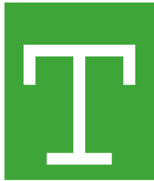
Chapter V

Performance, Motivations and Outlook

A. Corporate performance of M&As



he increase in cross-border M&As documented in the preceding chapter is taking place against a widespread perception that most M&As fail to deliver the expected gains set out at the time deals are announced.[1] For example, several management surveys of predominantly cross-border M&As in the mid-1990s concluded that the value of shares held by owners declined in more than half of the cases examined, while increases in the value of shares followed only a small proportion of all M&As (AT Kearney, 1999; KPMG, 1999). There is much controversy surrounding the question of post-M&A performance, however. This section looks at the evidence in the literature to shed light on how *corporate* performance is affected by M&As.

There are several ways of measuring performance. It is therefore important to keep a few points in mind. First, most studies in this area focus on *domestic* M&As and are based on data from the United States and the United Kingdom, where M&As have been prevalent since the beginning of the past century. There is only scant evidence from developing countries and economies in transition. Second, except for a few recent surveys, the experience in the 1990s has not yet been fully explored in the literature. Third, it is impossible to factor in what would have happened to a firm had a merger or acquisition not taken place. Fourth, it is important to distinguish the impact on firms from the impact on host and home economies. M&As that produce poor results from a strictly financial point of view may still exert a positive impact on an acquired firm and, under certain conditions, the host country. This section deals with the impact on corporations; broader economic impacts will be discussed in the next chapter.

The bulk of the empirical studies of the impact of M&As on corporate performance can broadly be classified into two categories. The first group can be found in the finance literature, and comprises what are called "event studies", which use changes in share prices to gauge changes in firm value. The second group belongs to the industrial organization literature and consists of studies that measure corporate performance mainly by comparing various measures of profitability before and after transactions. The rates of success or failure are typically assessed by comparing the performance with a relevant control group of companies.

The "event studies" generally assume that stock markets are efficient, meaning that changes in the share prices of the firms involved, after controlling for market movements in general and systematic risk, represent the value of the event. Corporate performance is measured by comparing the share prices from before and after M&As relative to a relevant control group. Evidence from a large number of articles analyzing short-term stock reactions to merger announcements indicates that a target firm's shareholders

benefit, and a bidding firm's shareholders generally lose or break even. [2] Only about one-third of published shareholder value studies were able to find positive effects for the bidding firm (Schenk, 2000). [3] Other studies have noted that the rates of return earned on common stock tend to deteriorate when the period after the merger is extended to one year or more (Jensen and Ruback, 1983; Magenheim and Mueller, 1988). Moreover, a survey of studies covering different time periods suggested that returns going to the acquirer deteriorated in the 1980s, as compared with the preceding decades (Sirower, 1997).

The results from various event studies are inconclusive with regard to the factors influencing the outcome of M&As. Some researchers have noted that the chances of a positive impact on performance increases if the firms involved are in related industries,[4] while others have reached the opposite conclusion.[5] Moreover, some studies indicate that returns to the acquiring company develop more favourably in cross-border M&As than in domestic ones,[6] whereas others do not support that finding.[7]

The industrial organization literature offers an alternative assessment of performance by using accounting data to measure, e.g. profitability or market shares a few years before and after M&As.[8] Empirical evidence here is also rather sobering. Although industrial organization studies normally consider longer time horizons than those in the financial literature, most of them do not show significant improvement in long-term profitability after acquisition (Scherer, 1988). For example, a study of United Kingdom firms over a 10 to 18 year period indicated little improvement in profitability relative to the period before acquisition and a decline in profitability relative to firms relying on internal growth (Dickerson et al., 1997).[9] Similarly, a survey of 22 accounting data studies from nine countries showed that the average acquiring firm does not earn a significantly higher return than the industry average (Bild, 1998). The most exhaustive study of post-merger performance, covering almost 6,000 M&As by 471 corporations in the United States and 900 divestitures, again found poor financial results from M&As (Ravenscraft and Scherer, 1987).[10]

The industrial organization literature does not provide any clear evidence in regard to how the relatedness of activities of the bidder and target firms affect M&A performance (Bild, 1998). In fact, some studies have concluded that conglomerate M&As provide more favourable results than horizontal or vertical M&As (e.g. Reid, 1968; Mueller, 1980b). Moreover, in the case of cross-border M&As, large cultural differences between bidder and target companies have been found to be positively related to acquisition performance in terms of sales growth (Morosini et al., 1998).

In addition to the above mentioned studies, which mainly focus on the performance of a firm as a whole following a merger or an acquisition, there is some evidence on how the target companies, or even target plants, are affected by takeovers. Although various studies have produced mixed results, ownership changes have been noted to exert positive impacts on the productivity of the acquired units.[11] For example, Canadian plants that were taken over in the 1970s achieved higher productivity increases than those that did not experience a change in ownership (Baldwin, 1995). United States data from the 1960s to the early 1980s indicate that productivity performance may be related to the size of the target (Caves, 1998). It appears that acquisitions can either lift the performance of an unproductive large unit or supply resources needed to leverage the strength of a highly productive small one (Caves, 1998, p. 1962). These conclusions are partly supported by a Swedish study of ownership changes undertaken during 1980-1994 and which, interestingly, distinguished between cross-border and domestic M&As (Modén, 1998). The study found that, prior to a takeover, average labour productivity of the target firms of both domestic and foreign acquirers was lagging behind the industry average. After an acquisition, however, firms taken over by foreign investors showed a substantial increase in labour productivity relative to the industry average, while productivity in domestically acquired firms stayed about the same, or declined somewhat. In addition, compared with both the industry average and with the acquired firms in domestic takeovers, foreign acquisitions developed more favourably in terms of total factor productivity, employment and market shares.

Similar observations have also been made in Argentina. Compared with companies that were not taken over, acquired companies experienced stronger growth rates of sales, productivity, employment and exports (box

VI.14). Moreover, acquired firms reported greater organizational and technological improvements. These results apply to both domestic and cross-border M&As vis-à-vis non-acquired companies. However, sales, employment and exports developed more favourably in the case of foreign takeovers, while the technological and organizational improvements were particularly noteworthy following domestic M&As.

Based on the above discussion, a few important points can be made:

- Studies in the finance and industrial organization literature lend support to the common perception that a large number of M&As "fail" in the sense that firms engaging in M&As do not produce better results, in terms of share prices and profitability, than those that do not enter into M&As. The picture is more positive, however, with regard to the performance of the target companies specifically. This suggests that improved performance at the level of the acquiree, if any, is often compensated by negative effects of the merger at the level of the newly formed firm as a whole. Moreover, some evidence indicates that cross-border M&As may outperform domestic ones, although several recent management surveys have found a high "failure" rate also among cross-border deals.

- The extent of "failure" crucially depends on the success criteria. As one study (Hopkins, 1999, p. 220) recently concluded:

  > "There seems to be clear evidence that mergers and acquisitions often fail. But this depends on how one defines failure. If failure is used in an extreme sense, such as the sale or liquidation of the business, then the rate of failure is relatively low. If failure is the lack of attainment of management's financial objectives, then the rate of failure is high."

- It is difficult to say to what extent the observed rates of "failure" are abnormal in any sense. As all investments have an element of risk associated with them, it is to be expected that a certain proportion of M&As will not live up to the expectations of those who have undertaken them, just as many new ventures, product development projects and greenfield investments do (box V.1). Whether the observed ratios of success are high or low given the associated risk is impossible to

Box V.1. The "failure" of a greenfield FDI: the closure of Siemens' computer chip plant in Tyneside, United Kingdom

In May 1997, Siemens AG (Germany) opened a new computer chip plant in Tyneside, near Newcastle in the United Kingdom. The new project was to create 1,100 jobs at the factory, at a cost of about $1.9 billion once completed.[a] The investment was welcomed by the local community, which had suffered economically from the steady decline in the region's traditional industries of coal, steel and shipbuilding. Hopes, however, were dampened soon, as the world price of the type of semiconductors to be produced in this plant declined from around $60 in 1995, when the plant construction was first announced, to $1.50 in 1998.[b] In early July 1998, Siemens' chief executive warned that the group's semiconductor business worldwide stood to lose around DM 1 billion, unless ways could be found to cut excess capacity. Then, later that month, the head of Siemens' semiconductor business announced that the Tyneside plant – the construction of which had started less than fifteen months ago and which had been tested – would not be opened for volume production.

This is an example of a decision to make a greenfield investment which, subsequently, is overtaken by industry developments. In this case, it was the slump of prices combined with rapidly changing technology which required new production facilities. In the semiconductor industry, a new generation of chips is put in production roughly every three years; a production facility that is not fully operational two years into a new generation is often too expensive to be reconfigured.

Source: UNCTAD.

[a] Matthew Rose, "For a short time, U.K. town's motto was 'Fish into chips': promise of a Siemens plant revived North Tyneside but then cost it dearly", *Wall Street Journal*, 20 October 1998.

[b] Mark Milner and Peter Hetherington, "Jobs blow to high-tech hopes: 1,100 to go as factory closure rocks recovery plans in North-east", *The Guardian*, 1 August 1998.

determine. To merge two separate companies, with different cultures and that previously may have been fierce rivals, into one single business entity is indeed a difficult task. Any merger or acquisition is a complex procedure from pre-deal planning to post-deal integration. The challenge is to create additional value through the transaction, a value that exceeds the premium paid plus the costs for making the deal work. The result depends to a great extent on the successful integration of the two work forces; taking over a major firm is like hiring a large number of new employees at once. This aspect is particularly important for acquisitions in which the skills and capabilities of the target firms are the main source of anticipated gains.

- Other criteria have to be taken into account to assess the extent to which M&As can be regarded as having succeeded or not. In that respect, the right counterfactuals must be considered. What would have happened if a firm had not undertaken a particular merger or acquisition? Even if a merger or an acquisition fails to deliver the expected financial returns in the short-term, the deal may still be motivated by specific strategic reasons, e.g. if the act prevents a competitor from securing a critical asset.

In view of the above, an examination of the broad set of motivating factors is required to explain what appears to be a paradox, i.e. the growth of M&As in spite of their performance results in terms of share prices and profitability. To explore this issue further, the following sections look more closely at the motivations underlying M&As.

B. Why do firms engage in cross-border M&As?

Why are firms increasingly engaging in cross-border M&As when undertaking FDI? Although cross-border M&As represent one mode of FDI entry into foreign locations, the received literature on international production can only partly explain this phenomenon. Indeed, the "OLI paradigm" – the most prominent explanation of FDI – does not distinguish between different modes of entry and was formulated primarily in reference to greenfield FDI (box V.2). Thus, it is useful to consider first the basic reasons for M&As in general, and for cross-border M&As in particular. As the acquisition behaviour of firms is closely affected by shifts in the business environment, the second part of this section addresses some of the major changes that have taken place in recent years with important implications for the cross-border M&A activity.

1. Motivations for conducting M&As

To explain why firms may prefer to grow via M&As rather than through organic growth, two factors stand out as being particularly important: speed and access to proprietary assets.[12]

Speed is crucial. M&As often represent the fastest means of reaching the desired goals when expanding domestically or internationally. For example, when time to market is vital, the takeover of an existing firm in a new market with an established distribution system is far more preferable to developing a new local distribution and marketing organization. For a latecomer to a market or a new field of technology, M&As can provide a way to catch up rapidly. Enhanced competition and shorter product life cycles accentuate the necessity for firms to respond quickly to opportunities in the economic environment, preferably before competitors move. The pressure of time and the feeling of urgency are highlighted in the observations often made in the information technology (IT) industry today that, in the new economy in which we live, a year has only 50 days, or in the business slogan that "Speed is our friend – time is our enemy". While erstwhile planning may have taken place in five-year intervals, the watchword today is "plaction" – plan and act at once.

The second main motivation for firms to merge with or acquire an existing company, rather than to grow organically, is the *quest for strategic assets,* such as R&D or technical know-how, patents, brand names, the possession of local permits and licences, and supplier or distribution networks. Ready made access to proprietary assets can be important because, by definition, they are not available elsewhere in the market and they take time to develop.[13]

Box V.2. The OLI paradigm and cross-border M&As

The OLI paradigm (Dunning, 1993) addresses three questions related to FDI:

Which firms undertake FDI? Firms investing abroad must possess specific proprietary or ownership ("O") advantages to overcome the extra costs of operating in a different, less familiar environment. These advantages are generally costly to create, but can be transferred to new locations at relatively low cost. The analysis of "O" advantages draws on industrial organization, resource based, evolutionary and management theories, with advantages residing mainly in firm-specific technology, brand names, privileged access to factor or product markets or superior technological or management skills. Initial "O" advantages allow firms to grow and invest abroad, but size and international spread can, in turn, feed back and provide new advantages (accessing capital markets and information, spreading risks and so on). In some cases, firms may go overseas to supplement or enhance their existing "O" assets ("asset-seeking" FDI) seeking synergies between their own strengths and those of foreign firms or institutions.

Where do firms choose to exploit their advantages, in the home country (by exports) or abroad, and in which foreign locations? They select sites with location ("L") advantages that best match the deployment of their "O" assets. The analysis of "L" advantages draws on trade and location theory, the main factors determining comparative costs being factor and transport costs, market size and characteristics, and government policies (e.g. stability, predictability, tariffs, taxes and FDI regulations). Asset-seeking FDI is drawn to locations with strong technological, educational or information creation activities.

Why do firms choose to internalize their advantages by direct investment in preference to selling them to other firms? The analysis of internalization ("I") draws on transaction-cost theories of the firm, and centres on the feasibility of and returns to contracting the sale of intangible advantages to other firms. The most valuable and new advantages tend to be internalized, since these are the most difficult to price and contract over time. The more mature ones are easier to price, less subject to uncertainty and less valuable to the owner: these are licensed more readily. Internalization can also explain vertical FDI, where a particular process or function is located abroad by TNCs to serve its production system (rather than subcontracted to independent suppliers). Transaction-cost analysis can also help explain why it is difficult or costly to contract independent firms for such arrangements, particularly in technology-intensive or strategic activities.

While the paradigm does not explicitly distinguish between different modes of FDI entry, the origins of the paradigm were more in greenfield investments than M&As. On the "ownership" side, the original thesis on which it draws explained the growth of United States companies in terms of an industrial organization analysis of barriers to entry in setting up new facilities (Hymer, 1960). The extension made to multi-plant operations again was conceived in terms of firms setting up new plants (Caves, 1971). The "internalization" analysis was based upon work explaining how firm boundaries were drawn in terms of the costs of hierarchical control (internalization) versus market control (externalization) of their assets (Coase, 1937; Williamson, 1971). The implicit setting was the expansion of firms by the building of new facilities rather than the joint internalization of assets by different firms involved in M&As. With regard to international investment in developing host countries, the analysis was entirely conducted in terms of greenfield FDI. Until recently, cross-border M&As in these countries were rare.

It is therefore useful to consider OLI factors specifically for M&As, and to distinguish mergers from acquisitions (box table V.2.1). Mergers are taken to involve firms of roughly similar size and capacity that jointly internalize their "ownership" advantages to gain economies of synergy, size and scope. Acquisitions are taken to involve larger, more powerful or better capitalized firms taking over smaller or weaker ones, and using this to gain speedy access to the latter's "ownership" and "locational" assets. The OLI factors can be considered separately for the three main types of M&As (horizontal, vertical and conglomerate), bearing in mind that horizontal transactions account for nearly two-thirds of cross-border M&A activity (figure IV.2).

Cross-border M&As and their characteristics call for an adaptation of the conventional analysis. The fact that M&As

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Box V.2. The OLI paradigm and cross-border M&As (concluded)

allow investors much faster access to, or offer new, ownership advantages accounts partly for their growing use in the current international competitive environment. The internalization factors are also different in that there is *joint* internalization, particularly in M&As between similar firms. In addition, the traditional OLI paradigm does not take into account non-economic explanations, such as personal motivations of managers or corporate responses under strategic interdependence.[a]

The traditional OLI analysis of locational factors is thus not particularly relevant in explaining mega mergers between TNCs, pooling not only their ownership-specific advantages, but also the global locational advantages of their worldwide production networks. The framework can still be applied to acquisitions by more advanced firms of less advanced ones — and so to FDI flows from developed to developing countries or economies in transition.

Box table V.2.1. The OLI paradigm and cross-border M&As

Type	Horizontal	Vertical	Conglomerate
Mergers	O: Both firms have O advantages complementing each other in scale, synergy, finance or market power. L: Standard location factors are not relevant where two TNCs merge their global production systems. I: Both firms seek to gain economies of scale by internalizing joint advantages. Joint internalization differs from "internalization" in usual OLI terms, but determinants (transaction costs in some sense) are similar. Mergers provide a much faster way of exploiting each other's advantages.	O: Both firms have O advantages that complement each other in different processes of the production chain. L: As with greenfield FDI, but also see horizontal mergers. I: Merging firms both seek to gain security, information, finance or market power, and to reduce transaction costs.	O: Both firms have O advantages in unrelated activities that may have economies of scope, but not technological complementarity. A merger is thus not based on O advantages in the usual sense; it may just involve access to finance. L: Mainly market size/ growth or prospects of capital appreciation, not location advantages in the OLI sense. I: Merging firms seek a larger capital base or economies of scope, but are not internalizing their O assets to save on transaction costs.
Acquisitions	O: Acquiring firms tend to have greater O advantages than acquired firms, or seek specific new O advantages (technology, contacts, etc.). L: As with greenfield FDI, except that many L advantages are "embodied" in the acquired firm. I: As with greenfield FDI, acquiring firms strengthen their competitive positions by internalization.	O: Acquiring firms have a stronger financial or managerial base that allows them to acquire vertically linked firms abroad. L: As with horizontal acquisitions. I: As with greenfield FDI, acquiring firms strengthen their competitive positions by internalization.	O: Acquiring firms have greater financial and/or managerial resources, but no O advantages in the usual sense. L: Mainly market size and growth and prospects of capital appreciation, not location advantages. I: Acquiring firms seek diversification or economies of scope, but are not internalizing in an OLI sense.

Source: UNCTAD.

Source: UNCTAD.

[a] In recent work, the need for adapting the OLI framework to meet new situations has been acknowledged; see Dunning (1998 and 2000).

Such assets may be crucial to advance a firm's *static* advantages, i.e. its income-generating resources and capabilities at a given moment in time, or to strengthen its *dynamic* advantages, i.e. its ability to sustain and increase the income-generating assets over time (Dunning, 2000). To take just one example of where the need for speed — the alternative between "build" or "buy" — and the search for proprietary assets came together: the main reason for the Indian company Tata Tea to acquire Tetley Ltd. in the United Kingdom was to obtain access to a global brand name and a global distribution network; reaching the same objective through organic growth would have been more or less impossible. To quote Tata Tea's Vice-Chairman who engineered the acquisition:

> "For us to develop a global market in the time frame we had in mind, the acquisition of Tetley, with its brand name and distribution system, was the only option."[14]

These two main advantages of M&As interact with a number of other driving forces, which play out differently in different industries and markets, and which often simultaneously affect the decision to undertake M&As. Many of the driving forces listed below can also motivate FDI in general, but, when speed enters the picture, they tend to favour M&As, as the objectives sought for can be realized more quickly:

- The search for new markets, increased market power and market dominance;
- Efficiency gains through synergies;
- Greater size;
- Diversification (spreading of risks);
- Financial motivations; and
- Personal (behavioural) motivations.

The *search for new markets and market power* is a constant concern for firms. Where domestic markets are saturated, in particular, foreign ones beckon. High transaction costs associated with arm's-length transactions involving intangible assets may explain why firms possessing ownership specific capabilities often prefer to exert direct control (instead of exporting or licensing) when exploiting them in new geographical locations or industry segments. Through M&As, firms can quickly access new market opportunities and develop critical mass without adding additional capacity to an industry. By taking over an existing company, immediate access to a local network of suppliers, clients and skills can be obtained. This motivation is of particular importance for cross-border M&As as the need for knowledge about local conditions increases when leaving the home market. Beyond this, and especially in markets characterized by oligopoly, M&As can also be motivated by the pursuit for market power and *market dominance*. Especially in the case of horizontal M&As, the motivation can well be the search for oligopolistic positions; in addition, consolidated market control may provide opportunities for anti-competitive practices and increased barriers to entry.

Anticipated *efficiency gains through synergies* are probably the most cited justification for M&As. Synergies can be static (cost reduction or revenue enhancement at a given point in time) or dynamic (e.g. innovation-enhancing) in character. Examples of the former kind of synergies include the pooling of management resources (one head office instead of two), revenue enhancement by using each others' marketing and distribution networks, purchasing synergies (greater bargaining power), economies of scale in production leading to cost reductions, and the avoidance of duplication of production, R&D or other activities. Dynamic synergies may involve the matching of complementary resources and skills to enhance a firm's innovatory capabilities with long-term positive effects on sales, market shares and profits. The search for static synergies may be particularly important in industries characterized by increased competitive pressure, falling prices and excess capacity, such as in the automotive and defence industries. Meanwhile, dynamic synergies may be crucial in industries experiencing fast technological change and that are innovation-driven, such as in information technology and pharmaceuticals. The efficiency-through-synergy motive is present for both domestic and cross-border M&As. However, the scope for rationalization and improving company performance by achieving an international specialization of the value chain can be particularly high in the case of cross-border investments that allow firms to locate different activities in places with appropriate mixes of locational advantages.

In a globalizing economy, *greater size* can be a crucial parameter, particularly in operations requiring economies of scale, large expenditures for R&D and the expansion of distribution networks for example.[15] Size in

itself can also make it more difficult to be taken over and, therefore, can have a protective function. Large size can furthermore create financial, managerial and operational synergies that reduce the operational vulnerability of firms. Sheer size normally means lower-cost access to investible funds as there are economies of scale in capital raising.[16] Information asymmetries between corporate insiders and investors can make internal financing more favourable.[17] A company can use its internal capital market by letting cash rich divisions with few profitable projects finance capital expenditures in cash poor divisions with better growth opportunities. Another advantage of size is that larger firms with multiple operations across geographical locations and segments can have an advantage in the collection and adoption of new information and innovation. The size motive can apply to both domestic and cross-border M&As.[18]

A fourth driver behind M&As is the desire for risk reduction (operational risks, foreign exchange risks, etc.) through product or geographical market *diversification*. Firms may make cross-border M&As on the basis that industry returns across countries may be less correlated than within an economy (Vasconcellos and Kish, 1998). By acquiring foreign companies, a firm may be able to circumvent tariff and non-tariff barriers and thereby lower the level of uncertainty. As intensified global competition and rapid technology development have led firms to focus on their core activities, however, the product diversification motive has become less important (Morck and Yeung, 1999), although geographical diversification plays a role.

There can be important *financial motives* behind M&As. Stock prices do not always reflect the true value of a firm. A potential acquirer can, for example, value a company's anticipated earnings stream higher than current shareholders do. Bad management of a firm, imperfections in the capital market and major exchange rate realignments may provide short-term capital gains to be made by acquiring an undervalued firm, or affect the timing of planned M&As. Such motivations are particularly important in the case of portfolio-type M&As and in economies with poorly developed capital markets or in financial crisis. In addition, some M&As are undertaken partly for tax considerations, e.g. to exploit unused tax shields.

The *personal gains (or behavioural)* explanation argues that corporate managers pursue their own self-interest, especially where corporate governance is weak (a manifestation of what economists have denoted the "principal-agent problem").[19] They may seek expansion or "empire building" to enhance executives' power, prestige, job-security or remuneration, even when this is not technically efficient or in the interest of shareholders (Baumol, 1967). They can also be under the pressure of financial markets – especially where double-digit growth rates are considered the norm – to show high growth and profit rates; M&As can provide the easiest route in this respect, compared to organic greenfield investment growth. Individual managers may also overestimate their ability to manage acquisitions and think that they are especially well equipped to make a merger-deal work.

The factors discussed so far basically apply to both domestic and cross-border M&As. In the case of the latter, a number of empirical studies have specifically analyzed the determinants of the choice between takeover M&As and greenfield investments as a mode of entry into foreign locations. In addition to the basic motivations identified above, many of these studies have also taken firm-specific, host country-specific as well as industry-specific aspects into account (box V.3).

While all factors mentioned here are important to consider when explaining why firms undertake cross-border M&As, it is seldom only one factor that is decisive. In fact, in a cross-national comparison testing several of the motives for M&As discussed above, no hypothesis examined received consistent confirmation, suggesting that there are multiple reasons simultaneously at work (Mueller, 1980a). To put it differently (Scherer and Ross, 1990, p. 159):

> "Mergers occur for a myriad of reasons, and in any given case, several different motives may simultaneously influence the merging parties' behavior".

2. Changes in the economic environment

So far the principal basic motivations for undertaking cross-border M&As have been examined. But the acquisition behaviour of firms is also greatly affected by changes in the

economic and regulatory environment and, when it comes to cross-border M&As, by the international economic and regulatory environment. This section considers some of the major changes — as regards technology, the regulatory framework and capital markets — that have taken place in the past decade and that have facilitated cross-border M&As and, indeed, encouraged firms to pursue them.

a. Technology

The rapid pace of technological change has intensified competitive pressures on the world's technology leaders. Consequently, the costs and risks of innovation have risen in most industries, as has the need to incorporate continuously new technologies and management practices. Firms thus need more efforts to maintain innovative leads, to find new areas of technological leadership, and to keep up with new knowledge and shorter product-life cycles. In an environment characterized by rapid technological change and rising expenditures for risky R&D projects, many firms feel compelled to enter into cross-border M&As as a way of sharing the costs of innovation and accessing new technological assets to enhance their innovatory capabilities. M&As allow firms to do this quickly. Such asset-seeking FDI by TNCs from developed (and increasingly from developing) countries is a rising form of FDI. It is likely to become more common as intangible, knowledge-based assets and access to a pool of skilled people and work teams become more important in the world economy.[20]

Box V.3. Determinants of the mode of FDI entry

The literature (see e.g. Harzing, 1999) has identified a number of firm-specific, host-country-specific and industry-specific-factors that affect the mode of entry of firms into foreign markets:

- Firms with lower R&D intensity are more likely to buy technological capabilities abroad by acquisition, while those with strong technological advantages tend to prefer greenfield ventures to a greater extent.
- More diversified investing firms are likely to enter new markets through acquisitions.
- Larger TNCs are traditionally more prone to acquire than smaller ones, although the latter have shown an increased tendency to acquire in recent years.
- There is weak support that high advertising intensity leads to more acquisitions. This propensity is strengthened where local firms can provide access to distribution systems and extensive knowledge of the local market.
- The greater the cultural and economic distance between home and host countries, the lower the probability of an acquisition. Most M&As concentrate in developed home and host countries with similar cultural and business practices.
- Acquisitions are encouraged by imperfections of capital markets that lead to the undervaluation of company assets (Gonzalez et al., 1998). By similar reasoning, they are also encouraged by economic crises that lead to sharp falls in asset prices generally.
- TNCs that already have an affiliate in a host country are more likely to prefer takeovers as a way of expansion in the same country, to avoid adding local production capacity and competition. This finding helps to explain why the continuous increase in transnational activity would lead to a stronger preference for M&As (Andersson and Svensson, 1994).
- In developing countries, the advantage of M&As is rarely access to proprietary technology or skills (with the exception of some newly industrializing economies). The advantage lies more in rapid market entry, local market knowledge, established distribution systems and contacts with the government, suppliers or customers.
- For firms to choose M&As instead of entry through greenfield investment, there has to be a supply of suitable target companies to acquire. This may not always be the case, most notably in a number of developing countries.
- Slow growth in an industry favours M&As. A number of the cross-border deals in the late 1990s have been undertaken in industries characterized by over-capacity, falling prices and slow growth. Under such conditions, firms may be reluctant to add new capacity as that could further deteriorate the situation. This applies, e.g. to raw material-based industries, such as paper and pulp, steel, metal mining, petroleum as well as to military equipment and the automotive industries (Kang and Johansson, 2000; UNCTAD, 1999a).

Source: UNCTAD.

But technological developments also have other implications. Some of the most important changes relate to the new information and communication technologies. They enable a better management of operations distributed worldwide, and provide new ways of organizing contacts within and between firms as well as with consumers. The use of electronic commerce, for example, makes it possible to restructure the supply chain and reduces the costs of reaching large consumer markets. By lowering transport, information-access and communication costs, technical progress has dramatically shrunk economic space. One result is more intense competition, as foreign competitors may be able to deliver goods and services more cheaply, technologies are diffused more rapidly and information is more broadly available. Another, however, is that TNCs can compete more effectively. They can communicate better across their international production systems, transfer goods and personnel across borders more cheaply and break up production and management processes to locate sub-processes in different countries to minimize cost. Even between different headquarters operations — finance, strategy, R&D, design, marketing — locational links are being loosened, as some TNCs place some of these operations in dispersed sites.[21]

Technological change thus has an impact on the size of firms, reduces costs and facilitates better management of far-flung transnational operations. It allows new management systems to be applied more effectively across the globe, and makes globally integrated production systems more feasible and cost-effective. Cross-border M&As play a critical role in allowing TNCs to set up and expand these systems to develop a portfolio of locational assets. As a result, too, TNCs gain more experience in "digesting" acquired enterprises into existing corporate systems which, in turn, makes the M&A route more enticing than before.

b Changes in the policy and regulatory environment

If the crucial role of technology makes asset-seeking FDI more important and technological changes have facilitated the operation of international production systems, changes in the policy and regulatory environment during the past decade have provided more space for these systems to expand, including through M&As. Key here are the liberalization of FDI and trade regimes, regional economic integration, privatization and the deregulation of various industries.

(i) Policies on FDI and cross-border M&As

The liberalization of FDI regimes has continued apace, typically on a unilateral basis. Most countries are now trying to attract direct investment, not just by removing restrictions, but also through active promotion and by providing high standards of treatment, legal protection and guarantees. Of the 1,035 FDI regulatory changes between 1991 and 1999 in over 100 countries in all regions, 974 went in the direction of facilitating FDI inflows (chapter I). Examples of such changes relevant to M&As include the removal of compulsory joint venture requirements, restrictions on majority ownership and authorization requirements. The international regulatory framework has also been strengthened, especially through the conclusion of bilateral investment protection and double taxation treaties (chapter I). Multilateral agreements support these trends. For instance, WTO agreements limit the use of certain investment-related measures that affect trade, like local content requirements on TNCs, and certain types of export requirements. World Bank and IMF programmes encourage countries to adopt more open, transparent and welcoming regimes towards foreign investors.

As FDI regimes typically apply to both greenfield investment and cross-border M&As, the latter have also been facilitated by FDI policy liberalization in developed and developing countries. A survey of the literature dealing with more than 100 national FDI regulatory frameworks reveals that most laws dealing with FDI do not explicitly make a distinction between greenfield investment and M&As.[22] Thus, when industries are removed from closed lists, both forms of FDI are typically permitted; and when restrictions on foreign ownership are removed, majority acquisitions of domestic firms are also allowed. Within this overall trend, however, a number of host countries have various policy instruments to deal with cross-border M&As, including special authorization requirements for cross-border M&As under their FDI laws, as e.g. in Malaysia (box V.4), Canada (box V.5) and, until recently, New Zealand and Sweden. Some countries also

have instruments to screen cross-border M&As for particular purposes, e.g. national security considerations (box V.6). Moreover, governments may reserve the right to approve some proposed investment projects and reject or modify others to preserve important public interests. Furthermore, when governments screen FDI projects, it may well be that more greenfield proposals have been approved than M&As; but as the relevant bodies do not normally publish their results and reasoning, no precise conclusions are possible. Finally, governments have sometimes kept "golden shares" in privatized companies in order to be able to preserve essential strategic interests; golden shares have been used to veto undesirable further changes in ownership and control of the privatized company.

Box V.4. Malaysia's guidelines for the regulation of acquisition of assets, mergers and takeovers

The Foreign Investment Committee (FIC) Guidelines of 1974 were formulated to establish a set of rules regarding the acquisition of assets or any interest, mergers or takeovers of companies and businesses. Through these Guidelines, the Government endeavours to reduce the imbalances in the distribution of the corporate wealth and to encourage those forms of private investment that would contribute to the development of the country in consonance with its economic objectives. The Guidelines provide that the proposed acquisition of assets or any interest, mergers or takeovers:

(a) Should result directly or indirectly in a more balanced Malaysian participation in ownership and control;

(b) Should lead directly or indirectly to net economic benefits in relation to such matters as the extent of Malaysian participation, particularly Bumiputera participation, ownership and management, income distribution, growth, employment, exports, quality, range of products and services, economic diversification, processing and upgrading of local raw material, training, efficiency, and research and development; and

(c) Should not have adverse consequences in terms of national policies in such matters as defence, environmental protection or regional development.

They also provide that the onus of proving that the proposed acquisition of assets or any interest, mergers or takeovers of companies and businesses is not against the objectives of the New Economic Policy is on the acquiring parties concerned.

The Guidelines apply to the following:

(a) Any proposed acquisition by foreign interests of any substantial fixed assets in Malaysia;

(b) Any proposed acquisition of assets or any interest, mergers and takeovers of companies and businesses in Malaysia by any means, which will result in ownership or control passing to foreign interest;

(c) Any proposed acquisition of 15 per cent or more of the voting power by any one foreign interest or associated group or by foreign interests in the aggregate of 30 per cent or more of the voting power of a Malaysian company or business;

(d) Control of Malaysian companies or businesses through any form of joint-venture agreement, management agreement and technical assistance agreement or other agreement;

(e) Any merger and takeover of any company or business in Malaysia whether by Malaysians or foreign interests; and

(f) Any other proposed acquisition of assets or interests exceeding in value of RM5 million whether by Malaysians or foreign interests.

The Guidelines, however, do not apply to specific projects approved by the Government comprising the following:

(a) Acquisition by Ministries and Government Departments;

(b) Acquisition by Minister of Finance Incorporated, Menteri Besar Incorporated and State Secretary Incorporated; and

(c) Privatization projects approved by the Federal or State Government.

Source: Malaysia, Ministry of Finance, 2000.

But the practice of countries in this respect has also changed over time. An example is the Republic of Korea which, until 1998, did not experience foreign purchases of majority interests in local firms, but which, in the face of the Asian financial crisis, opened all industries to M&As, except for a few sensitive ones (box V.7). Thailand represents another country that, in response to the financial crisis, liberalized its regulatory environment for cross-border M&As and even promoted them.[23] The ASEAN Investment Area, also in response to the financial crisis, extended in December 1998, and for a specified period of time, various incentives to cross-border M&As (ASEAN, 1998).

While FDI policies are being liberalized, cross-border M&As are increasingly reviewed as part of competition policy. By June 2000, some 90 countries have adopted competition laws or were in the process of doing so (table V.1). Merger review systems have been widely used for this purpose in a number of developed countries for many years (UNCTAD, 1997a). During the past fifteen years or so, such systems have also been adopted or strengthened in developing countries and economies in transition.[24] Thus, rather than the blanket restrictions on foreign takeovers imposed in past years under FDI laws, M&A reviews under competition laws proceed on a case-by-case basis, with competition concerns constituting the key benchmark. By and large, competition-based M&A reviews do not tend to discriminate between cross-border and domestic M&As. Thus, a switch from investment to competition control virtually always represents a step towards liberalization.

Box V. 5. Canada's regulatory regime on cross-border M&As

Canada has traditionally relied heavily on FDI to further its economic development. In the 1950s, it began to measure the level of foreign control in certain industries and to analyze the costs and benefits of foreign investment, primarily foreign takeovers. As a result, Canada introduced certain laws and policies to regulate foreign investment. During the 1980s, however, most of these regulations were removed except for a few, including the 1986 *Investment Canada Act*.

Under the *Investment Canada Act*, all foreign takeovers of Canadian companies are subject to notification to the Government; however, only significant ones are formally reviewed. Foreign takeover proposals are assessed on the basis of their "net benefit" to Canada. The factors of net benefit on which the assessment is based include:

(a) The effect of the investment on the level and nature of economic activity in Canada, including the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;

(b) The degree and significance of participation in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;

(c) The effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

(d) The effect of the investment on competition within an industry or industries in Canada;

(e) The compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the Government or legislature of any province likely to be significantly affected by the investment; and

(f) The contribution of the investment to Canada's ability to compete in world markets.

Most proposals for foreign takeovers of Canadian firms are reviewed and approved quickly (i.e. within 45 days), although large and complex ones sometimes need longer time for review. In 1999, there were 700 foreign takeovers of Canadian businesses, and between 5 and 10 per cent were reviewed. As a rule, reviewability is based on the asset value of the Canadian business to be acquired, which was 184 million Canadian dollars in 1999 and has been set at 192 million Canadian dollars for 2000. Canada's laws on foreign takeovers are applicable to investors from all countries.

Source: UNCTAD based on Chudy, *et al*, 2000.

(ii) Other changes in the regulatory environment

Trade liberalization gathered pace in the 1990s with the conclusion of the Uruguay Round. The cumulative effect has been a radical change in the signals and competitive setting for international investors. Firms now face more intense competition at home as well as abroad.

The formation of regional free trade areas has facilitated both greenfield investment and cross-border M&As in several ways. Regional trade agreements enlarge the size of the immediately accessible market for firms, and

Box V. 6. Control of cross-border M&As in the United States: the Exon-Florio provision

Section 5021 of the United States Omnibus Trade and Competitiveness Act of 1988 amended Section 721 of the Defense Production Act of 1950 and provides authority to the President of the United States to suspend or prohibit any foreign acquisition, merger or takeover of a United States corporation that is determined to threaten the national security of the United States. The Government can exercise this authority under section 721, also known as the "Exon-Florio provision", to block a foreign acquisition of a United States corporation only if the President finds that:

- There is credible evidence that the foreign entity exercizing control might take action that threatens national security; *and*
- The provisions of law, other than the International Emergency Economic Powers Act, do not provide adequate and appropriate authority to protect national security.

The Exon-Florio provision is implemented by the Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee chaired by the Secretary of the Treasury. To assist in making a determination, the Exon-Florio provision provides for written notice of an acquisition, merger or takeover of a United States corporation by a foreign entity. After reviewing the notified transaction, in some cases it may be necessary to undertake an investigation. This must begin no later than 30 days after notification. Any investigation is required to end within 45 days. Information provided by companies is held confidential and cannot be made public except in the case of an administrative or judicial action.

The Exon-Florio provision lists the following factors that the President or a designee may consider in determining the effects of a foreign acquisition on national security:

- The domestic production needed for projected national defense requirements;
- The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
- The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
- The potential effects of the transaction on the sales of military goods, equipment or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and
- The potential effects of the transaction on United States technological leadership in areas affecting United States national security.

The Exon-Florio provision was amended by Section 873(a) of the National Defense Authorisation Act for 1993 which requires an investigation in cases in which:

- The acquirer is controlled by, or acting on behalf of, a foreign government; and
- The acquisition "could result in control of a person engaged in interstate commerce in the U.S. that could affect the national security of the U.S.."

According to the latest statistics published by the General Accounting Office of the United States (box table V.6.), 1,258 notifications of foreign M&As were made to the CFIUS under the Exon-Florio provision between 1988 and 1999. Of these, 17 were investigated, seven were withdrawn before the final determination was made and the President blocked one.

/...

so attract foreign investors to serve them by setting up new facilities. They can enhance market transparency and, if they link national currencies, lower the costs of cross-border transactions. If they incorporate investment agreements, they make M&As more feasible. From a TNC perspective, the need to establish a local presence is particularly strong if an integrating area sets up high common external tariffs; but even low external barriers to trade can be a powerful magnet in rich or expansive regional markets. The formation of the European Community, for instance, provided a major stimulus to inward FDI and promoted

Box V. 6. Control of cross-border M&As in the United States: the Exon-Florio provision (concluded)

Box table V.6.1. Disposition of CFIUS notifications, October 1988 - December 1999

Year	CFIUS notifications	Notifications investigated	Notifications withdrawn	President blocked
1988	14	1	-	-
1989	200	5	2	1[a]
1990	295	6	2	-
1991	152	1	-	-
1992	106	2	1[b]	-
1993	82	-	-	-
1994	69	-	-	-
1995	81	-	-	-
1996	55	-	-	-
1997	62	-	-	-
1998	63	2	2	-
1999	79	-	-	-
Total	1 258	17	7	1

Source: United States, General Accounting Office, 1995, p. 4, based on CFIUS data as of January 1995, and United States , CFIUS data up to December 1999.

[a] In this case, the President ordered the China National Aero-Technology Import and Export Corporation, an aerospace company of China, to divest from MAMCO, which involved a United States aircraft parts manufacturer.

[b] The investors withdrew their offer on the last day of the investigation of this case, which involved the acquisition of LTV Missiles Division by Thomson-CSF.

Source: United States, Department of the Treasury, Office of International Investment, 2000

Box V.7. The Republic of Korea's shift in policy on cross-border M&As

In the wake of the 1997 financial crisis, the country's policy towards FDI through M&As changed as the Government sought to overcome the crisis by increasing foreign exchange liquidity. By May 1998, the restrictions on the foreign acquisition of domestic shares in the stock market, and restrictions on M&As and land acquisition by foreigners, had been abolished. Controls remain only in a few industries sensitive to national security, public health and environment protection. Restrictions on foreign equity ownership were abandoned in most industries, and even hostile takeovers by foreign investors have become possible.

The new investment policy, however, still slightly favours greenfield over M&A investment. For example, most of the newly introduced measures (other than the abolitions in share acquisitions), such as the creation of a foreign investment zone and tax incentives, basically imply investments in greenfield form. Thus, the tax regime favours greenfield FDI rather than M&As by allowing reductions of taxes on corporate income, acquisitions, registration, property and land under various laws. This benefits acquisition of assets, which are considered to be greenfield investment (as opposed to acquisition of shares, which are not) under the laws of the Republic of Korea.

Source: UNCTAD, based on Yun, 2000; and information provided by the Republic of Korea, Ministry of Commerce, Industry and Energy.

Table V.1. Countries that have adopted competition laws, as of June 2000

Africa	Asia and the Pacific	Central and Eastern Europe	Developed countries	Latin America and the Caribbean
Algeria (1995)	Azerbaijan [b]	Albania (1995	Australia (1974)	Argentina (1923, 1980, 1999)
Benin [a]	Bahrein [b]	Belarus (1992)	Austria (1988, 1993, 1999)	Barbados [a]
Botswana [a]	China (1993)	Bosnia and Herzegovina [a]	Belgium (1991,1999)	Bolivia [a]
Cameroon [b]	Cyprus (1990, 1999)	Bulgaria (1991, 1998)	Canada (1986, 1999)	Brazil (1962, 1990, 1994, 1998)
Central African Republic (1994)	Fiji (1993)	Croatia (1995)	Denmark (1997)	Chile (1959, 1973, 1980)
Chad [a]	Georgia (1996)	Czech Republic (1991, 1992, 1993)	Finland (1992, 1998)	Colombia (1959, 1992,1996, 1998)
Côte d'Ivoire (1978, 1991)	India (1969)	Estonia (1993, 1998)	France (1986, 1995)	Costa Rica (1994)
Gabon (1989)	Indonesia (1999)	Hungary (1984, 1990, 1996)	Germany (1957, 1998)	Cuba [a]
Ghana [a]	Iran, Islamic Republic of [a]	Latvia (1991, 1993, 1998)	Greece (1977, 1995)	Dominican Republic [a]
Egypt [a]	Jordan [a]	Lithuania (1992, 1999)	Iceland (1993)	Ecuador [a]
Ethiopia [a]	Kazakhstan (1999)	Poland (1990)	Ireland (1978, 1991, 1996)	El Salvador [a]
Kenya (1988)	Kyrgyzstan (1994)	Republic of Moldova (1992)	Israel (1959, 1988,1989)	Guatemala [a]
Lesotho [a]	Lebanon (1967)	Romania (1991, 1996)	Italy (1990)	Honduras [a]
Malawi (1998)	Malaysia [a]	Russian Federation (1991, 1992, 1995, 1998, 2000)	Japan (1947, 1998)	Jamaica (1993)
Mali (1997)	Malta (1994)	Slovakia (1991, 1994, 1998)	Liechtenstein (1992, 1995)	Mexico (1992, 1998)
Mauritania (1991, 1999)	Mongolia [b]	Slovenia (1993, 1998)	Luxembourg (1970, 1981)	Nicaragua [a]
Mauritius (1980, 1999)	Pakistan (1970)	The Former Yugoslav Republic of Macedonia [b]	Netherlands (1997)	Panama (1996, 1999)
Morocco (1999)	Philippines (1992)	Ukraine (1992, 1996, 1998)	New Zealand (1986)	Paraguay (1997)
Namibia [a]	Republic of Korea (1980)	Yugoslavia (1996)	Norway (1993)	Peru (1991)
Niger (1992)	Saudi Arabia [a]		Portugal (1993)	Trinidad and Tobago [a]
Rwanda [a]	Sri Lanka (1987)		Spain (1989, 1996, 1999)	Uruguay [a]
Senegal (1994)	Taiwan Province of China (1992, 1999)		Sweden (1993)	Venezuela (1973, 1992, 1996)
Sudan [a]	Tajikistan (1993)		Switzerland (1962, 1985, 1995, 2000)	
South Africa (1955, 1998, 1999)	Thailand (1979, 1999)		United Kingdom (1973, 1994, 1998)	
Tunisia (1991)	Turkey (1994, 1998)		United States (1890, 1976)	
United Republic of Tanzania (1994)	Turkmenistan (1993)			
Zambia (1994, 1998)	Uzbekistan (1992, 1996)			
Zimbabwe (1996, 1999)	Viet Nam [a]			
	Yemen [a]			

Source: UNCTAD, based on information provided by Governments; White & Case, 2000; United States, International Competition Policy Advisory Committee, 2000; and UNCTAD sources.

[a] Competition law is under preparation.
[b] Date of adoption of law not available.

restructuring by national, regional (intra-EU) and cross-border (non-EU) M&As (UNCTC, 1993). The initial impetus was greatly strengthened by the creation of a single market and, more recently, the launch of the Euro, which adds to competitive pressures and to the restructuring of previously segmented markets. Increased competition underlines the role of rapid responses by companies, thus favouring cross-border M&As in particular. Regional trade agreements in the developing world, like ASEAN in South-East Asia and MERCOSUR in Latin America, are stimulating similar restructuring, even if the markets involved are not as large and the integration processes less intense.

In parallel with trade liberalization and regional integration processes, there has been widespread *privatization* and *deregulation* of activities, most notably in such service industries as telecommunications, transportation, power generation and financial services. These changes have provided another stimulus to M&As in general and cross-border ones in particular. Privatization programmes in many developing countries and economies in transition have increased the availability of domestic companies for sale. In fact, the combination of privatization and deregulation has created a number of new TNCs. Previously state-owned utility companies, for example, facing new competitive pressures at home, have responded by becoming dynamic international investors. In Europe, activities that have long been strongly homebound, like water supply, power generation, rail transports, telecommunications, and airport construction, are now populated by transnational operators. The first wave of expansion (with foreign participation in privatization) is being followed by further consolidation and restructuring, with M&As again set to play a vital role.

c Changes in capital markets

Cross-border M&As have been facilitated by changes in world capital markets. The liberalization of capital movements, new information technology providing instant information across the globe, more active market intermediaries, and new financial instruments have had a profound impact on M&A activity worldwide. Whereas the liberalization of capital markets since the mid-1980s had already greatly facilitated the growth of cross-border M&As, most developed countries now have completely liberalized their capital accounts, with virtually unrestricted facilities for cross-border loans and credits, foreign currency deposits and portfolio investment. More recently, financial transactions have also been substantially liberalized in many developing countries.

In addition, the increased use of cross-border M&As mirrors changes in the market for corporate ownership. The number of available targets, both among publicly listed and non-listed firms, is rising. Financial advisors have been expanding their operations and are more widely presenting potential “deal opportunities” to prospective clients. The bulk of the major cross-border deals are handled by a small number of large deal makers, most of which are based in the United States (table V.2). The growing demand for acquisition targets is adding to a sense of urgency.

Table V.2. Worldwide M&A advisor rankings (deals completed, January-June 2000)

Rank	Advisor	Nationality	Value of deals (Billion dollars)	Number of deals
1	Goldman Sachs	United States	901	168
2	Morgan Stanley Dean Witter	United States	808	195
3	Merrill Lynch	United States	757	124
4	Credit Suisse First Boston	Switzerland	386	173
5	JP Morgan	United States	359	107
6	UBS Warburg	Switzerland	345	105
7	Rothschild	Luxembourg	255	73
8	Deustche Bank	Germany	240	97
9	Salomon Smith Barney	United States	227	156
10	Lazard	United States	214	77
11	Chase Manhattan	United States	208	82
12	Bear Stearns	United States	206	37
13	Lehman Brothers	United States	184	97
14	Donaldson, Lufkin & Jenrette	United States	118	157
15	RBC Dominion Securities	Canada	77	12

Source: UNCTAD based on *Financial Times*, 5 July 2000, p. 15.

Meanwhile, corporate executives are also under increased pressure from the stock market to participate actively in the global restructuring process to seize potential opportunities. This combines with new ways of financing major transactions. The liberalization of foreign equity ownership has facilitated M&As based on stock swaps rather than cash deals. (As noted in chapter IV, a number of mega deals have been financed in this way; see box IV.6.) Major M&As have also been facilitated by the rise of stock markets and ample liquidity in capital markets, which has allowed firms to raise large amounts of money through banks and bond issues. This was accentuated by the introduction of the single European currency, which has created a liquid market in European corporate bonds. Companies are increasingly issuing Euro-denominated bonds to refinance debt and to raise money for takeovers. For example, the rise of the Euro-denominated corporate bond market and the underlying Euro-syndicated loan market greatly facilitated Olivetti's acquisition of Telecom Italia (Ciucci, 1999).

It appears also that the increasing globalization of capital markets is contributing to a certain convergence of different systems of corporate governance and financing patterns (Maher and Andersson, 1999). One indication of this is the increased acceptance of M&As around the world. As noted earlier (chapter IV.B), the United States and the United Kingdom remain the most active countries with regard to M&As, but the incidence of takeovers (domestic as well as cross-border) has also increased in both continental Europe and Japan. The frequency of M&As also raises questions related to corporate governance, including as regards the protection of minority shareholders and the role of other stakeholders.[25]

C. A secular trend

The forces underlying the dramatic growth of cross-border M&As are complex and vary by industry and country. In essence, they reflect a *dynamic interaction* between changes in the global environment observed in the preceding section – new technologies, policy liberalization, deregulation and privatization, and changes in the capital market – and the multitude of basic factors motivating firms to undertake cross-border M&As (figure V.1). M&As are part of a process of regional and global restructuring, in which actions by national and international policy-makers trigger responses by firms and vice versa.

While this process is far from complete and its incidence is highly uneven, its direction is quite clear. The major changes that have simultaneously taken place in the international business environment have profoundly affected the setting in which firms are operating and have provided new and expanded business opportunities, as well as risks.

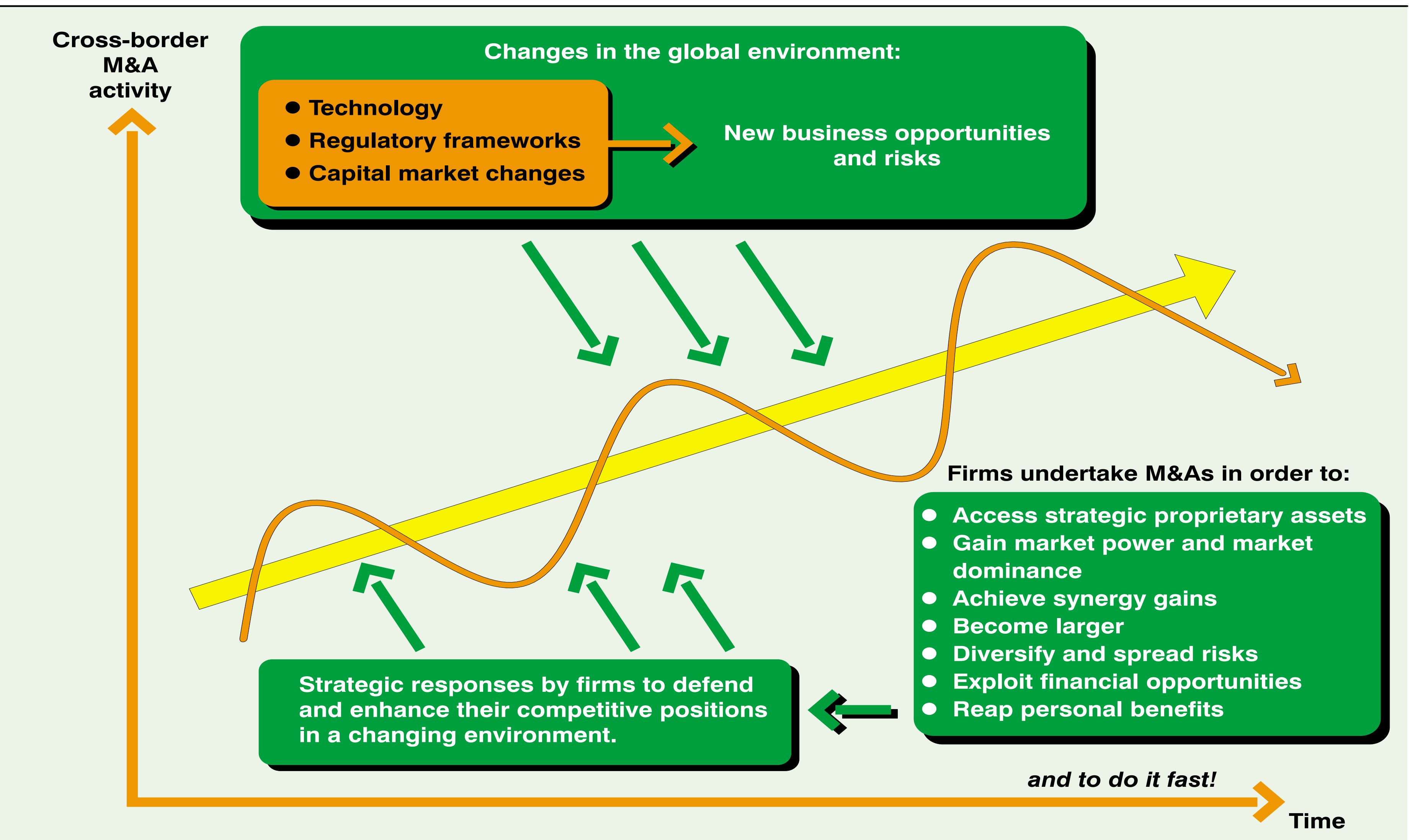
The advent of the internet has added to this as it stimulates M&A activity between "old economy" and "new economy" firms in search of opportunities and as it may lead firms to try to find new solutions to some of the problems to which M&As have traditionally represented the solution. An example is the business-to-business exchanges, which may be akin to functional mergers.

In this new and continuously evolving environment, the key strategic issue for firms becomes how to survive and prosper, knowing that there is a market for firms and that sanctions await them if they fail to deliver growth and profits. One such sanction is to be taken over. All the basic motivations for firms to undertake cross-border M&As then combine to become key elements in the overarching strategic goal to defend and develop competitive positions. Cross-border M&As are growing so rapidly in importance precisely because they provide firms with the fastest way of acquiring tangible and intangible assets in different countries, and because they allow firms to restructure existing operations nationally or globally to exploit synergies and obtain strategic advantages. In brief, cross-border M&As allow firms rapidly to acquire a portfolio of locational assets, which has become a key source of competitive strength in a globalizing economy (UNCTAD, 1995a).

The fact that a considerable part of the current expansion of M&A activity consists of major deals in industries in which a limited number of companies dominate the market, leading to a consolidation at the regional or global level, suggests that strategic interactions among the leading firms also play an important role. Indeed, under conditions of strategic interdependence and uncertainty, once the established equilibrium is disturbed by the move of a major player (say, to acquire a foreign company) it can be expected to have a strong impact on key competitors and to trigger a chain reaction of countermoves at both

FIGURE V.1

The driving forces of cross-border M&As



Source: UNCTAD.

domestic and international levels by rivals anxious to protect their positions (Schenk, 1996).[26] By pursuing a merger or acquisition, management minimizes the largest possible regret, which occurs when *ex post* successful moves by other players have not been imitated, or when they themselves become a target for a takeover. Thus, even firms reluctant to pursue this course may be forced into it for fear of becoming an acquisition target themselves. Such pre-emptive actions can be intended to create "strategic comfort" rather than shareholder value or economic wealth (Schenk, 1999). Moreover, if they do not move quickly enough, there may be fewer desirable partners left. By moving, however, they will help amplify a merger wave that has just started.

Like most previous major M&A waves, the current M&A boom has coincided with strong economic growth and buoyant stock prices. This suggests that the present level of M&A activity is likely to be affected by changes in the business cycle, by stock market corrections and by possible interventions by antitrust authorities.[27] However, as long as changes in the business environment continue to facilitate cross-border M&As – indeed, compel firms to pursue them – the volume of cross-border M&As may well oscillate over time, but it can be expected to do so on an upward trend.

D. An intriguing historical parallel

Major changes in the ownership structure of firms by means of M&As are not a new phenomenon. In fact, one of the largest and most significant waves of M&As in history took place in the United States around the end of the nineteenth century, reaching its climax between 1898 and 1902 (Chandler, 1990). During these five years, firms accounting for perhaps as much as one-half of the United States manufacturing capacity were involved in M&As (Bittlingmayer, 1985). That wave radically changed the industrial structure of the United States, setting the stage for the role of "big business" in United States industry in the twentieth century. National Biscuit, US Steel and International Harvester were among the many firms born out of the M&As that took place during this boom.

What were the main factors behind the wave of the end of the nineteenth and early twentieth century in the United States? Is it possible to draw parallels between it and the current worldwide increase in cross-border M&A activity? The two waves do seem to have much in common.

1. Factors behind the United States wave at the turn of the past century

There have been many attempts to explain this United States merger wave, and several major driving forces have been identified.[28] The main factors are related to important changes in the business environment that set off a series of corporate responses. These changes fall into three categories: technology, financial markets and regulatory factors.

- **Technology.** The United States M&A boom coincided with the overlap of two "long waves" of technological development. The last quarter of the nineteenth century marked the end of one long wave, which included the development of steam power, the railway and the telegraph, and the beginning of the next: the rise of electrical and heavy engineering (Freeman and Perez, 1988). The growth of the railroad and telegraph network significantly reduced information and transportation costs and brought firms from various regional markets together in direct competition in a single national market, increasing the incentives for firms to enhance their market power (Bain, 1944). The electrical and heavy engineering industries opened the way for the development of a variety of new products, as well as significant innovations in the production process, with unparalleled cost advantages through economies of scale and scope in production and distribution as a result. These innovations led to the creation of new industries and the transformation of many old ones. Thus, technology affected acquisitions in two ways. First, lower costs of transporting goods and people and of communicating over long distances made it possible for firms to compete in a larger national market, and to seek the benefits from economies of scale and grasp first-mover advantages in building a national production system. Second, new industries were born out of technological progress and firms in traditional industries were forced to respond to new production and market opportunities, often through consolidation.

- **Financial markets.** The second factor relates to changes in capital markets and the way investment was financed. Prior to

the M&A wave, most new enterprises relied on local businesses and venture capitalists for the initial capital, and on local banks for working capital. At the end of the nineteenth century, new ways of financing were introduced as investment bankers, especially those experienced in railroad finance, became increasingly more involved in instigating and financing industrial M&As.[29] At the same time, the organized securities exchanges emerged as important institutions in the financial market. During the M&A wave, which was then characterized by a buoyant stock market, large-scale consolidations were greatly facilitated by the exchange of shares, which became the predominant mode of financing major M&As.

- **Regulatory factors.** This third category of explanatory factors concerns changes in the legislative environment concerning, in particular, competition and incorporation laws. The most important was the passage of the Sherman Antitrust Act in 1890 and a number of subsequent court rulings. The Sherman Antitrust Act was passed in response to widespread anti-competitive collusion between manufacturers in many industries in the last quarter of the nineteenth century, first through informal agreements on price and output and then formalized in trade-association cartels.[30] While a series of Supreme Court rulings between 1895 and 1899 established that close inter-firm cooperation through trade associations was anti-competitive and actionable under the Act, M&As remained unchallenged by the courts until 1903.[31] This window of opportunity, together with increasing difficulties in enforcing contractual agreements by trade associations, made M&As the main means of achieving greater market control, and hastened the transformation of trade associations into merged corporations (Chandler, 1990).[32]

  The consolidation process was further facilitated by changes in the general incorporation laws, which permitted the formation of holding companies that might operate on a national scale. In this way it became possible to centralize the administration of constituent companies and concentrate production in a small number of large plants (Chandler, 1990). Such changes were first enacted in the state of New Jersey, which, as a result, accounted for almost 80 per cent of all consolidation capitalizations between 1895 and 1904 (Nelson, 1959).

2. Parallels with the current wave

The three factors that explain a good part of the M&A wave in the United States at the end of the nineteenth century also seem to be at work today:

- **Technology.** As at the end of the nineteenth century, recent decades have been characterized by major technological change. In particular, the 1980s and 1990s witnessed the blossoming – and convergence – of information and communication technologies. Falling costs of transportation and communication, with improved telecommunications and the internet, again led to an expansion of the markets in which firms act, this time involving many national markets, and allowing them to manage worldwide production systems. The new information technologies are prompting firms to merge in order to find new solutions in areas such as electronic business, the development of new products and services and the integration of different lines of business. At the same time, firms in traditional industries characterized by excess capacity, slow growth and greater domestic and international competition, are consolidating in order to attain a stronger global market position and to exploit economies of scale in various activities.

- **Financial markets**. Both waves were facilitated by developments in financial markets. In the current wave, the sweeping liberalization of capital movements has been crucial. In both cases, changes in the ways M&As were financed played an important role. For instance, while the evolution of the securities market opened the possibility of financing M&As through an exchange of shares in the United States wave, the liberalization of foreign ownership of shares has facilitated the financing of international M&As through stock swaps.

- **Regulatory factors.** Undoubtedly, like the end of the previous century, the end of the twentieth century also witnessed significant adjustments in the regulatory environment facilitating M&As, albeit of a different character. Whereas in 1898-1902, it was the interpretation of the 1890 Sherman Antitrust Act that barred cartel agreements, but did not bar M&As that had encouraged

consolidation, the recent wave of M&As has been made possible by the worldwide liberalization of FDI and trade regimes, deregulation and privatization (described earlier in this chapter), which create more space for undertaking M&As and allow the organization of international production systems. At the same time, international production is more protected and facilitated through bilateral, regional (including in particular the formation of the EU single market) and multilateral agreements.

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To conclude, there are indeed interesting parallels between the two merger waves. Common denominators are increased competition and major changes in the economic and government-business environment facing firms that have triggered corporate responses on a large scale. First, both waves were enabled by a combination of a significant lowering of technical barriers to wider geographic investment and trade, and technological change permitting reductions in the costs of transportation and communication and more integrated management of dispersed production facilities. In both periods, such circumstances led to increased competition and price pressure favouring consolidation.[33]

Second, new ways of financing M&As evidently played an important role in both cases. In particular, changes in the financial markets enabled firms to finance M&As using stock swaps instead of cash, nationally in the United States case, and internationally in the past decade. Third, each of the two waves was made possible by more permissive regulatory frameworks.

In the case of the United States, the M&A wave at the end of the nineteenth century helped to give birth to a national market and production system. It may well be that, what is occurring today as part of a secular trend towards more cross-border M&As, is the emergence of a global market for enterprises, as a complement to growing regional or global markets for products and services and an emerging international production system.

Notes

1 See, e.g. “Marrying in haste”, *Financial Times*, 12 April 2000.

2 See Jensen and Ruback (1983), Mueller (1996), Sirower (1997) or Bild (1998) for surveys of several studies.

3 Positive impacts on the share prices of the acquiring firm were observed by e.g. Asquith et al. (1983) and Franks and Harris (1989).

4 See e.g. Morck et al. (1991), Singh and Montgomery (1987), Kitching (1967), Kusewitt (1985) and AT Kearney (1999).

5 See e.g. Elgers and Clark (1980), Lubatkin (1987), Shelton (1988), Hunt et al. (1987) and Lahey and Conn (1990).

6 For example, studying 276 United States international acquisitions made in the period 1975-1988, a positive impact on the market value of the bidding firms was found (Markides and Ittner, 1994). In the case of 103 German M&As during 1994-1998, deals concluded with an international partner typically resulted in rising share prices of the acquiring firm while 43 per cent of domestic M&As experienced reductions in share values (Jansen and Körner, 2000). United States firms were also found to provide poorer results through domestic M&As compared with foreign M&As by United States firms during the period 1978-1986 (Morck and Yeung, 1991). A similar conclusion was drawn in a more recent study (Morck and Yeung, 1999).

7 See e.g. Schenk (2000) and Cakici et al. (1996). Eun et al. (1996) concluded that, while Japanese acquirers benefited substantially from acquiring United States firms, British acquirers experienced wealth reductions.

8 The use of accounting data is not without problems as firms can use various measures to manipulate published accounts.

9 Another study of United Kingdom M&As, from 1955 to 1970, using a three-year horizon, showed that the profitability of assets of combined firms was not significantly different from that of firms that did not engage in M&A activity (Singh, 1975).

10 While the bulk of the empirical studies are based on United States data, European studies tend to confirm these results (Mueller, 1980a).

11 See e.g. Lichtenberg and Siegel (1987) and Lichtenberg (1992).

12 See e.g. Ravenscraft and Scherer (1987), Scherer and Ross (1990) Hopkins (1999), Mueller (1980a), and Brealey and Myers (1988) for a discussion on different motives for M&As. The topic has also been

discussed by civil society, for example by NGOs such as the Consumer Unity and Trust Society of India (CUTS, 1999).

13 In some cases, a joint venture or strategic alliance may offer alternative ways for firms to access specific proprietary assets of other companies.

14 R. K. Krishna Kumar, Vice-Chairman, Tata Tea Ltd., at the UNCTAD Expert Meeting on Mergers and Acquisitions: Policies Aimed at Maximizing the Positive and Minimizing the Possible Negative Impact of International Investment, Geneva, 19-21 June 2000.

15 This does not mean that big is always better. For example, in innovation-driven industries characterized by rapid change, large organizations can be at a disadvantage vis-à-vis smaller entities in terms of creativity and flexibility.

16 The average interest rate paid by United States corporations was reduced by approximately 0.46 percentage points with each tenfold increase in company size (Scherer et al., 1975).

17 See, for example, Myers and Majluf, 1984.

18 For instance, while the main reason to allow the merger between two Brazilian companies, Companhia Cervejaria Brahma and Antarctica, in spite of their large market shares, was that significant cost reductions associated with economies of scale were sufficiently high to make it plausible to assume that the net effect on social welfare would not be negative, another argument that was influential in the debate was to let a national champion emerge that could be competitive in the regional market.

19 This conflict is particularly pronounced in so-called "outsider systems" of corporate governance with strong managers and widely-dispersed weak shareholders (Maher and Andersson, 1999).

20 This is reflected e.g. in the fact that firms pay retention bonuses to key staff in the case of some M&As.

21 For example, as a result of the merger between Astra (Sweden) and Zeneca (United Kingdom), the corporate headquarters was located in the United Kingdom, while responsibility for corporate R&D was placed in Sweden.

22 The survey of the literature was based on Andean Community General Secretariat, 1999; Asia-Pacific Economic Cooperation Secretariat, 1999; Association of South-East Asian Nations Secretariat, 1998; Economist Intelligence Unit, 1999; International Monetary Fund, 1999b; Lang, 1998; Tradeport, 2000; UNCTAD, 1999d, 1993, 1999f; United States Trade Representative, 2000; World Trade Organization, 1999. Information was also collected at the websites of the East-Weat Association (http://www.ewba.org/regional.htm), the Investment Promotion Network (http://www.ipanet.net) and the Organization of American States (http://www.sice.oas.org/trl_e.asp).

23 Since the end of October 1997, foreign firms, in Zones 1 and 2 can get approval from the Board of Investment to change their equity ownership to majority or 100 per cent control, if local shareholders agree. Between November 1997 and March 1999, 253 companies applied for permission to increase their ownership share (Brimble, 2000).

24 It is estimated that about 70 countries today have adopted mandatory or voluntary antitrust merger notification systems. For more information, see UNCTAD (2000f).

25 See in this context the OECD Principles of Corporate Governance contained in UNCTAD (2000a), volume IV.

26 An illustrative example of the role of strategic countermoves was the concentration of deals in a short period of time in the aluminium industry in 1998. The announcements of Alcan Aluminium's acquisitions of Indian Aluminium and Ghana Bauxite in March 1998 were, within five months, followed by another 13 cross-border deal announcements in the same industry.

27 The outcome of the merger reviews in the case of WorldCom and Sprint by the competition authorities in both the United States and the European Union may for example have a chilling effect on future M&As.

28 See e.g. Moody (1904), Watkins (1927), Bain (1944), Nelson (1959), Bittlingmayer (1985), Lamoreaux (1985) and Chandler (1990).

29 These included financial institutions like the railroad financiers J. P. Morgan & Co. and Kidder Peabody, as well as National City Bank and First National Bank of New York. Sometimes manufacturers financed their own mergers, as with Standard Oil and Du Pont.

30 For example, in the United States hardware industry alone, there were more than 50 cartels for as many specialized product lines (Chandler, 1990).

31 In 1903, a circuit court decided in the Northern Securities case (upheld by the Supreme Court in 1904) that M&As were not exempt from the Sherman Act.

32 In more than a quarter of all consolidations between 1895 and 1904, ten firms or more were simultaneously involved in mergers (Nelson, 1959).

33 For a discussion of the role of increased price competition in the United States wave a century ago, see Lamoreaux (1985).