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CROSS-BORDER MERGERS AND ACQUISITIONS IN DEVELOPED COUNTRIES: A STUDY IN 2008-2009

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Abstract

In 2008, the value of cross-border mergers and acquisitions (M&A) sales of developed country companies fell by 39 %, approximately their 2006 level, and the number of such M&A deals fell by 13 % as the financial and economic crisis made a dampening effect on cross-border M&A activity. Data for 2009 show a continuing downward trend: the number of high value M&A deals fell sharply, as banks avoided financing such transactions in the prevailing landscape of high and rising risk. In addition to lack of finance, the decline in the value of M&A transactions has been driven by sharp falling stock prices on developed countries' stock markets – where stock market indices plunged. The decrease in total cross-border M&As has had a significant impact on FDI flows, as they are strongly correlated with the value of cross-border M&A transactions. One outcome of the crisis is that a number of large privatization projects have had to be cancelled.

Keywords: mergers, acquisitions, financial crisis, economic downturn, impact of the crisis on cross-border M&As activity, development opportunities.

1. Introduction

Mergers and acquisitions (M&As), including privatizations involving FDI, have become a driving force of FDI, accounting for a high share of annual world FDI flows. Although the importance of M&As has largely been confined to FDI among developed countries, they are becoming important in developing countries as well. In countries in transition, both greenfield projects and foreign acquisitions (especially in the form of privatizations) are relatively new.

In 2008, cross-border M&As – the main mode of FDI entry, and the principal drivers of the FDI boom during the period 2003–2007 – plunged. The decrease in total cross-border M&As has had a significant impact on FDI flows, as they are strongly correlated with the value of cross-border M&A transactions. Cross-border M&A data by sector and industry for 2008–2009 show a decline in M&A activity in both manufacturing and services, but with a relative shift to non-financial services, and to food, beverages and tobacco. The value of M&As in the primary sector rose both in absolute terms and as a share of total M&As. Cross-border M&A data for the period 2007–2008 confirm a major rise of investments in agriculture and related activities.

The **objective** of the paper is to analyze the major trends and development opportunities with respect to the cross-border M&As in developed countries and examines the impacts of the ongoing financial crisis and economic downturn on cross-border M&As activity.

Research methodology: systematic and comparative analysis of scientific literature and statistical information.

The problems of foreign direct investment as well as cross-border M&As are investigated by most researchers. There are a number of issues (Duksaitė and Tamošiūnienė, 2009; Kawahara and Takeda, 2007; Miečinskienė, 2007; Zukauskas and Pikciunas, 2002) that analyzed cross-border M&As both in theoretical and practical level. There are the several academic empirical studies (Coeurdacier *et. al*, 2009; Novickytė, 2009; Martynova and Renneboog, 2006) that examined M&As in the Europe context. Some researches (Ekkayokkaya *et al*, 2009; Sood and Ahluwalia, 2009; Al-Sharkas *et. al*, 2008; Deltuvaitė *et al*, 2007; Vencappa and Vo Thi, 2007; Clavijo *et. al*, 2006) are designed for analysis of M&As in the financial sector. Dumludag (2009), Pazienza and Vecchione (2009), Vissak (2009), Zeng *et al* (2009), Basti and Bayyurt (2008), Brock and Urbonavicius (2008), Savrina and Grundey (2008) studied the problems related with foreign direct investment (FDI). A scientific works by Bohusova and Svoboda (2009), Pazienza and Vecchione (2009), Jarrett and Schilling (2008), Gryko and Kluzek (2008), Markovič (2008), Saee (2008), Aluko and Amidu (2005), Palm (2005), Šliburytė (2005) analyzed the specific fields of M&As. World Investment Report is one of the sources of statistical data.

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2. Inward FDI as the equivalent of cross-border M&A sales

After reaching a historical peak in 2007, FDI flows to and from developed countries fell markedly in 2008: inflows fell by 29 % and outflows by 17 %. The decline was widespread when the financial crisis and economic downturn strongly affected all major economies of the world in the second half of 2008. Companies cut their investments at home and abroad considerably. As the many developed countries fell into deep recession, FDI flows continued to decline in 2009, with an important decrease in cross-border M&As. FDI inflows to developed countries fell strongly in 2008, to reach $962 billion**.** Out of 38 developed countries, 23 survived a decline in FDI inflows (UNCTAD, 2009). All major host countries except the United States received lower FDI flows.

In 2008, FDI inflows into North America decreased by 5 %. Despite turmoil in financial markets, which originated in the United States and led to the sharpest recession of its economy in decades, the United States retained its position as the largest FDI recipient, both among developed countries and worldwide. FDI flows to the United States up by 17 %. The rise was due to a 61 % increase in equity capital inflows amounting to $250 billion (UNCTAD, 2009). The flows targeted mostly manufacturing and finance and the largest sources were the Netherlands, the United Kingdom, Japan and Switzerland in that order.

FDI inflows into Canada plummeted in 2008 by 59 % after a strong increase in the previous two years. This was principally as regards the end of the boom in natural resources that had led to a wave of high-value cross-border investments in the Canadian mining and natural-resource industries in 2006 and 2007. In 2008, foreign investors continued to invest in those industries, especially in the energy and metallic minerals sector, but the number of mega deals declined strongly. This caused the value of cross-border M&A inflows to decrease by 65 % in 2008. The key sources of Canada's FDI inflows were the United States and European countries.

FDI flows into the EU-27 countries fell by 40 % in 2008. The decline in inward FDI in the majority of these countries was due to the financial and economic crisis. In 2008, 7 of the 10 largest cross-border M&As worldwide took place in the EU, of which 4 were intra-EU transactions. Cross-border bank mergers played an important role, as the process of consolidation in the European financial services industry continued. In the first half of 2009, FDI activity in most of EU countries was down compared to the first half of 2008.

Inward FDI flows to the 15 countries of the euro zone declined in 2008 by 48 %. A great share of inflows to these countries consisted of intra-EMU FDI. 10 of the 15 EMU countries recorded a significant decline in FDI inflows in 2008. In France, FDI inflows fell by 26 %, from a record level in 2007, which was nonetheless still a high level. Really, France ranked second among FDI recipients worldwide in 2008, with inflows spread across a wide range of sectors. The total decline in FDI inflows was mainly due to cutbacks in lending by transnational corporations (TNCs) to their foreign affiliates located in France. Belgium FDI inflows plunged by 46 % in 2008. Flows to Belgium are very volatile. FDI inflows into Germany also fell strongly, by 56 %. As a result, Germany's ranking among the top developed-country recipients of FDI fell from 7th place in 2007 to 9th in 2008 (UNCTAD, 2009).

Austria, Italy and the Netherlands as host countries also recorded a decline in FDI inflows. Inward FDI in the Netherlands in 2008 turned negative (-$3.5 billion) compared with $118 billion in 2007. FDI inflows in Italy fell strongly by 58 %.

FDI inflows to Finland and Ireland became negative in 2008. Ireland was heavily hit by the financial crisis. Foreign investors withdrew a massive $38 billion worth of intra-company loans from the country, and reduced their equity investments by $9 billion. This caused FDI inflows to turn negative, falling by $45 billion: from an inflow of $25 billion in 2007 to minus $20 billion in 2008 (UNCTAD, 2009).

Looking at the overall downward trend of FDI inflows in 2008, five of the EMU-15 countries (Spain, Luxembourg, Greece, Portugal and Slovenia) recorded an increase in FDI inflows. Inward FDI to Spain more than doubled, driven by several high-value cross-border M&As. FDI inflows into Luxembourg, which were negative in 2007, turned positive and reached $3 billion. FDI inflows also increased in Greece (by 166 %), Slovenia (by 26 %) and Portugal (by 16 %).

Trends in inward FDI flows to the EU-15 countries that do not participate in the EMU were uneven in 2008. In Sweden inward FDI rose by 98 %, driven by an increase in cross-border M&As. However, privatization – a drive for recent FDI flows to Sweden – is slowing down due to the global economic downturn, which is likely to affect the country's inflows in 2009. In the United Kingdom, FDI inflows halved in 2008, and the country lost its position as the largest FDI recipient in Europe to France. The fall in inflows was mostly due to equity investments, which fell by 44 % in 2008 – the lowest value since 2005.

Despite the decline in inflows in the form of cross-border M&As, the United Kingdom recorded several high value transactions by foreign TNCs.

Inward FDI of the nine new EU member countries that did not participate in the EMU fell by 9 % in 2008. This was a much smaller rate of decline than that of inflows into the EU-15 countries (UNCTAD, 2009). Inward FDI flows to the group in 2008 were unevenly distributed: the Czech Republic, Hungary, Romania and Slovakia saw an increase in inflows that was more than offset by the decrease in flows to the Bulgaria, Estonia, Latvia, Lithuania and Poland. Four countries together accounted for the lion's share (77 %) of the group's total inflows: Poland ($16.5 billion), Romania ($13.3 billion), the Czech Republic ($10.7 billion) and Bulgaria ($9.2 billion). Despite the fact that the automotive industry has been the key driver of strong FDI inflows to the new EU member countries, the decline in euro zone car sales since the last quarter of 2008 has disclosed revealed the region's vulnerability on account of its serious reliance on the industry.

In Japan, inward FDI flows maintained their upward trend in 2008, reaching $24 billion, with around 70 % concentrated in the services sector. The current crisis not much affected the inflows. Nevertheless, the second largest economy in the world still has a low inward FDI stock. Large divestments in 2009 due to weakened activities by foreign finance companies further reduced FDI inflows in the finance industry, which is the largest FDI recipient industry in Japan.

The lumpiness of FDI in Switzerland led to a lower level of inflows ($17 billion) to that country in 2008. Inflows to Australia remained almost the same level, whereas those to New Zealand declined.

3. Cross-border M&A activity

The financial crisis and economic downturn made a dampening effect on cross-border M&A activity, the value of which fell considerably in the second half of 2008 compared with the second half of 2007. TNCs from developed countries continued to account for about 84 % of total cross-border M&As in developed countries, while TNCs, mainly from China and the Russian Federation, were by far the largest investors from developing countries and transition economies. The share of developing countries' cross-border acquisitions in developed countries declined marginally. In comparison to 2007, TNCs from Latin America and Asia substantially reduced their cross-border M&As in developed countries.

Decreased earnings of developed country TNCs and a decline in syndicated bank loans have particularly limited financing for investment. A drop in leveraged buyout transactions also dampened cross-border M&As, further depressing FDI flows. Cross-border M&A sales in developed countries fell by 33 % in 2008 (UNCTAD, 2009).

FDI flows to and from developed countries fell sharply in 2008, after reaching a historic peak in 2007. Inflows amounted to $962 billion, down by 29 % from the previous year, and these declines occurred in all major host countries except the United States. The 29 % decline in FDI inflows to developed countries in 2008 was mostly due to cross-border M&A sales that fell by 39 %, to $552 billion, in value after a five-year boom ended in 2007 (table 1). In Europe, cross-border M&A deals plummeted by 56 % and in Japan by 43 %. Worldwide mega deals have been particularly strongly affected by the crisis.

The number of cross-border M&A deals fell by 13 %, to 4,481. Data for 2009 indicate a continuing downward trend. The number of high-value M&A deals fell sharply during the first semester, as banks were hesitant to finance such transactions in the prevailing climate of high and rising risk. To a large extent, in addition to lack of finance, the decline in the value of M&A transactions has been driven by sharp falling stock prices on developed countries' stock markets – where stock market indices plunged, on average by more than 40 % in 2008. The financial crisis has also made equity and debt financing of M&A transactions more difficult and expensive. Leveraged buyouts, which generally involve private equity funds or hedge funds, almost sank during the course of 2008. These funds that were among the main drivers of the previous M&A boom have been deeply hurt by the crisis, therefore financing for large leveraged buyouts is hard to find. In addition, access to bank financing of cross-border M&As remains difficult. As a result, TNCs are cutting back their investment plans. Also the sharp drop in the value of cross-border M&As by private equity funds and other collective investment funds was associated with a strong decline in large-scale investments. So, in 2008 strategic investors dominated cross-border M&A activity, while private equity funds and other collective investment funds lost importance.

The current situation is very different from that of the last financial crisis, which originated in developing Asian countries in 1997 and had a significant negative influence on FDI flows to some of them, such as Indonesia. By contrast, this crisis began in the developed world, although it is rapidly spreading to developing and transition economies. Developed countries have already been directly hit, while the effects of the crisis on developing economies have so far been indirect in most cases, with varying degrees of severity. This has affected the patterns of FDI location and FDI flows.

Table 1. Developed countries: value of cross-border M&As sales and purchases, by region/economy, 2007-2009 (January-June) (Millions of dollars)

Region/economy	Net sales of companies in developed countries			Net purchases by developed countries' companies worldwide		
	2007	2008	2009 (Jan-Jun)	2007	2008	2009 (Jan-Jun)
World	903 430	551 847	102 313	841 999	539 598	99 936
Developed economies	743 949	464 828	89 146	743 949	464 828	89 146
Europe	500 453	280 016	76 370	515 503	197 191	66 907
European Union	473 025	248 873	73 909	489 091	180 484	59 509
Belgium	6 518	30 279	124	898	2 307	11 027
France	73 175	35 592	29 039	27 423	-3 397	280
Germany	48 820	54 966	4 885	42 445	27 243	-188
Italy	48 277	16 968	17 257	21 526	-5 740	1 301
Netherlands	-8 007	51 828	-752	160 646	-9 389	9 974
Spain	34 935	-12 644	3 321	50 821	29 381	14 932
Sweden	27 827	7 461	12 660	5 226	20 915	821
United Kingdom	211 989	38 116	3 833	146 833	100 713	15 671
Other developed Europe	27 428	321 143	2 461	26 413	16 707	7 398
Switzerland	10 461	25 128	2 543	19 412	5 641	6 530
North America	207 125	107 878	7 545	190 966	230 325	15 703
Canada	41 780	39 680	5 053	75 613	21 010	927
United States	165 345	68 198	2 492	115 353	209 315	14 775
Other developed countries	36 372	76 933	5 231	37 480	37 312	6 537
Australia	41 587	17 856	213	21 730	26 000	5 866
Japan	23 043	40 686	4 416	12 350	8 847	-1 400
Developing economies	119 807	60 868	7 402	70 375	57 574	10 028
Africa	9 405	7 361	18	3 462	13 093	2 780
Egypt	908	4 488	-	-813	15 058	1 407
South Africa	8 542	2 782	18	3 784	348	1 496
Latin America and the Caribbean	32 130	1 998	-643	14 243	14 119	-1 442
Brazil	8 790	4 685	66	4 849	7 211	479
Asia and Oceania	78 272	51 509	8 027	52 670	30 362	8 690
West Asia	25 994	7 030	7 037	14 332	4 179	1 394
Turkey	606	618	-	13 162	5 165	1 332
China	1 078	24 632	591	3 763	4 672	-31
Hong Kong, China	-1 501	-1 714	-1 086	5 161	4 558	392
India	26 559	8 850	76	16 383	7 602	3 206
Singapore	17 682	6 174	159	3 663	4 164	106
South-East Europe and the CIS	17 074	14 673	3 401	27 675	17 196	761
Russian Federation	15 443	13 727	3 401	22 550	13 352	778

Source: UNCTAD, World Investment Report 2009

Some signs of a still weak global economic recovery have popped up in the last months. According to the IMF analysis, the world economy is beginning to slowly escape from the worst recession experienced in the post World War II era. Corporate profits of the largest TNCs continued to rebound in the second quarter of 2009 after a sharp drop in the fourth quarter of 2008. While it is possible that these evolutions will positively influence FDI flows in the coming months, the forecast for the whole year remains one of decline (UNCTAD, 2009).

4. Sectoral trends

While FDI inflows in the manufacturing and services sectors of developed countries declined substantially in 2008, foreign investments in the primary sector experienced strong growth. On the other part, FDI outflows declined in the primary sector and services and increased in manufacturing.

Cross-border M&A sales in the primary sector in developed countries increased by 43 % (table 2). The consolidation process, which had been driven by the boom in natural resources, in the mining and quarrying industries continued in 2008 and 2009. Mining and quarrying TNCs from developed countries invested heavily in the sector through cross-border M&As in order to strengthen their position against competitors. Large companies from developing countries (especially from China) undertook cross-border M&As to acquire substantial stakes in developed-country companies in the primary sector.

Table 2. Developed countries: value of cross-border M&As sales and purchases, by sector/industry, 2007-2009 (January-June) (Millions of dollars)

Sector/industry	Net sales of companies in developed countries			Net purchases by developed countries' companies worldwide		
	2007	2008	2009 (Jan-Jun)	2007	2008	2009 (Jan-Jun)
Total	903 430	551 847	102 313	841 999	539 598	99 936
Primary	55 806	80 514	8 294	80 890	33 519	-3 343
Mining, quarrying and petroleum	54 895	78 604	7 823	80 483	29 826	-3 448
Secondary	311 264	261 139	18 967	128 754	209 539	14 465
Food, beverages and tobacco	45 629	107 922	1 623	29 662	75 743	1 624
Chemicals and chemical products	111 800	66 611	9 440	80 988	59 943	8 815
Non-metallic mineral products	34 933	11 926	-460	372	20 553	74
Metals and metal products	64 488	9 877	291	-1 872	3 660	-236
Machinery and equipment	17 704	13 236	184	2 945	5 788	207
Electrical and electronic equipment	21 894	10 537	5 628	34 370	23 786	561
Precision instruments	-17 165	22 980	1 996	-9 868	7 140	2 777
Services	536 360	210 194	75 051	632 143	296 497	88 814
Electricity, gas and water	91 681	34 998	48 990	41 405	13 978	26 725
Hotels and restaurants	8 188	3 155	539	-11 652	636	233
Trade	42 335	10 847	-2 890	-3 113	191	1 990
Transport, storage and communications	53 862	20 766	2 067	28 011	-7 117	7 747
Finance	214 827	33 794	21 358	567 124	270 740	54 455
Business services	88 666	96 833	3 963	11 817	21 631	-1 049

Source: UNCTAD, World Investment Report 2009

Cross-border M&A sales of companies in the manufacturing sector in developed countries declined by 16 %, whereas cross-border M&A purchases by developed-country TNCs increased by 63 %. Almost all industries suffered from falling investments, with the exception of food, beverages and tobacco.

Both cross-border M&A sales and purchases of developed countries in the services sector declined noticeably, by 61 % and 53 % respectively. While services remain the sector with the largest FDI activity in developed countries it suffered most from the financial crisis and the economic downturn. M&A activity in financial services slumped dramatically by about 84 %. Business services, among the larger industries, stood the sharp downward trend.

5. Conclusions

- In 2008, global FDI flows as well as cross-border M&As have been severely affected worldwide by the financial and economic crisis. Declines are drastic in 2009, as the impact of the global financial crisis and economic downturn on international trade and credit markets for investment begins to spread to the whole region. It should be noted that the impact of the crisis on the largest TNCs has differed widely by industry and country. Industries that are sensitive to the business cycle, such as metal manufacturing, have been among the worst hit by the crisis. Other industries that are less cyclical industries and are with more stable demand patterns, such as agribusiness and many services, have been less affected. Due to the sectoral performance, data on cross-border M&As in developed countries indicated a decline of inflows to manufacturing and services sectors, but with a relative shift to non-financial services, and to food, beverages and tobacco. The consolidation process in the mining and quarrying industries and the increasing participation of large companies from developing countries (especially from China) contributed to the rise of M&As in the primary sector in 2008.
- One impact of the crisis has been to reduce the cash financing of M&As, which had been the main method of funding in the boom years prior to 2008. Also the cost of debt financing for cross-border M&As has risen, as bank lending conditions have worsened sharply following tightening credit circumstances and rising interest rate premiums for the corporate sector. One outcome of the crisis is that a number of large privatization projects have had to be cancelled.
- Negative consequences of the economic and financial crisis on the cross-border M&A activity have continued to expand and deepen, particularly from the beginning of 2009. Another consequence of the crisis is an acceleration of industry restructurings to avoid bankruptcy of company or not to be acquired by another company. In some of the most affected industries, such as automotives, the crisis caused a wave of major restructurings. Companies less affected by the crisis, and having substantial cash reserves, could take takeover opportunities triggered by the crisis to increase their market share. Some large TNCs have undertaken major acquisitions. Hence, the crisis might accelerate underlying trends towards restructuring and concentration in many industries.
- The current economic crisis creates an opportunity for the largest TNCs to expand into additional markets at a relatively low cost and to promote their strategies with the aim of maximizing efficiencies across markets and regions. To overcome the consequences of the crisis, TNCs may rely more heavily in the short-term on non-equity entry modes, such as partnerships or licensing, to develop their international business, while being more cautious about equity investments, such as cross-border M&As and greenfield projects.
- A recovery in FDI flows will depend crucially on future developments in the world economy and the financial system. Until financial markets restore systemic stability and major economies recover, FDI will remain slow due to financing difficulties as well as poor markets and undefined profit prospects for TNCs. The results of *World Investment Prospects Survey* (UNCTAD, 2009b) point to a further decline in FDI activity in 2010 and a small recovery in 2011.
- The short-term outlook for FDI flows to and from developed countries has worsened sharply. In 2009, developed countries fell into the heavy economic and financial crisis in few years. However, the end of the economic downturn and a recovery of developed economies are not foreseeable in the near future. Additionally, access to bank financing of cross-border M&As remains difficult. Banks have tightened credit standards, and risk premiums have risen considerably. Collective investment funds as well as private equity funds that were important drivers of the previous M&A boom have been heavily damage by the crisis. Financing for large leveraged buyouts is hard to find. As a result, TNCs are cutting back their investment plans.

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