Chapter 9

M&A vs. Greenfield: FDI for Economic Growth in Emerging Economies

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ABSTRACT

The chapter has raised two critically important questions. First, is the M&A boom a one-time effect of privatization, or is it likely to be followed by a rise in Greenfield investment? Second, do these two types of FDI mode have different macroeconomic consequences in terms of aggregate investment and growth? The main purpose of this chapter is to analyze the two entry modes, mergers and acquisitions and Greenfield investment, specifically, and to present a comparative view of the same and how it leads to the economic growth of a nation. It is concluded that one should choose the right mode according to the different situation about the firms in the international market. The present chapter also concludes that Greenfields and M&As do have a positive homogenous effect on growth. Additionally, the enhancement of human capital is an important condition for the host countries to derive the maximum benefits from Greenfields and M&As. Also, there is empirical evidence of a two-way linkage between FDI and growth. However, the bidirectional relationship exists only for the M&A’s growth nexus.

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INTRODUCTION

The multinational enterprises (MNEs) and foreign direct investment (FDI) have always played a pivotal role in spurring economic growth and jobs by integrating the economy to the world market, transferring new technology and innovation, and developing human resources. FDI has grown rapidly since 1990 far exceeding the volume of world trade. The positive contribution of MNEs and FDI in economic development and growth is recognized and supported by economic literature, MNEs’ FDI decisions are little understood and until recently why they choose certain entry mode versus another has not been adequately explained in both theoretical and empirical sense.

The official definition of foreign direct investment specifies that a financial-account transaction is considered as FDI if a company’s stake in a subsidiary exceeds ten percent (OECD, 2008a). However, this definition brings together two different forms of foreign investment: Greenfield investment, whereby foreign investors build a new productive unit from scratch, and mergers and acquisitions (M&As), whereby foreign investors acquire existing assets. While the former implies an accumulation of capital, latter is essentially a transfer of ownership.

Within the neo-classical model, FDI is expected to promote growth through its contribution to capital formation (Solow, 1975). In latter study, Herzer et al. (2008) claim that supplementary capital brought about by FDI under the Solow-type standard framework does not have long-term effect on growth. The new endogenous growth model on the other hand reflected the importance of human capital and technology in the production function of the recipient economies. According to De Mello (1997), FDI might have encouraged the incorporation of new technologies and knowledge transfer from more developed nations to less developed ones. A number of studies have suggested that the positive technological and knowledge spillovers proposed by endogenous growth theories may not exist in less-developed nations. According to Kokko et al. (1996), domestic firms in less-developed countries, with backward production technologies and a low-skilled labour, may not be able to learn and benefit from multinational enterprises if the technology and knowledge gap is too wide. Aitken and Harrison (1999) eventually found that the increasing existence of foreign enterprises could have negative impacts on the host country’s economy. This could be problematic if investment inflows into a less-developed country are primarily in the form of resource-seeking FDI – a situation in which foreign investors invest abroad to obtain resources and other input supplies that are either too costly to obtain or unavailable in the home market (Brouthers et al., 2008). Thus, if FDI draws away a country’s scarce-resources, while labour skill and technological level is not insufficient to absorb advancements and other benefits from FDI, then such investments could discourage the positive spillovers.
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