Cross-border mergers and acquisitions in East Asia: trends and implications

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Mergers and acquisitions across national borders have increased in East Asia since the onset of the financial crisis. What has caused this new wave of mergers and acquisitions, what effects have they had, and what advantages might they offer to the region’s financially distressed economies?

Mergers with, or acquisitions of, domestic firms by international firms—cross-border mergers and acquisitions (M&A)—increased dramatically in East Asia following the financial crisis of 1997. It is still too early to draw strong conclusions from this experience, but examining the preliminary evidence is important. The new wave of M&A was triggered by important policy changes following the crisis, particularly in Korea and Thailand. Some people expected the mergers and acquisitions to speed up much-needed corporate and financial restructuring and, hence, facilitate a faster economic recovery. Economic recovery from the crisis, however, received little impetus from cross-border M&A. But neither were cross-border mergers and acquisitions mainly predatory, as other observers had feared. It is also important to note that the mergers and acquisitions were concentrated in nontradable services sectors, which had traditionally been insulated from competition. Such M&A can bring long-term benefits when they are accompanied by policies to facilitate competition and improve corporate governance.

Recent regional trends

Cross-border M&A in East Asia’s crisis countries (Indonesia, Korea, Malaysia, and Thailand) rose sharply in value from $3 billion in 1996 to $22 billion in 1999, before falling slightly to $18 billion in 2000 (Chart 1). (Unless otherwise noted, the statistical references to cross-border mergers and acquisitions in this article involve acquisitions of more than 50 percent equity.) This rise was due largely to significant increases in such activity in Korea (where its value was $13 billion in 1999) and in Thailand (where its value was $4 billion in the same year). Compared with other East Asian countries, a large number of cross-border M&A deals involved investment in Malaysia prior to the crisis, but because the volume of such transactions did not rise there after the crisis, Malaysia has become a less significant player. In Indonesia, cross-border M&A, which have traditionally been limited, doubled between 1998 and 1999 to reach $2.7 billion.

By breaking into these largely monopolistic activities, foreign investment could have a significant economic impact by bringing modern-operational practices into the affected firms and creating greater competition in the domestic economy. Evidence from Latin America strongly suggests that privatization of infrastructure has significantly improved productivity and given the poor better access to services. Owing to the greater exposure of its services sectors to the discipline of international capital, East Asia is catching up with other regions that have moved more aggressively to attract foreign investment. In East Asia’s financial sector, for example, the share of assets under foreign control rose to 6 percent in 1999 following the sale of distressed assets (see Chart 2). Among other East Asian countries such as the Czech Republic, Hungary, and Poland (where half of financial sector assets were under foreign control).

After the crisis, cross-border M&A increased as a share of East Asia’s foreign direct investment (FDI) inflows to East Asia. The share of M&A in East Asia’s FDI rose from 6 percent in 1995 to 13 percent in 1997 and increased further, to 20 percent, in 1999. Thus, the much-talked-about resilience of FDI during the crisis was due entirely to the rapid increase in M&A rather than to traditional foreign investment in “greenfield” projects (those designed to build new means of production). Recent FDI based on mergers and acquisitions reflects foreign-based firms’ entry into services (nontradable) sectors, whereas greenfield FDI was predominantly focused on manufacturing of goods for export and also of domestic subsidies for imports. Much of the East Asian M&A activity has been in sectors such as wholesale and retail trade, real estate, and financial services (see Chart 3).

As a consequence of these recent increases, cross-border mergers and acquisitions have accounted for an increasing share of foreign direct investment (FDI) inflows to East Asia. The share of M&A in East Asia’s FDI rose from 6 percent in 1995 to 13 percent in 1997 and increased further, to 20 percent, in 1999. Thus, the much-talked-about resilience of FDI during the crisis was due entirely to the rapid increase in M&A rather than to traditional foreign investment in “greenfield” projects (those designed to build new means of production). Recent FDI based on mergers and acquisitions reflects foreign-based firms’ entry into services (nontradable) sectors, whereas greenfield FDI was predominantly focused on manufacturing of goods for export and also of domestic subsidies for imports. Much of the East Asian M&A activity has been in sectors such as wholesale and retail trade, real estate, and financial services (see Chart 3).

M&A and economic recovery

Cross-border mergers and acquisitions can be beneficial to a host country when they prevent potentially profitable assets from being wiped out during domestic financial crises. Given the distress in the domestic economy’s financial sector, a highly indebted, loss-making enterprise may have no option but to become insolvent unless an external partner with financial staying power and confidence in the ultimate viability of the enterprise can finance it. Before-and-after comparisons of cash-flow returns of acquired firms lead to the conclusion that acquisitions bring wealth gains to distressed firms and that those gains are greater in cross-border M&A transactions than in domestic ones (see Hikino and Persson, 1997; Mohnen and Mojon, 1999; and Kang, 1993). Mergers can, however, also destroy value if the projected synergies among the merged firms do not materialize or if their corporate cultures clash (see Stearns and Doherty, 2000). In this context, cross-border mergers in the East Asian crisis countries are of special interest.

What have the results been? The evidence is not conclusive. For Thailand, however, Chart 3 shows an inverse relationship between the speed of recovery and the incidence of cross-border M&A. A similar pattern has been observed for Korea and Malaysia. Thus, macroeconomic recovery has apparently not been helped by cross-border M&A.

Recent regional trends

Buoyant export markets and countries’ ability to compete internationally were the keys to recovery. This does not imply, though, that cross-border mergers and acquisitions have not helped, especially in recovering export sectors, which have traditionally been viewed as drivers of East Asian export performance. Cross-border M&A transactions have been concentrated in nontradable services sectors that are highly dependent on external demand for their exports, such as Thai travel, tourism, and financial services (see Chart 2). Cross-border M&A can also benefit the region’s financially distressed economies by facilitating much-needed corporate restructuring and by improving the efficiency of its domestic financial sectors. In this context, the most significant player is Indonesia, which has been transformed by a series of cross-border M&A transactions that have been accompanied by a major restructuring of financial institutions. In Korea, cross-border M&A has also been significant, especially in the transport equipment sector, which has traditionally been highly dependent on external demand for its exports.

The share of cross-border acquisitions has increased from 30 percent to 50 percent of total acquisitions in East Asia’s financial sector (see Chart 2). Cross-border M&A in East Asia has traditionally been limited, but the rapid increase in M&A following the financial crisis has changed this pattern. Cross-border M&A has been significant in all East Asian countries, but it has been most pronounced in Indonesia, where it has been accompanied by a major restructuring of financial institutions. In Korea, cross-border M&A has also been significant, especially in the transport equipment sector, which has traditionally been highly dependent on external demand for its exports. Cross-border M&A in East Asia has traditionally been limited, but the rapid increase in M&A following the financial crisis has changed this pattern. Cross-border M&A has been significant in all East Asian countries, but it has been most pronounced in Indonesia, where it has been accompanied by a major restructuring of financial institutions. In Korea, cross-border M&A has also been significant, especially in the transport equipment sector, which has traditionally been highly dependent on external demand for its exports.
Cross-border mergers and acquisitions (M&As) sharply increased over the last two decades. It is often pointed out that cross-border capital reallocation is partly the result of financial liberalization policies, government policies and regional agreements. In this paper, we identify some of the main forces driving cross-border M&As using a unique database on bilateral cross-border M&As at the sectoral level (in manufacturing and services) over the period 1985-2004. We focus on the role of institutional and financial developments with a special attention to the role played by the Eu. Recent trends show that in spite of economic uncertainties cross-border mergers and acquisitions are gaining importance and considered to be a vital tool for growth. Read on to understand all about cross-border mergers and acquisitions of assets have been driven more by new opportunities created by policy changes that encouraged M&A than by firms' greater liquidity resulting from foreign exchange depreciations. The widely differing prices at which distressed assets were sold—which ranged from 25 to about 80 percent of their book values—suggest that these prices reflect differences in the assets' quality rather than fire sales.

Policy reforms
Since their crises in 1997, both Korea and Thailand have introduced various measures to build investor confidence through reforms aimed at protecting investor rights. For example, in 1999, cross-border M&A accounted for 0.9 percent of GDP in East Asia, compared with 1.8 percent of GDP in Latin America. The recent upsurge in mergers and acquisitions in East Asia, particularly in Korea, can be attributed largely to policy changes that have facilitated foreign acquisitions of local assets. Liberalization of foreign entry and ownership restrictions and the introduction of national accounting standards and shareholding systems have exponentially increased foreign investors' access to local markets.

Long-term prospecs
Cross-border mergers-and-acquisitions activity is still in an early phase in East Asia's financially distressed economies and remains small, relative to their size and stages of development. (For example, in 1999, cross-border M&A accounted for 0.9 percent of GDP in East Asia, compared with 1.8 percent of GDP in Latin America.) The recent upsurge in mergers and acquisitions in East Asia, particularly in Korea, can be attributed largely to policy changes that have facilitated foreign acquisitions of local assets. Liberalization of foreign entry and ownership restrictions and the introduction of national accounting standards and shareholding systems have exponentially increased foreign investors' access to local markets.

The most significant role for cross-border mergers and acquisitions is in encouraging longer-term reforms, such as operational restructuring and reallocation of assets, in firms. Foreign participation through M&A could also be more effective in improving efficiency, competitiveness, and corporate governance (see UNCTAD, 2000). Under the circumstances, foreign direct investment, in the form of cross-border mergers and acquisitions, has a significant role to play in the restructuring and continued development of financially distressed East Asian economies.