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A COMPARATIVE STUDY OF MERGERS AND ACQUISITIONS BY PRIVATELY- AND STATE-OWNED ENTERPRISES

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Introduction[1]

Governments have become much more welcoming towards foreign investors over the past several decades. The widespread use of screening, performance requirements, and outright restrictions on foreign ownership have given way to investment liberalisation, investment incentives and promotion, and the negotiation of thousands of bilateral investment treaties (BITs) providing foreign investors with special protections.

One exception to this shift in attitude relates to foreign investments by entities owned or controlled by foreign governments. Up until the FDI boom in 2001, cross-border investment by governments was not a major policy concern for the simple reason that there wasn't much of it. This issue has gained prominence in recent years as cross-border deals involving sovereign wealth funds (SWFs) and state-owned enterprises (SOEs) have grown rapidly.[2] By 2009, at the height of the global financial crisis, SOEs accounted for over 20 per cent of global cross-border mergers and acquisitions (M&A) and today continue to account for around 10 per cent, about four times more than their pre-crisis average. This surge in cross-border investment by SOEs has given rise to a number of concerns for governments, including with respect to national security, the proper functioning of markets, and responsible business conduct. In other words, governments consider that FDI by SOEs and privately-owned enterprises (POEs) are different and that SOE investments are less beneficial.

This paper empirically examines the proposition that SOE and POE cross-border investments are different. It does so by comparing all M&A by SOEs and POEs (with a value greater than USD 5 million) undertaken between 1 January 1996 and 31 December 2013. This amounts to 206,140 deals collectively valued at USD50 trillion. The main objective is to identify differences in the ways that privately-owned and state-owned enterprises expand into international markets using M&A, a primary vehicle for international direct investment.

1 The author is a Senior Economist in the Investment Division of the Organisation for Economic Co-operation and Development in Paris, France. Much of the information presented in this paper was prepared to support discussions in the OECD's Investment Committee. Important research support for the work has been provided by Ana Lehman, Frederick Lehman, Karl P. Sauvant, and Yuri Shima. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation for Economic Co-operation and Development or its member countries. This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries, and to the name of any territory, city, or area.

2 State-owned enterprises have been defined using many different ownership thresholds and there is no generally agreed threshold for determining when an enterprise becomes 'government owned'. In the present paper we focus mainly on firms that are 100% government-owned enterprises but also provide some comparative analysis of enterprises in which the government holds a minimum 25% stake. From this point on we use the term state-owned enterprise, or SOE, to denote any entity that is owned or controlled by government and which performs a commercial function.

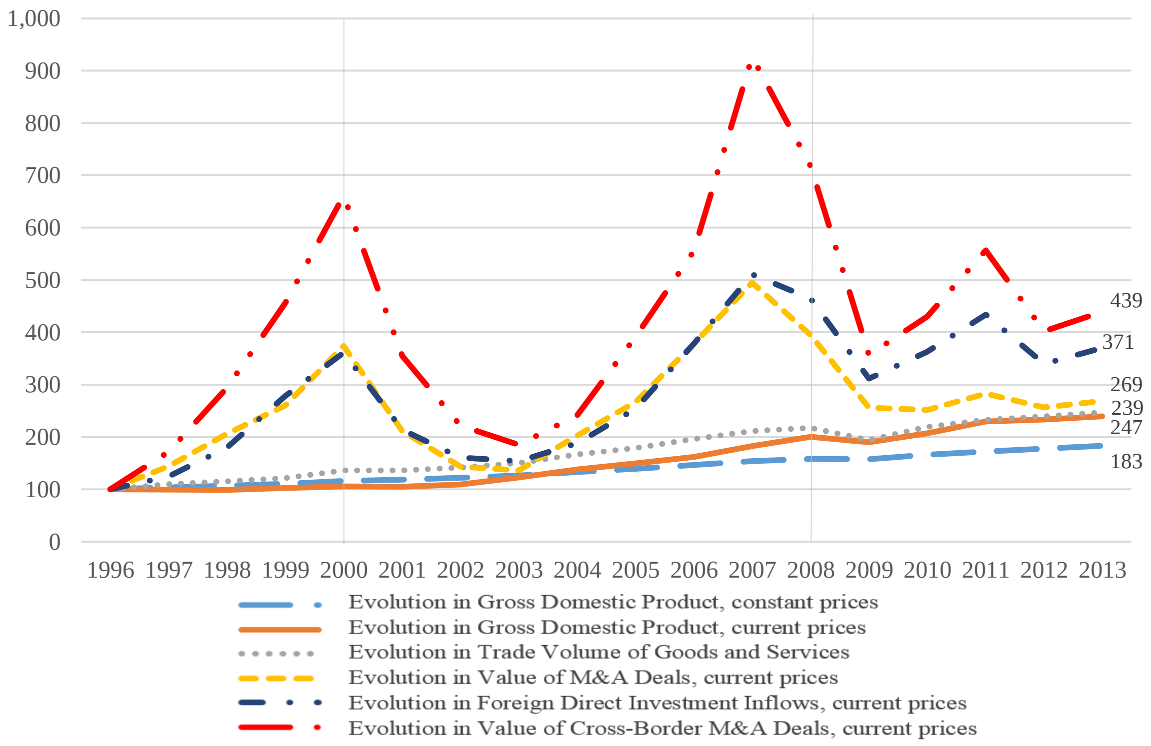
In section 2 we provide a brief overview of general M&A trends. Section 3 presents differences between POEs and SOEs with respect to their M&A investments. Section 4 concludes and proposes directions for future research based upon the main findings of this work.

2. General M&A trends

Notwithstanding the strong cyclical patterns associated with M&A activity, the general trend over the past 18 years has been upward. The total value of the deals grew from $1.1 trillion in 1996 to $2.9 trillion in 2013, which represents an average yearly growth rate of around 6%. Cross-border deals grew much faster than domestic M&A with an average yearly growth rate of 9%.

To get a sense of the relative economic importance of M&A activity over the period under study, we compare it with GDP, trade, and foreign direct investment (FDI). Figure 1 tells a clear story about investment-led globalisation, with international M&A growing consistently faster than any of the other economic variables, and foreign direct investment (FDI) coming in second. Interestingly this is especially the case after 2007, probably due to the emergence of countries like China as major outward investors during this period. Figure 1 also underscores the extent to which international investment (either M&A or FDI) has been growing faster and has been more volatile than trade (which in turn has grown consistently faster than GDP).

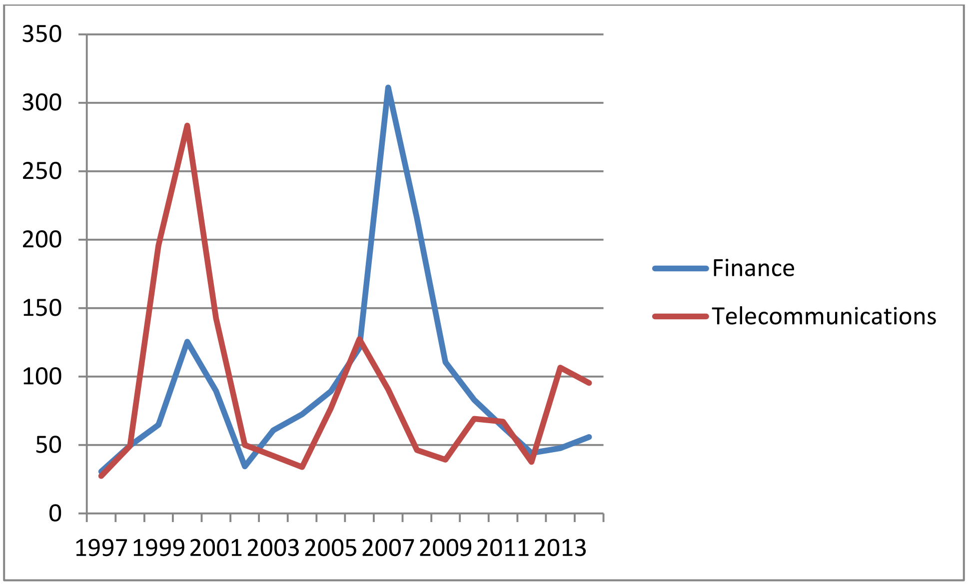
Figure 1. Growth of global M&A, GDP, Trade, and FDI inflows, 1996-2013 (1996=100)



Source: IMF, Unctad and Dealogic data.

The industry composition of cross-border M&A remains evenly balanced at the global level. The top eight sectors accounted for 66% of total cross-border M&A in 2014, with no sector accounting for more than 11%. Previous M&A cycles have tended to be driven by activity in one or two leading sectors. In the lead-up to the 2000 peak in international investment activity, telecommunications, propelled by a global wave of privatisations, was the driver. In the lead up to the international investment boom of 2007, the financial sector and real estate were the drivers (Figure 2). At the global level, there is no clear indication of an industrial sector breaking away as happened in previous M&A booms. Notwithstanding this point, one segment that has been booming and even exhibiting the signs associated with previous bubbles in the post-financial crisis era is the SOE segment, a issue to which we return later in the paper.

Figure 2. Cross-border merger and acquisitions in finance and telecommunications (USD billions)

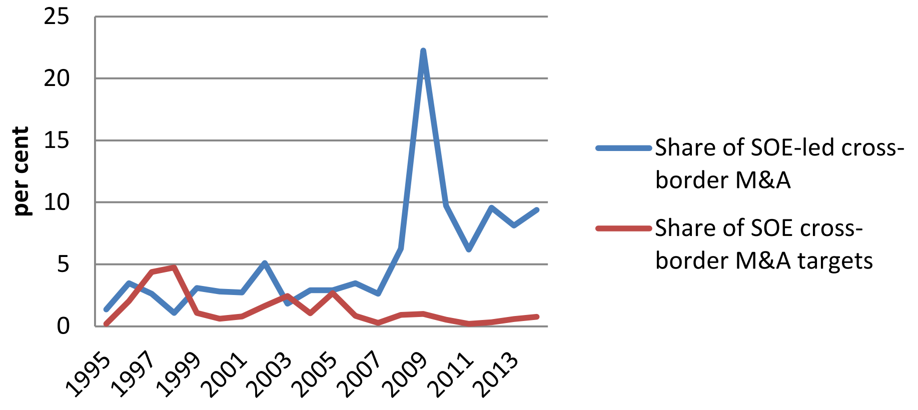


Source: Dealogic data.

3. M&A by SOEs and POEs

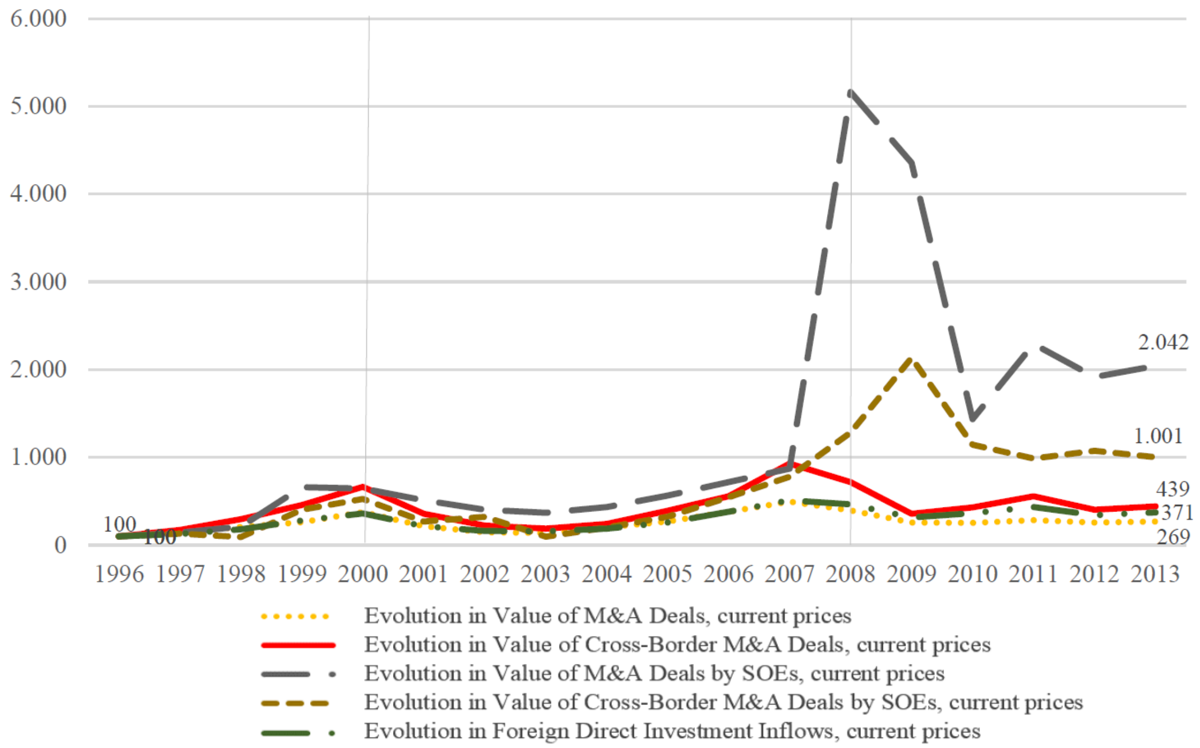
As mentioned in the introduction, cross-border investments by SOEs have boomed during the post-financial crisis era (figure 3). One of the reasons that this has raised concerns relates to the implications of this growth for markets. We can see in figure 3 the asymmetry between SOEs as cross-border acquirors and as cross-border targets. SOEs are very rarely acquired in cross-border deals, such that most of the targets of SOEs are privately owned firms. In effect, state-ownership is a domestic policy choice that is being increasingly exported.

Figure 3. State-owned enterprises as cross-border acquirors and targets



Interestingly, this international dimension of the rise of SOEs as acquirors would seem to represent an extension of what SOEs are doing at home. Figure 4 compares the evolution of the value of all SOE deals versus the value of their cross-border deals over the period 1996-2013. What it shows is that, although the increase in cross-border activity of SOEs has been impressive, it has grown about half as fast as overall M&A led by SOEs. SOEs have simply become much more active players in M&A during the past eight years. In 2013, 70 per cent of the value of all acquisitions by SOEs was in their own home countries.

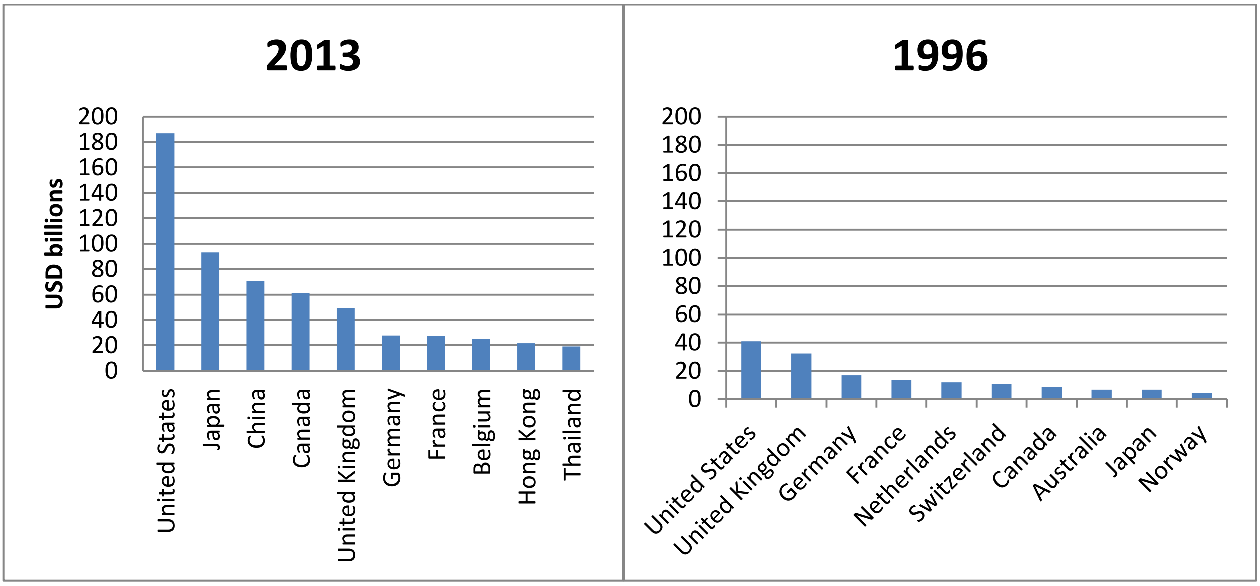
Figure 4. Evolution in the value of total and international M&A by SOEs



Source: Own elaboration based on IMF, Unctad and Dealogic data.

Figure 5 shows the top ten acquiring countries for total international M&A. The same scales have been used to provide a sense of the nominal growth in international M&A activity, as well as a sense of proportionality between countries and periods. These rankings reflect a story that is familiar from outward FDI data, namely the dominance of Europe and North America as the main sources of outward investment during the early stages of investment-led globalization, the decline of Europe as a leading source of outward investment in more recent years, and the rise of China and Asia more generally as major new international investors. In 1996, four European countries were among the top 5 sources of international M&A. By 2013, only one country (the UK) remained in the top 5.

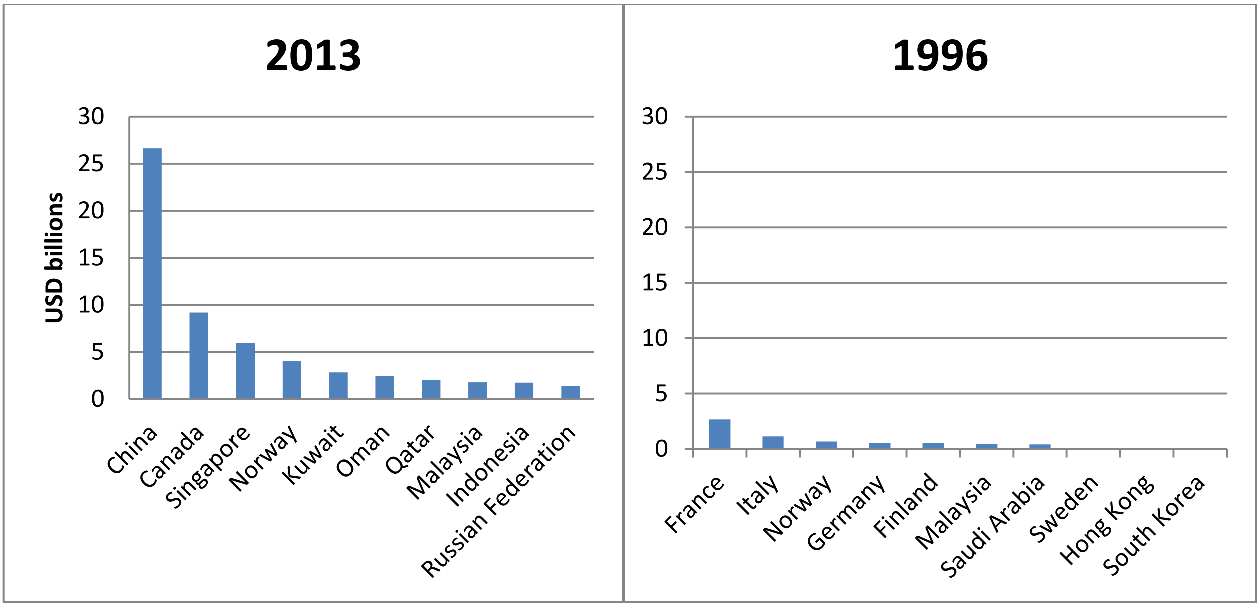
Figure 5. Top 10 acquiring countries, total cross-border M&A, 1996 and 2013



Source: Dealogic data

Figure 6 presents the top ten acquiring countries for SOE-led cross-border M&A. In this case the changes over time have been much more abrupt than what we observe in figure 5. In 1996, six European countries were the main sources of SOE-led international M&A. By 2013, only one of these (Norway) remained on the list. The only other country to appear among the top 10 in both years was Malaysia. Figure 6 also reflects the important role that sovereign wealth funds have come to play as government-owned sources of international M&A activity since much of the investment from countries like Canada, Singapore, and Norway reflects investment by funds controlled by governments as opposed to 'bricks-and-mortar' SOEs.

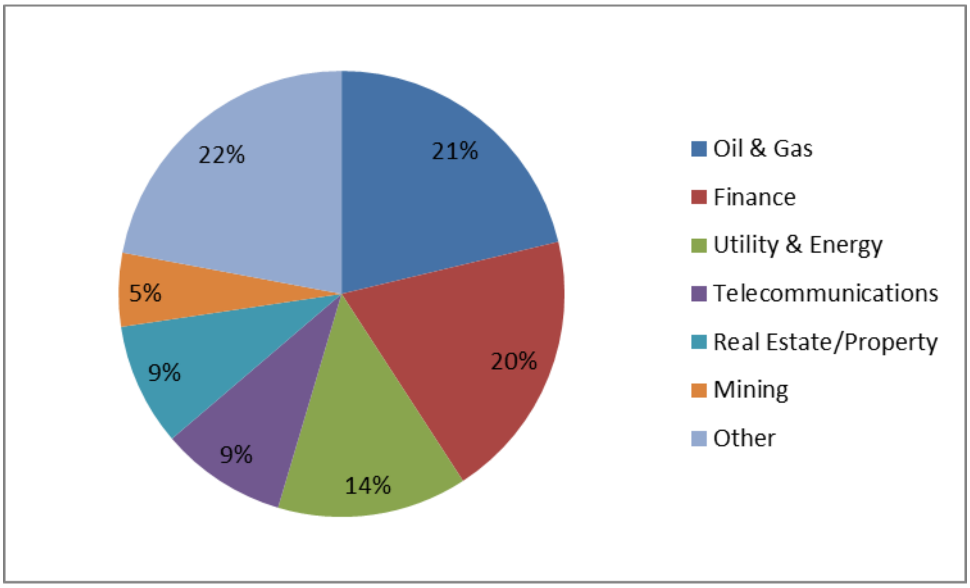
Figure 6. Top 10 acquiring countries, SOE-led international M&A, 1996-2013



Source: Dealogic data

Figure 7 shows the industry breakdown for SOE-led international M&A between 1996 and 2014.[3] Oil and gas is the most important sector at 21%, followed by finance with 20%. The high share of finance reflect and very significant involvement of SOEs in international M&A in this sector in the three years 2007-9. This is followed by utility and energy (14%), telecommunications and real estate (both 9%), and mining (5%). That 80% of SOE-led international M&A is directed at 6 sectors speaks to the relatively narrow range of industries covered by SOEs. International M&A by SOEs in real estate is a relatively new and growing phenomenon, with this sector accounting for a quarter of all SOE-led international M&A in 2014.

Figure 7. Industry breakdown for SOE-led cross-border M&A, 1996-2014

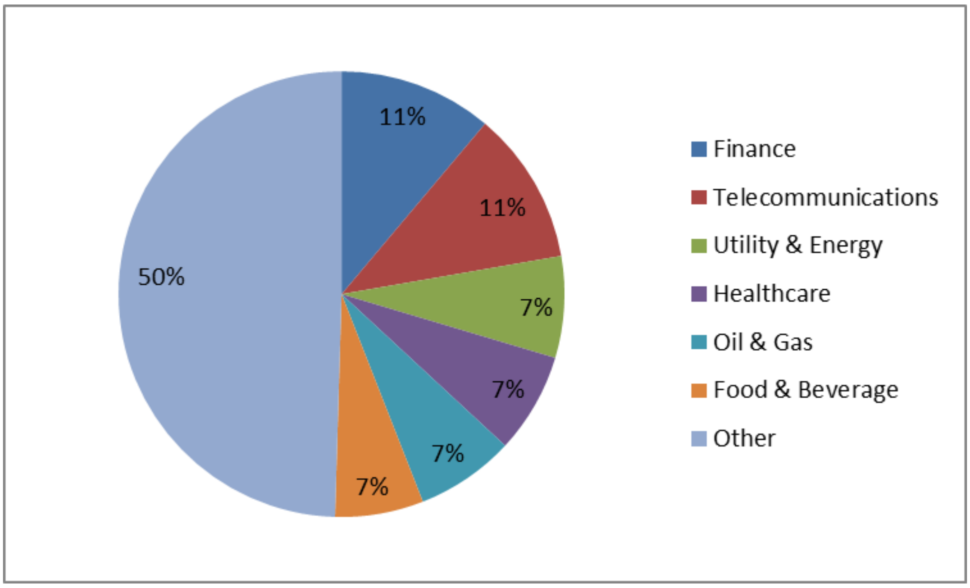


Source: Dealogic data

We can compare SOE-led with POE-led international M&A in figure 8. We again find oil and gas, finance, utility and energy, and telecommunications among the top sectors, albeit with some change in the ordering. Real estate and mining are replaced by healthcare and food and beverage as being among the top six sectors for POE-led international M&A. A main point highlighted in figure 8 is the much more diversified nature of POE M&A, with the top six sectors accounting for only half of the total.

3 Figures 8 and 9 have been updated to include data for 2014

Figure 8. Industry breakdown for POE-led cross-border M&A, 1996-2014



Source: Dealogic data

SOEs and POEs structure their M&A deals quite differently. Table 1 provides a comparative snapshot. A first important difference concerns deal size. SOE deals are on average more than twice as large as deals by POEs. This is the case for both domestic and international deals.[4]

Table 1. Summary of key features of POE and SOE M&A deals

		SOEs			POEs		
		Domestic	International	Total	Domestic	International	Total
Average deal size (USD mil)		496.9	577.9	520.8	231.1	245.5	234.9
Deal characteristics (% of deals)							
	Partial interest	52.8	54.9	53.4	32.2	28.5	31.2
	Majority interest	14.3	10.7	13.3	8.9	11.3	9.5
	Outright purchase	9.7	11.1	10.1	31.2	33.2	31.7
	Other	23.2	23.3	23.2	27.7	27.0	27.6

Another important difference between POEs and SOEs concerns the size of the stakes that enterprises take in their targets. Table 1 ranks deal characteristics in terms of whether acquirors go for outright purchase (100%), majority interest (>50%), or partial interest (<50%). It ranks these according to the favoured approaches of SOEs.

The favourite approach of POEs is to undertake outright purchases (32% of deals). In contrast, this is the least favoured option of SOEs (10%), while the majority of SOE deals are for a partial interest (53% of

4 This result is statistically significant at the 1% level. This result holds also when excluding financial sector deals (which tend to be larger and account for a large share of SOE investments), and when controlling for whether deals are domestic or international.

deals, versus 31% of deals for POEs).[5] More generally, POEs acquire larger stakes than SOEs in both international and domestic M&A (and irrespective of whether or not deals are in the financial sector).

One conclusion that can be drawn from the above is that SOEs are generally attributing higher valuations to their targets than POEs (i.e. on average they are paying much more to acquire smaller stakes in their targets). Preliminary analysis suggests that this is neither due to industry effects nor to firm size. Deeper examination of this issue would be required before we can conclude with certainty that SOEs are attributing higher valuations to their targets than POEs in like-for-like situations.

4. Does the level of government ownership matter?

To gain a better understanding of whether different ownership structures affect how firms internationalise, data was collected on 4591 cross-border M&A transactions in 2012 worth $704 billion. These deals were categorized according to four mutually exclusive types of international investors, defined as follows:

- Listed private investors: Listed companies in which no government owns 25% or more of common stock;

- Non-listed private investors: Firms that are privately-owned and not listed;

- Listed SOEs: Listed firms in which a government owns 25% or more of the common stock;

- Non-listed SOEs: Firms that are 100% owned by a government.

The 25% ownership threshold was chosen for pragmatic reasons. In previous work done at the OECD[6], the Forbes 2000 was classified using 25% and 50% ownership thresholds. Given that a significant share of cross-border M&A is accounted for by the world's largest firms, this classification was used as the basis for creating the "SOEs, listed" subsample, supplemented with additional research on the ownership structure for firms not covered in the Forbes 2000. The lower of the two thresholds was used to gain a fuller picture of government involvement in global FDI flows. Furthermore, the 25% threshold is used in many jurisdictions as the blocking minority above which a minority shareholder can block 'material transactions', changes in the bylaws, and other corporate decisions.

This sample also allowed for an analysis of cross-border M&A according to whether or not the acquiring firms are listed (for both the private and SOE sub-samples). Since non-listed firms constitute an important source of cross-border M&A, this sub-category provides an opportunity to expand our examination of the relationship between different ownership structures and international investment beyond the question of government ownership.

Table 2 synthesises all cross-border M&A transactions in 2012 for which data was available on the value of the transactions. Private listed firms accounted for $453 billion, or 64% of the total value of cross-border M&A, followed by private non-listed firms at $121 billion (17%), non-listed SOEs at $70 billion (10%), and finally listed SOEs at $59 billion (8%). As expected, the broadening of the definition of what constitutes an SOE to include firms in which governments own significant shares (25% or more) significantly increases the share of total cross-border M&A accounted for by SOEs (from 10% to 18% of the total).

[5] This result to be statistically significant at the 1% level.

[6] Przemyslaw Kowalski, Max Büge, and Monika Sztajerowska (2013). State-Owned Enterprises: Trade Effects and Policy Implications. OECD Trade Policy Papers, No.147.

Table 2. Summary of cross-border M&A activity by type of investor, 2012

(US$ millions)	Number of deals	Total value	Avg deal value	Avg acquired stake
Private, listed	3,015	453,362	150	69%
Private, not listed	1,301	120,934	93	54%
SOEs, not listed	147	70,024	476	41%
SOEs (25%+) listed	128	59,427	464	61%
Total	4,591	703,747	153	64%

Source: Dealogic M&A Analytics database, calculations by Secretariat.

As with the longer time series data presented in the previous section, one of the clear differences between the private and SOE sub-classifications relates to average deal size. On average cross-border M&A transactions by SOEs were four times larger than those by privately owned firms in 2012. One possible explanation for this relates to the fact that SOEs are generally larger than privately owned firms and might therefore also generally engage in bigger transactions. A related explanation would be if SOE cross-border M&A was concentrated in sectors, such as energy and mining, where deals are generally larger. However, the data show that this is not the case. Within sectors, SOE investments are generally several times larger than private investments.

For example, the average value of SOE cross-border M&A transactions in the mining sector in 2012 was $836 million. In contrast, the average value of cross-border M&A transactions by private firms in mining was $91 million. Average SOE investments are much larger than private investments across all sectors except services and wholesale trade.

A question that is raised by these significant differences in the average size of investments by SOEs versus the average size of investments by private firms is whether this might give rise to crowding out private investors. This could occur if the larger average deal values for SOEs are due to advantages these enjoy that allow them to pay more for targets than private firms. Such crowding out could affect not only private investment from third countries but also private outward investment from the home country of the SOEs.

Another distinction in table 2 can be seen with respect to the average equity stakes acquired by listed versus non-listed firms, whether private or SOE. On average, listed firms acquired 65% of the equity of their targets whereas non-listed firms acquired 48% on average, with non-listed SOEs being the only group of firms which generally acquired below 50%.

A large share of cross-border M&A by non-listed firms originates from emerging markets. In some cases, the data is capturing cross-border M&A activity by sovereign wealth funds. For example, Qatar is in second place behind China as a major source of cross-border M&A by non-listed firms. Despite the high aggregate value of Qatar's international investment activity, the portfolio nature of these investments is reflected in the relatively low equity stakes being acquired, 17% on average (compared with an average of 41% across all countries).

Another possible explanation for the generally lower equity stakes acquired by non-listed firms could pertain to their ability to raise capital. For example, listed SOEs from China generally acquired 57% stakes in their cross-border M&A deals. Non-listed SOEs from China generally acquired 44% stakes. This is an issue that would require a closer analysis of differences in the ways different types of firms finance their international investment activities.

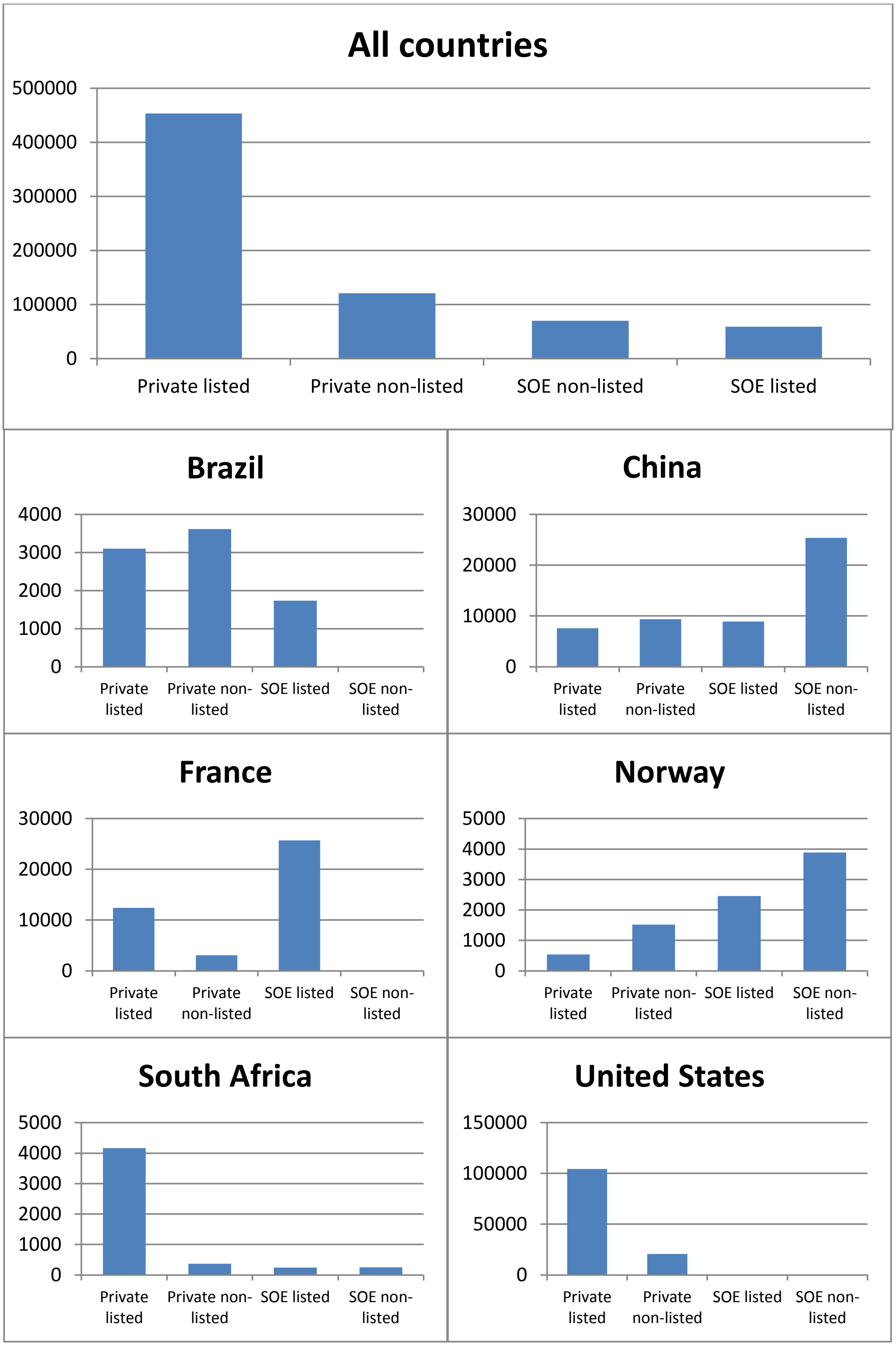
With respect to the 'outward' cross-border M&A of countries, an eclectic mix of profiles is observed. One interesting feature of these profiles is the difficulty in identifying any clear 'north-south' typology. While it remains that the emerging economies generally do have more significant SOE sectors, and thus tend to have a greater SOE presence in their outward international investments, similar profiles can be found across countries at different levels of development, suggesting that the challenges for policy makers of maintaining level playing fields for private and SOE investors cut across north-south lines.

Figure 9 presents comparisons of the cross-border M&A profiles for global cross-border M&A as well as for six countries; Brazil, China, France, Norway, South Africa, and the United States. To draw one or two comparisons, we see from figure 9 that private listed investors account for 83% of the outward cross-border M&A for South Africa and the United States and both are below average sources of SOE cross-border M&A. At the other end of the spectrum, China and Norway[7] have very high levels of outward cross-border M&A by non-listed SOEs, and France has the highest levels of cross-border M&A by listed SOEs.

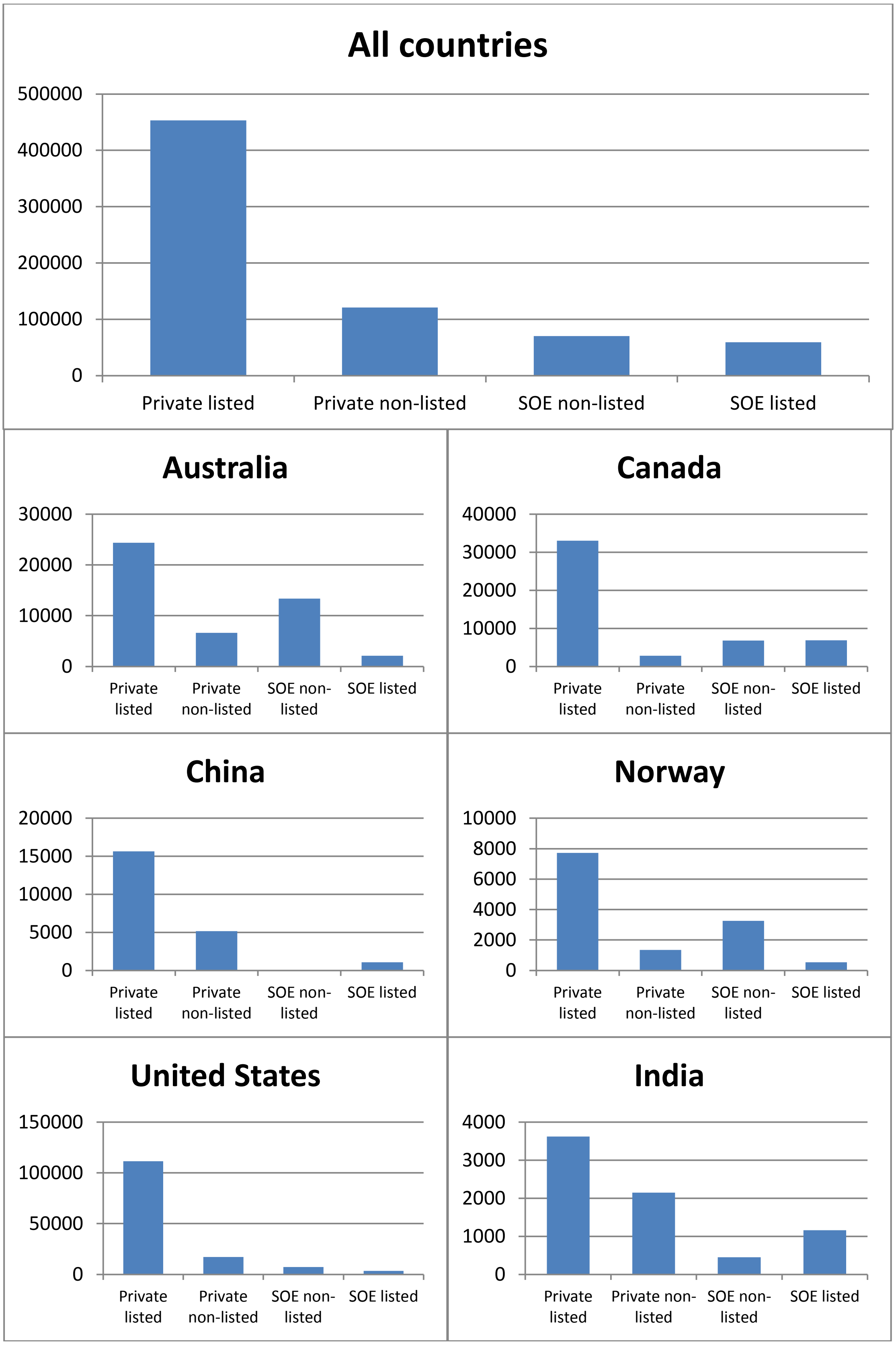
With respect to the target countries for cross-border M&A, we can generate similar country snap shots showing which countries are the main recipients of SOE cross-border M&A (and those that are not). Figure 10 presents the inward cross-border M&A profiles of six countries. From this, we see, for example, that Canada and Australia receive above average inward cross-border M&A by SOE investors, which makes sense given the industrial composition of SOE cross-border investment presented in figure 7. This could explain why both of these countries have been among the more active in formulating policies specifically addressed at SOE investments.

[7] In the case of Norway all of this investment takes place through Norges Bank Investment Management -NBIM which is a separate part of Norges Bank (the Norwegian Central Bank) and is responsible for managing the Government Pension Fund. NBIM also manages the country's foreign exchange reserves.

Figure 9. Outward cross-border M&A profiles of six countries, 2012



. **Figure 10. Inward cross-border M&A profiles of six countries, 2012**



An interesting contrast with Figure 9 can be found in a comparison of Norway and China. Whereas these countries share similarities in terms of the significant role of SOEs in their outward investments, they are quite different when it comes to inward SOE investment. Norway receives above average international investment from SOEs whereas China only receives 5% of its inward cross-border M&A from SOEs. The United States also receives a below-average share of inward cross-border M&A from SOE investors, 8%.

Conclusion and directions for future work

This paper has compared M&A by SOEs and POEs with a view to shedding light on the different ways that these types of firms expand internationally using cross-border investment. The key findings included the following:

- SOE-led M&A was one of the fastest growing sources of international investment in 2008-9, both at the domestic and the international levels and, despite declines after reaching record levels in 2009, remains high by historical standards;

- China is an important part of the SOE-led growth of international M&A, accounting for around 40% of the total. However, this has been part of a more general increase in China's outward investment, 60% of which is accounted for by POEs;

- SOEs engage in much larger deals than POEs, but also generally take smaller stakes in their targets than POEs, indicating that SOE targets generally have higher valuations than POE targets;

Notwithstanding our earlier finding that cross-border investments by SOEs cut across north-south lines, it remains that the rapid rise of emerging market economies and China as sources of international investment and the rising importance of SOEs as international investors are closely related stories. This relationship and some of our findings point to a question with potential implications for policy makers: does the surge in outward investment from these markets represent a bubble?

One of our key findings that points in this direction concerns the size of cross-border M&A deals. Just as previous booms have been led by surges in M&A activity in particular sectors, they have also been accompanied by sharp increases in average deal value. During each of the previous boom and bust cycles, the average value of cross-border M&A peaked at just under USD 150 million. Emerging markets (excluding China) have performed very much like the advanced economies in this regard since around 2004, reflecting the fact that they had not yet become important sources of outward investment at the time of the first international investment boom in 2000.

Up until 2004, China's average deal size wasn't much different than that of cross-border M&A from other emerging market economies and was generally lower than deals led by firms from the advanced economies. In the ten years since 2005, however, the average value of cross-border M&A deals by Chinese firms has been 76% larger than the world average. And in the last three years, they have been twice as large as the world average. Given that the turning point in previous MNE investment cycles has been marked by average deal sizes approaching USD 150 million, China's outward FDI has qualities which suggest the possibility of a correction. Given that China accounted for 8% of total global cross-border M&A in 2014, the biggest concern should perhaps not be with rising cross-border investments by SOEs but rather in the possibility that these might suddenly come to an end.