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***Backgrounder***

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## Preserving Control

*Canada and the International  
Market for Corporate Acquisitions*

Shay Aba  
Jack M. Mintz

### ***The Backgrounder in Brief***

*The claim that the declining Canadian dollar has resulted in a "sellout" of Canadian companies is based on the argument that Canadian assets have become cheap. Foreign acquirers are expected to have greater resources to buy up Canadian companies and Canadian companies are expected to be less able to buy up foreign assets. The data do not support the hypothesis. Even though the Canadian dollar has fallen significantly in the past several years, there has been no corresponding sharp increase in foreign takeovers of Canadian companies and, contrary to expectations, Canadian takeovers of foreign companies maintain their pace.*

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## ***About the Authors***

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**H**as the declining value of the Canadian dollar relative to the US dollar led to an increase in foreign takeovers of Canadian corporations? Is corporate Canada “selling out” to foreigners, particularly to US firms, as some commentators (see, for example, Rubin 2002) have suggested? And has the falling dollar also made it more difficult for Canadian firms to acquire companies abroad? The answer to all of these questions appears to be no.

Research at the Bank of Canada (Schembri 2002) indicates that the total value of Canadian firms taken over by foreigners is almost the same as the total value of foreign firms taken over by Canadians. Moreover, the exchange rate seems to play no role in explaining aggregate acquisition flows between Canada and the rest of the world. In this *Backgrounder*, we present and explain industry-specific data on crossborder takeovers involving Canadian firms over the past seven years.

To preview our conclusion, the data show that there has been some increase in foreign takeovers of Canadian firms but also an increase in Canadian acquisitions of foreign companies. Thus, the declining Canadian dollar cannot be viewed as contributing to the “selling out” of corporate Canada. During the 1995–2001 period, there were 202 more Canadian takeovers of foreign firms than foreign takeovers of Canadian firms. And had it not been for one very large transaction — the US\$40.4 billion takeover of Canadian-based Seagram Co. Ltd. by Vivendi SA, which resulted in a net reported value of foreign takeovers of Canadian firms of US\$24.6 billion — Canadians would have been net acquirers of foreign firms. But substantial variation across industries is apparent — for example, Canadians were net *sellers* of oil and gas firms but net *buyers* of finance, insurance, and real estate firms.

## Why Crossborder Takeovers Take Place

Many of the benefits of mergers that typically arise in deals within a country — economies of scale that reduce unit costs, better management, increases in market power that allow a company to improve its bargaining position with respect to consumers and suppliers, access to specific resources, and often lower tax bills — also apply to crossborder deals. A few motives are, however, unique for international mergers and acquisitions. Globalization, as exemplified by trade liberalization and reduced costs for crossborder financial transactions over the past 20 years (White 1998), has provided new opportunities for businesses to expand their activities. Firms that want to be leaders in their field must now regard the entire world as their market. And one popular way to gain access to foreign markets, foreign technologies, or reduced business costs is to buy existing foreign companies. Taxation, too, has increased crossborder transactions, as companies often find they can use international financing structures to obtain the capital they need to acquire foreign firms at a lower cost than by purchasing companies within a domestic market (Fuest, Huber, and Mintz 2002).

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***The Source of Mergers and Acquisitions Data in This Backgrounder***

The mergers and acquisitions data presented here are from Thomson Financial's SDC Platinum database and cover the 1995–2001 period. This comprehensive database shows the date the transaction was announced as completed, the nationality and name of both the acquirer and the target firm, the value of the transaction (if reported), and the industry group of the target firm. No limit is placed on the size of the transaction, but since we are examining takeovers, we include only deals where the acquirer ended up holding more than 50 percent of the target firm after the transaction was completed.<sup>a</sup>

One important limitation of the database is that it shows transaction values for only about 50 percent of all reported deals, although this lack of data pertains about equally for both domestic and foreign acquisitions (see the note to Table 1 for more details). In some of these cases, the transaction involved private firms that are not required to disclose the value of the deal.

- a It is possible for a firm to gain a controlling stake in another with less than 50 percent of the shares, but one cannot determine the controlling stake in such circumstances since the information is not available for each transaction.

The influence of the exchange rate on crossborder mergers and acquisitions is subject to debate. One view is that the exchange rate does not affect crossborder mergers at all.<sup>1</sup> For example, although a decline in the relative value of the Canadian dollar makes Canadian assets cheaper to buy, the return on an investment — including dividends, capital gains, and interest receipts — is also denominated in Canadian dollars. Therefore, the rate of return on investments, which is return divided by the value of assets, is no longer affected by devaluation for either domestic or foreign investors who have similar access to international markets (see also Schembri 2002 for a discussion of this view).

On the other hand, some financial models (see, for example, Myers and Majluf 1984) suggest that companies with large cash flows are able to finance acquisitions at a lower cost since they do not need to borrow debt and equity from outside investors who do not know the company's worth. Thus, according to such models, the exchange rate should affect crossborder mergers if foreign companies with greater cash flows, denominated in foreign currencies, are able to acquire firms more easily than domestic firms with cash flows denominated in a declining domestic currency. Foreign companies with cash flows denominated in their own currency should find it cheaper to purchase those assets that are denominated in a declining Canadian dollar, while Canadian companies that have cash flows denominated in Canadian dollars would be unaffected. Similarly, according to this view, a decline in the Canadian dollar should make it more expensive for Canadian companies to purchase foreign assets. Thus, a decline in the Canadian dollar should lead to more foreign purchases of companies in Canada and fewer

1 Taxation and its interactions with currency losses and gains can also influence the cost of capital for crossborder mergers. In a country with a weak currency and high tax rates, the cost of finance related to debt finance is cheaper than in a country with a strong currency and low tax rates. See Gordon (1986).

Canadian purchases of foreign companies. On balance, net Canadian acquisitions (the difference between Canadian takeovers abroad and foreign takeovers in Canada) should decline.

The influence of the exchange rate is complicated by three other issues. First, many Canadian companies have cash flows denominated in foreign currencies and thus may be in a similar position to foreign firms to undertake investments in the face of a decline in the Canadian dollar. Second, changes in the exchange rate, rather than its level, affect investment decisions — if the Canadian dollar is expected to depreciate, the cost of capital will be higher for investments in Canada, regardless of whether the investor is domestic or foreign. Third, industry-specific characteristics could imply that the link between the exchange rate and the direction of crossborder takeovers varies from one industry to another.

### An Overview of Crossborder Takeovers

Table 1 presents data on Canadian takeovers of foreign firms, foreign takeovers of Canadian firms, and net Canadian takeovers during the 1995–2001 period. Both the number and the value of the takeovers generally rose during the period, but dropped in 2001. This trend can be explained in part by stock market prices: when stock prices are high, potential target firms are more likely to sell in order to benefit from favourable valuations, and potential buyers might be more eager to make deals since their own shares are frequently used as currency to pay for the acquisition. Moreover, a booming economy and rising stock market prices are likely to reduce the perceived risk of the deal to the buyer. Thus, as long as stock markets were booming, the number and value of deals increased, but when the bubble burst toward the end of 2000, they dropped sharply.<sup>3</sup>

*As long as stock markets were booming, the number and value of deals increased, but when the bubble burst toward the end of 2000, they dropped sharply.*

Taking a look at just the number of transactions, the net number the number of Canadian takeovers was positive in six out of the last seven years, implying that Canadians were net buyers of firms. Over the entire 1995–2001 period, there were 2002 net takeovers. So while many Canadian companies were taken over by foreigners, a larger number of foreign companies were taken over by Canadians.

Looking at the value, rather than the number, of transactions, the net aggregate value of takeovers (the value of Canadian takeovers of foreign firms minus the value of foreign takeovers of Canadian firms) was positive in five of the last seven years. Based on the number of reported transactions, the net value of Canadian takeovers was –\$24.6 billion over the 1995–2001 period, implying that, in terms of value, more foreign takeovers of Canadian companies took place than Canadian takeovers of foreign companies. However, excluding one megadeal, Vivendi SA's acquisition of Seagram Co. Ltd., the net value of Canadian takeovers of foreign companies was actually greater than the value of foreign takeovers of Canadian companies.

For all industries, we do not observe any sharp trend towards net takeovers of Canadian companies, despite the significant devaluation of the Canadian dollar in

<sup>3</sup> If one assumes that the number of transactions is driven by expected cash flows, rather than stock prices, then the decline in 2001 is related to falling stock market prices only to the extent that stock prices reflect expected cash flows.

Table 1: *Crossborder Takeovers Involving Canadian Firms, 1995–2001*

	<b>Number of Transactions</b>	<b>Number of Transactions Where Values Were Reported</b>	<b>Total Reported Value</b>	<b>Average Size of Transaction<sup>a</sup></b>	<b>Median Size of Transaction</b>
<i>(US\$ millions)</i>					
<b>Canadian Takeovers of Foreign Firms</b>					
1995	193	102	10,011.9	98.2	9.7
1996	254	132	10,926.2	82.8	9.5
1997	288	158	14,266.8	90.3	12.9
1998	340	178	33,430.4	187.8	16.5
1999	289	124	21,814.1	175.9	18.0
2000	345	207	32,845.8	158.7	14.0
2001	254	136	24,184.0	177.8	12.8
Total	1,963	1,037	147,480.1	142.2	13.5
<b>Foreign Takeovers of Canadian firms</b>					
1995	181	101	9,675.8	95.8	16.2
1996	211	98	7,478.4	76.3	11.5
1997	230	102	9,733.0	95.4	21.6
1998	276	135	14,724.7	109.1	14.2
1999	257	112	27,703.0	247.3	18.8
2000	377	185	80,560.4	435.5	25.2
2001	229	118	22,169.7	187.9	18.0
Total	1,761	851	172,044.9	202.2	17.6
<b>Net Canadian Takeovers<sup>b</sup></b>					
1995	12		336.1		
1996	43		3,447.8		
1997	58		4,533.9		
1998	64		18,705.6		
1999	32		-5,889.0		
2000	-32		-47,714.6		
2001	25		2,015.3		
Total	202		-24,564.9		

<sup>a</sup> Calculated using only those transactions for which a value was reported.

<sup>b</sup> Net Canadian takeovers were calculated by subtracting transactions in which Canadian firms were targets from those in which Canadian firms were buyers.

Source: Thomson Financial, SDC Platinum.

recent years. Although foreign takeovers of Canadian companies rose in 2000, there is no sharp upwards trend in foreign takeovers in other years. Canadian takeovers of foreign companies peaked in 2000 as well and clearly were greater than foreign takeovers of Canadian firms, contrary to the hypothesis that the declining dollar has resulted in a “selling out” of corporate Canada. Thus, little relationship can be found between net takeovers of Canadian companies and the declining dollar.

Some observers claim that the foreign firms Canadians buy are typically small, while the Canadian firms that foreigners buy are typically large. Table 1 shows, however, that the real story is mixed: for transactions where the value was reported, Canadian takeovers of foreign firms were, on average, larger than foreign takeovers of Canadian firms in three of the seven years examined. In terms of the

**Table 2: Crossborder Takeovers Involving Canadian Firms in the Oil and Gas Sector, 1995–2001**

	Canadian Takeovers of Foreign Firms		Foreign Takeovers of Canadian Firms		Net Canadian Takeovers	
	Number of Transactions	Total Reported Value	Number of Transactions	Total Reported Value	Number of Transactions	Total Reported Value
	<i>(US\$ millions)</i>		<i>(US\$ millions)</i>		<i>(US\$ millions)</i>	
1995	7	69.1	11	646.6	-4	-577.5
1996	14	128.8	16	758.3	-2	-629.4
1997	19	869.2	15	1,484.6	4	-615.4
1998	18	98.7	14	5,754.0	4	-5,655.3
1999	10	221.3	14	3,230.0	-4	-3,008.7
2000	8	125.5	35	3,282.2	-27	-3,156.8
2001	7	588.4	32	10,606.5	-25	-10,018.1
Total	83	2,101.0	137	2,5762.2	-54	-23,661.2

Note: Of the 220 transactions, values are unavailable for 70; 41 (58 percent) of the 70 were takeovers by Canadians.  
Source: Thomson Financial, SDC Platinum.

median size of transactions, however, Canadian takeovers of foreign firms were of smaller companies than was the case with foreign takeovers of Canadian firms in every year except 1998.

### *Industry-Specific Takeovers*

Looking at crossborder takeovers in specific sectors of the Canadian economy over the 1995–2001 period, the story is again mixed. Foreigners were net buyers of Canadian companies in the retail and wholesale trade sector, for example, while Canadians were net buyers of foreign firms in heavy manufacturing, transportation, communications, and utilities. It has been suggested that foreign takeovers of Canadian firms have been particularly prevalent in the oil and gas and financial sectors. Indeed, as Table 2 shows, foreign takeovers of Canadian companies exceeded Canadian takeovers of foreign companies in the oil and gas sector in terms of both the number of takeovers (54 more) and the aggregate reported value of all transactions (US\$23.6 billion more). There was also a significant trend toward more takeovers of Canadian oil and gas companies by foreigners in the last three years of the period. In contrast, as Table 3 shows, Canadians were net acquirers of foreign firms in the finance, insurance and real estate sector (73 more takeovers, for an aggregate reported net value of US\$32.5 billion).

### Reasons for Differences Across Sectors

Space does not allow us to cover all the possible reasons for differences in the direction of crossborder takeovers from one sector to another. However, we briefly discuss two prominent areas, oil and gas and finance, insurance and real estate: the relative level of the exchange rate, the nature of Canadian and foreign regulatory regimes and concomitant opportunities for growth in different sectors, as well as the need to guarantee access to supplies of scarce resources.

**Table 3: Crossborder Takeovers Involving Canadian Firms in the Finance, Insurance, and Real Estate Sector, 1995–2001**

	Canadian Takeovers of Foreign Firms		Foreign Takeovers of Canadian Firms		Net Canadian Takeovers	
	Number of Transactions	Total Reported Value	Number of Transactions	Total Reported Value	Number of Transactions	Total Reported Value
	<i>(US\$ millions)</i>		<i>(US\$ millions)</i>		<i>(US\$ millions)</i>	
1995	13	467.3	12	274.0	1	193.2
1996	14	1,028.8	6	724.1	8	304.6
1997	41	5,493.1	15	979.8	26	4,513.3
1998	46	41,87.3	27	1,673.3	19	2,514.0
1999	24	1,962.1	20	2,791.0	4	828.8
2000	26	2,997.8	26	2,934.1	0	63.7
2001	24	6,476.4	9	566.0	15	5,910.4
Total	188	22,612.8	115	9,942.3	73	12,670.5

Note: Of the 303 transactions, values are unavailable for 133; 76 (57 percent) of the 133 were takeovers by Canadians  
Source: Thomson Financial, SDC Platinum.

*The Exchange Rate.* We have already noted that the evidence does not support the claim that the weaker Canadian dollar makes Canadian firms easy targets for foreign buyers. Indeed, Canadian firms were net acquirers of foreign firms over the 1995–2001 period.<sup>3</sup> However, a deviation of the nominal exchange rate from its level, reflecting differences in consumer prices among countries (purchasing power parity — PPP),<sup>4</sup> could lead to specific synergies when a substantial portion of the costs are denominated in one currency, while a substantial portion of the revenues are denominated in another. For example, Canadian banks could use their back-office operations partly to support their activities in the United States, generating revenues in US dollars. The weak Canadian dollar (relative to its PPP level) would thus give Canadian banks a cost advantage over their US-based peers. US banks could respond by acquiring a Canadian bank and, in turn, using its operations to support their activities in the United States, though Canadian regulations generally prevent them from doing so.

This analysis does not, however, apply to the oil and gas sector, since prices for those commodities are set in US dollars in international markets and revenues are thus directly linked to the US dollar. The lower Canadian dollar provides a cost advantage not only to foreign firms operating in Canada, but also to Canadian firms operating here. One cannot, however, entirely exclude the possibility that a weaker Canadian dollar is playing a role in foreign takeovers of Canadian oil and gas companies. The global oil and gas sector has been going through a consolidation,

3 Simple regressions of the net number of takeovers on the exchange rate, stock market prices, and bond yield provide no statistically significant results, suggesting that the exchange rate plays no specific role in the direction of takeovers.

4 For example, the current exchange rate for the Canadian dollar is about 64 US cents. The PPP value as calculated by the Organisation for Economic Co-operation and Development (OECD) is over 85 cents.

and foreign companies looking for targets might find Canadian firms more appealing than, say, US firms, since the lower Canadian dollar implies lower operational costs. Table 2 shows, for example, that the net number of foreign acquisitions of Canadian firms increased dramatically in 2000 and 2001, years in which the Canadian dollar depreciated against its US counterpart.<sup>5</sup> At the same time, a declining domestic dollar would have provided incentives for globally oriented Canadian companies to take over other domestic companies as well.

*In the finance, insurance, and real estate sectors, the existence of government regulations is an obvious reason Canadian takeovers of foreign firms exceed foreign takeovers of Canadian companies.*

*Regulations and Growth Opportunities.* In the finance, insurance, and real estate sectors, the existence of government regulations is an obvious reason Canadian takeovers of foreign firms exceed foreign takeovers of Canadian companies. Ottawa places strict limits not only on foreign ownership in the banking sector, but also on bank mergers within Canada, while some foreign countries, especially the United States, impose few or no restrictions. Canadian banks seeking to catch up with the increasing size of firms in their industry thus must turn to acquiring foreign banks. In the oil and gas sector, in contrast, there are no foreign-ownership restrictions.<sup>6</sup>

Another reason Canadian takeovers of foreign firms exceed foreign takeovers of Canadian firms is the existence of better opportunities for growth in the much more fragmented financial, insurance, and real estate sector markets south of the border, which accounted for about 70 percent of all Canadian acquisitions in the sector during the 1995–2001 period. One perceived measure of growth opportunities is the ratio of a company's stock price to its earnings per share, which represents how much the public is willing to pay today for a company's future earnings. On this measure, on average over the 1995–2001 period, US financial firms traded at 16 times earnings, while Canadian companies traded at 13 times earnings (data from Reuter's Stokval). (One should use this measure with caution, however, since other factors, such as accounting practices and perceptions of risk could also influence the price/earnings differentials.)

*Guaranteeing Supplies of Limited Resources.* Guaranteeing the supply of a scarce resource is a motivation for any takeover, national or international. Thus, the spike in energy prices in 2000–01 might have contributed to the flurry of takeovers of Canadian oil and gas firms in the past two years as foreigners attempted to guarantee their supplies of these vital commodities. Canadians might have done the same by purchasing foreign firms, but the smaller size of the Canadian economy relative to those of the United States and Europe, for example, would result in fewer takeovers by Canadian companies relative to the number of foreign takeovers of Canadian companies.

5 Of the 137 foreign takeovers of Canadian oil and gas firms over the 1995–01 period, 77 were by US firms.

6 In the communications industry, another regulated sector, there were 47 Canadian takeovers of foreign firms and 49 foreign takeovers of Canadian firms during the 1995–01 period. The reported value of the Canadian acquisitions was US\$6.6 billion larger than the reported value of foreign acquisitions of Canadian firms; however, no values were reported for nearly half of these transactions.

## Conclusion

With globalization, more Canadian companies than ever have been involved in crossborder mergers and acquisitions. Some increase in foreign acquisitions of Canadian firms has taken place for a variety of reasons; the relative decline of the Canadian dollar against the US dollar is not one of them. Overall, Canadian companies have been active in buying up foreign companies, more so than foreign takeovers of Canadian firms. This observation is also contrary to the hypothesis that Canadian companies are “selling out” due to the declining dollar.

Nonetheless, differences do appear among sectors. Foreign takeovers of Canadian companies have dominated Canadian takeovers of foreign firms in the oil and gas industry, for example, while the opposite is the case for finance, insurance, and real estate. The weak Canadian dollar might offer some explanation for differences in takeover experience among industries, though other factors may play equally, if not more important, roles.

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