Ownership, performance and national champions

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*The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission
Introduction

National champions
- Restrictions on the nationality of shareholders
- Interference with competition (state aids, regulation, relaxation of competition enforcement)
- Strategic coordination (security of supply)

Arcelor/Mittal, Eon/Endesa, OMV/MOL, Unicredito/HVB...

Additional merger control rules
- Decree 1739-2005 in France, Second energy package, German proposal

Volkswagen law, Lex Mol
### Introduction

<table>
<thead>
<tr>
<th>Implementation of the french decree</th>
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<tbody>
<tr>
<td>- National defense – broadly understood</td>
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<tr>
<td>- Differential treatment for EU and third countries, indirect control</td>
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<tr>
<td>- Test : durability of industrial and R&amp;D capability, threaten security of supply, national defense</td>
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<td>- 30 case in 2006, remedies in about half (location commitment)</td>
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<tr>
<th>Second energy package</th>
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<tr>
<td>- Enforce unbundling</td>
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<tr>
<td>- Investor must demonstrate direct and indirect independence from generation and supply</td>
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<tr>
<td>- No acquisition of network by foreigners unless there is an international agreement</td>
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Outline

- Legitimate reasons for restricting ownership? Corporate control and competition only?
- Illustration of some pitfalls of interfering with ownership
- Gains from unrestricted ownership
  - Evidence from the performance of domestic and foreign owned firms
    - Productivity and technological spillovers
  - Evidence from new member states
    - Transformation of the banking sector
- Conclusion
The informational underpinnings of an investor’s decisions are circumscribed by his or her social context. Rationality is “bounded” by social origins.

Domestic owners/investors may have more accurate information (it is transitory) but less ability to process it.

Managers from different cultures have different goals:
- There are no globally universal business goals.
- Managers from culturally close countries rank own and others’ goals-in-use in similar ways, culturally far countries in different ways.

Managers have different motivations:
- Achievement in the US vs affiliation, autonomy and dominance.
Different goals across culture

Relatively most important goals

UK
- This year’s profit
- Staying within the law
- Respons. towards employees
- Continuity of the business
- National pride
- Respecting ethical norms

Germany
- Respons. towards employees
- Respons. towards society
- Creating something new
- Gambling and gambling spirit
- Continuity of the business
- Honor face reputation
Nationality of managers

- **Ethical standards**
  - Significant differences in the attitude of German vs. French managers towards accepting gifts and favours in exchange for preferential treatment. *(Jackson, Artola, 1997)*

- **Performance of expatriates**
  - Managerial behaviours of American expatriates in Hong Kong similar to managers in the U.S. These managerial behaviours positively related to job performance for the managers in the U.S., but not related to job performance of the expatriates in Hong Kong.

- Decisions may be different, not necessarily worse
- Competition does not lead to a single outcome
- Equilibrium selection?
Arcelor/Mittal

- Walloon Region (SOGEPA)
- Luxembourg State
- Employees
- Corporación JMABC (ex-Aristrain)
- Others (*)

87.5%
Arcelor/Mittal

Arcelor
- 18 members of the board
- Many are close to governments (and/or former entities)
- 3 representatives from trade unions
- Shareholders cannot propose resolutions to the board
- Capital increase (within limits) without the consent of shareholders
- Not a surprise that Arcelor has a hard time to convince shareholders..

Mittal criticized for weak corporate control

Which is worse?

Commitment not to abuse from interference with ownership?
Foreign ownership

Evidence from a large sample of acquisitions (Mueller et al, 2002)

- After the acquisitions, profits do not change, relative to a control group of firms that did not merge (but there is large variance)
- Sales fall significantly relative to the control group (as much as 14% within 5 years)
- But there is no significant difference for domestic and cross border acquisitions.
- The nationalities of the target / acquirer do not matter
Conventional wisdom: foreign firms outperform domestic ones
- Evidence from various cross section studies (Greece, UK, Indonesia)
- Regarding total factor productivity and profits (Greece, Portugal)
- Differences are economically significant (18% for EU vs UK for instance)
- Foreign owned firms may adopt new technologies faster than UK firms
- Foreign firm pay higher wages (possibly because of higher K/L ration)
- FDI generate significant spillovers because of R&D; spillovers from FDI may account for 14% of productivity growth in the U.S.
Foreign firms perform better?

But there are significant measurement issues:
- Aggregation biases? More foreign owned firms in sectors with high productivity?
- Identification: foreign owned firms may be more productive because they are multinationals?
- Cherry picking? Foreign owned firms are more productive because the most productive domestic firms have been acquired?
New evidence using establishment level data (Griffith et al.) for manufacturing and services
Multinational establishments are more productive than purely domestic firms
Conditional on a firm being multinational, Foreign ownership has a marginal effect
Different investment behavior
No cherry picking for manufacturing
Possibly for services

Modest improvement in labor productivity following the acquisition

Home bias in R&D activity – in particular in R&D intensive sectors

Strong R&D intensity of multinational firms

Overall, being a multinational matters more than being owned by foreigners

But of course, a domestic multinational is a firm that has been allowed to invest abroad...
## Characteristics of foreign-owned and host country establishments

<table>
<thead>
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<th>British domestic</th>
<th>British-owned multinationals</th>
<th>Foreign-owned multinationals</th>
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<td><strong>Production</strong></td>
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<td>Value added/employee</td>
<td>92</td>
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<td>115</td>
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<td>103</td>
<td>126</td>
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<td><strong>Service sectors</strong></td>
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<td></td>
</tr>
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<td>Value added / employee</td>
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<td>113</td>
<td>120</td>
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<tr>
<td>Investment / employee</td>
<td>96</td>
<td>105</td>
<td>119</td>
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<tr>
<td>Intermediate inputs/employee</td>
<td>93</td>
<td>108</td>
<td>133</td>
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*Source: Griffith, Redding, Simpson, CEPR WP 2004*
## Characteristics of establishments that are taken over

<table>
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<tr>
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<th>Domestic to foreign Before (domestic)</th>
<th>Domestic to foreign After (foreign)</th>
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<td>142</td>
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<td>124</td>
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### Pharmaceuticals & Chemicals

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<th>British-owned Domestic</th>
<th>British-owned Multinational</th>
<th>Foreign-owned Multinational</th>
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<tr>
<td>% total intramural R&amp;D expenditure</td>
<td>16%</td>
<td>52%</td>
<td>32%</td>
</tr>
<tr>
<td>Intramural R&amp;D expenditure as % of value-added</td>
<td>19%</td>
<td>42%</td>
<td>23%</td>
</tr>
<tr>
<td>£s intramural R&amp;D per production employee</td>
<td>£7,660</td>
<td>£27,320</td>
<td>£16,170</td>
</tr>
<tr>
<td>R&amp;D employees as % production employees</td>
<td>12%</td>
<td>28%</td>
<td>12%</td>
</tr>
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*Source: Griffith, Redding, Simpson, CEPR WP 2004*
Banking in transition

- Unique data set of bank performance and characteristics (1994-2005)
- Allows for an estimation of banks interest margins, as well as an estimate of costs and an assessment of mark ups
- Foreign ownership is always associated with lower management costs
- Privatized banks earn higher margins
- By the later period, private domestic banks earn significantly margins
- Overall different sources of mark up
- State owned banks (national champion) are behind in all dimensions
## Margins, marginal costs and mark-ups on loans plus deposits

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<td></td>
<td>Margins</td>
<td>Marg.Cost</td>
<td>Mark up</td>
<td>Margins</td>
<td>Marg.Cost</td>
<td>Mark up</td>
</tr>
<tr>
<td>Newly established</td>
<td>-0.1</td>
<td>0.1</td>
<td>-0.2</td>
<td>1.1</td>
<td>-0.3</td>
<td>1.4</td>
</tr>
<tr>
<td>domestic</td>
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<td></td>
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<tr>
<td>Newly established</td>
<td>2.3</td>
<td>-2.5</td>
<td>0.2</td>
<td>0.8</td>
<td>-1.9</td>
<td>2.7</td>
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<tr>
<td>foreign</td>
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<td>Privatised</td>
<td>1.4</td>
<td>-0.6</td>
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*Source: Fries, Neven, Seabright, Taci, 2006.*
Productivity of Polish banks

Polish champion

- 1990s foreign investors invited into the banking sector, since Polish banks lack capital (stable ratio of banking assets to GDP 60%, EU15 average 278%), capabilities to screen loans (non-performing loans: 31% of total loans in 1993), adequately trained staff.

- Strategic foreign investors targeted to ensure transfer of capital, know-how and technology.

<table>
<thead>
<tr>
<th>No of banks</th>
<th>1993</th>
<th>1996</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign</td>
<td>10</td>
<td>25</td>
<td>39</td>
<td>48</td>
<td>46</td>
</tr>
<tr>
<td>Total</td>
<td>87</td>
<td>81</td>
<td>77</td>
<td>72</td>
<td>58</td>
</tr>
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- Still, sector's No 1 state-owned PKO BP was protected from foreign ownership and competition. Two recent striking events: its privatization and intervention in its competitors' merger.
Privatization of PKO BP

- Sept. 2004 government announced that non-institutional investors are preferred.
- Parliament decided foreign investors not allowed to buy shares of PKO BP.
- European Commission objects as the decision not compatible with the common market.
- Oct/Nov 2004: 37.7% shares were sold. With restrictions: foreign institutional investors allowed to buy max. 8.5% shares.
- Overall, big success: huge demand and sharp rise in shares' price in the first days.
- Ministry of Treasury owns 50% + one share as the only large institutional shareholder.
Takeover of HVB by Unicredito

Before takeover: No 1 state-owned PKO BP SA, No 2 Unicredito, No 3 HVB. After takeover: No 1 Unicredito, No 2 PKO BP

13/09/2005 Unicredito notifies takeover of HVB at DG COMP.

18/10/2005 DG COMP decision: takeover does not raise serious doubts as to its compatibility with the common market.

But Polish government against the takeover

2006: Unicredito negotiates with Polish government. Remedy: sell a part of HVB (30% of retail clients, 200 outlets)

03/10/2007 Polish financial sector regulator approves concentration; Uni No1, PKO BP No 2, but the difference small
Conclusion

- Hard to find a good case in favor of restricting foreign ownership of domestic assets
- Recent experiences with national champions in banking are not encouraging
- The multinational character of firms may matter more than ownership as a source of growth