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How host country governments can ensure competitive neutrality in cross-border M&As

by
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In competitive cross-border M&A markets, foreign and domestic investors compete based on their entrepreneurial capabilities. Differences in size, management skills, technology, and culture define investors' unique set of competitive advantages. In bidding processes for corporate assets, investors often offer the highest price, depending on whoever can use the assets most efficiently. Allowing firms to fully realize economies of scale through cross-border M&As increases economic efficiency. Furthermore, cross-border M&As may create a more competitive business environment in host countries, increasing the productivity of domestic companies.

Effective competition between foreign and domestic investors only exists to the extent that a level playing field is ensured. However, certain investors enjoy various government-created, undue competitive advantages not available to their competitors, such as preferential financing from state-backed institutions, beneficial regulatory treatment, debt forgiveness, or tax exemptions. While this concern is typically discussed focusing on the privileges that state-owned enterprises (SOEs) enjoy, private firms can also benefit from governmental support measures. Home country governments may grant their MNEs outward FDI incentives (e.g., loans, financial guarantees), placing them in an advantageous competitive position.[1]

Undue competitive advantages can have negative economic consequences. Firms that could use assets more efficiently may be outbid in cross-border M&A transactions, leading to an inefficient allocation of resources and preventing competitors from reaching their full efficiency potential or accessing key tangible and intangible assets.

To avoid competitive distortions, host country governments may implement investment-control measures, ensuring that no investor possessing undue competitive advantages can acquire domestic assets by exploiting such advantages. Indeed, some governments and the EU are considering

equipping their FDI-control regimes with specific measures to ensure competitive neutrality in cross-border M&As.[2]

Ensuring a level playing field through investment-control measures runs the risk of creating new disadvantages for specific investors, thereby impairing the objective pursued. This is the case if stricter obligations are imposed on certain kinds of investors but not on others that enjoy similar undue competitive advantages, or if the takeover process becomes associated with various uncertainties for foreign investors (e.g., delays in approval processes, unclear redressive measures). Recent research of the U.S. M&A-market suggests that policy risks and uncertainty related to mergers disproportionately deter foreign investors.[3]

In order to design investment controls that offer a level playing field among different kind of investors while ensuring that host countries remain open to FDI, governments should consider the following:

- Investment-control measures should be aimed at neutralizing undue competitive advantages and not at discouraging investments from SOEs. The dichotomy between SOEs and private firms hardly ensures a level playing field, as both can benefit from undue competitive advantages. Therefore, governments should employ ownership-neutral investment-control measures that apply to any foreign investor benefiting from undue competitive advantages.

- Investment-control measures should mirror domestic regulations regarding competitive neutrality. A level playing field is not achieved if only foreign MNEs supported by their home countries face investment restrictions, while simultaneously domestic firms' undue competitive advantages are tolerated. Therefore, the measures of an investment-control regime—such as the prohibition of acquisitions, repayments of subsidies, divestments of certain assets, the reduction of market presence—should apply in the same manner to all investors benefiting from undue competitive advantages. In this context, it is important to ensure that a uniform definition of undue competitive advantages is used, whereby existing definitions of subsidies (e.g., under WTO law) can serve as a reference.

- In terms of investment procedures, governments should coordinate with existing investment-control proceedings based on national security, competition law or sector-specific concerns. Applicable approval processes need to be transparent and their application coordinated. For instance, investment-control procedures should be completed by the competent authorities during the same time period as the applicable merger controls.

- Investment-control measures should be proportionate. Attempts to avoid all distortions of competition will likely do more economic harm than good. Therefore, governments should set thresholds regarding the value of targeted transactions and undue competitive advantages, as is the case in the European Commission's proposal.

The issue of competitive neutrality in cross-border M&As in general has long remained unaddressed. Ownership-neutral investment-control measures can be a tool to close this gap. However, a comprehensive government policy to ensure competitive neutrality must also take into account international commitments. Typically, international investment agreements addressing the issue of competitive neutrality focus on requirements for SOEs and rarely deal with undue competitive

advantages related to cross-border M&As in general. To remedy this discrepancy, governments should include specific obligations in their international investment agreements regarding competitive neutrality that apply to all enterprises, public or private. Finally, governments should try to agree on international best practices on undue competitive advantages, for example within the OECD.

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[1] Karl P. Sauvant and Clémence Boullangeret, "Trends in FDI, home country measures and competitive neutrality," in Andrea Bjorklund, ed., *Yearbook on International Investment Law & Policy 2012-2013* (New York: OUP, 2014), p. 98.

[2] See the EU Commission's Proposal for a Regulation on foreign subsidies distorting the internal market.

[3] Joseph A. Clougherty and Nan Zhang, "Foreign investor reactions to risk and uncertainty in antitrust: U.S. merger policy investigations and the deterrence of foreign acquirer presence," *JIBS*, vol. 52 (2021), pp. 454-478.

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