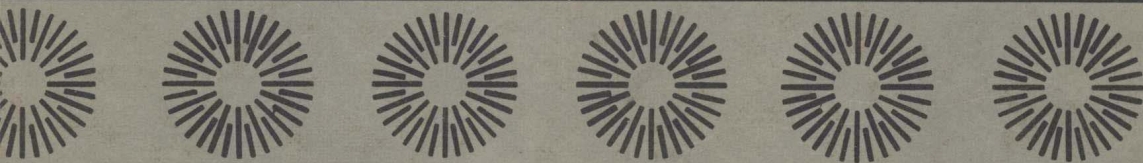


# **Transnational Mergers and Acquisitions in the United States**

**Sarkis J. Khoury**



**Lexington Books**

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## Foreword

At a time when many Americans are pessimistic about the future of the American economy, European and Japanese firms are investing billions of dollars of hard-earned assets in the United States. During the 1950s and 1960s, U.S. firms rushed abroad to invest in manufacturing, extractive, and service enterprises while European and Japanese firms mainly stayed at home, content to exploit world markets as exporters. By 1970, the book value of U.S. direct investment abroad had reached \$78 billion while foreign direct investment in the United States was a mere \$13 billion. This striking imbalance was an historical anomaly that could not endure in a competitive global economy. In 1958, European and Japanese firms accounted for only 25 percent of the assets controlled by the world's top industrial firms, but by 1978 they accounted for over 65 percent. And so, in the 1970s it was the turn of the Europeans and Japanese to invest in the United States. By 1978, foreign direct investment in this country had jumped to nearly \$41 billion and all signs pointed to a further rapid growth in the 1980s.

About half of the foreign investment ventures in the United States are taking place through the acquisition of U.S. firms. Such acquisitions rose from 20 in 1970 to 188 in 1978. What are we to make of this massive inflow of foreign business capital and, particularly, of the many acquisitions of American firms? What are the motives behind these transnational acquisitions? How do (and should) foreign firms plan, evaluate, and negotiate acquisitions in the United States? What are the effects of these acquisitions on competition, money and capital markets, the relative technological position, the balance of payments, and the economic policies of the United States? What are the microeffects on the operations of the acquired American companies?

All of these questions—and several others—are addressed by Sarkis Khoury in his *Transnational Mergers and Acquisitions in the United States*. Khoury not only describes his subject in detail (with several case examples), but also seeks to explain it by making judicious use of foreign investment theory with his own extensions to acquisitions. Throughout his discourse, Khoury maintains the scholar's objectivity, and he is not afraid to leave an issue unresolved when the empirical evidence is conflicting as, for example, in the question of the effects of foreign acquisitions on competition in the United States. All in all, Khoury offers us a pioneering study of a phenomenon that will surely grow in importance in the years ahead.

Today we hear the call for the "reindustrialization of America." Does not the inflow of foreign capital, technology, and enterprise support that call? After all, foreign investment contributed much to economic growth at the very start of this country, accounting for 10 percent of the national wealth in

1790. If history is any guide, we have no cause for alarm over the present situation. On the contrary, the strong inflow of foreign business capital represents a dramatic vote of confidence in the economic future of this nation. And so, I endorse Khoury's conclusion that impediments to that inflow are neither in the short or long-run interests of the United States. This is not to gainsay the possible need for some government regulation of foreign investment in this country, but such regulation should be directed toward enhancing the net social benefits of that investment for the country as a whole—not toward the protection of special interests.

Khoury has written an analytical book for managers involved in transnational acquisitions in the United States whether they are on the “acquiring” or “acquired” side. They will learn much of practical use in planning and negotiating mergers and acquisitions. But this book should also interest policy-makers who will gain a better grasp of the issues raised by foreign acquisitions and their implications for the United States, labor union leaders who will need to cope with widespread foreign ownership in American industry, and students who will add to their understanding of the role of the U.S. economy in an increasingly interdependent world economy. I heartily recommend this book to all those groups.

*Franklin R. Root*  
The Wharton School  
University of Pennsylvania

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# 1

## Introduction

### Introduction

Foreign involvement in the economic life of the United States is pervasive. Foreign firms are operating in almost every industrial and service sector of the U.S. economy. They have acquired or established firms in industries ranging from industrial chemicals to perfumes, from electrical machinery to food, and from mining to retail stores.

The acquisition of firms in the United States by foreign entities has been growing at an explosive rate, witnessed for the most part during the 1970–1979 period. The process continues unabated as of this writing. For the third quarter of 1979 alone, the Conference Board reported ten acquisitions by foreign firms in the food and related products industry; one in the furniture industry; one in the paper industry; seven in the chemical industry; four in the rubber and miscellaneous plastics industries; six in the stone, clay, and glass industries; four in the primary-metals industry; three in the fabricated-metals industry; eight in the nonelectrical-machinery industry; four in the electrical-machinery industry; one in the transportation-equipment industry; three in the instruments industry; and four in other industries whose industrial classification is unknown.

Foreign acquisitions in the United States are increasing not only in scope (industry coverage) and frequency, but also in size. Detailed data on the size of foreign acquisitions are available from the Federal Trade Commission (FTC) for 1977. These data show that for the completed foreign merger and acquisition cases, 46.4 percent were over \$100 million in size, 11.6 percent were between \$50 million and \$99.9 million, 27.5 percent were between \$10 million and \$49.9 million, and 4.3 percent were between \$1 million and \$9.9 million, and 10.1 percent were under \$1 million or unknown.<sup>1</sup> Many major acquisitions by foreign companies have taken place since. The acquisition of Howard Johnson Co. by the Imperial Group, Ltd., of Britain for \$630 million is only one example.

The growing interest of foreign firms in U.S. firms is delighting some academicians and regulators and alarming others. The acquisitions of U.S. firms by foreigners come at a time when the U.S. market is experiencing another dramatic development in the acquisitions of U.S. firms by other U.S. firms. The FTC recorded 1,182 such acquisitions in 1977 alone, 49.2 of which were in the \$100-million-plus category. The concern, therefore, is with the general issue of mergers and with transnational mergers in particular.

This was reflected in the action taken, although unsuccessfully by Federal Reserve Chairman Paul Volcker in late 1979. In order to stem what the *Wall Street Journal* (December 5, 1979) called the “three-year-old merger mania,” Volcker sent a strongly worded letter to 5,600 member banks, warning them against making nonproductive loans, such as corporate-takeover loans, which “do not clearly promise improvement in economic performance.” Senator Edward Kennedy, since assuming the chairmanship of the Senate Judiciary Committee, has introduced several bills to limit merger activity in the United States regardless of whether the acquiring firm is a domestic or a foreign corporation. (Amendments exempting foreign corporations have been proposed, however.) The Securities and Exchange Commission (SEC) recently (February 1980) proposed to Congress new rules intended to make acquisitions more expensive. The proposal would make almost all acquisition offers for more than 10 percent of the outstanding shares of the target company subject to full-disclosure requirements and shareholder protection under existing laws. The proposal would further require a company or an individual acquiring more than 5 percent of the shares of a target to disclose its purchase within a day and refrain from further purchases until filing requirements are met. The proposal also covers other areas such as conflicts of interest and corporate charter changes intended to protect incumbent management from takeover. The concerns also manifest themselves in many other ways which are covered in this book.

## Overview

Chapter 2 presents a historical review of foreign mergers and acquisitions in the United States. Particular emphasis is placed on the participants in these activities—their nationalities, their industry preferences, their locational choices within the United States, their methods of penetrating the U.S. market, and other related factors.

Chapter 3 deals with the motives of foreign mergers and acquisitions in the United States. It reviews the theories about foreign direct investment and examines various hypotheses of the motives of transnational mergers. These hypotheses deal with the impact on transnational-merger activity of relative exchange rates, relative economic stability, relative political stability (various measures of political stability are explored), and relative industry stability and strength. Particular emphasis is placed on comparing management-labor relations in major European countries with those in the United States; on the impact of U.S. balance-of-payments deficits and related accumulation of dollars overseas, and the increased corporate wealth overseas on transnational-merger activity; and on the impact of relative borrowing and equity costs on transnational-merger activity.



Chapter 4 deals with the legal considerations in foreign merger and acquisitions cases in the United States. It reviews the laws limiting activities of foreign firms in the United States. It also reviews the philosophies and considerations which influence U.S. merger laws and regulations—applicable antitrust laws, various state laws that apply to foreign mergers in the United States, regulations that foreign mergers must comply with, and new bills in Congress that relate to mergers, particularly foreign ones. Chapter 4 further looks at the tax laws of the United States—federal corporate-tax laws and federal tax laws affecting the acquiring company, the acquired company, and the methods of acquisition. United States tax laws dealing with repatriated earnings and other repatriated funds are also closely examined.

Chapter 5 deals with planning, evaluating, and negotiating mergers. An application of the wheel-of-opportunity fit-chart concept developed by Stanley Foster Reed is introduced as an effective planning device for transnational acquisitions. A model summarizing the decision variables and the choice process in licensing, export, and direct foreign investment—*de novo* or acquisition—is also presented. A good portion of the chapter is devoted to a capital budgeting model for evaluating acquisition candidates in the United States. The model accounts for all major international risks and is sufficiently flexible to allow considerable room for sensitivity analysis. Merger negotiations, while an art in many ways, are dealt with in this chapter from a technical standpoint. Required preacquisition studies, factors affecting the acquisition price, ways to counteract responses to unfriendly takeovers, and ways to negotiate friendly acquisitions (most desirable and most prevalent) are covered in detail.

Chapter 6 reviews the literature on the impact of transnational mergers and acquisitions. It analyzes the effects of transnational mergers and acquisitions on general welfare and competition, the money and capital markets of the United States, the U.S. balance of payments, the total U.S. employment level, economic growth and U.S. productivity, the competitiveness of U.S. manufactures and the relative technological position of the United States, industry structure and the quality and efficiency of the management of acquired firms, and U.S. economic policies.

Chapter 6 further analyzes the impact of foreign mergers and acquisition on corporate efficiency. An analysis is performed, based on a small sample of firms from various industries which have been infiltrated by foreign firms. By using various statistical techniques, a test is conducted to measure whether foreign firms have improved or diminished the efficiency of acquired U.S. firms. Data limitations imposed constraints on the scope and the efficiency level of the tests, however.

Chapter 7 summarizes the major findings of earlier chapters and concludes with a policy recommendation.