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State-owned enterprises face challenges in foreign acquisitions*

by

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Cross-border acquisitions by state-owned enterprises (SOEs) have increased sharply since 2008 and accounted for over 20% of total cross-border acquisitions in 2009; SOE acquisitions have since come down but remain close to 10% of the total.¹ However, this practice is not always preferred or viewed as appropriate by regulators, the public or other stakeholders in host countries. Foreign SOEs are often regarded as agents of their home-country governments, pursuing political agendas and implementing government strategies that are outside of normal business considerations. They may receive subsidies from home countries, a practice that conflicts with free-market principles. The lack of transparent corporate governance of SOEs, sometimes accompanied by a lack of operational efficiency, can make their acquisition of local firms even less desirable. Thus, after announcing the purchase of local firms, SOE acquirers still face the challenge of approvals by regulatory agencies. For example, all foreign SOE acquisitions in the United States require approval by the Committee on Foreign Investment of the United States (CFIUS).²

These concerns about state-owned foreign acquirers likely raise debates among regulators regarding the desirability of attracting foreign investments versus homeland security. Due to the intentional vagueness of governmental criteria regarding cross-border acquisitions, discretion is built into the regulatory process in many countries. For example, CFIUS can question whether foreign control over a US business, especially by foreign SOEs, presents national security concerns. Here, the concept of “national security” is vaguely defined, leaving room for regulatory discretion. Similarly, the threshold question for the Canadian regulator, about whether a transaction brings “net benefits,” also involves a concept lacking in clarity. Such vagueness and regulatory debates can result in significant uncertainty in the outcomes of foreign SOEs’ acquisitions.

Our investigation of cross-border acquisitions in the US from 1990 to 2012 suggested that acquisitions by foreign SOEs were no less likely to be completed than acquisitions by other foreign firms, but it took SOEs more days to complete their acquisitions after publicly announcing acquisition attempts.³ Our findings were based on multiple acquirer, target, deal, and industry attributes, including whether acquisitions were in the same industry and whether targets were in strategic industries that likely raised national security concerns. Interestingly, earlier studies⁴ found that Chinese SOEs were less likely to complete cross-border acquisitions than their private counterparts, suggesting negative reactions toward cross-border acquisitions by SOEs from that country. Our sample mainly consisted of SOE acquirers from

other countries, many of which are US political allies (e.g., UK and Canadian acquirers accounted for 29% of foreign acquisitions by SOEs). Acquisitions by these firms did not provoke strong negative reactions. Nonetheless, regardless of their home country, SOEs experienced a longer duration of deal making that indicates a longer debate and discussion process undertaken by government agencies (our deals were all friendly acquisitions, and thus regulatory approval is the main factor affecting the duration between acquisition announcement and completion).

Characteristics of both local targets and foreign acquirers are important factors in the success of acquisitions by SOEs. When target firms participate in more research and development (R&D) alliances in the host country, implying the centrality of target firms in the country's innovation system, SOE acquirers are less likely to complete their acquisitions than private foreign firms. Regulatory agencies may find it difficult to justify such deals because of political and strategic considerations that stem from the fear of losing proprietary knowledge to foreign governments.

However, there is no evidence that acquisitions take longer for foreign SOEs when they target firms with more R&D alliances. Given that limited monitoring mechanisms can be employed to prevent SOEs from sharing acquired technologies with other SOEs at home, especially those in national defense sectors, negotiations to address this issue may be seen as futile. As a result, regulatory authorities prefer to reject such acquisition proposals at the outset, rather than engage in discussions that prolong acquisition duration.

In addition, the alliance experience of foreign SOEs in host countries (e.g., manufacturing, marketing, R&D alliances) can facilitate acquisition completion and shorten acquisition duration. Alliance experience demonstrates those firms' credibility and increases their ability to deal with legitimacy concerns on the part of local stakeholders.

If home country governments want their SOEs to become global players and their acquisitions to be more welcome, some fundamental reforms at home are necessary; these reforms include providing a level playing field on which private firms can more freely compete with SOEs and improving the corporate governance and transparency of SOEs by reducing direct interference and subsidies, listing SOEs in investment destinations and/or introducing foreign ownership participation. These reforms will improve efficiency and competitiveness of SOEs and make them more legitimate in the eyes of host country stakeholders. If host countries want to increase foreign investment via acquisitions, they should build a more efficient system in evaluating FDI projects involving foreign SOEs. Bilateral trade agreements (e.g., the EU-Canada Comprehensive Economic and Trade Agreement) are useful to deal with concerns about foreign SOE investments from particular countries in a systematic fashion, which can also help reduce investment uncertainty for SOEs.⁵

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¹ OECD, *OECD Business and Finance Outlook*, "Multinational enterprise and the shifting global business landscape" (2015), pp. 181-197.

² Examples to illustrate the challenges include CNOOC's failed acquisition of the US oil company Unocal and Dubai Ports World's failed acquisition of the British firm P&O, which had operations in US ports.

³ Our sample was from the Securities Data Corporation (SDC), Compustat Global, and Bureau van Dijk (BvD) databases, and we used logit models to estimate the likelihood of acquisition completion and ordinary least square models to estimate acquisition duration. More details can be found in Jing Li, Jun Xia and Zhouyu Lin, “Cross-border acquisitions by state-owned firms: how do legitimacy concerns affect the completion and duration of their acquisitions?,” *Strategic Management Journal* (forthcoming).

⁴ Jianhong Zhang, Chaohong Zhou, and Haico Ebbers, “Completion of Chinese overseas acquisitions: institutional perspectives and evidence,” *International Business Review*, vol. 20 (2011), pp. 226–238.

⁵ International Centre for Trade and Sustainable Development & World Economic Forum, “The E15 initiative: strengthening the global trade and investment system in the 21st century” (2016), <https://www.weforum.org/reports/the-e15-initiative-strengthening-the-global-trade-and-investment-system-in-the-21st-century>.

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