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—Diana Tussie

## MERGERS AND ACQUISITIONS

The globalization of business, characterized by the growth of multinational firms and the internationalization of the production process, has been facilitated in large part by mergers and acquisitions (M&A). The main route to internationalization is foreign direct investment (FDI), and acquisitions constitute a substantial proportion of FDI. Mergers and acquisitions facilitate relatively rapid expansion abroad in order to penetrate new markets, establish manufacturing capacity, and access raw materials. The process of acquiring abroad can be complex, however, because potential acquirers often face unfamiliar business norms and practices, and there is a myriad of different legal and regulatory systems around the world.

A company (the target) is merged or acquired when another obtains a controlling stake (or full ownership) of its voting stock. The term *merger* usually implies a combination of equals, and it also connotes a friendly, as opposed to a hostile,

deal. Takeover attempts that are actively opposed by target management are known as *hostile bids*. These are sometimes known as *takeovers*, although this term is also used interchangeably with *acquisition*. In the vast majority of takeovers, the acquiring firm offers a premium over the pre-acquisition market price in order to entice target shareholders to sell their shares. Takeover premiums can be very large—premiums of 100 percent or more have been known—but the average is 20 to 30 percent. Target shareholders can be offered cash for their shares, or the acquiring firm's stock is offered in exchange. If the target firm is in a different currency zone from the acquirer, stock-for-stock acquisitions are straightforward when the acquiring, or parent, firm is also listed in the target's country. This is usually facilitated by American or Global Depository Receipts (ADRs or GDRs).

### Cross-Border M&A Activity

In their 2000 World Investment Report, the United Nations Conference on Trade and Development (UNCTAD) suggested that firms in many industries must be truly multinational to survive and prosper in today's highly competitive, globalized business environment. International expansion is largely facilitated by FDI, which includes mergers and acquisitions. Variations in international merger-and-acquisition activity are a critical driver of the FDI cycle in the developed world, and increasingly in developing countries. Figure 1 depicts the dollar value of M&A as a proportion of FDI for the period from 1987 to 2003. Acquisitions averaged 77 percent of FDI to developed countries over the period, from a low of 50 percent in 1993 to a high of 95 percent in 2000. For developing countries, the proportion of FDI in the form of takeovers is clearly much lower, but it has increased considerably over time, from 7 percent in 1987 to 25 percent at the end of 2003.

Though comprising the vast majority of FDI to developed countries, only one-quarter of total M&A activity is cross-border. Figures 2 and 3 depict cross-border acquisition activity for the years 1987 to 2003 in terms of U.S. dollars. Figure 2 shows that international M&A is dominated by acquisitions of U.S. and European companies. The figure is dominated by the pronounced peak for Europe and North America in 2000, which marked the end of the late 1990s M&A boom. The data also cover the final few years of the

## Mergers and Acquisitions as a Proportion of Foreign Direct Investment

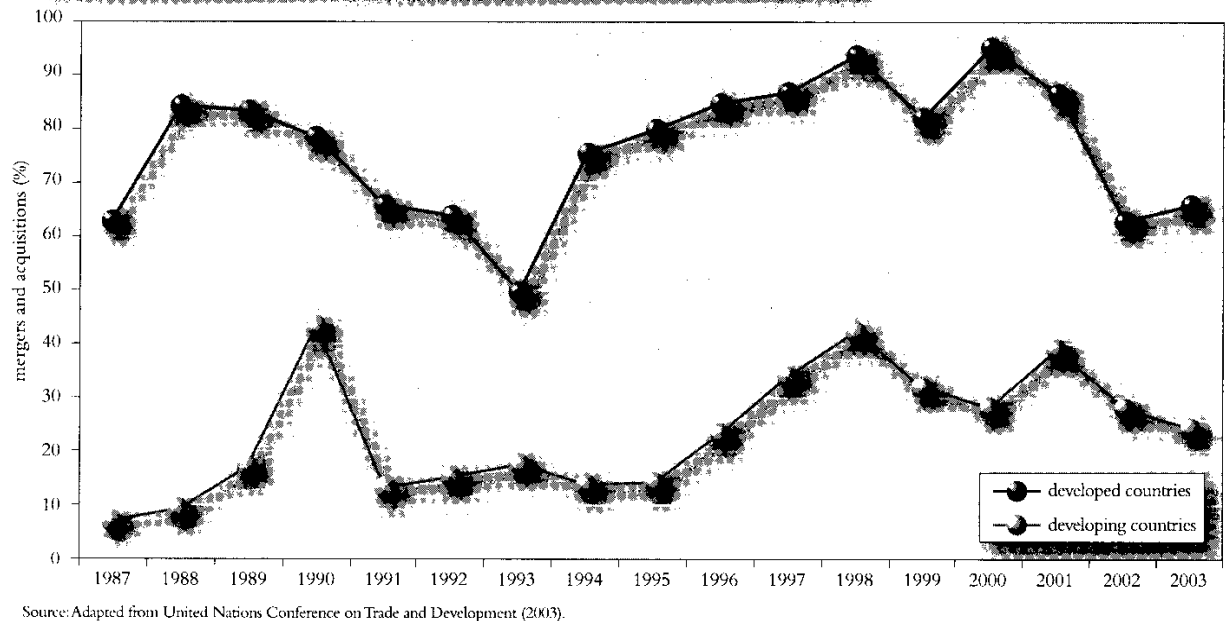


Figure 1. Chart showing the relationship of mergers and acquisitions to foreign direct investment (FDI) for developed and developing countries.

1980s merger wave, and it is clear that the 1990s boom in cross-border M&A was more than five times larger than the prior boom. Foreign takeovers of North American firms peaked at US\$79 billion in 1989, whereas the figure was US\$401 billion in 2000. The surge in European M&A reflects not only trends in takeover activity worldwide, but also the cross-border consolidation that occurred throughout the 1990s in anticipation of closer economic integration associated with monetary union.

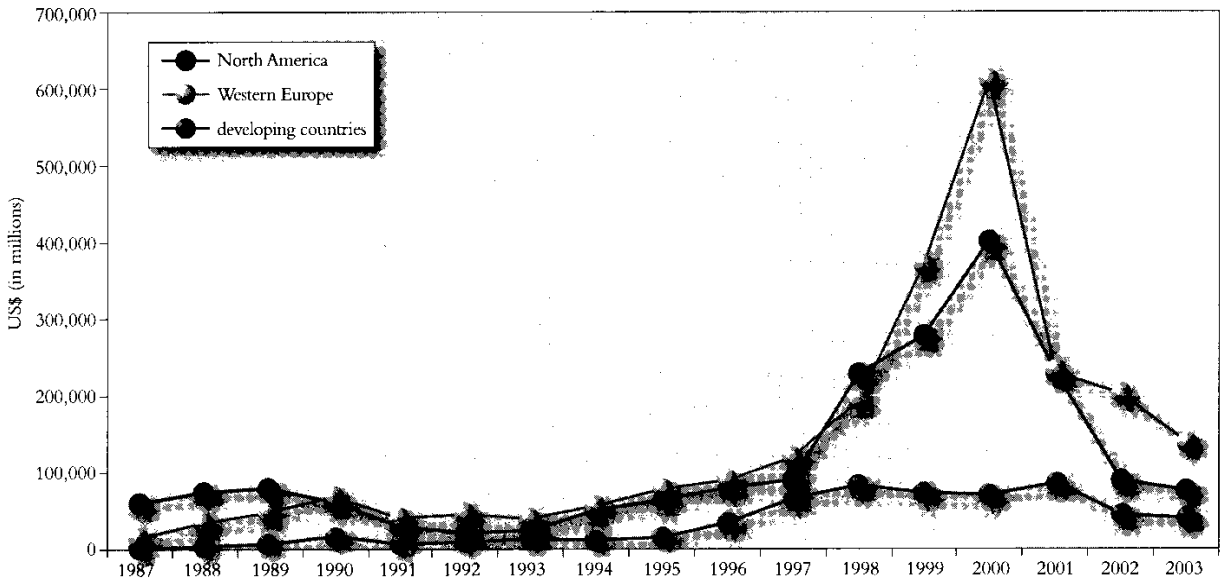
Figure 3 depicts the dollar value of takeover activity in Asia, Africa, central and eastern Europe, and Latin America. It is clear that M&A activity increased in developing and transition regions over the period. It was volatile in Latin America, however, escalating in the mid-1990s, peaking in 1998, and then falling off dramatically in the wake of the Asian crisis and the subsequent financial crises in Argentina and Brazil. Foreign M&A activity in Asia grew strongly and comparatively steadily, from US\$256 million in 1987 to more than US\$23 billion in 2003. Acquisitions by foreign firms in central and eastern Europe and Africa increased from virtually nothing in 1987 to more than US\$14 billion and US\$6 billion, respectively, in 2003.

## M&A Regulation

Mergers and acquisitions are heavily regulated in most countries. Two areas of regulation are invoked when a takeover bid is launched or a merger announced, irrespective of whether the bidder is local or foreign. The first relates to market dominance and competition issues, and the second governs the acquisition process. Some countries impose a third layer of regulatory scrutiny on foreign acquirers, such as the Foreign Investment Review Board in Australia.

Competition regulation of takeovers (called antitrust regulation in the United States) seeks to prevent mergers that create a new entity of such size or market power that competition is stifled. Despite the globalized nature of many product and services markets, this regulation is largely country-based. The exception is the European Union, where large mergers that potentially affect several member states have been overseen by the European Commission (EC) since 1990. The best-known and most controversial ruling from Europe's Competition Commission was disallowing the merger in 2001 between two U.S. companies, Honeywell and General Electric (GE). The merger triggered

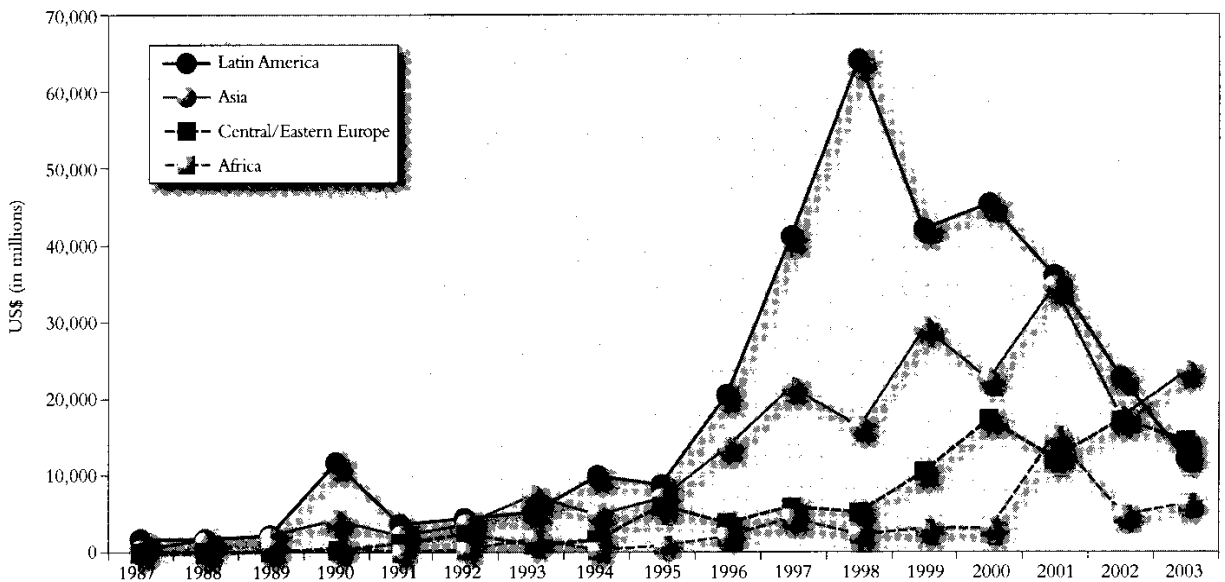
### Takeover Activity in North America, Western Europe, and Developing Countries



Source: Adapted from United Nations Conference on Trade and Development (2003).

Figure 2. Chart showing the dominance of mergers and acquisitions activity in North America and western Europe, as compared to developing countries, also shown in Figure 3.

### Takeover Activity in Developing Regions



Source: Adapted from United Nations Conference on Trade and Development (2003).

Figure 3. Chart showing mergers and acquisitions activity in developing countries.

an investigation by the EC because of GE's substantial presence in Europe, where it employed 85,000 people and earned US\$25 billion in revenue. A large industrial and financial services conglomerate, GE was keen to acquire Honeywell's aircraft electronics businesses because it felt Honeywell would provide a good strategic fit for GE's aircraft engine and aviation leasing businesses. However, the then competition commissioner, Mario Monti, believed that the merger was anticompetitive, not because it would give GE too much market power, but because it would facilitate "bundling." Monti's concern was that, like Microsoft's ability to provide complete software packages with personal computers (an issue that was the subject of extensive investigation by the U.S. Department of Justice in the late 1990s and early 2000s), GE would have been able to bundle together aircraft engines and aviation electronics in a powerful and potentially anticompetitive manner.

Regulation governing the process of M&As is invoked at a particular stock ownership threshold, usually defined as the point beyond which control of a company can be achieved. In the UK, for example, this threshold is 30 percent of voting shares. In contrast to the situation with competition regulation, which is both national and supranational, there is no Europe-wide regulation governing the process of acquisitions, although Europe has long tried to harmonize takeover law. After a 15-year gestation period, in December 2003 the European Union passed a takeover directive (formally known as the 13th Company Law Directive), which sets out general rules within which member states must craft their regulation, and this can be either statutory or self-regulatory.

The main purpose of regulations applying to the takeover process is to protect minority target shareholders. Takeover regulation plays an important role in maintaining the integrity of capital markets because shareholders might be reluctant to invest in markets in which minorities are treated unfairly. There is evidence that stock markets underperform in countries in which minority shareholder protection is weak (see, for example, Johnson et al. 2000), and this would compromise the optimal allocation of resources.

## Motives for Takeovers

There are many theories that explain why takeovers occur, and these apply equally well for domestic and cross-border

acquisitions. The best-known motive for takeovers is *synergy*, the notion that two companies are worth more together than apart. A second well-known explanation is known as the disciplinary (colloquially called the "kick-in-the-pants") takeover, in which incompetent or wasteful target management are ousted. The ability to conduct this type of takeover is critical in corporate governance systems in which shareholdings are dispersed, such as in Britain and the United States. Disciplinary takeovers are increasingly conducted by private buyout specialists. These organizations, usually formed as private partnerships, purchase businesses with a view to turning them around and selling them within a few years. In the 1980s, buyout specialists financed their purchases largely with debt (conducting leveraged buyouts or LBOs), and they were often labeled "corporate raiders." The most famous of these is the U.S. firm Kohlberg Kravis Roberts, which succeeded in the battle to acquire American food and tobacco conglomerate RJR Nabisco in 1989. This takeover became the subject of a best-selling book, *Barbarians at the Gate* (1990), by Bryan Burrough and John Helyar. Initially an American phenomenon, private equity firms now operate throughout the world, and over time they have shifted away from reliance on debt finance for their acquisitions as they have gained access to growing pools of equity capital raised from wealthy investors and institutions.

Alternative theories of takeovers take a more cynical view of management behavior. Generally speaking, these theories suggest that managers actively seek takeover targets when their firms are performing well and "cashed up." In such cases, managers may pursue inappropriate or ill-considered acquisitions, or "prize" targets, in an effort to increase the power and prestige of the management team. These behavioral theories are consistent with the evidence that M&A activity varies with the stock market or business cycle (Geroski 1984), that acquisitions tend to follow better-than-average company performance (Asquith 1983), and that takeovers often detract from the acquiring firm's value (Rau and Vermaelen 1998). As the difficulty of conducting truly successful takeovers (particularly cross-border takeovers) is becoming widely accepted, corporations and shareholders have become more wary of acquisitions. Instead of seeking out potential

targets when they are “cashed up,” companies are more likely to hand the cash back to shareholders by increasing dividends and buying back stock.

## The Economic Impact of Acquisitions on Stockholders

There is an extensive body of evidence showing that M&A activity creates value for stockholders and, by extension, improves economic well-being. However, most of the gains go to target shareholders, who are paid a substantial premium for their shares. The evidence on acquiring firm shareholders, by contrast, is that they tend to make very little, and often lose (see Jensen and Ruback 1983, a classic review article on these issues). As alluded to earlier, many takeovers are poor investments for acquiring firms. The post-takeover integration process can be difficult, and anticipated synergies often remain unrealized. Cross-border acquirers face even more complex challenges in unfamiliar legal and regulatory systems, and differences in culture, language, and business norms often add to the difficulty. A widely cited study by the accounting firm KPMG in 1999 found that 83 percent of cross-border takeover deals do not create shareholder value. This finding has been confirmed by several academic studies, which show that mergers and acquisitions that increase global diversification create significantly less value than domestic acquisitions (see, for example, Moeller and Schlingemann 2005). A classic example of the clash of business cultures that stymied integration and hindered the realization of synergies is the merger between Germany's Daimler-Benz and the U.S. carmaker Chrysler, described in the book *Taken for a Ride* (2000), by Bill Vlasic and Bradley Stertz.

## The Impact of Acquisitions on the Host Country

The debate about the impact of cross-border M&A on host countries centers on acquisitions as an alternative to “greenfield” FDI. A critical difference between the two is that acquisitions are a transfer of ownership of productive assets, whereas the “greenfield” FDI adds to the host country's capital stock, and therefore to its productive capacity and ability to generate employment. Particularly

for developing countries, acquisitions are seen by some as simply shifting the benefits of ownership offshore rather than adding to a country's wealth, and they are associated with job losses as operations are rationalized. UNCTAD's 2000 World Investment Report argued that, counterbalancing these potential disadvantages, acquisitions by foreign firms can bring benefits such as saving inefficient local businesses from closure, providing critical capital injections not available to local owners, enabling firms to grow and enter new regional markets, and enhancing the transfer of technology. The UNCTAD report concluded that, in the longer term, differences relating to employment and wealth generation tend to diminish over time, and that benefits to the host country depend more on the motivation for the FDI than on the mode of entry.

Strong opinion against takeovers by foreign acquirers has moderated since the 1970s and 1980s as the benefits of free takeover markets have become more widely accepted. This is particularly the case in Europe, where the European Union recognizes that a free cross-border M&A market is critical for the establishment of a true single economy. In some countries, however, such as France and Spain, popular opinion is still hostile to a free cross-border takeover market. In Germany there has been a backlash in opinion about foreign takeovers since the hostile takeover of Mannesman by the UK's Vodafone, a situation only worsened by the scandals relating to alleged bribery that followed. In Japan, the long-held antipathy to a free takeover market began to lessen during the 1990s when policymakers began to understand the important role M&A can play in the rationalization and reallocation of resources that is required to return the economy to health.

As the competitive pressures associated with globalization continue, an international reach will remain critical to the survival and success of firms in an increasing number of industries. While takeovers will continue to occur in waves, cross-border acquisition activity is likely to see continued growth, particularly in developing countries.

### See Also

Competition Policy; Foreign Direct Investment; Transnational Corporations; United Nations Conference on Trade and Development

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—Elaine Hutson

## MICROCREDIT SCHEMES

Microcredit schemes have become an important approach to poverty reduction and development, especially with the changes that have occurred in the management of the world economy since the 1970s. They are based on the idea that small- to medium-sized loans given to the poor—and to poor women in particular—as part of capital for investment in self-employment, are both a socially empowering and an economically efficient means to achieve poverty reduction. They are "micro" schemes in the sense that poor women and men at the community level are often proactively targeted as potential recipients of small amounts of credit. These schemes, which are offered in both rural and urban areas, have a global dimension in the sense that they have been adopted as a strategy for poverty reduction on a worldwide scale. Key global institutions, such as the World Bank and regional development banks, have included such schemes as a crucial component of their overall development strategy. Microcredit schemes have been implemented in countries such as Bangladesh, Bolivia, Kenya, Indonesia, and India.

Microcredit schemes are relevant to globalization debates in a number of ways. First, they are useful for examining debates about globalization and poverty—and more specifically whether processes of neoliberal globalization are empowering or disempowering. Second, evaluating the organization and management of microcredit schemes elucidates the role and power of nonstate actors in world politics; microcredit schemes can be drawn upon, for instance, to illustrate the rise of private authority under the globalization of neoliberal politics. Third, microcredit schemes exemplify the way in which a globalizing political economy is being established through neoliberal ideas and practices along the global-local continuum, engendering a specific logic of emerging global governance.

## How Microcredit Functions

Microcredit schemes are based on loans given to poor men and women as capital for investment in self-employment or