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The Impact of Foreign Direct Investment on Financial Performance: Results from the Mergers and Acquisitions (M&A) Experience of Canadian Firms from 1999 to 2005.

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Abstract

Mergers & Acquisition is an important strategy for higher market share, rapid market penetration and economies of scale. Trans-border M&A is an important part of the annual FDI (Foreign Direct Investment) flow. In recent years, Canada has witnessed an impressive number of mergers and acquisitions. The popular belief in connection with the subject of mergers and acquisitions is relatively mixed. However, when the acquirer is non-Canadian company especially from the countries other than the USA, Canadians express negative view on the M & A deals. In this study, we analyze the financial performance of pre- and post-acquisition of 95 mergers and acquisitions that took place in Canada between 1999 and 2005. These mergers and acquisitions have all been made by companies that are not Canadians. The results show that the post-acquisition financial performance is substantially the same as the one obtained pre-acquisition. We use the average earnings per share as a tool for calculating financial performance. In addition to measuring the change in earnings per share through pre- and post-acquisition, we conduct segmentation by industry, size of investment, business experience and nationality of the buyer to understand whether these factors can explain the success or failure of a merger or acquisition transaction. In light of the results, only the industry and business experience affect, to a certain level, the chances of successful mergers and acquisitions.

Research field: Strategic Management, Finance, M&A.

1. Introduction

Mergers & Acquisition is an important strategy for higher market share, rapid market penetration and economies of scale. Trans-border M&A is an important part of the annual FDI (Foreign Direct Investment) flow. According to Reuter and Thomson's survey (2010)[5] , the amount of M &A is likely to cross 3 trillion dollars. However, trans-border M&A is very often a controversial issue despite the fact that countries involved in such cases are believer of the free trade and investments and all of them are the member of the WTO (World trade organization). Economic nationalism in the name of national security, energy security, mineral resource security or untold economic security

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has barred many prospective M&A projects around the world. Dubai port authorities tentative bid for the US ports or the Australian BHP's corporation's bid for the Potash Corp. of Saskatchewan (Canada) are the latest series of such examples. There are many formal and informal structures in place which bar these trans-border M&A transactions. The "Administrative guidance" along with the multi-corporation "Keiretsu" system in Japan, the "Committee on Foreign Investment in the United States" (CFIUS) in the USA, Central State council of China, Investment Canada Act. and inter-connection requirements (for telecommunication) in the EU are all designed to protect national firms from takeover by foreign entity. Investment Canada Act's requirement of "Net benefit" approach to foreign direct investment is in stark contrast to the approach to merchandise trade, the traditional focus of trade policy, where the theory is reciprocity rather the Net benefit analysis. In recent years, Canada has witnessed an impressive number of mergers and acquisitions. The popular belief in connection with the subject of mergers and acquisitions is relatively mixed. However, when the acquirer is a non-Canadian company, the Canadian's reactions are much more negative than if the Acquirer is a Canadian firm. On the back ground of this reality in mind about the M&A, we analyze, in this study, the financial performance of pre- and post-acquisition of 95 mergers and acquisitions that took place in Canada between 1999 and 2005 in order to see what financial results says about the M&A. These mergers and acquisitions have all been made by non-Canadians companies. We use the average earnings per share (EPS) as a tool for calculating financial performance. In addition to measuring the change in earnings per share through pre- and post-acquisition, we conduct segmentation by industry, size of investment, business experience and nationality of the buyer to understand whether these factors can explain the success or failure of a merger or acquisition transaction. In light of the results, only the industry and business experience affect, to a certain level, the chances of successful mergers and acquisitions.

Several landmarks of the Canadian economy are thus passed into the hands of foreign investors. In this regard, the most recent example is that of Alcan, which was sold during the summer of 2007 to Rio Tinto for $ 38.1 billion USD (United States Dollars). There are hundreds of examples that are similar to Alcan. In this context, it should be noted that the biggest wave of mergers and acquisitions has not only hit Canada but also all the industrialized countries affected by increases of mergers and acquisitions.

To demonstrate the importance of the phenomenon of foreign direct investment (FDI), the UN report on world investment in 2008[6] establishes that the inflows of FDI increased significantly in recent years. These flows in 2007 reached the sum of 1.883 trillion USD. These figures include a large proportion of mergers and takeovers that reached, according to the United Nations report, the sum of 1.637 trillion USD in 2007. In Canada, according to the data on trade and investment in 2008[7], published by the

Ministry of Foreign Affairs and International Trade, FDI inflows to Canada were 118.1 billion USD in 2007.

This background on flows of foreign direct investment, especially on the impressive proportion of global mergers and acquisitions, raises the issue of the merits of FDI. In this regard, some authors argue that FDI increases economic growth because they generate technology transfers between the origin country and the host country (Borensztein et al.1998). FDI can improve productivity, quality and competitiveness (Thériault & Beckman 2008). FDI also increases knowledge about training the workforce, contributes to the acquisition and dissemination of new knowledge, and allows managers to learn new organizational practices (De Mello 1999). However, these studies are obviously well-contested by some authors. They claim, among other things, that the correlation between FDI and economic growth is not positive (Trailer Nabende & Ford 1998 cited by Li & Liu 2005, p.393). Other authors report that in the case of FDI, job losses are felt in the host country especially when it comes to mergers and acquisitions (Lehto & Böckerman 2008). In light of this, an inquiry is needed to determine whether a problem actually exists that foreign interests are investing heavily in Canada. In this regard, it is important to mention that the Canadian public opinion is much divided concerning FDI under the framework of the M&A.

The overall objective of this paper is to study on a longitudinal basis the pre-and post-trade financial performance of Canadian companies acquired by foreign interests. This study will focus only on profits that Canadian shareholders may gain from these transactions and what conclusions they should take when their company is in process of being bought by foreign interests. In order to achieve the main objective, the impacts of four factors on the financial performance of Canadian companies' pre and post-acquisition will be observed. These elements are the sector of activity, the number of years of operational experience of the buyer, the size of direct investment abroad and lastly the country of origin of the buyer.

The article is structured as follows: First, a literature review will be presented to better understand the concept of foreign direct investment in terms of mergers and acquisitions (M&A), Greenfield Investment, FDI determinants, roles of FDI in the host country, and the results of quantitative studies on financial performance of pre- and post-acquisition. Second, the discussion on methodology will be presented. The results section will follow the collection of data and analysis sections. These results will be analyzed in comparison with other quantitative studies. In this regard, this section will also address the limitations of this study as well as ideas for further research. Finally, this paper will be completed by a brief conclusion.

2. Literature Review

Mergers and acquisitions are undoubtedly one of the most important components of FDI. The clear consensus in the literature is that mergers and acquisitions are defined as the consolidation of companies. What the literature tells us about mergers and acquisitions is that they come in waves. Authors (Martynova & Renneboog 2008) state that acquisitions are more frequent in periods of economic recovery because of the availability of credit. Their study indicates that all waves of acquisitions end with a stock market crash or changes to regulations (anti-trust or deregulation of markets). Other studies show that the most recent wave of acquisitions of companies have not been made in order to restructure operations, but more in a context of expansion of an industry with high growth potential (Andrade & Stafford 2004).

According to the report prepared by the Task Force on Competition Policy[8], Canada is not lagging behind the important waves of mergers and acquisitions which are taking place worldwide. The most recent data indicate that Canadian companies are very active in the number of acquisitions abroad. In return, foreign acquisitions in Canada are less numerous, but their average monetary values are more important.

The literature pertaining to Greenfield Investment is not as plentiful as in the case of mergers and acquisitions. In fact, the distinction is rarely made between these two types of foreign direct investment. The Greenfield Investment is defined by Liu and Zou (2008) as projects of investment in new production facilities, new offices, buildings and in intangibles such as research and development. The study (Liu & Zou 2008) found that Greenfield Investment allows for a better diffusion of innovation through research and development that is done in the host country. These findings are not supported by the study of Slanger and Hennart (2007) who argue that companies that have a better knowledge in research and development will preferably choose the Greenfield Investment as a mode of entry instead of mergers and acquisitions.

According to the studies reviewed, Greenfield Investment does not come in waves such as mergers and acquisitions. The choice of this input method is mainly dictated by the knowledge that shareholders have on the local market and their expectations for return on investment (Hennart & Slanger 2007). However, there is no clear consensus in the literature on which of the two methods of FDI is more profitable for the host country. In this regard, no study arrives at an empirical conclusion since, as mentioned previously, the figures for Greenfield Investment are always combined with those of mergers and acquisitions.

3. Determinants of FDI

One of the first authors to address the issue of foreign direct investment was Kindleberger in the late 1960s. He reported that in a market where free competition exists, foreign direct investment would not be possible (Kindleberger 1969, quoted by Calvet 1981, p.43). According to Kindleberger, when all markets operate efficiently, it is not possible to benefit from economies of scale in production, and where barriers to trade and competition do not exist; the only option that exists for foreign investment comes from international trade.

The basis of this approach rests on the fact that local companies have a better understanding of their market than their international competitors. Therefore, for a foreign company that prefers FDI, the latter must have the upper hand, an important advantage over local companies so that their investment is profitable, and secondly, the market must be imperfect to accept the arrival of an outside company (Hymer 1960).

Kindleberger (1969) identifies that for a foreign direct investment to occur, it must fall into one of four categories. These categories or determinants of FDI are shown in the "Market Imperfection Paradigm" by Kindleberger.

The prime determinant of foreign direct investment refers to the notion of balance between supply and demand. Considering that this balance is not always achieved, the result justifies an increased flow of foreign direct investment. An example of this imbalance lies in the exchange rate between two countries. The literature shows that the depreciation of currency may mean that a country’s assets are undervalued. Consequently, this increases foreign direct investment because companies will try to take advantage of this opportunity to make a profit on the transaction (Froot & Stein 1991). According to Kindleberger’s theory, when the exchange rates return to equilibrium, we should see a reduction in FDI. This approach has been confirmed empirically by the study of Frost & Stein (1991). The imbalance in the market will also attract FDI in countries where the profit potential is greatest (Kindleberger 1969 cited by Calvet 1981, p.44). For example, it is common to see companies invest in countries that offer cheaper labor, in order to maximize their profit potential. According to Kindleberger (1969), another example of market imbalance is the different level of technological know-how. He argues that technological progress may vary between nations, which give some countries a competitive advantage. Companies operating in a market with superior technology will try to invest in comparatively less technological advanced countries to address this problem, and increase their return on investment through the transfer of knowledge (Al-Azad, Mohiuddin, & Rashid 2010; Nabende & Ford 1998 cited by Li & Liu 2005, p. 395).

The second determinant of foreign direct investment is found in both the host government and the country of origin. Very rarely they are neutral in regards to inflows and outflows of FDI. The entry requirements for companies vary by sector of activity and the amounts (Shapiro & Globerman, 1999). One of the main determinants of FDI is that governments have power to tax companies that settle in the host country. The literature on this subject is abundant on the direct effect of taxes on FDI. In fact, entry taxes result in fewer foreign investors to invest in a country (De Mooij & Ederveen, 2003). Furthermore, the literature shows that companies can, in some cases, also face charges in their country of origin. This happens primarily during the repatriation of profits received abroad. This double taxation between the host country and country of origin is clearly a determining factor for FDI (Blonigen 2005). The Government is also responsible for protectionist measures, which undoubtedly is another example of a determinant of FDI. The literature on this subject shows that the erection of barriers to entry, whether sectoral or general, will encourage foreign companies to promote FDI instead of exporting (Blonigen 2005). Blonigen defines this strategy as tariff-jumping. This strategy is most appropriate, according to Blonigen, for multinationals that can afford FDI. The big losers are the SMEs that don’t have the financial ability to support FDI, and have therefore adopted the strategy of export (Blonigen 2005).

The last two determinants of foreign direct investment are imperfect market structures and market failure imperfections. According to Kindleberger, prices are not determined by the market in an industry dominated by oligopolistic companies. This is confirmed by

Armel (2006) who indicates that FDI often concern oligopolistic industries. Why does the presence of oligopolistic companies represent an important determinant of foreign direct investment? Simply because it has been demonstrated by Kindleberger that companies operating in oligopolistic industries[9] are better positioned to generate profits and stimulate growth.[10] Moreover, oligopolistic companies that have products that control and are differentiated efficiently in their local market, will use their profits to capture new markets through, among other things, foreign direct investment. An example of this approach is the theory of product life cycle[11]; that the company embarked on an expansion abroad to maximize technology development done in the country of origin. This strategy was especially noted when the product developed reaches maturity in its country of origin, and that the company feared a possible decline in sales (Kindleberger 1969). Although some authors list other factors, most of the texts reviewed showed that foreign direct investments are made to 1) capture new markets and 2) reduce production costs (Buch et al. 2005).

4. Role of FDI in the host economy

From a macroeconomic perspective, the literature shows that the leaders of developed countries and emerging countries attach great importance to foreign direct investment. According to public belief, these investments would indirectly increase the productivity of local companies through the transfer of knowledge generated by foreign companies (Javorcik 2004). The literature appears divided on this issue because some empirical studies show that there is no correlation between the presence of foreign firms in a market and increased productivity. These findings have however been made in developing countries, and are inconsistent with recent studies in the United Kingdom and the United States of America which show that there is an increase in productivity in the host country after FDI (Haskel et al. 2007). Indeed, the study of Haskel conducted in the United Kingdom demonstrates that the presence of foreign direct investment increases the productivity of local companies by 0.5%. This increase in productivity has also been noted in the study and Piscitello & Rabbiosi (2005) conducted in Italy. This study also found that there is no distinction between Greenfield Investment and mergers and acquisitions, as it relates to both types of FDI.

Another advantage that emerges from FDI is the increase in competitiveness of local firms. In this regard, a study conducted in Ireland in 2005 (Barrios et al. 2005) shows that due to foreign direct investment, the local economy fits into two phases. The first phase involves a purification of companies that are underperforming, and why the coming of FDI on their local market leads to closure of activities. The second phase is much more attractive to governments because it has been shown that the number of start-up companies increases significantly in the post-FDI. In simple terms, this study establishes that in a developed country, the arrival of FDI increases competitiveness and the number of companies in the industry concerned by these investments.

According to Lehto & Böckerman (2008), FDI that took place in Finland between 1989 and 2003 have consistently resulted in job losses. This study was mainly dealt with the impact of mergers and acquisitions in various sectors. According to the authors, the job losses in manufacturing were more important than the loss of jobs in so-called non-manufacturing. Indeed, the authors found that job losses of 20% in the manufacturing sector two years after such mergers and acquisitions. For non-manufacturing sectors known, the authors found a temporary increase in the number of jobs. However, this increase is absorbed in full after a period of two years.

According to Doukas & Lang (2003), foreign companies that invest in their business performed better than post-acquisition financial companies wishing to diversify into fields of activities other than traditional activities. This study also demonstrates that the geographical diversification of activities in fields other than the core fields causes inefficiencies in the management of companies and negative synergies among different segments of the company's operations. In the short and medium term, it has been shown that these investments generate significant financial losses (Doukas & Lang 2003).

5. Pre-and post-acquisition financial performance

The study of Andre and Yen (2007) identified the pre-acquisition financial performance of 287 Anglo-Saxon companies excluding the United States of America. It should be noted that among the 287 observations, there were a total of 71 acquisitions of Canadian companies. The study covers the period between 1997 and 2001 of public companies. In addition, the transactions were only mergers and acquisitions with a majority stake in the share capital. The companies have all been categorized according to their industrial sector and also by the size of the investment. However, no mention has been made in this study regarding the business experience of the target company. Regarding the dependent variable of financial performance, the latter was measured by the change in earnings before interest, taxes, depreciation and amortization.

The study of Hanley & Zervos (2007) identified pre-and post-acquisition performance of 755 UK companies acquired by companies, mainly from the United Kingdom, the United States of America and other countries. The study period was between 1990 and 1996. The purpose of this study was to verify the nationality of the buyer had an impact on financial performance. The dependent variable was measured in this study was to increase the productivity of the workforce. Segmentation by industry code has also been made to identify if the industry code could have an impact on increasing the productivity of labor. No segmentation by size of investment experience or by the target company has been conducted.

In the short-term, empirical studies are unanimous in their conclusions. In a market, mergers and acquisitions should create value for both shareholders who sell only to those who buy (Martynova & Renneboog 2008). This is mainly verified by the selling of shareholders. Indeed, several empirical studies tend to prove that in the short term, cumulative average abnormal returns[12] are positive. However, the literature tells us that the long-term financial performance of shares is not positive. Indeed, empirical studies conducted mainly in the United States show a destruction of shareholder value of the new entity resulting from the merger or acquisition. These studies have analyzed all the transactions say friendly, hostile transactions, transactions financed through equity or through debt (Martynova & Renneboog 2008).

From an accounting perspective, Martynova & Renneboog (2008) have identified 14 studies of 26 which show a decrease in post-acquisition financial performance, seven studies found no significant changes and 5 studies demonstrate improved post acquisition financial performance. In the case of the studies showing a negative impact, the latter mainly use profitability ratios as a criterion for analysis. Conversely, studies demonstrating a growth in financial performance use indicators based on generated cash flows.

In Canada, there are few studies that have focused on the issue of post-acquisition financial performance following mergers and acquisitions. The most recent study was conducted by Andre et al. (2004) on the market performance of 267 companies, including 167 Canadian companies, merged or acquired between 1980 and 2000. This study did not discriminate on the nationality of the buyer and also included in its sample Canadian companies that have merged or acquired other Canadian companies. In addition, this study did not consider the business experience in its criteria for analysis. The results of this study show a negative impact on stock market performance over a period of 36 months following mergers and acquisitions. This study also shows that companies acquired by American interests have had negative performances over the long term. The study of Eckbo & Thorburn (2000) analyzes the financial performance of 1,846 Canadian companies with mergers and acquisitions in Canada during the period between 1964 and 1983. This study did not consider the size of the investment or the buyer experience in its independent variables. The results of this study demonstrate that Canadian buyers are making positive returns following mergers and acquisitions. These results were positive but neutral when the buyer was American.

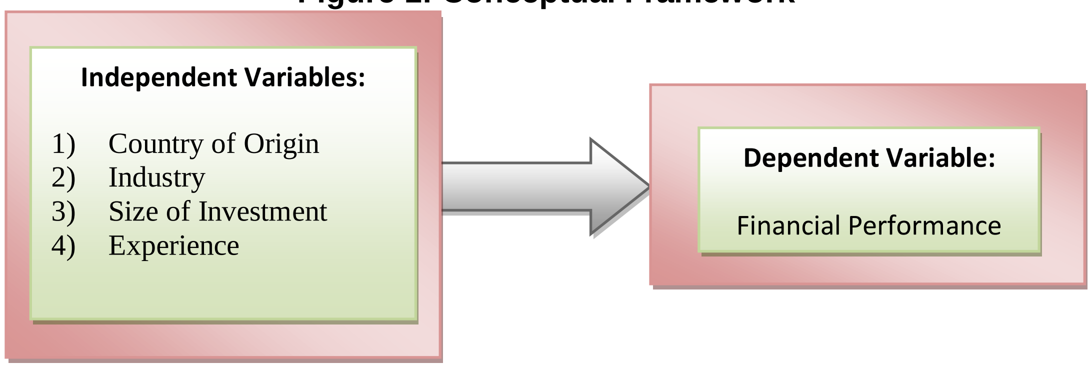
6. Conceptual framework and research hypotheses

Initially, when we speak of industry and business experience, the theory of "Industrial Organization View" tells us that the industry in which a company has implemented a strong influence on the financial performance of the company. This influence is more important than the internal forces of the company such as marketing, finance or operations management. The company's financial performance is mainly based on economies of scale it can achieve in its industry, barriers to entry that discourage the arrival of a new competitor, differentiation of products offered and the level of competitiveness (David 2008, p. 74).

In the case of the size of investment, the theory of "Resource-Based View" tells us that the internal forces of a company are more important than external factors presented in the theory of "Industrial Organization View" and thus allow a company to have a competitive advantage in its industry. The theory of “Resource-Based View" determines that the financial performance of a company based on these three items are availability of physical resources, the availability and training of human resources and the presence of organizational resources (David 2008, p. 106). The size of the investment or rather the purchase price of a company will be based on the availability of these resources within the acquired company.

Regarding the country of origin, cultural distance may explain the success or failure of a transaction between two companies from different countries on the scale of Hofstede (1980). Culture has been defined as the beliefs shared by members of an organization (Nahavandi & Malekzadeh, 1988, cited by Schoenberg 2000, p. 45). A strong corporate culture combined with a consistency between the culture of the purchasing company and the one that is bought generally produces better financial results (Deal & Kennedy 1982 cited by Schoenberg, 2000, p.45). Figure 1 shows schematically the interaction between the different concepts that were previously discussed.

Figure 1: Conceptual Framework



Considering the objectives of this research and in light of the literature review, the following hypotheses are therefore tested:

H1: The business has an impact on pre-and post-acquisition financial performance.

H2: The size of the investment has an impact on pre-and post-acquisition financial performance.

H3: The experience in business has an impact on pre-and post-acquisition financial performance.

H4: The country of origin of the buyer has an impact on post-acquisition financial performance

Data

To build a database sufficient to conduct this study, the Thomson One Banker database has been used. This database lists more than 615,000 mergers and acquisitions since 1979 worldwide. It should be noted that this database was also used in the study by André et al. (2004). A total of 95 companies were selected and the following selection criteria were applied:

a) The transaction must be regarded as a merger or acquisition.
b) Companies that purchase must not be Canadian.
c) The companies purchased must be Canadian.
d) Both the buyer purchased the company must be listed on an exchange.
e) The transaction must be completed between 01/01/1999 and 31/12/2005.

f) The acquisition must be at least 10% of the capital stock.
g) The type of transaction must include an exchange of shares.
h) The minimum value of the transaction must be 10 million USD.

In a second step, the SEDAR database was used to find the financial information of Canadian companies. Regarding the U.S. and foreign firms, the Bloomberg database was used. For this study, all data were extracted in Canadian dollars and were provided automatically by SEDAR and Bloomberg. The performance ratio that has been retained, earnings per share on an annual basis, was considered for three periods before the merger and acquisition (T-3, T-2, T-1), and three periods after the merger and acquisition (T +1, T +2, T +3). The year T-0 was not considered since it is not representative for the purposes of this study.

A distribution by SIC industry code has also been used. The number of transactions in the industrial sector of natural resources (30%) is lower than that recorded in the study by André et al. (2004) which was 38%. The fact remains that this business is greatly appreciated by foreign investors. Indeed, the deadline of December 31, 2005 used in this study therefore excluded transactions sizes that have taken place in the natural resource industry in 2006, 2007 and 2008. More specifically, the acquisition of Inco Ltd. by Companhia Vale does Rio Doce for 19.8 billion Canadian dollars, or that of Falconbridge Ltd. by XSTAT plc. for 19.2 billion Canadian dollars.

In terms of distribution by country of origin, the acquisitions by U.S. companies represent approximately 72% of transactions in the study. The second most active country, according to the United States of America, is Great Britain with 12 transactions totaling 15.7 billion USD. The number of years of Canadian companies that have been acquired and those foreign companies that have invested in Canada has been observed. The average age of foreign companies that have invested in Canada is 61 years. Indeed, it is more than double the average of Canadian companies (27 years).

7. Methodology

7.1 Definition of variables

The financial performance, which is our dependent variable, will be measured from a widely accepted indicator in the financial field, that is to say, the earnings per share[13]. Earnings per share represent net income (or loss) per common share outstanding. Firstly, this ratio is used to measure the financial performance, the increase or decrease of profitability, of the acquired company, and secondly to observe the creation or destruction of shareholder value of the acquired company. Several other performance ratios have been used in this study. The selection of the ratio of earnings per share was made in the interests of ease of data collection. Indeed, state owned enterprises are required to submit such financial information in their financial statements. In addition, the ratio of earnings per share has also been used in other similar studies including those of Healy & Palepu (1988), Sharma & Ho (2002), and that of Kumar & Bansal (2008). Furthermore, the ratio of earnings per share allows comparisons regardless of industry or the country of origin of the company.

As presented in the conceptual framework, the independent variables for this study will be the country of origin, industry, size of investment, and experience. Initially, it will check if the country of origin of the company that purchases could have a positive impact or negative impact on post-acquisition financial performance. This questioning is necessary because the vast majority of acquisitions made in Canada are by American firms. Are the differences or similarities in the cultural model developed by Hofstede (1980) able to explain the financial performance achieved? The independent variable will be segmented into three distinct parts: acquisitions by U.S. companies, acquisitions by European companies, and acquisitions from other countries mainly advanced emerging countries such as China, India as well as Brazil or financial giants from oil exporting countries using sovereign funds.

The second independent variable in the study will be the sector of activity. Since the last decade, the vast majority of Canadian natural resources companies were acquired (Andre et al. 2004). In this regard, this study will use segmentation similar to that developed in the study by André et al. (2004). Companies will therefore be divided by industry code SIC (Standard Industrial Classification)[14] varying between 0000 and 8900. The advantage of this segmentation is to check if the chances of success following an acquisition can be influenced by the industry type of the buyer and the acquired company. It should be noted that this independent variable will be checked for the pre- and post-acquisition periods of Canadian companies.

The third independent variable is the size of the investment. In this context, segmentation is performed for transactions less than one billion Canadian dollars, and those above this amount. This segmentation is interesting insofar as the current trend is the higher level of the dollar value of transactions conducted in Canada.[15] This will involve verifying whether the size of the investment could have an impact on pre-and post-acquisition financial performance. Indeed, the greater the investment needed to acquire the Canadian companies, the greater the level of overall indebtedness of the new entity resulting from the merger and acquisition is important. Thus, it is arguable that financial performance will be negatively affected by the size of the investment. Finally, the last independent variable in the study will be the number of years of experience of the purchasing company. It is arguable that the business experience could determine the success or failure of a transaction. The last independent variable will also be checked in pre-and post-acquisition.

7.2 Description of the Method

The method used in this article is inspired from Bruner (2003) and consists of the average three-year earnings per share of the Canadian company bought by foreign entities. This three-year average is then categorized into three segments, small (1), medium (2) and large (3). This categorization has been made for foreign companies buying Canadian companies. This procedure allows us to understand how likely a company that historically was in category 1 (small) can switch to Category 2 (medium) or to category 3 (large). The analysis will help understand which factors can influence the creation or destruction of value in terms of earnings per share. Table 1 shows the distribution of companies.

Table 1: Distribution of companies according to the average earnings per share

Category	Number of Companies	Percentage
Canadian Companies		
Category 1 (Small)	32	33.7%
Category 2 (Medium)	32	33.7%
Catégorie 3 (Large)	31	32.6%
Total	**95**	**100.0%**
Foreign Companies		
Catégorie 1 (Small)	30	31.6%
Catégorie 2 (Medium)	32	33.7%
Catégorie 3 (Large)	33	34.7%
Total	**95**	**100.0%**

Two sets of data are therefore presented. Firstly, a logit[16] be calculated to find the probability that a Canadian company located in category 1 (small) to go to category 3 (large). The independent variables for this calculation will be the business sector (industry) of the Canadian company, the purchasing price and the years of experience in business. The same calculation will be conducted to determine the probability that a company located in category 2 (medium) can go in Category 3 (large). The same calculation of probability will be made on the companies that purchase. In this regard, the independent variables will be the purchasing price, the business of the buyer, the business experience of the buyer and the nationality of the buyer. The processing of these data is performed using SPSS 13.0.

8. Results

8.1 Pre-Acquisition Results

As mentioned previously, the independent variables for this section will be the type of business of the Canadian company, the purchase price and the business experience. The reference category is category 3 performance, which is above the average. Table 2 therefore presents the results of this study for Canadian companies.

Table 1: Pre-acquisition Results

Pre-acquisition category		Beta	Std. Error	Wald	Sig.
1	Sector	-0.009	0.131	0.005	0.946
	Ln price	-0.687	0.218	9.806	0.002
	Ln experience	-1.189	0.532	4.960	0.026
2	Sector	-0.312	0.147	4.521	0.033
	Ln price	-0.833	0.237	13.898	0.000
	Ln experience	-1.076	0.537	4.010	0.045
	Pseudo-R squared : Cox and Snell 0,35 Nagelkerke 0,39 Mcfadden 0,19				

The result for the industry category 1 is not representative. Contrarily, the significant threshold is reached at category 2. From these results, it appears that the industry has little or no importance in regard to earnings per share generated in the pre-acquisition period. Regarding the purchase price, it is just as significant in category 1 as category 2. It can be said that when the transaction is more important from a monetary standpoint, the greater the likelihood that the company can be found in Category 3. In this case, in the sample of 95 companies that were analyzed, the five largest transactions were all classified in category 3 in pre-acquisition. According to the results obtained, the buyer experience is significant for a company may be in Category 3. The size of the investment and the experience of a company increase the likelihood that the Canadian company that will be bought has a better performance, measured by the earnings per share.

8.2 Post-acquisition Results

The results show that the similarity between the type of business of the Canadian company being bought and that of the foreign company that is purchasing is of strategic importance with regards to earnings per share generated in the post-acquisition period. As shown in Table 3, we can see that among the companies listed in the case of category 1 (small), the sig. of the industry is 0.034. Regarding category 2, the sig. of the industry is 0.153. Although this result demonstrates a trend, it is not considered significant at a threshold of 10%.

Table 2: Post-acquisition Results

Post-acquisition category		Beta	Std. Error	Wald	Sig.
1	Sector	0.295	0.139	4.506	0.034
	Ln price	-0.165	0.182	0.817	0.366
	Ln experience	-0.606	0.361	2.819	0.093
	Nationality	-0.392	0.538	0.532	0.466
2	Sector	0.196	0.137	2.041	0.153
	Ln price	0.028	0.162	0.030	0.862
	Ln experience	-0.423	0.332	1.622	0.203
	Nationality	0.297	0.424	0.489	0.484
	Pseudo-R squered : Cox and Snell 0,16 Nagelkerke 0,18 Mcfadden 0,80				

These results are not surprising since the diversification level activities of a company have operational risks that have been identified in various previous studies. In this case, the results presented above are similar to those of the study of Doukas & Lang (2003). They have studied, in the case of FDI that the post-acquisition financial performance was similar to transactions during the same industry versus those who were outside the same industry[17]. Their findings indicate that companies realize higher gains when the international diversification has been made in the same industry as the original transactions. Investments in non-related industries tend to 1) increase the operational inefficiencies and 2) produce negative synergies among the various departments of the company, which result in financial losses in the short, medium and long term. Our findings also confirm the results of King et al. (2004) who argue that on average and across the most commonly studied variables, acquiring firms' performance does not positively change as a result of their acquisition activity, and is negatively affected to a modest extent.

The acquisition price, depending on results, has no impact on post-acquisition financial performance of foreign companies. Indeed, the sig.of 0.366 for category 1 and 0,862 for category 2 are not significant. Previous studies examined did not consider the size of investment as an independent variable. The results are surprising since the price of the transaction had previously been considered in the section pre-acquisition as a determinant factor.

The buyer experience is significant in the case of foreign companies that were in category 1 (sig. of 0.093). In the case of companies that are in category 2, the buyer experience is not significant. These conclusions are consistent with some literature on the subject. Indeed, experience in business cannot, by itself, ensure success when it comes to mergers and acquisitions (Finkelstein & Haleblian 2002 quoted by Duncan & Mtar 2006, p. 397). The study by Finkelstein and Haleblian (2002) explains that experiences in mergers and acquisitions made earlier are more important and significant than the mere fact of being in business for many years. Primarily, companies who have experience in acquisitions have managerial knowledge needed to effectively integrate the acquired entity within the new group (Duncan & Mtar 2006).

According to the results obtained, the nationality of the buyer has no impact on post-acquisition financial performance of foreign companies. Indeed, the sig. of 0.466 for category 1 and 0.484 for category 2 are not significant. These results differ from those obtained by Andre et al. (2004). Indeed, they had analyzed 267 acquisitions in Canada between 1980 and 2000. Their main conclusion was that the nationality of the purchaser, particularly for U.S. buyers, produced a destruction of value at overlapping average abnormal returns over a period of 36 months.

In light of this discrepancy, it should be noted that the sample of 95 companies purchased by foreigners, the majority came from acquisitions by U.S. firms. In our opinion, the cultural distance of Hofstede (1980) could explain why our sample was not sensitive to the nationality of the purchaser. According to the cultural dimension developed by Hofstede, Canadian and American cultures are very similar. Also, as mentioned by Schoenbert (2000), the most important aspect in the context of mergers and acquisitions is to find a company that shares the same culture, both organizational and national. Our results corroborate those obtained by Stahl and Voight, (2008) who posit that the effects of cultural differences vary depending on the degree of relatedness and the dimensions of cultural differences separating the merging firms.

Parallel to the cultural similarity of Hofstede (1980), it is worth mentioning that the study of Hanley & Zervos (2007) had also reflected on the nationality of the buyer vis-à-vis the financial performance of companies in the United Kingdom acquired between 1990 and 1996. Their findings confirm that nationality has no bearing on their financial performance analysis. Irrespective of the nationality of the buyer, the companies analyzed in the study of Hanley & Zervos (2007) show a decrease in productivity of 6% to 9% following merger and acquisition transactions. Among interesting future research avenues, scholars should apply the model developed by Weber & Drori (2008) to verify if national and corporate culture exert significant impact in the Canadian mergers and acquisitions. An equally interesting avenue that could shed more light on Canadian mergers and acquisitions results is the model of human resource management policies of Weber & Tarba (2009).

9. Limitations and Implications

A first limitation of this study lies in the criterion used to measure financial performance. Indeed, earnings per share are an interesting measure but are incomplete. It would be interesting to use other criteria for financial performance as the cash flow generated by operations or return on assets. Another limitation involves the difficulty to properly isolate the portion of mergers and acquisitions in the financial statements of the merged post-transaction entity. Indeed, the selection criteria that were used in this study meant that it is mainly multinationals that have been analyzed. Therefore, their financial statements do not fully understand the integration of the Canadian subsidiary in the overall results of the new group. A trail for future research could analyze private companies instead of public companies. Finally, the sample of 95 mergers and acquisitions studied probably represents a further limitation of this study. It would be interesting to see if the results would be the same on a sample of 200 or 300 companies.

The contribution of this work to theory relies on the use of Canada as a field of analysis of mergers and acquisitions by foreign companies. In Canada, no other study had examined the financial performance of pre and post mergers and acquisitions by foreign companies. The study by André et al. (2004) had used mergers and acquisitions as a basis for analysis. However, they do not consider the same independent variables as those used in this work.

Theoretically, we retain from this article that the pre-acquisition financial performance is sensitive to the size of the investment and business experience. Indeed, the results obtained demonstrate that the two independent variables increase the likelihood that a Canadian company's (that has been purchased) performance is determined by earnings per share. This progress had historically not been verified by other Canadian studies. The post-acquisition financial performance also depends largely on the similarity between the industry of the buyer and the seller. The business experience of both companies is critical to a successful long-term union. These findings corroborate with those of Douglas & Lang (2003) concerning the similarity between the business of the buyer and the seller, and those of Duncan & Mtar (2006) concerning the criticality of business experience.

The main contradiction of this work comes from the nationality of the buyer. Indeed, the study by André et al. (2004) found that cross-border acquisitions between Canada and the United States performing less well than other transactions in the long term. Unlike the study by André et al. (2004), this study does not consider the nationality of the purchaser as a decision factor for the success or failure of a transaction. Moreover, it is possible to consider that the cultural distance developed by Hofstede (1980) could explain why positively nationality is not a decision factor in our model. In fact, most buyers of the 95 analyzed in this study were from the United States of America. The similarities between Canadian and American cultures are very strong. These similarities in culture could explain why our model was not sensitive to the nationality of the buyer. From a practical standpoint, this study could initially engage the Government of Canada. Indeed, the Canadian government, as seen in the last election campaign, increased the minimum threshold for consideration of foreign direct investment. The project was to reduce administrative procedures for transactions of less than 1 billion Canadian dollars. Currently, the review threshold for foreign direct investment in Canada is 312 million Canadian dollars[18]. Considering that our model was not sensitive to the size of the post-transaction investment, this increases the threshold for review would have no significant impact, but probably increases the number of foreign transactions.

Meanwhile, this work could also be of interest to Canadian financial institutions in their strategic approach to mergers and acquisitions. In the current economic climate, it has been demonstrated by various bodies that access to credit is very good in Canada. Thus, Canadian banks could be approached to finance future transactions of mergers and acquisitions in Canada by foreign companies. The results of this study could serve as their base of work in the qualitative analysis of a transaction. Finally, the key stakeholder is the Canadian shareholder whose company is in the process of merger and acquisition with a foreign company. Often Canadian shareholders hold equity positions in the capital stock of the new merged entity. The success of the transaction in the long-term is important to the stakeholder heart as their name and reputation are often attached to the transaction.

10. Conclusion

The main purpose of this article was to verify whether foreign direct investment as M&A activities has a positive or negative impact on the financial performance of purchased Canadian companies. More specifically, it was discussed whether the industry, the size of investment, business experience or country of origin of the buyer could explain the creation or destruction of value from the Canadian shareholder's point of view. The method used was to identify the earnings per share average of three years previous to the acquisition and earnings per share average of three years following the acquisition. These earnings per share were then categorized into three segments. This categorization was used to calculate odds that a company located in category 1 or 2 can go to category 3.

From Canadian Shareholders' point of view, they were asked whether mergers and acquisitions involving the creation or destruction of value. The results obtained from 95 companies are not conclusive. Indeed, of the 95 companies analyzed, only 28 have seen their post-acquisition financial performance improve in their basic earnings per share average over the span of three years. The vast majority of companies analyzed (44) have presented similar post-acquisition results to their pre-acquisition results. Regarding the independent variables in the study, only the industry and business experience have a significant impact. In other words, the results show that buyers who invest in the same industry as their operations have a better chance that the transaction is positive in the long-term. In terms of business experience, this variable was significant in the model developed. However, it should distinguish between the numbers of years experience in operation versus the experience of acquiring and integrating companies. According to the literature reviewed, it is mainly the experience of integrating companies it should be regarded as a guarantee of success for a transaction.

Endnotes

[5] (http://www.reuters.com/article/idUSTRE6AE1F220101115)
[6] United Nations. "Report on the World Investment Report 2008" http://www.unctad.org/en/docs/wir2008overview_fr.pdf (Accessed April 10, 2009)
[7] Foreign Affairs and International Trade Canada. "Canada's State of Trade and Investment Update 2008 – including a special feature on Canadian Direct Investment Abroad " http://www.international.gc.ca/economist-economiste/performance/state-point/2008.aspx?lang=eng (Accessed April 10, 2009)
[8] Government of Canada. "Sharpening Canada's Edge", http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/h_00009.html (Accessed April 10, 2009)
[9] Marché oligopolistique: Structure industrielle dans laquelle un nombre relativement peu élevé d'entreprises offrent des produits allant des produits standardisés aux produits très différenciés (Kotler, Filiatrault &Turner 2000,p. 247)

[10] In economics, we speak of an imperfect market when prices are not determined by the market.
[11] Cycle de vie du produit : Représente les phases distinctes de l'évolution des ventes d'un produit. (Kotler, Filiatrault &Turner 2000, p. 370).
[12] The abnormal returns are defined as the difference between the current return and the expected return on an investment strategy (Fabozzi & Modigliani 1995, p. 308)
[13] **Earnings per share (EPS) =** $\frac{\text{Net income less dividends on preferred shares}}{\text{Number of common shares}}$
[14] The SIC is a classification of companies and enterprises according to their production activities
[15] Government of Canada "Sharpening Canada's Competitive Edge", http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/h_00009.html (Accessed April 10, 2010)
[16] The logit model is used to model the probability of an event occurring given the values of a set of variables descriptive quantitative and / or qualitative.
[17] The performance index of this study was primarily EBITDA / Sales
[18] Industry Canada "Thresholds" http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html (Accessed April 19, 2009)

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Appendices

Appendix 1: Likelihood Ratio Test - Pre-acquisition

Effect	Model Fitting criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of reduced model	Chi-Square	df	Sig.
Intercept	194,210	26,147	2	0,000
Sect.Avantop	176,425	8,362	2	0,015
Inprix	188,193	20,131	2	0,000
Inage1	174,342	6,279	2	0,043

Appendix 2: Likelihood Ratio Test - Post-acquisition

Effect	Model Fitting criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of reduced model	Chi-Square	df	Sig.
Intercept	194,272	2,416	2	0,299
Inprix	193,151	1,294	2	0,524
Inage2	195,055	3,199	2	0,202
CodeNat	193,794	1,938	2	0,380
Sect.Acqueop	196,807	4,950	2	0,084