units and their staff in order to prevent disunity from diversification in the enterprise, and to emphasise the special importance of cooperation by creating mechanisms of corporate unity (motivation of employees, establishment of regional centres, development of corporate culture, etc.).

With regional management positions, emphasis should be given to the strategic areas of diversification. In economics, business sectors form the appeal.

In managing the diversification of business, less importance should be given to efficiency aspects. The regional focus of the study should be attributed to:

- optimisation (minimisation) of transaction cost agents when combined under a single management system with several spheres of activity;
- avoidance of the risks of specialisation in a deficit market in the region, as well as the possibility of reducing the proportion of products with special purposes;
- improvement of the effectiveness of information security of economic entities and integration of marketing research;
- build-up of R&D capacity and technical training production;
- acceleration of the exchange from the use of business relations of the subjects of management for all industries;
- increasing the efficiency of enterprises through the development work to improve the quality, service development, marketing and distribution channels;
- strengthening the position of industrial enterprises versus their competition;
- minimisation of the risks of entering new markets;
- possibility of manufacturing the same (commercially available) of the various raw products;
- strengthening the links between technology companies in the region;
- gaining experience.

As a result of minimising the risks associated with economic activity, diversification allows the volume of goods and services to be increased to ensure the profitability and sustainability of the company and the region as a whole.

Thus, we can consider the diversification of activities as a matter of the aggregate socio-economic and administrative relations that arise between the subjects of the region: industrial enterprises on the one hand and regional consumers on the

other, with participation of authorities and entities of the institutional environment.

Diversification of industrial activities at the regional level, with administrative relations structuring the interaction of the subjects of these relations, constitutes a corporate strategy that promotes the benefits of diversification.

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