# CHAPTER 1: INTRODUCTION

## 1.1 Overview and Background of the study

Economic crisis raises major concerns about the future of the economic outlook of international investment. The impact of economic crises in one part of the world and the interrelation between nations brought a concern on how trade and investments reacts. Financial crisis and tough economic periods offer opportunities to buy assets at bargain prices and take advantage of large scale consideration in some industries. During times of economic crisis, risk is high, therefore firms may strive to diversify and spread risks. Mergers and acquisitions (M&A) can be a preferred alternative for the companies facing financial difficulties. An organisation has different choices when it comes to coping strategies. Continuing operations and growth are important for any company, including those that are individually owned, listed or multinational.

Many organizations across the world have considered M&A strategies during hard times as opposed to green field or organic growth strategies. It is known, also, that mergers and acquisitions are a globally well-liked form of business investment, often representing huge resources reallocation in the economy. M&A activities they enable corporations to expand operations through buying or merging to become increasingly more integrated, a process commonly referred to as globalisation (PricewaterhouseCoopers, 2004).

The 2007 economic crisis originated in the United States and Europe and then spread to both developing and emerging market countries. Because of globalization, liberalization of economic policies and privatization in most of the developed and emerging countries, this crisis not only affected the developed countries but also their counterparts in developing and emerging countries as a result of the interrelationships and dependability of global investments. For example, the international financials system was shocked by the Lehman Brother bankruptcy which was followed by other bankruptcies and takeovers of USA and European financial institutions. Consequently, many economies in developed countries and emerging countries fell into recession.

The 2007 economic crisis started when low income home owners in huge numbers, particularly in the United States, ceased paying their mortgages and pushed many lenders in the financial services industry toward insolvency. This was exacerbated by the securitization or mortgages and mortgage derivatives that were distributed widely across the world. The sharp fall in housing prices and subsequent banking crisis was the major root of the 2007 European-American economic crisis as well as these countries' recessions. As the United States economy contracted sharply, its impact moved across export-dependent economies such as emerging Asian economies which, as a consequence, began to experience a contraction in investment (Mahani, et al 2009).

Most of the studies conducted in recent years, found that the volume of the cross-border mergers and acquisitions (CBMA) activities increased dramatically year by year between both developed and emerging countries.

1. A study done by Evenett, (2003), revealed that CBMA of the late 1990's were at least five times larger than those in the 1980's. Furthermore, a recent study by Erel et al (2009), posits that, about one-third of current M&A deals are cross-border. A study done by Accenture (2009) revealed that 58% of surveyed respondents reported their latest acquisitions as cross-border. The current trends show that while the CBMA deals are still dominated by developed markets, emerging markets acquirers have played an important role in recent cross-border deals. While the impact of the 2007 economic crisis has been noted in the developed countries, its impact on emerging markets and developing countries is an ongoing debate among investors and stakeholders.

2. According to the Kearney (2009), cross border M&A estimated for the period from 2002-2007 in emerging market firms grew at an annual rate of 26%, compared to a 6% global rate. The report showed that, global market cross-border M&A decreased by 38 % in the year 2008, while concurrently the figure on acquisition deals increased by 29 % in emerging market in the year 2007.

3. A study by Burksaitiene (2010) revealed that, in 2008 the value of cross-border M&A sales of developed country companies fell by 39%, approximately from their 2006 level. The number of such M&A deals fell by 13% as the financial and economic crisis had a diminishing

effect on cross-border M&A activity. The report further explains that, data for 2009 showed a continuing downward trend with numbers of M&A deals falling sharply as banks avoided financing such transactions in a prevailing landscape of high and rising risk. In addition to lack of finance, the report revealed that the decline in the value of M&A transactions was driven by a sharp stock pricing falls in developed countries' stock markets as stock market indices plunged. The decrease in the total cross-border M&A has had a significant impact on the FDI flows, as they are strongly correlated with the value of cross-border M&A transactions. A significant outcome of the crisis is that a number of large privatization projects were terminated (Burksaitiene 2010).

4. Beginning in 2010, the trend seems to have reversed. A Thomson Reuters report in the first quarter of 2010, found that M&A activities in emerging markets doubled to reach USD183 billion when compared to the same period in 2009. The report exposed that largest deals were in the Mexican telecom sector which offered USD 27.4 billion to acquire Carso Global Telecom, followed by the Indian telecom Bharati Airtel which offered USD 10.7 billion to purchase Zain Africa from Kuwait- based Zain Group.

5. As much as 45% of the acquisitions in recent years have been made across country borders (a firm headquartered in one country acquiring a firm headquartered in another country) (Schmidt, 2002). A study

done by Aybar and Ficici (2009) indicated that, on average, cross-border expansions of emerging market multinationals (EMMs) through acquisitions do not create value, and result in value destruction for more than half of the transactions analyzed. The financial crisis had a discouraging impact on M&A in developed countries because of the increasing uncertainty in macro-economic performance that resulted from the crisis and its aftermath (Urata, 1999).

6. In fact, real world data indicate that the negative effect of the financial crisis on the M&A activities and FDI inflows in developed countries is strong. Despite the fact that global FDI inflows rose by 30% to USD1,833 billion in 2007, FDI decreased in developed countries during the crisis because of a climate of increased uncertainty. In other words, the global financial crisis had a limited impact on FDI flows in 2007 but began to bite in 2008 (UNCTAD 2008). Based on available FDI data, UNCTAD estimated that the global FDI flows for the whole of 2008 were expected to be about USD1,600 billion, representing a 10% decline from 2007.

7. A United Nations survey (UNCTAD, 2008) on global investment prospects showed that the current financial crisis and economic downturn are making corporations more cautious about future foreign investment. According to the survey's results, only 21% of the companies anticipated a large increase in their FDI expenditures over the next three years, compared to 32% in 2007. The situation

indicated that the impact of the global financial crisis on FDI and M&A started to become clearer. Moreover, both inflows to and outflows from developed-country economies may have declined because of the financial crisis (UNCTAD, 2008).

8. A study by Faisal and Glaister (2008) concluded that economic recession or booms can affect the level of growth trend of global mergers and acquisitions activities and its regional focus. The report further posited that industrial characteristics such as growth prospects, favourable government policies and competition are a strong influence on cross-border mergers and acquisitions transactions. The report also explained that Slow growth, over-capacity and increased competition in global markets typically drive industrial restructuring and often make mergers and acquisitions preferable to Greenfield investments

## 1.2 Research problems

South East Asian countries have passed through different financial situation since 1996. Various financial trends have different impact along business cycles. The increase in cross border M&A activities globally is an indication that, due to globalization, countries are becoming more integrated. The PricewaterhouseCoopers (2004) report revealed that CBMA activities were getting more popular as they enable firms to expand and reach the global market in short time of period.

A study done by Urata (1999) in respect of impact of the 1997 Asia financial crisis explained that the financial crisis had a negative impact on foreign investment because of increasing uncertainty in macro economic performance that resulted from crisis and its aftermath. UNCTAD (2008) report on global investment commented that the financial crisis and economic downturn makes corporation more cautious about future investment.

The number of high value M&A deals cut down sharply during the first semester of 2009 as banks hesitated to finance such transactions in the prevailing climate of high and rising risk. To a large extent, in addition to lack of finance, the decline in the value of M&A transactions has been driven by a sharp fall in stock prices in developed countries' stock markets, where stock market indices plunged, on average by more than 40% in 2008 (Burksaitiene 2010). The financial crisis has also made both equity and debt financing of M&A transactions more difficult and expensive. Leveraged buyouts, which generally involve private equity funds or hedge funds, which were among the main drivers of the previous M&A boom, were deeply hurt by the crisis. As a result, financing for large leveraged buyouts became hard to find, (Burksaitiene 2010).

The 2010 World Investment Report revealed a slump in cross-border M&A accounts for most of the FDI decline in 2009. The report noted that mergers and acquisitions are usually more sensitive to financial conditions than "Greenfield projects," which it defined as investment in a market where no existing previous facilities. This is due to the unpredictable price signals which in most cases mergers and acquisitions depend on, and also to the different between the investment life cycle of Greenfield and that of mergers and acquisitions.

The original impact of the 2007 economic crisis may be different from that of 1997. The 1997 economic crisis originated from developing Asian countries, and it had negative influence to the economic as well as FDI and M&A in the region. The 2007 crisis began in the Unites States and Europe and it rapidly extended to developing and emerging economies. The effects of crisis on the developed countries have been directly seen, whereas the effects of the economic crisis in developed country to the emerging markets as well as developing economies have so far been indirect with different stages of impact.

### 1.3 Research Questions

Many studies revealed that during the 1997 crisis, which affected many Asian countries, M&A activities showed a positive trend. With the economic connections between emerging markets and developed countries, the situation is too ambiguous to suggest a conclusion regarding the investment situation and particularly cross-border M&A activities in emerging countries in the current economic crisis. The situation raises questions in relation to the situation in emerging market countries during the developed countries financial crisis. Some of questions ask; will the same trends emerge as in the 1997? How and to what extent has the financial crisis in developed countries affected cross-border M&A activities in emerging markets countries? The purpose of this study therefore, is to suggest answers to the following important questions:

1. What was the major cross-border M&A trends noticed in selected emerging market countries (Indonesia, Malaysia, Philippines, and Thailand) leading up to the 2007 economic crisis?
2. What was the impact of the 2007 financial crisis and economic downturn on these trends?

## 1.4 Research Objectives

The study has two main objectives:

1. To analyse major trends of cross-border M&A activities in selected emerging markets (Indonesia, Malaysia, Philippines, and Thailand) leading up to the 2007 economic crisis and
2. To examine the impacts of the 2007 financial crisis and economic downturn on these trends.

## 1.5 Significance of the Study

There have been a significant number of studies that examined cross-border M&A activities during the 2007 economic crisis in developed countries. A few studies have identified the trend in emerging markets. There seems to be a connection between developed countries and emerging countries from an economic perspective. This study aims to contribute to the body of knowledge regarding M&A trends in our four study countries, Indonesia, Malaysia, Philippines, and Thailand, and thus guide business people and decision makers during the economic downturns which are inevitable in a globalized, privatized economy and competitive world.

M&A is one of the most important means by which companies respond to changing conditions (Bruner, 2004). A company can be involved in two forms of growth; internal and external. Internal growth can be slow and ineffective if a firm is seeking an opportunity in short term advantages over its competitors (Gaughan, 2001). Economic crisis brings about uncertain situations in investments. Decisions on what to do at a particular time need insight and may require high risk-taking tolerance once investors decide to take a diversification strategy through mergers and acquisitions, either to expand their investments or to shore up existing investments.

UNCTAD (2000) revealed that, the most significant challenge for cross-border mergers and acquisitions is in effecting longer term reforms through 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. Under the circumstances, foreign direct investment, in the form of cross-border mergers and acquisitions, has a significant role.

### 1.6 Scope of the Study

This study covers four emerging markets located in Asian countries namely, Indonesia, Malaysia, Philippines and Thailand. These four countries were selected because of geographical location, level economic development and previous economic history. They are categorized as emerging countries in South East Asia, members of ASEAN and were highly affected by the 1997 economic crisis.

Data on M&A were obtained from different research engines, such as Bloomberg, Bursa Malaysia, PriceWaterhouseCoopers and UNCTAD World Investment Reports. The study employs statistical descriptive-study methodology to explore the trends of the announcements, deals and value of acquiring firms. The date for deal is set to be the date of the announcement of the respective cross-border M&A activities.

The cross-border M&A activities information of this study were obtained from various issues of the World Investment Report published by UNCTAD annually. It provides a list of the top emerging market and transition economy transnational corporations. Also, data for internal and external numbers of cross-border M&A activities for the period 2000–2010 were extracted from the countries security market data, Bloomberg data base, and UNCTAD's. Information on M&A transactions value were extracted from Bloomberg data base, security market information on the respective countries and UNCTAD's World Investment Report. Announcement dates, name of target country, name of acquired country, name of seller country, acquiring financial advisor and type and status of deals were captured from the Bloomberg data base. Other information related to economic development was obtained from the CIA world fact book.

### 1.7 Organization of the study

This report consists of five chapters. Chapter 1, Introduction of the study covers the first chapter together with the background information on cross-border M&A activities, the definition of the research problem and the purpose of the study. The chapter also presents the significance of the study. Finally, the organization of the report is discussed to give an overview of the thesis structure to the reader.

Chapter 2 covers the literature overview to gain knowledge from previous research in the M&A, economic crisis in emerging markets, cross-border M&A and foreign direct investment. The chapter starts with the overview of cross-border mergers and acquisitions. It also explains the motivation of the companies that employ M&A for their expansion and development. An overview of foreign direct investment also is discussed in this section. Finally, the literature review discusses the relationship between economic crisis and mergers and acquisitions.

Research methodology is discussed in Chapter 3. The chapter reviews the major research methods employed in this study. It starts with a review of research questions and objectives developed to assess the trend relationship between the economic crisis and the cross-border M&A. Data collections, summarizing and analysis is discussed in this chapter.

Chapter 4 presents the research results and discusses the findings of this study. The final chapter presents the conclusion of this research. First, it shows an overview of the study, thereafter summarizing the research results and the review of research objectives. The chapter ends with further research suggestion.