ANNEX 9

Mergers and Acquisitions (M&A) Type Transactions as a Part of FDI Statistics

1. Introduction

594. Analysis of Foreign Direct Investment (FDI) is important due to its impact on the production, employment, value added, etc., of the host economy. Distinguishing FDI by its type will help to refine this analysis as the purchase/sale of existing shares *versus* purchase/sale of newly issued shares will usually have significantly different results regarding their economic impact (see Chapter 2). The focus of this annex concerns practical recommendations on the compilation of FDI statistics to show investment in the form of Mergers and Acquisitions (M&A) type transactions, and, more specifically, purchase/sale of existing shares.

595. "Mergers" and "acquisitions" are two terms used by many interchangeably in spite of the fact that they do not relate to same types of operations. It is useful to distinguish them. A *merger* occurs when two (or more) companies agree to merge into a new single company rather than remain separated for creating business synergies. An *acquisition* is the purchase of existing shares issued by another company for increasing ownership or control level by the acquiring company. For more details on the nature of mergers and acquisitions, refer to Box A.9.1.

596. In order to avoid possible confusion due to terminologies which are commonly used, some clarification is necessary. For M&A type transactions, this *Benchmark Definition* refers to:

i) Purchase/sale of existing shares by the direct investor/direct investment enterprise (as opposed to purchase/sale of newly issued shares);

ii) The *equity* component of FDI inflows and outflows (but not to *reinvestment of earnings* and debt instruments); an analysis of M&A type transactions is not meaningful for FDI position statistics.

597. Therefore, statistics covered in the *Benchmark Definition* under M&A type transactions as a part of FDI relate to purchase/sale of existing shares by the direct investor /direct investment enterprise, with the ownership of 10% or more of the voting power of an enterprise (the necessary condition to establish a direct investment relationship). In other words, M&A type transactions as a part of FDI include changes for both minority ownership and control: *i)* significant influence (purchase/sale of shares in the range of 10% to 50%); and *ii)* controlling ownership (purchase/sale of shares of more than 50 per cent). Moreover, making a distinction between "mergers" and "acquisitions" will not impact directly the statistics on financial transactions but may have an impact, if the data are analysed in tandem with AMNE statistics.

Box A.9.1. **Mergers, acquisitions and divestment**

A *merger* refers to the combination of two or more companies to share resources in order to achieve common objectives. A merger implies that, as a result of the operation, only one entity will survive and frequently occurs following an acquisition (an acquisition is to be described later). In business, there are several types of mergers:

1. *Statutory merger* relates to the business combination where the merged (or target) company will cease to exist. The acquiring company will assume the assets and liabilities of the merged company. In most cases, the owners of merged companies remain the joint owners of the combined company.
2. *Subsidiary merger* relates to an operation where the acquired company will become a subsidiary of the parent company. In a reverse subsidiarymerger, a subsidiary of the acquiring company will be merged into the target company.
3. *Consolidation* is a type of merger which refers to a business combination whereby two or more companies join to form an entirely new company. All companies involved in the merger cease to exist and their shareholders become shareholders of the new company. The terms consolidation and mergers are frequently used interchangeably. However, the distinction between the two is usually in reference to the size of the combining companies. Consolidation relates to an operation where the combining firms have similar sizes while mergers generally imply significant differences.
4. *Reverse merger* is a deal where the acquiring company ceases to exist and merges into the target company. If a company is eager to get publicly-listed in a short period of time, it can buy a publicly-listed company and merges into it in order to become a new public corporation with tradable shares.
5. *Merger of equals* is a type of merger when companies involved are of similar sizes.

Based on the motivation of investors, mergers are usually referred to as following:

1. *Horizontal merger* occurs when two competitors combine, *i.e.* two companies having the same activity (*e.g.*, two companies in defence industry). Such a combination may result in an increased market power for the merged company and, consequently, may be opposed by antitrust regulators.
2. *Vertical merger* is the combination of two companies with complementary activities such as those having a buyer-seller relationship (*e.g.*, an operation between a pharmaceutical company and a company which specialises in the distribution of pharmaceutical products).
3. *Market-extension merger* occurs between two companies selling the same products in different markets.
4. *Product-extension merger* occurs between two companies selling different but related products in the same market.
5. *Conglomerate merger* relates to all the other types of transactions, *i.e.* when two companies do not have a specific relationship and are usually in different lines of business (*e.g.*, a tobacco company merging with a food company).

An *acquisition* is a transaction between two parties based on terms established by the market where each company acts in its own interest. The acquiring company purchases the assets and liabilities of the target company. The target company either becomes an associate or a subsidiary or part of a subsidiary of the acquiring company.

1. *Take-over* is a form of acquisition where the acquiring firm is much larger than the target company. The term is sometimes used to designate hostile transactions.
2. *Reverse take-over* refers to an operation where the target company is bigger than the acquiring company. However, mergers of equals (in size or belonging to the same sector of activity) may also result in a hostile take-over.

Box A.9.1. **Mergers, acquisitions and divestment** *(cont.)*

A *divestment (de-merger)* refers to the selling of the parts of a company due to various reasons: a subsidiary or a part of a company may no longer be performing well in comparison to its competitors; a subsidiary or a part may be performing well but may not be well positioned within the industry to remain competitive and meet long-term objectives; strategic priorities of a company to remain competitive may change over time and lead to divestment; loss of managerial control or ineffective management; too much diversification may create difficulties thus lead the parent company to reduce the diversification of its activities; the parent company may have financial difficulties and may need to raise cash; a divestment may be realised as a defence against a hostile take-over. Corporate divestment can be conducted in different ways:

1. *Corporate sell-off* is the sale of a subsidiary to buyers which are other companies in most cases.
2. *Corporate spin-off* occurs when the divested part of the company is floated on a stock exchange. The newly floated company is separately valued on the stock exchange and is an independent company. The shares in the newly listed company are distributed to the shareholders of the parent company who thereafter own shares of two companies rather than one. Through such an operation they increase the flexibility of their portfolio decisions.
3. *Equity carve-out* is similar to corporate-spin off but the parent retains the majority control. This form has the advantage of raising cash for the divestor.
4. *Management buy-outs (MBO) and buy-ins (MBI)* is a case that the buyer is the manager of the company that is being sold off. In the case of an MBI, a private company is bought by the management.

598. *Other types of FDI* are calculated as a residual, *i.e.* as the difference between total equity and M&A type transactions representing new investments. They include "Greenfield" investment (*ex nihilo* investment), extension of capital and investment for financial restructuring (investment for debt repayment or loss reduction). Greenfield investment and extension of capital increase the total assets of resident enterprises and, therefore, directly impact on production, etc. However, investment for financial restructuring does not usually have the same impact as either the greenfield or extension of capital types.

2. Compilation and recording of transactions

2.1. General principles

599. In order to provide internationally comparable FDI by type and to solve the practical issues involved in feasibility, it is essential to apply simple but, at the same time, objective criteria for recording the transactions. The breakdown is introduced to distinguish M&A type transactions and other types of FDI. The main focus is the "purpose" and "final destination/use" of investments (see chart). As a further refinement, it is analytically useful to identify whether the equity ownership is more (or less) than 50% after recording the transaction. Such data remains fully comparable with FDI statistics while basic principles are the same.

600. In order to limit additional reporting burden on respondents, limit the costs for compilers and ensure consistency with overall FDI statistics, it is recommended that these additional details be collected as an extension of regular data collection processes (*e.g.*, annual FDI surveys).

Box A.9.2. **Components of M&A type transactions as a part of FDI**

Foreign direct investment

Gross investments and divestments by non-residents

Investment in equity	Divestment in equity
Of which:	*Of which:*
M&A type transactions (purchase of existing shares in resident companies by non-residents)	M&A type transactions (sale of existing shares in resident companies by non-residents)
i) country and	*i)* country and
ii) industry	*ii)* industry
Other types of FDI (calculated as residual)	Other types of FDI (calculated as residual)

Gross investments and divestments by residents

Investment in equity	Divestment in equity
Of which:	*Of which:*
M&A type transactions (purchase of existing shares in non-resident companies by residents)	M&A type transactions (sale of existing shares in non-resident companies by residents)
i) country and	*i)* country and
ii) industry	*ii)* industry
Other types of FDI (calculated as residual)	Other types of FDI (calculated as residual)

Note: The above presentation relates to the conceptual framework by country and industry classifications. For data dissemination, data may be disseminated at higher level of aggregation if limited by confidentiality.

601. The number of transactions could be significant while their analytical relevance may be limited due to the small size of individual transactions. To limit the costs in proportion to the analytical relevance, compilers may apply an additional threshold.

602. Information compiled on country and industry classifications as suggested in the following chart, allow presenting M&A type transactions by country and industry. Information on M&A (including information on ultimate host/ultimate investor) are often well-known and disseminated in companies' press releases, specialised financial press, research papers, materials from the stock exchanges, or private databases. Compilers practically could refer to such information if they could not collect sufficient information from reporters.

2.2. Data collection as a part of FDI surveys

603. Respondents could be asked to provide additional information regarding the type of FDI as a part of regular FDI surveys. The questions would relate to both investment (I) and divestment (D) to determine net amounts for M&A type transactions. Related inquiries are outlined.

604. Following notes are provided as a guide to FDI compilers for M&A type transactions:

Q-1: *Was the purpose of the transaction to "purchase (or sell) existing shares" for the acquisition (or the disposal and reduction) of an equity stake in a direct investment enterprise in (or from) the immediate counterpart country?*

This question intends to determine whether the purpose of the transactions is to purchase (or sell) existing shares [or not] from the immediate[82] counterpart country.

1. If the answer is YES then the transaction is potentially an M&A type transaction with further information required to make a final determination [see Q-3]; or
2. If the answer is NO, then the respondent is requested to provide additional information on the purpose of the transaction [see Q-2]

Q-2:*Was the purpose of the transaction to "purchase (or sell) existing shares" for the acquisition (or the disposal and reduction) of an equity stake in a DIE in (or from) another economy?*

1. If the answer is YES, then the funds are passing through a direct investment enterprise (*e.g.*, a Special Purpose Enterprise (SPE) or an operational subsidiary) to their final destination and will not remain in the direct investment enterprise acting as the intermediary. The transaction is potentially an M&A type transaction with further information required to make a final determination [see Q-3]; or
2. If the answer is No, the transaction is greenfield investment, extension of capital or investment for financial restructuring. Then investigation will stop at this point and the transaction is identified as other type of FDI.

Q-3: *Did the transaction financed by an equity injection from an enterprise in another economy? Or Did the transaction finance an equity withdrawal to an enterprise in another economy?*

1. If the answer is YES, then the funds are passing through an intermediary in the country and are classified as other' on the basis that they are pass-through funds or capital in transit; or
2. If the answer in NO, then the transaction is an M&A type transaction and additional information is requested [see Q-4 and Q-5].

Q-4:*What is the country and the industry of the DIE in which an equity stake was purchased (or sold)?*

The respondent is requested to provide additional information on the country and the industry of the DIE (after looking through any entity through which the capital may transit).

Q-5*: Is the total percentage of ownership after the transaction more than 50%?*

The respondent is requested to provide additional information whether the percentage of ownership after the transaction will be more than 50 per cent. The information would help compilers to build an additional series for control.

Note: Share buy-back (one form of divestment) is not applied to the flow chart, since its treatment was deferred to the research agenda for further consideration.

82. "Immediate" counterpart refers the first country/enterprise outside the compiling economy.

Chart A.9.1. **Flow chart to identify Mergers and Acquisitions transactions within FDI – Investments**

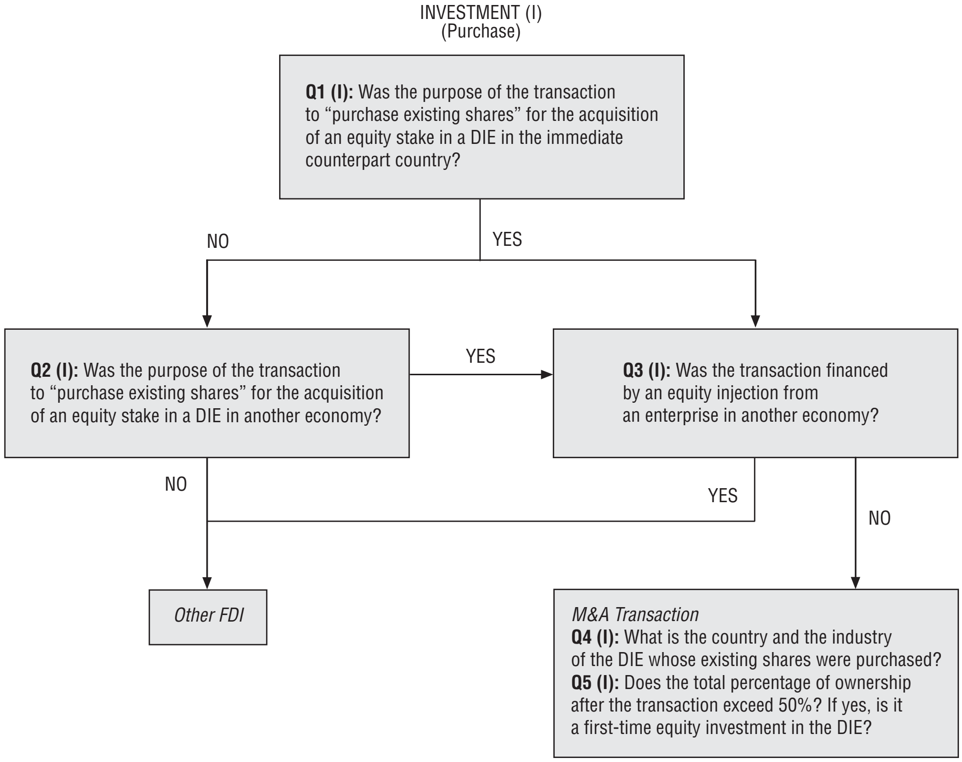

Chart A.9.2. **Flow chart to identify Mergers and Acquisitions transactions within FDI – Disinvestments**

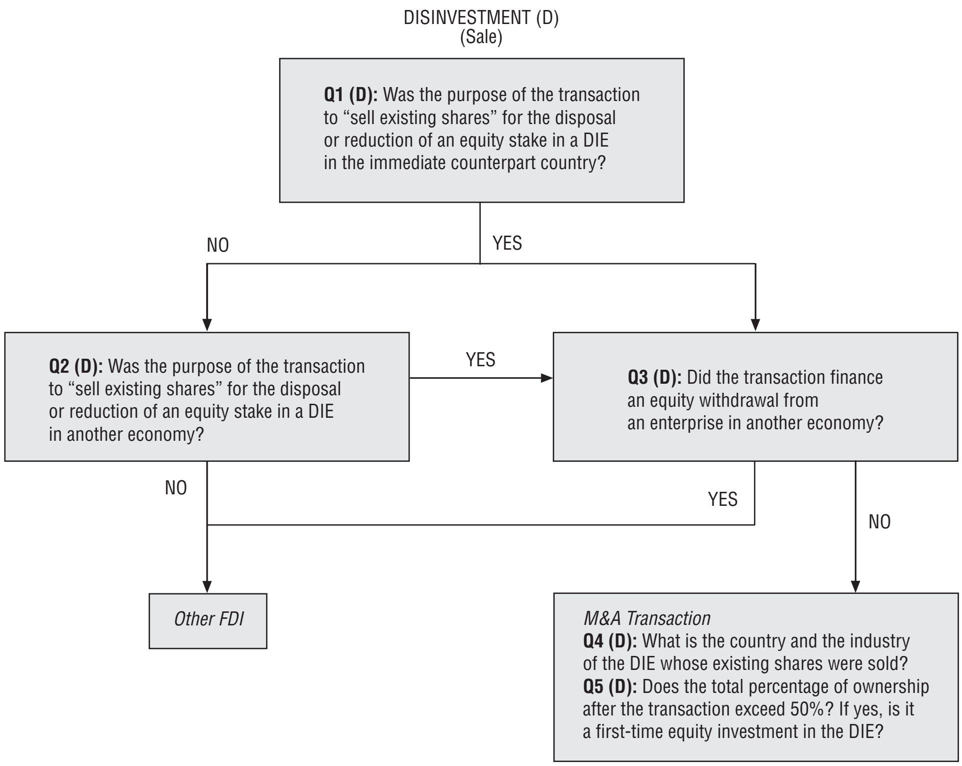

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Table A.9.1. **Examples of transactions**

FDI – Equity	
of which:	
M&A type transactions	
	• An investor (in economy A) purchases existing shares issued by a target company (in economy B) from its shareholders. • An investor (in economy A) establishes a subsidiary holding company (in economy B) to purchase existing shares issued by a target company (in economy B or C) from its shareholders.
Other types of FDI	
Greenfield investment	• An investor (country A) establishes a subsidiary company (country B). • An investor (country A) establishes a subsidiary holding company (country B) to establish a sub-subsidiary company (country B or C).
Extension of capital (for expanding business operations)	• An investor (country A) purchases shares newly issued by an existing subsidiary company (country B) for expanding its business operations. • An investor (country A) purchases shares newly issued by an existing subsidiary holding company (country B) to purchase shares newly issued by a sub-subsidiary company (country B or C) for expanding its business operations.
Investment for financial restructuring	• An investor (country A) purchases existing shares issued by an existing subsidiary company (country B) for debt repayment or loss reduction. • An investor (country A) purchases shares newly issued by an existing subsidiary holding company (country B) to subscribe existing shares issued by an existing sub-subsidiary company (country B or C) for debt repayment or loss reduction.

3. Practical examples

605. This section provides some examples to illustrate various investment patterns and their recording by country and industry. It also provides comparison for recording M&A type transactions as a part of FDI and M&A statistics by private sources.

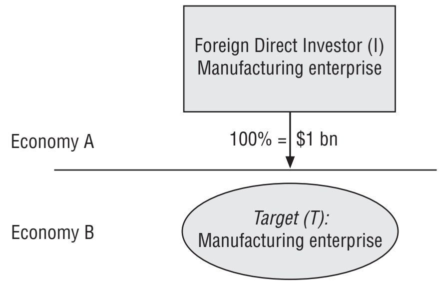
3.1. Practical examples (M&A with the capital only provided by a direct investor)

606. There are many instances where the funds for FDI transactions are provided either through SPEs (*e.g.* holding companies) newly established for the purpose of the investment, or through existing entities. If such funds are recorded according to the immediate counterpart, the results would be misleading not only when distinguishing FDI by type but also for the country and industry classifications. In other words, for transactions effected through SPEs, instead of recording them as M&A type transactions, they would be considered either as an increase in equity (extension of capital) if they are channeled through existing SPEs or as greenfield investments if they are channeled through newly created SPEs. Such recordings will distort the analytical information. Therefore, *the Benchmark Definition recommends that FDI statistics by type for M&A be compiled according to the final use of the investment.*

Figure A.9.1. **Direct M&A**

Description: A direct investor (I) in Country A purchases all the existing shares of a target company (T) in Country B for US$1bn.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase of all existing shares.

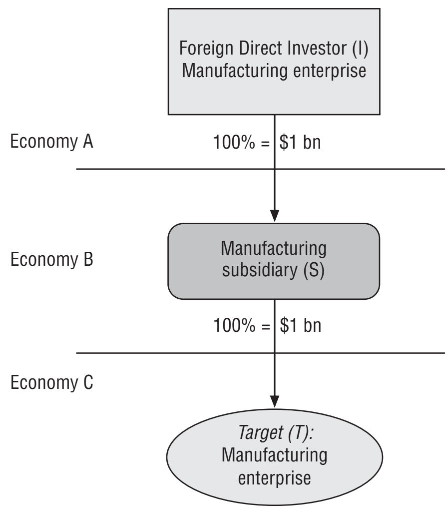


Reporting country	*FDI equity outflows*	*FDI equity inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–
Country: B	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** Country "A" **Industry classification:** Manufacturing

Figure A.9.2. **M&A through an operational subsidiary in a third country**

Description: An investor (I) in Country A transfers US$1bn. to its manufacturing subsidiary (S) in Country B mandated to acquire all the existing shares in a manufacturing company (T) in Country C on behalf of its parent in Country A.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares. Both Country A and Country C look through the operational subsidiary which transits the funds.

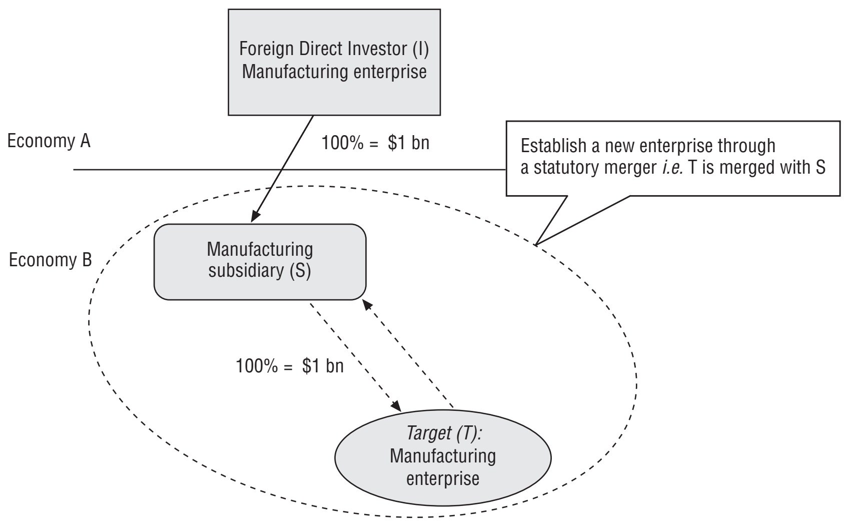


Reporting country	*FDI equity outflows*	*FDI equity inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** "C" **Industry:** Manufacturing	–
Country: B	**Amount:** $1 bn. **Type of FDI:** Other **Partner country:** "C" **Industry:** Manufacturing	**Amount:** $1 bn. **Type of FDI:** Other **Partner country:** "A" **Industry:** Manufacturing
Country: C	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner country:** "A" **Industry:** Manufacturing

Figure A.9.3. **Direct statutory merger**

Description: An investor (I) in Country A sets up a manufacturing subsidiary (S) in Country B. I invests US$1 bn. in S. The subsidiary then merges with a manufacturing company (T) in Country B by purchasing all the existing shares of this target company, which ceases to exist as a result of the merger.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.

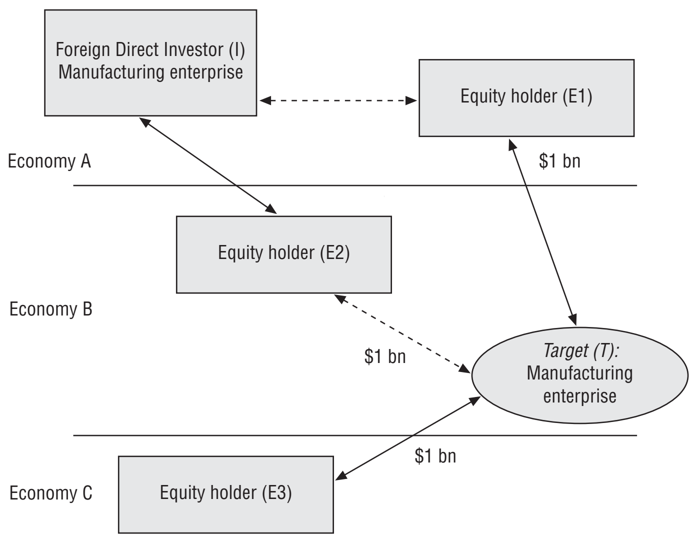


Reporting country	*Direct Investment Equity Outflows*	*Direct Investment Equity Inflows*
Country A	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–
Country: B	–	**Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing

Figure A.9.4. **Direct equity swap**

Description: A company (T) in Country B has 3 shareholders (E1, E2 and E3), one from each of countries A, B and C. Each of their 33.3% shareholdings is valued at US$1 bn. An investor (I) in Country A acquires all of these shares by means of a share – for-share' swap, using US$3 bn. of its own newly issued shares. As a result of the transactions, each of the former shareholders of Company T has become a shareholder in I and each own less than 10% of I's shares. Resident-to-resident transactions by investors in Countries A and B in enterprises in their respective countries are excluded from the scope of the exercise as they do not represent cross-border transactions.

Classification: FDI Equity, "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



Reporting country	FDI equity transactions		Portfolio investment*	
	Outflows	*Inflows*	*Net acquisition of financial assets*	*Net incurrence of liabilities*
Country A	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–	–	**Amount:** $2 bn. **Partner Country:** "B" = $1 bn. "C" = $1 bn.
Country: B	**Disinvestment = Inflow** **Amount:** $1 bn. **Type of FDI:** M&A **Partner Country:** "C" **Industry:** Manufacturing	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing	**Amount:** $1 bn. **Partner Country:** "A"	–
Country: C	–	**Amount:** $1 bn. (Divestment) **Type of FDI:** M&A **Partner Country**: "B" **Industry:** Manufacturing	**Amount:** $1 bn. **Partner Country:** "A"	

* Purchase/sale of shares by an investor with less than 10% ownership of voting power are recorded as portfolio investment (one component of financial account under Balance of Payments Statistics)

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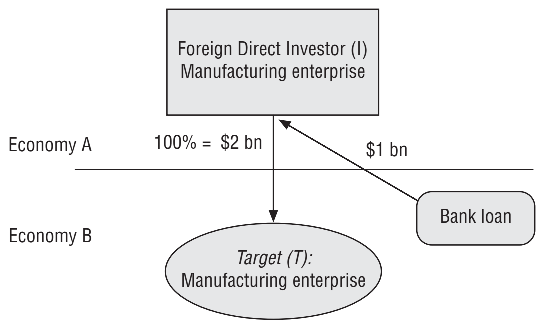
3.2. Practical examples (M&A where financing is provided by a direct investor and a local bank)

607. When a M&A transaction is partly financed by capital from a local bank, there is a major difference between recording M&A transactions as a part of FDI and M&A statistics of commercial sources.. Users and compilers should pay attention to such differences when analyzing M&A data.

Figure A.9.5. **Direct M&A with capital procured by a local bank**

Description: An investor (I) in Country A contracts a US$1bn. bank loan in Country B to complement US$1 bn. of its own resources to acquire a US$2bn. manufacturing company (T) in Country B.

Classification: "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



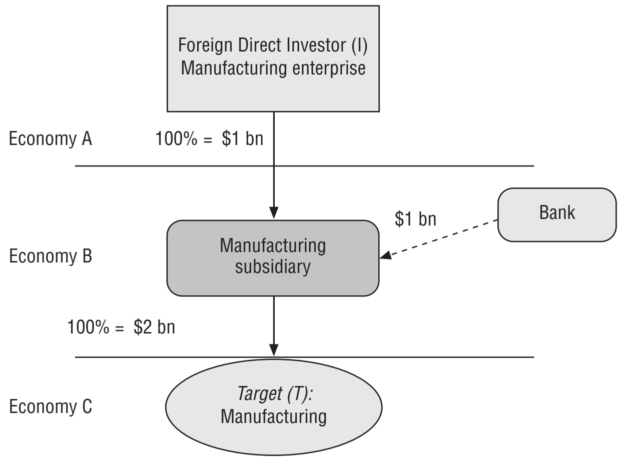
Reporting country	*M and A as part of FDI and other investment transactions*		***M&A statistics*** (commercial sources)
	FDI equity outflows	***FDI equity inflows***	
Country: A	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "B" **Industry:** Manufacturing	–	**Amount:** $2 bn. for M&A type transactions **Partner country:** Country B
Country: B	–	**Amount:** $2 bn. **Type of FDI:** M&A **Partner Country:** "A" **Industry:** Manufacturing	**Amount:** $2 bn. for M&A type transactions **Partner country:** Country A
	Other Investment, Net acquisition of financial assets*	***Other Investment,* * *Net incurrence of liabilities***	
Country: A	–	**Amount:** $1 bn. **Partner Country:** "B"	
Country: B	**Amount:** $1 bn. **Partner Country:** "A"	–	

* Loans between an enterprise and an unaffiliated bank are recorded as other investment (one component of financial account under the Balance of Payments Statistics).

Figure A.9.6. **M&A through an operational subsidiary in the third country with capital borrowed from a local bank**

Description: An investor (I) in Country A provides US$1bn. to its manufacturing subsidiary (S) in Country B. In addition to this financing, S borrows US$1 bn. from a local bank in Country B and acquires all the existing shares in a manufacturing company (T) in Country C for US$ 2bn.

Classification: FDI equity. "M&A type transactions " by using information on the final use of invested capital, *i.e.* purchase by Country A of all existing shares.



Reporting country	*M and A as part of FDI transactions*		*M&A statistics* (commercial sources)
	FDI equity outflows	*FDI equity inflows*	
Country: A	**Amount:** $2 bn. **Type of FDI:** M&A **PartnerCountry**: "C" **Industry:** Manufacturing	–	**Amount:** $2 bn. for M&A type transactions **Partner country:** "C"
Country: B	**Amount:** $2 bn. **Type of FDI:** Other **PartnerCountry**: "C" **Industry:** Manufacturing	**Amount:** $1 bn. **Type of FDI:** Other **PartnerCountry:** "A" **Industry:** Manufacturing	–
Country: C	–	**Amount:** $2 bn. **Type of FDI:** M&A **PartnerCountry**: "A" **Industry:** Manufacturing	**Amount:** $2 bn. for M&A type transactions **Partner country:** "A"

Note: $1 b bank loan is a resident to resident transaction for Country B and is therefore not shown in this table.

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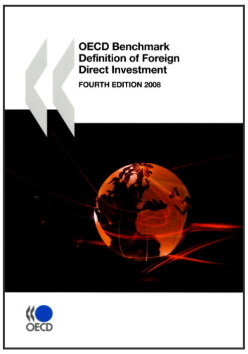
3.3. Comparison of data

Box A.9.3. Comparison of M&A type transactions as a part of FDI with M&A statistics by private sources

	M&A type transactions as a part of FDI	M&A statistics by private sources
Objective	To analyze M&A transactions as a subcategory of cross-border invest-ments in the form of FDI.	To analyse different types of business combinations of domestic, cross-border and a mixture of both.
Methodology	**Include:** ● Classifying transactions by direction: outward and inward FDI ● Purchase/sale of existing shares ● Amount reported corresponds to cross-border equity transactions between residents and non-residents which qualify as FDI (*i.e.* ownership of at least 10 per cent of voting power) ● International standards provide unified methodology and compilers are asked to provide metadata on deviations **Exclude** ● Debt instruments (inter-company loans) ● Reinvestment of earnings ● Non cross-border transactions ● Pass-through funds through SPEs	**Include:** ● Purchase of existing shares (acquisition or mergers of existing companies) ● Amount reported represents the total purchase of existing shares (including purchase of less than 10 per cent of voting power) ● Unified methodology is not available across various sources **Exclude** ● All types pass-through transactions and recording is for genuine target and genuine investor ● Divestments (when a resident company is sold by a non-resident owner to another company in a third country, the only transaction to be recorded by private sources is the acquisition by the third country)
Breakdowns	Main breakdowns based on the same concepts as FDI: ● by country (geographical allocation) ● by industry (ISIC)	● A large number of details are available such as: name of an investor/a target company, date of contract/ transaction, percentage of shares purchased/sold, types of shares purchased/sold, amount of a transaction (total amount of shares purchased or total enterprise value), and method of payment ● Country and industry classifications are based on the ultimate host/investing enterprise.
Data sources	Statistical surveys, ITRS administrative information and other officially published sources	Press releases, specialized financial press, research papers, materials from the stock exchanges, and surveys/reports undertaken for statistical purposes.



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