Lisbon, Nov. 16, 2007

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

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

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 perfomance of domestic and foreign owned firms
    Productivity and technological spillovers
  - Evidence from new member states
    Transformation of the banking sector
- Conclusion

Nationality

- 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 afilliation, autonomy and dominance

Different goals across culture

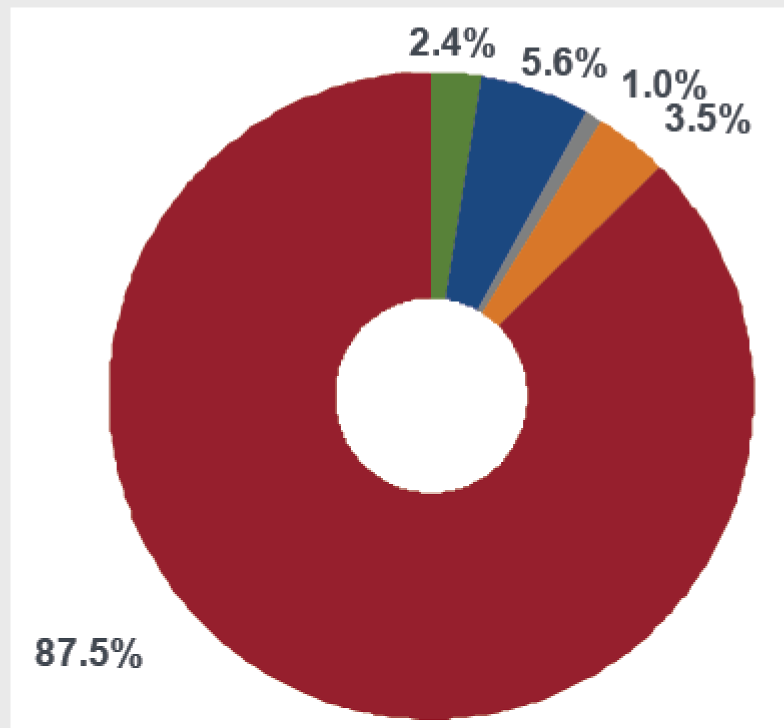
Relatively most important goals

UK	Germany
This years' profit	Respons. towards employees
Staying within the law	Respons. towards society
Respons. towads employees	Creating something new
Continuity of the businesee	Gambling and gambling spirit
National pride	Continuity of the business
Respecting ethical norms	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
- Corporaçion JMAC (ex-Aristrain)
- Others (*)

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

Foreign firms perform better ?

- 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

	British domestic	British-owned multinationals	Foreign-owned multinationals
Production			
Value added/employee	92	102	116
Investment/employee	94	98	115
Intermediate inputs/employee	88	103	126
Service sectors			
Value added / employee	94	113	120
Investment / employee	96	105	119
Intermediate inputs/employee	93	108	133

Source: Griffith, Redding, Simpson, CEPR WP 2004

Characteristics of establishments that are taken over

	Domestic to foreign		Domestic to domestic	
	Before (domestic)	After (foreign)	Before (domestic)	After (domestic)
Production				
Value added / employee	97	102	91	99
Investment / employee	130	115	93	96
Intermediate inputs/employee	117	141	83	93
Service sectors				
Value added / employee	115	117	94	101
Investment /employee	142	157	99	101
Intermediate inputs / employee	124	146	96	99

Source: Griffith, Redding, Simpson, CEPR WP 2004

R&D activity and ownership

Pharmaceuticals & Chemicals

	British-owned Domestic	British-owned Multinational	Foreign-owned Multinational
% total intramural R&D expenditure	16%	52%	32%
Intramural R&D expenditure as % of value-added	19%	42%	23%
£s intramural R&D per production employee	£7,660	£27,320	£16,170
R&D employees as % production employees	12%	28%	12%

Source: Griffith, Redding, Simpson, CEPR WP 2004

Banking in transition

- Unique data set of bank perfomance and characteristics (1994-2005)
- Allows for an estimation of banks interest margins, as well as en 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

	1995 – 1998			2002 – 2004		
	Margins	Marg.Cost	Mark up	Margins	Marg.Cost	Mark up
Newly established domestic	-0.1	0.1	-0.2	1.1	-0.3	1.4
Newly established foreign	2.3	-2.5	0.2	0.8	-1.9	2.7
Privatised domestic	1.4	-0.6	2.0	2.8	0.1	2.7
Privatised foreign	1.2	-1.6	2.8	0.4	-1.3	1.7

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.

No of banks	1993	1996	1999	2001	2003
Foreign	10	25	39	48	46
Total	87	81	77	72	58

- Still, sector's No1 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