



ESRI Research Bulletin

Foreign Acquisitions and Firm Performance

Iulia Siedschlag (ESRI and TCD), Ville Kaitila (The Research Institute of the Finnish Economy), John McQuinn (Cambridge Econometrics), Xiaoheng Zhang (TCD)

The *Research Bulletin* provides short summaries of work published by ESRI staff and overviews of thematic areas covered by ESRI programmes of research. Bulletin articles are designed to be easily accessible to a wide readership. A reference or references to the full publication is included at the end of each Bulletin article.

An archive of bulletin articles will be found at www.esri.ie/bulletin

Foreign Acquisitions and Firm Performance¹

***Iulia Siedschlag, Ville Kaitila, John McQuinn, and Xiaoheng Zhang**

Foreign direct investment in advanced economies is predominantly in the form of cross-border mergers and acquisitions (M&A). The number and value of cross-border M&A in the European Union have increased over the past two decades following a Directive adopted by the European Commission in 2005. The main objective of this Directive on cross-border M&A was to enable firms to benefit from the Single Market and to foster competitiveness for growth and employment as part of the Lisbon Agenda.

While foreign direct investment in greenfield projects is largely perceived as bringing benefits to the host economies, foreign takeovers of domestic firms are seen in many cases as detrimental to domestic interests and they often face opposition from the public and political parties.

The performance of acquired firms after acquisition by foreign investors depends on firm characteristics (such as age, size, capital intensity, capital-labour ratio) and firm performance (such as productivity, financial health) of the acquired and acquirer firms before acquisitions. From the perspective of acquired firms, both the best performers (“cherries”) and the worst performers (“lemons”) are likely to be acquired. In both cases, the motivation for acquisition is maximising profits. From the perspective of acquirers, cross-border M&A could be by the most or the least productive firms depending on the international mobility of their assets.

International empirical evidence indicates that foreign acquisitions lead most frequently to productivity increases, while the employment performance of firms in the post-acquisition period appears to be more mixed, depending on firm and sector characteristics. While most previous evidence has been available for firms in manufacturing, evidence on foreign acquisitions of firms in the services sector is very limited.

To fill this gap, in a recent published paper,¹ we provide evidence about the effects of foreign acquisitions on firm performance in both manufacturing and services sectors. Specifically, we used firm level data over the period 2001-2009 and examined the effects of foreign acquisitions on firm productivity and employment growth in six small open economies: Austria, Belgium, the Netherlands, Finland, Denmark and Sweden.

¹ Iulia Siedschlag, Ville Kaitila, John McQuinn, Xiaoheng Zhang, “International Investment and Firm Performance: Empirical Evidence from Small Open Economies”, *Journal of Economics and Statistics*, Vol. 234(6): 662-687.

<http://www.jbnst.de/en/content.php?id=23406>. <http://esri.ie/pubs/JACB201456.pdf>.

* iulia.siedschlag@esri.ie; ville.kaitila@etla.fi; jm@camecon.com; zhangx@tcd.ie.

The research results indicate that foreign investors tend to acquire larger firms in both manufacturing and services. Other characteristics of acquired firms differed across the countries analysed and between manufacturing and services. Our research finds that, in the service sector, high productivity firms (in Belgium and Denmark) as well as low productivity firms (in Austria) were more likely to be acquired by foreign investors. In manufacturing, foreign investors “cherry picked” high productivity firms (in Finland) while “lemons” were also acquired (in the Netherlands). While old service firms were more likely to be acquired (in Denmark and Finland), young manufacturing firms and more capital-intensive firms were more likely to be acquired. Manufacturing firms with high debt-to-fixed assets ratios were more likely to be acquired (in Belgium and Finland).

Taken together, the evidence suggests that foreign acquisitions had stronger effects on productivity and employment growth in services in comparison to manufacturing. Overall, no general pattern emerges on the effects of foreign acquisitions on productivity and employment growth. This result suggests that country-specific economic, social and institutional characteristics may condition the effect of foreign acquisitions on productivity and employment growth. These country-specific framework conditions include the degree of openness to international trade and investment, financial development and financial market efficiency, the quality of the education systems, as well as product and labour market regulations.

The European Commission examines cross-border M&A with respect to competition rules for the benefit of consumers. Our empirical findings indicate that national governments should not oppose or favour foreign acquisitions on the basis of expected economic effects in the post-acquisition period. Ensuring a level playing field is the best policy to reap the potential benefits of foreign acquisitions. Meanwhile, potential negative effects such as job losses following firm restructuring should be acknowledged and dealt with by income support and active labour market policies.