

## GLOBAL TRENDS IN BROWNFIELD INVESTMENTS IMPLEMENTED BY INTERNATIONAL FIRMS

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**Abstract.** This paper presents content related to international expansion, which is valid and important both from the point of view of the enterprise, as well as national and global economy. One of the forms of activity in foreign markets are international mergers and acquisitions. Transactions of this type of host on the world markets for a long time, and its characteristic is that their intensity is once more, and less in another time. The phenomenon of cycling between low and then increased activity brownfield investments are called waves of mergers and acquisitions. Each successive wave differs from the previous one, because the environment in which businesses operate is subject to dynamic changes that generate ever new opportunities and threats. The article presents the main trends in the international strategy to acquire, as well as the scale of this phenomenon in the years 2000–2013. Also pay attention to how Polish companies find themselves in the international market of mergers and acquisitions, on the one hand – as passive actors of the process of internationalization, on the other hand – as active entities conducting international mergers and acquisitions.

**Key words:** mergers and acquisitions, global economy, foreign direct investments (FDI)

### INTRODUCTION

International expansion remains an important and relevant issue both at the level of a firm and at the level of the national and global economy. Firms choose to pursue expansion strategies in a number of ways, one of which is international mergers and acquisitions. These transactions have been conducted in world mar-

kets for many years and one of their characteristics is their intensity which in turn increases and decreases. The cyclical nature of brownfield investment activity is referred to as merger waves. Each consecutive wave differs from the previous one, since the business environment undergoes dynamic changes, which always generate new opportunities and threats.

The paper aims to present major trends in international acquisition strategies and the scale of merger activity in recent years. It seems worthwhile to consider how Polish economic entities find their place in the international M&A market, when, on one hand, they become targets during the internationalization process, or, on the other hand, when they play a role as actors conducting international transactions of mergers and acquisitions.

## INTERNATIONAL EXPANSION OF FIRMS

In general terms, expansion (*Lat. expansio*) means that something is spreading over a certain area or that a country, for example, aspires to increase its territory and strengthen its political or economic influences. In the case of a firm, international expansion (also referred to as internationalization) involves activity undertaken outside its home country, leading to the extension of its economic operations. Literature on international business expansion associates it with forms of internationalization, a geographical extension of a firm's operations into overseas markets, the engagement of a firm's assets abroad, the internationalization of the value chain, the relationships of a firm within a business network [cf. Rymarczyk 2004; Wiktor 1998; Pietrusiński 2005; Gorynia 2007].

The International expansion of firms may take an active or passive form (Table 1).

**TABLE 1.** Active and passive forms of internationalization

Form of internationalisation	Active approach	Passive approach
Trade	export	import
Contracts	the sale of a good or a service under a contract	the purchase of a good or a service under a contract
Licensing	the transfer of a licence	obtaining a license
Franchising	acting as a franchisor	acting as a franchisee
Joint venture	the setting up of a joint operation outside a home country	the setting up of a joint operation in a home country
Independent economic activity conducted abroad	the setting up of a new enterprise or the takeover of an existing enterprise abroad	being taken over by a foreign enterprise

Source: author's own compilation based on [Rymarczyk 2004; Górczyńska 2008].



Active internationalization is a firm's international expansion in different forms. Passive internationalization, on the other hand, involves entering economic relationships with foreign partners without extending economic operations beyond the borders of the country where a particular enterprise is based. A different approach, however, argues that passive internationalization occurs when an enterprise is forced to compete against foreign players in its domestic market, while active internationalization means that a domestic enterprise competes in foreign markets [Gorynia 2007; Rozkwitalska 2007; Gołębiowski and Witek-Hajduk 2007].

Firms make a decision to expand internationally for a number of reasons [Rymarczyk 1996 and Album, Strandskov, Duerr, Dowda 1994]. The most common factors determining such a move are:

1. market-related factors, which comprise looking for new markets, the more effective use of production capacity, increasing a firm's competitiveness in the domestic market, the dynamic growth of foreign markets, increasing activity in the foreign markets where a firm is already present;
2. cost-related factors, such as economies of scale, the benefits of the experience curve, decreased labour costs, the elimination of transportation costs for raw materials and components, easier access to financing abroad and lower borrowing costs, the lowering of the risk involved in operating only in one domestic market and suffering from fluctuations in the demand in this market;
3. supplies-related factors, which are connected with purchasing raw materials, components and energy at a price lower than in the domestic market or which enable a firm to purchase raw materials, components and energy when the domestic market suffers from chronic shortages of relevant resources;
4. political factors, involving international trade policies implemented by both home and destination countries; the instruments that may be applied comprise, for example, an exports insurance system, corporate income tax incentives, VAT compensation, reduced customs duties.

An integrated approach to the analysis of the reasons underlying a firm's decision to expand internationally involves the consideration of the conditions – opportunities and threats – offered by the international and domestic environments (the macro-environment and the industry-related environment) and the potential of a firm itself, its strengths and weaknesses.

## **BROWNFIELD INVESTMENT AS A FORM OF INTERNATIONALIZATION**

The international expansion of firms is frequently presented as a multi-stage process. The most popular model of the international involvement of firms is the Uppsala Model, according to which the internationalization process is of sequential (gradual) nature and it involves sporadic export, export through independent



representatives, setting up a foreign sales subsidiary and, finally, starting a foreign production subsidiary [Rymarczyk 2004].

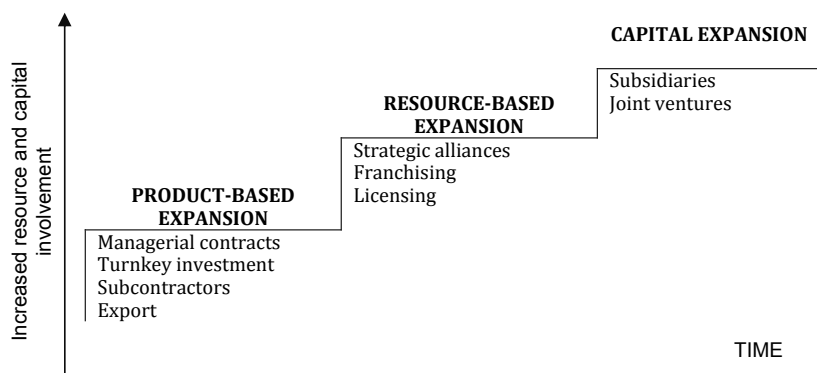
The behavior of firms during the internationalization process is determined both by their empirical knowledge about specific markets and their general knowledge on conducting economic activity. Therefore, the lack of such knowledge is considered a major obstacle to internationalization. As a result, experience building is the foundation of the sequential internalization of a firm. The concept of the multi-stage internationalization process is also proposed by H.G. Meissner and Ch.M. Korth [Sznajder 1995; Fabiańska and Rokita 1995].

The multi-stage internationalization model, however, is not without its faults. First of all, it does not account for the fact that many firms may omit certain stages [Duliniec 2007]. Moreover, Fonfara argues that the Uppsala Model does not indicate directly what the effects of internationalization are or whether a particular behaviour of a firm increases its chances of success [Fonfara 2009]. It is also not entirely clear what the dynamics of moving from one stage to the next one are. The sequential model is a one-way model, which cannot fully explain why a firm changes its strategy or abandons internationalization. The one-way orientation of the model assumes, or at least implies, the existence of the causal relationship between consecutive stages, which does not seem to be justified [Buckley et al. 2002]. Another counter-argument is the “born global” concept, the concept of a business organization which from inception seeks to achieve competitive advantage from the use of resources and the sale of outputs in multiple countries [Oviatt and McDougall 2005].

The international expansion of firms is achieved with the use of its different forms, ranging from product-based and resource-based expansion to capital expansion (Figure 1).

If the international expansion is assessed based on the level of capital and resource involvement and the time a firm needs to gain experience in foreign markets, the most advanced form of internationalization is capital expansion [Gorczyńska 2008]. Capital expansion in foreign markets can be implemented as a joint venture or a foreign direct investment (FDI).

Foreign direct investment involves capital outlays made by a resident of one country (“direct investor” or “parent company”) with the intention to assume long-term control over a firm based in another country (“direct investment target” or “subsidiary”). Long-term control means that there are both a long-term relationship between the direct investor and the direct investment target and a significant level of involvement which affords the investor effective participation in the management of the direct investment target. If an investment is to qualify as FDI (in compliance with the definition of OECD, IMF and UNCTAD), the threshold



**FIGURE 1.** Forms of international expansion

Source: [Gorczyńska 2008]

for capital involvement of a direct investor is determined at 10 per cent of voting shares [Oziewicz 2006].

FDI may be either greenfield or brownfield investment. The former involves setting up a new facility in the destination country and is characteristic of developing economies, while the latter (mergers and acquisitions – M&As) entails the purchase of an entire or majority stake in an existing entity based in the destination country. This form of FDI is typical of developed economies [Budnikowski 2006].

Mergers and acquisitions conducted on an international scale are motivated by a number of reasons. In general terms, these reasons fall under two major categories: synergy-related reasons and financial reasons [Karaszewski 2008 and further; Frąckowiak 2009 and further]. Synergy-related reasons may be of offensive or defensive nature. The former are connected with the intention to use a firm's existing potential more effectively (by decreasing its dependence on one market, achieving economies of scale, acquiring know-how, increasing profitability, raising a firm's relative market position), while the latter stem from the need to maintain a firm's market position under growing competition in the domestic market or the markets with the firm's presence. Financial reasons comprise, for example, a situation when a foreign company is taken over at a bargain (low) cost with the intention of selling off its assets at their market value or when a company is acquired and restructured in order to be sold later at a higher price, resulting from its increased value.

International mergers and acquisitions exert a significant impact on the economy of a destination country. Both positive and negative aspects of this form of international expansion of firms may be identified (Table 2).

**TABLE 2.** The impact of brownfield investments on the economy of a destination country

<b>RESOURCES</b>	
They supplement capital, technological and managerial shortages	transferred resources are not adapted to local needs (e.g. obsolete technology) or the investment brings in resources despite their availability in a destination country
<b>ENTREPRENEURSHIP</b>	
They stimulate entrepreneurship, implement new management techniques and working styles, increase competition in the market	the inflow of investment may eliminate local competition, cause excessive supply or lead to the monopolistic position of an investor
<b>EFFICACY</b>	
More effective resource allocation, the rise of sectors related to or supportive for those where foreign capital was invested	the shift of local businesses to less profitable industries
<b>BUDGET REVENUES</b>	
They contribute to GDP creation, generate budget revenues from taxes	they may contribute to lower budget revenues due to the application of transfer pricing
<b>BALANCE OF PAYMENTS</b>	
They create exports – in the short term they lower the current account deficit	they may cause increased imports by importing raw materials and components – this leads to the deterioration in the current account balance
<b>INTEGRATION ASPIRATIONS</b>	
They create links between the economy of a destination country with the world economy and contribute to better international division of labour	strong impact of changes in prosperity
<b>SOCIAL AND CULTURAL RELATIONS</b>	
The dissemination of business, consumer and cultural behaviour patterns	cultural differences cause tension and unrest

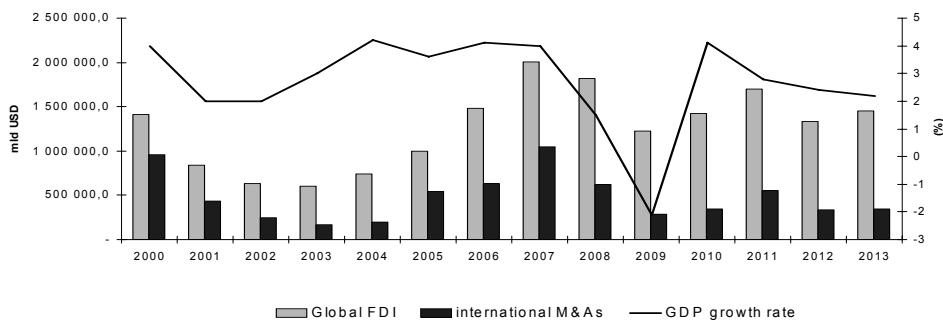
Source: author's own compilation.

## **LEVELS AND DYNAMICS OF INTERNATIONAL MERGERS AND ACQUISITIONS**

The scale of international mergers and acquisitions is illustrated based on the data published in the annual World Investment Report 2014 and the analyzed period comprises the years 2000–2013 [World Investment Report 2014].

Interestingly, the situation in the mergers and acquisitions market seems to act as a barometer in the economy (Figure 2). Assuming that the GDP growth rate

is one of the indicators reflecting the condition of the economy, when a global GDP growth rate is increasing, FDI and international brownfield investments are also growing. This is commonly referred to as a merger wave.



**FIGURE 2.** The values of global FDI, international mergers and acquisitions and the world GDP growth rate

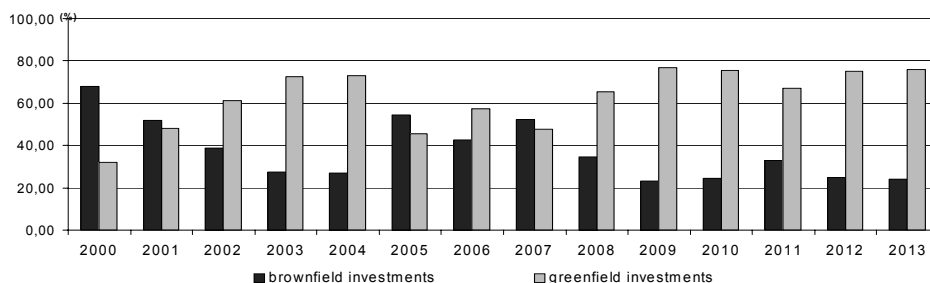
Source: [Word Investment Report 2014, [www.worldbank.org](http://www.worldbank.org)].

In the analyzed period of 2000–2013 the global economy underwent a series of merger waves. The period starting in the late 1990's and lasting until 2003 was characterized by a falling trend in international mergers and acquisitions, resulting from the crisis triggered by turbulences in global capital markets. In the years 2004–2007 the situation in international markets improved, the economy recovered slowly and the trust in huge transnational corporations was rebuilt, which led to increased interest in FDI and acquisition strategies in the world market. In the current period, which started in 2008, the ongoing global economic downturn has caused a dramatic fall in capital involvement in international markets, particularly in 2009. Although the global economy seems to be recovering gradually, the values of FDI and brownfield investments are still far from the levels of 2007.

The analysis of FDI values shows an interesting pattern of greenfield and brownfield investment values (Figure 3).

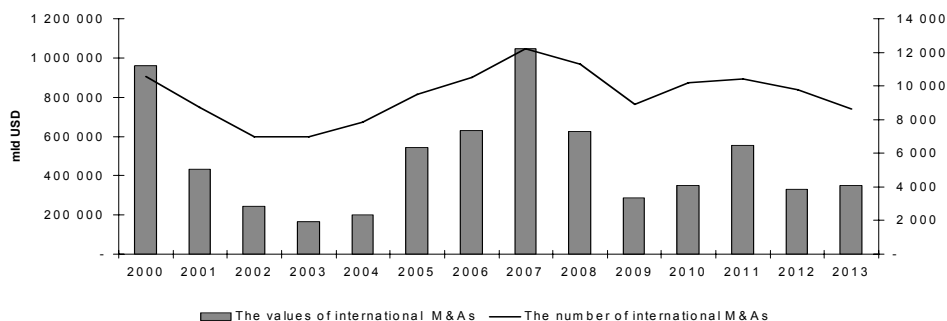
The global waves of economic meltdown in 2000 and 2008 caused that investors have been markedly more willing to get involved with greenfield projects, in particular since 2008. In 2008 the share of international M&As in FDI accounted for 34.43%, while in the years 2009–2010 it stayed at around 23–24%, which was the lowest value in the analyzed period. In 2011 it increased to almost 33% only to fall back to 24% in the following years. This indicates that investors choose the M&As strategy as a form of internationalization when the economic climate strengthens.

Figure 4 presents the values and numbers of international mergers and acquisitions conducted in the world economy.



**FIGURE 3.** The structure of international brownfield and greenfield investments

Source: [Word Investment Report 2014].



**FIGURE 4.** The values and numbers of international brownfield investment

Source: [Word Investment Report 2014].

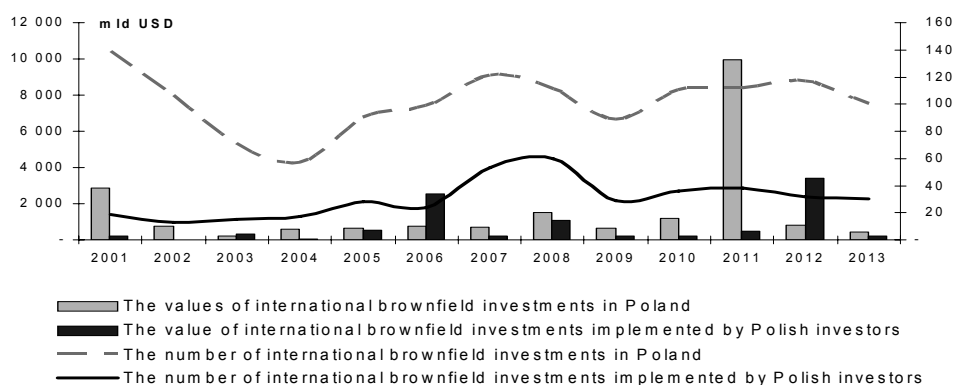
The data presented show that the highest value of brownfield investments was achieved in 2007, when the figure of 1 billion dollars was exceeded (USD 1,045,085 m). Moreover, also in 2011 the highest number of such transactions was reported (12,199). The following two years saw a decrease in the number of international M&As and, in particular, a fall in their value. This can be explained by the onslaught of the financial crisis in 2008. In 2010–2011 the values and numbers relating to international mergers and acquisitions rose, but in 2012 there were further decreases in the values – by 44.5% – and the numbers – by 11% – compared to the previous period. Finally, in 2013 the value of M&As slightly rose, with an accompanying fall in their number.

In the analyzed period, the industry structure changed in the area of brownfield investments. In 2000, sale transactions were mainly completed in the mining and agro-processing industries (50%), then in the service sector (38%) and, finally, in manufacturing (12%). In 2013, sale transactions as mergers and acquisitions were implemented mainly in the service sector (45%), manufacturing (36%) and in the mining and agro-processing industries (19%).



In the case of purchase transactions within international M&As, in 2000 they were mainly carried out in the service sector (75%), manufacturing (21%) and the mining and agro-processing industries (4%). In 2013 the structure of purchase transactions remained the same in terms of the order, but the proportions changed, amounting to 65% in the service sector, 28% in manufacturing and 7% in the mining and agro-processing industries.

The scale of international mergers and acquisitions conducted in Poland and by Polish investors is significantly lower than globally. However, the trends in world markets are also followed in the Polish market (Figure 5).



**FIGURE 5.** The values and numbers of international brownfield investments in Poland and implemented by Polish investors

Source: [World Investment Report 2014].

Polish firms tend to invest abroad more frequently and increase their investment activity in world markets. In the early 1990's FDI of Polish firms accounted for 0.01% of global FDI flows, while in the late 2000's the value rose to 0.4% (forty times as much!). Undoubtedly, this marks an important change in the Polish economy and indicates the level of its internationalization.

The record value of brownfield investments implemented in Poland was reported in 2011, which was connected with exceptionally attractive transactions (Żabka store chain, Kamis, Polkomtel).

Investment activity reveals the potential of Polish firms, which are quickly becoming active participants in the international system of investment capital turnover. The data published in the World Investment Report 2014 shows that the structure of FDI implemented by Polish investors is dominated by brownfield investments. An above-50% share of greenfield investments was only reported in 2007 and 2008.

## CONCLUSION

Mergers and acquisitions have had their place in the world economy for many years. The growth of the world economy, initiated in the 1990's, is the time when the merger wave has been the highest. Undoubtedly, this has in part been caused by globalization, fluctuations in prosperity and the political and economic transformation in many countries, including Poland.

Nowadays international mergers and acquisitions have become a universal phenomenon not only in the developed economies, but also in the developing countries and economies in transitions. Transformations occurring in the global economy offer new opportunities for firms to merge, they allow businesses to expand, enter new markets, seek savings on operational costs, and create value for investors.

Based on the numerical data presented in the paper, we can expect further growth in the mergers and acquisitions market both globally and in Poland. This trend will result from an improved macro-economic situation, greater activity of domestic firms and increased interest of foreign investors in providing capital to companies worldwide.

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### **GLOBALNE TENDENCJE W DOKONYWANIU INWESTYCJI TYPU BROWNFIELD PRZEZ PRZEDSIĘBIORSTWA MIĘDZYNARODOWE**

**Abstrakt.** Niniejszy artykuł prezentuje treści dotyczące międzynarodowej ekspansji, która jest aktualna i ważna zarówno z punktu widzenia przedsiębiorstwa, jak i gospodarki narodowej i światowej. Jedną z form aktywności na rynkach zagranicznych są międzynarodowe fuzje i przejęcia. Transakcje tego typu goszczą na rynkach światowych od dawna, a ich cechą charakterystyczną jest to, iż ich intensywność jest raz większa, a raz mniejsza. Zjawisko przeplatania się okresów słabej, a następnie wzmożonej aktywności inwestycji typu brownfield określa się mianem fal fuzji i przejęć. Każda kolejna fala różni się od poprzedniej, gdyż otoczenie, w jakim działają przedsiębiorstwa, podlega dynamicznym zmianom, które generują coraz to nowe szanse i zagrożenia. W artykule przedstawiono główne tendencje dotyczące międzynarodowych strategii nabyć, a także skalę tego zjawiska w latach 2000–2013. Zwrócono uwagę także na to, jak polskie podmioty gospodarcze odnajdują się na międzynarodowym rynku fuzji i przejęć, z jednej strony – jako pasywne podmioty procesu internacjonalizacji, z drugiej strony – jako aktywne podmioty realizujące międzynarodowe transakcje fuzji i przejęć.

**Słowa kluczowe:** fuzje i przejęcia, gospodarka światowa, bezpośrednie inwestycje zagraniczne (BIZ)



