

## Box 4

### Merger and acquisition activity and the composition of the financial account of the euro area balance of payments

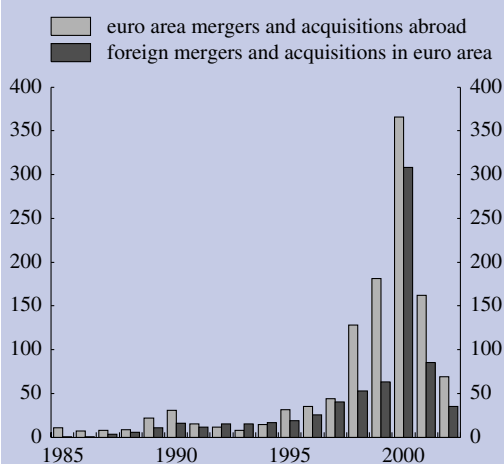
The direct and portfolio investment accounts of the euro area balance of payments were strongly affected by merger and acquisition (M&A) activity between 1998 and 2002 (see the article entitled “Developments in the external direct and portfolio investment flows of the euro area” in the Monthly Bulletin of July 2002). During this period, euro area companies were particularly active in forming partnerships with and investing in foreign firms as a means of strengthening their global market positions and acquiring technological know-how and expertise. The purpose of this box is to provide a more detailed account of the dynamics of euro area companies’ M&A activity and its relevance for developments in the composition of the euro area financial account. The analysis is based on data for settled M&A transactions from Thomson Financial.

#### Dynamics and composition of euro area merger and acquisition flows have shown marked changes

Euro area companies’ M&A activity outside the euro area has gone through different phases since the 1980s. After registering few and relatively small transactions until 1997, M&A investment increased markedly in 1998. The peak of activity was reached in 2000, when the value of euro area companies’ investment in M&A abroad soared to €366 billion. M&A investment by euro area companies dropped strongly after 2000, to €162 billion in 2001 and €69 billion in the first half of 2002. A similar pattern, although smaller in magnitude, was observed for M&A investment by non-residents in the euro area (see Chart A).

#### Chart A: Euro area merger and acquisition activity, 1985-2002

(EUR billions; annual data)



Sources: Thomson Financial and ECB calculations.

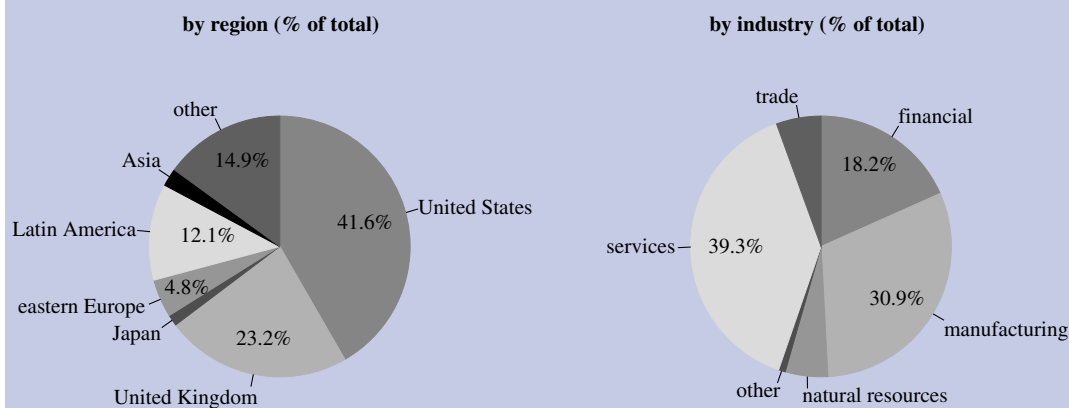
Note: Figures for 2002 are for the period from January to June.

This rapid rise in M&A activity in the late 1990s took place against a background of increased global economic integration and competition, a favourable global economic environment and the boom in high-technology industries, particularly in the United States. The sharp drop in M&A activity after 2000 coincided with the decline in global equity markets, led by technology indices, and the economic slowdown in developed economies.

The United States received the largest share of euro area companies’ M&A investment. In the period from 1985 to 2002, it accounted for 41.6% (or €479 billion) of the total. Other large recipients of euro area companies’ M&A investment were the United Kingdom (23.2% or €267 billion) and Latin America (12.1% or €140 billion) – see Chart B.

As to the sectoral composition of M&A activity, 39.3% of all M&A investment by euro area companies abroad was undertaken in the services sector, 30.9% in the manufacturing sector and 18.2% in the financial sector (see Chart B). A noteworthy aspect is the changing sectoral composition of M&A activity over the period from 1985 to 2002. Until the mid-1990s, more than half of all M&A investment occurred in manufacturing, whereas the M&A boom in the late 1990s took place mainly in the services sector and, in particular, in high-tech industries. The high-tech industry, comprising several sub-categories (biotechnology, computer equipment, electronics, communication technology and other high technology) of the sectors listed in Chart B, accounted for about 50% of all M&A investment in 2000. In the period from 1985 to 1997, by contrast, the share of high-tech industries in M&A activity was around 14%. This underlines the fact that M&A flows since 1998 have been driven mainly by M&A activity in high-tech industries.

**Chart B: Euro area mergers and acquisitions abroad, 1985-2002**



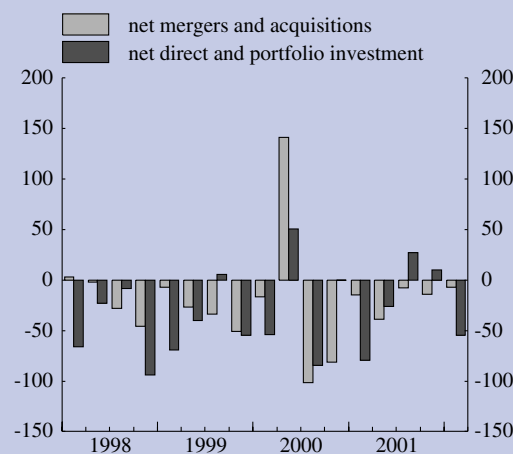
Sources: Thomson Financial and ECB calculations.

**Merger and acquisition activity plays an important role in overall developments in euro area direct and portfolio investment flows**

How M&A transactions are recorded in the euro area financial account depends on the method of settlement used. An M&A transaction settled in cash affects the direct investment account and “other investment” of the euro area balance of payments, whereas a settlement through an exchange of shares will affect the portfolio investment account. Chart C compares the magnitude of M&A activity with developments in direct and portfolio investment of the euro area. The chart shows that the net M&A activity outflows from the euro area have been substantial in most of the quarters since 1998, with the notable exception of the second quarter of 2000 when some major purchases of euro area firms by foreign companies led to significant net inflows. Net outflows related to M&A activity have accounted for a large share of the net outflows in combined direct and portfolio investment. Overall, M&A transactions are a key factor for explaining developments in the composition of the financial account of the euro area over the past five years.

**Chart C: Net mergers and acquisitions and net direct and portfolio investment, 1998-2002**

(EUR billions)



Sources: Thomson Financial, ECB and ECB calculations.