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Firms' transactions and knowledge flows in the European Union's Neighboring Countries

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OBJECTIVE

The relationship between the European Union (EU) and its neighbouring countries is a crucial issue for the future of Europe. The major aim of European Neighbourhood Policy (ENP) is to create close, peaceful and cooperative relationships with bordering countries generating stronger economic integration and cross border co-operation programs (COM 373, 2004). So far literature has mainly focused on the governance perspective of the ENP and on the movements of tangible elements like goods (trade), capital (FDI) and people (migration) while we know surprisingly little about the various forms of transactions that involve firms located in the ENC and generate important flow of knowledge and innovation.

Firms' transactions and agreements may take different forms like Mergers and Acquisitions (M&A) and alliances in the form of strategic alliances (SA) or joint ventures (JV). M&A and alliances are externally oriented corporate development efforts with the goal of achieving economies of scale, scope, market share, prestige, survival, and other outcomes essential to sustained competitive advantage. In general, these transactions, whatever their nature and motivation, generate potential knowledge flow among the companies involved and consequently between the geographical areas where companies are located.

The aim of the paper is to investigate in details the transactions and agreements performed by firms located in the ENC in order to explore the knowledge flows between companies in those areas and external firms. More specifically, we focus on the geographical directions of the transactions to appraise the role of spatial and cultural proximity among EU and ENC. Moreover, we examine the sectorial scope of the deals to assess the degree of industrial and technological relatedness of the transactions.

METHODOLOGY

The paper examines the evolution of the ENC transactions (M&A, JV, SA) between 2000 and 2011 looking at those deals involving at least a firm located in one of the ENC. Based on the SDC Platinum database (Thompson-Reuters) we consider 6299 announced M&A deals in which the target company is based in one of the ENC, 3816 announced M&A deals in which the acquirer company is based in one of the ENC, 911 announced SA and JV agreements in which at least one partner is based in one of the ENC, involving 1575 different firms.

The individual firm data are aggregate at the country level and using the information on the location of the companies involved and their primary economic activity we assess the spatial and industrial dimensions of firms agreements.

Moreover, we apply the Social Network Analysis (SNA) to examine the characteristics of the inter-firms agreements and the position of the neighboring countries within the networks.

MAIN RESULTS

M&A and alliances, changing resources and incentives of firms involved, represent a potential channel of knowledge exchanges generated along the variety of activities carried out before, during and after the deal. Therefore M&A and alliances transactions may be used as a valuable proxy of knowledge flow that involved ENC.

We show that the ENC market is still immature in terms of numbers of transactions in the observed period, with a significant share of transactions announced but not completed. Moreover firms in ENC are definitely more active in M&A than in alliances, and are more often target than partner.

Nevertheless, we observe a lot of differences between countries that could be a signal of a maturing path in some ENC market. More specifically, the most active M&A markets turn out to be Ukraine in the East and Israel in the South. Ukraine, sharing the borders to both the EU and Russia, is characterized by strong co-operation willingness and it represents one of the most important target country attracting relevant external investments. The case of Israel is obviously different since, despite its geographical collocation, it is characterized by GDP, technology levels comparable with those of the richest EU countries and it is fully integrated with the west economy.

M&A and alliances are subject to relevant risks, which, in the case of ENC markets, may be also connected to political instability and cultural differences. We have thus examined the share of announced M&A transactions, which are actually completed. It is evident that significant differences among countries in the completion rate do exist. More specifically, we found that Libya, Syria, Egypt, Azerbaijan and Belarus have relatively low share of completed transactions (50-60%). This may signal a situation of uncertainty in these countries linked to the political situation, high corruption and low indexes in easiness of doing business which makes more difficult the completion of the acquisitions, especially for the international deals. In some countries there is a resistance to international integration due to political and institutional factors and also for the fear of giving too much control to foreign multinationals.

Another interesting result which has emerged from the analysis is that the ENC show a relatively low level of domestic deals (47%) compared to the USA or the EU and this signals the weakness of the internal production structure, although we have observed over the period considered an increasing trend in the share of domestic

deals. Focusing on the international M&A and alliance we observe, as expected, that cross-border transactions are affected by the historical, cultural, political, economic and geographical links among, for example, EU and neighborhood countries. In general, firms entering in markets characterized by cultural and political differences come across an increase in the costs and risks associated with the transactions.

In regards to the sectoral dimension, there are relevant differences across countries in the sectoral distribution induced by the production specialization profile, the endowments of natural resources and the liberalization pattern of the internal markets. On average, results show that half of total transactions are realized within the same sector even though important sector-specific differences emerge. The most “closed” sector is the financial one (on average 85% of total transactions are completed by firms operating within the same sector), which signals a strong process of horizontal mergers and market concentration. On the other hand, there are sectors, such as mining and food, where the incidence of inter-industry deals is much higher (52%) and this indicates that a process of diversification and cross-sector technology transfer is operating.

POLICY IMPLICATIONS

The international transactions among firms from EU and ENC can have a central and increasing role in the knowledge transfer and integration process. For the ENC, in fact, firms’ transactions could be a fast way to activate knowledge transfer processes and to generate an important innovation pressure. Innovation considerations are, indeed, central to merger and alliances policy because dynamic efficiency is critical to successful economic performance and innovation itself is a key dimension of market performance, which is potentially affected by a merger or an alliance.

In this perspective, if the density of interactions between firms from the EU and ENC is high, neighboring countries become exposed to the influence of EU-based firms that often have more advanced technical solutions and organizational practices.

Despite the ‘globalization’ rhetoric, the volume of M&A and alliances appears limited by invisible barriers, such as perceived differences. One outcome of this process is that firms are seeking synergies and market opportunities consider nearby and well known market.

However, firms’ transactions between EU and ENP countries should expect to increase as a host of other policies take hold. These transactions might affect, not only the firms involved, but also both the locations and environment with which they are associated and the organizational and geographical shape of industries as a whole.

Among the different ways in which valuable interactions between the EU and ENC are generated, capital transactions represent a key channel. Thus, understanding M&A and alliances activities in this area might aid in increasing the effectiveness of the ENP, which is aimed at establishing close, peaceful, and cooperative relationships with bordering countries.

inable long run development and economic prosperity.