Critical thinking on foreign direct investment and international merger and acqui...

Business, Company

Foreign Direct Investment

Foreign direct investment (FDI) is an investment made to acquire long-term interest in an enterprise operating in an economy other than that of the investor (World Bank, 2011).

FDI has been more beneficial to both investors and host countries as compared to alternatives. The two parties, investors and host countries, engage in FDI and benefit in various ways. Investors gain new markets, attain efficiency, and aquire cheaper and more readily available resources, from the host countries. Moreover, FDI benefits the host countries by contributing to their economic growth, creating empolyoment, transfering technology and knowlegde, and increasing government revenue through taxation.

On the flipside, some countries have reservations of FDI for fear of crowding out their domestic industries. Others restrict the industries in which FDI can invest. For instance, Sweden excludes FDI from mining and tobacco industries.

China is an exemplary case study in the analysis of FDI. It is the most popular FDI destination for most companies. This is because it offers low cost labor, large domestic market, and advanced infrastructure. Its high population gives China a comparative advantage in terms of labor, and offers a large domestic market to investing companies. For instance, McDonald’s Corporation plans to accelerate their expansion by opening 1, 000 restaurants in China in the next three years to take advantage of this market (China Daily). Finally, China’s advanced infrastructure facilitates efficient operation of FDIs.

The interaction between investors and China has lead to a win-win situation where China benefits in terms of economic growth. From the National Bureau of Economic Research, “ FDIs account for 20 percent of China’s economy, and for over 40 percent of China’s recent economic growth” (NBER, 2011).

Even though China encourages FDI, it has several restrictions, which are stated in the relevant laws and regulations.

In conclusion, the host counrty, which is often developing, stands to benefit a lot more in terms of economic growth. The investing companies are often from developed countries, which are at their maximum production possibility frontier. At this level, they realize minimal growth rates compared to the developing countries, which are yet to reach this frontier.

Merger and Acquisition Activity

Merger and acquisition (M&A) is a strategy for expanding a business either locally or abroad. “ An acquisition is where an organisation takes ownership of another organisation whereas a merger implies a mutually agreed decision for joint ownership between organisations” (Johnson, Scholes and Whittington, 2008).

Companies use M&A as a strategy to gain advantage over their rival companies. These companies gain a more competitive edge, acquire a greater market share, achieve greater efficiency, reduce staff and costs, have economies of scale, improve purchasing power or bargaining power of the company, acquire new technology, enter new markets, thus increasing revenues and profits; have and exploit new sales opportunities, and spread

costs. In addition, M&A improves the organization's standing among investors, because bigger firms are able to raise capital more easily as compared to smaller firms. Further, the shareholders also get to increase their overall net worth.

However, there are the negative aspects of M&A. There may be clashes of culture between different types of firms, hence reducing the effectiveness of the M&A. Some employees may become redundant, especially those in the managerial positions, thus demotivating employees. Different firms pursue different objectives and goals; these differences could result in conflicts when two companies consolidate through either merging or aquisition. This in turn makes the decision-making process harder and may ultimately cause disruption in the running in the firm.

Over the years, there have been many mergers and acquisitions. One famous merger was the merger of two UK based companies Glaxo-Wellcome and SmithKline Beecham on 27 December 2000, to form GlaxoSmithKline, which is now the largest pharmaceutical & healthcare company in the world. GSK has benefited a lot from the merger. The company has improved its research and development (R&D) expertise, and in 2007, it opened a new R&D center in China. The two companies combined their knowledge and technology resulting in greater efficiency and competitive advantage. The merger also improved the firm's ability to generate sustainable long-term growth; it enhanced shareholder value as earnings per share grew by 14 percent in 2001 (GSK 2001), and it increased marketing power through a combined sales force. It also enabled the company to reduce operational costs by £950 million, resulting in increase in trading profit (GSK, 2001).

Moreover, the merged company attained a strong team of talented management.

In 2007, GSK acquired three other firms, “ Domantis, a leader in developing antibody therapries, Praesis Pharmaceuticals, a biopharmaceuticals company, and Reliant Pharmaceuticals, a producer of cardiovascular medicines” (GSK 2011). This acquisition has enabled GSK to continue improving its competitive advantage by increasing its product line, product innovation and R&D expertise.

In my opinion, M&A has both strengths and weaknesses. However, the strengths often far outweigh the weaknesses. From the latter, I draw the conclusion that M&A is a suitable strategy for organizations to undertake inorder to realize long-term success.

References

GlaxoSmithKline, 2001. Annual Review 2001 (online) [Updated 3 March 2011] Available at: [Accessed 22 April 2011].

GlaxoSmithKline, 2007. Our history. (online) [Updated 3 March 2011] Available at: [Accessed 22 April 2011].

Johnson, G. Scholes, K. and Whittington, R., 2008. Exploring Corporate Strategy. 8th ed. England: Pearson Education Limited, pp. 32-33.

National Bureau of Economic Research, 2011. Will Super-High Chinese Growth Continue? [online] Available at: [Accessed 22 April 2011].

Pigott, C. A., 2002. China in the world economy: the domestic policy challenges. China: Organisation for Economic Co-operation and Development Publishing.

Qingfen, D., 2011, FDI growth to remain robust over coming year. China Daily, [online] (Last updated 9: 25 AM on 18 January 2011) Available at : [Accessed 22 April 2011].

Ullah, S. Farooq, S. U., Ullah, N. Ahmad, G., 2010. Does Merger Deliver Value? A Case of Glaxo Smith Kline Merger, [online] Available at: [Accessed 22 April 2011].

World Bank, 2011. Foreign direct investment, net inflows (BoP, current US$). Available at: [Accessed 22 April 2011].