

Foreign direct investment in a country takes the form of either greenfield projects, which add to the productive capacity or acquisition of and mergers with existing enterprises in the country. Governments may earmark the areas in which foreign greenfield investment can be made and restrict investment in others; they may also impose conditions on acquisitions and mergers such as limiting the proportion of share capital foreigners can own in all or selected sectors of the economy. Such restrictions are normally designed to limit foreign control of domestic enterprises. While such restrictions were rigid and widespread some time back they are much more relaxed now; the objective in early times was to reduce foreign control over the economy; the objective today is to welcome foreign capital with minimum restrictions and many incentives.

Greenfield Foreign Direct Investment (FDI) adds to the stock of domestic capital investment; it expands the productive capacity by creating new productive assets. Acquisitions may or may not be followed by additional capital formation. The payments received by the domestic owners may be reinvested in some other project or they may be used for speculation. The new foreign owner may increase efficiency and expand operations or he may not. Greenfield FDI normally brings more new technology, organization and management know-how than acquisitions. Inflow of knowledge tends to be limited when existing affiliates of TNCs buy out their joint venture partners. Greenfield investment tends to increase competition while acquisitions tend to reduce competition and increase concentration. Such concentration can lead to monopoly in the absence of anti-trust or competition law in the country. Greenfield investment results in an inflow of foreign funds while acquisitions may be made with internal fund accruals and locally borrowed funds, particularly when the acquiring party

Foreign Direct Investment through Mergers and Acquisitions

Dr J B Kelegama

is an existing affiliate of a TNC. It should also be pointed out that greenfield investment creates new jobs and increases employment opportunities while acquisitions result in restructuring, downsizing and introduction of labour saving managerial techniques and consequent retrenchment. Whether it is greenfield investment or acquisitions and mergers, the main actors are the Transnational Corporations (TNCs) who are constantly strengthening their market presence in all the countries of the world.

Transnational Corporations

The global economy today is dominated by large transnational corporations which are becoming bigger and bigger every day, through mergers and acquisitions. Such enlargement of business enterprises is designed to reduce costs and increase profits but at the same time it reduces the extent of competition in global markets. Mergers and acquisitions take place in almost every economic sector so frequently that they are now expected as inevitable. Some of the big mergers and acquisitions are those between Boeing and McDonnell Douglas aircraft, Exxon and Mobil oil companies, Microsoft and Apple computers, BMW and Chrysler, Volkswagen and Rolls Royce cars and Sandoz and CIBA pharmaceuticals. The annual number of mergers and acquisitions in the world more than doubled between 1990 and 1997 from 11,300 to 24,600 and cross border mergers and acquisitions amounted to \$236 billion in 1977. In the first half of 2000, cross border mergers and acquisitions amounted to \$1.9 trillion which was 26 per cent higher than in the first half of 1999; the most active sectors were telecommu-

nications, films, food, business services, communications equipment and drugs. The domination of world markets by transnational corporations is illustrated by the fact that the top 10 TNCs account for 86 per cent of the world telecommunications market, 85 per cent of pesticides, 70 per cent of computers, 60 per cent of veterinary medicine, 35 per cent of pharmaceuticals and 32 per cent of commercial seed. The top 300 industrial transnational corporations account for 70 per cent of the total foreign direct investment and control about 25 per cent of the world's stock of productive assets.

Mergers

Most mergers are initiated because the firms involved are under threat from a change in the size or nature of a specific market. Thus, McDonnell Douglas merged with Boeing because its biggest customer —the US military establishment — was cutting spending by half. Some take place for greater scale; thus, Chrysler merged with Daimler-Benz because it was too small to prosper alone. A number of mergers occur when a small firm fears being swallowed up by a bigger rival; Bayerische Verinsbank merged with its rival Hypobank when it feared being gobbled up by Deutsche Bank. Mergers may succeed or fail. The Economist of July 22, 2000 described them as follows:

"They are, like second marriages, a triumph of hope over experience. A stream of studies has shown that corporate mergers have even higher failure rates than the liaisons of Hollywood stars. One report by KPMG,

constancy, concluded that over half of them had destroyed shareholder value, and a further third had made no discernible difference. Yet over the past two years, companies around the globe have jumped into bed with each other on an unprecedented scale. In 1999, the worldwide value of mergers and acquisitions rose by over a third to more than \$3.4 trillion. In Europe, the hottest merger zone of all, the value of deals more than doubled to \$1.2 trillion⁷.

TNCs in Developing Countries

Foreign direct investment in developing countries at the beginning was in greenfield projects. The transnational corporations relocated some of their labour-intensive industries in developing countries to take advantage of their cheap labour – textiles and clothing, shoes, soft toys, electronics, etc; some of them established subsidiaries to manufacture for the local market, particularly when imports were restricted. Such investments were the beginning of industrialization in developing countries, especially in East Asia; as a result of these foreign investments, they became leading exporters of labour-intensive industrial products. The extent to which transnational corporations have penetrated developing countries for trade, production, financial and other services is illustrated by the number of their affiliates in them in 1995; China 15,966, Singapore 10,708, Brazil 7,110, Taiwan 5,733, South Korea 3,671, Hong Kong 2,628, India 926, Sri Lanka 139,

The second and recent wave of foreign direct investment in developing countries is not in greenfield projects as before but in acquisitions of and mergers with domestic companies. This is especially so after the East Asian crisis of 1997-1998 which drove thousands of local firms into bankruptcy and made it possible for foreign firms to acquire them at rock bottom prices. Examples of these re-

cent mergers and acquisitions are: BASF (Germany) and Daesang (Korea); Commerzbank (Germany) and Korea's Exchange Bank; Bosch (Germany) and Mando Machinery Corporation (Korea); Volvo (Sweden) and Samsung Heavy Industries (Korea); Tesco (UK) and Lotus Super Markets (Thailand);

ABN-AMRO Bank (Netherlands) and Bank of Asia (Thailand). There are no purely Korean automobile firms now as all three of them have foreign investors/partners: Ford in Daewoo, Renault in Samsung and Daimler-Chrysler in Hyundai. In the banking sector, foreign shareholders own a majority interest in nearly half the leading banks. The unusually large inflow of foreign direct investment of \$15 billion in 1999 was mainly for these acquisitions of Korean firms by foreign TNCs.

The TNCs and their affiliates can create difficulties for indigenous enterprises. The affiliates of TNCs have access to their parents' brand and trade names, and to use their advantages most effectively they tend to adopt non-price modes of competition based on a heavy reliance on advertising and product differentiation. These strategies raise barriers to the entry of indigenous firms. In order to promote healthy competition between local and foreign firms, the authorities need to have competition policies to offset the monopoly power of TNCs and fiscal policies to assist indigenous firms to build up their own brands and technological capability.

Bank Mergers in East Asia

Acquisitions and mergers of commercial banks in East Asia is a significant feature in the aftermath of the currency crisis. Almost all the commercial banking systems were scuttled in the crisis-stricken countries and under IMF's advice, all restrictions were removed to allow foreign banks to acquire the weakened local banks as a means of quick recovery. Since 1998, foreign financial institutions have acquired all or part of 18 Asian banks. In addition, domestic banks have begun to merge and con-

solidate to increase their size and resources to meet the demands of globalization in the forms of competition from large transnational banks and new technology. Indonesia, for example, aims at reducing its 160 domestic banks to about 20 and already four state banks have merged to form the Bank Mandiri – the biggest bank in Indonesia. IBRA has taken over Bank Danamon and is merging it with eight other troubled banks. Thailand has reduced its 15 domestic banks to 12, five of which have been bought by foreign institutions as shown below. In Malaysia, the government is forcing the country's 38 banks and other financial institutions to merge into 10 groups and already Bank Bumiputra have merged with Commerce Asset Bank to form Bumi Commerce. In Taiwan, the government is encouraging the larger state owned banks to merge and South Korea hopes to create two or three large banks by merging small ones, to compete globally; two banks have already merged (see table below). The Development Bank of Singapore has acquired the government postal savings bank and become a regional bank by acquiring Thai Danu Bank, Bank of the Philippine Islands and Kwon on Bank in Hong Kong. The authorities are also goading five local banks to merge.

Consolidation of commercial banks is also taking place in Japan. In 1996, Japan's Bank of Tokyo and Mitsubishi Bank merged to create Bank of Tokyo – Mitsubishi, the largest bank in Asia with assets of \$ 719 billion and a profit of \$ 1.2 million in 1999-2000. Agreements have been signed for four more mergers:

1. Mizuho Group comprising Fuji Bank, Dai-ichi Kangyo Bank and the industrial Bank of Japan, to form the world's targets financial concern, later this year.
2. Merger of Sumitomo Bank and Sakura Bank in 2002.
3. Consolidation of Sanwa and two others under a holding company in 2001.

Banking Mergers and Acquisitions in East Asia

Hong Kong	Development Bank of Singapore buys 90% of Kwong On (1999) Standard Chartered buys Chase retail businesses (2000)
Indonesia	Bank Danamon merges with 8 other private banks (1999) Four state banks from Bank Mandiri (1999)
Malaysia	10 anchor banking groups formed (2000)
Philippines	Development Bank of Singapore buys 60% of Bank of South East Asia (1998) and 20% of Bank of Philippine Islands (1999-2000) Metro bank buys 51% of Solid Bank (2000) UOB gets 60% of West Mont
Singapore	Development Bank of Singapore takes over Post Office Savings Bank 1998
Thailand	Development Bank of Singapore buys 52% of Thai Danu (2000) HSBC purchases Bangkok Metropolitan Bank (2000) UOB Purchases 75% of Radanasin (1999) Stanchart purchases 75% of Nakomthon (1999) ABN-AMRO buys 75% of Bank of Asia (1998)
South Korea	Newbridge buys 51% of Korea First (1999) Commercial Bank of Korea and Hanil from Hanvit (1998)
Thailand	City Group buys 15% of Fubon Group, Taiwan's Financial conglomerate

Mergers and Acquisitions in India

An incisive article by Nagesh Kumar on "Mergers and Acquisitions by MNEs" in the Economic and Political Weekly of August 5, 2000, indicates that while foreign direct investment (FDI) inflows to India were greenfield projects until early 1990s, a substantial part of current (FDI) inflows, after liberalization of the economy, are in the form of acquisition of existing enterprises in the country. About 40 per cent of the FEI inflows from 1997 to 1999 have taken the form of mergers and acquisitions. Of the 256 deals entered into by TNCs in India between March 1993 and February 2000, 239 or 93 per cent were acquisitions and only 17 or 7 per cent were mergers. The bulk of the acquisitions had been in manufacturing, especially non-electrical machinery, food and beverages, industrial chemicals, pharmaceuticals and auto components. Acquisitions in the services were

4. Merger of Bank of Tokyo – Mitsubishi and Mitsubishi Trust and Banking.

The problem of Japan's failed banks has been solved as follows:

- Ripplewood Holdings (US) has taken over the former long-term Credit Bank of Japan to create Shinsei Bank;
- A consortium led by Japan's internet giant – Softbank – has bought Nippon Credit Bank and created Azora Bank;
- Asia Recovery Fund (US) has taken over Tokyo Sowa Bank.

Of the 500 largest banks in Asia, 145 are Japanese and they account for over 60 per cent of assets, deposits and loans of all the bank. Japan's banks suffered a loss of \$ 64.6 billion in 1998-1999, but it was reduced to a loss of only \$ 1.3 billion in 1999-2000. Net losses of the banks in Indonesia, South Korea and Thailand declined from \$ 40.1 billion to \$ 24.3 billion in the same period.

Table I ACQUISITIONS BY HINDUSTAN LEVER

Food & Beverages

June 1993	- Acquisition of Kothari General Foods (by Brooke Bond India)
June 1993	- Merger of Doom Dooma India (Brooke Bond)
June 1993	- Merge of Tea Estates India (Brooke Bond)
June 1993	- Merger of Brooke Bond India and Lipton India to form Brooke Bond Lipton India (Brooke Bond)
June 1993	- Acquisition of Kissan Products (Brooke Bond)
July 1993	- Acquisition of Cadbury's Dollops (Ice-Cream) (Brooke Bond)
March 1994	- Acquisition of Tata Oil Mills Company (TOMCO) (Lever)
May 1994	- Acquisition of Merryweather Food Products (Brooke Bond)
Dec. 1994	- Acquisition of Kwaliti Ice Cream (Brooke Bond)
April 1995	- Acquisition of Milk Food Ice-Cream (Brooke Bond)
Jan. 1996	- Merger of Brooke Bond of India into Hindustan Lever Ltd.
Jan. 1998	- Acquisition of Kwaliti Frozen Foods
Dec. 1999	- Acquisition of Rossel Industries (Tea Plantations)
Jan. 2000	- Acquisition of Modern Food Industries

Detergents

March 1995	- Restructuring detergents and chemicals business with Subsidiary Stepan Chemicals and Hindustan Lever Chemicals
Feb. 1996	- Acquisition of Vishisti Detergents

Personal Care Products

Jan. 1993	- Merger of Quest International with Pond's India
Oct. 1995	- Acquisition of Lakme Lever
Sept. 1996	- Acquisition of Lakme's manufacturing facilities
Jan. 1998	- Merger of Pond's India with Hindustan Lever

mainly in banking and financial services, and advertising. The majority of acquisition appears to have been motivated by buyouts of joint venture partners, entry to the Indian market and extension of the scope of operation.

Many products are highly sensitive to marketing networks and brand loyalties. Building extensive marketing networks and creating new brand loyalties are time consuming and expensive processes. Acquisitions on the other hand, provide the TNCs with a ready-made marketing network and established and popular brands. Thus, Coca Cola acquired Parle, the largest soft drink manufacturer in India with well established brands and nationwide bottling and marketing networks; and Pepsi Cola acquired Duke, a smaller soft drink manufacturer. Similarly, Hindustan Lever acquired Dollys, Kwality and Milk food to get into the Ice-cream market.

TNCs which set up joint ventures with local groups, have ended up in buying the entire stake of local partners after a few years, e.g. Daewoo and DCM Group, Ford and Mahindra and Mahindra, Fiat and Premier Automobiles, General Motors and Hindustan Motors and Mercedes-Benz and Telco. Buyouts of local partner took place in other joint ventures such as those with Electrolux and Whirlpool electrical appliances, Timex watches, machinery manufacturers such as Cummins, Sulzer, Vickers, Xerox, Kent-Taylor, Yokogawa, and IBM. Acquisitions to extend the scope of their operations or market share are that of Hindustan Lever buying TOMCO and Lakme to strengthen its presence in the edible oil, soaps and personal care products, Smith Kline Beecham Consumer acquiring Jagit Industries, Glaxco acquiring Biddle Sawyer Group, Exide and Standard Batteries, Electrolux and Intron, and ABN-AMRO bank and Bank AM's Indian branches. A

substantial part of the acquisitions has been financed by internal funds and domestic borrowings by existing affiliates of TNCs. Further, in a large number of cases, TNCs have acquired running and profitable domestic enterprises.

There has been increased concentration of business in some sectors of the Indian economy as a result of acquisitions. TNCs dominate the markets by controlling the greater part of it for example, Smith Kline Beecham Consumer Healthcare in health drinks, Hindustan

of the absence of anti-trust or competition laws in the country. The need for a competition policy is more pressing as the FDI and industrial investment policies are becoming more liberal. Such a policy can provide a level playing field for domestic enterprises vis-à-vis subsidiaries of TNCs which enjoy access to the parents' brand and trade names.

Hindustan Lever (Unilever)

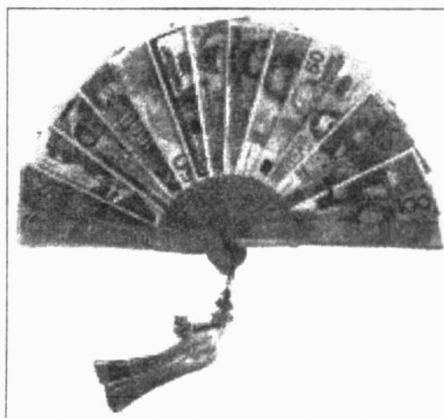
Unilever provides the best example of how foreign TNCs acquire and merge to expand and dominate markets. Established in India in 1913, it took over in the initial years, several firms that were engaged in the trade of soaps and merged them. Then three Unilever companies merged in 1944 to form Hindustan Lever Limited. Even in the years of restrictive policy before 1991 it acquired a number of small firms in financial difficulties such as Stepan Chemicals, Relish Foods, Sarif Garments, Ganesh Garments, Anand Apparels, Union Home Products and Sivalik Cellulose. With liberalization in the early 1990s it has strengthened its market presence and increased its size by acquisitions and mergers as in Table I.

Table II

Segments	Market Share of Hindustan Lever or Associates	
	1992-1993	1997-1998
Ice Creams	Nil	74.1
Sauce, Ketchups, Jams	Nil	63.5
Animal Feeds	n.a.	12.7
Tea	n.a.	20.5
Coffee	n.a.	5.9
Glycerin	37.4	40.9
STPP	44.8	65.1
DAP	7.9	8.8
Cosmetics & Toiletries	n.a.	56.5
Dental Hygiene Products	11.2	41.6
Soaps	19.7	26.0
Synthetic Detergents	33.1	46.7
Vanaspati	0.9	13.9

(Nagesh Kumar: Mergers and Acquisitions of MNEs, Economic and Political Weekly August 5, 2000)

Lever in Ice-cream, processed food and tea, Exide in batteries, Gillette in shaving products, Henkel in detergents, Electrolux in household appliances. GE capital in auto finance, WPP Group in



advertising. These virtual monopoly-like situations have been created because

The result of these acquisitions and mergers is the expansion of Hindustan Levers' market shares in several products as shown below: It has over half the market in Ice cream, sauce, ketchups, jams, STPP and cosmetics and toiletries. (see Table II)

India's concern regarding the aggressive policy of TNCs of acquiring indigenous firms was demonstrated in the National Convention of the Bharatiya Janata Party (BJP) – India's ruling party – on 28 August, 2000, which passed a resolution which stated "Foreign direct investment must be speeded up, but foreign companies must be encouraged to set up new units rather than buy existing Indian firms". ■