



European
Research Area

EUROPEAN POLICY BRIEF



SEARCH
SHARING KNOWLEDGE ASSETS:
INTERREGIONALLY COHESIVE
NEIGHBORHOODS

**Sharing Knowledge Assets: InterRegionally
Cohesive Neighborhoods (SEARCH) Project**

Ongoing project (01/08/2011- 31/07/2014)

FIRM TRANSACTIONS, KNOWLEDGE FLOWS AND PROXIMITIES IN THE EU NEIGHBORING COUNTRIES

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September 2013

INTRODUCTION

FIRMS' TRANSACTIONS AS FLOW OF KNOWLEDGE AND INNOVATION

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. In this sense, the relationship between the European Union (EU) and its neighbouring countries is a crucial issue for the future of Europe.

So far literature has mainly focused on the governance perspective of the ENP and on the movements of tangible elements like goods (trade), capital (foreign direct investment) 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. 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 the European Neighboring Countries (ENC).

The policy brief aims at investigating in details the **transactions and agreements** performed **from 2000 to 2011** 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, it will be explored the concurrent effect exerted by cultural, political and spatial distances on the flows of M&A deals occurred between any two countries belonging to the whole EU or to the ENC over the same period. More specifically, we investigate the role that distances play in determining the M&A activity by analyzing the drivers of both the probability of observing a cross-country economic and business interaction and the intensity of such interactions.

This policy brief forms part of SEARCH's policy brief series. It contains key observations on transactions among ENC and the rest of the world analysed as possible chance of knowledge flows.

EVIDENCE AND ANALYSIS

TRANSACTIONS AS A
CHANNEL OF
KNOWLEDGE FLOWS

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.

MAIN FEATURES OF ENC
TRANSACTIONS
MARKET...

It has been shown 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** in the deals.

...AND SOME
COUNTRIES'
PECULIARITIES

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.

INTERNATIONAL VS
DOMESTIC DEALS

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.

THE SECTORAL
DIMENSION

With 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.

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.

THE ROLE OF POLITICAL INSTABILITY AND CULTURAL DIFFERENCES

Also 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.

This result is robust to the econometric analysis. Main findings indicate that the probability of observing an M&A deal is positively related to the relative masses (population) and the economic development level (GDP per capita) of the acquirer and target countries, while it is negatively related all distance measures. In essence, **if two countries are very distant in terms of spatial, cultural, and institutional dimensions, the probability that they will not conclude a bilateral deal is high**.

Moreover results show that the acquirer country's level of economic development is a very important determinant of the intensity of M&A deals for the acquirer, while population is relatively more influential in the target country. Its technological level act as relevant and attractive features for potential acquirers, whereas the target's economic outlook (GDP per capita) rate of growth does not seem to provide any additional contribution.

POLICY RECOMMENDATIONS

A RIGHT WAY TO SUPPORT KNOWLEDGE FLOWS

The relationships between the EU and ENC countries has received great attention since 2007 when the EU has attempted to develop an integrated policy towards the non-candidate countries on the EU's eastern and southern borders as an alternative to further enlargements. Among the different ways in which valuable interactions between the EU and ENC are generated, capital transactions represent a key channel and M&A activity is one of the most effective ways for directing capital towards productive sites. Therefore, from a policy perspective our results, by enhancing our understanding of the determinants of M&A activities among EU and ENC countries, provide useful insights to assess whether the European neighbouring policy (ENP) is becoming effective in offsetting tangible and intangible barriers between the two country groups.

In this perspective, **in order to support knowledge flows among ENC and EU countries international transactions should be supported and encouraged by ENP** because 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.

LACK OF DEMOCRACY AND HUMAN RIGHTS AS A KEY CONDITION TO ENHANCE INNOVATION

Given the very important role played by political, cultural and social distance, **efforts towards a democratic reform and the achievement of widely recognized human rights should be strongly encourage by European institutions.**

As a matter of fact, notwithstanding the merits of the ENP and the goals achieved so far, the reported “distances” indicate that there is plenty of unfulfilled potential in the relationships between the EU and the ENC countries.

Moreover, the relative political-institutional distance measures employed in the empirical analysis indicate that **countries like Belarus, Libya, Syria, Azerbaijan, Russia, Ukraine, Moldova, Egypt, Jordan rank very low in terms of democracy, human right, rule of law, good governance and market economy principles, whereas top positions are taken by the most advanced EU countries, namely Sweden, Denmark, Finland, The Netherlands, Austria.**

This calls for more efforts from both sides in order to accelerate the process of ENC democratic reform and thus reduce the existing gap in democracy and human rights values. **Increased financial assistance and technical support from the EU side and stronger actions towards democratic control, political and civil liberties, competitive elections, freedom of organization and freedom of expression, fight against corruption and violence from the ENC side are expected to improve the level of cooperation, to increase economic integration and people movements, to make ties closer and to strengthen peaceful relationships.** Ultimately, this enduring process should guarantee widespread democratic shared values, indispensable for civil and political stability, sustainable long run development and economic prosperity.

RESEARCH PARAMETERS

Introductory statement

This policy brief summarizes the policy implications related to research about firms' technological alliances and knowledge flows among EU countries and ENC which are reported in three related contributions:
 Di Guardo M. C., Paci R. "Firms' alliances in the European Neighboring Countries" Search WP4.15
 Di Guardo M. C., Marrocu E., Paci R. "The Concurrent Impact of Cultural, Political, and Spatial Distances on International Mergers and Acquisitions" Search WP4.22
 Di Guardo M. C., Paci R. "Firms' transactions and knowledge flows in the European Union's Neighboring Countries" Search WP4.23s:

Objectives of the research

The main objectives of the research were 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;
- focus on the geographical directions of the transactions to appraise the role of spatial and cultural proximity among EU and ENC;
- explore the concurrent effect exerted by cultural, political and spatial distances on the flows of transactions;
- investigate the role that distances play in determining the M&A activity by analyzing the drivers of both the probability of observing a cross-country economic and business interaction and the intensity of such interactions.

Methodology

The research is based on the SDC Platinum database (Thompson-Reuter) and consider announced M&A SA and JV deals between 2000 and 2011 in which the target or acquirer company is based in one of the ENC. The research consists of two main parts. The first one is basically descriptive and examines the evolution of the ENC transactions (M&A, JV, SA). 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.

The second part examines, through a rigorous econometric analysis, the concurrent effects of cultural, political and spatial distances on the flows of transactions between 27 EU and 16 ENC countries including Russia. We employ a zero-inflated negative binomial specification within a standard gravity model to explore how those distances affect the probability that two countries choose in the first stage to be really involved in bilateral deals and in the second stage the rate of recurrence of the actual transactions.

PROJECT IDENTITY

Sharing Knowledge Assets: InterRegionally Cohesive Neighborhoods
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Duration

1st August 2011 and ends the 31st July 2014

Funding scheme

European Community's Seventh Framework Programme FP7-SSH-2010-2.2-1
(266834), 2011-2014
Collaborative Projects

Budget

EU contribution: 2,636,942.00 €

Website

www.ub.edu/searchproject

Further Reading

Di Guardo M. C., Paci R. "Firms' alliances in the European Neighboring Countries"
Search WP4.15
Di Guardo M. C., Marrocu E., Paci R. "The Concurrent Impact of Cultural, Political, and
Spatial Distances on International Mergers and Acquisitions" Search WP4.22
Di Guardo M. C., Paci R. "Firms' transactions and knowledge flows in the European
Union's Neighboring Countries" Search WP4.23