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## Analytical Paper

### Analysis in Brief

# Cross-border Acquisitions: A Canadian Perspective

1997-2002

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*This paper represents the views of the author and does not necessarily reflect the opinions of Statistics Canada.*



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## Cross-border Acquisitions: A Canadian Perspective

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Michael Marth

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## **Cross-border Acquisitions: A Canadian Perspective**

Michael Marth

Balance of Payments Division

### **Summary**

Globalization has affected the way companies operate in a number of ways. Over the years, enterprises have increasingly expanded beyond their domestic markets to participate in the global marketplace. In so doing, companies can choose, for example, to export, establish new operations or acquire existing companies.

Activity in cross-border mergers and acquisitions in recent years involving Canadian companies was relatively intense in terms of both numbers and values.

Canadian firms acquired foreign companies at a faster pace than foreign firms were acquiring companies in Canada.

Between 1997 and 2002, Canadian firms acquired 447 foreign companies, transactions which are called "outward", while foreign companies acquired 345 Canadian companies, so-called "inward" transactions.

In terms of value, however, foreign companies invested slightly more in Canada during this six-year period. This was primarily due to one extremely large European acquisition of a prominent Canadian company in 2000. Between 1997 and 2002, foreign companies acquired \$144 billion worth of Canadian companies, while Canadian firms acquired \$124 billion of foreign companies.

Europe edged out the United States as the largest acquirer of Canadian companies during the six-year period. This slight edge for Europe was due primarily to the same extremely large acquisition in 2000. In fact, in all years other than 2000, the United States invested significantly more through acquisitions in Canada than did Europe. The United States was the primary destination for acquisitions, accounting for over two-thirds of all outward mergers and acquisitions. Canada was a net acquirer of U.S. companies over the six-year period.

The most active industrial sector grouping was energy and minerals. This sector accounted for over one-quarter of inward mergers and acquisitions, and over one-fifth of the outward. The majority of the Canadian energy company acquisitions were made by American firms. Nearly one-half of the value of all outward acquisitions over the period was in the high-tech sector. In short, Canadian companies acquired U.S. technology, while American firms acquired Canada's energy companies.

The high level of activity in cross-border mergers coincided with the heavy use of share-exchanges to finance acquisitions. The high-tech sector was the most prolific user of share-exchanges over the period. For example, in 2000 over one-half of all inward share-exchanges, and over two-thirds of all outward share-exchanges, were in the high-tech sector.

This paper presents an analysis of cross-border mergers and acquisitions from a Canadian perspective. Both non-resident takeovers of Canadian companies and Canadian takeovers of foreign companies are examined by industry and region for the 1997 to 2002 period. In addition, the analysis highlights the use of share-exchanges as a means to finance these acquisitions.

## Overall trends

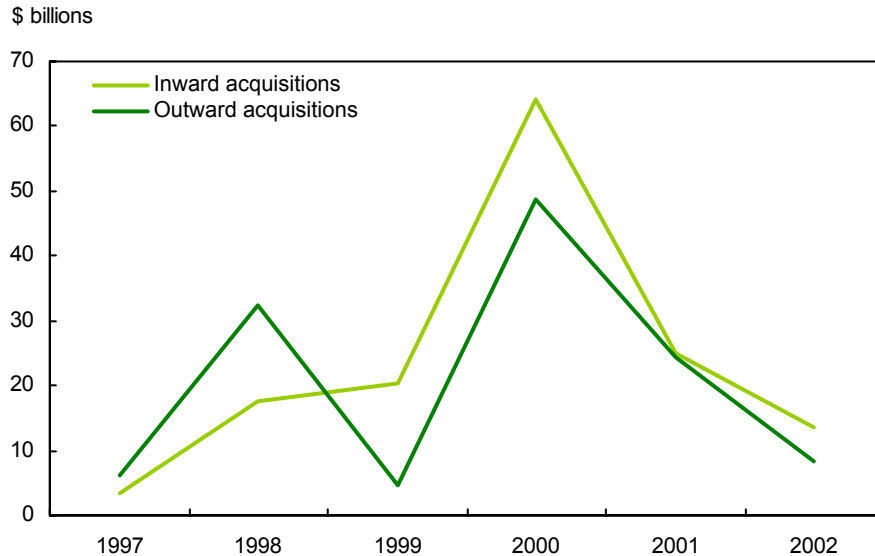
### Seven-fold increase in value of global cross-border mergers

On a global basis, the value of cross-border mergers and acquisitions rose seven-fold during the 1990s. In 1999, the value of these transactions hit \$720 billion, compared with less than \$100 billion in the early 1990s.<sup>1</sup>

About 90% of the value of all global cross-border mergers and acquisitions in 1999 was transacted in developed countries.<sup>2</sup>

For Canada, the value of inward mergers and acquisitions during the late 1990s was just over 10 times greater than those of the late 1980s.<sup>3</sup> The value of outward activity in the late 1990s was about eight times greater.

### Cross-border M&As rise in value



**Source:** Statistics Canada, Balance of Payments Division.

Overall, the value of cross-border mergers and acquisitions appears to have moved with the expansion of the economy and the rise of stock markets in general. Except for 1999, the values of both inward and outward transactions followed a similar pattern.

Mergers and acquisitions in Canada peaked in 2000, then declined rapidly in the following two years. The United States shared a very similar experience to Canada with respect to U.S.

1. United Nations Conference on Trade and Development, 2000, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development (Overview)*, New York and Geneva, p. 10.

2. *Ibid.*, p. 13.

3. Two articles that have cited the late 1980's period as an M&As wave are:

United Nations Conference on Trade and Development, 2000, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development (Overview)*, New York and Geneva.

National Bureau of Economic Research, 2003, *The Cross Border Mergers and Acquisitions Wave of the Late 1990s*, Working Paper 9655.

businesses acquired by non-residents.<sup>4</sup> Indeed, the decline in the value of mergers and acquisitions in 2001 and 2002 was experienced globally.<sup>5</sup>

### Large acquisitions drive merger values

Large transactions clearly played a key role in merger and acquisition activity in Canada during the 1990s.

### Large acquisitions drive M&A values

Value of M&A Flow	Inward transactions		Outward transactions	
	Number	Value	Number	Value
	%			
\$5 billion or more	3	47	2	35
\$1 billion to \$4.999 billion	9	29	7	35
\$500 million to \$999 million	11	10	10	12
\$100 million to \$499 million	36	12	29	15
less than \$100 million	41	2	52	3
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Source:** Statistics Canada, Balance of Payments Division.

In the case of foreign companies acquiring Canadian firms (inward transactions), flows of \$5 billion or more represented only 3% of all mergers and acquisitions during the period, yet accounted for nearly one-half (47%) of the total value. In contrast, flows of less than \$100 million accounted for 41% of all mergers and acquisitions, but only 2% of total value.

The contrast with respect to Canadian acquisitions of foreign firms was not quite as dramatic. Flows of \$5 billion or more represented 2% of all transactions, and just over one-third (35%) of the total value. In contrast, flows of less than \$100 million represented more than one-half (52%) of transactions, but only 3% of the total value.

The majority of transactions of \$5 billion or more were financed through share-exchanges.<sup>6</sup> Share-exchanges accounted for 86% of the value of inward transactions of \$5 billion or more, and 73% of the number of such transactions. With respect to outward transactions worth \$5 billion or more, share-exchanges were used for complete or partial payment in all cases and accounted for 88% of the value and 100% of the total number.

4 .Recent data on U.S. firms acquired by non-residents are found in: Bureau of Economic Analysis, June 2003, *Foreign Direct Investment in the United States*, Survey of Current Business, p. 55.

5. Export Development Corporation, June 2003, *Foreign Direct Investment Monitor*, p. 3.

6. Please refer to the *Background, concepts and data quality* and *Glossary* boxes for further details on share-exchanges. Treasury shares (also known as new shares) are commonly issued by the acquiring company in a share-exchange transaction.

## Financing

### Share-exchanges peak in 2000

The peak period of financing acquisitions through share-exchanges coincided with the peak in mergers and acquisitions in 2000. That year, share-exchanges were used to finance nearly two-thirds of the value of mergers and acquisitions.

However, in terms of numbers, only one-third of total transactions were financed through share-exchanges. These proportions were roughly the same for both inward and outward transactions.

In the 1997–2002 period, the total value of inward transactions amounted to \$144 billion. Just under one-half (49%) of the total value was financed through share-exchanges. Of the 345 inward transactions, 79, or 22%, were handled through a share-exchange.

In 2002 alone, the number of inward acquisitions was only half that of the previous year. Yet the proportion of acquisitions financed by share-exchanges more than doubled. This occurred because several large established companies with strong market valuations opted for share-exchanges in that year.

### Value of inward M&As peak in 2000

Year	Number of acquisitions		Value of acquisitions	
	Total	% financed by shares	Total	% financed by shares
		%	\$ millions	%
1997	41	10	3,522	24
1998	49	18	17,621	35
1999	65	27	20,202	46
2000	88	33	64,129	63
2001	68	12	24,931	38
2002	34	32	13,537	38
<b>1997–2002</b>	<b>345</b>	<b>22</b>	<b>143,942</b>	<b>49</b>

**Source:** Statistics Canada, Balance of Payments Division.

With respect to outward acquisitions, Canadian companies acquired 447 foreign companies during the six-year period for a total value of \$124 billion. Just under one-half (47%) of the total value was financed through share-exchange, as were 87, or 19%, of the 447 transactions.

The value of outward acquisitions and mergers peaked in 2000 at \$49 billion. This was more than 10 times the value of \$4 billion the previous year, which was the low point of the six-year period. While there were a few transactions valued at over a billion dollars in 1999, there were no large multi-billion dollar transactions as was the case with most other years.

### Number of outward M&As highest in 2000

Year	Number of acquisitions		Value of acquisitions	
	Total	% financed by shares	Total	% financed by shares
		%	\$ millions	%
1997	50	12	6,103	13
1998	77	19	32,245	53
1999	63	14	4,486	43
2000	103	29	48,638	60
2001	95	18	24,395	35
2002	59	17	8,365	23
<b>1997–2002</b>	<b>447</b>	<b>19</b>	<b>124,232</b>	<b>47</b>

Source: Statistics Canada, Balance of Payments Division.

### Share-exchanges highly visible in larger value acquisitions

Those mergers and acquisitions financed through share-exchanges had a much higher average value than those financed through other methods. For example, inward transactions involving share-exchanges averaged \$907 million between 1997 and 2002, compared with \$273 million among those financed through other means.

### Share-exchanges visible in larger value M&As

Year	Average inward transactions		Average outward transactions	
	Share-exchange	Other financing	Share-exchange	Other financing
	\$ millions			
1997	206	73	132	121
1998	701	285	1,171	243
1999	528	230	219	47
2000	1,393	402	976	266
2001	1,155	259	499	204
2002	472	363	192	132
<b>1997- 2002</b>	<b>907</b>	<b>273</b>	<b>687</b>	<b>180</b>

Source: Statistics Canada, Balance of Payments Division.

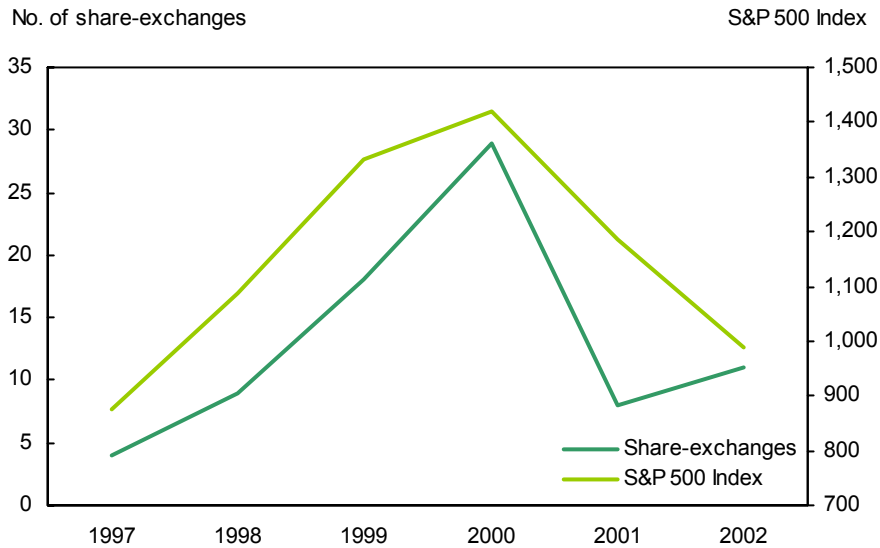
There are several ways to finance or pay for an acquisition. Some companies might use cash on hand, if available, while others may choose to finance the acquisition. In general, conventional financing, that is, a bank loan or line of credit, is easier to obtain if the acquisition and the associated risk are relatively small. Some acquiring companies might finance their acquisitions by share-exchanges if their stock was trading at a favourable price.

## Pattern of share-exchanges similar to stock markets

All things being equal, there would be more incentive for a company to use a share-exchange when its own shares are trading at a favourable value on the stock market. The accompanying charts compare the relevant stock market index to the frequency of share-exchanges.

In general, the trend in share-exchanges in both inward and outward transactions between 1997 and 2002 reflected trends in stock markets – the S&P 500 Index in the case of inward, and the TSX Index in the case of outward.

### Inward M&A share-exchanges and S&P 500 Index

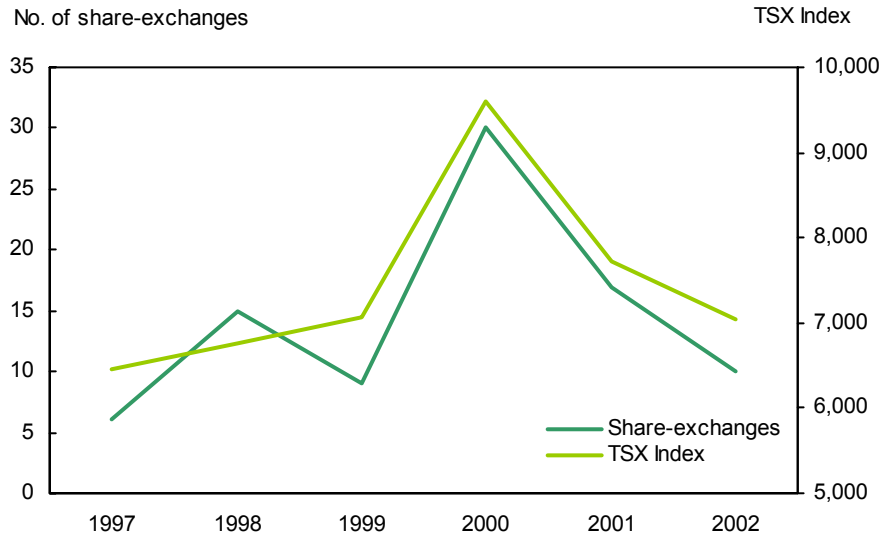


**Sources:** Statistics Canada, CANSIM, Table 176-0046 and Balance of Payments Division.

The only exception occurred between 1998 and 1999 in the case of outward share-exchanges. During this year-long period, the number of share-exchanges declined while the TSX Index kept rising. This was more a result of the decline in the number of outward acquisitions themselves than a decline in the use of share-exchanges.



## Outward M&A share-exchanges and TSX Index



**Sources:** Statistics Canada, CANSIM, Table 176-0047 and Balance of Payments Division.

The TSX Index was used as a comparison for outward transactions because these share-exchanges would have been made using the Canadian company's shares as payment. The S&P Index is a reasonable indicator since the majority of inward mergers and acquisitions are from the United States.

### High-tech sector heavy user of share-exchanges

The high-tech sector was a heavy user of share-exchanges between 1997 and 2002 for several reasons. First, many of the acquisitions were too large to be financed by cash on hand.

Second, high-tech companies are difficult to value in general, as a good portion of the assets are intangible in nature, which makes share-exchange a more attractive means to finance acquisitions.

Third, the high-tech sector as a whole experienced the greatest gains in share values in the late 1990s. In light of this, many companies may have considered it advantageous to use their higher share prices to finance these acquisitions.

Inward mergers and acquisitions financed by share-exchanges were very frequent in the high-tech sector.<sup>7</sup>

7. Hi-tech sector M&A data are derived from the Electrical and Electronic Components sector. The industrial activity is classified according to the Canadian Standard Industrial Classification System for Companies, 1980.

## High-tech sector frequent user of share-exchanges

Year	Percentage of hi-tech M&As financed by share-exchanges	
	Inward	Outward
	%	
1997	0	0
1998	33	27
1999	43	40
2000	85	58
2001	40	53
2002	25	12

**Source:** Statistics Canada, Balance of Payments Division.

At their peak in 2000, 85% of inward high-tech mergers and acquisitions were financed through share-exchanges, compared with only 33% for all sectors. In addition, share-exchanges in high-tech accounted for more than half of all share-exchanges in 2000.

The situation was similar for outward mergers and acquisitions in the high-tech sector, but with some noticeable differences. At their peak in 2000, 58% of outward high-tech mergers and acquisitions were financed by share-exchanges. There was no significant drop in 2001 as there was for inward transactions.

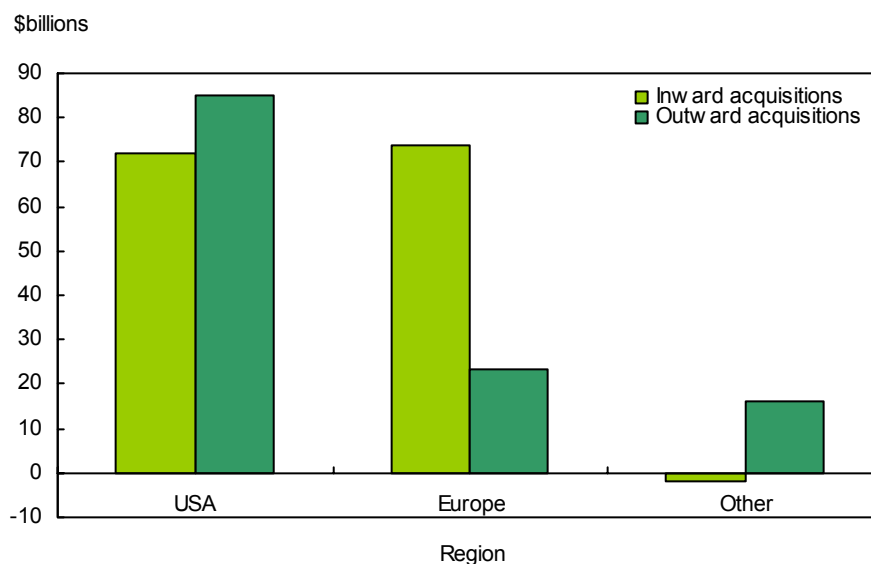
However, in 2002, the proportion of outward high-tech transactions financed by share-exchanges plunged to only 12%. Falling share prices and the overall downturn experienced by the sector contributed to the decline.

## Region

### Canada net acquirer of U.S. companies

There has been a great deal of recent discussion on the issue of foreign (non-resident) takeovers of Canadian companies. The data reveal that Canadian companies acquired a greater amount of U.S. assets through mergers and acquisitions than vice-versa over the six-year period.

### Canada net acquirer of U.S. companies



Source: Statistics Canada, Balance of Payments Division.

### Large acquisition puts Europe ahead

Between 1997 and 2002, companies in Europe as a region edged out their American counterparts as the largest supplier of investment for mergers and acquisitions in Canada.

### Net inward M&As split between Europe and the United States<sup>8</sup>

Year	USA	Europe	Other	Total
	\$ millions			
1997	3,781	-258	-2	3,521
1998	13,929	3,675	18	17,622
1999	21,090	3,536	-4,423	20,203
2000	-1,370	64,548	951	64,129
2001	23,144	624	1,162	24,930
2002	11,328	1,745	464	13,537
<b>1997-2002</b>	<b>71,902</b>	<b>73,870</b>	<b>-1,830</b>	<b>143,942</b>

Source: Statistics Canada, Balance of Payments Division.

8. The data in this study are presented on a net basis (i.e. acquisitions less any divestitures) which can result in "negative M&A" net figures.

During the six-year period, European companies acquired almost \$74 billion worth of Canadian companies through acquisitions, which represented 65% of all foreign direct investment flows from Europe.<sup>9</sup>

At the same time, American companies acquired \$72 billion worth. This represented about 46% of all types of foreign direct investment flows into Canada from the United States during the period.<sup>10</sup>

This slight edge for Europe was due primarily to an extremely large acquisition in 2000. Interestingly enough, the United States recorded a small net disinvestment in that same year.<sup>11</sup> In every other year, American companies invested significantly more in Canada through mergers and acquisitions than Europe.

In comparison, other regions were much less active in Canada, and actually recorded a net disinvestment of \$2 billion over the period, most of which occurred in 1999.

### U.S. primary destination for Canadian investment via mergers

Canadian companies invested most heavily in the United States through the acquisition of foreign companies during this period. This further reinforces the strong economic links between the two countries.

#### Net outward M&As most significant in United States

Year	USA	Europe	Other	Total
	\$ millions			
1997	2,396	2,074	1,634	<b>6,104</b>
1998	24,009	6,805	1,431	<b>32,245</b>
1999	5,418	-2,040	1,107	<b>4,485</b>
2000	30,147	11,494	6,997	<b>48,638</b>
2001	19,575	2,272	2,548	<b>24,395</b>
2002	3,334	2,805	2,226	<b>8,365</b>
<b>1997-2002</b>	<b>84,879</b>	<b>23,410</b>	<b>15,943</b>	<b>124,232</b>

**Source:** Statistics Canada, Balance of Payments Division.

Between 1997 and 2002, Canadian firms acquired \$85 billion worth of American companies, which accounted for 68% of its outward investment in mergers and acquisitions. Europe, a distant second, accounted for 19%, and all other countries 13%.

Acquisitions accounted for 65% of all direct investment flows into the United States, and 39% of those into Europe.<sup>12</sup>

9. Statistics Canada, 2003, *Canada's Balance of International Payments, 1st Quarter 2003, Table 41*, Catalogue no. 67-001-XPB, Ottawa.

10. *Ibid.*

11. In 2000, U.S. acquisitions of Canadian interests were significant, however, the value of Canadian companies sold back to Canadian residents by U.S. firms was greater.

12. Statistics Canada, 2003, *Canada's Balance of International Payments, 1st Quarter 2003, Table 27*, Catalogue no. 67-001-XPB, Ottawa.

## Industry

### Energy and minerals active on both sides of the border

Among the major industrial sectors, the most active group during the six-year period in terms of mergers and acquisitions was energy and minerals.<sup>13</sup>

This sector accounted for 28% of foreign purchases of Canadian companies, and 24% of Canadian purchases of foreign firms. This significant activity can be attributed to increasing demand for energy, rising energy prices, scarcity of resources and overall competitiveness in the North American market.<sup>14</sup>

Certain industries regulated by federal legislation have limits on the level or percentage of foreign ownership. These include industries such as banking, broadcasting, telecommunications, fishing and transportation. This limits inward mergers and acquisitions in these industry sectors. This equally applies to outward mergers and acquisitions with respect to other countries that have similar limits.

In terms of numbers, Canadian companies acquired more firms in every sector than foreign firms have acquired Canadian companies between 1997 and 2002.

### Number of outward acquisitions exceed inward acquisitions in all sectors

	Services & retailing	Finance & insurance	Electrical & electronic components	Energy & minerals	Other industries	Total
<b>Inward</b>	35	36	62	96	116	<b>345</b>
<b>Outward</b>	60	43	86	106	152	<b>447</b>

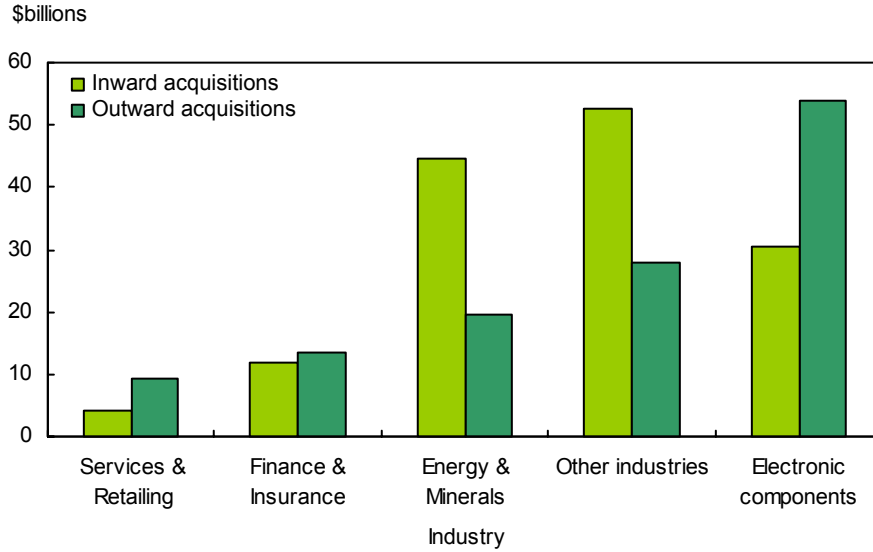
**Source:** Statistics Canada, Balance of Payments Division.

13. There are 6 major industry groupings used to present direct investment flows in *Canada's Balance of International Payments*, however, due to confidentiality a modified industry grouping has been presented.

14. As suggested by S. Aba and J. Mintz in *Preserving Control*, Backgrounder No. 62, C.D. Howe Institute, September 2002.

In terms of value, Canada was a net acquirer in electronics (the high-tech sector), and in the finance and insurance sector and the services and retailing sector. Foreign firms were net acquirers of Canadian companies in the energy and minerals sector.

### High-tech sector leads Canadian acquisitions abroad



**Source:** Statistics Canada, Balance of Payments Division.

## U.S. invested heavily in Canada's oil patch

Among the major industrial groups, the energy and minerals sector accounted for the most activity with respect to foreign firms purchasing Canadian firms.

### Net inward M&As focus on Canadian energy companies

	Energy & metallic minerals	Electrical & electronic components	Finance & insurance	Services & Retailing	Other Industries	Total
Year	\$millions dollars					
1997	-487	x	x	429	3,385	3,521
1998	5,586	x	2,463	x	6,274	17,622
1999	3,070	5,170	8,060	868	3,035	20,203
2000	7,179	18,098	1,358	1,286	36,208	64,129
2001	17,606	x	x	x	x	24,930
2002	11,641	539	x	974	x	13,537
	<b>44,595</b>	<b>30,585</b>	<b>11,956</b>	<b>4,246</b>	<b>52,560</b>	<b>143,942</b>

x - suppressed to meet the confidentiality requirements of the *Statistics Act*.

**Source:** Statistics Canada, Balance of Payments Division.

The energy and minerals sector accounted for 31% of the \$144 billion worth of Canadian firms purchased by foreign companies between 1997 and 2002.

Within the energy and mineral sector, energy alone accounted for over two-thirds of both the number and value of inward acquisitions. Just under \$32 billion of Canadian energy companies/assets were acquired during the six-year period, most of them by American companies.

In 2002 alone, energy and minerals represented 86% of the value of all inward mergers and acquisitions, and 71% the year before.

The high-tech sector was active from 1998 to 2001. This sector accounted for over 28% of inward mergers and acquisitions at its peak in 2000.

## High-tech in high demand by Canadian firms

Canadian firms acquired a significant number of foreign companies in the high-tech electrical and electronics sector between 1997 and 2002. High-tech accounted for about \$54 billion, or 43%, of the value of all outward acquisitions during the six-year period. The majority of the buying occurred in 1998 and 2000.

### Outward M&As lead by high-tech sector

Year	Energy & metallic minerals	Electrical & electronic components	Finance & insurance	Services & Retailing	Other Industries	Total
\$ millions						
1997	3,038	x	x	1,227	2,875	<b>6,104</b>
1998	x	16,719	3,700	x	7,012	<b>32,245</b>
1999	x	x	1,738	207	647	<b>4,485</b>
2000	7,776	30,713	x	430	x	<b>48,638</b>
2001	x	4,693	8,799	x	5,918	<b>24,395</b>
2002	5,464	x	1,461	994	x	<b>8,365</b>
	<b>19,588</b>	<b>53,760</b>	<b>13,497</b>	<b>9,332</b>	<b>28,055</b>	<b>124,232</b>

x- suppressed to meet the confidentiality requirements of the *Statistics Act*

**Source:** Statistics Canada, Balance of Payments Division.

Among the major sectors, energy and minerals accounted for the second largest value. Energy alone represented nearly \$9 billion, or 45%, and metallic minerals accounted for the remaining \$11 billion, or 55%. Both sectors were more active in the latter half of the period (2000 to 2002).

About \$11 billion, or 77%, of outward acquisitions in finance and insurance occurred in the United States.



## **Background, concepts and data quality**

Economic transactions that occur between Canadian residents and non-residents form Canada's balance of payments (BoP). Financial transactions in the BoP are classified as direct investment flows when there is a lasting interest and a significant degree of influence in the management of one company by another. For practical purposes, a rule of 10% or more of voting equity is used to categorize a direct investment relationship, irrespective of the level of control obtained.<sup>15</sup>

Direct investment flows can be divided into two groups, those that result in the creation of a new direct investment relationship, cross-border mergers and acquisitions (M&As), and transactions between existing direct investment partners. The vast majority of M&A flows result in full ownership of the target company.

Today's complex methods of financing acquisitions affect the M&A values recorded for BoP purposes. Conceptually, direct investment capital only includes funds provided directly across the border and not funds raised by a locally incorporated entity. The M&A data in this paper reflect the values of direct investment recorded in the BoP that are associated with merger and acquisition activity and not necessarily the full value of the assets acquired.

M&A flows that involved the use of share-exchanges as payment were basically of two types. In the first type, shares of the acquiring company were issued to shareholders of the target company. The second type involved a third company established in the target country and the issuance of exchangeable shares. Please refer to the Glossary at the end of this paper for additional information on exchangeable shares and their treatment within Canada's balance of payments.

Mergers and acquisitions data are recorded as of the closing date at market value. The data in this study are shown on a net basis (i.e. acquisitions less any divestitures) unless otherwise indicated. The counts of M&A flows are based solely on the number of direct companies acquired and do not include any subsidiaries that might also be owned by the target company.

The majority of mergers and acquisitions are first documented based on information from the financial press and electronic news services.<sup>16</sup> The data are considered to be of good quality. Other sources within both the private and public sectors are referenced in an effort to ensure the adequate coverage and quality of the BoP's mergers and acquisitions data.

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15. Statistics Canada, 2000, *Canada's Balance of International Payments and International Investment Position, Concepts, Sources, Methods and Products*, Catalogue no. 67-506-XPE, Ottawa, p. 67.

16. *Ibid.*, p. 68.

## **Glossary**

### **Exchangeable shares**

These are shares of a Canadian holding company created by the acquiring (foreign) company to allow Canadian resident taxpayers holding shares of the target company to receive payment in shares without immediately triggering tax consequences. The exchangeable shares are eligible to be exchanged for shares in the acquiring (foreign) company for a specified time period. Statistics Canada's Balance of Payments treat the exchangeable shares as if they have already been converted into shares in the acquiring company (i.e. foreign parent company) as of the closing date of the acquisition and not at the actual point of conversion.

### **Foreign Direct Investment (FDI)**

FDI is an investment of an entity resident in one economy obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise. For Balance of Payments purposes, direct investment capital only includes funds provided directly across the border and not funds raised by a locally incorporated entity.

### **Merger or acquisition**

Also known as a takeover. A merger or acquisition is a combination of two or more companies, either through a pooling of interests, where the accounts are combined; or the purchase method, where the amount paid over and above the book value of the target company is carried on the books of the acquirer company as goodwill; or a consolidation, where a new company is formed to acquire the net assets of the combining companies. In the Balance of Payments, mergers and acquisitions are a component of foreign direct investment flows.

### **Share-exchange**

This occurs when the acquiring company in an acquisition issues its own stock, as full or partial payment. The value of the transaction is calculated using the value of the shares on the stock market on the closing date of the transaction.