IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS

DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

ISSUES PAPER (DITEG) #4

DIRECT INVESTMENT: TRANSACTIONS ASSOCIATED WITH MERGERS AND ACQUISITIONS

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Direct investment flows have been very heavily influenced by large international mergers and acquisitions in recent years. For example in the year 2000 in Canada, the net change from transactions associated with cross border mergers and acquisitions accounted for 70% of Canadian Direct Investment Abroad and 65% of Foreign Direct Investment in Canada. While 2000 had by far the largest contribution, the averages over the last 10 years were 30% and 33% respectively.

The size of merger and acquisition activity led to the compilation of separate data on the impact of these transactions so that direct investment data are presented separately for these one time transactions. The press release for the Canadian Balance of Payments regularly refers to these data in explaining direct investment flows. These references are very often picked up and expanded on by the economic press and other analysts in their own analytical and interpretative articles.

Most of the value of M&As are in a small number of large transactions. The importance of these transactions to the overall quality of the data, for direct investment and other classes of investment, requires special operational attention. As such, the development of a separate class for merger and acquisition data can be seen as benefiting analysis and also acting as a quality assurance measure.

Note that by definition the net change from merger and acquisition transactions and net change from reinvested earning would be mutually exclusive. Taking these two 'of which' classes out of total net change in direct investment from transactions would leave an 'Other' class that would comprise primarily the net change from the infusion and withdrawal of direct investment capital from direct investment enterprises.

These infusions and withdrawals cover many different types of transactions. Some of which are the basis for other topics of discussion such as round tripping, extensions of capital and the treatment of flows through SPEs.

I. Current international standards for the statistical treatment of the issue

The OECD *Benchmark Definition of Foreign Direct Investment (Benchmark Definition)* and the IMF's *Balance of Payments Manual* do not provide for the separate delineation of flows associated with merger and acquisition activity from other direct investment flows.

II. Concerns/shortcomings of the current treatment

The nature of the transactions associated with mergers and acquisitions are quite different from other direct investment transactions. In general these transactions do not provide any new financing for the firms involved but rather represent a realignment of the portfolios of investors. The resulting firm may benefit in a number of ways from the merger or acquisition but the initial transactions are generally associated with changes in ownership of assets only.

Current classification does not call for these very large and specialized transactions to be isolated from other transactions for analysis.

Some countries as such as Canada provide information on the values of FDI that are associated with mergers and acquisitions. However, as there is no guidance in the manuals on this issue, the definition and coverage of these data across countries is likely inconsistent. For a discussion of definitions of mergers and acquisitions please refer to the note by the OECD.

While the documentation on what is included in the merger and acquisition series in Canada is incomplete, in practice the series would include examples of all of the cases defined in the Annex to the OECD issues note on this subject. On the inward investment, any transaction that would qualify as a direct investment flow and resulted form merger and acquisition activity would be included. For outward direct investment, the merger and acquisition series are based on the ultimate destination of the investment activity. That is, in cases where a Canadian resident company channeled funds through a special purpose entity in country B on route to acquire a company in Country C, this would be included in the direct investment data under the merger and acquisition sub-heading.

Another case of interest is that where a wholly owned Canadian subsidiary of a direct investor is used as the conduit by its parent to acquire a firm in a third country. In such cases it is often the case that the parent will provide all or part of the capital needed to acquire the third party. In this case, however, as there was already a direct investment relationship between the parent and the Canadian subsidiary, the capital moving from the parent to the subsidiary would not be considered an M&A investment. The outflow to the third country to acquire the target company would be included in our M&A data.

In addition, there are private commercial data sources such as Dealogic that report on values of mergers and acquisitions. These are not directly associated with the balance of payments data or foreign direct investment data and often have much broader definitions and coverage. These data may include the total value of assets of the firm or firms involved which may be quite different from the cross border flows that are considered for direct investment and the balance of payments.

III. Possible alternative treatments

There seem to be two options, first to add an 'of which mergers and acquisitions' split as part of the standard direct investment presentation for asset and liabilities and secondly to have this as supplemental information. While the first option would encourage the most uniformity across countries, there may be few mergers and acquisition in smaller countries in any given time period and thus confidentiality considerations may often result in suppression.

In the case of the Canadian data on mergers and acquisition, confidentiality concerns are one reason that only aggregate data have been released. There has been no release of data by country or industry.

The provision of supplemental classes for mergers and acquisitions would allow the provision of guidance on the standard definition and treatment while allowing countries to determine the analytical relevance for their own situation.

Possibly a third option would be to have the OECD adopt the mergers and acquisitions class as a required element in the Benchmark Definition but the IMF include it as supplemental information. Since the definition of the merger and acquisition component does not affect the overall definition of direct investment, this would allow for a common definition of FDI and M&As while not forcing smaller IMF members to provide these data.

IV. Points for discussion

1. *Do DITEG members fell that guidance should be provided on the creation of an 'of which mergers and acquisitions' class should be added to the OECD Benchmark Definition and the IMF's Balance of Payments Manual?*

2. *If DITEG members consider that an 'of which mergers and acquisitions' class should added should it be a supplementary classification or an additional breakdown in the official classification?*

3. *Do DITEG members have comments on cases raises in the Canadian context?*