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# Implications of Greenfields and Acquisitions on Host Countries

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***Abstract:*** *This paper investigates the implications of greenfields and acquisitions as entry modes used by transnational corporations (TNCs) on host countries. First, the impact of the two types of foreign direct investment (FDI) on host economies is analyzed comparatively, by sifting through the main opinions in the literature. The focus is on transition countries, where most of the acquisitions occurred within the privatisation process. The analysis is then applied to the particular case of Romania. By means of statistical data, the distribution of FDI flows on greenfields and acquisitions is presented. Moreover, their impact on the economy is analyzed using the ranking of the largest companies in Romania by turnover. Based on the results of the analysis, some conclusions are drawn concerning the main implications brought about by greenfields and acquisitions.*

***Key-words:*** *FDI, greenfield, acquisition, TNC*

## 1. Introduction

In the literature as well as in practice, foreign direct investment (FDI) is inevitably linked with transnational corporations (TNC), as these are the main vehicles for pursuing FDI. A TNC is a business firm incorporated in one country that has production and sales operations in several other countries (Eun and Resnick, 1998).

FDI as an entry mode into foreign markets can embrace two main types, namely greenfields and acquisitions. There is a dedicated strand of literature for this comparison. In-depth research on this matter was undertaken by Kogut and Singh (1988), Svensson (1998) and Harzing (2000). The World Investment Report 2000 (UNCTAD, 2000) is a comprehensive guide dedicated to the similarities and differences between greenfields and acquisitions. Some other studies that have dealt with this comparison at regional or national level are those of Meyer and Estrin (2001), Nisbet (2003), Haar and Marinescu (2014).

Empirically, the '90s and 2000s brought a dominance of acquisitions in worldwide FDI as opposed to greenfields, especially in services. Companies looked beyond frontiers to acquire targets due to technology gaps, poor sales of local firms, as well as part of their global strategy to strengthen their own position in the market,

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or their desire to expand in the EU single market. Even TNCs from emerging markets tended recently to acquisitions in their quest for expansion, in order to gain access to up-to-date technology (Boscor, Bratucu and Baltescu, 2013).

## 2. Differentiating the effects of greenfields and acquisitions on host countries

The importance of FDI to host countries has been demonstrated by the vast literature that investigates the relationship between investing TNCs and host country development. However, if we assess the implications of the two main types of FDI on host countries in a comparative way, several differences appear.

The main difference between the impact on the host country of FDI through greenfields or acquisitions lies in the short-term effects on capital formation and employment. Greenfields add directly to the stock of productive capital and employment in the host country, while an acquisition represents a change in ownership that does not necessarily involve any immediate additions to investment or employment in the host country. Over time, however, the impact of FDI through the two modes is likely to converge. Thus, the impact of FDI on host countries is difficult to distinguish by mode of entry once the initial period has passed. The possible exceptions are their impacts on market structure and competition, for instance when acquisitions have adverse effects by monopolizing production (closing down of the acquired firms or crowding out of local firms), and on economic restructuring, where acquisitions may play a more positive role than greenfields (UNCTAD, 2000).

Even though the long-term effects of greenfields and acquisitions may not differ much, the two alternatives are perceived differently. As Meyer (2004) shows, while greenfields are generally regarded as having positive spillovers, acquisitions are prone to opposition. Greenfields create new businesses and thus have direct positive effects on employment and domestic value added. They increase the pressure on local competitors, which may lead to an improvement of their efficiency, or force them to exit the market. Acquisitions, on the other hand, are at the time of entry fully operating enterprises. Following acquisitions, the new owners may or may not continue traditional business relationships, or their interaction with suppliers, which strongly influences related industries.

Thus, from the point of view of host countries' governments, greenfields are the better option. A new production facility is created, new jobs are provided, a new customer for local suppliers of utilities and raw materials arises, as well as a new taxpayer in the economy, while the benefits occurring in the case of acquisitions are only incremental to an already existing company, and some of its profits have to be ceded to foreign ownership. But, as stated earlier, most of the shortcomings of acquisitions in comparison with greenfields relate rather to the effects at entry or soon after entry. Over the longer term, when direct as well as indirect effects are taken into account, many differences between the impacts of the two modes diminish or disappear (UNCTAD, 2000).

However, as Svensson (1998) shows, the choice of entry mode has several specific implications for the TNC as well as for the host country. Greenfield establishments are more inclined to import intermediate goods from the home country than are acquired firms. Acquired firms, on the other hand, are characterized by their own corporate culture and connections with local subcontractors, and will not always be integrated with the parent. Acquisitions tend to use more local sourcing compared to greenfields as it takes a longer time to establish a local base of suppliers. Thus, their backward and forward linkages to domestic companies are likely to be better developed.

There is one vital difference between the two modes of entry as regards the technology transfer and upgrading that may occur: acquisitions involve existing local firms directly, albeit under new ownership, while greenfields do not. The impact of the latter on local firms' technology is thus slower (UNCTAD, 2000). TNCs induce local suppliers to meet higher quality standards by providing technical assistance and training. Technology transfer translates into higher technological content of exports. This results in increased competitiveness and better export opportunities for the host country.

In transition countries, privatisation accounted for the largest part of foreign acquisitions. This generates particular characteristics regarding the effects on host economies. The investor has to take responsibility for enterprise transformation and may face considerable post-acquisition investment in resource upgrading and organizational change while being constrained by stipulations of the privatisation contract. But, investors reported fewer bureaucratic obstacles to acquiring land and obtaining the permits required to start or expand production (Meyer, 2001). Also, it seems that greenfield FDI upgraded employment conditions more than acquisitions because the latter may tend to stick with the inherited norms and practices for some time (UNCTAD, 2000).

Positive effects of acquisitions include the much-needed capital for investment purposes, new technology, better management, a change in attitude by the disciplining of labour and the emphasis on quality, an efficiency gain, access to new export markets, a better position on the local market, enhanced reputation of the company and brand, improvement of relationships with customers and an overall higher financial credibility of the acquired firm.

The negative aspects of acquisitions in the privatisation process are related to the cutting off of local suppliers, restriction of production to low value-added activities and import of a major proportion of higher-value intermediate products, increased market concentration and massive layoffs. A decline in employment is possible as acquired companies are restructured and rationalized. Indeed, most studies find that employment in privatised firms usually falls (UNCTAD, 2004).

Though, when acquisitions of ailing firms are undertaken, then they actually save jobs and the effect on competition is not different from greenfields. As noted by Ilie (2002), in the case of privatisation with foreign investors, the contribution to economic growth arises by maintaining in operation a firm turned efficient.

Moreover, as Hunya (2001) points out, FDI contributed to a large extent to technology upgrading in the more developed transition countries. Foreign penetration changed their industrial specialization and contributed to export competitiveness on EU markets, especially when considering greenfields. But, for the rest of transition countries, the impact of FDI on defining new competitive advantages was limited. Most of FDI did not occur in the greenfield form, but as acquisitions in the privatisation process.

## 3. The impact of greenfields and acquisitions in Romania

Romania stands out as a remarkable exception in the region with a fairly balanced FDI stock between the two entry modes, greenfields scoring slightly higher than acquisitions (see table 1). The same situation holds for FDI in industry.

| Selected sectors | Greenfield | % | Acquisition | % |
|---|---|---|---|---|
| Industry | 10,219 | 53.0 | 9,056 | 47.0 |
| Trade | 5,757 | 81.6 | 1,301 | 18.4 |
| Services | 13,401 | 61.0 | 8,556 | 39.0 |
| Others | 3,150 | 26.4 | 8,758 | 73.6 |
| Total | 32,527 | 54.0 | 27,671 | 46.0 |

Table 1. *FDI stock across sectors in Romania, 2014 (€ million)*
Source: Romanian National Bank, 2015

In the case of trade, greenfields obviously prevail due to the new retail chains established after the ‘90s. In services, while foreign companies bought local banks and insurers, telecom providers entered the market from scratch. Acquisitions were strongest in utilities, such as electricity and gas, or in the oil industry.

When considering the impact of greenfields and acquisitions in Romania, as previously shown by Marinescu (2007), the largest FDI privatised mainly industrial companies with already above average export propensity or were directed towards services and trade, which are typically domestic market-oriented sectors. Thus, greenfields fall mainly into the resource-seeking category, generating industrial exports or into the market-seeking category, in the case of trade. Acquisitions are typically local market seekers, as is the case with various services and utilities.

The impact of greenfields and acquisitions on the Romanian economy can be better understood when looking at the ranking of the largest companies by turnover (see table 2). If in 2004 there were still 3 local-owned companies among the top 10 (=RO), after a decade, the top is fully dominated by foreign-owned subsidiaries, fairly divided (5 greenfields=G and 5 acquisitions=A). When financial performance during the 2004-2014 decade is analyzed, general improvement is clearly visible.

Haar and Marinescu (2014) observed that acquisitions generally exhibited a higher profit margin and turnover compared to greenfields.

| **Rank** | **Largest companies, 2004** | **[$million]** | **Largest companies, 2014** | **[$million]** |
|---|---|---|---|---|
| 1. | OMV Petrom (A) | 2143 | Automobile Dacia (A) | 4237 |
| 2. | Mittal Steel (A) | 1693 | OMV Petrom (A) | 3194 |
| 3. | Electrica (RO) | 1491 | Rompetrol Downstream (A) | 2135 |
| 4. | Rompetrol Rafinare (RO) | 1155 | Kaufland Romania (G) | 1799 |
| 5. | Metro C&C Romania (G) | 1025 | British American Tobacco (G) | 1555 |
| 6. | Romtelecom (A) | 823 | Petrotel Lukoil (A) | 1453 |
| 7. | Rafo (RO) | 635 | Lukoil Romania (G) | 1319 |
| 8. | Orange Romania (G) | 607 | E.ON Energie Rom. (A) | 1063 |
| 9. | Automobile Dacia (A) | 593 | Carrefour Romania (G) | 1026 |
| 10. | Mobifon (G) | 565 | Metro C&C Romania (G) | 1010 |

Table 2. *Top 10 largest companies in Romania by turnover 2004 vs. 2014 (Note: turnover has been calculated at the average exchange rate of that year)*
Source: Finmedia, 2005 and Doingbusiness.ro, 2015

## 4. Conclusions

The aim of this paper was to investigate the comparative implications of greenfields and acquisitions as the two main types of FDI, with a focus on Romania.

Governments around the world usually prefer greenfields as they create new jobs and new activity. But they can also drive local players out of the market. The long-term effects of greenfields and acquisitions are thus not very far apart. In transition countries, most investors were attracted by acquisitions in the lucrative privatisation process. Romania is an exception with a balanced FDI stock between greenfields and acquisitions. The large merit of greenfields was that they generated industrial exports, usually towards the EU. The merit of acquisitions was that they turned around ailing local state companies, pushing (or keeping) them into the financial top league of companies in Romania.

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