OWNERSHIP, PERFORMANCE AND NATIONAL CHAMPIONS

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1. Introduction

There is no commonly accepted definition of what a national champion may be. The terminology is generally used to refer to companies which are subject to a particular treatment from governments because of some national dimension in their operation. At the most general level, the location of assets introduces a national dimension in the operation of a firm and governments may wish to interfere with the management of assets, at least when take a particular significance from their own prospective. The most common interference may take the form of a restriction on the control of the assets, and in particular restrictions on the nationality of shareholders. This policy may rest on the presumption that the decisions of shareholders will be affected by their nationality and that national shareholders may, because of the system of incentives and constraints that they face, end up taking decisions that may be more closely aligned with those that the government would favour. Governments may of course also anticipate that they may have more leverage over national shareholders in case of divergence. Another type of common interference involves the implementation of regulation. For instance, merger control rules may be relaxed for firms with domestic assets. State aids may be awarded on different terms. Sector regulation may be implemented differently both in terms of opportunities (for instance in terms of access prices) and in terms of obligations (for instance in terms of investment in particular technologies or the coordination of investment to achieve agglomeration economies or security of supply).

Interference with regulation raises deeper issues in terms of the interplay between the design and implementation of regulation given that national government also have scope to affect the former. In what follows, I will thus focus on restrictions towards the nationality of shareholders, an area in which the principle of free movement of capital does not leave much scope for member states to introduce regulation.

European courts have indeed recently reaffirmed how far reaching these principles were. For instance, the European Court of Justice considered in a recent ruling that the cap, introduced by a German Länder, on the proportion of voting shares that could be held by a single investor in Volkswagen was contrary to internal market rules. At the time of writing, the Hungarian government was also facing the prospect of an infringement procedure with respect to the so called "lex Mol" which reduces the scope for control of MOL, the Hungarian energy incumbent.

Debates about the identity of shareholders are still not uncommon and often arise in the context of merger control. For instance, there was a lively debate a couple of years ago with respect to the acquisition of Arcelor by Mittal, a company controlled by an Indian family. In the context of the E.ON-Endesa transaction and more generally in the Spanish energy sector, concerns were expressed about the possibility that energy assets could be controlled by non-Spanish firms or non-Spanish shareholders. Echoes of these

[1] The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission.

concerns were heard recently, in the context of the attempt by OMV (the Austrian incumbent) to acquire MOL the Hungarian incumbent in the energy sector. The acquisition of HPV, a polish bank by Unicredito provides yet another illustration.

Some members states have also taken proactive steps in order to control the ownership of domestic assets. In particular, France has adopted a Decree in 2005 which enforces an ex ante control of acquisition by foreign firms with respect to possible concerns about national security defence , broadly understood. [2] This decree is in conformity with both internal market rules and the EC merger regulation, which give member states more scope for intervention in cases where "legitimate interests" involved.[3] There is currently a legislative proposal put forward by the German government which is comparable with the French decree.

Some insight can also be gained form a couple of years of implementation of the French decree, which has been adopted in 2005 and implemented fully in 2006 so that about 30 cases have been reviewed so far. The scope of activities that can be subject to this additional control depends on whether the buyer is from the EU or a third country; it is broader for the latter and could in that case include a significant fraction of software development. Concerns could be raised about the breath of this control given that in the absence of publication of the decisions, transparency and accountability are limited. Remedies can still be observed and it would appear that in a significant proportion of cases, commitments to maintain particular activities in France have been entered into. Perceptions could thus be created that this additional control could be used to reduce the relocation of assets on grounds that are not immediately related to national defence. This might trigger the development of similar legislations in other countries as a response and lead to an outcome which would be unattractive for all countries concerned. There is no question that national defence provides a sound justification for additional control. But at the very least, some transparency (admittedly a delicate instrument when it concerns national defense) might prove useful to avoid suspicions that it might be abused.

The second energy package put forward by the Commission also envisages some form of control of the identity of investors, in particular from third countries. The rationale behind this proposal is however not to introduce an additional prospective from which transactions could be considered (as in the case of national defence) but rather to ensure that existing community legislation takes full effect. In particular, the proposal ensures that unbundling requirements cannot be circumvented by making acquisitions or investments outside the EU. Indeed, one could imagine a situation in which a network is being purchased by a foreign investor, which at the time of the acquisition does not own any supply or any generation capacity but subsequently expands in these areas

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[2] This decree is sometimes referred to as the "yoghurt law" because it was adopted at the time at which there was a concern that Pepsi-Cola could actually take over Danone and accordingly that the French recipe for the production of yoghurt could potentially be shared with American interests. But the timing also coincides with the acquisition of Gemplus, the world leading manufacturer of SIM cards, by Texas Pacific, a US firm whose chief executive was a former director of the CIA.

[3] The 2004 Merger regulation reads: "Notwithstanding paragraphs 2 and 3, Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law.
Public security, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph."

outside the EU (so that upstream production can be bundled with a network without oversight from EU regulatory authorities).

Recently, public concern has also been voiced with respect to the investment policy of foreign sovereign funds. The public identity of the investors adds a dimension to the problem because of the scope for bargaining in the context of wider political and security issues. We will briefly return to this theme in the conclusion.

The rest of the paper is structured as follows. Section 2 discusses whether restrictions on ownership could be justified on the grounds of efficiency. Section 3 illustrates potential pitfalls from the restrictions of ownership and considers evidence regarding the consequences of foreign ownership on performance. Section 4 concludes.

2. Are there efficiency based reasons for restricting ownership?

In principle, the nationality of shareholders should not affect the efficiency of corporate control. From the perspective of mainstream corporate finance, institutions and competences do not vary according to nationality. And indeed, it is tempting to dismiss the case in favour of restricting ownership on this basis alone. Restrictions can then be characterised solely as interferences by governments which can presumably be understood in terms of a broader framework of political economy. Still, in this section, I will investigate possible reasons for restricting ownership in terms of efficiency.

A case for restricting shareholder ownership or restricting the nationality of shareholders might rely on the argument that domestic and foreign investors or managers may take different business decisions. This may arise because of bounded rationality. The informational underpinnings of an investor's decisions are circumscribed by his or her social context, which implies that rationality is "bounded" by social origins. That is to say that investors and managers from different countries might take different decisions simply because they have been raised in a different environment. It may also arise because they have different objectives functions and motivations at least to the extent that such objectives can be pursued besides the maximisation of returns
There is indeed some evidence that managers from similar cultures rank business goals in similar ways whereas managers from cultures that are far apart differ in their ranking. Table 1 presents some survey evidence regarding the objectives of managers. This evidence, which might appear as a confirmation of cultural clichés, suggest that while current profits is the first goal of UK managers, it is not even listed by German managers, who list responsibility towards employees and society as their prime concern. Of course, the expression of these preferences may not be regarded as exogenous and could, to some extent, be determined by different types of corporations. Institutions may in turn respond to the environment and it remains striking that such differences appear across national boundaries.

Relatively most important goals

UK	Germany
This years' profit	Respons. towards employees

Staying within the law	Response. towards society
Response. towards employees	Creating something new
Continuity of the business	Gambling and gambling spirit
National pride	Continuity of the business
Respecting ethical norms	Honor face reputation

Source : Hofstede et al., 2002

Cultural differences are documented across other dimensions; for instance, regarding ethical standards, Jackson and Artola (1997) found significant differences in the attitude of German and French managers in accepting gifts and favours in exchange for preferential treatment . It was also found that American managers that are expatriates in Hong Kong behave similarly to their American counterparts in the US. This arises despite the fact that these behaviours are positively related to job performance for the managers in the U.S., but not related to job performance of the expatriates in Hong Kong.

This evidence strikes with intuition; managers from different cultures have different goals, different ethical standards and respond to different incentive mechanisms but the implications of this observation are less clear. Arguably, domestic managers and shareholders may have a better understanding of local conditions and constraints and their decisions may be better understood by local constituencies. But managers and shareholders from different cultures may have a better understanding of foreign clients and competitors. That is also to say that domestic shareholders and managers will not necessarily take better decisions in terms of long term profitability. Different business decision might actually be associated with different development paths for the firm which correspond to different equilibrium outcomes in terms of competition. In this perspective , different types of competitive interaction can take place and decisions by managers and shareholders from different cultures can be seen as a mechanism of equilibrium selection. But, it is hard to argue in principle that the development path associated with dominant national control is inherently superior to the others. This is inherently an empirical issue for which we will review some of the empirical evidence.

3. Evidence on domestic ownership, control and performance

Before turning to more systematic empirical evidence, let me highlight, through a particular illustration, some of the potential consequences of interfering with ownership and the nationality of owners. As mentioned earlier, the acquisition of Arcelor by Mittal gave rise to public concern. Only politically incorrect commentators would mention nationality explicitly and much of the debate focused on the corporate structure of Mittal, in which control is exercised by small of number of family members (through a complex web of companies and preferential shares). It is instructive however to consider the corporate structure of Arcelor per-merger: 87% of the shares Arcelor's shares were in the hands of individual shareholders while governments (from Luxemburg, Belgium and Spain) States held the rest. The board did however not reflect this allocation ; out of 18 members, 13 were in a way or another very close to governments (according to my own judgement), giving them governments de facto

control of the management board. In addition, there were three representatives from the trade unions, and very few indeed left to represent 87% of the shareholders. Furthermore, the statutes stipulated that shareholders could not propose resolutions to the board and capital increases could be undertaken (within certain limits) without the consent of the majority of shareholders.

It is of course hardly a surprise, that in this environment, Arcelor had a very hard time to convince shareholders not to accept the offer from Mittal. Arguably issues of ineffective corporate control were more relevant for Arcelor than Mittal. But this also illustrates however one of the potential drawback of governments interfering with ownership (be it on the ground of nationality of some other dimension); it may be hard for government to commit not to interfere beyond what is required to address legitimate public policy goals.

Let us now turn to more systematic evidence on the potential link between the nationality of ownership and performance. There is a relatively large literature which support what has become a conventional wisdom, namely that multinational firms do outperform domestic ones. The transformation of Eastern Europe has provided a very useful laboratory experiment to analyse the effect the ownership and nationality on restructuring. I will refer in particular to the transformation of the banking sector. In a second stage, I will review some of empirical literature that exploits panels across sectors.

3.1 Transformation of the banking sector

Let me shamelessly advertise some of my own work in this area. In a recent paper (Fries et al., 2006), we estimated a revenue and a cost function for a large sample of banks in transition countries and attempted to account for differences in performance across banks over time. Table 1 summarizes some of results. This table presents the interest margins earned by the banks, the marginal cost and the resulting markup (on marginal cost) for different types of banks. State owned banks are the control group. Two striking features emerges from this table. First, foreign ownership is always associated with lower management costs Second, even if state owned banks may have has a marginal advantage in terms of interest margins relative to domestic entrants, this advantage has disappeared in later periods. State owned banks that often have been protected from foreign investors do worse in terms of interest margins.

Table 1: Banks in Transition Countries: margins, marginal costs and mark-ups on loans and deposits

	1995-1998			2002-2004		
	Margins	Marginal Cost	Mark up	Margins	Marginal 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)

The polish bank PKO may be of a good illustration. PKO was protected twice. First, at the time at which privatization plans were formulated (sept 2004), parliament decided

that foreign investors would not be allowed. The Commission objected and in Nov 2004, 37.7 % of the shares were sold, 8.5 % went to foreign investor but the bank remained under public control (with the Ministry of Treasury holding 50 % + 1 share). Second, in 2005, the second largest bank, Unicredito announced its intention to buy HVB, the third largest bank. The merger entity would had become the largest bank, ahead of PKO. The merger was notified to the Commission which concluded that it was compatible. Additional remedies were however imposed by the polish government, such that 30 % of retail clients of HVB and about 200 outlets had to be divested. Unicredito/HVB, which is now at par with PKO has thus arguably not been allowed to become "excessively" competitive.

3.2 Evidence across sectors

A number of surveys document the conventional wisdom that, for a given national market, multinational firms outperform domestic ones (see among others Griffith, 1999). For instance, studies on a cross-section of firms have found that, in a number of countries, profits and total factor productivity of foreign owned firms are higher . And differences can be economically significant (18% comparing EU owned firms with UK firms for instance). Research also indicates that foreign owned firms may adopt new technologies faster than UK firms. It is also found that foreign firms pay higher wages, which may be related to the observation that they have higher capital-labour ratios and hence higher labor productivity. Foreign firms also appear to generate knowledge spillovers and here again the effect may be significant. It is found for instance that spillovers from Foreign Direct Investment could account for 14 percent of productivity growth in the US[4].

These studies should however be interpreted cautiously (see Griffith et al. 2004). First, there may be an aggregation bias in particular because there may be a higher proportion of foreign owned firms in sectors with high productivity. Second, there may be an issue of identification: it may very ell be that that what leads to high productivity is not foreign ownership, but the fact that a firm is a multinational. And finally, there may be an issue of "cherry picking"; foreign-owned firms may appear to be more productive simply because they happened to have acquired the most productive domestic assets.

Fortunately there is new evidence for France and the UK which exploits very detailed data at the plant level that has become available recently and addresses these potential biases. I am going to refer to work that has been undertaken for the UK by Griffith et al. (2004) but there are similar results for France.

Griffith et al (2004) analyse labour productivity and value-added per employee, among British firms that are owned by British shareholders, British firms that are owned by British multinationals and British firms that are owned by foreign multinationals.

Table 2: Characteristics of foreign-owned and host country establishments

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4 Evidence from time series, i.e. changes in ownership, is more agnostic. For instance, Mueller et al. (2002) find that that after an acquisitions profits do not change, relative to a control group of firms that did not merge, although there is a large variance. Sales fall significantly relative to the control group, by as much as 14% within 5 years. However, there is no significant difference for domestic and cross-border acquisitions, and nationalities of the target or acquirer do not matter.

	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 sector			
Value added/employee	94	113	120
Investment/employee	96	105	119
Intermediate inputs/employee	93	108	133

Source: Griffith et al. (2004)

Table 2 shows that being part a multinational groups affects productivity. The evidence actually suggests that performance is affected as much by the type of firms as by nationality. Conditional on a firm being multinational, foreign ownership has a marginal effect at least according to some indicators.

Table 3: 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 sector				
Value added/employee	115	117	94	101
Investment/employee	142	157	99	101
Intermediate inputs/employee	124	146	96	99

Source: Griffith et al. (2004)

Table 3 considers a panel and shows the characteristics of the establishments that are targets of acquisitions, in terms of labour productivity, before the merger and for the three years that follow. All levels are indexed with the industry average of the corresponding year. The first two columns refer to domestic firms taken over by foreign multinationals, and the last two refer to domestic firms that are being taken over by domestic multinationals. This evidence first indicates at least in terms of most indicators that the performance improves after the acquisition. The improvement is not clearly superior when a foreign multinational is involved relative to a domestic multinational. Finally, it is observed that targets in the manufacturing sector tend to have a poor performance before the acquisition. Hence, there is no "cherry picking". By contrast, there is evidence that foreign multinational target the high performers in the service sector.

With respect to R&D, Table 4 shows that multinationals have a higher level of R&D than domestic firms. However, British multinationals have a more intensive level of R&D than foreign-owned multinationals. This evidence indicates that multinationals

display a strong R&D intensity but also confirms that there is a home bias in R&D, i.e. that multinationals undertake a disproportionate amount of R&D in their home base.

Table 4: R&D activity and ownership

	British domestic	**British-owned multinationals**	**Foreign-owned multinationals**
Pharmaceuticals & chemicals			
Percent total intramural R&D expenditure	16	52	32
Intramural R&D expenditures as % value added	19	42	23
Intramural R&D per production employee (£)	7,660	27,320	16,170
R&D employees as % production employee	12	28	12

Source: Griffith et al. (2004)

To sum up, this evidence suggests that the nationality of ownership may actually matter less than the multinational character of the firm in terms of performance. But one should not conclude that foreign ownership can be restricted without cost in terms of performance; indeed, a domestic multinational is a firm that has been allowed to invest abroad and would not have become more efficient without access to foreign assets. What is required is to allow for open capital flows. Restrictions on foreign ownership are restrictions on the growth of multinationals and as such an impediment to productivity growth.

4. Conclusion

In conclusion, it is hard to find a good case in favour of restricting foreign ownership of domestic assets in terms of efficiency. Even at the level principles, there is no clear cut case. The empirical evidence reveals that multinational character of the firms may actually matter more for growth and productivity than the actual identity of the shareholders. But the growth of multinational firms requires access to foreign assets so that a presumption against interference remains. In addition, admittedly anecdotal, evidence confirms that government may find it difficult to commit to not to interfere beyond is required to achieve possibly legitimated public policy objectives. Some scepticism towards the promotion of national champions by restricting foreign ownership is thus warranted.

When sovereign national funds are involved, additional issues arise. Investment flows from funds controlled by governments that may have conflicts with the EU involves additional risks and opportunities. In the long term, stakes in EU firms will create a commonality of interests. But there is a risk that sovereign funds might be in a position to impose significant costs on EU economies or threaten to do so. Such strategy would in all likelihood involve significant opportunity cost for these funds but they may find it attractive because of some other dimension unrelated to the investment at stake Accordingly, large sovereign investments from countries which are not long term security partners may require a policy response and preferably at the EU rather than national level.

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