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IMPACT OF INTERNATIONAL INVESTMENT FLOWS ON DEVELOPMENT: OUTCOME OF THE EXPERT MEETING ON MERGERS AND ACQUISITIONS, 19-21 JUNE 2000

Note by the UNCTAD secretariat

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INTRODUCTION

1. In line with the decision by the Trade and Development Board at its twenty-fourth executive session on 24 March 2000, the secretariat has prepared this note on the policy considerations raised by experts in the Expert Meeting on "Mergers and Acquisitions: Policies Aimed at Maximizing the Positive and Minimizing the Possible Negative Impact of International Investment", as stated in its outcome.[1] The purpose of this note is to identify and comment on the policy questions posed by the experts for consideration by the Commission on Investment, Technology and Related Financial Issues at its Fifth session.

2. The outcome of the Expert Meeting has been sent to Member States for comments. Two Member States[2] have provided comments, which have been taken into account in this note. In addition to the views expressed by the two Member States, this note incorporates the views of the experts as reflected in the Chairperson's summary of discussion from the Expert Meeting and the analysis in the *World Investment Report 2000*. The policy considerations of the outcome of the Expert Meeting, identified by the experts as the most pertinent policy issues to consider in the area of cross-border mergers and acquisitions (M&As), are reproduced in full (italicized), followed by comments and observations. The last section presents the proposals that have been put forward on future work on cross-border M&As.

POLICY CONSIDERATIONS

3. *As increased investment is not an end in itself, some countries have found that positive impact depends, among other things, on having the right economic policies, the right level of government activity, a regulatory framework and a competition policy. Some Governments do not have specific policies concerning cross-border M&As (paragraphs 8 and 9 of the outcome).*

4. Comments made by the two Member States converged on one point: that the impacts of cross-border M&As should be assessed from a long-term perspective, taking into account their developmental impact on economies at different levels of development. Guidelines and criteria for M&As should be elaborated accordingly.

5. The need for specific policies concerning cross-border M&As will derive from an analysis of the impacts of different forms of FDI, most notably greenfield FDI and cross-border M&As. Under *normal circumstances*, and especially when cross-border M&As and greenfield investments are *real* alternatives, greenfield FDI is more useful to developing countries than cross-border M&As. Other things (motivations and capabilities) being equal, greenfield investment not only brings a package of resources and assets *but* simultaneously creates additional productive capacity and employment. Cross-border M&As may bring the same package but do not create immediate additional capacity. Furthermore, certain types of cross-border M&As involve a number of risks at time of entry, including reduced employment, asset stripping and slower upgrading of domestic technological capacity. When

[1] Report of the Expert Meeting on Mergers and Acquisitions: Policies Aimed at Maximizing the Positive and Minimizing the Possible Negative Impact of International Investment (TD/B/COM.2/EM.7/3).
[2] Namely Mauritius and Trinidad & Tobago.

M&As involve the participation of competing firms, there are, of course, the possible adverse effect on market concentration and competition, which can persist beyond the entry phase. *Over time*, differences between the modes of entry tend to fade or disappear – possibly with the exception of the impact on competition.

6. Under *special circumstances*, however, cross-border M&As can play a useful role, a role that greenfield FDI may not be able to play. This is the case, for instance, during financial or economic crises, when firms in a country experience several difficulties or face the risk of bankruptcy, and when no alternative to FDI is available. Large capital-intensive privatizations may also fall into this category, when domestic firms are not able to raise the required funds or lack other assets (such as managerial practices or technology) that are needed to make the privatized firms competitive. When there is a need for rapid restructuring due to intense competitive pressure or overcapacity, M&As lead to a restructuring of existing capacities rather than adding new. In some of these circumstances, host countries have found it preferable 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 M&A partners.

7. A precise and secure legal framework was noted by experts to be a prerequisite for successful M&As. In the case of least developed countries, the challenge of dealing with cross-border M&As is compounded by the need to improve or to put in place a general regulatory framework. Several of these countries do not have a competition policy or a regulatory body to oversee industry regulation. There is a lack of well-trained technical staff or lawyers and the financial services are often inadequate. Thus, there is an obvious need for technical assistance in these countries.

8. *Policy responses for cross-border M&As among SMEs and among large firms may be different. Some Governments encourage cross-border M&As among SMEs to facilitate their access to foreign finance and improve their competitiveness (paragraph 10 of the outcome).*

9. There may be a need to pay more attention to how cross-border M&As affect SMEs, e.g. in the areas of financing, access to markets and competition. Experts noted that if well-run local firms are taken over with the intention to eliminate competitors, the domestic production base could be weakened. In some countries, cross-border M&As have led to a loss of indigenous brands, a loss of jobs and increased industrial concentration as local competitors, in particular SMEs, are driven out of the markets. Allowing mergers between local competitors has sometimes been seen as a measure to pre-empt take-overs by foreign firms. From the perspective of the impact of M&As on market concentration and competition, the size of the corporations involved plays a critical role.

10. *In privatization, some countries have maintained "golden shares" and have sought commitments from strategic foreign investors on further investment. When such commitments are made, there is often a trade-off between the up-front price of assets to be sold and these commitments. Some countries have restructured their public sector as an alternative to privatization (paragraphs 11 and 12 of the outcome).*

11. In the case of privatization, "golden shares" have sometimes been used by Governments to prevent asset stripping or other corporate decisions that are likely to jeopardize development objectives. Host country Governments have also sometimes

demanded commitments from foreign investors to undertake further investments in the future. Performance targets relating to the expansion and modernization of infrastructure and improved service are often a feature of privatization involving a strategic investor. Such commitments are generally made in exchange for market or other privileges as well as a reduction in the initial prices. The evidence of these commitments is mixed. It may well be that in some cases sequential investment would have taken place even without these requirements. Experience suggests that most post-privatization commitments in regulated industries should be addressed through a well-designed regulatory regime based on service improvements expected from FDI rather than on privatization covenants.

12. *In the case of privatization and sales under exceptional circumstances, some countries have found that the price of assets is important but not the only consideration. In the case of sudden sales under such circumstances (including involving cross-border M&As), e.g. in an economic crisis, some countries have found it difficult to determine the right prices. A clear long-term developmental perspective was found helpful in this respect (paragraph 15 of the outcome).*

13. Measures and institutions facilitating corporate valuation, such as appropriate accounting, reporting and auditing rules and well-functioning capital markets can minimize pricing problems. Complications with the pricing of assets are compounded when the firm being privatized is a local monopoly and/or when privatization takes place in a country without a functioning capital market. In these instances, there is great difficulty in producing a comparable price or providing expert opinion on earnings prospects. The risk of undervaluation increases if the negotiating position of the host country *vis-à-vis* foreign investors is weak. Moreover, to obtain the best price from privatization, a competitive and transparent tendering process is crucial. Careful attention must also be paid to the profile of the buyer and the quality of the offer. Moreover, in order to mitigate the negative effects and to limit the risk of misuse of resources obtained from privatization, some countries have established mechanisms for determining how revenue from privatization is allocated.

14. *Some Governments have in place measures to deal with the problem of lay-offs, such as the training and retraining of laid-off workers. Some countries have found it useful, because (among other things) of these employment effects, to emphasize a balanced development of the domestic and foreign enterprise sector (paragraph 13 of the outcome).*

15. On employment effects, some of the experts noted that, in some cases, lay-offs were inevitable, because the target company was run inefficiently. It was noted that in the long term M&As could lead to increases in employment. However, political economy cannot ignore the short-term unemployment problem, even if these are acceptable under economic theory. The need for policies to deal with massive lay-offs was emphasized. As M&As typically create anxieties at all levels of a firm’s staff structure, consultations are important. Early consultations and discussions with worker representatives can provide lead-time for taking measures to minimize hardship through e.g. the retraining and relocation of workers. An appropriate mechanism for consultations can be helpful in this respect and some experts discussed the possibility of setting up a special fund for the purpose of retraining unemployed workers, perhaps with contributions from foreign investors. It is also more important than ever for countries to adapt, expand and strengthen their social safety nets for workers and strengthen the domestic enterprise sector and its competitiveness to facilitate the creation of more jobs. Specific commitments and measures for employment retention have a role to play

as short-term complementary measures, especially where safety nets are weak or non-existent. Trade unions play an important role in ensuring that qualitative gains in employment conditions achieved over time are not dissipated in the course of M&As, including cross-border M&As.

16. *Some countries seek to establish corporate governance rules (paragraph 14 of the outcome).*

17. Corporate governance rules assume an important function in the context of cross-border M&As, and some countries have strengthened such rules with a view to protecting the interests of domestic minority shareholders and other stakeholders. In this regard, host country company law and stock-exchange rules may merit special attention to secure adequate guarantees for minority shareholders. These guarantees will enable minority shareholders to be informed of and participate in decisions to sell or merge, including sufficient and timely information on potential foreign buyers. The minority shareholders' right to dissent and to dispose of their shares has also been emphasized. In addition, it has been pointed out that the interest of other stakeholders, including workers, suppliers, consumers and government, should be taken into account when designing policy responses in the context of strengthening corporate governance systems.

18. *Competition policy, the national dimension: In the light of the rise of cross-border M&As, a number of countries pay increasing attention to the importance of competition laws and cooperation between competition authorities. They have found that policies aimed at maintaining the contestability of markets and the dissemination of the culture of competition complement the adoption and implementation of competition laws. They also found that special attention to the relevant market definitions, market performance and market structure is warranted (paragraph 16 of the outcome).*

19. As noted above, cross-border M&As can have strong effects on market structure and competition, both at the time of entry and subsequently. Competition policy has been identified as the most important policy instrument for Governments to consider in this context. The challenge is to ensure that policies are in place to deal with those M&As that raise competitive concerns, and that they are implemented effectively. As FDI restrictions are liberalized worldwide, it becomes all the more important that regulatory barriers are not replaced by anti-competitive practices by firms. This suggests that the culture of FDI liberalization that has become pervasive, combined with the growing importance of M&As as a mode of FDI entry, has to be complemented by an equally pervasive culture recognizing the need to prevent anti-competitive practices of firms. In the context of cross-border M&As, the adoption and implementation of competition laws, paying attention not only to the domestic but also to international M&As is required. Reviews of cross-border M&As may go beyond traditional competition policy concepts and need to take into account the contestability of markets. Policy-induced market distortions can be as important as private anti-competitive behaviour.

20. A related challenge is how to determine the relevant market in products and industries characterized by constant innovation, not least because policy priorities involving the modernization, technological upgrading, etc. of some sectors may contradict competition policy principles. There is often tension in competition policy analysis between the effects of

M&As on the present market structure, the process of innovation and the consolidation and restructuring that occur in certain high-technology product markets.

21. As of June 2000, competition laws had been or were in the process of being adopted by 90 countries. Merger review systems have been used in a number of developed countries for many years and during the past fifteen years or so, such systems have also been adopted or strengthened in developing countries and economies in transition.

22. *Competition policy, the international dimension: Apart from national merger reviews, international cooperation might be useful, especially at the regional level. For example, as merger control is costly, cooperation at the regional level has been found useful by some. An exchange of information between countries affected by M&As has also been found useful by some countries. Another form of cooperation involves joint review mechanisms. Standardization of time limits was also mentioned. When reviewing cross-border M&As, countries in a position to do so, could make information relevant to developing countries available to them. Some countries rely on donor partners for technical assistance to develop their laws and regulatory frameworks in this area (paragraphs 18, 19 and 20 of the outcome).*

23. Increasingly, 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 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. The UNCTAD Set of Restrictive Practices is, to date, the only multilateral instrument in this area. International action is particularly important when dealing with cross-border M&As with global dimensions, especially for smaller countries that lack the necessary resources to mount and enforce such policies on their own.

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

25. Enhanced bilateral or regional cooperation and joint investigation of M&As may also be further explored. The amount of bilateral or multilateral exchange of information in the area of merger control is today limited to a few countries and sometimes based on personal relations. Nevertheless, the importance of close bilateral cooperation in the review of individual merger cases has been recognized in many countries. This cooperation is evidenced by the intense joint investigations and coordinated remedies of some large M&As

that have been conducted by the European Union and the United States recently. Such contacts increasingly take place among competition authorities of developing countries.

PROPOSALS ON FUTURE WORK

26. Experts at the Expert Meeting and the two Member States mentioned above have formulated the following proposals for future work on cross-border M&As:

- To research the incidence and quantum of subsequent investment;
- To analyse the impact of, and related policy responses to, various types of cross-border M&As (notably cross-border M&As among SMEs, among large firms and between SMEs and large firms) on market structure and key areas of economic development, focusing in particular on the impact on SMEs;
- To study successful cases of M&As to serve as a basis for the preparation of policy guidelines, with focus on economic policies, regulatory framework and competition policy which are necessary for maximizing the positive impact of cross-border M&As.

27. The following suggestions for technical assistance to be provided, especially to least developed countries, were also communicated by the two Member States:

- To provide some countries with the capability to value assets being sold;
- To make the cost of arbitration more affordable for some countries;
- To assist some countries in formulating policies concerning cross-border M&As;
- To develop the capacity of some countries to improve the competitiveness of SMEs;
- To develop measures to handle the re-employment of laid-off employees;
- To assist countries, in particular small countries, in the preparation and implementation of an appropriate competition policy.