Current Developments in Transnational Business

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CURRENT DEVELOPMENTS IN TRANSNATIONAL BUSINESS

Cross-border mergers and acquisitions, particularly those involving large firms, vast sums of money and major restructuring of the activities of firms, are among the most visible faces of globalization. The impact of mergers and acquisitions on development can be double-edged and uneven. Concerns are voiced in developed and developing countries especially about the market power of transnational corporations and potential anti-competitive implications of mergers and acquisitions. UNCTAD, the United Nations Conference on Trade and Development, has published its World Investment Report 2000, which looks at the relationship between cross-border mergers and acquisitions and global development. In this edition of World Chronicle, Karl P. Sauvant, Chief of the Division on Investment, Technology and Enterprise Development at UNCTAD, talks about the new edition of World Investment Report 2000.

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ANNOUNCER: From United Nations Headquarters in New York, this is World Chronicle, an unedited interview programme about major global issues. Here now to introduce our guest is the host of today's World Chronicle.

LITTLEJOHNS: I'm Michael Littlejohns, and this is World Chronicle. Driven by the recent wave of cross-border mergers and acquisitions, global FDI, or foreign direct investment outflows, reached $865 billion in 1999. Indications are that FDI flows for 2000 may well surpass the one-trillion-dollar mark. In its tenth anniversary edition, the World Investment Report 2000 examines the relationship between cross-border mergers and acquisitions and development. The Report, produced by UNCTAD, the United Nations Conference on Trade and Development, is a most valuable resource for understanding the workings of the globalized economy.

Our guest today has been the team leader of the World Investment Report since it was first published in 1991. He is Karl P. Sauvant, Chief of the Division on Investment, Technology and Enterprise Development at UNCTAD.

Joining me to talk with Mr. Sauvant are Judy Lessing of Radio New Zealand and Jack Freeman from The Earth Times.

Mr. Sauvant, welcome to World Chronicle.

Mr. Sauvant, just a few years ago transnational corporations were reviled in this building. Nobody could say a good thing about them. In fact, there was a whole department headed by Peter Hansen, who is now the UN Commissioner-General in Palestine which was devoted to analyzing transnational corporations and finding a lot of fault with them. Now it seems to me that without transnational corporations none of these big numbers we have been talking about in the introduction would have been possible. What's happened? Why is there the change of heart?

SAUVANT: Well I think there are a number of very straightforward reasons why countries have turned around in terms of the evaluation of the role that foreign direct investment can play in development. And I think most important is that indeed all countries are seeing that foreign direct investment is a package of tangible and intangible assets that firms bring to a country and which can contribute to the development of any particular country now, so you see that all countries in the world are actually actively seeking foreign direct investment and the assets that come with it. And indeed the fact that foreign direct investment has reached the levels it has reached
in 1999 is partly, but only partly, a result of a cross-border wave of mergers and acquisitions which is driving the growth of foreign direct investment.

LITTLEJOHNS: What were the main areas in which FDI was most prominent?

SAUVANT: Traditionally, foreign direct investment has been most prominent in natural resources but more recently, and in fact since the mid-1980’s, beginning of the ‘90s, the most important sector in which foreign direct investment expands is services. In fact, services foreign direct investment accounts for over half of foreign direct investment floats, followed then by manufacturing.

LITTLEJOHNS: What do you mean precisely by services?

SAUVANT: Services includes everything from trading to telecommunications to financial services. In fact, financial services and trading alone account for approximately 80 percent of foreign direct investment in the services sector.

LESSING: Mr. Sauvant, in the Report you draw a distinction between mergers and acquisitions on the one hand and something that you call "green fields investment". Can you tell us more about green fields investment?

SAUVANT: Green field investment is basically investment undertaken by a company that comes into a country, acquires a piece of land and then basically builds up a factory, a production facility, while a merger and acquisition is basically taking over an existing facility and then perhaps integrating it into the overall network of a particular transnational corporation. Now, we are normally speaking about mergers and acquisitions but if you look at the figures you see that perhaps only three percent of the total of mergers and acquisitions consists of mergers; the rest is acquisitions. And even those mergers which are called mergers are very often not real mergers but acquisitions by another name.

LESSING: When you see this huge growth – Michael was talking about it earlier – are some of these huge multinational companies – we know that their incomes and their whole structure are bigger than many countries in the world – are they in a sense becoming quasi-states?

SAUVANT: No. I think you certainly cannot speak about TNCs, or multinational corporations, as quasi-states. They lack all the attributes a state has, beginning with sovereignty. They are subject to the laws and regulations of the
countries in which they are operating. But of course because they operate by definition in more than one country obviously the question arises whether international rules in this particular area dealing with various aspects of the activities of transnational corporations may be required. And one of the areas where this has been coming up in a particularly important way, is precisely the question of competition law because mergers and acquisitions can be used for anti-competitive purposes or in any event could have as effect an anti-competitive effect. And since mergers and acquisitions involve by definition a cross-border context in various countries, the obvious question is what can you do at the international level in order to deal with this phenomenon.

LESSING: And what can you do?

SAUVANT: Well, there is an immediate response to that and that is cooperation at the bilateral level between merger authorities. And indeed, if you look some of the main countries involved in the merger and acquisition business so to speak, namely the United States and the European Union, you will see that between the two merger anti-trust authorities the cooperation has been actually quite active. But you also find some work now in the World Trade Organization where countries are examining the possibility whether a global approach to mergers and acquisition – or to competition policy I should say, it's more than mergers and acquisition – is required. It's certainly something which is cooking. In fact, you know in the World Investment Report, we’re drawing a little parallel. We looked at the United States at the end of the 19th century where you also had a tremendous merger and acquisition wave as a result of which, or in the framework of which, you actually saw the emergence of an integrated market and production system within the US and, as a complement to that, the emergence of a national market for companies. And in fact one of the results if you so wish, was the Sherman Anti-Trust Act which was the first step to emerge a control system at the national level of the United States. Now you can make, I think, the parallel that what you see today is the emergence of a global market for firms and the emergence of a global market for goods and services and the emergence of an international production system driven by multinational corporations. And the obvious question is do you need – and the Report certainly would suggest that we do need – a global approach to competition policy.

FREEMAN: Speaking of competition, the poor countries have been complaining for some time now about the need for a level playing field. From the
Report I see that the US took in roughly 30 percent of the total FDI, foreign investment, that went in to the US. All of the least developed countries combined took in about a half of one percent. Is the field tilting more and more?

**SAUVANT:** Well, it's quite clear that after several years during which the share of the developing countries in total foreign direct investment flows has been increasing, in '99 it dipped a bit. However, if you look at the amount that – in this case you mentioned the least developed – the 48 least developed countries received in terms of foreign direct investment as a percentage of let's say the total investment, then actually the figure is not that bad. In fact in many cases, in the least developed countries, foreign direct investment accounts for ten percent or more of total investment while in the United States and in other developed countries that share is not that high. So what you have is if you look at foreign direct investment flows and the distribution of foreign direct investment flows, in terms of absolute numbers you are right. Developing countries, and in particular the least developed countries, get very little but the little they receive is fairly important for the countries involved. And this, of course, is not to say that all of them want and need more investment in order to promote their development and that's precisely why each of them is competing in the world market for investment; for more foreign direct investment.

**LITTLEJOHNS:** Mr. Sauvant, this is a quite a tome this report of yours. Almost a coffee table book. Apart from the numbers that we've heard about and read in the document is there anything in it that breaks new ground would you say as the team leader? Can you tell us some of the elements which perhaps are new in this tenth anniversary edition?

**SAUVANT:** Well, I think this Report, as always, deals with the global figures, the growth of the international production system in its global scope as well as in its regional scope paying special attention of course to Latin America, Asia and Africa. And that is important because that is part of the globalizing world economy. In fact, I would argue the foreign direct investment networks established by multinational corporations are a productive core of the globalizing world economy and to document that and to pursue that is one task that the World Investment Report does. Now, this year, we looked particularly at the phenomenon of cross-border mergers and acquisitions. It's actually the first, if you wish, book-length examination of this
phenomena and we’re starting with documenting precisely that cross-border mergers and acquisitions actually only accounted for less than a hundred billion dollars in 1987 and in 1999 now account for about 720 billion. And indeed this is the basis of what we call a global market for firms, which is, I think, a fairly new phenomenon. It’s a global market in the sense that it includes not only the US and Europe but it also includes, increasingly, Japan and developing countries and countries of Central and Eastern Europe and that’s a new phenomenon. Now the obvious question then is what is driving the cross-border mergers and acquisition wave and that is one of the key issues which we are looking at in the Report. And then we are asking precisely the question from a developing country point of view: what difference in terms of development does it make if a foreign company comes in as a green field investment or through a merger and acquisition.

LITTLEJOHNS: So you have never done mergers and acquisitions before in this book?

SAUVANT: We have not analyzed them in terms of what are the driving forces and what is the impact on development compared to green field investment.

FREEMAN: In conventional economics isn’t it seen that a surge in mergers and acquisitions is sort of a final phase of a bull market?

LITTLEJOHNS: Before you answer that, this is World Chronicle. Our guest is Karl P. Sauvant, Chief of the Division on Investment Technology and Enterprise Development at UNCTAD.

SAUVANT: Well, in the past you had a certain co-relation, I think, between booms in mergers and acquisitions and the stock market but not necessarily always, number one. Number two, I think what we are seeing I would say, over the last 15 years or so, is a secular trend not only to more mergers in general and acquisitions in general, but also cross-border mergers and acquisitions. And I think that has something to do with the fact that we live in a globalizing world economy, that boundaries are being opened, that competition is everywhere now and that therefore companies feel, for a number of reasons, they have to merge, to have to acquire in order to remain competitive in this globalizing market.

LESSING: Could we look just for a moment – picking up on something Jack said about countries which are called developing countries and what a small percentage they’re getting of this foreign direct investment. If a country or a group of
countries in the developing world, particularly least developed countries, wish to get more foreign direct investment do you have advice for them what they should do?

SAUVANT: We have actually a whole part of our organization that provides advice to developing countries in all matters related to foreign direct investment. To answer that question you basically have to go back to what are the determinants for attracting foreign direct investment and we identify basically three sets of determinants. The first one is a regulatory framework. It’s quite obvious if you don’t allow foreign direct investment you will get very little so the regulatory framework has to be enabling. The second set of factors, and that in many ways is the most important one, are economic factors. Do you have a big market, a growing market, a market which has resources be it natural resources or, increasingly important, is human resources, technology. And the third set of factors concerns basically what we call business facilitation; that you have for instance an investment promotion agency that tries to look after foreign investors. Now among these three factors of course, the economic factors, while decisive, are the most difficult to influence and for least developed countries in particular, by definition, the economic factors are not very attractive. So a lot of countries focus their attention on having their regulatory framework right and having business facilitation right. And in fact UNCTAD then advises countries how this can be done, what is a state-of-the-art framework for foreign direct investment, not only to attract foreign direct investment, but also to see to it that the countries involved benefit from foreign direct investment as much as possible. Cause after all the issue is not just to attract but to make sure or to increase the likelihood that foreign direct investment contributes to development.

LESSING: I’m sorry, Jack, I just want to follow this just for a second. It may have been implied but nowhere do you mention a good and stable government.

SAUVANT: Oh, that’s right. We have not looked in this Report at the determinants. We had in the 1999 Report an extensive discussion of actually what is the impact of foreign direct investment on development and what are the conditions. Obviously, a stable government, a well functioning administration, sound macro-economic policies are all important pre-conditions which, at least if they are there, help to attract foreign direct investment. But the basic factor remains the economic
determinants. Even if a country does not necessarily have a most stable government, if the economics are right companies are likely to invest.

**FREEMAN:** I'd like to focus on the benefits of investment. Five years ago the international community agreed upon the goal of eradicating poverty over a period of years. To what extent do investment and/or mergers and acquisitions impact alleviating poverty in a poor country?

**SAUVANT:** Well, the link is between foreign direct investment and growth to the extent that investment in general, and foreign direct investment in particular, contribute to growth. I think you can make a convincing argument that you don't have growth without investment and in turn when this growth is being distributed within countries then it will help to alleviate poverty. So clearly, the focus, the role of foreign direct investment is in terms of contributing to growth. It has little to do with the distribution of whatever growth occurs. That is primarily the task of government. Now, as you ask how does the impact now differ between green field investment and mergers and acquisitions and that's a key, the key question, because most people would look at mergers and acquisitions as being merely a change in ownership and most obviously it does not immediately contribute to productive assets in the country. So for many people green field investment is good and mergers and acquisitions are neutral or even bad. And in fact mergers and acquisitions and cross-border mergers and acquisition as we know from daily newspaper reports are sort of one of the most visible faces of the globalizing world economy and there are lots of fears and lots of concerns not only in developing countries, but also in developed countries. So we have looked into this and our conclusion is that obviously a generalization which says green field investment is good and cross-border mergers and acquisitions are bad is much too simplistic. Much too simplistic. You can find, of course, that at the time of entry it is true that no new production capacity is being created. However - I'm just giving an example. However, if the alternative would have been that the company goes bankrupt, well that is something which is quite valuable for the country involved. And then in most cases cross-border mergers and acquisitions, like other investments, are followed by sequential investments, by investments down the line. Similarly, if you look at the undeniable effect which you have in most cases of mergers and acquisitions that employment is being reduced the question is again what is the counter-factual. The company would have gone bankrupt, would have also lost employment; in fact all
employment. On the other hand, if as a result of a merger and acquisition the company becomes internationally more competitive then eventually it will expand and create new employment. So the point is that if you look at mergers and acquisitions compared to green field investment I think you can say that under normal circumstances green field investment is more desirable than mergers and acquisitions. But under a number of circumstances mergers and acquisition certainly can make a contribution to economic growth and development as well.

LITTLEJOHNS: Mr. Sauvant, here in the United Nations as you know a great deal of attention is devoted to the problems of Africa. The Security Council has devoted many meetings to the subject and so has the General Assembly and various other UN bodies. Is Africa getting a piece of the pie in this FDI?

SAUVANT: Africa is getting a piece of the pie but it is a small piece of the pie. In terms of absolute figures it's around $10 billion which is divided between 53 countries on the continent and clearly, African countries are eager to attract more foreign direct investment. But I think one has to make an important qualification here and that is you have to differentiate. You cannot look at Africa as one continent. You have to look country by country. There are some countries that are actually doing much better than the average developing countries and there are other countries which of course are not doing well at all. So what our message is, and it is also the message which comes through in this Report, is that investors should not write off Africa. It should look at Africa. They should look country-by-country, industry-by-industry, project-by-project, investment opportunity by investment opportunity and they will find that on the aggregate, to return to the aggregate, foreign direct investment in Africa is more profitable actually than in most other regions in the world. So if you want to look for profitable investment opportunities don't write off Africa. Look at it and differentiate.

LESSING: One of the countries that you list in the Report in Africa as getting a lot of foreign direct investment is Angola. Now this is a country which is in governmental chaos. There's a civil war going on, it's been going on for a long time, what's the factor in Angola that makes it an attractive investment opportunity?
SAUVANT: One word: oil. Incidentally, it also shows that the political framework, the nature of the government, is not necessarily the determining factor. It's the economic factor that there is oil.

LITTLEJOHNS: Well there's another word: diamonds.

SAUVANT: Yes.

LITTLEJOHNS: What's the situation there with diamonds?

SAUVANT: I don't know to what extent multinationals are involved in diamonds exploration, at least in West Africa, but in oil it's quite clear that international oil companies have invested in Angola and in other places.

FREEMAN: The Report mentions — it says and I quote, "predatory conduct that is by foreign firms remains a significant risk" unquote. What can be done about that risk?

SAUVANT: I think this goes back to the broader picture that we are in a world economy where we are liberalizing trade and investment laws. And that means that actually governments have fewer instruments to deal with multinational corporations. The other side of the coin is that one has to be particularly careful that now the regulatory barriers to trade and investment are not being replaced by restrictive business practices of transnational corporations. In fact, within the UN system there is a code, a set of principles dealing with restrictive business practices, and when we spoke earlier about the need for having an international approach to competition policy and it's precisely one of the issues. One of the issues is cross-border mergers and acquisition but another key issue is precisely to deal with any anti-competitive practices of firms and this becomes an increasingly important challenge as you can see from various cases which are being pursued in the United States and in Europe.

LITTLEJOHNS: We have only about a minute left, would anti-competitive practices include bribery and corruption?

SAUVANT: Well, the issue of bribery and corruption is certainly an issue that is receiving a lot of attention not only in the UN system but elsewhere. It is a factor that influences or that can influence investment decisions. There is now an OECD — a convention of the developed countries dealing with bribery and corruption and efforts are being made to see that indeed as many countries as possible join that particular convention.
LITTLEJOHNS: But at the moment at lot of countries presumably require bribery in order to open their doors, don’t they?

SAUVANT: Probably you will find bribery and illicit payments in one hundred percent out of the members of the United Nations.

LITTLEJOHNS: 100 percent?

SAUVANT: Yeah. I’m willing to bet that in each country you’ll find cases of bribery. Of course of various scale.

LITTLEJOHNS: Mr. Sauvant, that’s all the time we have. Thank you for being with us on this edition of World Chronicle.

Our guest has been Karl P. Sauvant, Chief of the Division on Investment, Technology and Enterprise Development at UNCTAD. He was interviewed by Judy Lessing of Radio New Zealand and Jack Freeman from The Earth Times.

I'm Michael Littlejohns. Thank you for joining us. We invite you to be with us for the next edition of World Chronicle.

ANNOUNCER: Transcripts of the programme may be obtained free of charge by sending a stamped, self-addressed envelope to World Chronicle, United Nations, Room S-827L, New York, N.Y., 10017.

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