The Institutional Quality as a Determinant of Growth Effects of Cross-border Mergers and Acquisitions in the European Transition Countries

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Abstract

The aim of this empirical study is to evaluate the influence of the interdependence of cross-border mergers and acquisitions and the quality of the institutional setting on GDP per capita using dynamic panel data analysis for 22 European transition countries from 2000 to 2014. Our empirical results suggest that current cross-border mergers and acquisitions have a negative effect on GDP per capita in the year of merger or acquisition, but the influence of their lagged level has a strong positive effect one year later. All governance indicators are found to have a significant effect on GDP per capita while the only significant interaction term between cross-border mergers and acquisitions and control of corruption is negative. This implies that the higher level of cross-border mergers and acquisitions with its negative impact offset the positive effect of control of corruption on economic growth in current period.

Keywords: *cross-border mergers and acquisitions; institutional setting; GDP per capita; transition countries*

JEL Classification: E22; F21; F23; O52

Introduction

An issue that has recently started to attract the attention of academic researchers is the effects of cross-border mergers and acquisitions (C-B M&As) on the economic growth of host countries. The excessive debate has been opened

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for the sake of deeper exploration and understanding of above mentioned effects. It is important to find the ways for effective response to the vast variety challenges posed by these transactions. Being efficient in the terms of global challenges is an imperative not only at the macro level but also at the micro level. Under condition of intensive competition on the international and domestic markets, investors opt for C-B M&As deals in order to take advantages from the openness of the national economy, the liberalization of investment regimes and the emergence of financial innovations (UNCTAD, 1999).

C-B M&As are the widely used mode of FDI which involves a transfer of ownership from domestic to foreign company. The acquisitions are aimed at investment in existing business activity or company. The foreign investor gets an ownership or controlling share in the company as a result of purchase. In turn, the merger can be defined as a combination of two or more independent companies in order to create an entirely new business entity. As in case of acquisitions, local company also ceases to exist, while the foreign company continues to use its name for the further operations.

This type of foreign direct investment (FDI) represents the most attractive method of investment for those companies that strive to consolidate, protect and enhance their global competitive position. Through M&A, companies tend to exploit the advantages from the consolidation of strategic industries in the form of economy of scale and/or scope, brand alignment, market expansion, leveraged management talent etc. (Kaczanowska and Nanfelt, 2012). Multinational companies usually acquire or merge with knowledge-intensive and innovative firms in order to provide access to new technology and know-how, to reduce risks and technology development costs, as well as time required for the implementation of innovation. The crucial driving forces behind M&As are need for exploitation of economy of scale or other "synergies", strengthening of market position, enhancement of market discipline, diversification opportunities etc. (Andrade, Mitchell and Stafford, 2001).

In the past three decades there were significant changes in the features of FDI flows. Being quite volatile indicator, during the past decade the share of C-B M&As in total FDI volume has varied within 40% and 50%. It is worth noting that it is very difficult to estimate the exact share of C-B M&As in FDI inflows since these transactions can be financed locally or directly from the international capital markets (UNCTAD, 2000). Starting from the 1990s and onwards, the dynamics of C-B M&As was nearly the same as for global FDI inflows. Developed countries have been traditionally an important destination for C-B M&As. Their share of developed countries in total value of C-B M&As sales in 1995 amounted to 93%, while the share of developing countries and transition countries

were 6% and 0.5%, respectively. However, in the early 2010s developing and transition countries absorbed more than 20% of C-B M&As total value.

The aim of our paper is to investigate the impact of C-B M&As on the host country's GDP per capita not only in the year of mergers or acquisition but also in the long-run. We will try to explore whether this impact is transmitted via quality of institutional setting by taking into account its interaction with this form of FDI. We will demonstrate that transition countries which are highly ranked in institutional quality ratings achieve positive economic effects of C-B M&As. Our paper is organized as follows. In the Section 1 we give an overview of empirical studies which mainly investigate the growth-enhancing effect of FDI while Section 2 provides data and research methodology. Then, we present our findings and give interpretations.

1. The Literature Review

In the economic literature, there is no broad agreement about the economic effects of FDI inflows, as well as C-B M&As at macroeconomic level. It is worth noting that most of the studies rest on exploring the determinants of the size and direction of incoming C-B M&As, rather than on evaluating their effects. In addition, the economic effects of C-B M&As on macroeconomic level are less critically debated and empirically investigated in comparison to the other types of FDI. There are several reasons for such scientific interest. Namely, effects of C-B M&As are very difficult to estimate due to the lack of reliable data regarding this transactions. This is the consequence of the fact that these transactions are subject of individual company decision. Investors have no interest to release the information about their C-B M&As activity details that could lead to their unwanted exposition to the competition regulators and tax authorities. Furthermore, it is necessary to be especially cautious in evaluating their short-run and long-run economic effects on host economies. Short-term effects of C-B M&As provide an incomplete picture, or may even give rise to misleading perceptions of M&As (UNCTAD, 1999). In any case, the fact that cannot be ignored is that their economic effects are determined by national features, so they differ from country to country depending on the level of economic development and quality of their financial, institutional and corporate environment (Pinto and Zhu, 2009).

In the majority of the cross-country studies authors investigate the empirical relationship between FDI and economic growth (Carkovic and Levine, 2002; Mencinger, 2003; Neto, Brandão and Cerqueira, 2008). Despite the indefinite opinion of the scientific community, it can be concluded that the dominant position

is about the positive FDI effects. According to Campos and Kinoshita (2002) and Ajide, Adeniyi and Raheem (2014), FDI has a positive and significant impact on economic growth. This impact on economic growth is magnified by the interdependence of FDI and the financial markets development (Alfaro et al., 2004), stock of human capital (Borenzstein, De Gregorio and Lee, 1998) and trade volume (de Melo, 1999).

On the other hand, the authors considering the impact of C-B M&A at macroeconomic level usually find negative or neutral effects. For instance, Neto, Brandão and Cerqueira (2008) report negative and significant impact of C-B M&A on economic growth in developing countries. The results of the this study are in line with conclusions made by Wang and Wong (2009) namely that the positive effects of C-B M&As on economic growth can be achieved only if the host country has a minimum level of human capital. Based on the sector-level analysis (OECD countries for the period 1985 – 2008), Doytch and Cakan (2011) show that M&A tend to be either neutral to growth or cause a negative effect with the exception of the sector of services. On the other hand, Ashraf, Herzer and Nunnenkamp (2014) argue that C-B M&As have a positive effect on total factor productivity in developed and developing host countries of FDI in contrast to greenfield investment. According to their findings, the productivity enhancing effects of M&As do not refer only to the acquired domestic firms and a narrow network of local suppliers, but also carry over to the macroeconomic level of developed host countries. Teplý, Stárová and Černohorský (2010) find that M&As in the European banking industry lead to the net value creation on average. The authors reject a pure transfer of value from bidders' to targets' shareholders.

Based on these empirical studies, one can conclude that unified theoretical explanation for economic effects of C-B M&As does not exist and it seems that such unified theory could unlikely emerge. The reason lies in the fact that the economic effects of C-B M&As largely depend on the period and countries or sectors chosen in the studies, methodological approach, as well as country--specific effects of host countries.

2. Data and Research Methodology

Our sample consists of 22 European transition countries[1] for the period from 2000 to 2014 and this panel data set is strongly balanced. The choice of the time period and set of transition countries depended on the data availability. The decision

[1] Albania, Armenia, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Georgia, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine.

about independent variables is made on the basis of previous empirical studies, as well as existing theoretical knowledge about the possible economic effects of C-B M&As.

Following previous empirical works by Carkovic and Levine (2002) and Efendić, Geoff and Adnett (2014), we estimate the role of institutional setting as a mediator of economic effect of C-B M&As on GDP per capita by employing this form of panel model specification:

$$\text{Log}(\text{GDPpc}_{it}) = \beta_0 + \beta_1 \text{Log}(\text{GDPpc}_{it-1}) + \beta_2 \text{M\&As}_{it} + \beta_3 \text{M\&As}_{it-1} + \beta_4 \text{INS}_{it} + \\ + \beta_5 \text{M\&As}_{it} * \text{INS}_{it} + \beta_6^{T} \text{CON}_{it} + \varepsilon_{it}$$

with subscripts *i* and *t* denoting country ($i = 1 \ldots 22$) and time respectively, and β_0 to β_6 regression coefficients. GDPpc_{it} represents GDP per capita (in natural logarithm), GDPpc_{it-1} is the lagged dependent variable, $\text{M\&As}_{it}$ stands for C-B M&As as a percentage of GDP; $\text{M\&As}_{it-1}$ is C-B M&As one year after merger or acquisition, INS_{it} is institutional quality; $\text{M\&As}_{it} * \text{INS}_{it}$ is interaction term between institutional quality and C-B M&A, while CON_{it} is a vector of growth determinants including:

- government balance (Budget_{it}),
- domestic investment as percentage of GDP (DI_{it}),
- GDP per capita PPP in 1989 dollars (in natural logarithm) (Income_{it}).

We tried to include higher order lags of C-B M&As and GDP per capita but they prove to be insignificant. Data for our dependent variable – GDP per capita – is taken from the World Bank. The variable of interest is C-B M&As measured as percentage of GDP which is taken from the United Nation Conference on Trade and Development FDI database.

Based on results of previous empirical researches (Neto, Brandão and Cerqueira, 2008; Wang and Wong, 2009; Doytch and Cakan, 2011), we expect current C-B M&As to have a negative impact on GDP per capita, while their lagged level should produce positive effect.

Governance balance is used to assess the impact of government's stabilization measures on output performance and the expected sign of this variable should be positive. The data for governance balance is obtained from European Bank for Reconstruction and Development (EBRD) and Eurostat. Domestic investment is calculated as the difference between Gross Fixed Capital Formation and inward FDI based on the data of the World Bank as in the study of Adams (2009). We expect that this variable will have positive impact on GDP per capita in the current period.

Initial conditions in transition countries are presented with the help of data on Purchasing Power Parity Income (PPPI) per capita in 1989 which comes from IMF publication (IMF, 2000) (except for Serbia, Bosnia and Herzegovina and Montenegro which is based on author's calculation). By using GDP per capita in 1989, we take into account the fact that countries had different initial conditions at the beginning of their transition process which had influence on their further economic and institutional development. The effect of this variable on GDP per capita is ambiguous. The negative sign might lead to conclusion that countries which had initiated their transition process with lower level of GDP per capita have later achieved faster economic growth. On the other hand, positive sign might indicate that countries characterized by better initial conditions before the beginning of their transition from socialist economy to market system have achieved higher economic performance.

Institutional quality (INS_{it}) is composite governance indicator which is obtained with the help of Principal Component Analysis (PCA) method. This variable reduction technique summarizes the six Worldwide Governance Indicators (WGIs): Voice and Accountability (VA), Political Stability and Absence of Violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL) and Control of Corruption (CC) into one factor. The value of each indicator ranges from –2.5 to 2.5 with higher values indicating a better quality of institutional setting.

In order to assess the influence of governance indicators on the relationship between M&As and dependent variable, the six WGIs are included in regressions one at a time to avoid multicollinearity among them. The mediation effect of M&As and governance factors on GDP per capita is considered with the help of their interaction term. The quality of institutional setting is assessed using data from the WGIs provided by Kaufmann, Kraay and Mastruzzi (2010). We expect that the institutional quality measured both by overall and separate governance factors will have positive impact on GDP per capita, while we do not have a priori expectation on its interaction terms with C-B M&As.

To assess the influence of institutional development efficiency on economic effects of C-B M&As on GDP per capita, we use system Generalized Method of Moments estimator (GMM) (Blundell and Bond, 1998). This estimation technique proved to be appropriate for dynamic panels in terms with small number of periods (T) and large number of observation (N); linear functional relationship; dynamic dependent variable (dependence on its own past values); independent variables which are not strictly exogenous and fixed individual effects (Roodman, 2006). Since the variables of institutional setting are characterized by long-term persistence (Acemoglu and Robinson, 2008), the system GMM estimator

allows us to reduce biased parameter estimates and imprecision associated with other methods. For instance, the quality of the institutional arrangements varies considerably from one country to another, whereas it does not significantly change over time. Institutions are resistant to change and this is generally relevant to informal institutions.

We use two-step estimates in order to produce theoretically robust results and perform the 'Windmeijer correction' (Windmeijer, 2005) using Stata's 'small' command (Roodman, 2006). The one-year lagged GDP per capita, C-B M&As and domestic investment are considered as endogenous variables and instrumented with GMM-style instruments, while other explanatory variables are treated as exogenous. We have instructed STATA to include only second, third and fourth lag of the endogenous variables as instruments. The collapse option is used to reduce the size of the instruments matrix in order to obtain one instrument per variable instead of one instrument for each variable in each period.

For the estimation of the coefficients and the standard errors of the long-run effects of C-B M&As, quality of institutional setting and particular governance indicators on GDP per capita, we take into account the explanation given by Papke and Wooldridge (2004) and use the command 'nlcom' in STATA 12. All the estimations are performed in STATA software using xtabond2 program written by Roodman (2006).

3. Empirical Results and Discussion

In Table 1 we present correlation matrix for GDP per capita regression variables. The correlation coefficients between GDP per capita and set of indicators (government effectiveness, rule of law, control of corruption and overall institutional quality) have value greater than 0.7, which might indicate the presence of multicollinearity problems. Therefore, we perform additional tests to confirm that there is no harmful multicollinearity, which occurs if a variance inflation factor (VIF) is in excess of 10, or a tolerance is 0.05 or less. Since none of the variables have the VIF over 10, we conclude that the results are suitable for further analysis.[2]

In terms of diagnostics in the Table 2, the results of the Hansen test show that the chosen instrument set is exogenous, while the AR(2) test indicates that there is no problem of autocorrelation. The signs of the coefficients of the variables are largely as expected. The lagged level of GDP per capita has a positive and highly significant impact on the GDP per capita in the current period in all

[2] These results could be provided by the authors upon request.

regressions. The value of this coefficient is below 1 which points to the existence of the convergence. We find that current C-B MAs are negatively associated with GDP per capita and this influence is significant in four of seven regressions. The sign of the coefficients is consistent with the theoretical expectations and empirical studies (Neto, Brandão and Cerqueira, 2008; Wang and Wong, 2010). This type of FDI involves transfer of ownership from domestic to foreign company and does not immediately lead to an increase of its productive capacity or technological upgrading. At the time of entry, C-B M&As are usually accompanied with the risk of lay-offs, closure or relocation of production in order to underpin the corporate strategy of foreign investors.

T a b l e 1

Correlation Matrix for GDP per capita Determinants

	GDPpc	**M&A**	**Budget**	**DI**	**Income**	**INS**	**CC**	**PS**	**RL**	**RQ**	**VA**	**GE**
GDPpc	1.00											
M&A	–0.04	1.00										
Budget	–0.15	–0.02	1.00									
DI	0.22	–0.25	–0.02	1.00								
Income	0.41	0.01	0.08	0.35	1.00							
INS	0.74	0.03	–0.21	0.08	0.45	1.00						
CC	0.70	0.02	–0.13	0.12	0.44	0.94	1.00					
PSAV	0.67	0.07	–0.22	0.21	0.45	0.82	0.75	1.00				
RL	0.73	0.00	–0.21	0.12	0.48	0.97	0.92	0.79	1.00			
RQ	0.67	0.01	–0.18	0.02	0.38	0.93	0.83	0.65	0.90	1.00		
VA	0.61	0.07	–0.23	–0.07	0.23	0.92	0.83	0.67	0.88	0.76	1.00	
GE	0.74	0.02	–0.19	0.07	0.52	0.95	0.89	0.74	0.93	0.89	0.85	1.00

Source: Authors calculations.

We believe that the privatization-related FDI had negative impact on GDP per capita since it was followed by the rise of unemployment and crowding-out of less efficient domestic companies which were not able to withstand the competitive pressure in the domestic market. We share the same view as Mencinger (2003), who points out that transition countries have not achieved growth-enhancing effect of FDI because it mainly took the form of acquisition which were related to massive and often politically motivated privatization. We find that one can justify the concerns about C-B M&A (mostly related to unemployment, crowding-out effect on domestic investment and uncompetitive behavior of foreign affiliates established through this form of FDI) which were identified by Ovin and Maček (2010) on the sample of the European host countries.

However, the lagged C-B M&As turned out to be positive and significant, so we can conclude that this form of FDI might have a postponed effect. We argue that after the initial shock in the year of mergers or acquisitions C-B M&As lead to an increase of GDP per capita as a result of synergy effects, which arise from

the partnerships established between domestic and foreign companies, technology transfer and employees skills improvement. This finding is consistent with the study of Adams (2009) and Sapienza (2010) who find that the contemporaneous FDI is negatively correlated with economic growth, while it's lagged level records positive correlation. The authors point out that spillover effects from this type of capital flow in terms of know-how and technology, need time to arise.

The positive and highly significant coefficients on government balance suggest that budget deficit has strong impact on GDP per capita in the current period. This is consistent with the results of Efendić, Geoff and Adnett (2014) who also find that higher budget deficit is accompanied by higher GDP per capita. In all our regressions, domestic investment has a positive but not significant impact on the GDP per capita. The impact of the initial GDP per capita is not robust in different regressions and its p-value is not close to the conventional level of significance. This variable has negative impact on economic growth in columns from 5 to 7, which is in the line with the findings of Neto, Brandão and Cerqueira (2008), Carkovic and Levine (2002) and Campos and Kinoshita (2002).

In addition, overall institutional quality index is highly statistically significant and has an economically substantial impact on GDP per capita. All governance indicators which were included separately in the regression stimulate economic growth of the C-B M&As recipient's country. These influences are strong and statistically significant in all our regressions. Their contributions to an increase of GDP per capita range from 0.14 for political stability and absence of violence to 0.23 for government effectiveness. While governance factors have positive signs and significance as expected, their interaction term with C-B M&As observe mixed pattern. Unexpectedly, the interaction term between C-B M&As and quality of institutional setting is negative but it is not statistically significant.

The significant coefficient of the interaction term between C-B M&As and control of corruption leads to the conclusion that the impact of C-B M&As has been transmitted via this governance factor. The interaction coefficient on C-B M&As and control of corruption is negative. This means that the higher level of C-B M&As with its negative impact (which prove to be significant) offsets the positive effect of control of corruption on GDP per capita in current period. Despite the efforts of authorities of transition countries to fight against corruption, foreign investors may find ways to bypass regulatory barriers which has adverse effects on economic performance. Considering the signs and significance of all interaction terms, we conclude that C-B M&As and CC are taken to be substitutes. The negative interaction of C-B M&As with rule of law and government effectiveness has not affected the economic growth in a significant way.

Table 2

GMM Estimates of the Economic Effect of C-B M&As on GDP per capita

Variable	1	2	3	4	5	6	7
GDPpc(-1)	0.785***(0.031)	0.799***(0.026)	0.816***(0.048)	0.776***(0.032)	0.816***(0.023)	0.759***(0.065)	0.758***(0.055)
M&As	–0.071 (0.043)	–0.074**(0.035)	–0.070 (0.061)	–0.063* (0.031)	–0.088**(0.035)	–0.117* (0.068)	–0.079 (0.055)
M&As (-1)	0.021** (0.007)	0.020***(0.007)	0.016* (0.009)	0.019** (0.007)	0.019* (0.009)	0.025** (0.010)	0.021** (0.008)
Budget	0.020***(0.005)	0.016***(0.004)	0.017** (0.007)	0.020***(0.005)	0.021***(0.004)	0.020***(0.005)	0.019***(0.005)
Income	0.025 (0.049)	0.065 (0.039)	0.026 (0.072)	0.026 (0.052)	–0.047 (0.134)	–0.049 (0.176)	–0.033 (0.107)
DI	0.008 (0.011)	0.0004 (0.005)	–0.0003 (0.013)	0.007 (0.008)	0.023* (0.012)	0.024 (0.026)	0.014 (0.017)
INS	0.058***(0.014)						
INS*M&As	–0.007 (0.006)						
CC		0.227***(0.063)					
CC*M&As		–0.107**(0.051)					
PSAV			0.145***(0.050)				
PSAV*M&As			0.029 (0.050)				
RL				0.193***(0.053)			
RL*M&As				–0.033 (0.021)			
VA					0.147***(0.051)		
VA*M&As					0.046 (0.033)		
RQ						0.161** (0.074)	
RQ*M&As						0.037 (0.034)	
GE							0.225** (0.087)
GE*M&As							–0.007 (0.016)
Time effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	280	283	280	283	284	281	281
No. of groups	22	22	22	22	22	22	22
No. of instruments	17	17	17	17	17	17	17
Hansen test (p value)	0.682	0.791	0.131	0.767	0.531	0.602	0.576
AR(1)	0.025	0.001	0.049	0.008	0.009	0.103	0.069
AR(2) (p value)	0.674	0.562	0.140	0.631	0.176	0.383	0.542

Notes: Numbers in parentheses are standard errors. ***, **, * indicate significance at the 1, 5 and 10% level.

Source: Authors calculations.

On the other hand, C-B M&As produce a positive coefficient only when they are interacted with the political stability, voice and accountability and regulator quality. Unlike our findings, Ajide, Adeniyi and Raheem (2014) show that, while some of the governance indicators included separately inhibit economic growth (rule of law, regulatory quality and voice and accountability), the interaction between FDI and these governance indices produce positive economic effect on output growth. It is interesting that the authors are unable to explain why these indicators retard the economic growth in Sub-Saharan Africa. However, it is not wide-spread view but there are studies which confirm the fact that the raising institutional quality does not cause higher level of FDI and economic growth in comparison to countries characterized by poor governance.

For example, Belgibayeva and Plekhanov (2015) show that foreign investors can view corruption as a valuable opportunity to get around rules and regulations. They point out that in such cases the marginal effect of corruption on FDI might be neutral of positive.

T a b l e 3

The Long-run Effect of Changes in C-B M&As on GDP per capita

Variable	1	2	3	4	5	6	7
M&As	–0.333* (0.174)	–0.370** (0.161)	–0.385 (0.294)	–0.283** (0.126)	–0.483** (0.197)	–0.490** (0.186)	–0.331* (0.169)

Notes: Numbers in parentheses are standard errors. ***, **, * indicate significance at the 1, 5 and 10% level. The coefficients are calculated using command "nlcom" in Stata 12. These results are based on the equations from the Table 2.

Source: Author's calculations.

According to the results in Table 3, the long-run coefficients of C-B M&As are negative and significant (with the exception of the result based on the equation 3) indicating that this type of FDI negatively contributes to GDP per capita. The long-term elasticity ranges from –0.49 to –0.28 suggesting that this type of FDI does not stimulate output performance over time. Taking into account the magnitude of the short-run effects of C-B M&As on GDP per capita (see Table 2), we conclude that their negative effects are even stronger in the long-run.

From the long-run perspective, the quality of overall institutional setting has positive and significant influence on economic performance, while its interaction with C-B M&As is negative but not significant (see Table 4).

All governance indicators are positively and significantly correlated with GDP per capita over time. According to the long-term coefficients of interaction terms with rule of law and control of corruption, there is a negative and significant mediation effect on GDP per capita.

T a b l e 4

The Long-run Effect of Changes in Independent Variables on GDP per capita

Variable	Long-run coefficient
INS	0.273*** (0.041)
INS* M&As	–0.035 (0.026)
CC	1.133*** (0.220)
CC* M&As	–0.533** (0.237)
PSAV	0.792*** (0.220)
PSAV*M&As	0.160 (0.260)
RL	0.867*** (0.137)
RL*M&As	–0.148* (0.085)
VA	0.803*** (0.266)
VA*M&As	0.255 (0.173)
RQ	0.673*** (0.152)
RQ*M&As	0.155 (0.116)
GE	0.933*** (0.172)
GE*M&As	–0.032 (0.063)

Notes: Numbers in parentheses are standard errors. ***, **, * indicate significance at the 1, 5 and 10% level. The coefficients are calculated using command "nlcom" in Stata 12. These results are based on the equations from the Table 2.

Source: Author's calculations.

Conclusion

The aim of this paper is to analyse the interdependence between C-B M&As and quality of institutional setting and observe the economic effects of that nexus on GDP per capita in 22 European transition countries in the period 2000 – 2014. Our results indicate that C-B M&As have negative effect on GDP per capita in the current period. This negative impact in the year of merger or acquisition could be explained by the rise of unemployment and crowding-out of less efficient domestic companies which are not able to withstand the competitive pressure in the domestic market. In addition, the majority of transition countries implemented FDI-friendly policies in order to create stimulating investment climate, which favoured the interests of foreign investors at the expense of domestic companies and was responsible for crowding-out of domestic investment. Our line of argument is that the large exemptions from corporate income tax or subsidies per FDI-related job could provide wrong signal to potential investors that they do not have to base their business concept on long-term production. The short-term speculative interest of foreign investors could lead to the change of the market structure and the increase of concentration, which could have adverse effects on economic performance.

The influence of one-year lagged C-B M&As is positive and significant suggesting that this form of FDI might have a postponed effect. The gradual increase in a company's profitability leads to the need for additional staff, but mainly in the mid- and long-term. However, we find that the C-B M&As do not

provide positive economic effects for the host transition countries in the long--run. Considering the example of Western Balkan countries, we believe that foreign investors tend to reduce the number of employees and production in the long-run or even leave transition countries after they have made the most of all the incentives available on the local market. Unfortunately, domestic companies are not in position to compensate losses that could occur in such circumstances.

We have shown that the quality of the overall institutional setting is important when it comes to the economic effects of C-B M&As on GDP per capita. Persistence in implementation of institutional reforms results in an increase of the economic potential and the competitiveness of transition countries. On the other hand, its interaction term with C-B M&As is negative but not significant. All governance indicators are important in explaining an increase in GDP per capita both in short and long-run. We argue that this type of FDI might be motivated by rent-seeking interests because of the negative mediation effect of C-B M&As and the control of corruption on GDP per capita. The higher level of C-B M&As with its negative impact offsets the positive effect of control of corruption on economic growth in current period.

Our findings have important implications for policymakers from countries in transition. The existence of negative economic effects of this type of FDI on GDP per capita in the long and short term points to the necessity for more thorough research into the factors that lead to their occurrence. We believe that special attention should be given to those aspects of governance whose interactions with C-B M&As prove to have a significant influence at the macroeconomic level (interaction with control of corruption in short and long-run and interaction with the rule of law in the long-run).

The negative impact of C-B M&As could offset the positive results on macroeconomic performance achieved through the improvement of institutional quality, especially in the field of corruption prevention and combating. Therefore, the fight against corruption should only be organised if it is systematic and systemic, which requires the involvement of the state authorities at different levels. If this problem is not approached in this way, then corruption inevitably leads to the collapse of the rule of law and dysfunction of institutions. It should be noted that efforts aimed at increasing institutional capacities can also be frustrated very easily by a lack of coordination between formal and informal institutions in transition countries. Therefore, it is necessary to devote attention to determining the gap between these two institutional domains so as to diminish the adverse consequences for economic dynamics.

The government should create favourable conditions for the attraction of foreign companies which could lead to economic growth and export diversification and

contribute to technological modernization and employment. The building of a favourable institutional environment can only be a gradual process of integration comprising economic development, politics, and civil society institutions. We believe that it is important to identify the development needs of transition countries and align them with the motives behind foreign investors seeking to invest and do business in those countries.

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