Benefits and Threats of Cross-Border Mergers and Acquisitions for European Transition Countries

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The increasing volume of international capital flows and within them cross-border mergers and acquisitions has been playing an increasingly important role in the world economy. Most countries have used foreign direct investments to import much needed technology as well as organizational and managerial skills, to upgrade productivity, to gain know-how and improved access to the world markets.

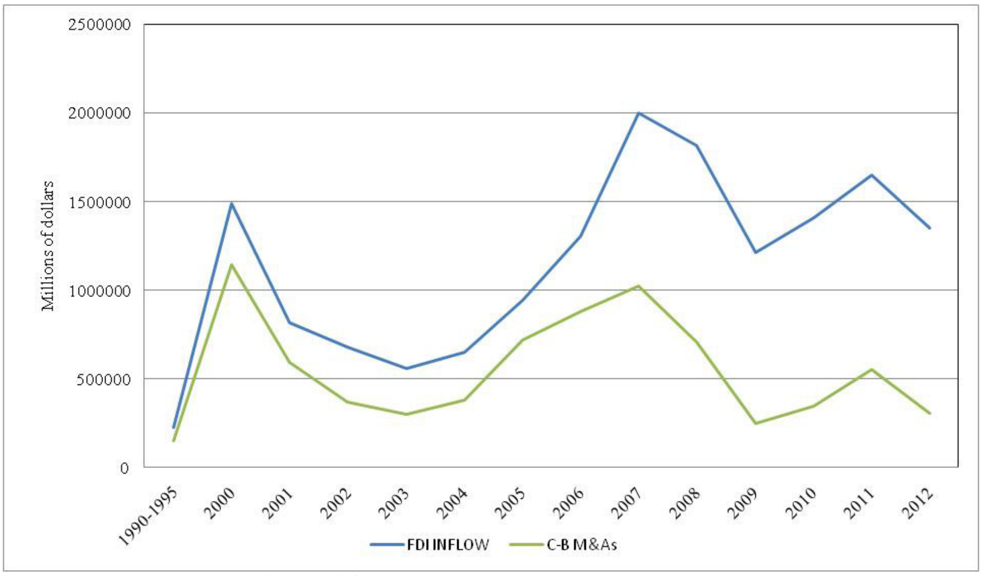
There are many researches and articles on the effects of foreign direct investments, but there are just a few studies examining the specific effects of cross-border mergers and acquisitions as an entry mode of foreign direct investments. The aim of the proposed article is to identify the benefits and threats of inward cross-border mergers and acquisitions in European transition countries. Using total analysis author joined the empirical facts about the experiences of individual European transition countries in terms of economic effects of cross-border mergers and acquisitions on the level of a group of European transition countries. With this methodological approach stylised facts about the effects of cross-border mergers and acquisitions on the host country can be shown.

The results of the empirical analysis suggest that in all European transition countries concerned inward cross-border mergers and acquisitions are treated as an important tool for economic growth and competitiveness development. On the other hand, certain threats of such processes have been pointed out, especially in the form of crowding out domestic firms, low acquisition price, anti-competitive behaviour of foreign affiliates and reduction of employment. The stronger emphasis on benefits compared to the threats shows the importance of these processes for host countries development.

Introduction

The movement of international capital flows has been very dynamic through the years. Their volume changed due to different circumstances and the same applies to their forms. Figure 1 shows the development of foreign direct investment (FDI) inflow, and cross-border mergers and acquisitions (C-B M&As) from 1990 to 2012.

Figure 1. The development of FDI and C-B M&As from 1990 to 2010



(Adapted from UNCTAD, 2000, 2001, 2013)

According to the *World Investment Report* (2000, 2012) global FDI inflows were at low level between the years 1990-2000. In 2000, FDI inflow reached record levels of $1,500 billion. Terrorist attacks in the United States caused a large decline in 2001 (41 %) and in the years later. In 2005, FDI again stabilised and reached $982 billion. In 2007 (UNCTAD, 2008:3-9), global FDI already recorded $1,970 billion. Economic and financial crisis caused a decline of FDI in 2008 and in 2009. In 2008, it was reduced by 12 % compared to the previous year and in 2009 by 32% compared to 2008. In 2010, the volume of global FDI began increasing and thus increased by 15 % compared to 2009 (to $1,200 billion) but was still by 30 % lower than the highest volume of FDI that was recorded in 2007. In 2011 FDI value was 17 % higher than in 2010, while in last year FDI inflow again dropped and recorded $1,350 billion[1].

The main factors that influenced to the global FDI flows in the last years were structural weaknesses in the global financial system, weaker growth in the European Union and significant policy uncertainty in areas crucial for investor confidence (UNCTAD, 2013).

Figure 1 also shows the development of C-B M&As within FDI. Data for this type of FDI are available since 1987, when C-B M&As stood at $75 billion. In 2000, their value was already $1,144 billion and in 2007 $1,022 billion. Due to the economic and financial crisis also the value of C-B M&A dropped, in 2012, it was $308 billion. In the following chapter the effects of FDI and C-B M&As on the host economies are shown.

[1] The strong decline in FDI flows (18 %) in 2012 is in stark contrast to other macroeconomic variables, including GDP, trade and employment growth, which all remained in positive territory in 2012.

Empirical Study of Economic Effects C-B M&As

There is quite a rich choice of FDI research in the literature. Mostly they are exploring general FDI development, factors influencing FDI flows and the distribution of FDI over regions and states. Studies are researching mostly economic consequences of inward FDI for individual state or company. Some of authors researching economic effects of FDI are *Barro* (1991), *Barro and Sala-i-Martin* (1995), *Aitken and Harrison* (1999), *Lipsey* (2002), *Johnson* (2005).

On the other hand much seldom is the research on C-B M&A's effects as a part of FDI. The first reason for that is the problem with the data collection as some of data required for such a study is unobtainable. Another can be that in order to disguise unwanted C-B M&A's outcomes companies hide the incriminated data and include them in reports of entire company. Besides, quite often it happens also that national governments declare acquisitions as mergers so as to pacify public sentiments.

The existing studies about effects of C-B M&As on the host economy mostly focus on the analysis of individual macroeconomic or financial consequences of such processes or relate to a group of companies or sectors. While the first group of studies are too broad to be able to recognise the differences among individual groups of countries, the latter are too narrow to be able to explain and establish stylised facts. In the following chapter we are showing stylised facts with inward C-B M&As in European transition countries as shown in the research *Maček* (2009).

The Data, Sample and Method

In our analysis we used the total analysis (Walras) for recognizing stylised facts and eventual differences among countries. We therefore joined empirical facts about the experiences of individual microeconomic units or countries on the level of a group of transition countries. With this methodological approach we gained relevant information and obtained robust results.

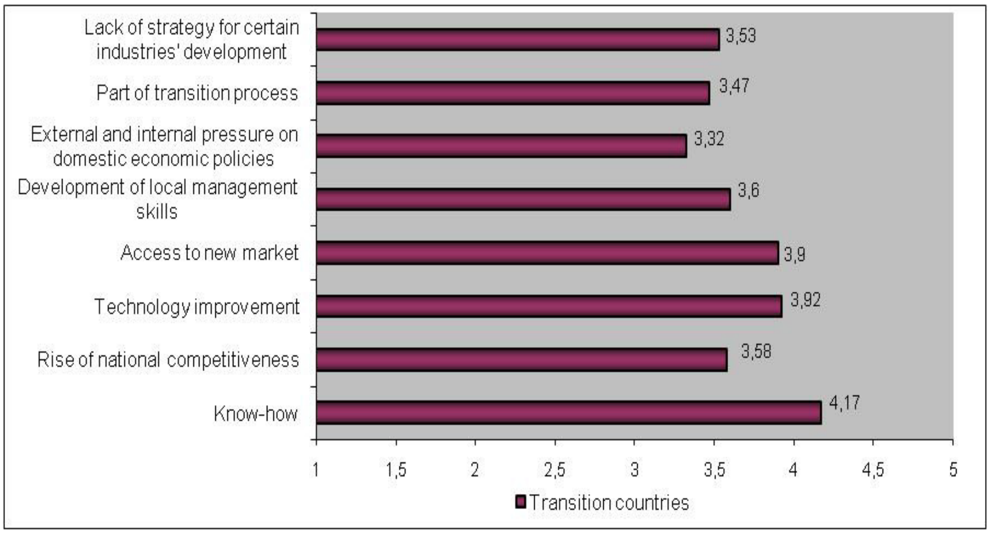
Studies employing a similar methodological approach replace the lack of data on C-B M&As with interviews of government officials or journalists from individual countries, where authors rely on information obtained from editors and renown journalists. They are thus exposed to risks of either biased information or lacking knowledge of the subject matter. In order to avoid these risks to the highest possible extent, the sample in our total analysis comprises scientists, professors and experts employed at European business schools. The risk of bias was reduced as deans of schools invited their colleagues to participate, whose research or pedagogical work deals with the treated phenomenon. The respondents were to some extent included in C-B M&As or were at least very familiar with the professional and public debate in local circles and the media. When testing the size of the difference in the answers provided by professionals from the same country, there was no need to reject or exclude any of the answers from the sample used in the empirical analysis.

We are presenting some results of the analysis carried out with the help of a questionnaire consisting of 21 questions in the fields of effects of inward C-B M&As, government reactions and the media relation to these processes in European transition countries. The sample included experts from 60 business schools from the following European transition countries (the number of respondents is in parentheses): Belarus (2), Bosnia and Herzegovina (2), Bulgaria (2), Croatia (4), Czech Republic (4), Estonia (2), Georgia (2), Hungary (4), Latvia (3), Lithuania (6), Poland (4), Romania (4), Russia (4), Slovakia (3), Slovenia (4), Serbia and Montenegro (2), Turkey (4), Ukraine (4). For statistical analysis the program SPSS-X for Windows and Microsoft Excel were used. This chapter uses frequency distribution to present the obtained answers on the effects of C-B M&As in transition countries.

Analysis of Effects of C-B M&As

First we verified the positive expectations of the respondents for the upcoming C-B M&As in their country. The results are shown in the Figure 2.

Figure 2. Positive expectations for the upcoming C-B M&As

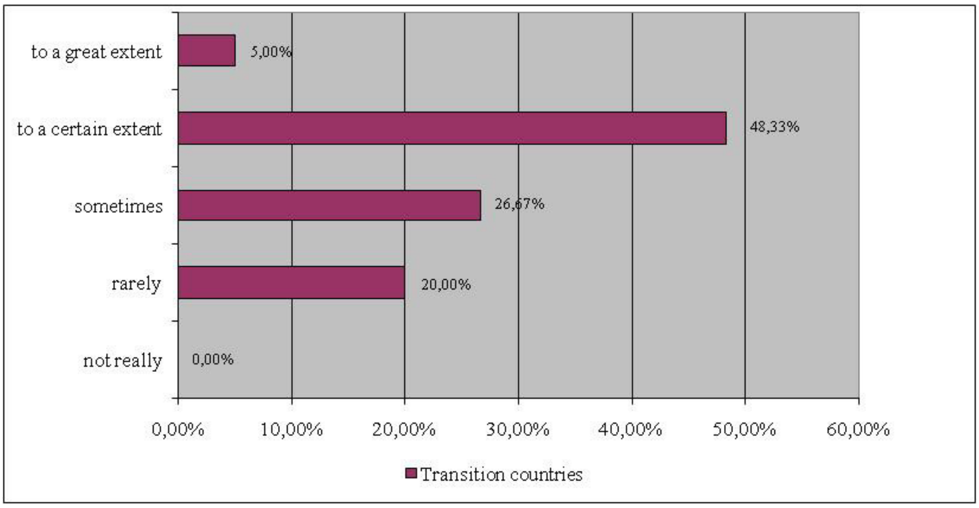


Respondents from transition countries expect C-B M&As to bring know-how transfer, technology improvement and access to new market. Almost all answers received very high scores, the average score of fewer than 3.5 is recorded only to external and internal pressures of foreign investors on domestic economic policies in order to be able to act more efficiently and transparently in the field of investments.

Technology improvement in the form of anticipated benefits of C-B M&As is very high rated. That corresponds to *Lall's* (2002) findings, who stressed that technology improvement as a result of C-B M&As was especially evident in countries, where technology levels were low prior to the foreign investment. Very high rated were also benefits in the form of development of managerial skills, support for strategy of individual industries and rise of national competitiveness. By the opinion of the respondents C-B M&As also bring benefits in the form of support to the transition process, which can be attributed to the fact that with dynamic growth C-B M&As appear as a characteristic of transition in receiving countries. As the least important anticipated benefits of C-B M&As, the respondents state benefits in the form of external and internal pressures on domestic economic policies, which are due to the transition process somehow expected in transition countries.

Such results of the anticipated benefits of C-B M&As in the future correspond to the results of numerous studies where authors proved benefits of C-B M&As. *Bertrand and Zitouna* (2006), see the main contribution of C-B M&As to be in know-how transfer, increased productivity and development of R&D facilities. A comparison of results provided by our empirical analysis with other often quoted studies thus shows realistic expectations of the professional public concerning the benefits that C-B M&As are supposed to bring to the receiving countries. The next figure shows answers to the question to what extent C-B M&As influenced privatisation income in the host country.

Figure 3. Contribution of C-B M&As to privatisation income

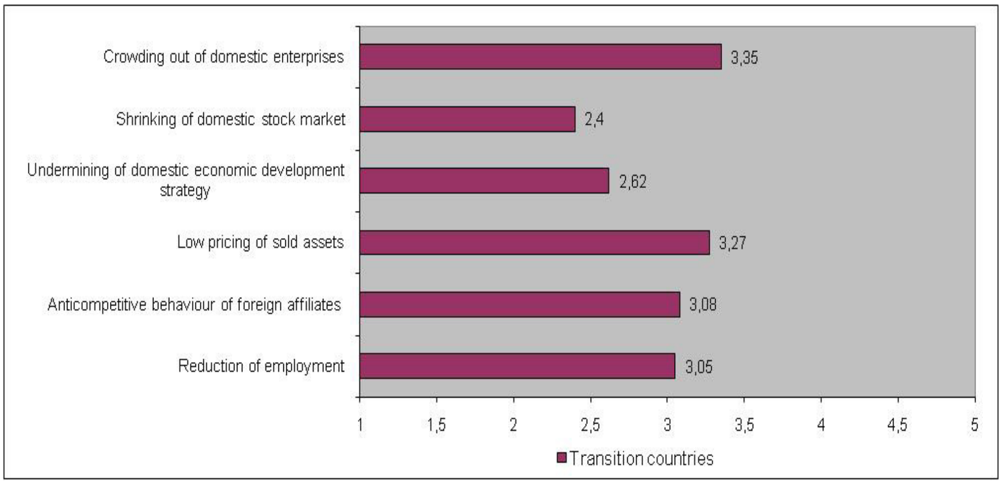


The Figure 3 shows that privatisation income had to a certain extent increased in transition countries because of C-B M&As. Only 20 % of the respondents from transition countries believed that these processes did not contribute to the increase of privatisation income, while approximately 53 % believed that the contribution was substantial.

Also this result was expected as transition countries are countries with a prevailing privatisation model, where a substantial share of state property has been allocated to residents and mutual funds that did not produce any privatisation property. The results of our empirical analysis are comparable to the study by Calderon et al. (2004) that empirically proved the increased volume of C-B M&As particularly in countries undertaking privatisation of public enterprises.

On the other hand C-B M&As can also bring threats to the host countries. Typical risks of C-B M&As exposed in studies (Hitt et al., 1991; Benacek 2000; Blonigen & Taylor, 2000; Tandon, 2000; Haller, 2005; Johnson, 2005; Tsang & Hauck, 2007; UNCTAD, 2007; Kamaraj, 2008) are anti-competitive behaviour of foreign affiliates, diminished R&D intensity, the closing of companies, diminished competition on the domestic market, reduction of employment, too low prices paid for domestic companies with regard to the market price, the shrinking of the national stock market because shares are being transferred to a foreign stock market and endangering economic objectives of an individual country. We verified these treats in our empirical analysis. The results are shown in the Figure 4.

Figure 4. Realised threats of C-B M&As



Crowding out of domestic enterprises and too low prices paid for domestic companies are the most exposed threats of C-B M&As in European transition countries. On the other hand, the lowest threat is the shrinking of domestic stock market and undermining of the domestic economic development strategy (only these two threats were below average score).

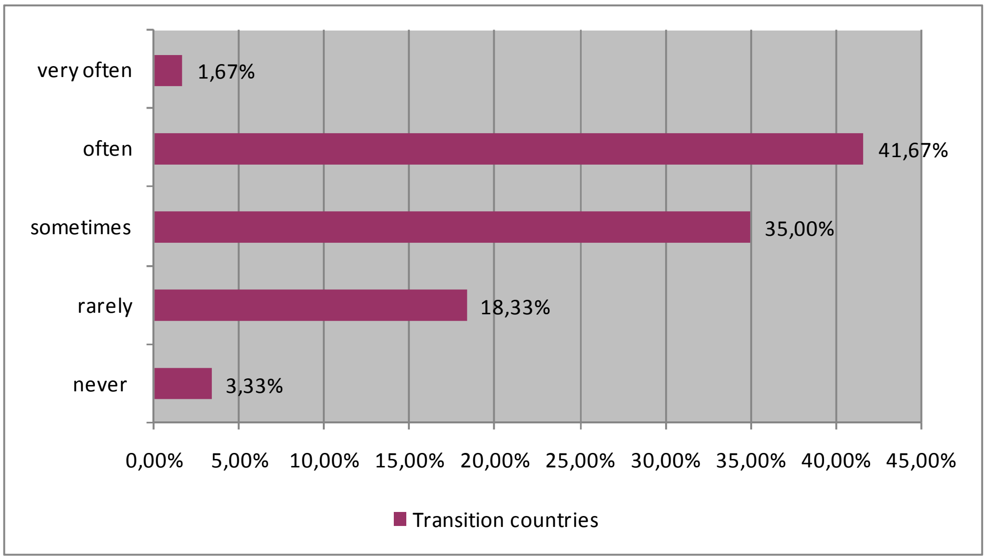
The values for threats did not substantially exceed mean values, but they still indicate that the mentioned threats are present in transition countries. On the other hand, the results also indicate the effect of globalisation and increased volume of C-B M&As on the professional public, which has started to accept these processes as a tool of privatisation and economic restructuring that as such have to happen. The stronger emphasis on benefits compared to the threats shows the importance of these processes for the host countries development.

If we compare the obtained results with the results available from other studies, we can notice that Lall (2002) proved that crowding out of domestic firms because of C-B M&As, which the respondents in our empirical analysis mostly ranked the highest, can happen in all countries regardless of the development level if the foreign firm has privileged access to local factors relative to local competitors. *Gallagher and Zarsky's* study (2006) has proven that negative impacts of these processes are usually present in poorer and less developed countries.

Reduction of employment, which is often mentioned threat of C-B M&As in the literature (UNCTAD, 2007) was not especially stressed by our respondents. Professional public is obviously aware that the threat in the form of employment reduction can occur at the time of entering to foreign market, especially as C-B M&As do not open new production capacities. In the long run, once an acquired company strengthens its market position, C-B M&As can contribute to increased employment in the host country.

Within the analysis of C-B M&As' effects, we also verified the frequency of the threat in the form of asset stripping and closing of companies due to C-B M&As, which was especially stressed by Lall (2002:7) as a consequence of these processes. The results are shown in Figures 6 and 7.

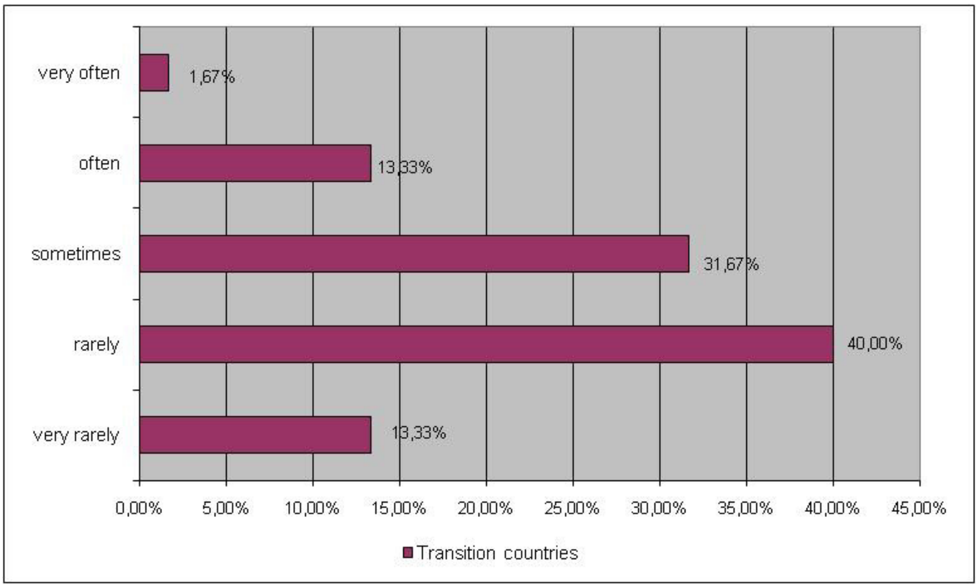
Figure 5. Have C-B M&As caused asset stripping and closing of firms?



As seen in the Figure 5, the threat of asset stripping and closing of firms due to C-B M&As was realised often (41.67 %) or very often (1,67 %). On the one hand, about 22 % of the respondents believe that this rarely or did not happen.

The threat of closing R&D facilities because of C-B M&As was realised to smaller extent than the threat of asset striping and closing of firms. Different authors have proven the effect of C-B M&As on R&D facilities in different ways. While *Hitt* et al. (1991) stressed the reduced volume or closing of R&D facilities as a highly likely consequence in the event of C-B M&As, *Bae and Seungwook* (2001), *Cassiman* et al. (2005) *Bertrand and Zuniga* (2006) have shown that the effect of C-B M&As on the R&D department is positive and a consequence of continual investments of foreign investors in these departments. The authors believe that in evaluating this effect, we need to consider that the foreign acquisition of a company changes the R&D department's function in such a company. It often happens that prior to the foreign acquisition the domestic company used the R&D department predominantly to support local products or to adapt its products to the market, while once a foreign owner enters, the R&D department is specialised to become a department for shaping knowledge and ideas. The extent to which C-B M&As have caused the closing or reduction of R&D facilities in transition countries is shown in the figure below.

Figure 6. Have C-B M&As caused ceasing of R&D facilities?



The figure shows that the mentioned threat was not a very often one in our sample of countries. In transition countries, 53 % of the respondents said it happened rarely or very rarely, while 15% of the respondents believed that it happened often or very often.

Conclusion

The presented article shows that the professionals comprising our study sample predominantly hold a positive view of C-B M&As and see these processes as a component part of opening and growth of host countries. Some concerns about this form of international capital flow that were exposed in the study shows the presence of the threats that C-B M&As can cause to the receiving countries. Nevertheless, as the benefits have been stressed more than threats, we can claim that international capital flows and within them C-B M&As are an important tool for economic development in transition countries.

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