Chapter

# VI FDI and Development: Does Mode of Entry Matter?

## Introduction

Cross-border M&As, particularly those involving large firms, vast sums of money and major restructurings, are among the most visible faces of globalization. Not only do they dominate FDI flows in developed economies, they have also begun to take hold as a mode of FDI entry into developing and transition economies (chapter IV). As with globalization generally, the impact of M&As on development can be double-edged and uneven. Indeed, perhaps to a greater extent than many other aspects of globalization, cross-border M&As and the expanding global market for firm ownership and control in which they occur — raise questions about the balance of their benefits and costs for host countries. These questions arise despite the generally welcoming attitude towards inward FDI.

Concerns are expressed in political discussions and the media in a number of host countries that acquisitions as a mode of entry are less beneficial for economic development than greenfield investment, if not positively harmful. At the heart of these concerns is that foreign acquisitions (mergers, as noted in chapter IV, are rare in developing countries and economies in transition) do not add to productive capacity at the time of entry, but simply transfer ownership and control from domestic to foreign hands. This transfer is often accompanied by lay-offs and/or the closing of some production or functional activities (e.g. R&D); it entails servicing the new owner in foreign exchange; and, if the acquirers are global oligopolists, it may well lead to market dominance. In fact, cross-border M&As can be used to reduce competition in domestic markets. They can lead to strategic firms or even entire industries (including key ones like banking) falling under foreign control, threatening local entrepreneurial and technological capacity-building. The concerns are not only economic, but also social, political and cultural. In industries like the media and entertainment, M&As may seem to threaten national culture or identity. A large shift of ownership of important enterprises from domestic to foreign hands may even be seen as eroding national sovereignty and amounting to recolonization.[1] When the acquisitions involve "fire sales" — sales of companies in distress, often at prices viewed as abnormally low — concerns become particularly acute. All these concerns can create the impression that greenfield FDI is "good", while FDI through cross-border M&As is "bad".

All of these concerns are further accentuated when they are placed in the broader context of globalization, rapid change, marginalization of some economies or groups within economies, and increasing inequality. (Witness the protests against various symbols of globalization.) TNCs are thought to benefit disproportionately from globalization, while local SMEs in developing countries are perceived as being affected adversely. M&As, particularly in their cross-border form, appear to be little more than a vehicle for the expansion of big business.

Concerns over cross-border M&As are by no means confined to developing countries. They are also expressed in many developed countries, sometimes more vehemently. When Japanese investors acquired Rockefeller Center in New York City and film studios in Hollywood, the United States media reacted with indignation.[2] More recently, when Vodafone AirTouch (United Kingdom) sought to acquire Mannesmann (Germany), there was again indignation in some quarters. While nationalistic reactions to foreign takeovers are diminishing in force, they can be strong enough to lead host governments to intervene, particularly if takeovers are hostile.

A dispassionate analysis of the effects of M&As on development is therefore needed to throw light on the validity of these concerns, and especially on the validity of the view that greenfield FDI is better than FDI through M&As. Such an analysis must be based on an understanding of the driving forces of cross-border M&As and their global context, in particular, the emergence of a global market for firms. (This context and these forces have been discussed in the preceding two chapters.) The present chapter examines the impact of FDI through M&As on the development of host countries. The starting point is the impact of FDI in general on different areas of development, as identified in *WIR99* (UNCTAD, 1999a). The chapter then goes on to compare the impact of FDI through M&As with that of FDI through greenfield ventures and, where differences exist, suggests policies that could reduce the negative effects while strengthening the positive ones. Although direct investors sometimes have a real choice between entering a host country through greenfield FDI or entering it through M&As, the two modes are not always realistic alternatives — as when a telecommunication network is privatized or a large ailing firm needs to be rescued, and no domestic buyers can be found[3] (box VI.1). Hence the discussion below also considers situations in which M&As are the only realistic way for a country to receive FDI,[4] focusing on how M&As affect the performance of the acquired enterprise and the host economy.

Of course, in principle, both host countries and TNCs have other options. For countries, the priority is, in any event, to stimulate domestic investment and enterprise development, since FDI can only be a complement to domestic efforts. They can encourage domestic M&As (box VI.2) and establish public enterprises. They can also obtain international resources through strategic alliances, other non-equity arrangements for inter-firm cooperation and, of course, arm's

**Box VI.1. To what extent are greenfield FDI and cross-border M&As alternatives?**

A comparison of the impact of FDI through cross-border M&As with that of greenfield FDI assumes that the two modes of foreign entry constitute alternatives from the perspectives of both host countries and TNCs. In principle and even in practice this may be the case, but they are rarely perfect substitutes for each other. From a host country's perspective, substitutability depends on its characteristics, including its level of economic development, FDI policy, the institutional framework and specific circumstances.

***Level of economic development***. While both modes may be options in developed countries with a large pool of strong private enterprises and well-functioning markets for corporate control, this is not always the case in developing countries and economies in transition. For example, M&As are typically not a realistic alternative to greenfield investment in the least developed countries, in which investment opportunities may exist but there are few firms to acquire. In other developing countries with a more advanced industrial sector and more developed capital markets, the acquisition of a local firm can represent a realistic alternative to greenfield FDI. Mergers between local firms in many developing countries and developed country firms are typically not feasible because of large differences in size, technology or management experience. In general, the higher the level of development of a host country, the larger the supply of firms that may be targeted for cross-border M&As.

***FDI policy***. Another obvious prerequisite for cross-border M&As is that they have to be permitted by the national regulatory

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**Box VI.1. To what extent are greenfield FDI and cross-border M&As alternatives? (concluded)**

framework. The liberalization of FDI regimes has gone far, and most countries now actively promote the inflow of FDI. In many cases, liberalization applies to both greenfield FDI and cross-border M&As. However, in a number of developing countries, foreign takeovers are *de facto* (if not *de jure)* restricted. Even in some developed countries, authorization is needed for the acquisition of companies in certain industries. Policy liberalization as regards foreign acquisitions has been shown to have a strong impact on the pattern of inward FDI in countries with a strong industrial base. In Argentina, for example, cross-border M&As accounted for almost 60 per cent of total FDI inflows between 1992 and 1999. While privatization was initially responsible for the bulk of M&As, foreign acquisitions of private firms have gradually increased in importance, accounting for more than one-third of total inflows between 1996 and 1998 (Chudnovsky and López, 2000).

***Institutional framework***. The balance between cross-border M&As and greenfield FDI is also related to the institutional environment. For example, even among developed economies, the use of M&As is affected by differences in corporate governance and ownership structure. These help to explain the diverging patterns of M&As in the United States and the United Kingdom, on the one hand, and Germany and Japan on the other. In developing countries, underdeveloped asset markets and poor accounting standards may make it more difficult to assess accurately the value of corporate assets.

***Exceptional circumstances.*** Examples include financial crises (as in Asia in 1997-1999) and large privatization programmes (as in Latin America or Central and Eastern Europe). Both produce, though for different reasons, a large one-off supply of firms in financial or competitive trouble. In both sets of circumstances, policy-makers have welcomed the cross-border acquisitions of local enterprises: greenfield FDI could not in these circumstances play the role of cross-border M&As in rescuing ailing companies and restructuring state-owned firms.

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To sum up, even though there are a number of situations in which the two modes of FDI entry are not realistic alternatives, they remain alternatives often enough to justify the comparison of their impacts on development. From a host-country perspective, this also means that host countries can influence both forms of entry through various policy measures. Such measures, however, should be based not only on a realistic assessment of a host country's locational advantages, but also on an awareness of factors guiding firms' choices.

Firm-level factors were discussed in greater detail in chapter V. They can vary from industry to industry, depending on market structure and industry characteristics. High market concentration and high barriers to entry limit the probability of greenfield investment. This is the principal reason why, in such service industries as telecommunications, power generation and financial services, cross-border M&As are a predominant mode of entry. Similarly, in industries characterized by slow growth or excess capacity, firms are not likely to add new productive capacity, if they can acquire existing assets. It should be noted that the market power of existing firms can be affected by the introduction of new technology (like cellular phones in telecommunications) or through regulatory changes leading to a removal of barriers to entry and increasing the scope for greenfield investment.

The emergence of a knowledge-based economy and the liberalization of markets favour cross-border M&As. The former underlines the significance of skills and other knowledge-based assets for competitiveness and, consequently, leads to the increasing importance of asset-seeking FDI: of the two modes of FDI entry (leaving aside other modes and especially strategic alliances), only M&As can be used to access assets embodied in firms. The latter has increased competitive pressures, forcing firms to access assets or restructure *rapidly* and consolidate their operations in strategic response to competitors' moves, actual or expected (chapter V). As *speed* has become a critical parameter, the greenfield option is often ruled out as an entry mode at an early stage of corporate decision-making.

*Source*: UNCTAD.

length transactions. While countries need to consider these and other options, the analysis here focuses on greenfield investment vs. cross-border M&As, although other options are not neglected. In other words, the analysis takes as given a situation in which a country has decided that FDI is the preferred option, and the question is whether it matters that it is greenfield FDI or FDI via cross-border M&As.

Comparing cross-border M&As with greenfield investment often means considering counterfactuals — what might have happened if cross-border M&As had not taken place. Such a counterfactual must take account of not only the industry and host-country context, but also of the broader setting of trade, technology and competition. The fact that this setting is changing rapidly, and that these changes are driving the current surge in cross-border M&As (see chapter V), is crucial to the analysis. FDI and trade liberalization, accelerating technological change, intensifying competition and integrated production systems mean that firms — in developing as well as developed economies, large and small — must upgrade and restructure to remain competitive. Macro-economic disturbances, such as financial crises

**Box VI.2. A domestic merger: the sale of Kia Motors Corporation**

In July 1997, Kia Motors Corporation, the second largest automobile company in the Republic of Korea, ran into a serious liquidity crisis. Attempts to save it in the ensuing few months failed, and the company was put under legal custody in April 1998. Kia was one of the country's ten largest business groups before its bankruptcy. It had a relatively specialized business portfolio, including passenger cars, commercial vehicles, specialized steel products and some other small companies, and was not a typical *chaebol* in that it had no family owner with a controlling share involved in company management. Because it was run by a professional management team and was more specialized in its business portfolio, it had a good image in the Republic of Korea and was regarded as a national champion. Because of its unique position in the economy, the creditors (i.e. the major banks) and the Government hesitated about what to do with the company.

After the Asian financial crisis reached the Korean economy in November 1997 and a new President took office, the Government announced in June 1998 that Kia would be sold through an international auction. Both domestic and foreign auto companies expressed their interest in acquiring it.

Major creditor banks decided to decapitalize the existing equity of Kia and infuse new capital amounting to around Won 1-1.5 trillion. This new equity would be sold to the company acquiring Kia. In other words, the acquiring firm would buy the new equity of Kia and also assume some part of its debt. It was also decided that Kia and Asia Motors, a firm specialized in commercial vehicles, would be sold in a single deal. In the auction scheduled for 30 August 1998, five companies participated; three domestic firms (Hyundai, Daewoo and Samsung) and two United States companies (GM and Ford). The first auction failed to produce a deal because the terms of the bids offered by the companies failed to meet the condition laid out by the creditor banks. The second bidding on 25 September also failed to produce a successful bidder. By this time, GM had dropped out and only four firms submitted bids. The major problem was how much of the total debt of Kia and Asia Motors would be absorbed by the creditor banks. (The total debt amounted to Won 12.8 trillion.) After these two auctions had failed to produce a successful deal, the creditor banks further reduced the total debt to be assumed by the acquiring firm. On 11 October, Hyundai was finally selected from among four bidders because it asked for the smallest debt reduction. The deal was successfully completed in March 1999. Hyundai took over its largest competitor in the domestic market and decided to maintain Kia as a legally separate company for the time being.

This case shows that greenfield investment is not an alternative when it comes to a bankrupt company — but rescue by a domestic company may be. In restructuring failed companies in the aftermath of the Asian financial crisis, the creditors and the Government basically faced two choices, selling the company to a domestic firm or to a foreign firm. More precisely, it was a matter of selling the failed firm to an acquirer that offered the most favourable deal to the creditors.

*Source:* Jung, 2000.

(as in Asia in 1997-1999) and debt and fiscal problems (as in parts of Africa), intensify pressures on both firms and countries, making adjustment more difficult. So, too, does the need to change economic systems (as in Central and Eastern Europe). These circumstances clearly affect any comparison between the two modes of entry.

As emphasized in chapter IV, not all cross-border M&As are FDI in the normal sense. Some are portfolio investments (for measurement purposes, acquisitions of less than 10 per cent equity). Others are close kin to portfolio investments, being solely or primarily motivated by financial considerations, regardless of the equity share involved. Portfolio or portfolio-type cross-border M&As are not considered here, since the focus is on M&As as a mode of *FDI* entry. In any event, the share of portfolio and portfolio-type M&As in the total value of cross-border M&As appears to be relatively small (box IV.1 and figure IV.3). The present chapter thus focuses on the impact of cross-border M&As undertaken for *strategic* corporate reasons rather than for more or less immediate financial reasons.

Concerns as to the impact of cross-border M&As on host country development arise of course even when cross-border M&As go well from a corporate viewpoint. But there can be additional concerns arising from the possibility that M&As may not, in fact, go well. As discussed in the preceding chapter, half of all M&As do not live up to corporate-performance expectations of the parent firms, as measured by shareholder value. This may not matter for the development of host countries, especially when the performance of *acquired* firms benefits from M&As. Furthermore, greenfield investments face their own risks, and it is unclear that these are lower than those of M&As.[5] The risk of choosing the wrong target for acquisition may be greater in developing or transition economies, where corporate governance may be weak and corporate cultures different from those of acquirers from developed countries,[6] but the difficulties in maintaining or improving post-merger performance may still be smaller given the resource gap between the acquirer and the target. Resource flows are more likely to be in one direction (towards the newly acquired foreign affiliate) and the synergies between the parties may be less important.

As regards M&As that go well, efficient implementation from an investor's point of view need not, of course, imply a favourable impact on host-country development. This applies to FDI through M&As as well as to greenfield FDI. The main reason is that the objectives of TNCs and those of host economies do not necessarily coincide (UNCTAD, 1999a). In any event, both cross-border M&As and greenfield investments, regardless of whether they go well or not, can have undesirable effects on host countries. This again underlines the importance of policies to ensure that host countries benefit from FDI regardless of its mode of entry.

Apart from considerations related to whether M&As are well — or badly — done, the developmental impact of FDI through cross-border M&As — both in itself and in comparison with greenfield FDI — depends on a number of other factors. These include, in particular:

- The type of investment made through M&As and the motivation underlying it. Both direct effects and effects through linkages and spillovers vary according to whether an investment is natural-resource-seeking, market-seeking, efficiency-seeking or created-asset-seeking. Effects also depend on whether the choice of the M&A mode is based on a purely financial motivation, or on an economic one related to firm performance. In the case of purely financially motivated M&As, undertaken in the expectation of a rise in the value of the shares of the acquired firms or with a view to divesting ("stripping") some of the assets at higher prices, there may be a limited transfer of resources to the acquired enterprise, or none, or a negative impact.

- The situation of the host-country enterprises acquired through M&As. This factor influences the outcome in interaction with the investors' motivations. If M&As involve the purchase of competitive firms with a view to exploiting their assets for the benefit of an acquiring TNC, asset transfer to the host economy might be limited. But this need not exclude other benefits — those associated, for example, with more intense competition leading to more efficient local firms. The parent firm might also enhance the capabilities of its newly acquired affiliate, e.g. by giving it a world product mandate. On the other hand, if firms are purchased because they are not competitive, a transfer of additional assets to the acquired firm can take place. In many developing countries and, especially, economies in transition, the supply of competitive firms with capabilities similar to those of developed-country firms is limited, leaving ample room for substantial resource inflows through cross-border acquisitions.

- The environment in which an investment through M&As is made. Here the key factor is whether M&As take place in an industry or an economy with a robust, dynamic and expanding market, or in a static, stagnant or declining one.

- The time-frame within which the impact is considered. Effects at the time of entry may differ significantly from subsequent ones.

All of these factors will be examined below as appropriate. The discussion is organized into sections by the areas in which FDI most affects development (UNCTAD, 1999a): financial resources and investment; technology; employment and skills; export competitiveness; and market structure and competition. For each, the examination begins with a stylized summary of the general impact of FDI based on the discussion in *WIR99.* It goes on to consider the differences in impact of the two modes of entry and the impact of M&As on their own where greenfield FDI is not feasible. The analysis is often conceptual, but draws on empirical evidence and experience whenever possible. It concludes with an exploration of the policy implications in each area. The final section provides a summary and conclusions which also touch on the broader impact of cross-border M&As and policy implications.

## A. External financial resources and investment

In various ways FDI affects resource flows and investment in productive capacity in host countries (box VI.3). The flows of capital and income arising from the activities of foreign affiliates also affect the balance of payments and the allocation of benefits from foreign investment between host countries and foreign investors. In the discussion below the effects on financial resources and investment are considered separately.

### 1. External financial resources

Investment through cross-border M&As adds to the financial resources of a host country at the time of entry,[7] as does greenfield FDI, to the extent that neither is financed by locally raised capital. Inflows of FDI via greenfield projects manifest themselves in new production facilities, while those via M&As transfer the ownership of local assets to foreign hands, placing investible resources in the hands of the former local owners in the form of cash or disposable shares. The effect on financial inflows is the same if the size of the TNC investment is identical. Both can result, in due course, in profit outflows and repatriated capital. (The question of whether or not the investible resources are actually invested is discussed below.)

There may, however**,** be two sorts of differences between the financial impacts according to the mode of entry. The first relates to the exchange-rate impact of the flows, particularly in the initial period. A foreign merger or acquisition typically places resources in the hands of the local owners of a firm *immediately*,[8] while the inflows involved in setting up new facilities in a greenfield project may take the form of "in kind" contributions, and a cash inflow may be spread over time and recipients. If a transaction is large, the former may, in the absence of appropriate policy measures, create greater pressures on the domestic currency than a greenfield investment of the same volume, leading to currency appreciation. Privatizations involving foreign buyers are a typical case in which the exchange rate may be affected by such sudden inflows. Intervention by monetary authorities via open market transactions and sterilization measures can neutralize most of the negative impact (currency appreciation with a negative impact on international balances and export performance, or inflation).[9] These actions have to strike the right balance between the costs (for example, the interest to be paid by the central bank on the financial instruments used to absorb excess foreign capital inflow) and the benefits (the avoidance of major disturbances in the domestic economy) of such intervention.

## Box VI.3. FDI, external financial resources and investment

FDI affects the volume and characteristics of investible financial resources and actual investment in host countries. It also affects the balance of payments of host countries and the division of benefits from investment between them and other countries.

***External financial resources for development.*** The net impact of FDI on the quantum of capital flows to developing countries is usually positive: it increases the inflow of foreign financial resources available for investment. Inflows of FDI have become the single most important source of private foreign savings for developing countries as a group (chapter I). The impact over time depends on the amount of capital brought from abroad by TNCs (equity inflows paid in "cash" and funds raised directly from international capital markets) less the volume of FDI-related financial transfers abroad (intra-company and other loan repayments and repatriated capital and profits) from the host country. During 1991-1997, each dollar repatriated from developing countries was matched by three dollars of new inflows.

As a source of finance FDI offers certain advantages over other sources of foreign finance to developing host countries. It has proved to be more stable than other types of financial flows, as reflected in the Asian financial crisis and the Mexican crisis of the mid-1990s. Direct investors show a longer-term commitment to host economies than lenders (particularly short-term lenders) and speculative portfolio investors. FDI is also easier to service than commercial loans, since profits tend to be linked to the performance and business cycles of the host economy. A part of FDI inflows, however, can be driven by short-term financial motives and thus behave just like speculative portfolio investments.

As a source of external finance, FDI complements domestic savings and contributes to growth through the indirect or direct financing of investment. An excess inflow of FDI (or any other type of capital inflow) in a short period may lead to the appreciation of the exchange rate of the national currency and reduce the competitiveness of exports, thus leading to the reduction of investment in export industries. It is also possible that FDI could effectively substitute for domestic savings, resulting in their reduction and enabling increased consumption or leading to capital flight under certain condition. In the second-round effects, the increased consumption could induce an increase in investment through the accelerator effect. Unless there is unemployment and excess productive capacity to be utilized, this could bring the risk of overheating.

A profitable FDI project, with profits repatriated in foreign exchange, must necessarily result in greater *balance-of-payments* outflows than an identical national project financed locally. There are many projects, however, that can be undertaken only by foreign investors, or not at all, or could not be undertaken at comparable levels of efficiency by domestic firms. Moreover, comparisons of financial inflows and outflows cannot capture total balance-of-payments effects. This can only be done by evaluating the effects of all outputs and inputs. Whether FDI has a positive or negative impact on the host country's balance of payments depends on the following factors: the size of FDI inflows, net of disinvestment; outflows of direct investment income; the export and import propensities of foreign affiliates; the indirect impact of FDI on foreign-factor income outflows; the indirect impact of FDI on the export and import propensities of domestic firms; and the indirect impact of FDI on import demand by consumers in the host country.

The balance-of-payments effects of FDI and the country distribution of the value added by foreign affiliates can be affected by *transfer pricing* — the pricing of intra-firm transactions across national boundaries. TNCs have frequently considerable freedom in assigning prices in these transactions, particularly when there are no arm's length prices to serve as reference. This allows TNCs to shift profits between countries to lower their tax burdens or escape other restrictions on repatriating or declaring profits. The risk of unacceptable transfer pricing rises when there are large differences in tax regimes between countries and there are no double-taxation agreements in force. Concern about transfer pricing, greatest in the 1960s and 1970s, has declined as tax differences have narrowed, double-taxation agreements have proliferated and the desire to attract FDI has become widespread. Efforts to counter transfer pricing are now undertaken primarily by the tax authorities of major home countries like the United States and Japan.

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Secondly, there can be an important difference between the financial impacts of the two modes because cross-border M&As involve the *pricing* of firms. This is driven by many factors (box VI.4), and can raise problems. (Greenfield FDI does not normally raise issues concerning the value of the facility set up.) If an enterprise is sold at a price below its "correct" (social) price, there is a loss to the host economy.[10] The pricing of cross-border M&As may raise three sorts of problems:

- Under certain conditions, as when equity markets are underdeveloped or economic systems are in transition, it may be difficult to price assets correctly (box VI.4). Experience in economies of Central and Eastern Europe shows, for example, that, in the absence of capital markets or reference prices, there can be major problems in pricing the assets of state-owned enterprises. This increases the chances of a wrong valuation, and the prices received may be higher or lower than in the perceived valuation of a comparable greenfield project. The possibility of undervaluation increases if the negotiating position of the host country *vis-à-vis* foreign investors is weak, or if the host country does not make potential investors compete through bidding (Samonis, 2000). A careful consideration of the social benefits and costs to the host economy from FDI in a privatized enterprise is necessary to arrive at the right price. The way the bargaining process is carried out by privatization agents also influences the price. Much depends on their expertise, efficiency, honesty and independence. The right management of the privatization process involving FDI requires many skills, especially in M&A techniques. After all, privatizations are just a variant of M&As.

- Pricing problems may arise even when there are active equity markets, if financial or other crises lead to firms being significantly under-valued. This allows foreign entrants to acquire them very cheaply. In the Asian crisis, the complaint was frequently voiced that foreign investors were able to snap up local firms at "fire sale" prices. While it is true that many firms were sold below what their sellers (and in some cases, buyers) considered their long-term value (Zhan and Ozawa, 2000), that may have been the only alternative to bankruptcy in some instances. In a number of cases, cross-border M&As served to save firms that could not raise finance elsewhere and added to foreign exchange resources in the host economy, an unlikely contribution from greenfield FDI in times of crisis. Under normal circumstances, the firms would not have needed a capital injection, or the financial system may have been able to provide additional liquidity. But the crisis-hit countries were caught in a severe credit crunch and many firms did not have the option of raising finances from local or international lenders. There could also have been additional gains from such cross-border M&As if the M&As had led to a restructuring of the acquired firms.

  Cross-border M&As during a crisis may result in a net gain to a host economy even if the investors were to sell their

**Box VI.3. FDI, external financial resources and investment (concluded)**

***Investment.*** Typically, FDI adds to productive capacity in a host country through the investment expenditures of affiliates. The value of investment expenditures by foreign affiliates is not necessarily the same as that of FDI inflows, since resources can be raised in local and international capital markets. Data on United States FDI abroad suggest that capital expenditures by foreign affiliates in host countries usually exceed the value of FDI inflows. FDI may also affect the volume of host-country investment indirectly by crowding in (stimulating entry of) or crowding out (inducing exit of) domestic investment. Either is possible, depending on the activities undertaken by TNCs, the strength of local enterprises and the functioning of local factor markets. TNCs may crowd in domestic investment when they introduce new goods and services to the host economy, create local supply links and do not pre-empt local credit. They may crowd out domestic enterprises by entering activities already populated by local firms in which there is little room for further expansion, in which domestic firms are unable to compete with the foreign affiliates, or by using their size and "bankability" to gain privileged access to local capital markets.

*Source:* UNCTAD, 1999a.

acquisitions for a profit when markets recovered. This would be true if the profits made from the financial transactions were lower than the loss the economy would have suffered from the closure of the firms involved. There is little evidence to suggest, however, that most M&As in Asia were undertaken for short-term financial reasons (Zhan and Ozawa, 2000). It may be argued that a better option would have been for governments or international institutions to provide liquidity to the stricken firms and so prevent fire sales, or to allow a debt standstill supervised by

**Box VI.4. Is there a correct price in privatization-related M&As?**

The correct market price of any productive asset is the present discounted value of future earnings adjusted for risk. This is "correct" in theory, assuming perfect foresight, full information on earning potential (including the impact of technological changes), no externalities (so that the private and social values of future earnings are equal) and no policy changes. Capital markets in developed countries provide a rough approximation in normal times, based on the existing prices of comparable assets and an assessment of technical change and other market imponderables. Even in these countries, M&As face pricing problems inherent in all asset pricing, and they are aggravated when they involve privatization. The difficulties are compounded when the firm being privatized is a utility with a local monopoly in a country without a functioning capital market. In privatization in a transition or developing economy, there may be no capital markets to throw up a comparable price or provide expert opinion on earning prospects.

There are two sets of factors affecting the price-setting process in privatizations:

- ***The economic and political setting.*** The risk element in pricing is affected by political and economic stability and general attitudes to FDI and privatization. The country "image" may affect not just prices, but also the numbers and origins of potential investors. A host country with a low rating as an investment destination may attract marginal players who in the long run perform badly. The nature and credibility of the policy reform process within which privatization takes place also affect risk. The strength and efficiency of the legal and judicial system of intellectual property protection and of the financial system will all affect prices. Broadly speaking, a clear political commitment to strong rules of the game may result in higher general prices, but there may well be circumstances outside a government's direct control, e.g. pressure from neighbouring governments when strategic assets are involved.

- ***The privatization process***. There are many ways to "create" a market for an enterprise being privatized. The best way is to get a large number of competitive bids from a variety of firms (domestic and foreign) and, if foreign firms are the only contenders, from established and trustworthy TNCs. Where the objective is to get a strategic partner with specific technological or other assets, however, there may need to be a trade-off between the up-front price and other conditions. For example, the privatization of telecommunications companies to foreign strategic investors has generally been by means of "controlled auctions" designed to achieve the highest possible price for the shares sold, from a limited number of pre-selected candidates that meet pre-established criteria. The price also depends on the market position of the enterprise being sold and the regulatory framework in place if it is a natural monopoly or oligopoly. It is further affected by prior restructuring and the performance conditions attached to the sale. (The less — or less efficient — the restructuring and the stronger the conditions, the lower the price.) The bargaining process itself is critical. The managers and workers of the firm being sold can become an important pressure group affecting a sale, influencing the choice of partner, the performance conditions, and the the price. Sophisticated privatization operators use complex computerized optimizing techniques to evaluate bids. The buyers will use advanced techniques and high-powered teams in their turn — in addition, of course, to good old-fashioned pressure, lobbying, mystification and threats.

*Source:* UNCTAD.

adequate bankruptcy procedures. This option, however, was typically not open in the depths of the crisis: in a number of cases, M&As appeared to be the only solution, as not enough additional liquidity was available through official or banking sources.

- Another risk of M&As is that, during normal situations and with active stock markets, they allow for asset stripping. The acquired companies can be broken up by corporate raiders and their component parts sold off at a profit. This can have a further impact on financial resources, because the proceeds of asset sales can be repatriated to home countries. Asset stripping is often regarded with disfavour as it may involve speculation and financial manipulation for quick profit, with destructive effects on productive capacity. Indeed, it may be harmful if viable firms are bought, dismembered and sold off by entrants who do no restructuring or rationalization.[11] Certain types of asset stripping can, however, also serve a useful function. If asset stripping occurs when firms are managing their assets badly and places the viable assets under better management while disposing of the unviable ones, it improves the use of productive assets. In the case of privatization, asset stripping can be guarded against by governments retaining "golden shares" to enable them to influence or even veto corporate decisions they consider undesirable.

The impact of profit repatriation and transfer pricing on financial flows and the balance of payments of a host economy may differ according to the mode of entry. On the one hand, outflows of earnings are likely to begin sooner with M&As than with greenfield FDI when the acquired firm is profitable — though they may take longer where an affiliate has to be restructured. On the other hand, the scope for transfer pricing may be higher in greenfield projects than in cross-border M&As, at least initially. A parent firm may have greater leeway in setting intra-firm prices in greenfield ventures, since in M&As reference prices may be available from earlier transactions (that now become intra-firm). But this difference is unlikely to be very large, and it will most likely diminish over time. When a joint venture between local and foreign investors is taken over by the latter, the scope for transfer pricing may increase with the shift of control over the foreign affiliate and its transactions to foreign owners.

## 2. Investment

As discussed, under normal conditions, there is little difference in the direct impacts of FDI through M&As and greenfield projects on absolute inflows of external financial resources. However, effects on host-country capital formation may differ under the two modes for given amounts of FDI. Greenfield FDI takes the form of a direct addition to host country production facilities once a project is completed, while M&As provide funds to local interests. Whether or not these funds are actually used for productive new investment depends on other factors. Where the investment opportunities exist, it is likely that productive investment will follow. In the case of privatization, one way to deal with this problem is that funds received are immediately deposited in an investment account of the acquired company, dedicated towards new investment (box VI.5).

Over the longer term, there is no reason to expect any difference in the impacts on capital formation of the two modes of entry. Both forms can be accompanied or followed by new (sequential) investment. Evidence from developing countries shows that sequential investment after cross-border M&As can be sizeable — so sizeable that a study of foreign acquisitions in Argentina (dominated by privatizations) and Chile (dominated by acquisitions of privately-owned companies) questions the distinction between the two modes of entry as regards their impact on investment. To quote:

> "One of the more interesting survey results is that the frequent distinction between the purchase of existing assets versus greenfield investments is actually of relatively small significance in economic terms. In most instances when a foreign investor entered the host country's market through the purchase of domestic enterprises (whether wholly or through joint ventures), the initial purchase of assets ended up being only a small portion of the total investment." (Agosín, 1995, p. 3). "...During the 1990-

93 period, later investments of the privatized companies surveyed were responsible for 75 per cent of the FDI expended in further purchases of privatized assets in that country.[12] Furthermore, these same companies have additional investment plans for the 1994-96 period equal to 42 per cent of their original investments ... In the case of Chile, 10 of the 15 enterprises surveyed said that the initial investment or purchase of existing companies constituted only a small fraction of their subsequent investments" (Agosín, 1995, pp. 26).

Another study, comparing foreign acquisitions of private companies in Argentina during the 1990s with domestic acquisitions and domestic firms not participating in M&As, also yielded interesting results. It showed that increases in investments in firms acquired by foreign investors exceeded by a factor of two increases in investment in domestic M&A firms and by a factor of six those in domestic non-M&A firms (Chudnovsky and López, 2000). In Peru, 35 per cent of the FDI inflows came through privatizations and resulted in an FDI stock of $8.5 billion by the end of 1999; the new owners committed themselves to additional investments of around $7 billion for the modernization and expansion of acquired facilities (UNCTAD, 2000d). In the Republic of Korea, cross-border M&As had larger sequential investments than greenfield FDI; during the period 1997-1999, the ratio of sequential to new investments was 125 per cent for cross-border M&As and 85 per cent for greenfield investments (Yun, 2000). In many M&A cases, this is not surprising as the new owner may have to undertake substantial investments in order to revitalize existing facilities. Sometimes, the new owner can be a minority foreign shareholder in a joint venture taking over the company in order to restructure it.

Privatizations in Central and Eastern Europe have also tended to lead to large sequential investments. In many cases, such

**Box VI.5. Turning investible resources into investment: an example from Bolivia's privatization**

Bolivia privatized its long distance telecommunication company ENTEL in 1995, through an international public bidding, open to national and foreign investors. ETI Euro Telecom International (an affiliate of Telecom Italia) made the winning bid. Through the capitalization of ENTEL, it agreed to inject fresh capital equal to $610 million in the exchange for a 50 per cent of equity participation (of the newly enlarged capitalized company) and 100 per cent management control. These resources were deposited in accounts of ENTEL to be used later for investments in the modernization and expansion of the company, in accordance to investment plans and the fulfillment of technical (quality) requirements. This arrangement stipulated that the privatized enterprise could not invest abroad until it had met its commitments to expand services in rural areas and in public telephone. Priority had to be given to:

- The installation of telephone services in every community of over 350 inhabitants;
- The installation of local services in every community of over 10,000 inhabitants;
- The replacement of manual and similar telephone exchanges with digital ones; and
- A five-fold increase in the number of public telephone booths.

The privatization contract also obliged the new owners of ENTEL's to submit an updated investment programme every three months, to be verified by the telecommunication regulator (SITTEL).

ENTEL enjoys exclusivity for long-distance services and its cooperatives for local services up to end-2001, on condition that it meets the goals of expansion and service improvement. These goals, too, are monitored and certified by the telecommunication regulator.

By March 2000, investment into ENTEL had reached $469 million, i.e. more than 75 per cent of the deposited amount.

*Source:* Government of Bolivia.

additional investments were fuelled by the rapid transfer of new technologies to the new affiliates (Hunya, 1997; Estrin, et al., 1995; Carlin, et al., 1994; Rojec, 1997). An UNCTAD survey of Central and Eastern European countries found that enterprises in the sample increased their capital investments by 28 per cent per year in the period preceding and 37 per cent per year in the period following privatization.[13] In Poland, there is evidence from the early phase of privatization (1992-1994) to suggest that investment outlays by firms privatized to foreign owners were higher and grew faster than in companies privatized to local entrepreneurs (Dabrowski, 1996).

Post-M&A sequential investments therefore reflect several factors, such as the need to revive a run-down plant or to meet growing demand. But where an acquired company needs restructuring and rationalization through the elimination of inefficient activities and the reduction of employment, there may be no new investment, at least in the short-term. In more advanced host countries, an acquired firm may be highly efficient and not in need of modernization. This may explain the weak sequential investment in cross-border M&As in Canada, as well as in other developed countries, where such asset-seeking investments are common (Chudy, Dery and Zahavich, 2000).[14]

In the case of privatizations, governments of host developing and transition economies have sometimes sought commitments from foreign investors to undertake further investments in the future. In telecommunication companies, performance targets relating to the expansion and modernization of public telecommunication facilities and improved service quality are generally a feature of privatization involving a strategic investor. For example, Bolivia, the Czech Republic, Latvia and South Africa, in addition to reinvestment of the purchase price in the privatized company, required future commitments from strategic investors to satisfy targets relating to network expansion, modernization and service quality set in advance by the governments (Eisenberg, 2000). Such commitments are often made in exchange for market or other privileges as well as a reduction in the initial prices. It is also customary for the investor to be made liable for precisely calibrated penalties should it fail to reach expansion and modernization goals. Monetary penalties are, however, not intended to be so draconian as to frustrate the policy objective of expanding and modernizing the public telecommunication network as soon as practicable. Sometimes a non-monetary penalty, such as a reduction in the exclusivity period, is prescribed. A combination of monetary and non-monetary penalties were prescribed in the Czech Republic, Hungary and South Africa (Eisenberg, 2000). The evidence on the effectiveness of these commitments is mixed. In some cases they did not work (leading, nevertheless, to a reduction of the sale price) while in others they did, for example in Bolivia (box VI.5). It may well be that in some cases sequential investment would have taken place without these requirements, since, as noted earlier, such investment is quite common and sizeable in FDI related to privatization. Experience suggests, however, that most post-privatization commitments in regulated industries should be addressed through a well-designed regulatory regime based on service improvements expected from FDI rather than on privatization covenants.

What of the effects of M&As and greenfield FDI on the *crowding out* and *crowding in* of domestic firms? While an acquisition, by definition, involves the transfer of assets from local to foreign owners and so lowers the level of domestic ownership in the firm, its effects on other firms may or may not differ from those of greenfield entry. In final product markets, FDI entering through either mode may crowd out domestic firms if foreign affiliates are more efficient than locally owned firms. In fact, this may occur faster in the case of greenfield FDI, where TNCs are more likely to bring in newer technologies at the outset, than in M&As that involve taking over existing facilities. On the other hand, the acquisition of competitors in host economies can strengthen the competitive position of the firms involved, driving others out of the market (see section E below). This may more often be the case in market-seeking acquisitions than in asset- or efficiency-seeking ones. Crowding out of local firms can also occur if a foreign firm has privileged access to local factors (capital and skills) relative to local competitors, but this can occur with both modes of entry.

Case-study evidence on crowding out at the economy level (which does not distinguish between greenfield and M&A FDI) is inconclusive (UNCTAD, 1999a, pp. 172-173). In a recent study covering 32 developing countries (Agosín and Mayer, 2000), 17 showed neutral effects, 9 showed crowding out, and 6 showed crowding in. In general, therefore, there is little reason to expect a systematic difference with respect to crowding in and out between the two modes of entry.

Greenfield FDI and M&As may differ in their linkages with domestic suppliers, with different indirect effects on stimulating domestic entrepreneurship in intermediate product markets. An established local firm tends to have stronger linkages with other firms in the economy than a new foreign entrant as it takes time to establish local supply relations; these linkages are likely to persist after a merger or acquisition and may well be strengthened. A greenfield entrant, with long-standing supply links through its parent firm with enterprises overseas, may minimize transaction costs and risks by continuing to source overseas. As its information on the host country economy grows, local suppliers upgrade and/or its overseas suppliers undertake "follow on" FDI in the host country, its supply chains within the host country are likely to develop similarly to those of an M&A entrant. But linkages may not persist in acquired firms. If the local suppliers of an acquired firm turn out to be costly, unable to meet the quality and delivery needs of the acquirer or uneconomic to upgrade, they may well be replaced by foreign suppliers. In these circumstances, of course, greenfield FDI will also source its inputs abroad. Over the longer term, there will probably be no significant difference between the local linkages established by either mode of entry.

## 3. Summary

### *External financial resources*

- FDI through M&As can bring in capital faster than greenfield investment does. This may or may not be an advantage to the host economy, depending, among others, on how well the capital inflow is managed from the macro-economic point of view. M&As carry a higher risk of reduced domestic (but not necessarily total) savings, permitting higher consumption with a possibility of potential inflationary pressures on the host economy.

- The financial implications of cross-border M&As may be affected by the mispricing of assets in a host economy; greenfield FDI does not suffer from this. M&As can impose a cost on a host country when its firms or their assets are sold to foreigners "on the cheap" relative to their economic value. But, in some cases, there may be economic gains for a host economy if the alternative is bankruptcy and foreign acquisitions save or restructure troubled domestic firms. In the latter case, FDI through cross-border M&As performs a function that greenfield FDI, by definition, cannot perform.

- "Asset stripping" for short-term financial gain is another potential cost of entry through cross-border M&As. It can also lead to a faster outflow of funds.

### *Investment*

- Differences between the two modes of entry may arise from the way the financial resources provided are used. In greenfield FDI, they are necessarily invested in the plant set up by a TNC. Proceeds obtained through cross-border M&As are fungible and can be used for productive as well as unproductive purposes.

- Over the longer term, both modes of entry are likely to provide similar investment inflows in similar situations. Thus, even in a case in which only cross-border M&As are feasible, as with some privatizations, there can be large sequential investments, particularly in capital-intensive enterprises like utilities that call for heavy investment.

- There is no clearly discernible difference between the two entry modes with respect to the crowding in and crowding out of domestic enterprises, though M&As are likely to have more beneficial linkage effects in the earlier phases of investment.

### *Policies*

- Where maximizing long-term capital inflows is a policy objective, as when investment opportunities are plentiful and domestic savings fall short of investment requirements, there may be little reason for policies to differentiate between greenfield FDI and cross-border M&As. In order to make sure that sequential investment follows a foreign acquisition, some countries have inserted future investment commitments into privatization deals. As noted, the evidence on the effectiveness of these commitments is mixed. Countries could also consider structuring incentives in such a way that, following M&As, the creation of additional productive capacity by the new owners is encouraged.

- Countries could structure taxation rules in such a manner that they encourage the previous owners of firms sold in M&As to reinvest the proceeds obtained in productive capacities. In the case of privatizations, the funds obtained from foreign investors could be left with the newly acquired firm for investment purposes.

- Attracting the right kind of foreign partner in a cross-border merger or acquisition is important. Targeting may have a role to play here.

- To obtain the best prices in privatizations, a competitive and transparent tendering process is crucial. Careful attention must also be paid to the profile of the buyer and the quality of the offer.

- Pricing problems can be minimized by measures and institutions facilitating corporate valuation, such as appropriate accounting, reporting and auditing rules and well-functioning capital markets.

- The interests of domestic minority shareholders and other stakeholders need to be protected.[15] In particular, the host country's company law and stock-exchange rules may need to be strengthened to ensure that they include adequate guarantees for minority shareholders to be informed of and participate in decisions to sell or merge, including sufficient and timely information on potential foreign buyers. The minority shareholders' rights to dissent and to dispose of their shares need also to be protected.

- To prevent asset stripping or other corporate decisions that are likely to jeopardize development objectives, e.g. closures or relocation of productive activities abroad, governments of host countries can use such a device as "golden shares", which give them a veto over certain kinds of corporate decisions.

- The negotiating process is critical to the outcome of M&A deals — both private and privatization-related. In these negotiations, negotiators from developing countries and transition economies frequently face powerful companies with considerable legal and financial firepower. Governments can help in two ways: by providing technical advice and training domestic negotiators in the art and techniques of cross-border M&A negotiations; and by providing financial assistance to domestic firms to get the best national and international advice on their M&A deals.

- To help financially distressed but viable local companies (and where no other alternatives are available), governments can use proactive measures to attract specific types of M&A partners, such as matchmaking, securing outstanding debts or providing insurance for financial risks.

## B. Technology

Transforming and upgrading the technologies used in production and strengthening national technological capabilities, including the capacity to innovate, are major objectives of countries with respect to their development process. The transfer of technology and its efficient application and diffusion are therefore some of the most important benefits sought by developing countries from FDI (UNCTAD, 1999a). TNCs tend to be leading innovators. They are leading suppliers of technology to developing countries and economies in transition, through FDI and other (externalized) forms of transfer. They can also stimulate the development of innovatory capacities in host economies, thereby supplementing technology development that takes place through R&D in domestic firms and publicly funded institutions (box VI.6).

**Box VI.6. FDI and the transfer, diffusion and generation of technology**

***Technology transfer.*** Generally TNCs are leading innovators in their industries. They transfer technologies by internalized modes — to the firms within their production systems, including the foreign affiliates they control — or externalized modes — to other firms, through licensing, minority joint ventures, subcontracting, strategic alliances or capital goods sales. Internalized technology transfer has the following characteristics:

- Generally TNCs transfer more modern and productive technologies to their affiliates than those available in host countries, especially developing and transition economies. However, the nature of the technology or process transferred reflects both the conditions in each host economy (wages, skills, supply capabilities, scale and so on) and the motivations of the TNCs concerned. Advanced host countries receive complex technologies or functions, while less developed ones receive simple technologies and processes.

- FDI may be a more expensive mode of transfer than externalized modes (e.g. licensing) where these are realistic alternatives. The latest and most valuable technologies, however, are not generally available on licence. Strategic inter-firm technology alliances, which may vary in form from equity joint ventures to contractual agreements, are another means by which technology transfers occur between foreign and local firms. These, however, mainly involve firms from developed countries and more advanced developing countries that have already built up some technological knowledge and capabilities. Moreover, firms in many host developing countries may find it difficult to implement efficiently even the mature technologies that are available by licensing or other contractual arrangements. Countries may therefore prefer FDI, as it provides the skills and knowledge needed for efficient implementation. FDI can also provide other benefits, such as export market access and brand names, not available in arm's-length technology purchases. And FDI can provide an effective means of updating technologies quickly, which is important for countries that lack the ability to improve and innovate on imported technologies. Taking these factors into account, FDI may often prove to be the cheapest long-term means of technology transfer.

- The techniques deployed in foreign affiliates are geared to local capabilities and exploit the existing comparative advantages of host countries. There is a risk that these advantages may remain static if the host economy does not strengthen its capabilities. TNCs may also restrict the access of particular affiliates to technology, in order to minimize inter-affiliate competition. They may hold back the upgrading of affiliate technology in line with growing local skills and capabilities or invest insufficiently in host country training and R&D, in accordance with their global corporate strategies.

- Foreign affiliates are generally in the forefront of new management and organizational techniques, quality management standards, training and marketing methods.

***Technology diffusion.*** There may be positive spillover effects from foreign affiliates to a host economy through four channels:

- Competition with local firms, stimulating them to improve technological capabilities and raise productivity;

- Cooperation between affiliates and local suppliers and customers, stimulating technology spillovers to vertically linked firms and service providers;

- Labour mobility, particularly of highly trained personnel, from foreign affiliates to domestic firms including supply businesses set up by former TNC employees, often with the support of their former employers; and

- Proximity between foreign and local firms, leading to personal contact, reverse engineering, imitation and the formation of industrial clusters facilitating technological upgrading in host countries.

***Technology generation.*** The impact of FDI on innovation capacity in host developing countries has so far been rather limited. TNCs tend to centralize R&D in their home countries

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## 1. Technology transfer and upgrading

To the extent that foreign investors enter a country to undertake value-adding activity in which they have a lasting interest, there is no reason to expect the mode of entry to make a major difference to the technology transfer involved. They would be interested in operating efficiently in either case and would presumably do whatever is needed in technological terms to ensure this. However, other things remaining the same, since a takeover involves working with an existing facility and a greenfield investment setting up a new one, the latter is more likely to involve newer equipment and work practices from inception.[16] This may mean that affiliates established through cross-border M&As have older technologies to start with, though this need not mean that these are less desirable. For instance, technologies in an acquired firm may be better adapted to the local environment or have a stronger learning base that allows them to be used more efficiently. Where the acquired firm has obsolete or inefficient equipment, the acquirer is very likely to inject new equipment, technologies and production methods to make it competitive.

In most developing countries and economies in transition, cross-border M&As, especially by developed-country TNCs, are likely to raise the level of hard and soft technologies and the related capabilities of acquired firms, because of the greater technological strengths that foreign investors usually have. Even in developed countries, where technological differences between M&A partners are relatively small, it has been observed that M&As tend to increase the productivity of acquired firms (Caves, 1998,[17] p. 1963; Modén, 1998). In developing countries, where the technological differences between domestic firms and foreign acquirers are often large, the impact on the acquired firm is likely to be correspondingly larger. However, the nature of the host economy, the activity concerned and the motivation of the investor will all make a difference to the technology transfer and upgrading that occur. The more open to international competition a host economy, or the more export-oriented the activity in question, the stronger is this effect likely to be. Similarly, the stronger the skill and technology base in a host economy and the greater the receptiveness of acquired firms, the faster and more effective will the transfers be. Needless to say, if M&As are not efficiently carried out because of the inadequate

**Box VI.6. FDI and the transfer, diffusion and generation of technology (concluded)**

and a few other advanced industrial countries, so as to reap economies of scale and linkages with technology and research centres. Developing countries attract only marginal shares of foreign affiliate research, and much of what they get relates to production (adaptation and technical support) rather than innovation. Still, in recent years, TNCs have located some strategic R&D in developing countries that have the required human resources.

In sum, the content of technology transfers by TNCs to their foreign affiliates in developing countries depends on the nature of the industry, the pace of technical change, and conditions in the host economy (the trade and competition regime and local skills and capabilities). The extent of spillovers to other domestic enterprises depends on technological and other capabilities in the host economy, particularly among suppliers, and the strength of local technology institutions. Where local supply capabilities are low, spillovers will also be low. This may change over time as local capabilities increase and foreign affiliates gain familiarity with suppliers, taking on local flavour. The intensity of the spillover impact of FDI through competition will depend on the openness of the economy, domestic competition policy and the ability of local firms to take up competitive challenges and to restructure. The impact of FDI on the capacity of developing countries to innovate is low, because, with few exceptions, developing countries attract very small shares of TNCs' R&D. All these economic factors being given, TNCs will differ among themselves in their technological trajectories for reasons of corporate strategy.

*Source:* UNCTAD, 1999a.

assessment of technological complementarities, the benefits will be reduced or negated. Where the merging of two companies takes a long time, the benefits will take that much longer to realize.

There is one vital difference between the two modes of entry as regards the technology transfer and upgrading that may occur: M&As involve *existing local firms directly*, albeit under new ownership, while greenfield investments do not. The impact of the latter on other local firms' technology (through, e.g. competition and demonstration) is thus slower. Where the technological gap between foreign entrants and domestic firms is large, greenfield FDI may in fact drive some existing domestic firms out of the market. In that situation, to the extent that countries prefer to preserve capabilities already built up in local firms, they might prefer M&As. There may then be a case for incentives for M&As that save and strengthen technological capabilities in host country firms, similar to incentives to greenfield FDI that brings in new technologies.

As for *upgrading* technologies over time, much depends on the status of an acquired firm at the time ownership is transferred. If it needs considerable upgrading to bring it to competitive levels, there is likely to be relatively rapid change, as compared to a foreign greenfield facility near technical frontiers. On the other hand, if a facility is already technically efficient, there may be little upgrading for some time; in the long run, upgrading will occur in line with overall changes in the technical capabilities of a TNC and the position of the affiliate in its strategy and structure. Where an acquisition is made to access local technology, no upgrading may take place in the acquired firm, although it might occur in other facilities owned by the TNC. For example, in the Chilean mining industry, in which domestic and foreign firms already had modern technologies, there was little upgrading following cross-border M&As in the 1990s (Riveros, et al., 1995). On the other hand, in Swedish TNCs that acquired foreign firms to gain access to R&D in the latter, knowledge flows vis-à-vis the foreign acquisitions were found to be reciprocal, with flows to the acquired firm preceding those in the opposite direction (Bresman, et al., 1999). Upgrading in foreign affiliates established through acquisition may be slow where an acquired firm suffers from organizational "inertia" and its integration into the TNC's system takes time; its inherited capabilities and habits can make it difficult for a new owner to introduce new technologies.

Apart from these considerations, however, the technological upgrading of affiliates over time should not differ much by mode of entry. The process depends more on the market orientation of the investment, local skills and capabilities in the host country, and corporate strategies (UNCTAD, 1999a). Evidence for Asia (Zhan and Ozawa, 2000), some Latin American countries (Argentina: Chudnovsky, et al., 1995; Mexican car industry: Mortimore, 1998) and Central and Eastern Europe (Zemplínerová and Jarolim, 2000) shows that FDI through cross-border M&As can lead to considerable technological upgrading. Such upgrading also occurred in foreign acquisitions in Sweden, according to a study of a sample of firms covering selected years during the period 1980-1994 (Modén, 1998). Foreign acquisitions increased both the labour and the total factor productivity of the acquired firms; moreover, the productivity improvements in them were greater than those observed in locally acquired firms.

The transfer of soft technologies, including management and organizational practices, is an important aspect of knowledge transfer within TNCs. Evidence from several studies suggests that foreign investors introduce new or improved management techniques to acquired firms (Allard and Lundborg, 1998, p. 45). This seems to be of particular importance in acquisitions of state-owned enterprises, including service providers. In Argentina, for instance, the principal contributions of foreign acquirers of gas and, to a lesser extent, electricity utilities lie in the organization of the new enterprises (Chudnovsky, et al*.*, 1995, p. 10). Improved practices for effective corporate governance may also be transferred when acquisitions are made by TNCs from countries with well-developed private sectors and governance systems. At the same time, differences between the management styles of the acquired and the acquirer may create problems, since these need more time to be harmonized. It has been noted that successful acquisitions are often distinguished by the respect accorded to the local management culture (Allard and Lundborg, 1998). Finally, as regards management as well as other aspects, the scope and direction of technology transfer and upgrading will depend upon the roles assigned to firms after acquisition, with some becoming more restricted due to specialization within the global systems of the acquirers while other become centres of excellence for a particular product or function.

## 2 . Technology diffusion

From the viewpoint of host-country development, what matters is not just the transfer of technology to foreign affiliates, but also, and more importantly, the wider dissemination of the technologies from those affiliates to other parts of the local economy. The local diffusion of technology by foreign affiliates depends on their linkages with the local economy and the spillovers captured by the local economy. If existing linkages by acquired firms are efficient, TNCs are likely to retain and strengthen them. Foreign affiliates established through M&As are likely to have stronger local links than greenfield FDI, which will take time and effort to develop such linkages. While this is true in the short- to medium-term, it may also be true in the long-term, because of the cumulative effects of building capabilities, contacts and trust. Thus, FDI through M&As may lead to a better diffusion of technology transferred by TNCs than FDI in greenfield sites. For example, in Swedish TNCs (Andersson, et al., 1996) and in foreign affiliates in some Central and Eastern European countries (Szanyi, 2000), greenfield foreign affiliates have been found to import more intermediate inputs from home countries than acquired firms. In the case of Swedish foreign affiliates, moreover, the difference between the two groups studied did not diminish over time. If, on the other hand, the local linkages of acquired firms are weak or inefficient, M&As will lead to a switching of supply chains abroad, with lower diffusion of new technologies locally. This case, however, will be no different from that of a greenfield investment sourcing overseas.

Policy efforts to strengthen linkages (and thereby technology diffusion) by imposing local content requirements are relevant to FDI through M&As, as well as greenfield projects. Their relevance is, however, constrained by their potential for distorting resource allocation and by the TRIMs agreement within WTO, which generally prohibits the imposition of certain performance requirements on foreign investors. Policies focusing on strengthening local supplier (and distributor) capabilities and, in particular, on inducing TNCs to retain existing linkages can, however, contribute to encouraging technology diffusion.

Technology diffusion from foreign affiliates to the host economy at large can also involve institutions such as research centres, universities, extension services and quality-assurance services. Foreign affiliates often use these institutions more actively than local firms in developing countries because of TNCs' greater technological awareness and skills. The impact of the mode of entry in this respect is likely to be similar to that noted with regard to diffusion to local firms with supply linkages. Where an acquired firm has strong and efficient institutional linkages, TNCs are likely to retain and enhance them, thereby contributing to the building up of national innovation systems. Where the linkages are weak or inefficient, they are likely to behave like greenfield entrants and build them gradually over time while relying initially on overseas linkages.

Technology diffusion can also take the form of spillovers to local competitors and other firms, by demonstration, competitive pressure, and the movement of technical and professional staff. These are unlikely to differ by mode of entry. (Competition issues as such are taken up in section E.)

## 3. Technology generation

Usually TNCs concentrate their technology generation efforts (R&D) in advanced countries. It is often feared by host countries with local R&D capabilities that cross-border M&As can cause innovative activity in acquired firms to be reduced, shifted elsewhere or shut down. How realistic is this fear? Where local R&D is uneconomic to start with (built up to adapt technologies for small-scale production in protected markets, often the main reason for R&D in developing countries) and becomes even more uneconomic in a liberalized environment, M&As may certainly reduce it. This may be a loss to the host economy if activities that are currently uneconomic could, with a certain measure of protection, become profitable in the future. The key factor here is the expected dynamic comparative advantage of these activities. Curtailing uneconomic R&D activities that cannot be made more efficient or better serve the market in the long run may allow for more rapid technology upgrading and release valuable human resources for other uses. Where local R&D *is* economic, however, and reduced by TNCs for strategic reasons (because it duplicates R&D elsewhere or does not suit their product or location strategy), it can be harmful for a host economy. This eliminates valuable capabilities built up with considerable effort and pulls the country down the technological ladder.

At the same time, where local R&D is economic, there is little reason to expect that acquiring TNCs in many industries will reduce it unless it duplicates what is being done elsewhere. TNCs tend to value a broad range of technological activity, aimed to suit different conditions and markets. The cost of R&D of certain kinds can be much lower in affiliates in developing countries or transition economies than in developed countries because of the lower costs of obtaining certain types of scientific and technical personnel.[18] Thus, TNCs can efficiently locate segments of R&D activity that suit the endowments of host economies and the competitive strengths of affiliates in them. In the case of efficiency-seeking or created-asset-seeking FDI, the acquisition of a firm with R&D capabilities can save the time and effort needed to build such capabilities from scratch. TNCs can then use the human and knowledge resources at their disposal to enhance the quality of existing R&D and integrate it into their larger research systems.

All this suggests that it would be rational for TNCs to increase R&D in acquired firms with prior R&D capabilities, especially if the motivation is efficiency-seeking or asset-seeking, although with the possibility of greater specialization in the context of their global systems and strategies. Where the host economy has other efficient sources of innovative activity, TNCs can use their local R&D facilities to monitor and tap into those sources. A greenfield affiliate in an economy with strong human resources may also invest in R&D, but this is likely to take much longer to develop. The greenfield affiliate may also attract trained researchers away from other facilities in a host country.

Systematic evidence is lacking, but there are examples of both decreasing and increasing R&D in acquired affiliates with R&D capabilities. For example, R&D in several acquired enterprises in Latin America has been wound up or downscaled as production was reoriented towards less technology-intensive activities. In Hungary, on the other hand, when General Electric acquired Tungsram, it initially cut the latter's R&D activities, but later resumed and strengthened them.[19] In the Republic of Korea, the acquisition by Volvo of a unit from Samsung not only saved this unit from an uncertain future but also created the potential to turn it into a centre of excellence with a world product mandate from Volvo (box VI.7). Government policies can play a role in influencing the outcome, by either influencing the choice of the foreign partner (say, in a privatization or acquisition of a major private firm) or the acquirer's decision on locating technological activity (through incentives or persuasion).

Does the mode of entry make a difference to TNC investment in local technological activity? Given local skills, factor prices and institutions, would an investor who downgrades an acquired firm's technological activity undertake R&D in a greenfield affiliate? There is no strong *a priori* reason to expect this. It is unlikely that a TNC would close down efficient R&D in an acquired firm but would launch R&D in a new affiliate in the same setting. As noted, the opposite is likely because of the learning costs involved.

In the context of developed countries, it has been suggested that, when there are strong market, product, technological and organizational complementarities, M&As improve the technological performance of TNCs (Hagedoorn and Duysters, 2000). When both the acquiring and acquired firms are highly research-oriented and their resources complementary, M&As lead to increases in research output per researcher. This need not mean, of course, that R&D in the acquired firms necessarily increases. Furthermore, M&As can lead to a reduction of R&D in acquired firms if there is duplication of R&D or few complementarities between the acquired and acquiring firms. Where an acquired firm is well below the technological frontier, its R&D activity may be reoriented towards absorbing and improving existing technologies; this may lead to lower R&D spending, while raising its efficacy. Purely financial mergers, where the acquirer lacks the necessary technological capability or is not committed to technological excellence, may also lead to R&D reductions (Hagedoorn and Duysters, 2000).

The foreign acquisition of a *local technological leader* raises fear that the acquiring TNC will "strip" the local firm of its technological assets and innovatory activities to transfer them overseas, depriving the local economy of the revenues, spillovers and linkages that such assets and activities generate. This is one major reason why many developed countries seek to prevent the takeover of "national champions". The urge to protect champions is particularly strong in defence and other strategic technologies with strong linkage and spillover benefits. The risk of losing strategic assets in this way is certainly real, especially when the technology has strong spillover effects on other products and activities and these are captured by overseas firms. As noted, however, TNCs acquiring technologically strong firms tend to preserve their R&D capabilities and links with local technological sources even if they exploit their proprietary technologies for their own benefit. Indeed, it is in their interest to strengthen these capabilities by integrating them into their own research networks. This follows from the logic of asset-seeking FDI (Dunning, 1993), which is an increasingly important motive for outward FDI in developed countries (UNCTAD, 1998a).

Studies of acquisitions by TNCs in some developed countries support this reasoning. In Sweden, there was no "stripping" of R&D-related technological assets in a sample of acquired firms covering the period 1980-1994; on the contrary, R&D was strengthened in the acquired firms (Modén, 1998). Similarly, foreign acquisitions of R&D-oriented Danish firms led mainly to a strengthening of their R&D assets (Pedersen and Valentin, 1996, p. 171). Another study of Swedish TNCs, mentioned earlier, that examined acquisitions made mainly to gain access to the R&D of the acquired units, throws light on knowledge transfer in cross-border M&As. In the early stages of an acquisition, knowledge transfer was mostly one way, from the acquiring to the acquired unit. Over time, the transfer became more reciprocal and shifted from relatively articulated technologies (e.g. patents) to more tacit flows. The facilitators of knowledge transfers included telecommunication, visits and meetings (Bresman, et al., 1999).

While these findings apply primarily to M&As in the developed world, they are also relevant to some newly industrializing economies. Technology-seeking firms from

**Box VI.7. Turning an ailing unit into a centre of excellence: Volvo's acquisition of Samsung's construction equipment division**

As a result of the Asian financial crisis, the Korean conglomerate (*chaebol*) Samsung Group decided in 1997 to divest from its loss-making and debt-ridden construction equipment division, Samsung Heavy Industries, and concentrate on shipbuilding and plant construction.[a] This would immediately enable the company to reduce its high debt-equity ratio and invest part of the proceeds into its core business.

Volvo Group of Sweden bought Samsung Heavy Industries in May 1998 for $500 million, saving it from an uncertain future. Moreover, Volvo decided to make the acquired company (re-named Volvo Construction Equipment Korea Co.) its global centre of excellence for excavators. In the longer term, Volvo also intends to transform Volvo Korea into a global research and production centre for construction equipment in Asia and the world. In order to achieve these objectives, Volvo plans to set up a new R&D centre in the Republic of Korea whose task would be to develop new products, modify existing products and develop core parts for various other products. In April 1999, Volvo closed some plants in Sweden and Germany and transferred the production to its Changwon Plant in the Republic of Korea. In 1999 alone, Volvo invested an additional $200 million to strengthen its operations in the Republic of Korea.

*Source:* Jung, 2000.

[a] In a separate deal, Samsung also sold its fork lift truck business to Clark Equipment Co. of the United States for $30 million.

Mexico, the Republic of Korea, Taiwan Province of China and other developing economies have been acquiring firms with strong technological assets in developed countries (particularly in Silicon Valley). Such M&As have boosted the technological base of the acquiring firms without apparent damage to the host economies. Recently, technology seeking M&As have also been undertaken by developed-country TNCs in the Republic of Korea (Zhan and Ozawa, 2000).

Notwithstanding the evidence cited above — and given the limited nature of available evidence in this regard and, in particular, the broader context of globalization and the greater opportunities open to TNCs to switch the location of various functions — the possible loss of (or decrease in) viable or promising R&D activities in host countries cannot be overlooked. Policy-makers may consider measures to preserve local R&D activities, particularly on grounds of infant technology development. In cases where firms with high R&D potential are offered for purchase by foreign investors, measures could be taken to encourage R&D in acquired firms after a change of ownership. This is particularly important in cases in which firms slated for acquisition are at the forefront of R&D activity. The objective should not necessarily always be to maintain local R&D regardless of cost; when local efforts cannot keep up with international frontiers or the longer-term chances of maintaining a successful local capability are slim, it may be more economical to let local R&D disappear. It is not easy to pick winners and losers, least of all in technology generation. Nevertheless, if a sound economic case can be made, governments may try to influence foreign acquirers to preserve established innovatory activities in important areas by means of carefully crafted financial incentives or public-private sector cooperation.

## 4. Summary

### *Technology transfer*

- Both modes of entry can lead to similar technology transfers and upgrading in affiliates established through FDI. The content of the transfer depends on the needs of the acquired companies in a given context of local factor endowments, market conditions and affiliate orientation.

- One difference between the modes of entry lies in the speed of implementation. This depends in turn on the efficiency with which M&As are conducted and the absorptive capacity of the local enterprises. The greater the technological strengths and capabilities of acquired firms and the better managed the M&A process, the greater the likelihood that acquisitions would contribute to a rapid build-up of technological competence and activity.

- Greenfield FDI may transfer newer equipment and technology at inception, but entry through M&As may also be followed by technology transfers to foreign affiliates. Foreign affiliates established through M&As may, moreover, be able to absorb technologies faster because of capabilities already existing in the acquired firms. Much depends on the original technological status of the acquired enterprise.

- M&As can offer the benefit of involving local acquired enterprises directly in the technology transfer and upgrading, including soft technologies and especially improved organizational and managerial practices, while greenfield FDI does not: it transfers technology to a new affiliate and affects local firms through linkages and spillovers. The former may, therefore, be preferable in terms of saving and upgrading existing capabilities.

### *Diffusion*

- The greater the capabilities and human-resource development in a host country, the more likely is diffusion to take place through linkages and spillovers from foreign affiliates, regardless of mode of entry.

- M&As may diffuse technology faster because their linkages are likely to be stronger.

### *Innovation*

- Innovative activity may be downgraded by M&As in countries in which it is lagging behind world frontiers, but is likely to be enhanced where it is actually or potentially efficient. There may, however, be situations in which an acquiring TNC's location strategy leads it to scrap significant R&D activity in a host country even if it is efficient.

- Where good R&D capabilities exist, M&As may be able to tap them faster than greenfield investments. However, where an acquired firm suffers from significant technological inertia, the process may turn out to be slower.

- The stripping of technological assets by M&As is a risk, although probably a small one in most developing and transition economies.

### *Policies*

- Within the context of an overall national technology policy, there may be a case for providing incentives to foreign acquirers that save and strengthen existing capabilities and firms, similar to the "pioneer" incentives provided by many countries to greenfield investors who bring valuable new technologies or export-oriented facilities. This should not involve actively discouraging greenfield entry, but only making takeovers more beneficial.

- On the R&D front, a government may consider encouraging the preservation of efficient local activity (particularly in strategic industries) through approximate negotiations with acquirers and by offering incentives.

- The stimulation of local diffusion needs policies to strengthen skills and technology support systems for supplier industries and competitors. It may be desirable to offer special incentives to investors that preserve and increase local supply and other linkages.

## C. Employment and skills

Unemployment and a concentration of large numbers of workers in low-wage employment, with poor and insecure conditions of work, continue to plague most developing countries and economies in transition. Increasing gainful employment and shifting it towards higher-quality jobs are important to the development of these countries as is improving workers' skills. FDI affects the quantity and quality of employment and the development of skills in a number of ways (box VI.8).

### 1. Employment quantity

The direct impact of FDI through cross-border M&As on the quantity of employment is likely to differ markedly from that of greenfield FDI, especially at entry and in the short-term thereafter. A greenfield investment generates new employment, while an acquisition transfers responsibility for existing employees — who may then be laid off by the new owner. Lay-offs are likely for three main reasons: rationalizing and eliminating duplication, enhancing efficiency (particularly in privatized enterprises), and reducing excess capacity. Of course, the opposite might also happen, leading to increased employment. In the longer-term, employment in foreign affiliates acquired through M&As is likely to increase if the restructuring and integration that follows the acquisition is successful.

Employment effects are likely to vary according to the motivation of the foreign acquirer and the characteristics of the acquired firm.[20] A simple classification of motivations suggests the following:

- In *market-seeking* cross-border M&As, where TNCs acquire firms to access domestic or regional markets or international marketing networks, the direct effect on employment is likely to be neutral or positive in the short- to medium-term. A TNC is likely to retain the existing workforce to cater to its newly acquired market, and to raise employment if the market grows or if the affiliate increases its market share. Acquisitions by TNCs in the food industry in Costa Rica, for example, led to increased employment in some firms.[21]

- In *strategic-asset-seeking* M&As, TNCs also tend to maintain employment in acquired firms if, as is likely, the employees of these firms have valuable skills and capabilities. If M&As lead to productive synergies between the parties, operations are likely to expand and raise employment.[22]

## Box VI.8. FDI, employment and skills

The **quantitative** effects of FDI on the volume of employment in a host country can be summarized as follows:

- FDI may increase employment directly by setting up new foreign affiliates or expanding existing affiliates, and indirectly by stimulating additional employment in suppliers and distributors (depending on the intensity of local linkages). In the medium-term, employment can also rise through multiplier effects from the new income generated by FDI or through the increased demand stimulated by improved efficiency and restructuring of competing firms.

- FDI can preserve employment by acquiring and restructuring firms that would otherwise go bankrupt.

- FDI decreases employment through the divestment and closure of foreign affiliates, the liberalization of protected (inefficient) activities, changes in parent company strategies, mergers between parent companies in home countries, or the restructuring of newly acquired firms in host countries with corresponding indirect effects.

The **qualitative** impacts of FDI on employment (on wages, job security and conditions of work, such as health and safety standards, hours of work and workers' rights), include the following:

- ***Wages.*** Foreign affiliates generally pay higher wages than domestic firms in similar activities. The difference is more marked in industries that demand higher levels of skills, technology and marketing and in export-oriented activities that need to ensure consistent quality and timely delivery. However, some export-oriented affiliates (especially those of TNCs from developing countries) may pay low wages because their *raison d'être* is tapping low-wage labour in simple assembly activities.

- ***Job security.*** Foreign affiliates tend to offer greater job security because of their size, competitive strength and need for a stable workforce. Investors, however, motivated by low wages offer insecure employment, since they can move to other countries as wages rise. New forms of work organization imported from home countries may also result in greater insecurity.

- ***Other conditions of work.*** Working conditions in foreign affiliates are generally better than in local firms. In particular, large and visible TNCs tend to comply with local and international standards and even with the labour standards in their home countries. This may not, however, be the case in low-end, labour-intensive industries.

In the area of ***skills***, TNCs tend to upgrade employee skills in host countries by investing in training. Employees may leave foreign affiliates and carry their skills to other firms or set up their own firms. Generally TNCs induce or support local suppliers to train workers to meet their quality standards and influence local competitors or unrelated firms to emulate their training practices. They may also interact with local education and training institutions to improve practices, curricula and links with industry. Affiliates of firms on the frontiers of human-resource management are generally better at providing training than local firms. However, TNCs investing to take advantage of low-cost labour may do relatively little training, though they may still raise supervisory or technical skills to meet the standards of export markets. Skill upgrading feeds back into TNC activity: TNCs react to the availability of skills by raising the technological content of their investments, contributing to further learning and skill creation.

What determines the frequency, scope and intensity of these effects in a host country? The quantity of employment generated by FDI depends on the amount of net investment in new production activity, the nature of the activity (whether labour-intensive or capital-intensive) and the technology transferred. It also depends on market orientation. In market-seeking FDI, the size of a host-country market limits the amount of investment and hence employment, while in export-oriented FDI the market can be much larger and the potential for direct and indirect employment generation greater. Employment quality is also affected by the level of education and labour markets in a host economy and the activity and technology of the affiliate. In general, the more efficient the labour markets and the higher the skill levels in a host economy, the greater the chances of attracting FDI associated with high employment quality and good training practices.

*Source:* UNCTAD, 1999a.

- In *efficiency-seeking* M&As, where the acquired firms have low costs and the likelihood of improving technical efficiency or finding various synergies with the acquirers, the outcome will vary according to the technological status of the acquired firm, the extent of employment duplication between the acquired firm and the rest of the TNC, the trend of the market and the global strategy of the acquiring TNC. Acquired firms with poor technology or management or with substantial excess capacity are likely to lose employees as they are restructured. Those offering synergies may suffer some losses as duplicated functions are eliminated, but this may be offset by the strengthening of other functions, and employment may increase. Overall, the horizontal mega-mergers of the 1990s have led to considerable downsizing to realize synergies and focus on core competencies (Kang and Johansson, 2000, p.16). M&As in the world automotive industry during the 1990s have been followed by cuts in employment despite an increase in output.[23] In this industry, restructuring to improve efficiency in the context of global over-capacity has been taking place across the board, and greenfield FDI is less and less of an option for firms and countries that have established production capacity. M&As in the financial-service industries have also led to lay-offs. In Brazil, for example, the acquisition of local banks by foreign firms resulted in significant lay-offs (Vidotto, 1999). Staff reductions also followed the acquisitions of a number of Thai banks by foreign investors in the context of the recent financial crisis.[24]

- Cross-border M&As driven primarily by short-term *financial considerations* may have employment-reducing effects when restructuring is required and when financial markets or the managers in the home country treat post-acquisition employment reduction as an indication of restructuring. In other words, information on lay-offs can substitute for more detailed technical information (that markets may not have) on restructuring. This can create incentives for acquirers to undertake technically unnecessary redundancies where the need for signals is very strong. Acquisitions driven by the quest for short-term financial gains may also lead to unemployment if gains are sought through asset stripping and the dismantling of production units. On the other hand, where the acquired firm is profitable and dynamic and M&As are a form of portfolio diversification, firms can show increasing employment because they now have more resources to invest.

Cross-border acquisitions in *privatizations* often lead to lay-offs after (and in some cases, before) the change of ownership. This was the case with the recent privatizations of electric power generation and distribution in Latin America involving the Spanish firm Endesa (ECLAC, 2000, p. 154), and the privatizations of telecommunication services in several developing countries and economies in transition.[25] Another example, this time from Asia, is that of the Manila Water Works, acquired by two TNCs in 1997; employment dropped from 7,370 to 4,580 employees (PSI, 2000).

In Central and Eastern Europe, where state-owned enterprises accounted for half or more of total employment prior to the onset of transition, privatization to cross-border investors (as well as to domestic ones) and the restructuring that followed led to large employment cuts in the acquired enterprises. A 1999 UNCTAD survey of the pre- and post-privatization performance of 23 major companies acquired by foreign investors in seven countries of Central and Eastern Europe found that employment in the enterprises decreased before as well as after privatization.[26] Nevertheless, the rate of decrease of employment in privatized enterprises was often smaller than the general rate of decline in employment in these countries and was more pronounced in the period preceding privatization. This suggests that other employers were less successful than foreign investors in preserving jobs, or that foreign investors acquired the more efficient of the privatized enterprises. There are inter-country differences in Central and Eastern Europe in the extent of employment reduction following privatization. Reductions of staff and sales of non-core businesses were more frequent in the early stage of privatization in the Czech Republic than in Poland and Hungary (Rojec, 1995).

The immediate loss of employment following an acquisition may not be a net loss to an economy if the local firm was in competitive difficulties and would have gone bankrupt in the absence of an acquisition. FDI entry through M&As in this case represents a *conservation of employment* even if the numbers employed are smaller than before. In crisis or transition economies, the employment conservation effect of cross-border M&As may be quite strong (Zhan and Ozawa, 2000; Hunya and Kalotay, 2000). For example, a study of early privatizations in Poland found that 90 per cent of foreign investors changed the organizational structure of the enterprises they bought, but only 20 per cent reduced employment (Jermakowicz, 1994). Employment also remained unchanged following privatization, according to a study on foreign-owned enterprises in Slovenia (Rojec, 1997).

Once the initial adjustment after privatization has been made, employment might well increase. This happened, for example, in the telecommunication industries of some developing countries. Growing markets, or increased demand, stimulated by lower post-acquisition prices for the products of privatized enterprises, can stimulate sequential investments leading to employment generation side-by-side with productivity increases. In the Czech Republic, Hungary and Poland, downsizing was often followed by large new investments and employment remained stable or increased (Hunya, 1997).

The *indirect employment effects* of M&As include effects on employment in other firms in the economy through linkages and through the "crowding out" or "crowding in" of domestic enterprises (UNCTAD, 1994a; UNCTAD, 1999a). As discussed in section B, if linkages in acquired firms are strong and internationally competitive, they are likely to be retained and strengthened by acquiring TNCs; this would lead to employment in supplier firms being maintained or increased. If linkages are weak or inefficient, there will be a switch to new sources, leading to a reduction of employment in former suppliers. This may be compensated for by an increase of employment in other suppliers if the switch is within the host economy. If the switch is to imports, however, there would be a larger loss of employment. In comparison with greenfield FDI, however, it is not clear that there is a net loss of employment. Greenfield investors would tend to rely on foreign suppliers to a greater extent, especially in the initial phase of their operations. Furthermore, even without foreign entry, inefficient local suppliers would lose ground if the economy opens up to competing imports. International competition would force all firms, local and foreign, to switch to the most economical sources.

As far as crowding in and out of local firms goes, the effects on employment can vary. In a saturated domestic market, a greenfield investment (once it is fully operational), if successful, will necessarily reduce employment in competing firms, while an acquisition of existing capacity will not. When domestic firms merge to strengthen their competitive position *vis-à-vis* incoming foreign competitors, there may be layoffs in these firms. On the other hand, if the market has excess or growing demand, domestic-market-oriented greenfield investment can flourish along with existing firms and add to employment in net terms. In such markets, firms entering through M&As will also expand their operations through sequential investments, adding to employment. In other words, M&As and greenfield FDI are unlikely to differ in their indirect employment effects, apart from short-term adjustment effects. In the case of export-oriented investments, the indirect effects of both modes on employment are again likely to be similar, since production is not constrained by domestic market size and demand.

The effects of M&As on employment quantity also raise broader economic issues. If a host economy has efficient labour markets and is expanding so that laid-off employees are quickly absorbed elsewhere, redundancies in any particular activity do not matter that much. Indeed, firm turnover and labour movement are a necessary, though often painful, feature of a dynamic economic change. It is when labour market conditions do not allow for rapid adjustments or when there are few other opportunities for employment that redundancies in particular firms raise social and economic problems. In developing countries characterized by high unemployment, insufficient training, infrastructure and lack of resources to upgrade workers' skills, these problems can be acute and the cost particularly high in terms of unemployment.

Problems caused by lay-offs following cross-border M&As call for government policies and measures by employers and trade unions to minimise the hardships and adjustment costs faced by wage-earners. One important step is to ensure that early consultations with worker representatives take place to discuss the reasons for any proposed M&As or privatizations and address the concerns and needs of workers. This is important not least because M&As increase anxiety over job security at all levels, highlighting the need for timely information and consultation. There is increasing recognition among countries, trade unions and company managers that consultations with employees in these situations are a corporate duty. A number of international labour instruments — notably the ILO Tripartite Declaration on Multinational Enterprises and Social Policy and the employment chapter of the OECD Guidelines for Multinational Enterprises — also call for such consultations (box VI.9). The European Union goes further in protecting employee's rights in the event of M&As (box VI.10).

In some cases of cross-border M&As in developing and transition economies, future commitments on employment, at least for a few years after a cross-border acquisition or privatization, are negotiated. This may be particularly important where social safety nets are weak or non-existent. For example, in Poland, the acquisition of two telecommunication equipment manufacturers by Siemens guaranteed continued employment of 100 per cent (in one acquisition) and 75 per cent (in the other), but only for 18 months (Floyd, 2000, p. 12). Such measures are transitional in nature. Some governments have incorporated workplace grants in M&As and privatization deals, in effect subsidizing wages (Kuruvilla, et al., 1998, for the Philippines; Phang, 1999, for the Republic of Korea) and, thereby, acquirers.

Obtaining employment commitments from M&A investors can be helpful in some cases. But for the society as a whole, a general policy of strengthened social safety nets may be more beneficial in the long run. Compensatory measures, including allowances for employees who resign voluntarily, can also be negotiated as part of a merger, acquisition or privatization deal. Indeed, as M&As grow in importance, the need to introduce, expand and strengthen social security systems, and in particular unemployment benefit systems, becomes more important than ever (Mody and Negishi, 2000, p. 11). A proactive safety net not only provides unemployment benefits, but also establishes training, retraining, counselling and guiding programmes for the unemployed. The financing of such programmes could come not only from fiscal, but also from privatization revenues. Governments can enter into partnerships with private companies with respect to proactive measures, including the provision of job search and mobility assistance, retraining and vocational training. Thus, the development of government-sponsored business advisory services and credit facilities linked to enterprise restructuring or privatization projects can enhance the mobility of laid-off employees (ILO, 1998). These mechanisms cannot, however, replace the Government as the main agent of social security and retraining.

## 2. Employment quality

Employment quality refers to wages and conditions of employment, such as contractual status, hours of work, industrial relations (including the right to organize and to collective bargaining) and equal opportunities. TNCs tend to offer high-quality employment unless they are in low-technology, export-oriented activities outside the purview of normal labour laws (UNCTAD, 1999a, pp. 267 and 270-271). Other things being equal, a greenfield venture is initially likely to offer higher quality employment, while the inertia inherent in M&As can lead the acquirer to preserve old, lower-quality norms. This effect is likely to erode as the acquired firms introduce new management practices and are integrated into the corporate culture of their parent firms. Over time, therefore, there should not be much difference between the two entry modes. Changes in employment conditions after a merger or acquisition may, however, have a stronger demonstration effect on other local firms in terms of employment practices than the practices in a greenfield affiliate, because of the stronger local linkages and contacts in the former case.

The impact on employment quality of foreign entry through M&As depends on the motives of the investor and the conditions in the acquired firm and the host economy.

**Box VI.9. International guidelines on consultations, negotiations and other employee-related matters relevant for M&As**

There are two international instruments that are explicitly addressed to TNCs and which, explicitly or implicitly, are relevant to cross-border M&A employment issues: the ILO Tripartite Declaration on Multinational Enterprises and Social Policy[a] (UNCTAD, 1996b) and the OECD Guidelines for Multinational Enterprises (OECD, 2000).

The Tripartite Declaration, in paragraph 26, provides that reasonable notice be given:

"26. In considering changes in operations (including those resulting from mergers, take-overs or transfers of production) which would have major employment effects, multinational enterprises should provide reasonable notice of such changes to the appropriate government authorities and representatives of the workers in their employment and their organisations so that the implications may be examined jointly in order to mitigate adverse effects to the greatest possible extent. This is particularly important in the case of the closure of an entity involving collective lay-offs or dismissals."

Paragraph 54 then stipulates that relevant information be made available:

"54. Multinational enterprises should provide workers' representatives with information required for meaningful negotiations with the entity involved and, where this accords with local law and practices, should also provide information to enable them to obtain a true and fair view of the performance of the entity or, where appropriate, of the enterprise as a whole."

And paragraph 56 provides for consultation:

"56. In multinational as well as in national enterprises, systems devised by mutual agreement between employers and workers and their representatives should provide, in accordance with national law and practice, for regular consultation on matters of mutual concern. Such consultation should not be a substitute for collective bargaining."

Similarly, the text of the revised OECD Guidelines, adopted by the Governments of the 29 member countries of the OECD and of Argentina, Brazil, Chile and Slovakia at the OECD ministerial meeting of 27 June 2000, states under the "Guideline on Employment and Industrial Relations":

"6. In considering changes in their operations which would have major effects upon the livelihood of their employees, in particular in the case of the closure of an entity involving collective lay-offs or dismissals, provide reasonable notice of such changes to representatives of their employees, and, where appropriate, to the relevant governmental authorities, and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects. In light of the specific circumstances of each case, it would be appropriate if management were able to give such notice prior to the final decision being taken. Other means may also be employed to provide meaningful co-operation to mitigate the effects of such decisions."[b]

"8. Enable authorized representatives of their employees to negotiate on collective bargaining or labour-management relations issues and allow the parties to consult on matters of mutual concern with representatives of management who are authorised to take decisions on these matters."

Both the ILO Tripartite Declaration and the OECD Guidelines are non-binding recommendations addressed to TNCs. However, they also indicate that these principles reflect good practice for both transnational and national enterprises, which, wherever relevant, should be subject to the same expectations in respect of their conduct in general and their social practices in particular.

Of relevance also are the OECD Principles of Corporate Governance (UNCTAD, 2000a). They recommend that the corporate governance systems of companies should recognize the rights of stakeholders, as established by law, and encourage active co-operation between corporations and stakeholders. Among others, the Principles recommend that:

/...

Market-seeking or strategic-asset-seeking M&As may upgrade employment quality to assure delivery and quality of products and retain skilled workers. However, M&As may also provide opportunities for an acquirer to negotiate changes in employment conditions with disadvantageous effects for workers, at least in the short run; an obvious example is the privatization of state-owned enterprises, in which employees' benefits may not be retained after acquisition. Another is the deunionization observed in some countries, when TNCs acquire plants that have delisted unions (Cooke, 2000a and 2000b). In acquisitions of firms in distress, takeovers may involve measures to lower wages and cut costs by reducing other benefits. At the same time, a reduction in the staff of privatized firms can lead to higher wages for the work force that remains. This is illustrated by domestic privatizations in Sri Lankan tea plantations (Salih, 1999), the Korean iron and steel industry, (Park, 1997) and Chinese foreign-invested state-owned enterprises (Fan Gang, et al., 1998).

Trade unions can play an important role in minimizing the negative impacts of the rapid growth in international production and maximizing the gains to labour (UNCTAD, 1994a; Bailey, et al., 1993). They can ensure workers' representation in the decision-making process affecting them and, in the context of lay-offs, enhance transparency, information flows and the discussion of alternatives. Some unions are also developing special initiatives to address the problems to which M&As can give rise, such as sudden lay-offs, changes in contractual status and conditions of work. Examples include the "employment pacts" that are being concluded between some trade unions and employers to guarantee employment and continued production over a period of time (ILO, 2000c, pp.17f).[27] Another example is the incorporation of "work-ownership" — a concept pioneered by the National Automobile, Aerospace, Transportation and General Workers' Union of Canada — into collective bargaining agreements. Under such agreements, firms acknowledge that the workers own the contribution to the product they make. Thus, a company cannot be sold off or work out-sourced without the agreement also applying to an acquiring firm or newly established supplier (ILO, 2000c, p. 17).

**Box VI.9. International guidelines on consultations, negotiations and other employee-related matters relevant for M&As (concluded)**

"D. Where stakeholders participate in the corporate governance process, they should have access to relevant information" (UNCTAD, 2000a, vol. IV, p. 263). The annotation to this principle indicates that "Where laws and practice of corporate governance systems provide for participation by stakeholders, it is important that stakeholders have access to information necessary to fulfil their responsibilities" (UNCTAD, 2000a, vol. IV, p. 274).

Obviously, this provision is of immediate relevance to cross-border M&As.

*Source*: UNCTAD.

[a] A number of ILO Conventions, as well as many other international arrangements, are of course also relevant to TNCs, even though they do not address them specifically. Among the ILO instruments perhaps particularly relevant in the context of M&As are the ILO Convention Concerning Termination of Employment (Convention 158, of 1982) (ILO, 2000a) and the ILO Recommendation Concerning Termination of Employment at the Initiative of the Employer (Recommendation 166, of 1982) (ILO, 2000b).

[b] Paragraph 6 of the revised OECD Guideline on Employment and Industrial Relations reproduces verbatim the previous text of this guideline, except for the last two sentences which were added in the new version. The first new sentence suggests that the appropriate timing of the notice given to employees in the relevant situations should be prior to the final decision being taken, but this is qualified by the phrase "if management were able to" do so. Notice prior to the final decision is indeed a feature of the industrial relations laws and practices of a number of OECD countries. At the same time, the revised Guideline recognizes that giving notice to employees is not the only means to ensure an opportunity for meaningful co-operation to mitigate the effects of such decisions and the laws and practices of a number of OECD countries provide for other such means as defined periods during which consultations must be undertaken before decisions are implemented (see Commentary on Employment and Industrial Relations, OECD, 2000).

In the case of privatizations, employees who remain in a company may be offered stock options as part of a privatization package, strengthening their potential role in its management. However, this does not necessarily guarantee voting rights. In the Telmex (Mexico) privatization, for example, unionized workers bought 3 per cent of Telmex public shares as individuals and the union's retirement fund bought 1.4 per cent. This, however, did not give the union a seat on the company's board, although it was agreed that workers would be allowed to continue purchasing shares and would be entitled to a seat when their purchases reached 10 per cent of all shares. This goal was not reached as many workers cashed in their shares and others chose to exert direct control over their shares rather than hand them over to the union's share fund (ILO, 1998).

## 3. Skills

TNCs tend to invest more in training than local firms and to deploy more modern training practices and materials. They also bring in expatriates with specialized skills and establish strong linkages with training institutions and schools. The main difference between the two modes of TNC entry is likely to lie primarily in the short-term inertia associated with acquisitions. In the long-term, there is no reason to expect any important difference. Upgrading of skills has been observed, for example, in the auto-supplier industries in Mexico. Though cross-border M&As here reduced the number of local supplier firms, they enhanced the quality of employment in the firms that survived. These firms were acquired from Mexican owners in the early 1990s, and incoming TNCs provided shop-floor training, as well as training in quality control, design, technical norms and specifications (Romijn, et al., 2000, pp. 36f). In Zimbabwe, an agro-processing firm, Olivine, a joint-venture with a TNC, provided training at all levels as earnings were reinvested to upgrade the firm's competitiveness (Romijn, et al., 2000, p. 25).

There is a risk that M&As may result in the best, most highly skilled employees of the acquired firms being transferred abroad for use elsewhere in a TNC network. This may be regarded as an undesirable brain drain for a host economy, though it may lead to higher welfare and skill creation for the employees concerned (and for the host economy if and when they return). However, where a host economy has such desirable skills at low cost, foreign employers can attract workers abroad by other means. A greenfield venture may also bid workers away from other firms and send them abroad, or foreign firms may hire workers without investing locally at all.

At the same time, the integration of an acquired affiliate into a TNC system can lead to such significant skill inflows as new work systems, management techniques and production technologies are introduced. The deliberate downgrading of skill levels in a newly acquired facility is fairly unlikely; it would make sense for a TNC to do this only if it went for an acquisition to access low-wage

**Box VI.10. Employees' rights in the event of M&As in the European Union**

The European Community's Council Directive 98/50 (1998) "on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses" requires, in article 6, both the transferor and transferee to inform the representatives of their employees affected by a transfer of the date and reasons for the transfer, the economic and social implications for the employees, and any measures envisaged in relation to them. The information must be given in good time before the transfer is carried out and, in any event, before employees are directly affected by the transfer as regards their employment and conditions of work. Representatives of employees should be consulted in good time on such measures, with a view to reaching an agreement. In addition, article 3 imposes an obligation on an acquiring company to respect established contracts of employment. Apart from the requirements on the provision of information and the consultations mentioned before, the Directive gives unions an influence on the acquisition process.

*Source*: European Community, 1998.

unskilled labour. This is unlikely to form the basis of a strategic acquisition, because setting up a new venture to access low-cost labour would be much simpler.

## 4. Summary

### Employment quantity

- The employment effects of cross-border M&As and greenfield FDI differ in the first instance. Greenfield FDI directly and immediately creates new jobs, while M&As do not. On the contrary, there are several reasons why M&As may lead to lay-offs.

- However, not all cross-border M&As lead to direct employment losses. There are several conditions in which they add to employment even in the short-term, as when corporate decisions lead to the immediate expansion of capacity.

- If employment in acquired enterprises would have declined even further or disappeared entirely in the absence of cross-border M&As, as, for example, in cases in which firms go bankrupt, M&As conserve employment for a host economy.

- In the long-term, and taking indirect effects into account, there is no reason to expect a systematic difference between the two modes of entry on employment. Instead, differences will depend on the motivation underlying FDI.

- Lay-offs nevertheless cause economic loss and social problems. Wherever they occur, even for sound economic reasons, governments should therefore make provisions to deal with them, to retrain workers and to help create other employment opportunities by means, among others, of policies generally conducive to investment and enterprise development. Where social safety nets are lacking, large-scale lay-offs may create extreme distress.

### Employment quality and skills

- Greenfield FDI may upgrade employment conditions more than M&As because the latter may tend to stick with the inherited norms and practices for some time. Furthermore, cross-border M&As can be used to renegotiate work conditions and lead to their downgrading. Thereafter, M&As may upgrade employment quality faster to bring the new affiliates in line with corporate norms and competitive needs. Over time, there is no reason to expect any systematic difference between the two modes.

- There is, similarly, no reason to expect systematic differences in skill creation. If the integration of an acquired affiliate takes time and there are many inherited "bad work habits", however, retraining may take longer.

- There may be a risk of skill loss if an acquiring company transfers abroad the best jobs or the most qualified employees of an acquired firm. However, this is not likely in most cases: acquired firms are more likely to benefit from an inflow of new skills as technologies and management systems are integrated into the parent TNCs.

### Policies

- As M&As typically create anxieties at all levels of a firm's staff structure, consultations are important. Early consultations and discussions with worker representatives can provide lead time for taking measures to minimize hardship through e.g. the retraining and relocation of workers. An appropriate mechanism for consultations can be helpful in this respect.

- As FDI through cross-border M&As increases the prospects for sudden and large-scale lay-offs from employment in the formal sector, it is more important than ever that countries adapt, expand and strengthen their social safety nets for workers and strengthen the domestic enterprise sector and its competitiveness so that it creates more jobs.

- Specific commitments and measures for employment retention have a role to play as short-term complementary measures, especially where safety nets are weak or non-existent.

- Trade unions play an important role in ensuring that qualitative gains in employment conditions achieved over time are not dissipated in the course of M&As, including cross-border M&As. Forms of information-sharing need to be found for M&As taking place in firms that lack formal worker representation.

## D. Export competitiveness and trade

FDI can help developing countries exploit existing comparative advantages and build new ones. It is the principal means for them to enter the international production systems of TNCs that increasingly figure importantly in world trade, particularly in complex manufactures (box VI.11).

### 1. Building export competitiveness

There is an important difference between FDI through the two modes of entry when it comes to building export competitiveness in host economies. Greenfield entry may be the only feasible mode of foreign entry for many new export-oriented activities, particularly in export-processing zones, since there are generally few local firms with major export potential to acquire. In export-oriented activities that are closely integrated into international production chains — as in electronics — there is little scope for independent local firms. The skill and technological needs are very high and the transaction costs inherent in firms hitherto under different ownerships integrating their operations in fast-moving technologies are often prohibitive. Greenfield FDI is thus the dominant form of entry.

Greenfield and M&A FDI may, however, be real alternatives in the case of protected, locally-owned activities that need to raise competitiveness in the face of rapid trade and FDI liberalization. For the host economy or industry, greenfield investment would be preferable where restructuring local firms is costly and prolonged, and M&As where they could manage the restructuring quickly and effectively. In liberalizing economies, M&As can be a valuable means of preserving and upgrading local capabilities. The automotive component industry has been restructured by cross-border M&As in Mexico, Brazil, Argentina (Mortimore, 1998) and more recently Thailand, when the alternative facing them was declining competitiveness and, in some cases, bankruptcy. Greenfield entry would also have provided competitive facilities, but may have led to a loss of local capabilities and a greater disruption of local supply chains and activities.

What of the export orientation of affiliates established by the two modes? The experience of Central and Eastern European economies provides a mixed picture. In Hungary, most new export-oriented enterprises located in export-processing zones were established through greenfield ventures but some privatized enterprises also became major exporters. In general, however, M&As were less export-oriented than greenfield investments (Éltetö and Sass, 1997). In contrast, in the Czech Republic, the export intensity of affiliates established through M&As was not significantly different from that of greenfield investments. The major exporter in both cases was the automobile industry; the difference in export performance reflects its different evolution. In Hungary, foreign investment in automobiles was greenfield, since earlier it had no automobile industry. In the Czech Republic, the national incumbent Skoda was a well-established producer and exporter. After its sale to Volkswagen, the share of exports in Skoda's sales increased from 34 per cent in 1990 to 52 per cent in 1995 and 80 per cent in 1999; Skoda accounted for 76 per cent of the automobile exports of the country by 1998 (Zemplínerová and Jarolim, 2000). In Poland, the picture is unclear (Uminski, 2000). A survey of early privatizations (1990-1994) shows that the share of exports in sales increased in firms sold to foreign owners, while falling in locally owned firms (Dabrowski, 1996). A survey of 23 firms in seven Central and Eastern European countries shows that exports grew rapidly both before and after privatization, but faster before than after (39 and 34 per cent, respectively). In an example from a developing country, Costa Rica, acquisitions of local firms oriented towards the domestic market were partly redirected to the regional market, a process which, however, also involved an increase in imports (box VI.12).

**Box VI.11. FDI, export competitiveness and trade**

TNCs account for a large share of world exports and imports. Their role is greater in technology- and skill-intensive industries, the most dynamic and high value-added activities in trade. TNCs are increasingly setting up integrated production systems across countries, with considerable specialization by technology level and labour costs; thus, intra-firm trade is playing a greater role in some of the most advanced areas of trade. TNCs are also very active in sourcing natural resources and resource-based manufactures from developing countries and relocating simple labour-intensive activities and processes (within high technology industries) there to tap their low wages. Thus, TNC participation can help host countries raise exports in all kinds of industries by providing the missing elements, tangible as well as intangible, that they need to compete or by improving the local base of skills and capabilities. However, the impact of FDI on strengthening host countries' export competitiveness and their ability to compete with imports is not unambiguously positive: much depends on the nature of local skills and capabilities and on measures taken to improve these over time. To summarize the main effects of FDI:

- ***Exploiting static comparative advantages.*** FDI can be an effective means of providing the missing resources, such as the skills, training and technology, capital goods and intermediate inputs needed to exploit the host countries' existing comparative advantages. These advantages can be natural resources and low-wage unskilled labour in less developed countries, or the base of capabilities built up earlier (behind protective barriers) in more advanced countries with import-substituting experience. FDI may not, however, be sufficient to sustain export growth as wages rise and it becomes necessary to develop more skill-intensive and technology-intensive exports. TNCs can improve worker skills, but cannot upgrade the local base of education and capabilities. Unless the host country does this, there is a danger that TNC-based export growth will peak and then stagnate.

- ***Creating dynamic comparative advantages***. In countries with adequate education and capabilities, TNCs can help create dynamic comparative advantages by means of new skills and more advanced technologies. This has been the case with dynamic industries like electronics in some countries of South-East Asia. In countries with more advanced industrial and technology bases, TNCs can feed into innovation by setting up R&D centres and interacting with local research.

- ***Providing access to international markets.*** Successful exporting needs not only competitive products, but also marketing expertise and access to international markets. FDI can provide a major benefit in this respect, especially in markets in which established brand names and large distribution networks are important assets. Where trade is internal to TNCs, as in some high technology products, joining TNC networks is often a *conditio sine qua non* for increasing exports. On the other hand, foreign affiliates may have less freedom than domestic firms to choose export markets and diversify their product range. Those assigned to the low end of the value-added chain may stagnate relative to competent and technologically progressive local firms.

- ***Raising local linkages.*** To the extent that a foreign affiliate sources inputs locally, FDI in export-oriented industries links domestic suppliers indirectly to international markets. These enterprises may later be able to exploit these links further on their own. With trade liberalization, the decision of foreign affiliates to source their inputs locally or abroad is subject more to cost and delivery considerations than to host-government trade policies. When they first enter a new host country, TNCs may tend to use established overseas suppliers with whom they have strong linkages. However, there are advantages to having suppliers nearby, and TNCs invest in developing local suppliers when the cost of bringing them up to the necessary technical and quality levels is modest. Some of this takes place through FDI in supplier industries, including producer services. Where the costs of developing supplier industries are too high to induce such associated investment, promoting linkages needs government support to help local firms raise their skills and technology levels.

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**Box VI.11. FDI, export competitiveness and trade (concluded)**

Over time, the linkages of foreign affiliates and local firms tend to become similar as their information on local and foreign suppliers converges.

Statistical analyses show a positive link between FDI and manufactured export performance. The list of the most dynamic exporters in the developing world shows that the great majority depends heavily on TNC export operations (UNCTAD, 1999a). However, export-oriented TNC operations are concentrated in a few developing countries, with high technology export networks encompassing an even smaller number.

Inward FDI also affects the volume and composition of host-country imports. It has been found, in most cases, to lead to a net increase in imports (UNCTAD, 1996a, pp.73-85), adding to both arm's length and intra-firm purchases of goods and services. Some of these imports serve to complement domestic comparative advantages and strengthen export competitiveness. The composition of imports also tends to change, as production by foreign affiliates is often more technology-intensive than domestic production. The economic implications of increased imports by foreign investors depend upon the quantity, quality and prices of their products.

*Source:* UNCTAD, 1999a.

## 2. Reliance on imports versus local sources

Greenfield and M&A FDI may differ in the extent to which they rely on imported or local inputs. As noted earlier, greenfield projects tend, at least initially, to have weaker local linkages, relying more on foreign suppliers and intra-TNC trade. Acquired firms are likely to continue to rely on local suppliers with which they have established links, as long as the suppliers are competitive with alternative sources. Interestingly, the higher import propensity of greenfield FDI can persist over a longer term, as Swedish data show (Andersson, et al., 1996, p. 66). In the Czech Republic as well, greenfield foreign enterprises were found to rely more on imported supplies than did acquired firms (Zemplínerová and Jarolim, 2000). In 1998, the imports-to-sales ratio of the former was 30 per cent higher than of firms acquired by TNCs.

In the services sector, however, where cross-border M&As are often an important means of foreign entry, the import propensities of acquisitions can be high. In Central and Eastern Europe, according to the 1999 UNCTAD survey that covered large infrastructure

**Box VI.12. M&As and trade: the experience of firms in Costa Rica's food industry**

A survey undertaken in early 2000 by the Ministry of External Trade of Costa Rica of ten companies in the country's food industry that had been acquired by foreign firms shows that export destinations are concentrated in neighboring countries, suggesting that some investors were seeking access to Central American markets through the acquisition. For example, two of the firms that were hitherto producing for the domestic market have emerged as regional exporters of dessert foods, while four others increased their export values, two of them significantly. Seven firms in the sample are centering their export activity on two to three subregional countries each.

On the other hand, eight of the ten surveyed firms display a negative trade balance with import values amounting from twice to five times as much as those of exports. It is not clear, however, from the available information whether this reflects a short- to medium-term effect due, for example, to the import of capital goods for strengthening or upgrading production capacities after acquisition, or an effect that might extend over a longer-term, due to import-sourcing of inputs that could persist and that is not offset by export earnings.

*Source:* Costa Rica, Ministry of Foreign Trade, 2000; and UNCTAD.

companies, the growth of imports accelerated significantly after privatization. Imports increased at 40 per cent per annum after privatization, as compared with 14 per cent per annum before it. This rapid growth in imports has to be evaluated in the context of a rapid growth in the provision of goods and services to customers at falling costs, as well as increased efficiency in downstream industries due to improved access to and the lower costs of producer services.

### 3. Summary

*Building export competitiveness*

- Many export-oriented activities, particularly those integrated into international production systems, are new to developing countries and involve greenfield FDI rather than M&As. However, M&As can play an important role in restructuring and reorienting firms coming to be exposed to international competition. This role is more important in large import-substituting economies with strong domestic capabilities and is likely to grow in significance.

- In European economies in transition, M&As have tended to be more domestic-market-seeking than greenfield investment, but there are striking exceptions. Much depends on the specific situation of the countries and industries involved.

*Reliance on imports versus local sourcing*

- FDI through cross-border M&As may rely more on local suppliers relative to greenfield foreign affiliates, which take time to establish local links. Although import reliance may be quite high, especially in acquisitions in capital- and technology-intensive industries, the preservation of links with local suppliers may be an advantage of FDI through cross-border M&As.

*Policies*

- Apart from general policies to strengthen competitiveness, governments could consider offering incentives for restructuring firms for export activity, just as they do for new export-oriented greenfield investments.

- Governments can target export-oriented TNCs for specific M&As. Governments can also directly influence the export performance of M&As through incentives linked to export performance (to the extent that they do not conflict with trading rules).

## E. Market structure and competition

FDI has complex effects on a host-country's market structure and competition. Large foreign affiliates can pose serious challenges for maintaining effective competition in host economies, by increasing market concentration or engaging in anti-competitive behaviour. They can also promote competition rather than restrict it (box VI.13).

### 1. Market structure

What difference does the mode of foreign entry make to market structure? Greenfield entry initially adds to the number of enterprises — potential competitors — in a host country, reducing market concentration. M&As leave the number of competitive firms intact. The net effect on market structure is, however, more complex than this. Greenfield FDI may not add to the number of competitors if the investing firm were present earlier in the market through trade or licensing agreements. It may increase concentration if the new foreign affiliate offsets the dominant market positions of incumbent firms, or takes a dominant market position itself. Cross-border M&As can, on the other hand, have a positive effect on competition if the entrants take over ailing domestic firms that would otherwise have been forced out of the market. They can also challenge established domestic oligopolies by merging with other domestic firms to create effective rivals.

One relevant difference between the two entry modes is that M&As can, in contrast to greenfield entry, be used to reduce competition via "monopolizing mergers and acquisitions" (UNCTAD, 1997a). This type of cross-border M&As can occur in the following situations:

- The acquiring firm was exporting substantially to a market before it buys a competing firm in it;
- A foreign firm with an affiliate already in the market acquires another, thereby acquiring a dominant or monopolistic market share;
- The investing TNC acquires a market leader with which it has previously competed;
- The acquisition is intended to suppress rather than develop the competitive potential of the acquired firm.

In addition, there can be important adverse effects on market structure and competition (as well as in the other areas of development considered in this chapter) of cross-border M&As that occur in other economies. For example:

- Parent firms of foreign affiliates located in a host country merge and consequently merge their affiliates, reducing local competition;
- A TNC with an affiliate in a host country acquires an enterprise in a third country that has been a source of import competition in the host country market;

**Box VI.13. FDI, market structure and competition**

**Market structure**

TNCs flourish in concentrated markets. Their main ownership advantages (in technology, product differentiation and organization) are found in oligopolistic industries with large firms. Consequently, their entry also tends to occur in concentrated industries. This may initially add to the number of firms, though it can force the exit of less efficient firms and thereby raise concentration levels. This is not necessarily anti-competitive conduct. If markets are contestable, the result can be a more efficient and competitive industrial structure. Much depends on the openness of a market to trade, the intensity of local competition, the actual conduct of leading firms and technology. The chances of abuse of market power are much greater in protected markets or in those in which the Government favours selected enterprises than in open ones. Patchy evidence suggests that FDI may be associated with reduced concentration in developed countries and with increased concentration in developing ones, where strong domestic firms are relatively scarce. As to effects on competition, the evidence from developing countries is mixed.

**Competitive behaviour**

TNC entry puts competitive pressure on domestic firms. There is evidence that this leads to an increase in product quality, variety and innovation in host economies. There is little evidence, however, that it leads to lower prices. Domestic firms may react to the competitive pressure by enhancing capabilities or be forced out altogether. Both might be desirable outcomes from the economic point of view as long as they reflect genuine market forces rather than predatory behaviour by foreign affiliates. However, when domestic producers of low-quality, low-price goods and services go bankrupt and these products disappear, the low-income population is left in distress. Predatory conduct remains a significant risk, although recent investment and trade liberalization have raised contestability in national markets. Nevertheless, the urgency of an effective competition policy has not diminished for host economies.

**Privatization of natural monopolies**

Another important issue for many economies is the impact on competition of foreign purchases of state-owned companies that hold monopoly positions. The problem is particularly acute with respect to natural monopolies, where privatization has to be accompanied by (often complex and flexible) regulatory structures and rules. Developed countries are experimenting with different policies, like introducing competition in particular segments where several producers can operate (e.g. power generation), or regulating and assessing the operation of monopolies in different ways (yardstick competition, price setting or negotiated rates of return). The impact of foreign private ownership is in this context a part of the larger array of regulatory issues.

*Source:* UNCTAD, 1997a.

- Two foreign affiliates in a host economy merge, although their parent firms remain separate, eliminating competition between the two affiliates and leading to a dominant market position.

In general, it is horizontal M&As (i.e. M&As between firms making similar products) that cause the main problems for competition policy. However, vertical M&As can also raise competition issues. For instance, they may increase the potential for keeping rivals from sources of supply or raise barriers to new entry. To repeat, the final outcome for competition depends on the context. Higher concentration by itself does not indicate anti-competitive conduct; it may simply reflect scale and efficiency considerations. Cross-border M&As (or M&As with foreign affiliates) may be a way for domestic firms to stand up to large TNCs entering the market. The crucial issue is the size of the relevant market: national, regional or global. This differs from industry to industry. Much depends also on how contestable the market is. Where a market is open to import competition and new local and foreign investment, the domestic concentration level need not necessarily make a difference to effective competition.

Evidence available on the consequences of M&As for concentration is less than conclusive. Evidence in the form of government actions in developed countries, relating to cross-border as well as domestic M&As, suggests that the majority of M&As do not have negative effects on concentration. In the United States and the European Union, competition authorities scrutinize only a small minority of cross-border M&As to assess negative impacts on competition. An even smaller number of transactions is subject to such obligations as selling off parts of the business or is completely ruled out. In the United States, for example, in fiscal year 1999 (ending 30 September) only 1.6 per cent of 4,679 M&As transactions notified to anti-trust authorities resulted in enforcement actions, with only about 1 per cent being challenged in the end (United States, Department of Justice, 2000). The situation is similar in the European Union: in 1999, only 14 out of 292 transactions (less than 5 per cent) were challenged or subject to a second-phase investigation. An additional 19 cases were cleared during the first phase of investigation. In Japan, all 3,813 M&As notified in 1998 were cleared, although two transactions "were revised in response to concerns raised during pre-notification consultation" (*ibid.*, p. 7). However, the lack of official action does not necessarily mean that firms did not increase concentration: the authorities may have believed the M&As to be in the public interest even if concentration did increase.

Evidence is scarce in developing countries because many of them do not have competition laws or the resources to implement them vigorously. Even if they have such laws, they might not have merger control provisions. In one country that provides such evidence, the Republic of Korea, the situation seems to be similar to that in developed countries. The Korean Fair Trade Commission has ordered corrective measures for only 3 out of 132 cross-border M&As notified in 1998 (Yun, 2000, p.12). In Mexico, all 55 notified cases of cross-border acquisitions of Mexican firms in 1997 went through unhindered as "no competition risk was registered" (Mexico, Federal Commission on Competition, 1997, pp. 7-8).

At the same time, there are examples of M&As between TNCs and incumbent firms resulting in the TNCs assuming dominant or quasi-monopolistic positions. In India, for instance, Hindustan Lever Limited, the Indian subsidiary of Unilever, acquired its main local rival, Tata Oil Mills Company, to assume a dominant position in the toilet soap (75 per cent) and detergent (30 per cent) markets (Mehta, 1999, p. 24). Hindustan Lever Limited also acquired several local companies in other markets, such as the ice cream makers Dollops, Kwality and Milkfood. This raised its market share in the ice cream market from zero in 1992-1993 to 69 per cent in 1996-1997 and over 74 per cent in 1997-1998 (Kumar, 2000, pp.13 and 17). Smith Kline Beecham, with a 64 per cent share in the Indian market for health drinks, acquired two brands from the domestic producer Jagjit Industry Limited (Kumar, 2000, p. 17). In Mexico, a United States brewery Anheuser-Busch — already present in the Mexican market — acquired a controlling stake (50.2 per cent) in the Mexican brewery Grupo Modelo SA, the marker leader, in 1998. Although data on the combined market share of the two companies are not available, it is presumably higher than the 55 per cent held by Modelo in 1996.[28]

In the countries of Central and Eastern Europe, many industries had monopolistic structures before the transition to market-based systems. Privatization therefore raised the very real possibility of monopoly positions being maintained or strengthened (Zemplínerová and Jarolim, 2000). In the Czech Republic, concentration in manufacturing fell during 1989-1995 as a result of the splitting of large companies into smaller units but, in the second half of the 1990s, domestic mergers raised concentration in a number of industries. A number of the merged firms were later sold to foreign investors. However, an analysis of concentration ratios in 87 manufacturing industries in 1998 did not find any strong correlation between cross-border acquisitions and the share of the largest producer in an industry's sales, excluding imports (Zemplínerová and Jarolim, 2000, table 5). Of the 15 industries in which the share of the largest producer was above 50 per cent, only four showed a link between the share and cross-border M&As, probably because of the sale of domestic companies with high shares to foreign investors. In the remaining 11 cases there was no link between the high ratio and cross-border M&As. The introduction of imports reduced the shares of dominant firms in many industries (including the four foreign firms with high shares) sufficiently to alleviate competition concerns. In small economies imports are, of course, often the only way through which competition can be maintained.

Nevertheless, the threat of the abuse of market power is always present. TNCs in countries with weak regulatory frameworks are by no means immune to the temptation to use this power to achieve dominant positions or secure higher levels of protection. Indeed, in the first years of transition and privatization in Central and Eastern Europe, foreign investors sought and frequently secured monopoly positions or protected markets. In Hungary, for example, privatization programmes offered foreign firms attractive local companies with strong market positions for sale (Antalóczy and Sass, 2000).

## 2. Competitive behaviour

The competitive conduct of TNCs is perhaps even more important than their impact on market structure (box VI.13). While conduct is not expected to vary by mode of entry, in cross-border M&As, the assets of the acquiring company are supplemented by those of the acquired one, access to which may have been a major motive for the acquisition. This can give the new company significant competitive advantages over incumbent or overseas rivals, greater than those achieved through greenfield FDI. An example is the retail trade industry, where TNCs take over local retail chains and combine their advantages of global sourcing with the advantages of the established distribution network. Greenfield FDI does not enjoy this advantage, and takes more time to build up local assets.

Neither conceptual analysis nor empirical evidence suggests that foreign affiliates, once operational, differ in their competitive conduct because of the mode of entry. Both types have engaged in anti-competitive practices — and both have added to competition. Take anti-competitive behaviour. Firms investing abroad through greenfield ventures may try to restrict competition by using "market-allocation investment cartels". The Timken Roller Bearing Company is a good example. The United-States-based Timken arranged with its major international rival, a United Kingdom firm also called Timken, to enter new markets as partners (via joint ventures), fix prices, allocate territories and participate in cartels to restrict exports (UNCTAD, 1997a). Affiliates established by M&As can indulge in similar restrictive practices.

At the same time, both types of affiliates can add to market competition by their activities. As noted above, the injection of new technologies, management methods and marketing techniques can place incumbent firms under great competitive pressure. This pressure can be particularly beneficial in host economies with a history of protected markets and entrenched local oligopolies.

## 3. Summary

The effects of cross-border M&As on market structure and competition need close scrutiny by policy-makers in host countries. At the time of entry, M&As do not add to the number of competitors, as greenfield FDI does. In fact, M&As — unlike greenfield FDI — can be used deliberately to reduce the number of competitors serving a host-country market when the acquiring TNC already serves the market. At the same time, there are also scenarios in which M&As can actually prevent a reduction in the number of competitors with a potentially positive effect — by, for example, acquiring ailing domestic firms.

There is no evidence that, in the longer run, foreign affiliates created through M&As would behave differently from foreign affiliates established through greenfield FDI when it comes to anticompetitive practices. However, the potential for a direct reduction in competition at the time of entry, and the avenues this may open for anticompetitive practices, requires the attention of policy-makers, especially of competition authorities. As elaborated above, there are several typical constellations in which M&As take place that deserve the attention of policy-makers even if the primary objective of these deals is not to reduce competition.

As countries liberalize and reduce policy impediments to FDI and trade, competition policy becomes increasingly important in regulating market structure and competition. Competent regulatory bodies and frameworks become critical for ensuring that the risk of negative impacts (including the impacts of cross-border transactions) is minimized. The concluding section will return to this issue, emphasizing the challenges faced by policy-makers in developing countries in the demanding sphere of competition policy and regulation.

## F. Summary and conclusions

With the emergence of a market for firms spanning developed countries and increasingly also developing countries and economies in transition, TNCs have indicated a strong revealed preference for M&As as a mode of entry of FDI. In fact, cross-border M&As are becoming an important means by which firms reshape and restructure themselves under conditions of dynamic change and in the context of the globalization of markets for goods and services and the emergence of an international production system.

The essential difference between cross-border M&As and greenfield FDI is that the former by definition involve a transfer of assets from domestic to foreign hands and, at least initially, do not add to the productive capacity of host countries. This, in turn, leads to a range of concerns over insufficient resource transfers, lay-offs, asset stripping (including the stripping of technological and innovatory capacities), and, above all, adverse effects on market structure and competition. These concerns are, furthermore, embedded in broader apprehensions regarding an erosion of national economic sovereignty, a weakening of national enterprises, and a loss of control over the direction of national development and the pursuit of social, cultural and political goals. These concerns, in turn, are linked to fears regarding globalization and the perceived power of large TNCs.

Such concerns need to be considered carefully. Their examination in the present chapter focussed on the impact of cross-border M&As in key areas of economic development and whether this impact differed from that of greenfield FDI. A good part of the discussion has been conceptual, and more empirical work is needed to understand the matter fully.

The discussion in the preceding sections suggests that, especially *at the time of entry and in the short term,* M&As (as compared to greenfield investment) may involve, in some respects, smaller benefits or larger negative impacts from the perspective of host-country development. To summarize:

- Although FDI through both M&As and greenfield investment brings foreign financial resources to a host country, the financial resources provided through M&As do not always go into additions to the capital stock for production, as they do in the case of greenfield FDI. Hence a given amount of FDI through M&As may correspond to a smaller productive investment than the same amount of greenfield FDI, or to none at all. However, when the only realistic alternative for a local firm is closure, cross-border M&As can serve as "life preservers".

- FDI through M&As is less likely to transfer new or better technologies or skills than greenfield FDI, at least at the time of entry. Moreover, it may lead directly to the downgrading or closure of local production or functional activities (e.g. R&D capabilities), or to their relocation in line with the acquirer's corporate strategy. Greenfield FDI does not *directly* reduce the technological or other assets and capabilities in a host economy.

- FDI through M&As does not generate employment when it enters a country, for the obvious reason that no new production capacity is created in a merger or an acquisition. Furthermore, it may lead to lay-offs, although it can conserve employment if the acquired firm would have otherwise gone bankrupt. Greenfield FDI necessarily creates new employment at entry.

- FDI through M&As can increase concentration in host countries and lead to anti-competitive results; in fact, M&As can be used deliberately to reduce or eliminate competition. It can, however, prevent concentration from increasing when takeovers help preserve local firms that might otherwise have gone under. Greenfield FDI, by definition, adds to the number of firms in existence and cannot directly increase market concentration upon entry.

Most of the shortcomings of FDI through M&As in comparison with greenfield FDI relate to effects at entry or soon after entry. *Over the longer term,* when direct as well as indirect effects are taken into account, many differences between the impacts of the two modes diminish or disappear. To summarize:

- Cross-border M&As are often followed by sequential investments by the foreign acquirers — sometimes large, especially in special circumstances such as privatizations. Thus, over the longer term, FDI through M&As can lead to enhanced investment in production just as greenfield FDI does. The two modes are also likely to have similar effects regarding the crowding in and crowding out of domestic enterprises.

- Cross-border M&As can be followed by transfers of new or better technology (including organizational and managerial practices), especially when acquired firms are restructured to increase the efficiency of their operations. To the extent that TNCs invest in building local skills and technological capabilities, they do so regardless of how those affiliates were established.

- Cross-border M&As can generate employment over time, if sequential investments take place and if the linkages of acquired firms are retained or strengthened. Thus, in the longer run, differences between the two modes as regards employment generation tend to diminish and depend more on the motivation for entry than on the mode of entry. If employment reductions occur due to restructuring for greater efficiency, the consequences may be less disruptive than when greenfield FDI eliminates uncompetitive firms.

- The effects on market structure, whether negative or positive, can persist after entry. The capacity to engage in anticompetitive practices is greater with M&As that increase concentration, especially when they occur in weakly regulated oligopolistic industries.

In sum, host-country impacts of FDI are difficult to distinguish by mode of entry once the initial period has passed — with the possible exception of the impacts on market structure and competition.

In addition to the effects on the principal *individual* aspects of economic development summarized above, the overall impact of cross-border M&As as against greenfield investment also needs to be considered, taking into account the specific economic context and the development priorities of individual host countries. Particularly important here is the impact on economic restructuring. The restructuring of industries and activities is necessary for growth and development, especially under conditions of rapid technological change and increasing global competition. Such restructuring can of course also take place through domestic M&As and not only cross-border ones; Argentina offers interesting comparisons in this respect (box VI.14). Economic restructuring can also be important under exceptional circumstances, such as financial crises or transitions to market-based economic systems. Cross-border M&As may have a role to play here since they provide a package of assets that can be used for various types of restructuring and, furthermore, have the attributes of speed and the immediate involvement of local (acquired) firms; they can thus usefully supplement domestic resources and efforts. Greenfield investment, of course, can also help economic restructuring; but it has no role to play in conserving domestic enterprises and may, indeed, hasten the demise of weaker domestic firms if and when it out-competes them.

Finally, there are the broader apprehensions regarding a weakening of the national enterprise sector and a loss of control over the direction of national economic development and the pursuit of social, cultural and political goals. These issues acquire urgency when cross-border M&As result in industries thought to be strategic[29] coming under the control of foreign TNCs. They may acquire a yet further edge in developing countries since these countries are predominantly host rather than home countries for FDI in general and cross-border M&As in particular.

The basic question here is what role foreign firms should play in an economy, regardless of whether they enter through greenfield investment or cross-border M&As. It has to do with the extent of foreign ownership that a country can accept comfortably, and the economic, social, cultural and political consequences of such ownership. Many governments, local enterprises and civil-society groups feel that certain activities (e.g. the media) should be exclusively or primarily in local hands.

There are no *a priori* solutions to these concerns. Each country needs to make its own judgement in the light of its conditions and needs and in the framework of its broader development objectives. It also needs to be aware of — and to assess — the trade-offs involved, whether related to efficiency, output growth, the distribution of income, access to markets or various non-economic objectives. And it needs to note as well that some of these concerns are raised by *all* FDI, although the specific nature of M&As may exacerbate them. The impact of cross-border M&As also depends on host-country circumstances:

- Under *normal circumstances* (i.e. in the absence of crises or systemic changes), and especially when cross-border M&As and greenfield investments are *real* alternatives, greenfield FDI is more useful to developing countries than cross-border M&As. Other things (motivations and capabilities) being equal, greenfield investment not only brings a package of resources and assets *but* simultaneously creates additional productive capacity and employment; cross-border M&As may bring the same package but do not create immediate additional capacity. Furthermore, certain types of cross-border M&As

**Box VI.14. The impact of cross-border M&As in Argentina in the 1990s**

Between 1992 and 1999, cross-border M&As accounted for almost 60 per cent of FDI inflows in Argentina. In the early 1990s, most were related to privatizations; after 1993-1994, most were acquisitions of private firms, and accounted for one-third of FDI flows in 1996-1998. Domestic M&As also increased during the 1990s. Given these trends, an examination of the Argentinean experience is useful for understanding the effects of cross-border M&As on a developing economy.

To examine these effects, the performance of manufacturing firms participating in M&As in Argentina was compared with that of an appropriate control group of firms from the same industries and of similar size which did not participate in M&As.[a] Matching firms were arranged in pairs to compare, first, firms involved in M&As in general (i.e. both domestic and cross-border M&As) with firms, both domestic and foreign not participating in M&As (sample A of firms in box table). Secondly, the performance of firms participating in cross-border M&As was compared *indirectly* with that of firms participating in domestic M&As by examining how each group performed relative to comparable non-M&A firms (samples B and C). And thirdly, the performance of the two groups (not necessarily including the same firms) was compared *directly* with each other (sample D). Since only three among the M&A firms in these samples were state-owned before the merger or take-over, the analysis yields findings primarily about M&As involving private companies. It is the first analysis of its kind in Argentina, and one of the few in developing countries. The key findings of these comparisons follow.

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## Box VI.14. The impact of cross-border M&As in Argentina in the 1990s (continued)

### Box table VI.15.1. The performance of foreign and domestic M&A and non-M&A firms in Argentina between 1992 and 1996

| Item | Sample A[a] M&A firms (all) | Sample A[a] Non-M&A firms (all) | Sample B[b,c] M&A firms (foreign) | Sample B[b,c] Non-M&A firms (domestic) | Sample C[c,d] M&A firms (domestic) | Sample C[c,d] Non-M&A firms (domestic) | Sample D[e] M&A firms (foreign) | Sample D[e] M&A firms (domestic) |
|---|---|---|---|---|---|---|---|---|
| | Number | | | | | | | |
| Firms | 99 | 99 | 51 | 51 | 41 | 41 | 19 | 19 |
| | Increase in per cent in 1996 (1992=100)[f] | | | | | | | |
| Sales | 51* | 25 | 63** | 25 | 24 | 28 | 64 | 44 |
| Exports | 143 | 122 | 138 | 110 | 111 | 58 | 145 | 48 |
| Imports of inputs and final goods | 56 | 34 | 25 | 31 | 58 | 70 | 161 | 214 |
| Imports of capital goods | 166 | 57 | 189 | -15 | 23 | -39 | 53 | 328 |
| Investment in productive assets | 92 | 52 | 85 | 13 | 36 | 18 | 65 | 97 |
| Number of employees | -4 | -5 | 1 | -9 | -18 | 2 | 3 | -23 |
| Productivity[g] | 50 | 29 | .. | .. | .. | .. | .. | .. |
| R&D expenditure | 70 | 50 | 53 | 34 | 278 | 39 | 79 | 220 |
| | Thousands of dollars per enterprise | | | | | | | |
| Cumulative training expenditures between 1992 and 1996 | 569* | 113 | 820 | 150 | 459 | 133 | 261 | 115 |
| | Per cent | | | | | | | |
| Improvements in product and process technology and organizational and managerial practices[h] | 62.1* | 55.8 | 61.6* | 49.4 | 55.8 | 50.2 | 56.8 | 71 |

| Item | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 | 1992 | 1996 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Ratios,[i] in per cent | | | | | | | | | | | | | | | |
| Exports/sales | 8.7 | 10.7 | 6.7 | 9.7 | 10.9 | 12.8 | 6 | 8 | 6.1 | 7.9 | 5 | 6.7 | 13.2 | 16 | 11.7 | 11.1 |
| Imports of inputs and final goods/sales | 9.6 | 11.1 | 7.3 | 8.2 | 9.1 | 11.2 | 7.8 | 7.7 | 9.2 | 9.1 | 3.8 | 6.4 | 3.9 | 7.1 | 6.2 | 8.6 |

*Source:* Chudnovsky and López (2000).

[a] M&A firms include firms acquired by local or foreign investors between 1990 and 1996. Non-M&A firms include local firms as well as foreign affiliates that did not undergo a change of ownership.
[b] M&A firms (foreign) are firms in which foreign investors have acquired at least 10 per cent of the total equity. Non-M&A firms include firms in which the entire equity is in the hands of domestic investors.
[c] It should be noted that firms in samples B and C are not identical to those in sample A. In sample A, M&A firms were matched with non-M&A firms independently of whether the latter were domestic- or foreign-owned. Samples B and C, respectively, compared cross-border and domestic M&A firms with only domestic non-M&A firms and hence, had to replace some of the firms included in the control group in sample A.
[d] M&A firms (domestic) are firms acquired by domestic investors. Non-M&A firms are those in which the entire equity is in the hands of domestic investors.
[e] M&A firms (foreign) are firms in which foreign investors have acquired at least 10 per cent of the total equity. M&A firms (domestic) are those acquired by domestic investors.
[f] Estimated as the increase in the average values for each group.
[g] Since not all the firms surveyed provided data on productivity, only 37 pairs could be arranged in sample A to compare productivity between "M&As" and "non-M&As". In B, C and D the samples were too small to be representative.
[h] The firms were asked to indicate whether they have or have not adopted 19 different types of possible improvements in the fields of product and process technology, labour organization, quality control, managerial routines, marketing, etc. For each firm, the percentage of improvements actually adopted was estimated relative to total possible improvements. Thus, the data in this row represent the averages of the ratios for these improvements.
[i] Estimated as the average of firms' ratios.
* indicates statistical significance at the 0.05 level.
** indicates statistical significance at the 0.01 level.

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**Box VI.14. The impact of cross-border M&As in Argentina in the 1990s (concluded)**

***All M&A firms vs. all non-M&A firms.*** The average sales, productivity, exports, investment expenditures and imports of capital goods have grown much more rapidly in M&A firms than in non-M&A firms, with export propensity showing the smallest difference in growth (box table, sample A). M&A firms have also introduced more improvements in product and process technologies and in organizational and managerial practices. They have incurred larger expenditures on training and have increased their R&D expenditures more rapidly. Contrary to expectations, the average employment level has not fallen more in non-M&A firms, despite the fact that sales per employee have grown considerably faster in M&A firms than in their non-M&A counterparts. The average differences in performance between M&A firms and non-M&A firms were found to be statistically significant in the case of sales, training expenditures, and technological, organizational and managerial improvements.

***Foreign vs. domestic M&As: indirect comparison.*** The performance of firms acquired through cross-border M&As *vis-à-vis* domestic non-M&A firms (box table, sample B) is superior for almost all of the variables examined, except imports. Surprisingly, employment in foreign M&A firms increased slightly while that in domestic non-M&A firms decreased considerably. The average differences in performance between foreign M&A firms and non-M&A firms were statistically significant in sales and in technological, organizational and managerial improvements. On the other hand, a comparison of domestic M&A firms with domestic non-M&A firms (sample C) does not provide any clear evidence of a better performance by the former. Sales by domestic M&A firms grew less than those of non-M&A firms. Moreover, whereas employment was significantly reduced in the former, it increased slightly in the latter. Domestic M&A showed stronger performance in training and technological, organizational and managerial changes, but the differences are not statistically significant. On the whole, these findings, combined with those regarding the relative performance of foreign M&A firms as compared with non-M&A firms, suggest that firms acquired through cross-border M&As have tended to perform relatively better than those acquired through domestic M&As.

***Foreign vs. domestic M&As: direct comparison.*** This comparison, based on a sample too small to be statistically significant, suggests that foreign M&A firms performed better in terms of sales and exports, while domestic M&A firms did better in investment, R&D expenditures, and technological, organizational and managerial improvements (sample D). As regards employment, domestic M&A firms have apparently rationalized more than foreign M&A firms, in which employment increased slightly.

Although these results must be interpreted cautiously, since their statistical significance is partial and the scope of the analysis limited, it seems plausible to conclude that M&A firms performed better than non-M&A firms, while firms acquired through cross-border acquisitions seemed to perform, relatively speaking, better than firms participating in domestic M&As. The direct comparison of these two groups, based on a limited sample of firms, did not produce clear evidence about the superiority of either of these groups. Nevertheless, the analysis tends to support the hypothesis that M&As, both foreign and domestic, were generally a useful tool for microeconomic restructuring in a context of far-reaching trade and investment liberalization and in the absence of any significant public policy to help local firms adapt to the new rules of the game after many years of inward-oriented economic regimes. In these circumstances, M&As turned out to be an important part of a market-driven restructuring strategy for Argentinean firms, a strategy which seemingly produced more efficient and competitive firms. This helped the economy of Argentina to restructure to meet the demands of a liberalizing and globalizing environment. The effects of this strategy on welfare and competition still remain to be explored.

*Source:* Chudnovsky and López, 2000.

[a] The comparison used data from a survey conducted in 1997 by Argentina's National Institute of Statistics and Census, which included 1,639 manufacturing firms, representing 54 per cent of sales, 50 per cent of employment and 61 per cent of exports of the manufacturing sector, and providing data on sales, foreign trade, employment, innovation, manufacturing practices, investment and other variables for two years: 1992 and 1996.

involve a number of risks at the time of entry, from reduced employment through asset stripping to the slower upgrading of domestic technological capacity. And when M&As involve competing firms, there are, of course, the possible negative impacts on market concentration and competition, which can persist beyond the entry phase.

- Under *exceptional circumstances,* cross-border M&As can play a useful role, a role that greenfield FDI may not be able to play, at least within the desired time-frame. Particularly relevant here is a situation of crisis in which firms in a country experience several difficulties or face the risk of bankruptcy and no alternative to FDI (including public funding) is available. Large capital-intensive privatizations (or a large number of privatizations within the framework of a comprehensive privatization programme) may also fall in this category, because domestic firms may not possess (or be able to raise) the required funds or have other assets (such as modern managerial practices or technology) which are needed to make the privatized firms competitive. The need for rapid restructuring under conditions of intense competitive pressures or overcapacity in global markets may also make host countries find the option of FDI through cross-border acquisitions of some of their firms useful. The advantage of M&As in such conditions is that they restructure existing capacities. In some of these circumstances, host countries have thus found it useful to relax cross-border M&A restrictions, extend incentives previously reserved for greenfield investment to FDI through M&As, and even make active efforts to attract suitable cross-border M&A partners.

Although there are countries in which exceptional circumstances may be overriding for some time (for example, for economies in transition implementing massive privatization programmes or countries experiencing financial crises), most countries are characterized by a mixture of normal and exceptional circumstances. Thus, even countries in sound economic condition might have a number of enterprises (or even entire industries) that are uncompetitive and require restructuring. And, of course, competitive enterprises can also be targets of cross-border M&As. The factors that influence the impact (box VI.15) of cross-border M&As on development — regardless of circumstances — were summarized in June

**Box VI.15. Intergovernmental experts on cross-border M&As: views on impact**

At an intergovernmental meeting organized by UNCTAD at Geneva, from 19 to 21 June 2000, experts from developed and developing countries and from economies in transition agreed on an “Outcome” of the meeting that included the following observations as regards the impact of cross-border M&As:

> “The following possible positive effects were mentioned: immediate capital inflows; immediate or follow-up new investment and resulting job creation; job conservation as acquired ailing firms are rescued or acquired firms are able to grow; immediate transfer of technology, especially information technology, and of managerial and other skills, leading to improved competitiveness; transfer of marketing skills; improvement of corporate governance; access to, and integration with, global markets and increased exports; restructuring of firms and industries; longer-term industry development perspective; greater efficiency and productivity and improved quality of services; and increased tax and privatization revenues.”
>
> “The following possible challenges were identified: immediate reduction of employment; increase of concentration; less competition; no addition to the capital stock at the time of entry; possible low pricing of sold assets due, for example, to a lack of expertise; shrinking of domestic stock markets; crowding out of local enterprises, especially SMEs; loss of indigenous brands; cost of arbitration; and increase in the foreign control of a host country’s economy, of special concern in sectors considered of strategic importance for the country.”

*Source:* UNCTAD, 2000e, paras. 5-6.

2000 in the "Outcome" of an intergovernmental Expert Meeting on Mergers and Acquisitions as follows (UNCTAD, 2000e, para. 7):

> "The economic policy framework and the country's level of development are key. Other factors affecting the impact are: whether a short- or long-term perspective is taken to evaluate effects; the normal or exceptional circumstances (such as privatization programmes or financial crises) in which cross-border M&As take place; the motivation of the investor (e.g. market seeking or efficiency seeking); the situation of the acquired enterprise; and the availability of alternatives as regards modes of entry of investment."

Many of these factors — and the specific consequences of cross-border M&As — can be influenced by policy measures. This underlines the central message of *WIR99,* which dealt with FDI and development generally, namely that policy matters. Policy matters especially when it comes to the risks and negative effects associated with cross-border M&As. This is not to minimize the importance of various alternatives to cross-border M&As. For example, while cross-border M&As are an alternative to greenfield FDI, the viability of other options such as strategic alliances or public intervention must also be considered carefully. There may even be a role for international action (box VI.16).

Policy also matters (as in the case of domestic M&As) in that sectoral policies need to address a number of potential negative effects, e.g. as regards employment and resource utilization. In addition, FDI policies in general can be used to maximize the benefits and minimize the costs of cross-border M&As, through e.g. sectoral reservations, ownership regulations, size criteria, screening and/or incentives. Specific cross-border M&A policies can also be used for some of the same purposes, e.g. the screening of cross-border M&As to ensure that they meet certain criteria.

The most important policy instrument, however, is competition policy. The principal reason is that M&As can pose threats to competition, both at the time of entry and subsequently. The search for increased market share and market domination is one of the characteristics of business behaviour. In the new knowledge-based economy, the search for market power — or even monopoly — is accentuated by the nature of the costs of knowledge-based production. As was recently observed: "the constant pursuit of that monopoly power becomes the central driving thrust of the new economy" (Summers, 2000, p. 2). Indeed, the threat of monopoly, or tight oligopoly, is potentially the single most important negative effect of cross-border M&As and therefore poses the single most important policy challenge. The challenge, more precisely, is to ensure that policies are in place to deal with those M&As that raise competitive concerns, and that they are implemented effectively.

Indeed, as FDI restrictions are liberalized worldwide, it becomes all the more important that regulatory barriers to FDI are not replaced by anticompetitive practices of firms.[30] This means that, as observed in *WIR97,* "the reduction of barriers to FDI and the establishment of positive standards of treatment for TNCs need to go hand in hand with the adoption of measures aimed at ensuring the proper functioning of markets, including, in particular, measures to control anticompetitive practices by firms" (UNCTAD, 1997a, p. XXXI).[31] This puts the spotlight squarely on coordinated competition policy as a means to assess and address the impact of cross-border M&As on host-country economies, although policies aimed at maintaining a well-defined contestability of markets also have a role to play (UNCTAD, 1997a). It also suggests that the culture of FDI liberalization that has become pervasive, combined with the growing importance of cross-border M&As as a mode of entry, has to be complemented by an equally pervasive culture recognizing the need to prevent anticompetitive practices of firms. In the context of cross-border M&As, this requires the adoption of competition laws and their effective implementation, paying full attention not only to domestic, but also to cross-border M&As, both at the entry stage and subsequently. M&A reviews are indeed the principal interface between FDI and competition policy. Thus, there is a direct, necessary and enlarging relationship between liberalization of FDI entry through M&As on the one hand and the importance of competition policy on the other.

Increasingly, however, competition policy can no longer be pursued effectively

**Box VI.16. International support for firms in currency-related distress**

Even domestic firms that are well-managed and profitable may find themselves in serious financial difficulties because of events beyond their control. For example, a sudden and steep depreciation of a country's currency can lead to a large increase in its domestic firms' import costs and liabilities denominated in foreign currencies. If the depreciation is furthermore part of a financial crisis for the country, the lack of access to finance, whether from national or international banks or from the government, can threaten the very survival of firms, especially in developing countries. In consequence, small and medium-sized enterprises, in particular, may go bankrupt or be taken over at fire-sale prices. This in turn can be a blow to the domestic enterprise sector — the cornerstone of economic development.

The principle of international financial assistance is that if *countries* are in trouble, special funds and facilities set up in the framework of international financial agencies come to their aid. Recent experience has highlighted some of the shortcomings of the existing arrangements, and ways and means of reshaping and strengthening the international financial architecture are being explored. This revised architecture might conceivably include, among other things, schemes to strengthen the ability of governments to help *firms* facing liquidity problems under crisis conditions.

During the recent Asian financial crisis, a number of countries have experimented with such schemes. Examples (see Stone, 1998) include the "Jakarta Initiative" under which over-exposed Indonesian firms approach their creditors for a standstill and the creditors provide new funding, if the firm is considered viable and creditors can reach consensus. In the Republic of Korea, the Financial Supervisory Committee has provisions for the exchange of short-term foreign debt owed to commercial banks for government-guaranteed debt of longer maturity. In Thailand, the Corporate Debt Restructuring Advisory Committee, chaired by the Bank of Thailand, has introduced a non-binding debt-restructuring scheme.

At the international and regional levels, recent schemes (which often are administered through national restructuring agencies in the countries concerned) include the following: [1]

- The International Finance Corporation (IFC), the private-sector arm of the World Bank, provides capital, generally in the form of long-term equity and loans, to enterprises in developing countries (IFC, 2000, p. 20). It also undertakes short-term interventions when necessary. In Indonesia, for instance, the IFC has set up a facility for trade finance and working capital to assist exporters with short-term finance (IFC, 2000, p. 32). In collaboration with Chase Capital Partners of Hong Kong (China) and other Asian investors, the IFC established a restructuring fund in 1999, the Asia Opportunity Fund, that is expected to disburse up to $1.1 billion over the next three to five years. In addition, it has established the Asian Debt Facility to provide loans and guarantees directly to companies about to be restructured (IFC, 2000, pp. 32-33). To date, the Asian Opportunity Fund has invested in six firms, while the Asian Debt Facility is yet to be utilized. Roughly 25 per cent of the finance available had been disbursed by mid-2000.

- The Asian Development Bank established the Asian Currency Crisis Support Facility in 1998. Japan pledged $30 billion, of which $100 million was made available during 1999 to five of the crisis-stricken economies. Governments can use the loans for a variety of purposes, including bank restructuring and corporate-debt restructuring. To date, Thailand has used $3 million from this facility for restructuring specialized financial institutions (ADB, 2000, pp. 164-165 and 266).

- EBRD activities reflect the concern over liquidity squeezes and currency risks in several ways. A significant proportion of EBRD operations involves the provision of working capital, notably in countries and situations where existing credit lines from the local banking system may not be renewed and access to foreign banking lines may be difficult during financial sector crises. On this basis, EBRD can relieve the liquidity squeeze on corporate borrowers with sound long term fundamentals and help relieve pressure on balance sheets from possible foreign exchange losses. Operation design and client selection are tailored to the Bank's mandate in economies in transition.

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through national action alone. The very nature of cross-border M&As — indeed the emergence of a global market for firms — puts the phenomenon into the international sphere. This means that competition authorities need to have in place, and to strengthen, cooperation mechanisms among themselves at the bilateral, regional and multilateral levels, in order to respond effectively to M&As and anti-competitive practices of firms that affect their countries.[32] The UNCTAD Set of Principles and Rules on Restrictive Business Practices is, to date, the only multilateral instrument in this area (box VI.17). International action is particularly important when dealing with cross-border M&As with global dimensions, especially for smaller countries that lack the resources to mount and enforce such policies on their own (box VI.18).

* * *

In chapter V, an intriguing parallel was drawn between the emergence of a *national* market and production system in the United States during the last decade of the nineteenth century, in the wake of a massive domestic M&A wave, and the emergence at the present time of a *global* market for firms, as a complement of the evolving global market for products and services and the development of an international production system. The United States wave, and the quest for increased market power that was part and parcel of it,

**Box VI. 16. International support for firms in currency-related distress (concluded)**

Currency risks are managed and hedged to the extent possible, including through the use of local currency financing instruments in certain countries. In addition, the EBRD is also involved in programmes supported by the European Commission, the Group of 7 and individual donor countries designed to mitigate the high risk of operating in certain countries and sectors, including those vulnerable to financial crises.

The question arises whether the volume, coverage and terms of reference of such regional and international schemes ought to be extended so as to provide a *greater and more rapidly accessible* measure of financial support to firms — including small and medium-sized enterprises — in distress because of developments over which they have no influence.

The numerous problems associated with such schemes call for careful analysis. They begin with the need to have in place appropriate national restructuring and bankruptcy procedures. They include the need to determine the form that a liquidity provision should take. And, in particular, they involve the need to define criteria and conditions for screening firms deserving assistance. The precise implementation modalities are likely to differ by country and industry, depending on the specific cause and extent of financial distress. A monitoring of the firms' performance would also need to be in place and measures would need to be taken to avoid moral hazard. Nevertheless, if fostering domestic enterprise is important for development, it might be worthwhile considering whether international schemes along these lines could assume the role of a rescuer of well-functioning enterprises in developing countries hit by financial difficulties under exceptional circumstances, so that the stock of otherwise healthy domestic enterprises is preserved and continues to grow.

*Source*: UNCTAD.

[a] Precursors of these included the Foreign Exchange Risk Coverage Trust Fund (Ficorca), established in 1983 in Mexico to restructure corporate foreign debt. Participating firms were able to swap foreign debt for peso-denominated debt under a Government-guaranteed exchange rate. Some 2,000 corporations participated and approximately $12.5 billion of debt was restructured. Similar arrangements are operational in Chile, Hungary, Poland. In the United Kingdom, the "London Approach" was introduced in 1989 and is another example of a Government-mediated approach to corporate debt restructuring. Between 1989 and 1997, the Government, in conjunction with the Bank of England, handled 160 cases (Stone, 1998).

caused the courts of that country (beginning in 1903) to interpret the (1890) Sherman Antitrust Act to cover M&As and, eventually, Congress to adopt (in 1914) the Clayton Act, which prohibited M&As likely to lessen competition, and the Federal Trade Commission Act, which created the Federal Trade Commission to police violations of the Act. This marked the beginning of M&A control in the United States and of a process which, over the nearly 100 years since then, has led to a further strengthening of that country's competition control system.[33] The Sherman Act also was the antecedent of similar legislation in other countries. Today, some 90 countries have adopted antitrust laws, most of which were introduced in the 1990s.

The world economy today may well be seeing the beginning of a similar challenge in terms of global market structure and competition. If the parallel with the United States experience is indicative, this could mean that what is already happening may be only the beginning of a massive consolidation process at the regional and global levels. If so, it is all the more important to put in place the necessary policy instruments to deal with this process. Among these policy instruments, competition policy has pride of place. In the end, a global market for firms may need a global approach to competition policy, an approach that takes the interests and conditions of developing countries fully into account.

**Box VI.17. The UNCTAD Set of Principles and Rules on Restrictive Business Practices**

The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices was adopted by the United Nations General Assembly in 1980 as a voluntary instrument. It is addressed to Governments and stresses that States should adopt, improve and effectively enforce appropriate legislation and procedures for the control of restrictive business practices (RBPs), by domestic firms as well as TNCs. Since 1980, many States have adopted national competition legislations that include provisions on RBPs. The main objectives of the Set are:

- to ensure that RBPs do not impede or negate the realization of benefits from trade liberalization;
- to attain greater efficiency in international trade and development;
- to protect and promote social welfare in general and, in particular, the interests of consumers.

To this end, the Set calls for enterprises to refrain from practices including "mergers, takeovers, joint ventures or other acquisitions of control" (Section D,4(c)) when, "through an abuse or acquisition and abuse of a dominant position of market power, they limit access to markets or otherwise unduly restrain competition" (Section D,4). Hence, the Set calls for control of such M&As, especially when they adversely affect international trade and development.

Cross-border M&As should therefore be dealt with in a holistic way, taking into consideration their various developmental impacts, such as concentration of economic power, on the one hand, and the encouragement of innovation on the other. There is a need to regulate transactions that carry the highest possibility of anti-competitive behaviour (including cross-border M&As) to minimize their negative impacts on development. There is also a need for international co-operation in the area of cross-border M&A control, including through the exchange of information and co-operation in proceedings, subject, however, to confidentiality safeguards.

The Set established an institutional machinery within UNCTAD to monitor its application through regular exchanges of information on the implementation of the Set's recommendations, an annual review of developments by UNCTAD, consultations, continued work on a model law on RBPs, and wide-ranging technical assistance. These measures are meant to strengthen the capacity of the developing world to deal effectively with cross-border M&As. The next quinquennial review conference is scheduled for 25-29 September 2000, to review all aspects of the Set, including the role of competition policy in economic development.

*Source*: UNCTAD, 1996b.

**Box VI.18. Technical assistance and international co-operation in the area of merger review**

The growth of cross-border M&A activities draws increased attention of policy makers towards competition policy and merger review. The globalization of markets and production poses challenges for the design of appropriate competition policies and especially for an effective policy implementation. For developing countries, this applies both in the case when a local firm is directly involved in a merger or an acquisition, and when mergers take place between major foreign TNCs with indirect consequences for third countries. This growing international dimension of M&As may call for new initiatives to strengthen international co-operation between competition authorities in developed and developing countries.

Technical assistance in the area of competition policy already exists at both the bilateral and multilateral levels. At the multilateral level, UNCTAD, in co-operation with other organizations such as the World Bank, the WTO and the OECD, provides assistance to developing countries and economies in transition. The main types of requests for assistance include:

- States without competition legislation may request information about restrictive business practices (RBPs) or introductory seminars;
- States that are in the process of drafting legislation in the area may request information on legislation in other countries and seek drafting advice;
- States that have just adopted competition legislation may seek advice on setting up a competition authority, including the training of officials through workshops and on-the-job training with competition authorities that have more experience;
- States that have adopted legislation and which have experience in the control of RBPs may wish to consult one another on specific cases and exchange information;
- States that wish to revise their legislation might seek expert advice from competition authorities in other States.

In addition to the work that is currently conducted, it may be worth exploring how international co-operation (including regional co-operation) in this area may be strengthened. For example, non-confidential information on specific M&A cases could be made available to a greater extent to developing countries. Even countries without a merger review system may be interested in learning about the potential effects of major M&As, e.g. if there is risk for the creation and abuse of a dominant position in specific markets. In some cases, competition authorities in developing countries could benefit from technical assistance provided by developed country authorities to assess the likely impact of individual M&As on the market structure in their countries. Naturally, that would have to take important aspects into account, such as the confidentiality of some of the information submitted by the merging parties, the short time allowed for merger reviews and the problem of determining which developing countries may be concerned in an individual case.

Enhanced bilateral or regional co-operation and joint investigation of M&As may also be further explored. Bilateral or multilateral exchanges of information in the area of merger control are today limited to a few countries and sometimes based on personal relations. Nevertheless, the importance of close bilateral co-operation in reviews of individual merger cases has been recognized in many countries, as witnessed by the joint investigations and co-ordinated remedies of some large M&As conducted by the EU and the United States recently. Such contacts increasingly take place also among the competition authorities of developing countries. For example, in Brazil, an exchange of information and experience has taken place with competition authorities in Argentina, Mexico, the United States and Venezuela.

*Source*: UNCTAD.

## Notes

1 In Latin America, for example, extensive purchases of local firms by Spanish investors have been dubbed *reconquista* ("New world conquest", *Time*, 1 May 2000, pp. 44-48), and the sale of well-known firms to foreign investors has generally aroused concern (see, for example, "The nationalist groundswell in Brazil", *The Economist*, 26 February 2000, pp. 67-68).

2 The purchases of the Center and the studios — Columbia Pictures and Tristar Pictures — proved to be bad investments. Both suffered losses soon after the purchase. The Center was repurchased by United States investors by the mid-1990s ("Rockefeller Center heads back to American hands", *International Herald Tribune*, 13 September 1995; "Sony's American dream turns sour", *International Herald Tribune*, 18 November 1994). On the press reaction, see, for example, "For sale: America", *Time*, 14 September 1987, pp. 52-62; or "The selling of America", *Fortune*, 23 May 1988, pp. 55-64.

3 In theory, of course, foreign direct investors could even then engage in greenfield investments. In some cases, they actually do because it may be more advantageous for them to start afresh than to rehabilitate an existing facility.

4 The two modes can also be linked with each other. For example, a foreign firm that enters a host country via an acquisition may immediately expand via new investment. If this investment is financed through an increase in the parent firm's equity stake in the affiliate, it constitutes greenfield FDI. Conversely, an affiliate established via a greenfield project may expand through acquisitions of local companies, which will be FDI if financed by the parent company.

5 M&As and greenfield investments also face different sets of information and strategic needs, and have different advantages and disadvantages. In M&As, the targeted firm embodies information on markets, inputs, factors and local policies, and comprises a set of ready-made skills, capabilities and routines. At the same time, it requires the acquirer to collect information on how good or useful these capabilities are and whether they can be efficiently digested. A greenfield investment does not have access to ready-made information or capabilities, but it also does not require the investor to digest alien skills and routines.

6 The risk would be reflected in the price, but this does not reduce the economic cost if a venture goes wrong. To the extent that this is a real possibility, and greenfield entry is able to make better-informed decisions, there may be a net cost associated with cross-border M&As. The appropriate policy response is to improve the availability of corporate information, the transparency of governance, and the efficiency of capital markets. This would be advisable in any case for attracting FDI in any form and, indeed, for promoting economic development.

7 Except in the case of an exchange of stock between the two companies involved in a merger or acquisition. However, this is much less frequent in developing countries than in developed countries.

8 It should, however, be noted that some large cross-border M&A transactions include long-term financing arrangements (some extending up to 20 years).

9 Alternatively, revenues in foreign currencies from the sale of state-owned firms can be kept in separate accounts and released only gradually. Also, under certain circumstances, appreciation can be desirable. This was the case in some countries during the Asian financial crisis as the sharp depreciation in exchange rates brought about a debilitating increase in the corporate debt-servicing liability denominated in foreign currency.

10 The loss of financial resources is due to the lower sale price of the assets sold; this does not necessarily affect the subsequent performance of the acquired firm or the subsequent development impact of a given acquisition. One example where the sale price of a privatized state-owned enterprise was perhaps far from optimal but the long-term performance of the acquired firm was positive is the purchase of Czech Skoda Auto by Volkswagen.

11 Asset stripping can, of course, be undertaken by domestic investors as well, as evidence from Hungary suggests. During privatizations in Hungary, foreign buyers usually paid the full price for enterprises, while local buyers often used "soft" payment techniques, arbitraging between the nominal price and the price they received after dismembering the purchased companies and selling the component assets at a premium (Mihályi, 2000).

12 Twenty-six privatized foreign affiliates and two greenfield affiliates were surveyed in Argentina.

13 The survey conducted from January to June 1999 reviewed the pre- and post-privatization performance of 23 major companies selected from 7 Central and Eastern European countries: Croatia, the

Czech Republic, Hungary, Latvia, Poland, Romania and Slovenia. In 22 of these companies, the performance of the two or three years following privatization could be followed up with detailed data. Data availability for the two years preceding privatization was more limited, but still satisfactory: 16 firms provided data in this respect. The combined asset value of these enterprises at the time of their privatization exceeded $5 billion, i.e. 8 per cent of the combined inward stock of the seven countries. The increase in investment before privatization was most likely due to the restructuring of these enterprises prior to their sale.

14 Another example of the acquisitions of competitive firms not leading to sequential investment includes acquisitions made with a view to achieving a financial gain, i.e. those related to portfolio investment. They can dominate cross-border M&As in some industries in developing countries, as appeared to have been the case in Chile in power generation and banking in the second half of the 1990s. This does not mean, however, that acquisitions of efficient firms cannot lead to sequential investment. Such acquisitions can be a preferred way to enter new markets, because they are faster than greenfield FDI, they save TNCs considerable effort and transaction costs, and do not intensify competition in the market. If this happens in a developing country like Argentina, it may lead to sequential expansionary investment, as seems to have been the case in the acquisitions covered by the study mentioned earlier (Chudnovsky and López, 2000).

15 This matter may be complicated by the fact that firms involved in cross-border M&As may be subject to different corporate-governance rules and practices. The OECD Principles of Corporate Governance may be of relevance here (UNCTAD, 2000a, vol. IV).

16 However, a greenfield investment may not use technology of the latest vintage if local factor endowments make the use of older vintages more economical. Similarly, TNCs may, where appropriate, deploy used equipment in a new plant.

17 The results cited do not distinguish between cross-border and other M&As but some studies suggest that, if anything, cross-border M&As generate better results at the firm level than domestic ones (see chapter V).

18 R&D in computer software clusters, such as those in Bangalore, India, is an example (see UNCTAD, 1995a, chapter III).

19 When General Electric acquired a majority share in Tungsram in 1990, its restructuring led to an initial reduction of R&D activities in the latter (Weiszburg, 1997). This changed in 1994 when GE fully bought out Tungsram and made its research centre its only overseas R&D facility and re-focussed it on light source research (Marer and Mabert, 1997).

20 See chapter V; Hamill, 1993, pp. 95, 112-118; UNCTAD, 1999a, pp. 100-101. A study of 55 acquired firms in Denmark over the period 1975-1990 attempted to examine the relationship between the motivation of the acquirer and impact on employment: it showed that employment rose in all categories of firms for the first five years after the acquisition, showing a 30 per cent increase over the time of acquisition. Thereafter, paths diverged according to the motive for the acquisitions. Market-seeking acquisitions — generally with low technological assets — showed a decline in employment, reaching their original level of employment by the tenth year. Employment in affiliates established through strategic-asset-seeking and efficiency-seeking acquisitions continued to rise, with the latter showing more sustained rises. In the tenth year, employment in the asset-seeking firms was around 45 per cent higher than at the time of acquisition, while in efficiency-seeking M&As, it was 80 per cent higher (Pedersen and Valentin, 1996).

21 Data for four large firms in the food industry acquired by TNCs between 1995 and 1997 show that employment in 1999 increased in three cases and remained constant in one (Costa Rica, Ministry of Foreign Trade, 2000).

22 See, for example, the reference to asset-seeking firms in footnote 20 (Pedersen and Valentin, 1996).

23 Employment in the automotive industry in the Triad countries decreased by roughly one-quarter during the 1980s and continued to decline during the 1990s, despite an increase in output. In several developing countries (e.g. Argentina and Thailand), however, employment in the industry rose during the period 1990-1997, while in a few others (e.g. Brazil) it declined (Romijn, et al., forthcoming).

24 "More bank unions set up to protect staff", *The Nation*, 9 March 2000.

25 Based on data from the International Telecommunications Union (1993, 1996-1997 and 1999), and Hunya and Kalotay (2000). It should be noted that, in a number of countries, employment increased after privatization.

26 For example, Tatramat, the state-owned white goods company in Slovakia, employed 2,300 people in 1989, of whom 1,000 were laid off in 1990-1991. Of the remaining employees, 550, working in the

washing machine arm of the firm, were transferred to another part of Tatramat when Whirlpool (United States) acquired shares in a joint venture with Tatramat for the production of washing machines in 1992. In 1993, employment in the joint venture was reduced from 470 to 219, with the early retirement of some workers and the dismissal of others who did not accept the management systems and conditions introduced by Whirlpool (Ferencikova, 2000).

27 Examples include the *Standortssicherungs-vereinbarungen* in Germany, the four-year agreements recently signed between the United Auto Workers Union and the auto producers in the United States, and the agreement between the International Association of Machinists and Boeing in the United States (ILO, 2000).

28 *The Wall Street Journal*, 11 September 1998, and http://wev.netlink.net/preparedfoods/1998/9807/latin.htm.

29 The definition of which industries are "strategic" differs from country to country. It also changes over time.

30 Government actions, including incentives and market privileges to attract foreign investors, also contribute to an environment that provides scope for anti-competitive practices (UNCTAD, 1997a).

31 For a full discussion of the interrelationship between FDI, market structure and competition policy, see UNCTAD, 1997a.

32 For a detailed discussion of international cooperation in this area, see UNCTAD, 1997a. For a recent contribution to this discussion see United States, Department of Justice, 2000.

33 The most important additions came in 1950, when the Clayton Act was significantly amended, and in 1976, when the Hart-Scott-Rodino Antitrust Improvement Act was adopted to provide the Federal Government with the opportunity to review the impact on competition of M&As and other consolidations before they are completed (see www.usdoj.gov/atr; and www.ftc.gov for more information).