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World Investment Report

2000

Cross-border Mergers and Acquisitions and Development

Overview

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Note

UNCTAD serves as the focal point within the United Nations Secretariat for all matters related to foreign direct investment and transnational corporations. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). In 1993, the Programme was transferred to the United Nations Conference on Trade and Development. UNCTAD seeks to further the understanding of the nature of transnational corporations and their contribution to development and to create an enabling environment for international investment and enterprise development. UNCTAD's work is carried out through intergovernmental deliberations, technical assistance activities, seminars, workshops and conferences.

The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable, unless otherwise indicated.

A slash (/) between dates representing years, e.g., 1994/95, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g., 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

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UNCTAD/WIR/2000 (Overview)

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World Investment Report 2000:
Cross-border Mergers and Acquisitions and Development

Overview

Transnational corporations, the firms driving international production,…

International production by transnational corporations (TNCs), now numbering some 63,000 parent firms with around 690,000 foreign affiliates and a plethora of inter-firm arrange-ments, spans virtually all countries and economic activities, rendering it a formidable force in today's world economy. The world's top 100 (non-financial) TNCs (with General Electric in first place), based almost exclusively in developed countries (see table 1 for the top 25 of those firms), are the principal drivers of international production. The $2 trillion in assets of their foreign affiliates accounted for about one-eighth of the total assets of all foreign affiliates worldwide in 1998. The foreign affiliates of the top 100 TNCs employ over 6 million persons, and their foreign sales are of the order of $2 trillion. They are concentrated mainly in electronics and electrical equipment, automobiles, petroleum, chemicals and pharmaceuticals.

Despite the prominence of the top 100, the universe of TNCs is quite diverse, and includes a growing number of small and medium-sized enterprises, TNCs from countries in Central and Eastern Europe that have only recently begun to engage in international production, and large TNCs based in the developing world. Although less transnational overall than the world's top 100 TNCs, some of the developing-country TNCs are quite sizeable — witness, for example, the size of the foreign assets ($8 billion) of Petroleos de Venezuela, the largest TNC from the developing world and the only developing-country firm to appear in the top 100 list (see table 2 for the top 25 of those firms).

The expansion of international production has been facilitated by virtually all countries through changes in their regulatory environments. Over the period 1991-1999, 94 per cent of the 1,035 changes worldwide in the laws governing foreign direct investment (FDI) created a more favourable framework for FDI (table 3). Complementing the more welcoming national FDI regimes, the number of bilateral investment treaties — concluded increasingly also between developing countries — has risen from 181 at the end of 1980 to 1,856 at the end of 1999. Double taxation treaties have also increased, from 719 in 1980 to 1,982 at the end of 1999. At the regional and interregional levels, an increasing number of agreements (most recently between the European Community and Mexico) are helping to create an investment environment more conducive to international investment flows.

Evidence on the expansion of international production over the past two decades abounds. Gross product associated with international production and foreign affiliate sales worldwide, two measures of international production, increased faster than global GDP and global exports, respectively (figure 1). Sales of foreign affiliates worldwide ($14 trillion in 1999, $3 trillion in 1980) are now nearly twice as high as global exports, and the gross product associated with international production is about one-tenth of global GDP, compared with one-twentieth in 1982 (table 4). The ratio of world FDI inflows, which stood at $865 billion in 1999, to global gross domestic capital formation is now 14 per cent, compared with 2 per cent twenty years ago. Similarly, the ratio of world FDI stock to world GDP increased from 5 per cent to 16 per cent during the same period. And the number of transnational parent firms in 15 developed home countries increased from some 7,000 at the end of the 1960s to some 40,000 at the end of the 1990s.

The ascendance and deepening of international production have given rise to new policy challenges. The distribution of international production, and of the corresponding benefits associated with it, is one of the most important of these. While the size of international production has risen significantly over the past few decades, not all countries have participated in it to the

Table 1. The world's top 25 TNCs, ranked by foreign assets, 1998
(Billions of dollars and number of employees)

Ranking 1998 by: Foreign assets	Ranking 1998 by: TNI[a]	Ranked in 1997 by: Foreign assets	Ranked in 1997 by: TNI[a]	Corporation	Country	Industry[b]	Assets: Foreign	Assets: Total	Sales: Foreign	Sales: Total	Employment: Foreign	Employment: Total	TNI[a] (Per cent)
1	75	1	84	General Electric	United States	Electronics	128.6	355.9	28.7	100.5	130 000	293 000	36.3
2	85	4	91	General Motors	United States	Motor vehicles	73.1	246.7	49.9	155.5	...	396 000	30.9
3	45	3	44	Royal Dutch/Shell Group[c]	Netherlands/United Kingdom	Petroleum expl./ref./distr.	67.0	110.0	50.0	94.0	61 000	102 000	58.0
4	76	2	80	Ford Motor Company	United States	Motor vehicles	...	237.5	43.8	144.4	171 276	345 175	35.4
5	19	5	29	Exxon Corporation[d]	United States	Petroleum expl./ref./distr.	50.1	70.0	92.7	115.4	...	79 000	75.9
6	60	6	75	Toyota	Japan	Motor vehicles	44.9	131.5	55.2	101.0	113 216	183 879	50.1
7	54	7	54	IBM	United States	Computers	43.6	86.1	46.4	81.7	149 934	291 067	53.0
8	21	30	42	BP AMOCO	United Kingdom	Petroleum expl./ref./distr.	40.5	54.9	48.6	68.3	78 950	98 900	74.9
9	59	10	71	DaimlerChrysler	Germany	Motor vehicles	36.7	159.7	125.4	154.6	208 502	441 502	50.4
10	3	9	4	Nestlé SA	Switzerland	Food/beverages	35.6	41.1	51.2	52.0	225 665	231 881	94.2
11	51	8	50	Volkswagen Group	Germany	Motor vehicles	...	70.1	52.3	80.2	142 481	297 916	53.8
12	7	18	5	Unilever	Netherlands/United Kingdom	Food/beverages	32.9	35.8	39.4	44.9	240 845	265 103	90.1
13	63	-	-	Suez Lyonnaise Des Eaux	France	Diversified/utility	...	84.6	12.9	34.8	126 500	201 000	45.6
14	73	-	-	Wal-Mart Stores	United States	Retailing	30.2	50.0	19.4	137.6	...	910 000	37.2
15	8	14	2	ABB	Switzerland	Electrical equipment	...	32.9	23.1	27.7	154 263	162 793	89.1
16	43	11	39	Mobil Corporation[d]	United States	Petroleum expl./ref./distr.	...	42.8	29.7	53.5	22 100	41 500	58.6
17	17	42	25	Diageo Plc	United Kingdom	Beverages	27.9	46.3	10.5	12.4	65 393	77 029	76.7
18	38	24	32	Honda Motor Co Ltd	Japan	Motor vehicles	26.3	41.8	29.7	51.7	...	112 200	60.2
19	52	19	56	Siemens AG	Germany	Electronics	...	66.8	45.7	66.0	222 000	416 000	53.6
20	41	21	34	Sony Corporation	Japan	Electronics	...	52.5	40.7	56.6	102 468	173 000	59.3
21	34	33	68	Renault SA	France	Motor vehicles	23.6	43.2	25.4	39.8	92 854	138 321	61.8
22	12	28	21	News Corporation[e]	Australia	Media/publishing	22.9	33.6	10.5	11.7	...	50 000	78.7
23	40	25	38	BMW AG	Germany	Motor vehicles	22.9	35.7	26.8	37.7	53 107	119 913	59.9
24	81	22	78	Mitsubishi Corporation	Japan	Diversified	21.7	74.9	43.5	116.1	3 668	11 650	32.7
25	67	17	60	Nissan Motor Co Ltd	Japan	Motor vehicles	21.6	57.2	25.8	54.4	...	131 260	42.6

Source: UNCTAD/Erasmus University database.

[a] TNI is the abbreviation for "transnationality index", which is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
[b] Industry classification for companies follows the United States Standard Industrial Classification as used by the United States Securities and Exchange Commission (SEC).
[c] Foreign assets, sales and employment are outside Europe.
[d] Mergers between Exxon and Mobil into ExxonMobil, and Hoechst AG and Rhone-Poulenc SA into Aventis are not documented yet as they took place in 1999.
... Data on foreign assets, foreign sales and foreign employment were not made available for the purpose of this study. In case of non-availability, they are estimated using secondary sources of information or on the basis of the ratios of foreign to total assets, foreign to total sales and foreign to total employment.

Note: The list includes non-financial TNCs only. In some companies, foreign investors may hold a minority share of more than 10 per cent.

Table 2. The top 25 TNCs from developing economies, ranked by foreign assets, 1998
(Millions of dollars, number of employees)

Ranking by					Assets		Sales		Employment		TNI [a]
Foreign assets	TNI [a]	Corporation	Economy	Industry [b]	Foreign	Total	Foreign	Total	Foreign	Total	(Per cent)
1	34	Petróleos de Venezuela S.A.	Venezuela	Petroleum expl./ref./distr.	7 926	48 816	11 003	25 659	6 026	50 821	23.7
2	14	Daewoo Corporation	Republic of Korea	Trade	..	22 135	..	30 547	..	15 000	49.4
3	6	Jardine Matheson Holdings, Limited [d]	Hong Kong (China)/ Bermuda	Diversified	5 954	9 565	7 921	11 230	..	160 000	67.6
4	12	Cemex, S.A.	Mexico	Construction	5 639	10 460	2 334	4 315	9 745	19 761	52.4
5	35	PETRONAS - Petroliam Nasional Berhad	Malaysia	Petroleum expl./ref./distr.	5 564	26 184	3 757	11 133	2 700	18 578	23.2
6	8	Sappi Limited	South Africa [c]	Pulp and Paper	4 574	6 475	3 246	4 308	10 725	23 640	63.8
7	19	Hutchison Whampoa, Limited	Hong Kong (China)	Diversified	..	13 389	2 191	6 639	20 845	39 860	39.4
8	9	First Pacific Company Limited	Hong Kong (China)	Other	4 086	7 646	2 527	2 894	15 063	30 673	63.3
9	39	Sunkyong Group	Republic of Korea	Diversified	3 851	36 944	12 029	38 274	2 400	29 000	16.7
10	49	Petroleo Brasileiro S.A. - Petrobras	Brazil	Petroleum expl./ref./distr.	3 700	33 180	1 300	15 520	417	42 137	6.8
11	45	New World Development Co., Limited	Hong Kong (China)	Construction	3 414	13 465	376	2 628	30	16 512	13.3
12	31	China State Construction Engineering Corporation	China	Construction	3 290	7 300	1 950	5 890	5 535	239 102	26.8
13	36	YPF Sociedad Anonima	Argentina	Petroleum expl./ref./distr.	3 278	13 146	880	5 500	1 754	9 486	19.8
14	21	LG Electronics, Incorporated	Republic of Korea	Electronics and electrical equipment	3 127	12 824	4 841	12 213	27 819	60 753	36.6
15	17	China National Chemicals Import & Export Corporation	China	Trade	3 000	4 950	7 920	13 800	510	8 415	41.4
16	43	Keppel Corporation Limited	Singapore	Diversified	2 598	17 321	376	2 127	1 700	11 900	15.7
17	24	Companhia Vale do Rio Doce	Brazil	Transportation	1 947	13 539	3 025	4 321	7 076	40 334	34.0
18	20	Hyundai Engineering & Construction Co.	Republic of Korea	Construction	..	7 094	..	3 815	..	22 787	37.6
19	15	Citic Pacific, Limited	Hong Kong (China)	Diversified	1 842	8 771	908	1 755	7 639	11 871	45.7
20	28	Enersis, S.A.	Chile	Electric utilities or services	1 697	16 117	306	3 406	9 342	14 336	28.2
21	3	Guangdong Investment Limited	Hong Kong (China)	Diversified	1 695	2 577	614	812	16 015	17 330	77.9
22	26	San Miguel Corporation	Philippines	Food and beverages	1 676	3 552	287	1 811	4 338	15 923	30.1
23	40	Samsung Electronics Co., Limited	Republic of Korea	Electronics and electrical equip.	..	17 213	..	16 640	..	42 154	16.3
24	44	Shougang Group	China	Steel and iron	1 610	6 990	830	4 270	1 548	212 027	14.4
25	16	Barlow Limited	South Africa [c]	Diversified	1 574	2 624	1 734	3 769	..	27 804	43.9
				equipment	..	4 483	..	2 921	..	19 719	28.1

Source: UNCTAD/Erasmus University database.

[a] TNI is the abbreviation for "transnationality index", which is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

[b] Industry classification for companies follows the United States Standard Industrial Classification which is used by the United States Securities and Exchange Commission (SEC).

[c] Within the context of this list, South Africa is treated as a developing country.

.. Data on foreign assets, foreign sales or foreign employment were not made available for the purpose of this study. In case of non-availability, they are estimated using secondary sources of information or on the basis of the ratios of foreign to total assets, foreign to total sales and foreign to total employment.

same extent. FDI, albeit an imperfect measure of international production, is concentrated in a handful of countries — ten countries received 74 per cent of global FDI flows in 1999. Just ten developing countries received 80 per cent of total FDI flows to the developing world. The transnationality index, a more complex measure of the extent of a country's involvement in international production, shows a similar picture (figure 2). More importantly, there are no signs that the concentration of international production across countries has been declining over time. However, in many least developed countries that have received only small amounts of FDI, such investment is important vis-à-vis the size of domestic investment. What remains a challenge for these countries is the ability to attract not only more, but also higher-quality FDI — broadly defined as investment with strong links to the domestic economy, export orientation, advanced technology and skill or spillover effects.

Another challenge is posed by issues arising from the ability of TNCs to internalize cross-border transactions and bypass national controls and scrutiny. For example, TNCs can use transfer pricing on intra-firm trade to minimize their tax exposure, depriving host or home countries of tax revenues. Furthermore, cross-holdings, share listings in several stock exchanges, the location of headquarters in countries other than the country of origin, and sourcing of inputs from facilities

Table 3. National regulatory changes, 1991-1999

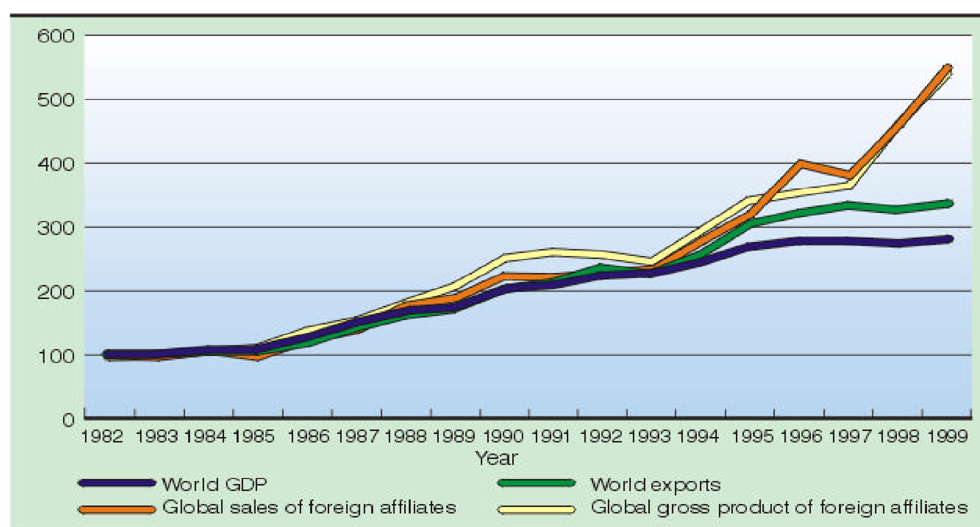
Item	1991	1992	1993	1994	1995	1996	1997	1998	1999
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60	63
Number of regulatory changes of which:	82	79	102	110	112	114	151	145	140
More favourable to FDI [a]	80	79	101	108	106	98	135	136	131
Less favourable to FDI [b]	2	-	1	2	6	16	16	9	9

Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, table I.3, p. 4.

[a] Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives.
[b] Including changes aimed at increasing control as well as reducing incentives.

Figure 1. The growth of sales and gross product associated with international production, GDP and exports, 1982-1999

(Index, 1982=100)



*Source:*UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure I.1, p. 6.

Table 4. Selected indicators of FDI and international production, 1982-1999
(Billions of dollars and percentage)

Item	Value at current prices (Billion dollars)			Annual growth rate (Per cent)				
	1982	1990	1999	1986-1990	1991-1995	1996-1999	1998	1999
FDI inflows	58	209	865	24.0	20.0	31.9	43.8	27.3
FDI outflows	37	245	800	27.6	15.7	27.0	45.6	16.4
FDI inward stock	594	1 761	4 772	18.2	9.4	16.2	20.1	18.8
FDI outward stock	567	1 716	4 759	20.5	10.7	14.5	17.6	17.1
Cross-border M&As[a]	..	151	720	26.4[b]	23.3	46.9	74.4	35.4
Sales of foreign affiliates	2 462	5 503	13 564 [c]	15.8	10.4	11.5	21.6[c]	17.8[c]
Gross product of foreign affiliates	565	1 419	3 045 [d]	16.4	7.1	15.3	25.4[d]	17.1[d]
Total assets of foreign affiliates	1 886	5 706	17 680 [e]	18.0	13.7	16.5	21.2[e]	19.8[e]
Exports of foreign affiliates	637	1 165	3 167 [f]	13.2	13.9	12.7	13.8[f]	17.9[f]
Employment of foreign affiliates (thousands)	17 433	23 605	40 536 [g]	5.6	5.0	8.3	11.4[g]	11.9[g]
Memorandum:								
GDP at factor cost	10 611	21 473	30 061 [h]	11.7	6.3	0.6	-0.9	3.0[h]
Gross fixed capital formation	2 231	4 686	6 058 [h]	13.5	5.9	-1.4	-2.1	-0.3[h]
Royalties and fees receipts	9	27	65 [h]	22.0	14.2	3.9	6.3	0.5[h]
Exports of goods and non-factor services	2 041	4 173	6 892 [h]	15.0	9.5	1.5	-1.8	3.0[h]

Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, table I.1, p. 2.

[a] Data are only available from 1987 onwards.
[b] 1987-1990 only.
[c] Based on the following regression result of sales against FDI inward stock for the period 1982-1997:
Sales = 636 + 2.71 * FDI inward stock.
[d] Based on the following regression result of gross product against FDI inward stock for the period 1982-1997:
Gross product = 239 + 0.59 * FDI inward stock.
[e] Based on the following regression result of assets against FDI inward stock for the period 1982-1997:
Assets = -714 + 3.86 * FDI inward stock.
[f] Based on the following regression result of exports against FDI inward stock for the period 1982-1997:
Exports = 129 + 0.64 * FDI inward stock.
[g] Based on the following regression result of employment against FDI inward stock for the period 1982-1997:
Employment = 13 287 + 5.71 * FDI inward stock.
[h] Estimates.

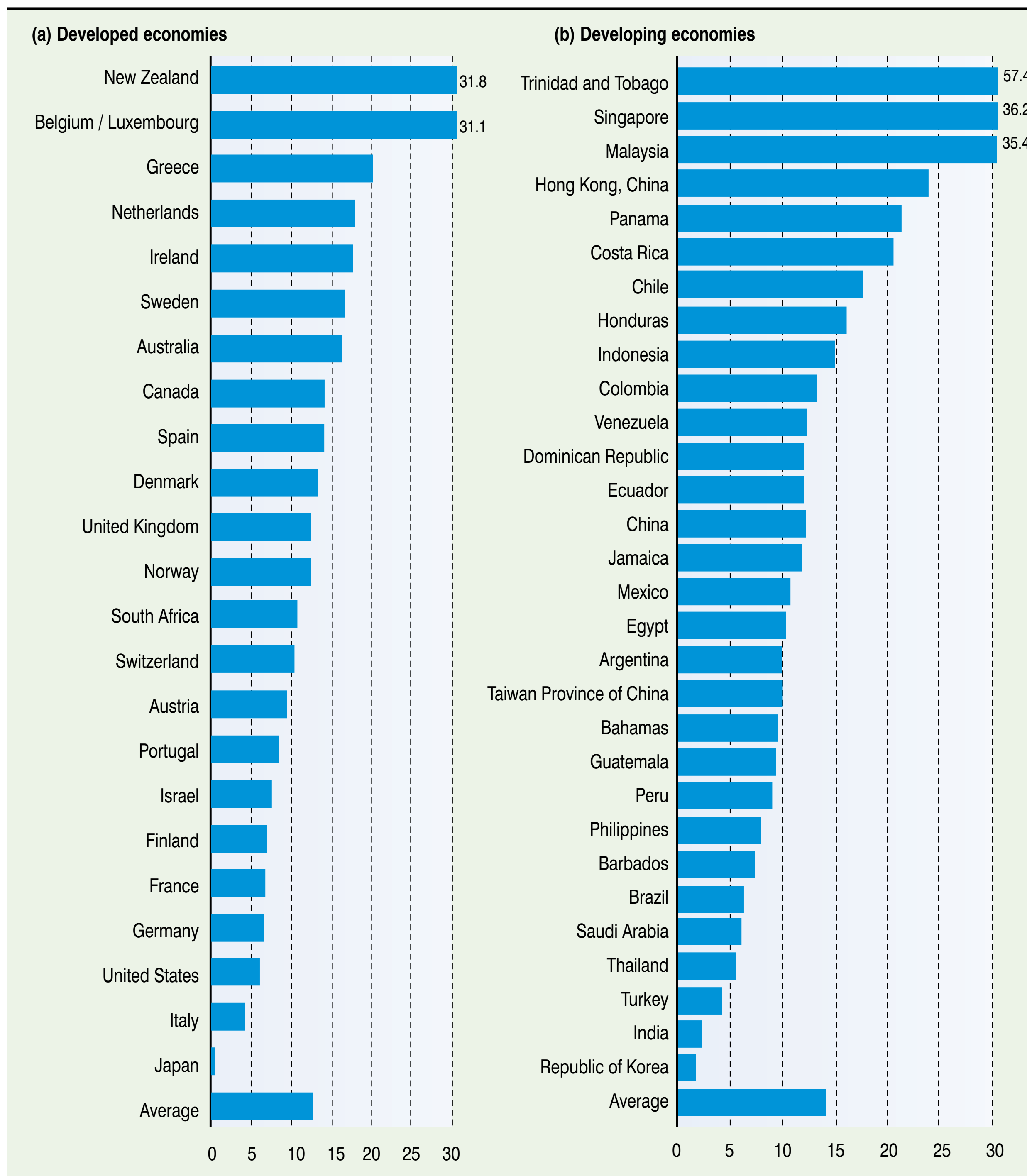
Note: Not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and the sales of the parent firms themselves. Worldwide sales, gross product, total assets, exports and employment of foreign affiliates are estimated by extrapolating the worldwide data of foreign affiliates of TNCs from France, Germany, Italy, Japan and the United States (for sales and employment) and those from Japan and the United States (for exports), those from the United States (for gross product), and those from Germany and the United States (for assets) on the basis of the shares of those countries in the worldwide outward FDI stock.

in multiple countries are all examples of how the ownership and nationality of TNCs have become less clear-cut. Finally, given that the micro-economic interests of TNCs and the development objectives of host countries do not necessarily coincide, governments need to ensure that policies are in place to ensure that they maximize the benefits gained from FDI. This means creating dynamic locational advantages so as to attract especially higher-quality FDI. It also means creating an integrated and coherent framework of policies conducive to development, implementing it properly and establishing a framework for property rights and dispute settlement. However, it requires effective bargaining capabilities in host countries.

... invested record amounts abroad in 1999, but mostly in the developed world.

Driven by the recent wave of cross-border mergers and acquisitions (M&As), global FDI outflows reached $800 billion in 1999, an increase of 16 per cent over the previous year. Indications are that FDI flows in 2000 may well surpass the one-trillion-dollar mark. (Beyond that year, predictions are difficult to make.) After stagnating in 1998, FDI flows to developing countries

Figure 2. Transnationality index[a] of host economies,[b] 1997
(Percentage)



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure I.13, p. 23.

[a] Average of the four shares : FDI inflows as a percentage of gross fixed capital formation for the past three years (1995-1997); FDI inward stocks as a percentage of GDP in 1997; value added of foreign affiliates as a percentage of GDP in 1997; and employment of foreign affiliates as a percentage of total employment in 1997.

[b] Only the economies for which data for all of these four shares are available were selected. Data on value added are available only for Finland (1996), France (1996), Italy, Japan, Norway, Portugal (1996), Sweden (1996), the United States, China, India (1995), Malaysia (1995), Mexico (1993), Singapore and Taiwan Province of China (1994). For other economies, data were estimated by applying the ratio of value added of United States affiliates to United States outward FDI stock to total inward FDI stock of the country. Data on employment are available only for Austria, Denmark (1996), Finland, France (1996), Germany, Ireland, Italy, Japan, Portugal (1996), Sweden (1998), the United States, Brazil (1995), China, Hong Kong (China), Indonesia (1996), Mexico (1993) and Taiwan Province of China (1995). For other economies, data were estimated by applying the ratio of employment of German and United States affiliates to German and United States outward FDI stock to total inward FDI stock of the economy.

have resumed their earlier growth trend. In 1999, developing countries received $208 billion in FDI, an increase of 16 per cent over 1998 and an all-time high. The share of developing countries in global FDI inflows has, however, fallen, going from 38 per cent in 1997 to 24 per cent in 1999 (figure 3).

Developed countries attracted $636 billion in FDI flows in 1999, nearly three quarters of the world's total. The *United States* and the United Kingdom were the leaders as both investors and recipients. With $199 billion, the United Kingdom became the largest outward investor in 1999, forging ahead of the United States. Large M&As in the United States, driven partly by the continuing strength of its economy, rendered it the largest recipient of FDI with $276 billion, nearly one-third of the world total.

TNCs based in the *European Union* (EU) invested $510 billion abroad in 1999, or nearly two-thirds of global outflows. Within the EU, the United Kingdom, France and Germany were the largest outward investors, while the United Kingdom and Sweden were the largest recipients — in the case of the latter, owing to one single large acquisition. In the case of outflows, extra-EU FDI has been more important than intra-EU investment since 1997, owing to a few large M&A deals, but intra-EU FDI remained significant as TNCs were still adjusting their investment plans to the various EU directives deregulating and opening up new industries. The EU's single currency, the euro, has stabilized exchange rates, contributing in this manner to a reduction of transaction costs for investors in the region; but it has also increased competition, which has exerted more pressure on firms to restructure and consolidate their operations.

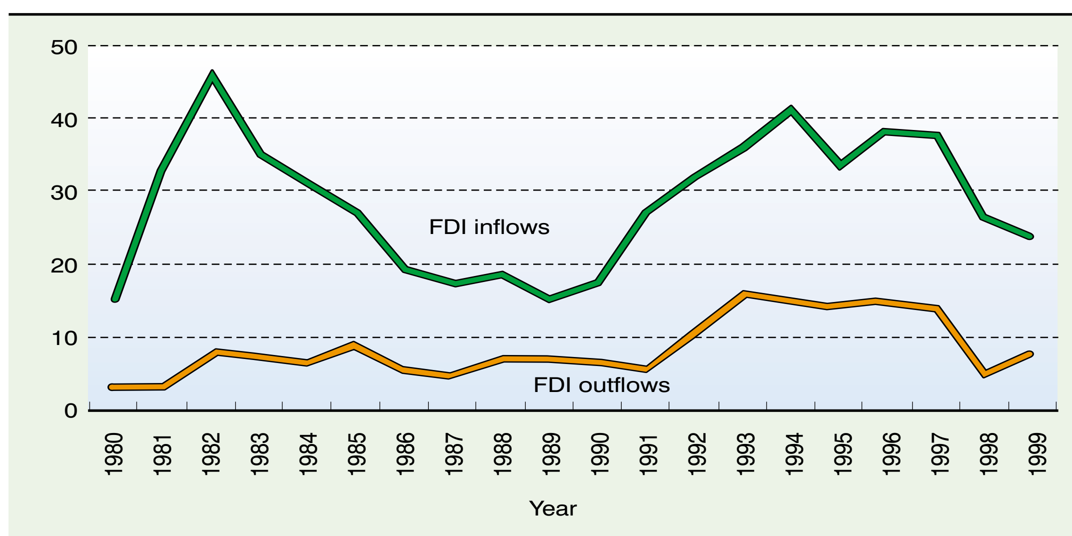
FDI flows to *Japan* quadrupled, reaching a record $13 billion in 1999, the largest annual inflow to date. Dispelling the image of Japan as a country where M&As are either unwelcome or difficult to undertake, most of these inflows arrived through cross-border M&A deals. As for Japanese FDI outflows, they declined in 1999 by 6 per cent, to $23 billion, although Japanese TNCs, among the most affected by the Asian financial crisis, are beginning once again to increase production in Asia.

FDI rebounded in East and South-East Asia, and gained momentum in Latin America and the Caribbean,...

Contrary to general expectations, FDI flows to *East and South-East Asia* increased by 11 per cent, to reach $93 billion in 1999. The increase was mainly in newly industrializing economies (Hong Kong, China; Republic of Korea; Singapore; and Taiwan Province of China), whose inflows

Figure 3. Share of developing countries in world FDI flows, 1980-1999

(Percentage)



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure I.9, p. 18.

increased by almost 70 per cent. In the Republic of Korea, FDI inflows reached an unprecedented $10 billion. Inflows to Singapore and Taiwan Province of China experienced a significant recovery after a sharp decline in 1998. FDI in Hong Kong (China), now the second largest recipient in the region, increased significantly — by more than 50 per cent — to reach $23 billion in 1999. This increase was largely due to the 1998 wave of "re-domiciling" funds owned by Hong Kong investors and foreign investors based in Hong Kong (China) and also to a large amount of reinvested earnings as a result of the distinct turnaround in local economic activity in 1999. Nevertheless, FDI flows declined in three of the five countries most affected by the recent financial crisis (Indonesia, Thailand and the Philippines). Flows to China, which had been well above $40 billion for four consecutive years, dropped by nearly 8 per cent, to just over $40 billion in 1999. South-East Asian low income countries which are dependent on other countries in the region for FDI continued to be adversely affected by the negative impact of the crisis on Asian outward investment.

Behind the recovery of FDI in the region lies intensified efforts to attract FDI, including greater liberalization at the sectoral level and increased openness to cross-border M&As. Cross-border M&As in the five countries (Indonesia, Malaysia, the Philippines, Republic of Korea and Thailand) most affected by the recent crisis reached a record level of $15 billion in 1999. Indeed, M&As have become an important mode of entry for TNCs investing in the region, averaging $20 billion during the period 1997-1999, compared with an average of $7 billion during the period 1994-1996.

FDI in *South Asia* declined in 1999 by 13 per cent, to $3.2 billion. Inflows to India, the single largest recipient in the sub-region, were $2.2 billion (a 17 per cent decrease). FDI flows to *Central Asia* declined slightly in 1999 to $2.8 billion, losing the momentum exhibited during the initial phases of liberalization and regulatory reform. The *Pacific Island* economies saw an improvement in their inflows in 1999, which rose to $250 million. FDI flows to *West Asia* increased to $6.7 billion, with Saudi Arabia receiving most of the new investment.

Outward FDI from developing Asia recovered from its recession during the financial crisis (increasing by 64 per cent in 1999 to an estimated $37 billion), still lower than the pre-crisis level. Hong Kong (China) remained the major outward investor, accounting for over half of the total outflows from the region. Divestment by Asian TNCs continued in 1999. In some cases, Asian TNCs sold their existing overseas businesses; in others, they were themselves acquired by foreign TNCs. Many Asian TNCs have been unable to take advantage of the cheap assets available due to the crisis; exceptions were those based in Hong Kong (China), Singapore and Taiwan Province of China, which managed to maintain their financial strength to engage in M&As, mostly in neighbouring countries.

FDI flows to *Latin America and the Caribbean* continued to increase in 1999, reaching a new record level of $90 billion, a 23 per cent increase over 1998. For the fourth consecutive year, Brazil was the largest recipient in the region, with $31 billion in investment inflows, mostly in non-tradable services and domestic-market-oriented manufacturing. Argentina's inflows more than tripled, reaching $23 billion in 1999; it overtook Mexico as the region's second largest recipient. Mexico received $11 billion in 1999, mainly in export-oriented manufacturing. A significant part of FDI flows to Latin America has entered through M&A deals, which reached a value of $37 billion in 1999. Some $16 billion of it involved the acquisition of local private companies by foreign-based TNCs. Privatization, however, remained important in Argentina, Brazil and to a lesser extent Chile, with a significant participation by TNCs based in Europe. For the Andean Community countries, FDI through privatization remained low.

... but flows to Central and Eastern Europe rose only modestly, while Africa continued to receive no more than a marginal share of FDI inflows.

In 1999, FDI flows into *Central and Eastern Europe* increased for the third consecutive year, reaching $23 billion in 1999. Still, the region accounted for less than 3 per cent of global FDI flows. As in 1998, Poland, the Czech Republic and the Russian Federation continued to be the top recipients of FDI flows. In the case of the last, FDI flows have rebounded, but they are still half the level of their 1997 figure of $6 billion. In relation to the size of their economies, Estonia, Hungary and the Czech Republic are the region's leaders. TNCs based in the European Union

are the principal investors in Central and Eastern Europe, and services are gaining in importance over manufacturing. The size of the domestic market in the case of large recipients, such as Poland, or privatization programmes allowing the participation of foreign investors, as in the case of the Czech Republic, are the principal determinants of FDI in the region. Central and Eastern European countries are not significant outward investors, registering less than $3 billion of outflows in 1999.

Despite a modest rise in FDI flows to *Africa* — from $8 billion in 1998 to $10 billion in 1999 — the region's performance remains lackluster. On a more positive note, though, FDI flows to Africa have stabilized at much higher levels than those registered in the early 1990s, in response to the sustained efforts of many countries to create more business-friendly environments. Some countries, such as Angola, Egypt, Morocco, Nigeria, South Africa and Tunisia, have attracted sizeable amounts of FDI in recent years. Angola and Egypt, in particular, have been especially successful, overtaking Nigeria to become the largest FDI recipients in the region in 1999. Although the absolute levels of FDI were small for most countries, they were nevertheless often significant in relation to the size of their domestic economies, as measured by both GDP and gross domestic capital formation. Finally, there is more diversification in terms of both source countries — with the United States being the most important one, followed by European countries — and in terms of sectors — with manufacturing and services gaining in importance over natural resources. On the negative side, FDI in Africa continues to be highly concentrated in five countries (whose composition, however, has changed over the years), with the bulk of African countries receiving meager amounts and the continent's share of world FDI inflows languishing at 1.2 per cent.

The responses to a survey of 296 of the world's largest TNCs carried out jointly by UNCTAD and the International Chamber of Commerce at the beginning of 2000 indicate that the modest increase in the level of FDI flows into Africa observed in recent years may well be sustained in the future. One-third of the 65 respondents intend to increase investment in Africa in the next three to five years, and more than half expect their investment to remain stable. More than 43 per cent of the respondents expect that Africa's overall prospects for attracting FDI will improve in the next three-to-five years, but another 46 per cent expect no change. South Africa and Egypt are viewed as the most attractive African locations. In general, the more developed countries in the region ranked higher than those at the bottom of the ladder, but a few least developed countries, notably Mozambique, Uganda, the United Republic of Tanzania and Ethiopia, were also viewed as attractive FDI destinations. Tourism, natural resource industries, or industries for which the domestic market is important — such as telecommunications — were viewed as the most promising in their potential to attract FDI. Textiles and clothing industries for which the international market is important ranked low. The survey findings also pointed out that the negative image of Africa persists and acts as a disincentive for foreign investors. But they also underline the need to differentiate among the countries of the continent.

The findings of the survey are broadly in line with those of an earlier survey of African investment promotion agencies conducted in 1999. There are, however, some interesting differences as regards the determinants of FDI decisions. TNCs ranked the size of domestic markets high and access to international markets low, while it was the belief of African investment promotion agencies that TNCs placed more emphasis on access to global markets, regulatory frameworks and incentives. Both TNCs and investment promotion agencies, however, recognized that corruption, the high costs of doing business, the poor state of the physical infrastructure and difficulties in accessing capital will be obstacles to attracting FDI in the foreseeable future.

Cross-border M&As, transacted in an emerging global market for firms, are the main force behind the latest rise of FDI,...

Over the past decade, most of the growth in international production has been via cross-border M&As (including the acquisitions by foreign investors of privatized state-owned enterprises) rather than greenfield investment: the value of completed cross-border M&As rose from less than $100 billion in 1987 to $720 billion in 1999 (figure 4). It should be cautioned, however, that data on the value of cross-border M&As and FDI flows are not truly comparable, for a variety of reasons that relate to how M&As are financed and to the balance-of-payments methodology used in calculating FDI flows, which is not applicable to M&As. Still, regardless of whether investments take place through greenfield establishments or M&As, they add to the size of international production.

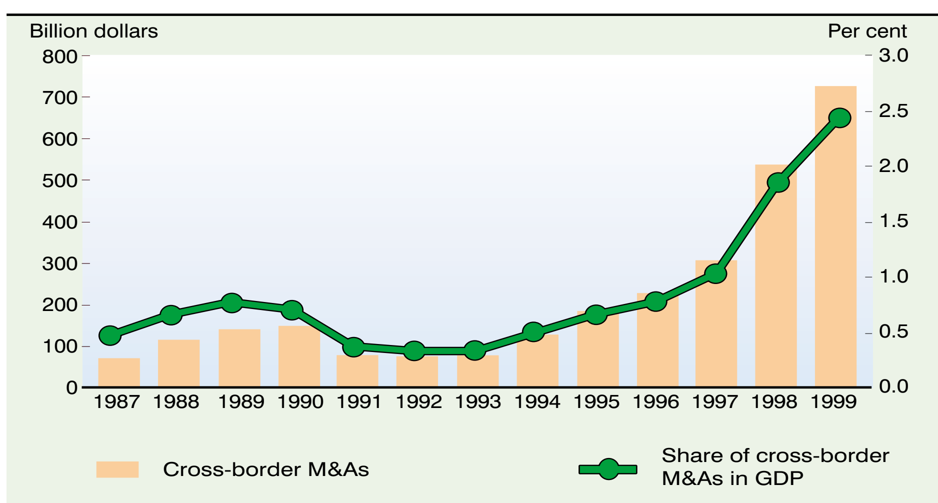
Less than 3 per cent of the total number of cross-border M&As are officially classified as mergers (although many of them are so only in name) — the rest are acquisitions. Full acquisitions account for two thirds of the total number of cross-border acquisitions. Minority acquisitions (10-49 per cent) account for about one-third of cross-border acquisitions in developing countries, compared with less than one-fifth in developed countries. Cross-border M&As can be classified functionally as horizontal (between firms in the same industry), vertical (client-supplier or buyer-seller M&As), or conglomerate (between companies in unrelated industries) (figure 5). In terms of value, about 70 per cent of cross-border M&As are horizontal. In terms of number, that share is 50 per cent. Vertical M&As have been increasing in numbers in recent years. While many of the cross-border M&As in the late 1980s were driven by the quest for short-term financial gains, most M&As today appear to have strategic and economic rather than immediate financial motives. Also, most of the recent cross-border M&As are not hostile: hostile M&As accounted for less than 5 per cent of the total value and less than 0.2 per cent of the total number of M&As in 1999.

The total *number* of all M&As worldwide (cross-border and domestic) has grown at 42 per cent annually between 1980 and 1999. The *value* of all M&As (cross-border and domestic) as a share of world GDP has risen from 0.3 per cent in 1980 to 8 per cent in 1999. Two big M&A waves can be distinguished during this period: one in 1988-1990 and another from 1995 onwards. The recent wave has taken place alongside a boom in domestic M&As. Consequently, during the 1990s, the share of cross-border M&As in all M&A deals has not changed: it averaged about 25 per cent in terms of both value and number of completed transactions. (In 1999, however, that share in terms of value was nearly 31 per cent (figure 6).) Apart from traditional bank loans, the recent M&A boom has been facilitated by the increased use of such financing mechanisms as the issuance of common stocks, the exchange of stocks and corporate debt. In addition to the traditional bank loans venture capital funds have also been significant as a source of finance, enabling many new firms or small and medium-sized enterprises (SMEs) to engage in M&A activity.

Following earlier trends, cross-border M&As increased by 35 per cent in 1999, reaching — according to UNCTAD estimates — $720 billion in over 6,000 deals. About one-sixth of these M&A transactions (in terms of number) involved foreign affiliates already present in host countries. Cross-border M&As are expected to increase further in 2000, with several mega deals already announced or completed (e.g. Vodafone AirTouch-Mannesmann). The year 2000 may well see a total value of cross-border M&As above $1 trillion.

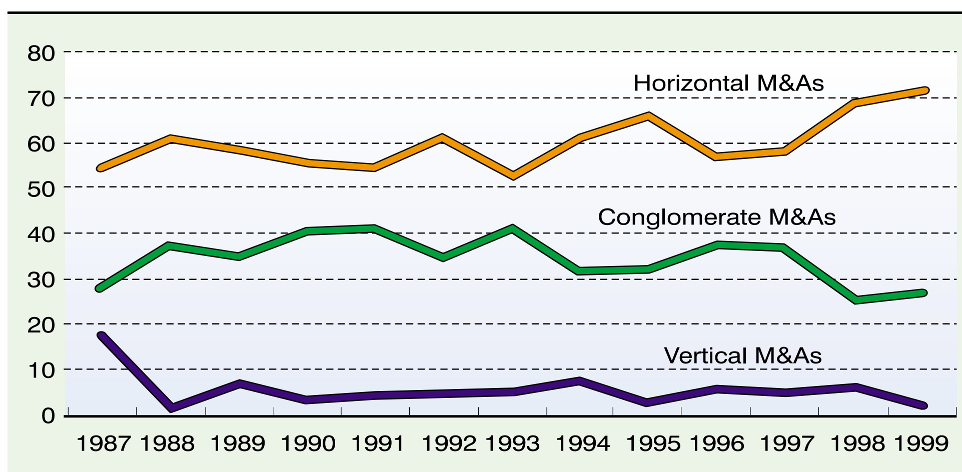
The ratio of the value of cross-border M&As to world FDI flows reached over 80 per cent in 1999. M&As are particularly significant as a mode of entry for FDI in developed countries. In the developing world, greenfield FDI is still dominant. FDI flows to developing countries

Figure 4. Value of cross-border M&As and its share in GDP, 1987-1999



Source: UNCTAD, UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure I.4, p. 13.

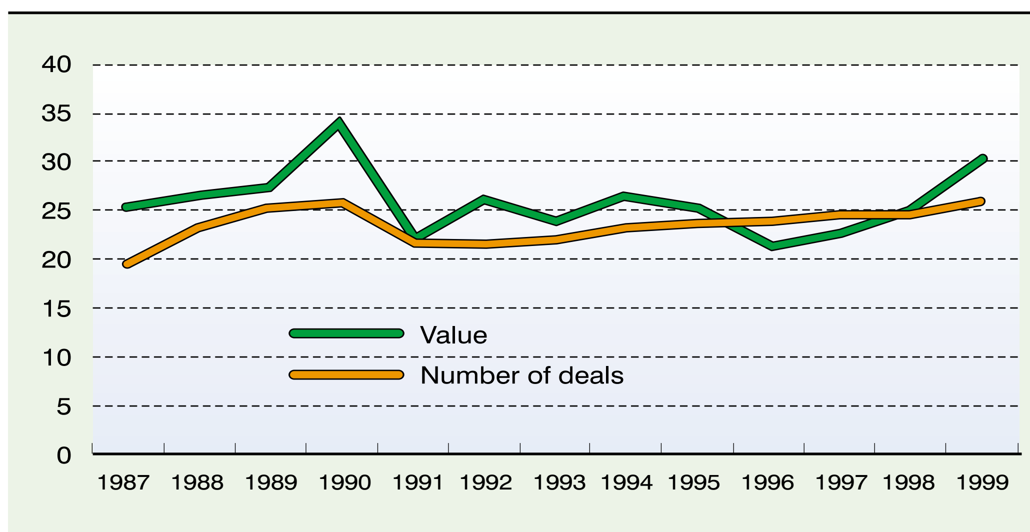
Figure 5. World cross-border M&As, by type (horizontal, vertical, conglomerate),[a] 1987-1999
(Percentage of the total value)



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure IV.2, p. 102.

[a] For the definition of each type of M&As, see annex table A.IV.1.

Figure 6. Cross-border M&As as a percentage of all M&As in the world, 1987-1999



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure IV.6, p. 107.

associated with M&As have been on the rise, however, their value increased roughly from one-tenth of the value of total FDI inflows at the end of the 1980s to one-third at the end of the 1990s (figure 7). In Central and Eastern Europe, due to fluctuations in cross-border acquisitions associated with privatizations, the share of M&As in total FDI inflows has varied widely from year to year.

Some interesting parallels can be drawn between the current M&A boom and the one that occurred in the United States at the turn of the nineteenth century, reaching its climax between 1898 and 1902. Both M&A waves have been affected by major technological developments, new means of financing M&As and regulatory changes. But while the recent wave is an international one, the older one was confined to the United States. And just as the earlier boom in the United

States contributed to the emergence of a national market for goods and services and a national production system, complemented by a national market for firms, so is the current international boom reinforcing the emergence of a global market for goods and services and the emergence of an international production system, complemented by an increasingly global market for firms.

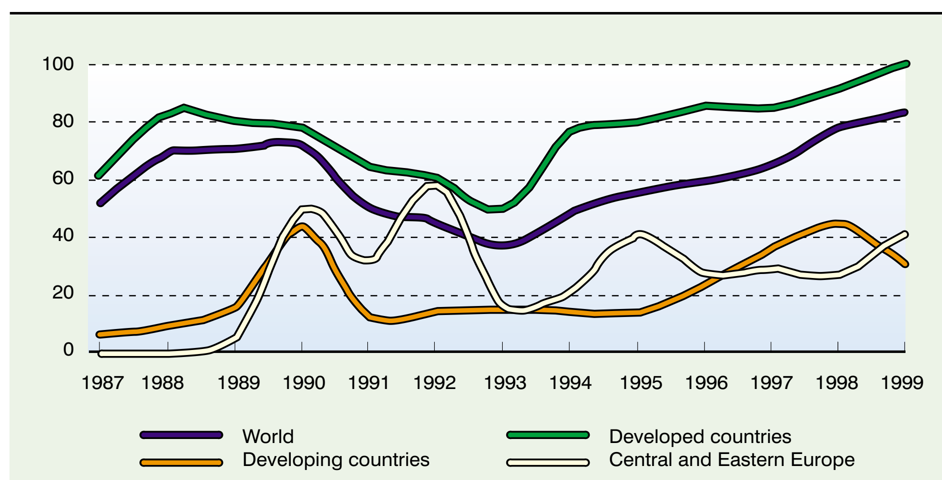
... driven by strategic corporate objectives ...

The current spate of cross-border M&As is occurring despite the fact that many M&As have not delivered the anticipated positive results to the acquiring firms in terms of both share prices and "real" economic effects such as profits and productivity. Although the impact on the target firms often appears to be more favourable, the growth of cross-border M&As as a mode of expansion may still be regarded as somewhat paradoxical. In order to understand the phenomenon more fully, both basic motivations for M&As and changes in the economic environment — and their interaction — need to be taken into account.

In general, from a foreign investor's perspective, cross-border M&As offer two main advantages compared with greenfield investment as a mode of FDI entry: speed and access to proprietary assets. The crucial role of speed in today's business life is illustrated by such quotes from top executives as: "In the new economy in which we live, a year has 50 days" or "Speed is our friend — time is our enemy". Cross-border M&As often represent the fastest means of building up a strong position in a new market, gaining market power — and indeed market dominance — increasing the size of the firm or spreading risks. At the same time, financial opportunities may be exploited and personal gains be reaped by top management. Moreover, cross-border M&As may allow firms to realize synergies by pooling the proprietary resources and capabilities of the firms involved, with potential static and dynamic efficiency gains. The relatively poor financial performance record of M&As suggests, however, that there may be other reasons to consider.

They have to do with advances in technology, liberalization and changes in capital markets. The rapid pace of technical change has intensified competitive pressures on the world's technological leaders, which are often TNCs. By merging with other TNCs with complementary capabilities, firms can share the costs of innovation, access new technological assets and enhance their competitiveness. The spreading and deepening of the international production system through cross-border M&As has furthermore been facilitated by the ongoing removal or relaxation of restrictions on FDI (including restrictions on cross-border M&As) in many countries. Trade liberalization and regional integration efforts have added an impetus to cross-border M&As by

Figure 7. Value of cross-border M&As in relation to the value of FDI flows, world and by host region,[a] 1987-1999
(Percentage)



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure I.5, p. 16.

[a] Cross-border M&A sales as a percentage of FDI inflows.

setting the scene for more intense competition and by prompting regional corporate restructuring and consolidation. Capital market liberalization, in turn, and the proliferation of new methods of financing M&As, have made cross-border M&As easier. Finally, the idea that there is an increasingly global market for firms, in which firms are bought and sold, has become more widely accepted.

The current wave of unprecedented global and regional restructuring through cross-border M&As reflects a dynamic interaction between the various basic factors motivating firms to undertake M&As and changes in the global economic environment, in the pursuit of strategic corporate objectives (figure 8). For many firms, the quest to survive and prosper in the emerging global market for firms becomes the key strategic issue and, hence, drives the M&A trend. In the market for firms, sanctions can await those that fail to deliver growth and profits. One such sanction is to be taken over. All the basic motivations for firms to undertake cross-border M&As then combine to become key elements in the overarching strategic goal to defend and develop competitive market positions. Cross-border M&As are growing so rapidly in importance precisely because they provide firms with the fastest way of acquiring tangible and intangible assets in different countries, and because they allow firms to restructure existing operations nationally or globally to exploit synergies and obtain strategic advantages. In brief, cross-border M&As allow firms rapidly to acquire a portfolio of locational assets which has become a key source of competitive strength in a globalizing economy. In oligopolistic industries, furthermore, deals may be undertaken in response to the moves or anticipated moves of competitors. Even firms that would not want to jump on the bandwagon may feel that they have to, for fear of becoming targets themselves.

... and concentrated mainly in a handful of developed countries and industries.

Some 90 per cent of all cross-border M&As (by value in 1999; table 5), including most of the 109 mega deals with transaction values of more than $1 billion, were carried out in developed countries. These countries have had the highest share of M&As in their GDPs and have witnessed a parallel increase in FDI flows.

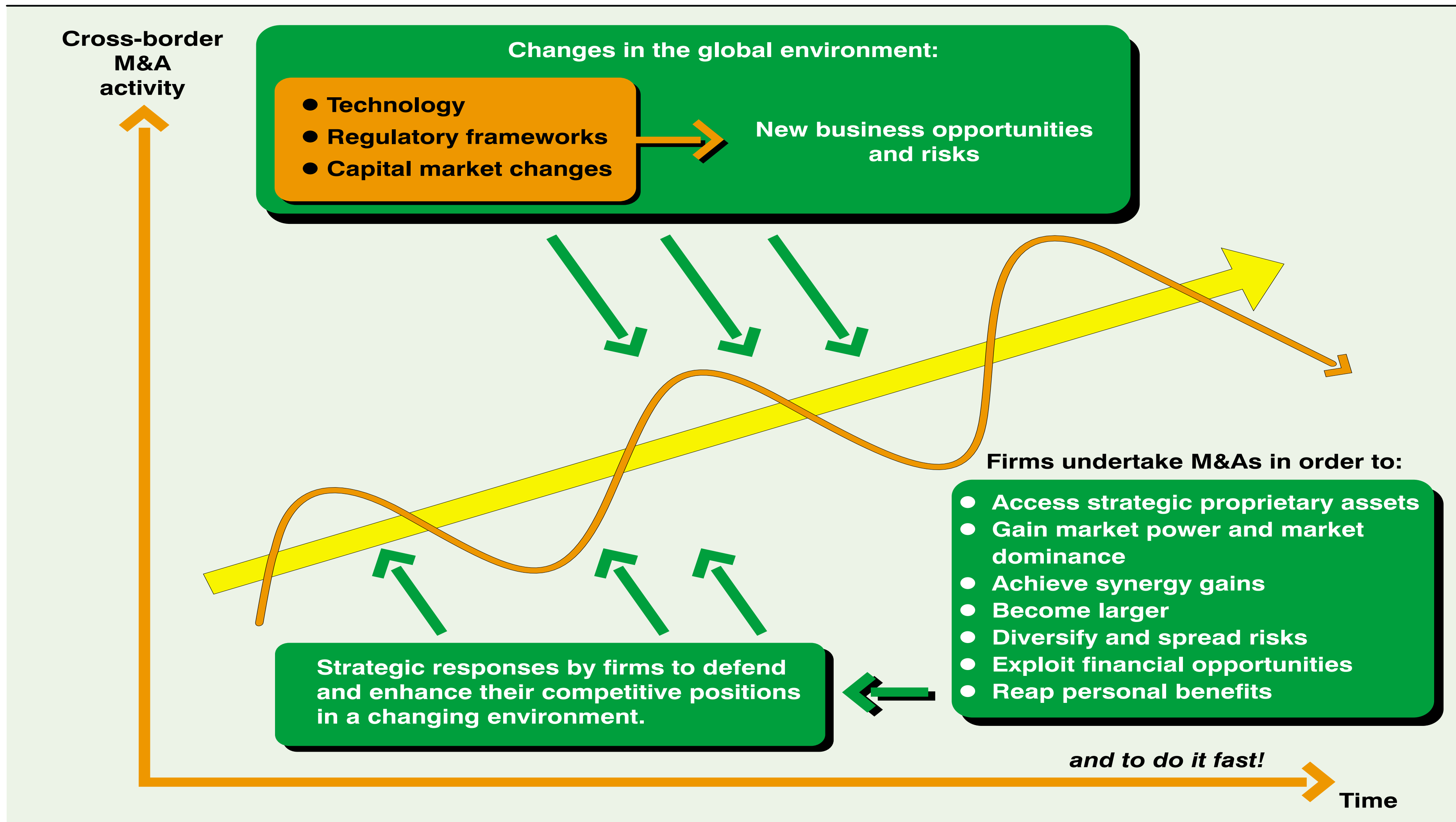
Western European firms engaged actively in cross-border M&As in 1999, with a total of $354 billion in sales and $519 billion in purchases. Intra-European-Union M&A activity accounts for a significant share of these transactions, driven by the introduction of the single currency and measures promoting greater regional integration. Most of the purchases outside the region involve United Kingdom firms acquiring United States firms. The United Kingdom, Sweden, Germany and the Netherlands were the largest target countries, while Germany and France were the largest acquirers after the United Kingdom.

The United States continued to be the single largest target country with M&A sales of $233 billion to foreign investors in 1999 (table 5). More than a quarter of all M&A deals in the United States in 1999 were concluded by foreign acquirers in 1999, compared with 7 per cent in 1997. Cross-border M&As are today the dominant mode by which FDI enters the United States market. M&A-associated investment in foreign affiliates in the United States accounted for 90 per cent in terms of value and 62 per cent in terms of the number of projects of all FDI in 1998. On the outward side, United States firms acquired foreign firms valued at $112 billion in 1999, $25 billion less than in 1998. The decline reflects a lower number of mega deals.

The value of Japanese M&A purchases overseas increased significantly in 1999, primarily due to a single transaction. In general, Japanese TNCs still prefer greenfield investments to M&As, especially when investing in developing countries. Cross-border M&A sales in Japan have risen rapidly in recent years, and were larger than purchases during the period 1997-1999. This is due to changes in the regulatory framework for M&As, corporate strategies favouring M&As pursued by foreign-based TNCs, and the changing attitudes of Japanese firms towards M&As.

Automobiles, pharmaceuticals and chemicals, and food, beverages and tobacco were the leading industries in the manufacturing sector in terms of worldwide cross-border M&A activity in 1999. Most M&As in those industries were horizontal, aiming at economies of scale, technological synergies, increasing market power, eliminating excess capacity, or consolidating and streamlining innovation strategies and R&D budgets. In most of the industries in which horizontal M&A activity is strong, concentration ratios have intensified. In automobiles, M&A

Figure 8. The driving forces of cross-border M&As



Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, figure V.1, p. 154.

activity between car makers and suppliers has also led to greater vertical consolidation. Telecommunications, energy and financial services were the leading industries in M&A activity in the services sector, largely as a result of recent deregulation and liberalization in these industries. In financial services, competitive pressures and mounting information technology costs have given an added impetus to M&As.

It was not until the late 1990s that developing countries emerged as important locations for incoming cross-border M&As in terms of value. While their share in world cross-border M&As remained constant at less than 10 per cent in terms of value almost every year until the mid-1990s, in terms of the number of deals, it increased from 5 per cent in 1987 to 19 per cent in the late 1990s. The value of cross-border M&As undertaken by firms *from* developing countries rose from $3 billion in 1987 to $41 billion in 1999 (table 5).

Among the developing regions, Latin America and the Caribbean dominate cross-border M&A sales, with Brazil and Argentina as the main sellers. Privatization has been the main vehicle for M&As in both countries. In Asia, cross-border M&A sales gathered pace in 1999. In the Republic of Korea, acquisitions by foreign firms exceeded $9 billion in 1999, making it the largest recipient of M&A-associated FDI in developing Asia. In Africa, Egypt, Morocco and South Africa have been the targets of most foreign acquisitions. In the other African countries, M&A activity has been slow, due partly to the slow pace of privatization and partly broader reasons related to the investment climate and limited availability of attractive firms for purchase in the private sector.

The principal acquirers of firms based in developing countries have traditionally been TNCs based in developed countries. European Union firms became the largest acquirers during 1998-1999, replacing United States firms and accounting for more than two-fifths of all cross-border M&As in developing countries. Cross-border M&A purchases by firms based in developing countries nearly doubled in 1999 after dipping in 1998 in response to the Asian financial crisis. Asian firms in fact became the principal targets of these purchases in 1999, with Singapore the leading buyer. Cross-border M&A purchases by firms from the five Asian countries most affected by the financial crisis also increased, reflecting improvements in their liquidity position. The same trend can be observed in Latin America and the Caribbean, with significant increases in purchases by firms from this region in recent years.

Table 5. Cross-border M&As: sales and purchases, by region, 1990-1999

(Billions of dollars)

	Sales					Purchases				
Region/economy	1990	1995	1997	1998	1999	1990	1995	1997	1998	1999
Developed countries	**134.2**	**164.6**	**234.7**	**445.1**	**644.6**	**143.2**	**173.7**	**272.0**	**511.4**	**677.3**
of which :										
European Union	62.1	75.1	114.6	187.9	344.5	86.5	81.4	142.1	284.4	497.7
United States	54.7	53.2	81.7	209.5	233.0	27.6	57.3	80.9	137.4	112.4
Japan	0.1	0.5	3.1	4.0	15.9	14.0	3.9	2.7	1.3	9.8
Developing countries	**16.1**	**15.9**	**64.3**	**80.7**	**63.4**	**7.0**	**12.8**	**32.4**	**19.2**	**41.2**
of which :										
Africa	0.5	0.2	1.7	0.7	0.6	-	0.1	-	0.2	0.4
Latin America and the Caribbean	11.5	8.6	41.1	63.9	37.2	1.6	4.0	10.7	12.6	24.9
Europe	-	-	-	-	0.3	-	-	-	-	-
Asia	4.1	6.9	21.3	16.1	25.3	5.4	8.8	21.7	6.4	15.9
Pacific	-	0.1	0.3	-	0.1	-	-	-	-	-
Central and Eastern Europe[a]	**0.3**	**6.0**	**5.8**	**5.1**	**10.3**	**-**	**0.1**	**0.3**	**1.0**	**1.6**
World[b]	**150.6**	**186.6**	**304.8**	**531.6**	**720.1**	**150.6**	**186.6**	**304.8**	**531.6**	**720.1**

Source: UNCTAD, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development*, table IV.3, p. 108.

[a] Includes the countries of the former Yugoslavia.
[b] Includes amounts that cannot be allocated by region.

In Central and Eastern Europe, M&A activity has fluctuated widely, doubling in 1999 to $10 billion. Poland, the Czech Republic and Hungary have been the major target countries owing to their large privatization programmes. European Union firms are the principal acquirers in this region.

Among developed countries, the sectoral patterns of cross-border M&A activity differ significantly between the European Union and the United States. In the former, chemicals, food, beverages and tobacco are the most targeted industries for M&As by foreign firms. In the latter, electrical and electronic equipment and chemicals are the preferred target industries. In the European Union and the United States, financial firms are the most aggressive acquirers. In Latin America and the Caribbean, M&A activity is concentrated in public utilities, finance, petroleum products, transport, storage and communications. In the five countries most affected by the Asian financial crisis, finance is the dominant industry in foreign acquisitions. Finance, but also food, beverages and tobacco, are the principal target industries in Central and Eastern Europe.

The special features of cross-border M&As raise concerns about the balance of benefits for host countries...

Cross-border M&As, particularly those involving large firms, vast sums of money and major restructurings of the activities of firms, are among the most visible faces of globalization. And, 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 these transactions take place — raise questions about the balance of their benefits and costs for host countries (box 1). These concerns are further accentuated in the prevailing context of globalization and the rapid changes associated with it. TNCs are seen to benefit disproportionately from globalization, while local SMEs in host developing countries are affected adversely. M&As, and in particular their cross-border variety, appear to be little more than a vehicle for the expansion of big business.

Box 1. What concerns do cross-border M&As raise for host countries?

In a number of host countries, concern is expressed in political discussions and the media that FDI entry through the takeover of domestic firms is less beneficial, if not positively harmful, for economic development than entry by setting up new facilities. At the heart of these concerns is that foreign acquisitions do not add to productive capacity but simply transfer ownership and control from domestic to foreign hands. This transfer is often accompanied by layoffs of employees or the closing of some production or functional activities (e.g. R&D capacities). It also entails servicing the new owner in foreign exchange.

If the acquirers are global oligopolists, they may well come to dominate the local market. Cross-border M&As can, moreover, be used deliberately 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.

Concerns over the impact of cross-border M&As on host-country development arise even when M&As go well from a corporate viewpoint. But there can also be additional concerns related to the possibility that M&As may not, in fact, go well. Half of all M&As do not live up to the performance expectations of parent firms, typically when measured in terms of shareholder value. Moreover, even in M&As that do go well, efficient implementation from an investor's point of view does not necessarily mean 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 commercial objectives of TNCs and the development objectives of host economies do not necessarily coincide.

The areas of concern transcend the economic and reach into the social, political and cultural realms. In industries like media and entertainment, for example, M&As may seem to threaten national culture or identity. More broadly, the transfer of ownership of important enterprises from domestic to foreign hands may be seen as eroding national sovereignty and amounting to recolonization. When the acquisitions involve "fire sales" — sales of companies in distress, often at low prices considered abnormally low — such concerns are intensified.

Source: UNCTAD.

Concerns related to cross-border M&As are not confined to developing countries. They are also expressed in many developed countries, often more vehemently. When Japanese investors acquired the Rockefeller Center in New York and film studios in Hollywood, the press reacted with indignation. When Vodafone AirTouch (United Kingdom) recently sought to acquire Mannesmann (Germany), the reaction was similar 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.

All these concerns need to be considered carefully. They are examined in *WIR2000* by focussing on the impact of cross-border M&As in key areas of economic development, and whether it differs from that of greenfield FDI. A good part of the discussion in this volume is conceptual, and more empirical work is needed to understand the matter fully.

The starting point of the examination is the impacts of FDI in general on different key areas of development, as identified in UNCTAD's *WIR99*. The *Report* then compares the impact of FDI through M&As with that of FDI through greenfield ventures. Comparing cross-border M&As with greenfield FDI often means considering counterfactuals — what might have happened if cross-border M&As had not taken place. Such counterfactuals need to take account of not just the industry and host-country context, but also of the broader setting of trade, technology and competition.

Not all cross-border M&As are FDI. Some are portfolio investments (acquisitions of less than 10 per cent equity, for measurement purposes). Yet others are akin to portfolio investments, being solely or primarily motivated by financial considerations, regardless of the equity share involved. Portfolio or near-portfolio M&As are not considered here, since the focus is on M&As as a mode of *FDI* entry, not on cross-border M&As *per se*. In any event, the share of portfolio or near-portfolio M&As in the total value of cross-border M&As is small.

For some direct investors there is a genuine choice between entering a host country through greenfield FDI and entering it through M&As. However, the two modes of entry are not always realistic alternatives for either TNCs or host countries, as for example when a telecommunication network is privatized or a large ailing firm needs to be rescued and no domestic buyers can be found. Hence *WIR2000* also considers situations in which cross-border M&As are the only realistic way for a country to deal with a given situation, focusing on how M&As affect the performance of the acquired enterprise and the host economy.

... especially at the time of entry and shortly thereafter, ...

The essential difference between cross-border M&As and greenfield FDI is that the former involve, by definition, a change of assets from domestic to foreign hands and, at least initially, do not add to the productive capacity of host countries. The discussion in *WIR2000* 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 bring 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, while in the case of greenfield FDI they do. 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 merger or acquisition can serve as "life preserver".

- 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), or to their relocation in line with the acquirer's corporate strategy. Greenfield FDI does not *directly* reduce the technological 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, may increase the number of firms in existence and cannot directly increase market concentration upon entry.

...but those fade in the longer term, when both direct and indirect effects of M&As come into play,...

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 on market structure and competition.

In addition to the principal effects on the important *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. It 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.

... although concerns regarding foreign control and ownership generally may linger.

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 national social, cultural and political goals. These issues acquire urgency when cross-border M&As result in industries thought to be strategic 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. Trade-offs between economic objectives and broader, non-economic ones, in particular, require value judgements that only countries alone can make.

The circumstances of host countries are particularly important for determining impact.

Apart from consideration related to the time at entry versus the longer run, circumstances in which host countries find themselves deserve underlining when it comes to the assessment of the costs and benefits of cross-border M&As:

- 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, 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 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 severe difficulties or face the risk of bankruptcy and no alternative to FDI (including public funding) to M&As by foreign investors is available to help them. 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 be able to raise the required funds (including in international financial markets) or have other assets (such as modern managerial practices or technology) that 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 face 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 of cross-border M&As on development — regardless of circumstances — were summarized in June 2000 in the "Outcome" of an intergovernmental Expert Meeting on Mergers and Acquisitions as follows (UNCTAD, 2000, 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; motivation of the investor (e.g. market seeking vs. efficiency seeking); the situation of the acquired enterprise; and the availability of alternatives as regards modes of entry of investment."

Regardless of circumstances, policy matters — and competition policy takes pride of place among policies addressing cross-border M&A concerns.

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 the *World Investment Report 1999*, 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 assistance, especially for firms in distress because of developments over which they have no influence.

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 sectoral reservations, ownership regulations, size criteria, screening and 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 shares and indeed 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. 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, 1997, p. XXXI). 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. 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 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. 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.

A postcript

WIR2000 draws an intriguing parallel 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, caused the courts of that country to interpret the Sherman Antitrust Act to cover M&As and, eventually, Congress to adopt 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 has, over the nearly 100 years since then, led to a further strengthening of that country's competition control system. 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.

Rubens Ricupero
Geneva, July 2000 Secretary-General of UNCTAD

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Annex:

World Investment Report 2000: Cross-border Mergers and Acquisitions and Development

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