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Workshop on International Investment Statistics

Draft OECD Benchmark Definition of Foreign Direct Investment, 4th edition

PRELIMINARY PROPOSALS TO IDENTIFY CROSS-BORDER MERGERS AND ACQUISITIONS AS A PART OF FDI STATISTICS

By the OECD Benchmark Advisory Group

Proposals included in this document should be considered as work in progress but not as final recommendations.

OECD Workshop on International Investment Statistics is invited to review revised proposals at its next meeting to be held in March 2007.

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Boxes

SEGREGATING MERGERS AND ACQUISITIONS (M&A) AS A BREAKDOWN OF FDI STATISTICS: PRELIMINARY PROPOSALS

1. Background

1. The first edition of the OECD publication *International Investment Perspectives* (2002) included an article on trends and recent developments in foreign direct investment (FDI). The article was mostly based on the statistics compiled by the Investment Division from OECD member countries. In addition, the article included detailed information on cross-border M&As from a private data source. The Secretariat received a number of comments from member countries indicating that including in the same article the two types of data (FDI statistics and M&As from private sources) which use different methodologies could be misleading, in particular when detailed information by source and destination is provided.

2. While cross-border M&As represented a very large share of FDI, lack of compatible data prohibited an in depth comparative analysis of FDI by type. One could only draw rough conclusions due to methodological differences in these data sets.

3. The impact of FDI in the host economy would differ depending on the type of FDI. In other words, the economic impact of cross-border investments in the form of M&As as opposed to an altogether new establishment (greenfield investments) is very likely to be quite different. In between these two types of investments is also a third one which is the extension of capital e.g. by issuance of new shares which in turn could be acquired by non-resident investors and qualify as FDI (if they meet the overall criteria).

4. Given the growing number of cross-border M&As as well as the size of individual deals, users have expressed the need for statistics broken down by different types of FDI and by partner country and by economic activity. M&A breakdown in the context of FDI would promote international comparability and should be viewed as a trademark for a growing number of users. Moreover, by “type” for FDI data and those on the Activities of Multinational Enterprises would potentially provide interesting analytical information.

5. The Secretariat organised an informal meeting in 2003 between FDI experts and a private data source which disseminate M&A information. It also became clear that a few OECD countries already compiled such statistics as a part of their FDI statistics. Nevertheless, each country followed a “national” methodology, differing from each other while agreed definitions and concepts were not available.

6. Following from the requests of users, it was agreed that there is a need to include methodological standards in the *Benchmark Definition* to guide national compilers to identify FDI by type, M&As, greenfield investments, and extension of capital. To that end, these items were included in the joint IMF/OECD list of DITEG issues for review.

Box 1. Recommendations of IMF/OECD Direct Investment Technical Expert Group (DITEG)

(i) The group agreed that classifying the statistics by type of FDI responds to user requirements keeping in mind that the analytical interpretation of FDI differs depending on the type of investment. Three possible breakdowns discussed were:

(a) Cross-border mergers and acquisitions (CM&A);

(b) Greenfield investments;

(c) Extension of capital.

(ii) The group agreed that such breakdowns:

(a) be recommended as supplemental items (on a voluntary basis);

(b) be limited only to two categories (a) CM&As and (b) Other, which would include greenfield investment and the extension of capital;

(c) be limited solely to the financial accounts, namely to FDI equity capital and other capital flows (but not to FDI income or FDI positions);

(d) also provide data by (a) partner country; and (b) industry within the limits of confidentiality concerns.

(iii) The group raised the confidentiality issues and considered the possibility of disseminating data separately for inflows and outflows or as net flows. The group did not take a firm decision.

(iv) The group acknowledged the need for developing the underlying concepts and definitions and recommended firmly that this fundamental work should be conducted.

(v) The group also considered the need for harmonising the statistical recording of different types of transactions which may be involved in CM&A operations with special focus on the recording of purchases by exchange of securities.

Box 2. Deliberation of OECD Workshop on International Investment Statistics (WIIS)

In April 2005:

(1) WIIS agreed to incorporate new breakdowns by type of FDI as supplemental items in the *Benchmark Definition*. WIIS recommended basic concepts and definitions and the methods for recording different elements of financing M&A operations be developed and harmonised.

(2) WIIS recommended that:

(a) the breakdowns relate to (1) mergers & acquisitions and (2) other types of FDI (which would include greenfield investments and extensions of capital);

(b) the breakdown relates to financial accounts only (FDI equity capital and other capital);

(c) that the information be provided (a) by partner country and (b) by industry classification, taking into account confidentiality problems which may arise;

(d) Inflows and outflows be reported either separately or as net flows. It was even suggested that inflows and outflows should be reported separately for assets and liabilities;

(3) WIIS recommended that developmental work of the Benchmark Advisory Group be further reviewed/discussed by the WIIS (this would have to be by electronic means, given the timetable).

In April 2006:

WIIS was given a presentation by Japan on a possible future methodology to segregate M&A and other type of FDI. The group did not discuss the proposal. On the other hand, WIIS decided that a project group would work on the proposal and present a second draft in October 2006. The work will be completed in 2007, on time to incorporate the results in the *Benchmark Definition,* to be finalised by end-2007.

Developmental work to date:

The initial proposal was further refined by the PG on M&As. The proposal benefited from the input by the PG-M&A members and Japan took the lead in preparing the present document.

Box 3. Methodological differences of M&A data compiled by commercial sources

To draw the attention of the reader to avoid the misuse or misinterpretation of M&A data based on different sources. Main differences between official FDI statistics and M&A statistics of commercial sources are:

- the purpose of data collection is different, hence different methodologies;
- the coverage of the value reported;
- data coverage;
- time of recording;
- net recording.

The following comparative table shows as an example direct investment M&A of Canada, compiled by Statistics Canada and cross-border M&As of Canada compiled by M&A Global Database of Dealogic (a global investment banking analysis company).

Inflows of M.& A. for Canada

Billion of Canadian $

	1998	1999	2000	2001
Statistics Canada (Catalogue #67-001)	17.4	21.0	65.4	24.6
Dealogic	27.3	46.9	208.9	78.9

Outflows of M.& A. for Canada

Billion of Canadian $

	1998	1999	2000	2001
Statistics Canada (Catalogue #67-001)	32.2	4.5	42.9	24.2
Dealogic	59.9	24.4	63.0	46.5

These two tables show drastically different M&A data for both inflows and outflows. The most extreme case is in the year 2000 where M.&A. inflows reported by Dealogic, greatly overstates Statistics Canada published numbers, at around $65 billion (Canadian $).

2. For the consideration of WIIS

7. The present document represents work in progress and should by no means be considered as a firm proposal.[1] It elaborates a proposal for data collection but does not, for the time being focus on data presentation and dissemination. These latter aspects will be further developed as the conceptual issues are concluded and presented to WIIS at its next meeting in March 2007.

8. Points for discussion:

(1) *Delegates are invited to review the proposed methodology in detail and provide comments and guidance.*

(2) *The proposal classifies not only first time investments but also subsequent investment into M&A and others investments. Delegates are invited to comment on this approach.*

(3) WIIS deliberation provides guidance on the presentation of the data:

- Total FDI equity capital + other capital.

  Of which: M&As

All data (*total* and *of which*) will be presented (a) by partner country and (b) by economic activity.

This recommendation by WIIS raises concerns for consistency regarding the basis used for data series:

(a) Total FDI equity capital + other capital are on an immediate counterparty basis. Therefore both the geographic allocation and the economic activity will be attributed according to immediate (1^{st} level) counterpart.

(b) *Of which* M&As will be according to ultimate host/investing country.

Delegates are invited to express their views on the discrepancy between the two data sets and possibly review of the WIIS deliberation of April 2005.

(4) The current proposal covers only "equity capital" but does not relate to "other capital" which was included in the deliberation of WIIS. *Delegates are invited to review their deliberation whether "other capital" should also be included in the category: "of which M&As"? If yes, what would be the value-added of such a classification from an analytical point of view?*

(5) *Delegates are invited to clarify*

(a) Whether M&A statistic should, in line with FDI methodology, cover cross-border transactions above 10 per cent qualifying as FDI or should M&A statistics apply only to transactions which correspond to more than 50 per cent ownership of the voting power, i.e. control?

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1. This proposal benefited from the contributions of the M&A PG and was prepared under the leadership of Japan.

(b) *If consistency between FDI and M&A statistics is recommended, should the presentation of data include a further breakdown of the data by "control" providing data series which can, potentially, be used with statistics on the activities of multinational enterprises (ANME's statistics)?*

(6) The proposal includes a new type of FDI which was not initially included in the WIIS deliberation. It is investment for financial restructuring, which results in the increase of equity capital and the decrease of borrowings. *Should the classification of M&A and others could be further broken down into the Greenfield investment and the investment for financial restructuring rather than (i) M&As, (ii) extension of capital and (iii) greenfield investment?*

(7) *Delegates are invited to review Annex 1 and provide comments on the outline which is intended as the basis for incorporating these new concepts in the Benchmark Definition. It is also intended to include numerical examples in the Annex of the Benchamrk Definition devoted to M&As. Suggestions on the type of examples are most welcome.*

3. FDI by type: Proposal under development for the Benchmark Definition, 4th edition

3.1 Coverage and definition of M&A and other types of FDI

9. ***M&As*** *relate to a type of FDI whereby there are changes in the ownership by the direct investor of the equity capital of 10 per cent or more of the direct investment enterprise*. In other words, M&As include both changes to (i) significant influence (purchase/sales of shares in the range from 10 per cent to 50 per cent); and (ii) controlling ownership (purchase/sales of shares of more than 50 per cent.)

10. ***Other types of FDI*** (other than M&As) *are those that accompany changes in the level of equity capital*. They include Greenfield investments (*ex nihilo* investments), extension of capital. Investment for financial restructuring or investments in corporate type mutual funds may (or not) be considered as a type of FDI [still to be debated]. Extension of capital accompanies increases of total assets of direct investment enterprises, and therefore, the levels of production and employment of direct investment enterprises change. Investment for financial restructuring does not accompany increases of total assets of direct investment enterprises as invested capital is used for debt repayment or loss reduction.

3.2 Types of business combinations to be considered as cross-border M&As qualifying as FDI[2]

11. A ***merger*** is referred 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.

12. In business, there are three types of merger: statutory mergers, subsidiary merger and consolidation.

(i) ***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.

(ii) ***Subsidiary merger*** relates to an operation where the acquired company will become a subsidiary of the parent company. In a reverse subsidiary merger, a subsidiary of the acquiring company will be merged into the target company.

(iii) ***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.

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2. Types of business combinations to be excluded from cross-border M&As qualifying as FDI.

Strategic alliance is an arrangement under which two or more firms co-operate with a view to achieving commercial objectives. As an alternative to M&As failures, companies have explored other business combinations. However, the objectives of strategic alliance and M&As are different. Strategic alliance is not the outright acquisition and its form can vary between simple agreements between firms up to the creation of separate and legal entities.

Joint venture is a well know form of strategic alliance which involves two or more companies with legally distinct structures investing in an entity and, consequently, participating in its management. Motivations for such alliances are cost reductions, sharing technology, product developments, market access or access to capital.

Consolidation relates to an operation where the combining firms have similar sizes while mergers generally imply significant differences**.**

13. Based on the motivation of investors, mergers are usually referred to as *horizontal, vertical* or *conglomerate* mergers:

(i) ***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.

(ii) ***Vertical merger*** is the combination of two companies with complementary activities such 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).

(iii) ***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).

14. An ***acquisition*** is a transaction between unrelated 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.

15. ***Divestment*** 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:

(i) ***Corporate sell-off***: in most cases buyers are other companies.

(ii) ***Corporate spin-offs****:* 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.

(iii) ***Equity carve-out*** is a partial divestment; it is similar to corporate-spin off but the parent retains the majority control. This form has the advantage of raising cash for the divestor.

(iv) ***Management buy-outs (MBO) and buy-ins (MBI)****:* Sometimes 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.

16. Other types are:

(i) ***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.

(ii) ***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.

3.3 Practical classification method to present FDI statistics by information on the ultimate investee enterprises

17. To produce a simple and objective criterion for presenting FDI statistics by information on the ultimate investee enterprises, it would be precise to focus on investments related to tangible expansion of enterprises as following (see Chart 1):

(i) It is inquired whether a case is a first-time investment by the direct investor in the direct investment enterprise. By obtaining the answer to this question, the investment is classified into initial investment if the answer is yes, and into additional investment if the answer is no.

(ii) It is inquired whether the invested capital is used for the acquisition of shares newly or already issued by an existing ultimate investee enterprise. By obtaining the answer to this question, initial investment is classified into "Initial M&A-type investment" (acquisition of already-issued shares) if the answer is yes, and into "Initial Greenfield-type investment" (acquisition of newly-issued shares) if the answer is no.

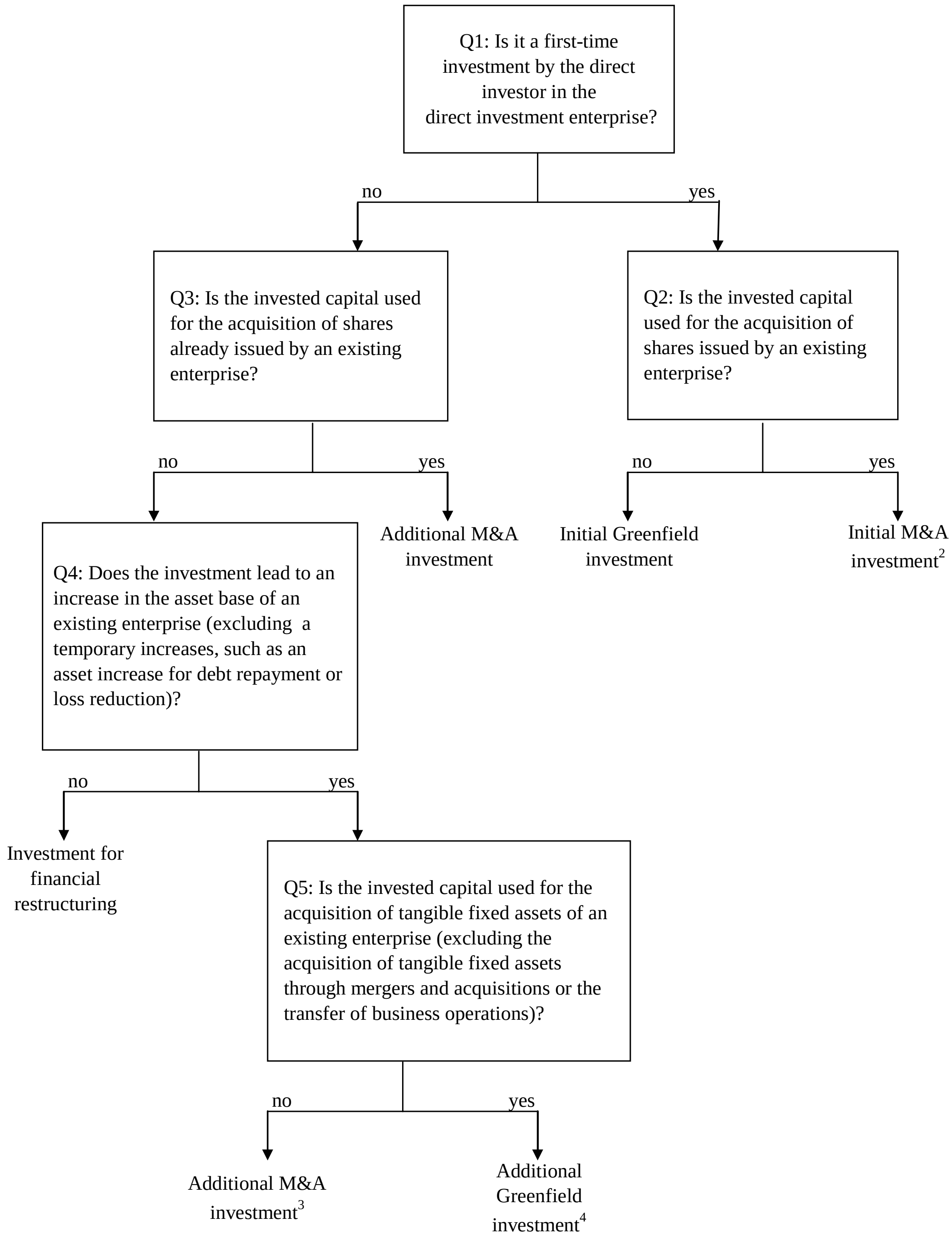
(iii) It is inquired whether the invested capital is used for acquisition of shares already issued by an existing ultimate investee enterprise. By obtaining the answer to this question, additional investment is classified into "Additional M&A-type investment" (acquisition of already-issued shares), if the answer is yes, and into other types of investment if the answer is no.

(iv) It is inquired whether the investment leads to an increase in the asset base (total assets) of an ultimate investee enterprise. By obtaining the answer to this question, other types of investment is classified into "Investment for financial restructuring" (investment that does not increase the total assets, e.g., an asset increase for debt repayment or loss reduction) if the answer is no, and into other types of investment if the answer is yes.

(v) It is inquired whether the invested capital is used for acquisition of tangible fixed assets of an ultimate investee enterprise. By obtaining the answer to this question, other types of investment is classified into "Additional Greenfield-type investment" if the answer is yes, and into "Additional M&A-type investment" if the answer is no.

18. As a result, most FDI fall into five categories (see Chart 2). The term "Greenfield" is usually used in describing initial investments. Thus, using a terminology, such as "Organic growth investment" for "Additional Greenfield-type investment" would be user-friendly.

Chart 1: Flow chart to classify FDI by types of operations



Notes: 1. These definitions assume that the target enterprise is the ultimate investee enterprise.
2. Investment for financial restructuring could be included.
3. Investment for the acquisitions of existing software is included. Investment related to an capital increase for producing new software (through the acquisition of non-tangible fixed assets) could be also included.
4. Investment for the acquisition of tangible fixed assets for producing new software could be included.

Chart 2: Examples of Transactions

FDI – Equity capital				
	of which:			
		M&A		
			Initial M&A investment	– An investor (country A) initially acquires shares already issued by a target company (country B) from other shareholders. – An investor (country A) establishes a subsidiary holding company (country B) to initially acquire shares already issued by a target company (country C) from other shareholders.
			(Additional) M&A investment	– An investor (country A) acquires shares already issued by a target company (country B) from other shareholders to increase its percentage of ownership. – An investor (country A) subscribes for shares newly issued by an existing subsidiary holding company (country B) to acquire shares already issued by a target company (country C) from other shareholders to increase its percentage of ownership through a subsidiary holding company.
		Other types of FDI		
			Greenfield investment	– An investor (country A) established a subsidiary company (country B). – An investor (country A) established a subsidiary holding company (country B) to establish a sub-subsidiary company (country C).
			Extension of Capital for the organic growth	– An investor (country A) subscribes for shares newly issued by an existing subsidiary company (country B) for expanding its business operations. – An investor (country A) subscribes for shares newly issued by an existing subsidiary holding company (country B) to subscribe for shares newly issued by a sub-subsidiary company (country C) for expanding its business operations.
			Investment for financial restructuring*	– An investor (country A) subscribes for shares already issued by an existing subsidiary company (country B) for debt repayment or loss reduction. – An investor (country A) subscribes for shares newly issued by an existing subsidiary holding company (country B) to subscribe for shares already issued by an existing sub-subsidiary company (country C) for debt repayment or loss reduction.

* Investment for financial restructuring is not included in WIIS recommendation.

ANNEX 1:
OUTLINE OF TEXT TO BE INCLUDED IN BENCHMARK DEFINITION
[CORE TEXT OR ANNEX]

1. Compiling M&As as a part of FDI statistics

1.1. ***FDI flows (only):***

1.1.1. ***Inflows (net)* –** investments and divestments by non-resident enterprises (of more than 10 per cent)

1.1.1.1. Equity capital

1.1.1.2. Other capital if financed by inter-company loans (??)

1.1.2. ***Outflows (net)* –** investments and divestments abroad by resident enterprises (of more than 10 per cent)

1.1.2.1. Equity capital

1.1.2.2. Other capital if financed by inter-company loans (??)

1.2. ***Coverage of data collection*** *[the details]*

1.2.1. name of the investor enterprise (acquirer)

1.2.2. name of the investment enterprise (target company)

1.2.3. geographical allocation of the investor

1.2.4. geographical allocation of the investment enterprise

1.2.5. economic sector of the investor

1.2.6. economic sector of the investment enterprise

1.2.7. date of the transaction (i.e. when completed)

1.2.8. per cent of the shares sold or purchased

1.2.9. amount of the transaction

1.2.10. method of payment (cash, shares, fixed interest securities, deferred payments)

1.2.11. type of securities (ordinary shares, preference shares, other securities)

1.3. ***Modalities of data collection for M&As***

1.3.1. Enterprise surveys

- as a part of established FDI inquiries
- as separate inquiries

1.3.2. Other sources

- specialised press
- other sources, such as administrative information

2. Data dissemination as a sub-category of FDI statistics

2.1.1. Geographical allocation

2.1.2. Industry allocation

2.1.3. Confidentiality concerns – possible groupings for aggregate data in case of confidentiality concerns.

3. Recording transactions according to sources and methods of funding M&As

3.1. ***General principles*** – inflows/outflows counterparts either in direct investment (if 10 per cent or more) or in portfolio investment (if less than 10 per cent)

[Illustration of a simple structure to demonstrate basic principles]

3.2. ***Geographic allocation***

3.2.1. transactions via intermediaries (e.g. SPEs) – to record for ultimate destination

[Illustration to demonstrate basic principles – reference to UIC/UHC]

3.2.2. transactions when the parent company of the subsidiary [target] which is acquired are not in the same country and the investor [acquirer] is in a third country,

[Illustration to demonstrate the recording for all three countries]

3.3. ***Principles for recording payments by exchange of securities***

3.3.1. Describe various possible patterns used for such financing which requires identifying the nature and the source of payments (data collection based on bank settlements can only capture cash payments) and identify principles

3.3.2. Time of recording (time of settlement)

3.3.3. Principles for recording [FDI flows when more than 10 per cent of shares are exchanges]

3.3.4. Valuation [prices agreed by transactors]

3.3.5. Practical examples [illustrating several cases starting from more simple to more complex]

ANNEX 2: OECD BAG – PROJECT GROUP M&A (EDG)

Canada

France

Japan

United Kingdom

IMF

OECD