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How Foreign Acquisitions Boost Productivity at Home

Foreign expansion can be more than just a gateway to new markets. When acquired in context, overseas companies can provide the capabilities and skills to raise productivity in operations back home.

Cross-border acquisitions accounted for nearly one third of all M&A deals in 2013 (according to Thomson Reuters Deals Intelligence) as companies looked to overseas markets to gain advantage over domestic competitors.

Moving into foreign territory comes at a price. Apart from the acquisition itself, there are costs associated with the increased complexity and coordination needed to operate in different markets, resources trade-offs and what is known as the liability of foreignness. Recent research however, suggests there are ways to offset this expense, by unlocking greater benefits from the acquisition. When made in the right context, cross-border M&As generate learning which can be transferred to the acquiring company's domestic operations, significantly increasing efficiencies and productivity.

By targeting companies in countries and markets more competitive and innovative than their own and by investing domestically to help transfer the newly-acquired expertise into the home arena, firms are in a better position to reap the full benefits of the deal.

Acquisitions can't be made in isolation

Our study **Productivity Enhancement at Home via Cross-Border Acquisitions: The roles of learning and Contemporaneous Domestic investments**, analysed 183 cross-border acquisitions by French organisations between 1993 and 2001 and found companies that bought firms outside their own country experienced greater productivity in their domestic operations three years on, compared to companies that had not.

It is notable that firms which invested in more competitive countries or industries made even greater productivity gains domestically, while, the greatest success was realised by companies which invested resources into the home arena in conjunction with the acquisition process.

These results suggest cross-border acquisitions should not be considered on their own but as part of an integrated strategy. There needs to be interplay between expansion plans, alliances, capital expenditure programmes, innovation and internal investments, for firms to reap the full benefits from any foreign M&A deal.

Acquisitions made in isolation may be wasted investments.

Opportunities in foreign markets

Expanding operations across borders provides the acquiring firm with new resources and knowledge exposing it to R&D capabilities, organisational processes, managerial practices and other functional skills that may be retrieved and used in its domestic market. While local acquisitions also improve resource efficiency and knowledge, our research shows cross-border acquisitions generate stronger efficiency and productivity gains.

Acquiring firms in foreign markets provides investor companies with opportunities to access, not only resources embedded in the specific target firm, but within the firm's broader environment – such as the knowledge, resources and customers of local suppliers; public research institutes with which the target firm collaborates; or technological and non-technological spillovers from rivals.

So, the location or ecosystem of the foreign acquisition determines to a large extent the degree of access investing firms have to new learning and resources. Greater knowledge and expertise is gained if the knowledge gap between host and home markets is greater.

Essential productivity-enhancing investments

But no matter how innovative or experienced the new market, it is difficult to transfer newly-acquired knowledge back home without added investment in capital goods into the domestic operations. For instance, to make the most of the latest advances in IT and communications, firms must invest in new computers and related frameworks, and to reap the benefits of innovative organisational and management practices (such as Japan's flexible automation practices) it's often necessary to invest in equipment, building and infrastructure.

Cross-border acquisitions and internal investments are mutually beneficial to productivity.

Consider the French company L'Oréal, which acquired the U.S. black-centred beauty firms Softsheen (in 1998) and Carson (in 2000) as part of its strategy to become a leader in the ethnic hair and beauty market. L'Oréal fused the two companies and invested US$11 million in research studying the skin and hair of different ethnic groups. It is now the world's dominant manufacturer of ethnic haircare products.

Another example was the acquisition of the Brazilian bank, Banco Real, by Dutch banking corporation, ABN AMRO. When ABN AMRO discovered Banco Real had strong online banking capabilities and skills, it surprised many by transferring some of the Banco Real IT engineers and managers to its central headquarters in Holland where they shared their skills and worked to improve the corporation's systems and online offerings. The combined resources of the Dutch and Brazilian firms plus the investment in new equipment enabled ABN AMRO to create new online products.

No trade-off

Our study shows there is no trade-off when it comes to foreign investment. Far from it. Making acquisitions abroad doesn't mean companies will divert all their investment to the foreign market. In many cases it actually encourages domestic investment, as the firms most successful at leveraging productivity gains are those that make simultaneous investment in their home market to open the way for the transfer of knowledge from the newly-acquired foreign subsidiary to domestic operations.

When you buy a firm it's just the beginning of the process. You may have already invested a lot of resources in the acquisition but if you cannot make extra investment at home to leverage the knowledge you will not be able to exploit its full capabilities.

Laurence Capron *is an INSEAD Professor of Strategy and The Paul Desmarais Chaired Professor of Partnership and Active Ownership. She is also the Director of the* ***M&As and Corporate Strategy*** *programme, part of INSEAD Executive Education portfolio. She is the author of* ***Build, Borrow or Buy: Solving the Growth Dilemma****. You can follow her on Twitter* ***@LaurenceCapron****.*

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