FOREWORD

The OECD Committee on Industry and Business Environment (CIBE) organises Business and Industry Policy Forums on current and emerging issues facing the business community. These have included sessions on the industrial aspects of the Asian financial crisis (1999), the growth and policy challenges posed by emerging service industries (1999), the effects of the "New Economy" on industry structure (2000), policies to encourage firms to pursue "beyond compliance" environmental strategies (2000), and issues related to the Internet and business performance (2001).

OECD Business and Industry Policy Forum
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A sixth Forum was organised on 19 February 2002 on *Global Industrial Restructuring: Recent Trends and Policy Issues.* The purpose of the Forum was to draw major stakeholders from government, industry and trade unions together to examine: *i)* the effects of the global economic slowdown and the events of 11 September on the global restructuring strategies being pursued by firms in OECD countries; *ii)* ways that the benefits associated with global tie-ups could be enhanced while addressing industry adjustment issues more effectively; and *iii)* areas where policy frameworks could be strengthened to improve global restructuring outcomes (see Annex 1 for a copy of the programme).

The Forum indicated that the economic slowdown did not deter firms from proceeding with global restructuring and that in some instances, the pressures to do so actually increased. The process was slowed, however, by economic and regulatory impediments and conflicting regulatory frameworks within the OECD area. Simplification and harmonisation were singled out as key to improving framework conditions in this regard. The Forum also underscored the growing need for governments to develop more effective policies to assist workers and communities adversely affected by plant closures and job losses. Finally, the Forum suggested that the principles that drove the expansion of globalisation during the 1990s (deregulation and market liberalisation) may not prevail during the next decade. Instead, a shift may occur that places greater emphasis on cultural and economic diversity rather than the shared "free market" values that guided the 1990s. Such a shift would subject globalisation strategies to greater oversight by countries, and could require corporations to become far more decentralised in managing their international operations.

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SUMMARY

The Business and Industry Policy Forum explored how the global restructuring strategies being pursued by firms have changed over time, the challenges that firms face in developing and implementing such strategies, and the principal policy issues that governments need to address to improve and strengthen the environment in which the restructuring takes place. Such restructuring intensified during the 1990s, driven by a series of economic and technological developments that encouraged firms to enhance their competitiveness through global tie-ups. Cross-border mergers and acquisitions (M&As) and international strategic alliances are now dominating the internationalisation of industry, supported by dynamic growth in electronic commerce. The global restructuring has generally tended to boost firm efficiency and has helped to spur innovation by facilitating the diffusion of technology and production, and managerial and marketing expertise.

The global economic slowdown in 2001, combined with the events of 11 September, intensified adjustment pressures and had a significant effect on the character and scope of global industrial restructuring. Falling profits and sharp declines in equity markets limited the extent to which businesses could engineer and finance major restructuring initiatives. At the same time, the pressure and need for such restructuring increased as a result of weakened demand and diminished market prospects. The situation differed considerably across industrial sectors, with some experiencing acute difficulties that gave rise to government intervention; other sectors, however, were not significantly deterred in their restructuring strategies.

The changes in the structure, scope and intensity of restructuring raise challenges for enterprises and governments. For enterprises, the benefits associated with the development and implementation of cross-border strategies are often undermined by duplicative and/or conflicting national regulatory regimes which add to the costs of proceeding with proposed deals. The differences also introduce uncertainty when deals are reviewed under different standards by competition authorities in concerned jurisdictions. Moreover, different taxing and governance policies can significantly affect the viability of given transactions. It was agreed that efforts to identify areas where policies

could be harmonised and simplified would therefore be beneficial in improving and strengthening the environment in which global restructuring takes place.

For governments, the interest of firms in pursuing global restructuring initiatives does not always correspond with national interests, particularly when the restructuring involves the closure of facilities or transfer of key functions to other countries. It was felt that this could lead to a "hollowing-out" or loss of strategic activities such as research and development. This tendency was downplayed by firms participating in the Forum, which noted that, at their companies, knowledge management and development was a decentralised phenomenon, with senior management overseeing the co-ordination and facilitation of knowledge transfers and exchanges. Concern over hollowing out was also addressed in the context of a discussion of the increase that is occurring in the outsourcing of manufacturing and research and development activities to non-OECD areas. This was viewed as an issue that needed to be examined in greater depth, as it could have significant implications for the future economic development. Finally, considerable attention was paid to the adverse effects that restructuring can have on workers and communities affected by plant closures, and the need for trade unions, governments and business to develop more effective adjustment policies and practices.

TRENDS IN GLOBAL INDUSTRIAL RESTRUCTURING

Long-term trends

Firm and industry restructuring takes a variety of forms. It includes investment in new plant and equipment, mergers and acquisitions, cessation or downsizing of operations and the forging or termination of commercial alliances with other firms. These sorts of actions are not mutually exclusive, as firms generally proceed in these three domains simultaneously. Investment in a new or existing facility, for example, can take place at the same time that a firm withdraws from a different area, and/or concludes an agreement with another company to enter into a joint marketing or research initiative.

The restructuring process is an ongoing one, with successful firms constantly adjusting to shifts in competitive conditions in their markets. What was notable during the 1990s was the scope and speed of restructuring, and the increasingly important role that cross-border activities played. Factors driving this acceleration in global activity are diverse. The liberalisation of rules governing trade and capital movements, combined with privatisation and other regulatory reforms, have, for example, opened markets, requiring firms to adjust to rising international competition. More efficient capital markets and more open contestable markets for corporate control have also been key, while falling transport, computing and telecommunications costs have worked towards facilitating and expanding international transactions. Finally, advances in information and communication technology (ICT) have had beneficial effects on the ability of firms to communicate and co-ordinate across geographically dispersed operations.

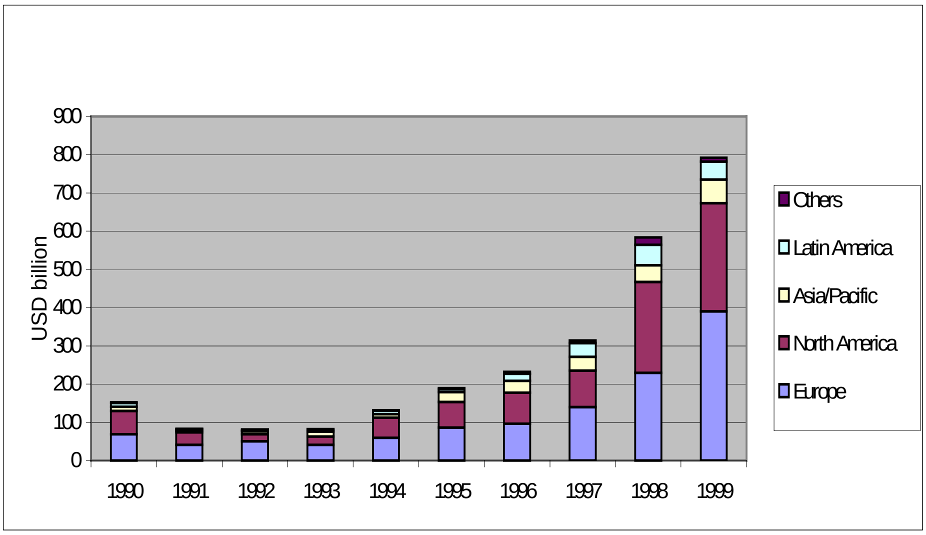
Trends in foreign direct investment illustrate the extent to which the role of cross-border activities increased. During 1989 to 1999, nominal net foreign direct investment from OECD countries rose from USD 220 billion to USD 768 billion, achieving an average annual growth rate of close to 15% (OECD, *2001a*). This was triple the rate of growth of GDP during the same period. Investment inflows into the OECD area grew at the same rate, rising from USD 171 billion to USD 684 billion. The growth was accompanied by notable changes in the structure of FDI. Cross-border M&A and international joint ventures supplanted "greenfield investments" in importance. Moreover, while large OECD firms still dominate global flows, the universe of firms engaged in FDI expanded, with many of the newer entrants being small and medium-sized enterprises (SMEs) and countries which were formerly largely FDI recipients.

Forms of global investment and alliances

Investment in new plant and equipment is one of the more important ways in which corporations have traditionally expanded international operations. Recipient countries have generally welcomed this type of investment, to the extent that it promised to foster economic development and expanded job opportunities. The role that such investment has played in recent years, however, is relatively small in terms of value, though it has maintained its importance in terms of number. In the United States, for example, greenfield FDI inflows accounted for only 10% of the total value of FDI inflows in 1998, which was down from 30% earlier in the decade. In terms of the number of investments, its role fell from 50% to about 40%.

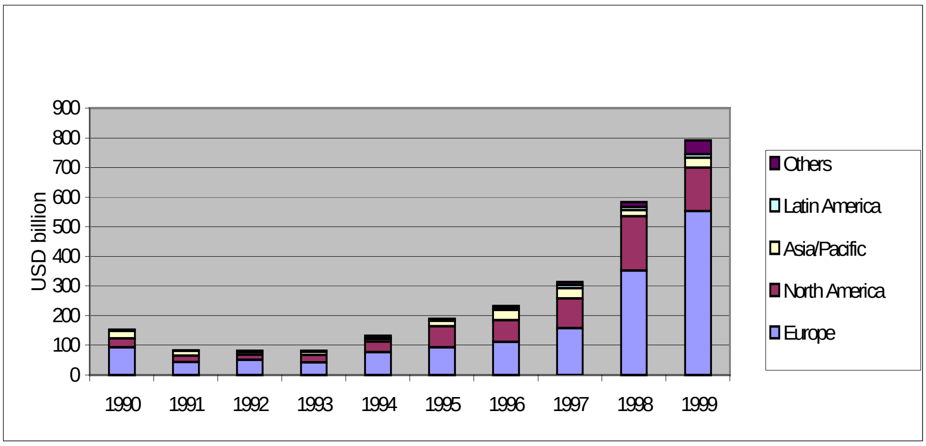
Cross-border mergers and acquisitions (M&As), however, currently dominate foreign direct investment (FDI) activity. In the case of the United States, these transactions accounted for 90% of the total value of FDI inflows in the late 1990s, and close to 60% of the number of investments. Viewed from a slightly different perspective, the value of M&As (*i.e*. the total value of the assets at stake in M&As) worldwide increased by more than five-fold during 1990-99, rising from USD 153 billion to USD 792 billion, with a particularly sharp increase during the second part of the decade **(Figures 1, 2** and **3**) (OECD, 2001*b*). Much of the increase reflects a rise in the number of mega-mergers (*i.e.* mergers and acquisitions valued at over USD 1 billion). These mega-deals accounted for 24% to 40% of the total value of M&As during 1990-94, while accounting for 1%, or less, of the total number of deals. By 1998, the share had risen to over 60% (and to 77% during January-October 2000), with their share in the total number of deals rising slightly, from around 1% to 2%.

Figure 1. Inward M&As, by region



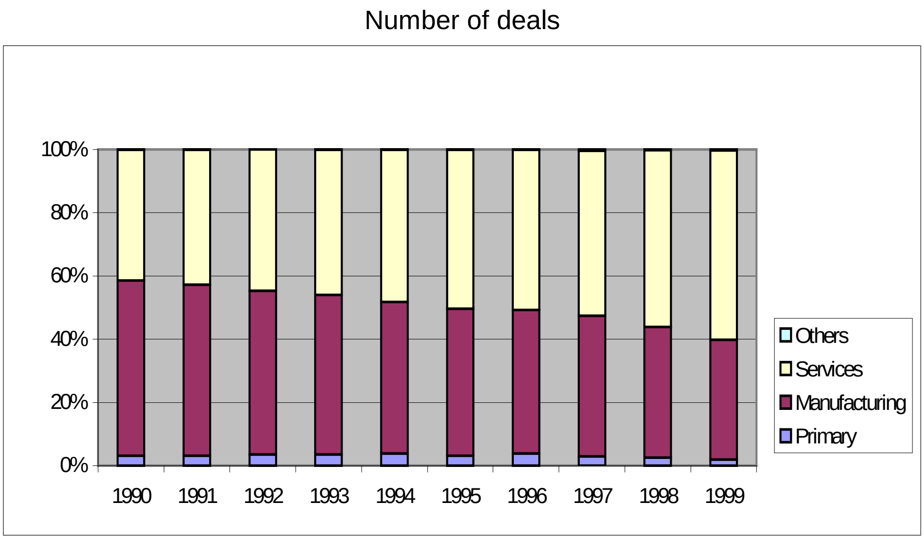
Source: OECD, 2001*b.*

Figure 2. Outward M&As, by region



Source: OECD, 2001*b.*

Figure 3. Cross-border M&As by sector



Source: OECD, 2001*d.*

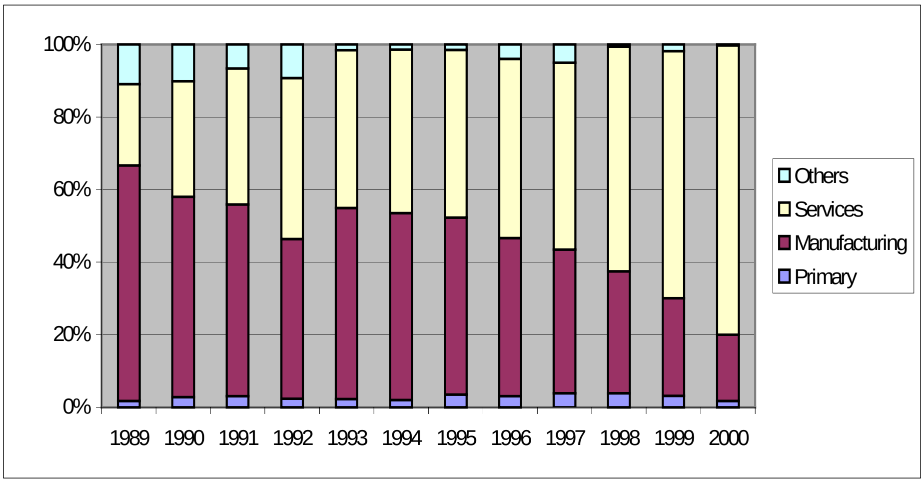
Unlike the M&As that took place during the 1980s, which often involved diverse activities, most mega-mergers that took place during the latter 1990s were among firms in the same sectors. This reflects a growing tendency by firms to concentrate on those aspects of their business in which they have competitive strengths. This is often being achieved by withdrawing from non-core activities, while expanding investment in basic operations. The extent to which this has occurred within the OECD area has, however, varied. In the case of Japan, for example, companies have generally been slow to expand outsourcing, preferring to maintain fully integrated operations that manufacture or provide a full complement of products (Nezu, 2002).

In addition to M&As, *international strategic alliances* emerged as a major form of globalisation during the 1990s. Such alliances range from relatively non-committal short-term, project-based co-operation to more inclusive long-term equity-based arrangements. Equity-based engagements include joint ventures, minority equity investments and equity swaps. Non-equity engagements include a host of inter-firm co-operative agreements involving research and development, co-production, technology-sharing, supply arrangements, marketing agreements, and various types of co-operative consortia. The relative importance of the different types of alliances varied during the past decade, with alliances related to business services growing markedly in overall importance, to over 50% in the year 2000. For the period as a whole, alliances associated with joint manufacturing and production projects were the most common, accounting for 31% of the total number of deals, followed by joint sales and marketing activities (27%) (**Figure 4**) (OECD, 2001*b*).

Alliance activity fluctuated during the 1990s, rising during the first half of the decade, before easing during the second half (**Figure 5**). While Europe and North America dominated M&A activity, the Asian Pacific area played an equally important role in the case of alliances. *Electronic commerce* has played an important role in the development of alliances, both in business-to-business (B2B) and business-to-consumer (B2C) relations. In the B2B area, the ease with which solicitations can be tendered internationally via the Internet and the ability to conduct real-time "virtual" auctions can open up competition to a greater number of potential suppliers or customers, without respect to the scope of their traditional marketing areas. In this instance, the benefits would appear to be particularly promising for those small and medium enterprises which have heretofore lacked the resources to develop foreign markets.

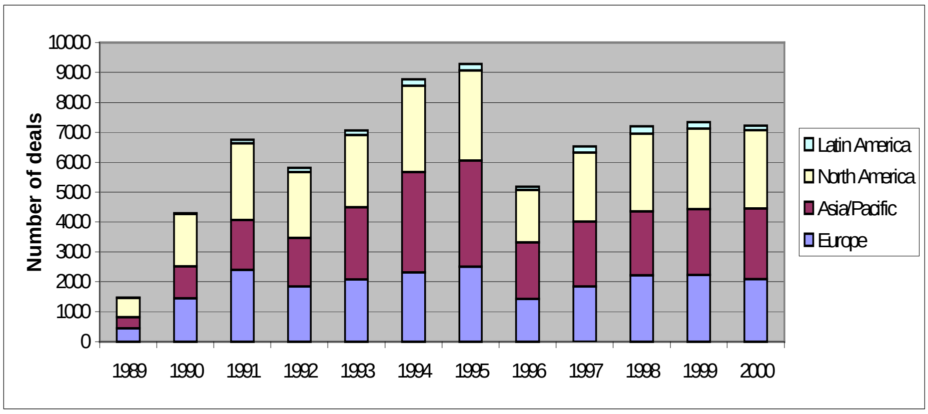
Figure 4. Cross-border strategic alliances by sector

Number of deals



Source: OECD, 2001*b.*

Figure 5. Cross border strategic alliances, by region



Source: OECD, 2001*b.*

In the B2C area, electronic commerce has given companies a highly cost-effective vehicle for exploiting global markets, by enabling companies to operate virtually everywhere, without investing in, or establishing, overseas facilities. This is achieved through the creation of electronic storefronts that can be "visited" by anyone with Internet access, without respect to location. In addition to opening up opportunities for global marketing initiatives, the interactive character of the Internet enables customers to order and pay for goods and services. Moreover, digitised products – such as software, music, and written materials – can be delivered over the Internet, for testing and/or final consumption.

As with B2B, alliances have been established to exploit opportunities more effectively. In the finance sector, for example, a number of commercial banks and securities brokerage houses have formed international alliances with Internet service providers to provide consumers with a variety of services. From January to October 2000, more than 40 such alliances were formed with Internet service providers, computer programming services and software companies.

Factors driving global restructuring

The restructuring of firms and industries on an increasingly global basis during the 1990s was driven by a combination of economic and technological factors (OECD, 2001*b*). Changes in government policies in key areas facilitated the restructuring, while providing additional incentives for the development of global strategies. Traditionally, corporations have pursued foreign activities principally with a view towards *lowering production costs* and/or gaining *access to protected markets*. Firms engaged in labour-intensive manufacturing, for example, sought to decrease costs by locating labour-intensive operations in countries where wages were substantially lower. In addition, formal and informal barriers to trade often provided further incentives to develop offshore operations, as did advantageous investment climates that might include tax incentives and other forms of support to promote local economic growth. While these factors continue to play an important role, others are also influencing strategies. Growing global competition, for example, is requiring companies to seek efficiencies that may require increasing their scale of operations. Often this can be achieved best not by investing in greenfield plants, but by acquiring existing facilities, wherever they may be located.

In a related area, *excess capacity* in some sectors has tended to intensify pressures to restructure on a global basis. The auto, petroleum and chemicals/pharmaceuticals sectors are examples where mega-mergers have been pursued to achieve larger economies of scale, while providing opportunities for firms to phase out non-competitive facilities and rationalise key functions – such as research and development, marketing, and distribution networks.

Combining and/or accessing strategic *intangible assets* – such as management skills, technical know-how and related assets – is also playing an important role. These arrangements typically serve to enhance the value of a firm's assets and to optimise returns over the long term, with lesser attention to costs as such. In this context, corporations are now defining their value in terms which include their intangibles. Increased attention is being paid, for example, to the importance of the capabilities of human resources to firm performance – which would include the knowledge, skills and abilities of systems engineers, programmers and researchers. This point was particularly important in understanding the global strategies being pursued by Ispat and Lafarge, leading producers of steel and building materials, respectively (Picard, 2002 and Sarrazin, 2002*)*. Both defined their companies' interests and successes in international acquisitions in terms of their ability to exploit their managerial and technical "know-how" to transform acquired entities into higher performing units.

The soaring cost of *research and development* is driving firms to explore new strategies for co-operation, on a global basis. High R&D costs for developing new generation drugs, for example, is considered the major driving force behind recent alliances and M&As in the pharmaceuticals sector. In addition to high costs, increasing technological complexity is pressuring firms to expand the scope of co-operative undertakings. Building and maintaining competence in non-core areas, for example, is an expense that firms may not be able to support in a cost-effective manner. Some of these functions can be contracted out, while others can be addressed through collaborative networks. Development and design of automobiles, for example, requires high levels of expertise in ICT, materials science, electronics, etc., which might be best exploited through strategic alliances. Pharmaceutical companies are also active in this area, outsourcing a major share of R&D in order to accelerate development of new products. In this context, firms can use M&As to acquire key technologies, thereby avoiding potentially costly research and development. This is also relevant for ICT firms, where leading firms such as Fujitsu have become more aggressive in exploring and exploiting R&D developed outside the firm (Nezu, 2002).

In addition to the factors discussed above, the speed and scope of global industry restructuring have been greatly influenced by changes in framework conditions. These changes have tended to facilitate, if not promote, such restructuring – largely through market liberalisation and deregulation. *Integration of regional markets* in Europe and North America, for example, has encouraged firms to expand their operations geographically, leading to more M&As and marketing alliances.

In *product markets*, the ongoing lowering of tariff and the strengthening of the multilateral rules governing trade are promoting a freer exchange of goods. This is providing new opportunities for companies to expand markets, while subjecting them to more intense global competition. Surviving and thriving are thus requiring companies to think increasingly in global terms. This is serving to reinforce the economic pressures mentioned earlier. Moreover, the development of complementary rules governing *trade in services*, has provided a framework for promoting the liberalisation and expansion of cross-border transactions, which should similarly provide incentives for increased global co-operation. Finally, liberalisation of *international capital movements* and *FDI* has facilitated increases in the level of cross-border transactions, across a wider range of countries.

Regulatory reform in many sectors is playing an important role in the dramatic increases in M&As and strategic alliances by opening up new opportunities for M&As and strategic alliances. This has been particularly noticeable in telecommunications, where cross-border M&As and alliances have become common. Vodafone Group Plc, a UK-based firm, is a case in point. Through acquisitions and alliances, the company has grown from a small, local mobile phone operator, to a GBP 21.4 billion firm with interests in mobile networks in 28 countries across five continents (Lloyd, 2002 and Vodafone Group Plc, 2001).

Privatisation is contributing to cross-border merger activity by increasing M&A opportunities and exposing firms to heightened competition. Significant increases in inward M&As in Latin America and in Central and Eastern Europe, for example, are linked to privatisation of state enterprises in telecommunications, energy and other sectors. In the case of Brazil, partly owing to the privatisation of public enterprises, inward M&As increased rapidly in recent years from USD 4.7 billion in 1996 to USD 24.8 billion in 1998. Moreover, acquisition of privatised mills has been the principal vehicle through which the steelmaker Ispat has expanded to become one of the world's largest steel producers (Picard, 2002).

Greater *institutional ownership* of equity and reforms in *corporate governance* structures are pressuring firms to explore ways to enhance shareholder value, while the dismantling of anti-takeover defences has made corporate management more responsive to shareholder concerns. This is resulting in more open consideration of cross-border M&As and alliances. In Japan, for example, the evolving nature of corporate relationships with shareholders, stakeholders and banks has led to record numbers of alliances and M&As, both domestic and international. Similar pressures are occurring in countries where tightly-knit cross-shareholding relationships among companies (as has been the case in France, Germany and Japan) are giving way to more widely dispersed ownership and greater transparency. The increased openness that this has prompted has resulted in more active consideration of ways to improve performance through corporate restructuring. A study of M&As involving French firms between 1997 and 1999, for example, shows that the emerging influence and role of institutional investors has been a principal factor underlying the recent wave of M&A activity (OECD, 2001*b*).

Finally, *access to international financial markets* and *risk diversification* have been mentioned as factors influencing global expansion. In the case of Lafarge, being a sizeable industry leader has enabled the company to generate interest from those institutional investors who have an interest in managing a diversified portfolio that may only contain a single cement producer (Sarrazin, 2002). Moreover, foreign holdings have helped the company to moderate swings in business activity, which, in the case of cement, tends to be highly cyclical on a country-by-country basis.

Outlook

As indicated above, the growth in globalisation has been supported by governmental policies that, in recent years, have focused on liberalising markets and promoting economic efficiency. Characterised as a "business class" model, the policies have aimed at the opening of economies to foreign investment, deregulation, fiscal discipline, privatisation and trade liberalisation (Davis, 2002). The widespread acceptance of the model has been supported by key global institutions such as the World Bank, the International Monetary Fund and the World Trade Organisation. Should it continue, one could expect tendencies towards integration to be strong, with weaker and less adaptable countries finding themselves at a disadvantage in an increasingly global and highly competitive environment. For the business community, the implications could be that competitive pressures would continue to drive firms to focus even more on core operations, outsourcing other activities to the extent possible.

On the other hand, it has been argued that the widespread support that the business class model attracted may have peaked, and that a shift could be occurring towards a world that is shaped more on economic and culture diversity rather than shared values. In such a scenario, countries are seen as taking a more interventionist role in their economies, basing their policies and actions more on cultural values and practices than on economic principles and objectives. Characterised as a "prism" model, markets would continue to matter, but their importance would be balanced by a recognition that governments may need to intervene to assure that social needs are addressed (Davis, 2002 and Royal Dutch Shell, 2002). In this context, fiscal, investment and related policies would be managed more actively to assure they were consistent with and contributed to a country's vision of society. For business, the diversity in framework conditions among countries would require tailoring initiatives to local conditions, while recruiting and developing competent local staffs to implement strategies. Globalisation would therefore continue, but would be subject to greater scrutiny.

Short-term trends

The economic environment for global industrial restructuring changed considerably during 2000 (**Table 1**). Robust growth in most OECD countries gave way to significant slowdowns, with a number of countries falling into recession. Real GDP for the OECD area as a whole slipped by an estimated 0.2% during the second half of 2001, with growth of 0.6% in the European Union offset by declines of 3.4% and 0.2% in Japan and the United States (OECD, 2002). This represented a sharp reversal from the decade-high growth of 3.9% achieved in 2000. The slowdown became increasingly evident during the first-half of 2001, with the marked correction in the high-tech sector and the lagged impact of the rise in oil prices. Prospects for a relatively swift but moderate recovery dimmed on 11 September. The terrorist attacks that took place in the United States on that day inflicted a shock to the world economy that is expected to have longer-term economic implications in a number of sectors.

Table 1. Economic projections for 2001-2003

	2000	2001	2002	2003
Real GDP				
United States	4.1	1.2	2.5	3.5
Japan	2.4	-0.4	-0.7	0.3
European Union	3.4	1.7	1.5	2.8
Total OECD	3.9	1.0	1.8	3.0
Private capital formation [1]				
United States	9.9	-3.2	-3.2	7.6
Japan	10.4	0.5	-8.2	-0.6
European Union	6.5	0.5	-0.6	4.1
Total OECD	8.7	-1.3	-2.1	5.1
Inflation [2]				
United States	2.3	2.2	1.5	1.6
Japan	-2.0	-1.4	-1.4	-1.7
European Union	1.4	2.3	2.3	1.9
Total OECD [3]	1.9	1.8	1.2	1.1
Unemployment rate				
	Percentage of labour force			
United States	4.0	4.8	5.6	5.3
Japan	4.7	5.0	5.8	6.0
European Union	7.8	7.4	7.6	7.5
Total OECD	6.1	6.4	6.9	6.7

1. Real gross private non-residential fixed capital formation.
2. GDP deflator.
3. Less Turkey.
Source: OECD, 2002.

The change in economic conditions had a significant effect on the character and scope of industrial restructuring. On the one hand, falling profits and sharp declines in equity markets limited the extent to which businesses could engineer and finance major restructuring initiatives. On the other hand, the pressure and need for such restructuring increased in many instances as a result of weakened demand and diminished prospects. As discussed below, the situation differed considerably across industries, with some experiencing acute difficulties that gave rise to government intervention.

In general, it appears that companies responded to the slowdown by focussing attention on ways to enhance their competitiveness at existing facilities through cost-saving measures. Marginal or non-core facilities were sold or closed, while employment was pared, with a view towards increasing efficiency. Although expectations for recovery have improved for 2002, capital expenditures are expected to drop by close to 2% in the OECD area (OECD, 2002).

With regard to global tie-ups, while the resources available for big deals may in many instances have fallen, the opportunities to purchase selected assets at low prices could well result in a higher volume of smaller scale deals. This is already evident with Internet-based companies, where surviving firms are selectively buying up portions of failed or failing concerns. A relatively small portal, iWon (United States), for example, recently participated in the purchase of bankrupt Excite.com for less than USD 10 million, which is a small fraction of the company's previous market valuation (of USD 6.9 billion) (Hansell, 2001). The USD 5 million invested by the company (the balance was purchased by InfoSpace, Inc.) is expected to be leveraged into a 40% to 50% increase in the company's revenues, which reached USD 70 million in 2001.

The shifting environment is reflected in recent data on mergers and acquisitions. The value of global M&As (including domestic as well as cross-border deals) fell by 50% during 2001 to USD 1.74 trillion, while the number of deals fell by 26%, to 28 828 (Whitman, 2002). While their overall level was down, activity actually increased in some sectors. In the United States, for example, M&A activity in the financial services, consumer products and basic industry sectors rose during January-October 2001 from previous years, as firms took advantage of depressed asset prices to acquire facilities which could improve their competitive positions (Lipin, *et al.*, 2001).

SECTORAL DIMENSIONS OF GLOBAL INDUSTRIAL RESTRUCTURING

Automobiles

Faced with overcapacity, the automotive industry has undergone significant consolidation during the 1990s, through a number of major mergers and acquisitions and strategic alliances. The largest deal occurred in 1998, when Daimler (Germany) and Chrysler (United States) combined in a USD 40 billion merger (OECD, 2001*b*). In addition, Ford (US) took over Volvo Car (Sweden) in 1999 and Land Rover (United Kingdom) in 2000, and Renault (France) acquired 37% of Nissan (Japan) in 1999. Moreover, GM (United States) is currently negotiating the acquisition of Daewoo (Korea). Related consolidation has also occurred among component suppliers.

Strategic alliances have traditionally played an important role in the industry, with firms taking minority positions in foreign companies with whom they had strategic bilateral relations. M&As and alliances have also been prompted by the need to combine resources and spread risks for the development of vehicles. Currently under study, for example, is a project in which DaimlerChrysler (Germany/United States), Mitsubishi Motors (Japan) and Hyundai (Korea), would work jointly on a "world engine" that would power up to one million vehicles in the near future. The alliance is being explored with a view toward enhancing the effectiveness and reducing the cost of engine development (Ball, *et al.*, 2002).

The economic slowdown intensified competition in the motor vehicle industry. Faced with declining consumer confidence in the post 11 September period, US automakers responded by offering highly favourably financing terms to new car buyers. These efforts helped to lift sales to a level that was only slightly lower than the record level attained in the year 2000. The outlook for 2002 is less promising, however, as world demand is expected to ease. While further industry consolidation could occur, most companies appear to be focussing their attention on increasing the efficiency of existing facilities.

Energy

The oil industry experienced significant consolidation during the 1990s. In addition to Exxon-Mobil (1998) and Chevron-Texaco (2000), which were mergers between American-based firms, the tie-ups brought a number of international players together, as follows (International Energy Agency, 2001*a*):

- BP (United Kingdom) and Amoco (United States), in 1998.
- BP Amoco (United Kingdom/United States) and Arco (United States), in 1999.
- Total (France) and PetroFina (Belgium), in 1999.
- TotalFina (France/Belgium) and Elf (France), in 2000.

Companies generally pursued the mergers with a view towards reducing costs by exploiting economies of scale more effectively, and by expanding access to international markets. Consolidation has also occurred among oilfield service companies, with favourable effects on the quality and cost of their products and services. The year 2001 was a turbulent one for the energy industry. After surging to over USD 30 per barrel in 2000, crude oil prices eased during February to September, at which time they dropped to below USD 20 per barrel (International Energy Agency, 2001*b*). Market conditions are expected to improve during 2002, although there is a great deal of uncertainty as to the extent of recovery. Consolidation in the industry continued during the year as the US firms Phillips and Conoco announced their intent to merge in November 2001, with a view towards strengthening their international competitiveness (Conoco, 2001). Further consolidation is likely, particularly if growth in demand is at relatively low levels (Davis, 2002).

Pharmaceuticals

Global restructuring in the pharmaceutical industry has been driven in large part by the rising cost of research and development, which is a key competitive factor and "cost" for firms. Strategic alliances have been used extensively by firms in the R&D area, but they have declined in recent years, while the importance of global mergers and acquisitions has grown (OECD, 2001*b*). After two surges in activity in 1989 and 1995, the level of M&As rose significantly in 1999. Unlike the previous surges, the most recent activity has had a far more international character.

The economic slowdown did not negatively affect merger and acquisition activity in the industry. In the first half of 2001, both the value (excluding the 2000 GlaxoSmithKline merger) and the number of deals (including domestic mergers) increased significantly from the year-earlier level (PriceWaterhouseCoopers, 2001). The strong merger activity was driven by three factors – a drive to strengthen positions in the fast-growing US market, interest in enhancing the commercial attractiveness of products through combinations with companies that have developed innovative drug delivery processes, and the major market opportunity available to makers of generic drugs (which are becoming increasingly global) due to the expiration of a significant number of blockbuster drug patents.

Semiconductors

The global economic slowdown put pressures on the semiconductor industry to consolidate, as global sales fell by an estimated 31% in 2001 to about USD 141 billion (Semiconductor Industry Association, 2001). Toshiba (Japan), for example, agreed to sell its US chip plant to Micron Technology (United States), while negotiating a joint venture involving memory chips with Infineon Technologies (Germany). At the same time, Micron Technology was negotiating with Hynix Semiconductor (Korea) over a possible alliance, sale or merger (Benoit, 2001). Further consolidation is likely, as firms are in the process of upgrading to a new generation of chip plants, which is a costly undertaking that only the most competitive firms will be able to finance. Longer-term prospects for the industry are favourable, as demand is expected to strengthen during 2002, recording an overall increase of 6%. Further increases in 2003 and 2004 could lift sales to an estimated USD 218 billion in 2004, which would surpass the 2000 level (Semiconductor Industry Association, 2001).

Shipbuilding

The shipbuilding sector has not undergone major restructuring in recent years. While there have been some mergers and take-overs (for example in Korea after the Asian financial crisis) and some limited foreign participation in shipbuilding activities in some countries, there has been little consolidation or other change. Despite the concerns expressed for some years about over-capacity in the industry, new facilities have continued to be brought on line, and improved technology and shipbuilding techniques have acted to improve productivity, and with it capacity.

One of the principal reasons for over-capacity has been the continuing direct and indirect support received by shipyards from governments that consider shipbuilding to be both a strategically important industry sector, and a heavy employer of labour. The continued support by governments has meant that competition in shipbuilding has been distorted in ways that protect inefficient operators against bankruptcy and closure. In the short term the global economic slow-down and the events of 11 September have reduced the level of demand for new vessels, which could contribute to an increasing imbalance between supply and demand. Governments have so far not, however, proposed any specific action in favour of the shipbuilding industry as a result of those attacks.

Shipping

The international maritime sector, both bulk and liner (*i.e.* containerised and general cargo) operate in relatively free and competitive environments. The liner sector has undergone considerable global restructuring in recent years, while the bulk sector may be relatively more affected by a prolonged economic downturn. While there are some minor indirect support measures (such as differential tax treatments and special social security provisions for crews operating on international voyages), governments no longer support shipping activities through subsidies, and those markets are generally contestable.

The bulk market is characterised by a large number of small shipowners, who may operate a few bulk carriers or oil tankers. Charter rates are highly volatile and react readily to changes in economic conditions, demand by cargo owners and international events. Charter rates were already falling prior to 11 September and have fallen more sharply since then, as concerns have grown about global economic conditions. Because of the lack of government support for this sector, inefficient operators will be driven out of the market by prolonged poor market conditions. Alliances and other co-operative arrangements are virtually unknown in this sector.

In the liner sector, there has been a measure of consolidation over recent years as carriers have striven to build some economies of scale into their operations, principally so that they could operate increasingly larger fully cellular container vessels. These have grown in recent years from 2 000 TEU (twenty-foot equivalent units) to 4 000 TEU and 6 000 TEU. Some vessels up to 7 000 TEUs are under construction. In 1997, the world's top 20 container operators accounted for about 48% of the world's cellular fleet. By the middle of 2001, this had grown to almost 72% of the world's fleet, indicating relatively rapid concentration. Extensive consortia and alliance arrangements are also a feature of the liner industry, and these are in widespread use.

While governments do not provide extensive support to the liner shipping sector (and therefore bankruptcies and withdrawals from the industry are quite common), the liner sector does enjoy some exemptions – in all OECD and many non-OECD countries – from the application of antitrust laws to certain co-operative activities between groups of liner operators. These exemptions extend to common rate setting, discussions amongst competitors and in some cases to the ability to fix supply, and together these tend to reduce the impact of poor freight rates and other economic conditions on the least efficient operators, who as a result may continue to operate after the time that they would have done in a totally competitive environment.

Steel

Restructuring in the steel industry in recent years has resulted in significant consolidation worldwide, as firms have striven to enhance their competitiveness through major cross-border mergers and acquisitions. The restructuring has been driven by intense competition, which is pressuring firms to close marginal facilities and exploit synergies with other producers. In Europe, British Steel (United Kingdom) merged with Hoogovens (Netherlands) in 1999 to form Corus Steel, while Usinor (France), Arbed (Luxembourg) and Aceralia (Spain) recently merged to form the world's largest steel firm (Arcelor) (OECD, 2001*b* and Arbed, 2001). Moreover the LNM Group/Ispat (United Kingdom and the Netherlands), from a relatively small mill built in Indonesia, has become a major world steel producer during the 1980s and 1990s through the acquisition of facilities in Canada, France, Germany, Ireland (now closed), Kazakhstan, Mexico, Trinidad and Tobago and the United States (Picard, 2002 and Ispat, 2002). Related consolidation, much of which has a national focus, is occurring in most other areas, including the United States and Japan.

The economic slowdown intensified restructuring pressures in the industry. In the United States, for example, over 30 firms accounting for close to 30% of capacity have filed for bankruptcy or liquidation. With the situation deteriorating worldwide and tensions in trade rising, governments initiated a major multilateral effort in September 2001 to explore ways to facilitate the closure of inefficient excess capacity in their respective countries, and to examine ways to strengthen competition in steel through stronger disciplines on subsidies and related support measures (OECD, 2001*d*). In the current environment, the cost of closing facilities is viewed as one of the principal factors deterring many firms from implementing restructuring plans fully. In some instances high "legacy" costs (such as retirement benefits) are also an important factor, to the extent that they discourage industry consolidation via mergers and acquisitions.

Telecommunications

Advances in technology and regulatory reform have proven to be a powerful stimulus driving structural change in the telecommunications industry (OECD, 2001*b*). The opening of markets to foreign competition through deregulation, for example, has enabled large telecommunications operators, many of whom were previously national monopolies, to become global operators by acquiring and/or by forming alliances with foreign firms. Much of the globalisation that occurred during the 1990s reflected an interest on the part of telecommunications firms in capitalising on new and emerging opportunities in expanding markets. The economic slowdown has changed the focus, as firms are now struggling to weather a sharp decline in financial performance, which is resulting in increased industry consolidation.

The most recent examples of such consolidation include the USD 45.9 billion take-over of Orange Plc (United Kingdom) by France Telecom, in August 2000. Firms in the United States, United Kingdom, Germany and France have been most heavily involved, with firms in Latin America and eastern Europe becoming targets. In Asia, firms in Hong Kong (China) have been active, while a number of Australian firms have been acquired by foreign interests. Japanese firms have been relatively slow to expand into foreign markets through acquisitions, though DoCoMo, a dominant mobile communications operator, recently acquired a 15% interest in KPN Mobile (Netherlands), with a view to sharing the growing costs of developing third generation communication services. With regard to cross-border alliances, many deals have focused on the provision of Internet-related services (such as e-mail and Web access), via mobile telephony.

Tourism

Global alliances and voluntary networks are playing an increasingly important role in a number of tourism industries. For example, most airlines have established worldwide strategic alliances that have a key impact on tourism. The growth in these link-ups is being driven largely by efforts to increase efficiency and expand market share. In hotels and catering, for example, voluntary networks are aimed at reaching a wider market and broadening the services provided by independent businesses competing with large, integrated chains. The number of mergers and acquisitions in the tourism sector has grown steadily in recent years as in other service industries. The major industrial groups in the tourism sector are now established worldwide and have international development programmes. Small businesses are preponderant in the sector, but multinational enterprises play a key pace-setting role for tourism supply as a whole. There is reason to believe that the restructuring and consolidation process will accelerate in some OECD countries in which the tourism industry is more fragmented than elsewhere.

The events of 11 September had a pronounced impact on the tourism industry, aggravating an existing slowdown in the sector. The effects were particularly severe on long-haul tourism, air carriers, hotels and business travel in general. Businesses closed, while capacity, working hours and employment levels were reduced (World Tourism Organisation, 2001). Not every destination and every part of the industry was, however, affected to the same extent. Domestic tourism, travel by road and rail and individual trips, for example, seem to have been more resilient, and may in some respects have experienced increased activity as travellers shifted their modes of transport. In the absence of new major external factors, the industry expects a return of consumer confidence during 2002.

Air travel was significantly affected by the events of 11 September, with the volume of travel and fare prices both declining sharply. In the United States, October 2001 airfares were 19% less than their year-earlier levels, while passenger-traffic declined by 23%. Total revenues were thus off by 38%. The effects on employment were significant, with more than 80 000 workers (around 15% of the workforce) facing furlough (Air Transport Association, 2001*a* and 2001*b*). In Europe, the air transport industry was also hit hard by the events of 11 September. Declining demand resulted in the grounding of 108 aircraft (about 5.6% of the fleet), jeopardising the jobs of 17 000 employees (5% of the workforce). Further job cuts were expected to affect a total of 30 000-40 000 workers. In addition, insurance costs doubled while measures to enhance security were expected to costs as much as EUR 145 million. The situation was expected to result in revenue losses of EUR 3.6 billions during 2001 (European Commission, 2001*a*). In response, Governments have provided various types of assistance to the industry (**Box 1**) which has raised issues of competition on common routes.

The "shock" that the events of 11 September have had on the industry are likely to intensify ongoing restructuring. In Europe, the need for further consolidation became more pressing, with two airlines which had already been experiencing financial difficulties – Swissair (Switzerland) and Sabena (Belgium) – falling into bankruptcy. At the same time, low-cost, "no-frill" airlines are expanding market share through aggressive marketing strategies that use low fares to attract travellers. Their success is requiring full-service carriers to enhance their efficiency by cutting costs and exploiting other strategies to meet the increasing competition. In addition to consolidation, the role of strategic alliances, which are already common in the industry in the form of code-sharing, maintenance, catering and related services, may be enhanced.

With regard to *aviation*, the events of 11 September deepened and lengthened an expected decline in commercial aircraft demand, leading to more intense competition among aerospace suppliers (Velocci, 2001). Overcapacity, price pressures and financial considerations are likely to promote further industry restructuring. Although there could well be some multi-billion dollar deals involving major systems integrators, consolidation is likely to be most common among smaller companies, with transatlantic activity to increase in intensity.

In the case of the largest commercial aircraft makers – Boeing and Airbus – the uncertainty that the events of 11 September have created has resulted in a lowering of expectations. At Boeing, revenue estimates for 2002 were trimmed by 10%, with cash flow expected to drop by some 40% from previous calculations (Boeing, 2001). With the number of commercial deliveries of planes expected to drop by at least 25%, employment will be reduced by more than 10% by the end of 2002. At Airbus, an expected 40% increase in deliveries during 2000 to 2003, has been revised, with a 6% decline expected in 2002, and a further decline in 2003 (Done, 2001).

Box 1. Government aid to airlines

With the financial viability of air carriers at risk, the United States passed an Air Transportation Safety and System Stabilisation Act, which came into force on 22 September 2001 (US Congress, 2001). The Act includes a number of economic measures to support the industry, including compensation for losses associated with the suspension of operations at airports in the aftermath of the terrorist attacks (USD 5 billion). Moreover, the Government has made up to USD 10 billion available to carriers which have been unable to secure finance on reasonable terms due to the attacks. In addition, provisions to delay payments of certain airline-related excise tax deposits have been made, while measures designed to improve the terms under which carriers can secure insurance have been introduced.

In Europe, Member States of the European Union were authorised to introduce temporary mechanisms designed to provide liability insurance to airlines (European Commission, 2001*a*). They could, for example, cover the risks or assume the cost of the increase in insurance premiums, on condition that such aid was strictly regulated and notified to the Commission. On an exceptional basis, they were also authorised, subject to Commission oversight, to compensate airlines for the costs associated with the four-day closure of American airspace. In addition, regulations governing slots were eased to enable carriers to retain their rights during the market downturn, while the possibility of co-ordinating schedules and capacities more closely (subject to Commission oversight) was introduced.

RESTRUCTURING ISSUES

The development and implementation of global restructuring strategies by firms are affected by the regulatory, economic and cultural environments in which they take place. These environments, which vary considerably among countries, can have a significant impact on the character and scope of restructuring, and can influence the degree to which the restructuring succeeds (**Box 2)**.

Box 2. M&A Scorecard

Surprisingly few mergers and acquisitions live up to initial expectations. An analysis of the estimated USD 12 trillion in M&A that took place during 1996-2000, for example, suggests that 70% to 80% failed to generate economic wealth, and that at least USD 5.8 trillion was therefore "wasted" (in the sense that no wealth was created) in pursuit of these transactions in the US and EU alone (Schenk, 2001). In addition to these losses, non-productive M&As and alliances, whether national or international, can have other adverse effects – by diverting investment funds from promising projects, by increasing lay-offs and by precipitating sell-offs to strengthen balance sheets.

Successful restructuring is most difficult at the international level when cross-border differences in work approaches, regulations and policies present an added challenge. Factors influencing the success and failure of global industrial restructuring initiatives – and their costs and benefits – are discussed below in terms of: *i)* organisational approaches, *ii)* national regulations, *iii)* market competition, *iv)* taxation and *v)* employment issues.

Organisational approaches

The success or failure of global restructuring strategies depends to a large measure on the ability of companies to integrate and exploit the human and technological resources that each party possesses. Outcomes generally fall short of expectations, as differences in corporate cultures prove difficult to overcome, and envisioned synergies do not materialise to the extent calculated. Research indicates that culture clashes head the list of obstacles to successful enterprise integration (Coopers and Lybrand, 1992). In the case of cross-border transactions, lack of experience in a country can seriously hamper merger/acquisition initiatives, thereby lowering success rates. Data collection and integration problems are abundant and companies need to rely on local advisors for understanding the local context (legal system, tax system, accounting practices, local management style, etc.) and for assistance in the integration phase when national cultural differences can pose problems. Gaining a level of trust in the acquired local managers is crucial.

A study of French and German managers involved in mergers and joint ventures showed that conflicts in work relationships were largely due to cultural differences in organisational behaviour relating to planning, authority, commitment, monitoring and teamwork. While more than 50% of managers reported cultural differences in work giving rise to tensions, they noted that these were often not regarded as important by headquarters management. In general, insufficient account may be taken of the inherently conservative change-resistant aspects of company culture (Harper and Cormeraie, 1995 and Perkins, 1997). Corporate communications structures are rarely in place in the early stages of a joint venture and their neglect is claimed to be an important obstacle to success (Balmer and Dinnie, 1999). The vast majority (86%) of companies do not implement a communications programme due to lack of support from top management, insufficient resources, or lack of understanding (A.T. Kearney, 1999).

Organisational factors contributing to failures in global restructuring include:

- *Emphasis on short-term financial and strategic considerations* – Separating deal making from integration is a major source of the subsequent problems that befall a merger. Firms focus too much on the earlier stages of the deal (financial issues, cost reductions, legal issues, etc.) to the detriment of organisational issues and, in particular, human resources (Southern Methodist University, 2001).

- *Need for an integration plan* – Failures are also attributed to the lack of an integration plan. One study found that prior to acquisition, fewer than 20% of companies had considered the steps necessary to integrate the acquired company into their own organisation. In contrast, companies with strong integration plans have created above average value in their industries (Mercer Management Consulting, 1999). Integration problems are exacerbated by the size of mergers, such as the recent merger of the industrial giants DaimlerBenz and Chrysler, who held between them over 400 000 employees.

- *People and management issues* – Inadequate management-related preparation and staff training are a main cause of companies' failures in cross-national ventures (Harper and Cormeraie, 1995). In one survey, 9-13% of human resource executives surveyed observed that people issues play no part in the process until after the merger becomes official, and thereafter 20% believe that it plays a moderately significant role, becoming pivotal only after the deal is closed (Conference Board, 1998). Training managers for working in cross-cultural environments is often neglected, resulting in a high rate of burnout in expatriate managers.

On the other hand, the success that Lafarge, Ispat and Vodafone have had in their international undertakings has in part been explained by the decentralised approach that each has pursued when acquiring a foreign unit. Lafarge, for example, underscores the importance of supporting local and national cultures, while introducing the company's know-how and operational techniques into an acquisition (Lafarge, 2002). The same is true of Ispat, where business units are operated independently with a relatively small number of corporate managers, and Vodafone, which creates partnerships with foreign entities, then relies on local staff to tailor Vodafone's principles and objectives to local situations (Picard, 2002 and Lloyd, 2002).

National regulations

Global industrial restructuring may be impeded or slowed by differing rules and regulations governing enterprise transactions and corporate governance. In many OECD countries, for example, mergers need to be approved by boards of directors and then submitted for ratification by the shareholders of the respective corporations. There are, however, differences across countries. Similarly, holding companies can be an effective organisational tool that businesses can use to facilitate restructuring. Common in the United States, the United Kingdom, France and Germany, they have only been recently been allowed in Japan and Korea.

While the majority of take-overs are "friendly", there are instances where parties seek to acquire control over a firm without its consent or agreement. Most OECD countries have regulations designed to protect corporate shareholders from swift and secret take-overs by outside parties, which affect the extent to which take-overs can be conducted in different jurisdictions (Weston, Chung and Diu, 1998). For example, in the United States, any party who acquires 5% or more of the stocks of a public corporation is obliged to notify the Securities and Exchange Commission within 10 days of crossing the

5% threshold. In the case of public tender offers, a minimum waiting period of 20 days is required, during which a public tender offer must be held open. In most European countries, regulations require parties acquiring control of a company to make a public offer for all the remaining shares, with a view towards protecting the interest of minority shareholders. In Germany, such tender offers are recommended, but not required. Broader efforts to harmonise take-over rules in the European Union have been undertaken, but have yet to be realised (European Commission, 2001*b*).

The methods that companies can use to finance acquisitions are also sometimes subject to regulations which differ across countries. "Stock swaps" are a case in point. Such swaps have been used increasingly to finance mergers and acquisitions. In 1999, for example, the share of M&As financed by swaps (in terms of value) represented some 36% of all cross-border M&A transactions and almost half of the large-scale transactions (OECD, 2001*b*). The swaps are attractive because they greatly reduce the amount of cash and other finance needed to conclude a transaction. However, in Japan, such swaps were not permitted prior to 2000, while in Korea they are still not permitted as such (although a virtual swap could be structured, as long as cash is used to facilitate the purchase and sale of the stocks involved in the swap).

The regulation of product markets can also be an issue in some sectors. In the case of telecommunications, the transformation and evolution of the industry and markets have progressed at a speed that has oftentimes exceeded the ability of regulators to keep up with events, resulting in a gap that can slow industry development (Lloyd, 2002). Closing the gap, it is argued, requires a suitable complement of technical and policy experts who understand how technology is evolving, industry structure, and the technical and technological issues that need to be addressed. Moreover, in support of industry growth, it is essential that legal and regulatory structures be transparent and predictable.

Market competition

While global mergers and acquisitions and strategic alliances can enhance the performance of firms, they invariably have effects on competition in product and service markets. Global industrial restructuring can enhance competition by increasing the number of competitors in different markets. In some instances, however, consolidation has increased concentration to the point where national authorities have undertaken investigations to determine whether actions might be needed in order to assure that competition would not be unduly limited. When they are large in size, mergers and acquisitions can trigger review thresholds in more than one country. In a few instances, for example, a great many national competition agencies have reviewed a single merger.

This potential review of a transaction in multiple jurisdictions has raised issues, and given rise to a debate among OECD countries on the value and need for harmonisation of competition guidelines (OECD, 2001*e*). On occasion, for example, reviewing agencies have reached different conclusions, as occurred recently when General Electric (United States) sought to acquire Honeywell (United States). Fortunately, there have been few such conflicts to date, as national competition agencies have developed informal but effective means of co-operation in reviewing such mergers. Consistent with the 1995 OECD Council Recommendation concerning co-operation on anti-competitive practices, for example, competition authorities share information with each other and assist each other in acquiring needed information on a cross-jurisdictional basis (OECD, 1995).

The business community has itself underscored the importance of improving the process for reviewing mergers and acquisitions. In a recent assessment of international merger control procedures, the Business and Industry Advisory Committee to the OECD (BIAC) expressed support for the right of individual jurisdictions to apply their own laws to mergers which have effects in their markets. At the same time, it is argued that the proliferation of merger control regimes imposes significant – and unnecessary – costs on virtually all international transactions, and that actions should be taken to eliminate unnecessary costs in a manner which does not compromise the legitimate interests of any jurisdiction in enforcing its competition laws (BIAC, 2001). The need for reform is in many respects shared by governments, who are currently working with each other and the business community to develop improved procedures.

Beyond competition reviews, the timetables that firms must adhere to and the steps that they are required to take in finalising a transaction can differ widely, or conflict, among jurisdictions. In such cases, key decisions and actions might have to be made hastily to assure compliance, raising the risk that serious strategic or administrative errors could be made (Sarrazin, 2002).

Taxation

National taxation approaches can have significant effects on the form and extent of corporate restructuring. By effectively raising the cost of the sale of an asset as part of a merger or restructuring, these factors can reduce the incentive for pursuing potentially beneficial deals. Moreover, the nuances in the way that policies in these areas are implemented can encourage firms to structure their transactions in sub-optimal ways, so as to minimise or avoid taxation. Within the OECD area, the situation differs considerably, as tax regimes are complex systems that have been tailored to reflect principles and traditions specific to each country. In the case of corporate capital gains, for example, long-term rates range from tax-free in the case of Belgium, Denmark, Luxembourg, New Zealand and Switzerland to 30% or more in half of the OECD countries (OECD, 2000).

A number of OECD countries have introduced provisions to reduce or minimise taxes associated with business restructuring at national and international levels. Korea, for example, enacted several measures which permit capital gains taxes to be deferred and has reduced registration taxes. Japan introduced deferrals of capital gains taxes applied to stock exchanges, stock transfers and corporate de-mergers. The United States has a "tax-free" corporate reorganisation system which does not recognise gains or losses in the process of corporate reorganisations, as long as certain conditions are met (Weston, Chung and Siu, 1998). In general, if a merger or acquisition involves an exchange of the stock of one company for the stock of the other, it is a tax-free transaction. If cash or debt is used, however, it becomes a taxable transaction. In addition, corporate de-mergers also can be tax-free to both the corporation and to its shareholders. However, in this instance "tax-free" entails a tax deferral rather than an outright exemption. That is, capital gains for the corporation are not recognised until the transferred assets are sold to third parties. For the shareholders of the target firm, taxes are deferred until the common shares received in the transaction are sold.

Germany introduced a comprehensive "tax-neutral" corporate restructuring system in 1995. Under the *Business Reorganisation Act*, certain types of corporate restructuring, including mergers and de-mergers (spin-offs, split-offs and split-ups), are simplified. A complementary *Business Reorganisation Tax Act* enables qualifying firms to defer capital gains taxes when they combine or divide. Germany also eliminated, as from 2002, corporate taxes on capital gains when stocks of subsidiaries are sold, provided the shares are retained for more than one year (German Federal Ministry of Finance, 2000).

In France, capital gains which occur in a merger transaction are considered as unrealised gains and are not subject to corporate taxation until acquired assets are sold. France also allows tax-neutral de-mergers, provided they meet certain criteria and are approved by tax authorities. If corporate de-mergers do not meet these requirements, they are considered liquidations and are subject to taxation. In these instances parent companies would pay corporation tax on liquidation income, while shareholders would pay dividend tax, since the distribution of shares would be treated as distribution of liquidated assets.

The way that companies are permitted, or required, to *consolidate* their tax returns can have important tax consequences that, in turn, affect the form that industry restructuring takes (Hoffman, Raabe, Smith and Maloney, 1999). In general, when two or more firms merge and operate as business units within an integrated company, the losses of one business unit can offset taxable profits of others. However, if two or more firms are combined as in a parent-subsidiary relationship, the losses of one subsidiary cannot generally offset taxable profits of other subsidiaries controlled by the same parent. Instead, corporate tax is charged on the basis of each separate company's performance, unless special provisions such as group relief exist. Gains from inter-company transactions between subsidiaries also cannot be deferred.

In response, an increasing number of OECD countries (including the United States, the United Kingdom, Germany, France, the Netherlands, Australia, Austria, New Zealand, Finland and Spain) are adopting consolidated taxation systems. Consideration is also being given to this in Japan and the European Union. Under the consolidated system, all profits and losses of parent and affiliated subsidiaries are combined for tax purposes. Thus, corporations can choose optimal corporate forms without facing tax distortions. However, in general, foreign subsidiaries are subject to taxation in the countries in which they are operating. Thus, it is not possible to consolidate foreign subsidiaries with domestic member companies.

Employment issues

Global industrial restructuring raises social issues relating to the effects of upsizing and downsizing on employees. Cross-border M&As and alliances can yield dividends in terms of company performance and profits as firms combine their human and other resources. They can generate jobs and wealth, particularly in the longer-term, as firms integrate and build on core competencies. However, there will inevitably be short-term adjustment costs for firms, workers, communities and nations. In sectors such as steel and banking, for example, global restructuring has led to significant job losses. Such negative impacts on employment may intensify in the current economic downturn.

To address adverse employment effects, governments can ensure efficient labour markets so as to facilitate the contraction, expansion and alteration of business activities and related employment. They can strengthen social safety nets to allow smooth industrial restructuring and minimise social disruptions.

Moreover, they can provide assistance for training and retraining, job search and mobility, and promote the portability of pensions and benefits.

In the United States, for example, the *Worker Adjustment and Retraining Notification* (WARN) Act of 1988, requires employers to provide notice 60 days in advance of certain plant closings and mass layoffs (US Department of Labor, 1988). The notice must be provided to either affected workers or their representatives (*e.g.* a labour union), to the State dislocated worker unit and to the appropriate unit of local government. The purpose of the Act was to provide workers and their families transition time to adjust to the prospective loss of employment, and to provide State dislocated worker units with information that would enable them to make assistance available on a timely basis.

In the European Union, guidelines on consultations with workers have been established at European Community level, with national authorities often imposing further obligations on firms operating in their respective jurisdictions. The need to strengthen framework conditions was underscored in 2001, when the European Parliament adopted a resolution on the social consequences of industrial restructuring (European Parliament, 2001). The resolution reaffirms the freedom that firms should have to manage their undertakings in ways that secure their commercial success, while emphasising the need to involve workers more actively in managing the changes that this may entail. Following up on a call for a more pro–active stance by governmental authorities, the European Commission is now exploring the development of a series of "best practice" principles that could be used to improve outcomes.

The notion that workers should play an increased role in managing the change that accompanies restructuring has taken hold in some areas. In France, for example, the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations negotiated an international agreement with the food group Danone which spells out the social principles to be applied in the context of a restructuring plan announced by the company in 2001. The agreement contains commitments on redundancies, the future of closed facilities, training opportunities and indemnities for redundant workers (TUAC, 2002).

Not all countries, however, have developed policies and procedures aimed at smoothing adjustment for firms and employees – at least not to the same extent as has occurred in some areas in Europe. This may have implications for the ways that firms undertake global restructuring, providing incentives for firms to shift adjustment to countries which are less regulated and where, as a result, the firms have greater operational freedom to design and implement measures relatively quickly, with limited economic consequences.

Issues related to adjustment have been addressed in the OECD through a set of guidelines adopted by governments for multinational enterprises. The guidelines are a set of voluntary principles and standards provided by governments to encourage industry to adopt responsible business practices. They cover a range of areas, including employment and industrial relations, human rights, environment, information disclosure, competition, taxation and science and technology. With respect to restructuring, they specify (OECD 2001*f*):

> *In considering changes in their operations which would have major effects upon the livelihood of their employees, in particular in the case of closure of an entity involving collective lay-offs or dismissals, [enterprises should, within the framework of applicable law, regulations and prevailing labour relations and employment practices] provide reasonable notice of such changes to representatives of their employees, and, where appropriate, to the relevant governmental authorities, and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects. In light of the specific circumstances of each case, it would be appropriate if management were able to give such notice prior to the final decision being taken. Other means may also be employed to provide meaningful co-operation to mitigate the effects of such decisions.*

Although voluntary, governments actively promote the acceptance and implementation of the guidelines, through national contact points (which are responsible for encouraging observance of the guidelines in a national context and for ensuring that information on the guidelines is diffused), the OECD Committee on International Investment and Multinational Enterprises, and collaboration with business and trade unions through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD.

Beyond improving processes, there is a view that companies could do more to improve the internal mobility of workers affected by restructuring. Both the BIAC and TUAC noted that more creativity could be used in this context by, for example, exploring the development of new or enhanced activities to which redundant workers could be reassigned, and/or by modifying work environments through the use of flexible work schedules that would provide opportunities for a greater population of workers. Training and placement assistance are also key, in those instances where external mobility needs to be expanded.

POLICY IMPLICATIONS

Adjusting to new paradigms

The potential shift towards more localised responses to globalisation (inherent in the move from a "business class" environment to a "prism" orientation) would likely have significant implications for the scope and structure of the global strategies developed and implemented by firms. The need to address and accommodate increasingly diverse cultural and societal situations, for example, could require firms to adapt more flexible approaches to their international operations, giving local units more autonomy in carrying out corporate strategies. There may also be implications for multilateral initiatives, such as trade negotiations. While it may be possible to agree to more comprehensive rules, it could well be that the rules will have to be more flexible in order to gain widespread acceptance by countries with different priorities and goals.

Harmonising policy frameworks

National policy frameworks affect the nature, scope and degree to which global industrial restructuring can take place. In some areas, such as bridging cultural differences, business will need to take the lead, although there may be roles that governments and trade unions can play to facilitate more effective co-operation across borders. In other areas, governments are clearly in a position to reduce or eliminate impediments to global transactions and facilitate global industrial restructuring. In this regard, regulations on enterprise transactions, corporate governance frameworks, competition policy approaches, and taxation of transactions associated with corporate restructuring differ considerably across countries. If global industrial restructuring is considered to enhance firm, sectoral and national economic performance, the question arises as to the degree to which national policy frameworks should be harmonised to facilitate such restructuring.

In the case of competition policy, harmonisation of the principles to be applied to assessments of proposed mergers and acquisitions would provide firms with a more predictable environment that would lower the risk that a deal could be acceptable in one jurisdiction, but be rejected in another. Moreover such harmonisation could be useful to the extent that it reduced the need for multiple jurisdictions to conduct independent assessments of a single transaction. At the very least, there appears to be a need to rationalise processes among jurisdictions so that they do not undermine or otherwise discourage promising transactions to take place.

The character and structure of "take-over" rules also needs to be examined, with a view towards developing more effective contestable markets for corporate control. On the one hand, regulatory regimes which permit incumbent management and allied shareholders to "veto" hostile take-overs against the wishes of non-controlling shareholders can impede beneficial restructuring. On the other hand, the adverse effects that poorly conceived and/or weakly financed take-overs can have on the viability of enterprises suggest that such take-overs need to be subject to certain controls. At the very least, parties who will need to "vote" on take-overs should have access to information on the nature and intent of the take-over proposal, as well as information on the methods to be used to finance such transactions.

Similarly, in the field of taxation, the sale or absorption of assets usually results in a series of taxable events which can significantly influence the "economics" of restructuring. Recognising that this can impede the restructuring process, a number of countries have deferred or eliminated certain taxes on capital gains and sought to simplify other tax rules. Related reforms may be beneficial on rules governing the carry-over of net operating losses, the conditions under which companies consolidate the taxes of subsidiaries, and the double taxation of dividends within firms (*i.e.* taxation at the subsidiary and parent company levels).

Regulation

The Forum suggested that there are a number or areas where governments are lagging in the development of regulations to respond to situations where new technology has rendered existing rules ineffective or obsolete. Telecommunications, where the industry and markets are in a constant state of transformation, is a case in point (Lloyd, 2002). In this sector, a legacy of over-regulation continues to be reflected in competition policy in a number of jurisdictions, while under-regulation is causing serious bottlenecks in others. In this instance, there is a need for technicians and policymakers who understand emerging technology and industry and market issues, and who are prepared to move more rapidly to establish effective, transparent, predictable regulatory regimes.

Knowledge management

The restructuring of companies on a global basis often results in the consolidation of strategic functions such as research and development, in a fewer number of locations. This raises issues in the countries where these functions are lost, as it could undermine its long-term competitiveness in knowledge-intensive endeavours. It is not clear to what extent, however, this is currently a problem. The firms participating in the Forum indicated that their success in pursuing global strategies reflected a decentralised approach in which management plays an active role in facilitating the identification and transfer of knowledge and "best-practice" techniques across units (Picard, 2002, Lloyd, 2002 and Sarrazin, 2002). Issues may be more pronounced, however, in sectors where basic research is a principal activity, as is the case in pharmaceuticals and certain high-tech industries. In these instances, there may be a scope for policies designed to develop and maintain a certain level of competence in specific fields.

The way that knowledge is being developed and diffused is spurring entrepreneurship and innovation within firms, by bringing new approaches and perspectives into companies. There is evidence that this is having a pronounced effect on productivity and efficiency in some sectors, such as the mining and resource industries. Further examination of this, and related effects would, however, be beneficial.

Outsourcing

Many firms are increasing the scope of their outsourcing, which, in the case of industry, is often resulting in a shift in manufacturing operations to foreign locations. There is concern that continued erosion in manufacturing may not be sustainable, as it could lead to a "hollowing out" of activities that may need to be maintained to ensure balanced economic development. On the other hand, there are questions as to whether diversification, *per se*, is vital to economic prosperity. There is also concern that the environmental and social consequences of off-shore outsourcing are not being effectively addressed, which may undermine efforts to advance with policies and objectives in the field of sustainable development.

Supporting adjustment

Restructuring is an ongoing process that firms pursue with a view towards increasing efficiency and enhancing shareholder value. When it succeeds, benefits can include higher productivity and increased levels of innovation and economic growth. Moreover, there are often important spill-over benefits associated with global tie-ups. Exchange of technology, production, managerial and marketing expertise, for example, can strengthen national competency and provide a basis for development of a wider range of internationally competitive firms. Benefits may not, however, be equally shared among countries, particularly when facilities are downsized or closed in one area, or when strategic activities are shifted from one country to another, with a view towards enhancing efficiency. The costs associated with such restructuring can be high, particularly when workers and communities are faced with a reduction or cessation of operations at a specific location.

The different social and economic implications of global industrial restructuring attracted increased attention during the 1990s. With individual country interests often diverging from those of multinational firms, questions were raised as to the role that governments could and/or should play in influencing the scope and structure of restructuring in general, and in specific cases. These issues have become more significant during the current economic slow-down, as governments are struggling with the economic and social costs of growing unemployment, even as tax revenues slump. The different approaches that national authorities take in addressing issues have implications for firms, as these differences can create obstacles or obligations that influence the timing, scope, cost and character of restructuring plans.

In addition to addressing the immediate financial implications for workers and communities, there are associated, longer-term issues and costs related to promoting economic stability in affected areas and providing workers with the means and/or incentives to find new employment through, for example, training, financial support, and related assistance. The current economic slowdown has complicated the situation, at least in the short term, by intensifying pressures for industry restructuring, leading to rising redundancies. At the same time lower growth has slowed the level of job creation, which is limiting the opportunities for affected workers to find new jobs. The challenge for governments, employers and workers is thus to identify ways that the economic and social costs associated with adjustment can be minimised, without unduly slowing or impeding the restructuring process.

In this context, the roles that each of the parties – governments, firms and workers – could or should play deserve further attention. There may be benefits for employers being more forthcoming in providing workers with information on actions that will result in significant job losses, as is already required in some countries. How long such pre-notification periods should be, however, is not clear. In some instances a lengthy period may not prove burdensome to a firm, while in others, even a relatively short lead-time could be problematic. Beyond notification, the roles that each of the players could or should assume in managing the change associated with restructuring need to be examined. Consultations and related obligations to assist workers and communities could help to promote positive adjustment, for example, provided the costs and burdens are reasonable.

There are also issues related to supports that governments may extend to ailing firms to forestall downsizing or plant closures. The provision of state aids, loans or tax relief, for example, are likely to influence the extent and scope of restructuring in a given country (which is generally their intent), shifting burdens to areas which do not match such concessions, as could related measures designed to pressure firms to reconsider specific decisions. At the very least, such assistance distorts competition, providing less competitive firms with a means to enhance their position, at the expense of other players. The situation in the steel, shipbuilding and airline sectors provide examples of where this has already emerged as a major concern. That said, it was pointed out that governments might have an important role in supporting the transfer of state-owned enterprises to private owners (Picard, 2002). Absent such support, the sale of such facilities could be slowed, as could needed restructuring.

The terms and conditions under which governments could or should intervene in individual cases need to be reviewed. Safeguarding certain strategic activities may, for example, be justified in certain instances. In other cases, governments may decide to provide financial assistance or trade protection to firms or industries, with a view towards facilitating adjustment. Such support, however, can act simply to slow or impede needed restructuring, while distorting competition.

Other

The events of 11 September are prompting significant changes in corporate thinking about *risk management*. The benefits of centralising key functions and activities, for example, are being weighed more carefully against the risks that this could pose. Moreover, firms could well take a more cautious approach in designing and implementing their global strategies. The role that governments should take to deal with issues related to risk needs to be examined more closely, as do the terms and conditions under which any risk-related support should be provided.

Finally, *small and medium-sized enterprises* have much to gain from more open, global markets. Their ability to take advantage of expanding opportunities may, however, be constrained in light of the small scale of their operations and limited resources. Moreover, there is a danger that industry consolidation may diminish the contestability of markets. These, and related market failures, should be addressed by governments to assure that the benefits associated with globalisation are more fully realised.

ANNEX

AGENDA : GLOBAL INDUSTRIAL RESTRUCTURING: RECENT TRENDS AND POLICY ISSUES

19 February 2002, 9.30 to 18.00

1. Opening remarks

   Chairman, John SPASOJEVIC

   Minister-Counsellor, Australian Embassy in Washington

   Department of Industry, Tourism and Resources

2. Global industrial restructuring in the current economic context: Firm and sectoral strategies

   Energy – *Mr. Ged Davis, Vice President, Global Business Environment, Royal Dutch Shell*

   Telecommunications – *Mr. Daniel Lloyd, Senior Manager, Public Policy, Vodafone Group Plc*

   Steel – *Mr. Jean-Pierre Picard, Director, Flat Products Group, Ispat International*

GENERAL DISCUSSION

3. Global industrial restructuring: Opportunities, issues and impediments

   Electronics – *Mr. Risaburo Nezu, Senior Executive Officer, Fujitsu Research Institute*

   Building materials – *Mr. Jacques Sarrazin, Group Vice President, Strategy, Lafarge S.A. (BIAC)*

GENERAL DISCUSSION

4. Challenges for business, trade unions and governments

    OECD Business and Industry Advisory Committee (BIAC), *Mr. Douglas Worth, Secretary-General*

    OECD Trade Union Advisory Committee (TUAC), *Mr. Bernard Rousselet, Secrétaire national,*

    Fédération générale des Mines et de la Métallurgie-CFDT

GENERAL DISCUSSION

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