State-owned enterprises experience greater regulatory scrutiny when acquiring firms abroad: Study

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New research shows that state-owned enterprises (SOEs) experience greater regulatory scrutiny when acquiring firms in foreign economies, thus increasing the costs of the acquisition.

The study, published in *Global Strategy Journal*, suggests that a liability of stateness is at play, a phenomenon that occurs when host country stakeholders consider the SOE to be less legitimate and acting as a representative of a foreign political power. However, the research also showed that an SOE's acknowledgment of the social and political dynamics at play could help temper this liability.

According to study authors Cheng Li of the University of Manitoba and Klaus Meyer of Western University, ideological conflicts arise when SOEs attempt to make acquisitions in societies with a strong market capitalism ideology, such as the U.S. Because these societies view state ownership with suspicion and disapproval, it results in SOEs being 9% more likely to attract additional regulatory scrutiny than comparable private-owned enterprises.

One notable example of this effect was the Dubai Ports World controversy from 2006: At issue was the sale of port management businesses in six major U.S. seaports to a state-owned company in the United Arab Emirates. The U.S. House Committee on Appropriations voted to block the deal over concerns about national port security, and DP World dropped the deal.

Li and Meryer explored the notion of liability of stateness in the study by using a sample of cross-border acquisitions with acquirers from 44 economies and targets in 50 U.S. states. While they identified the increased regulatory scrutiny, they also found two ways to combat the liability.

First, the acquiring state-owned foreign firms were less likely to receive additional scrutiny when they acquired a firm through subsidiaries rather than through parent organizations. This makes the state influence less visible, raising fewer concerns of foreign government influence among regulators.

Second, SOEs can work with local communities to overcome the negative perception if the acquisition helps the local economy. The study used local employment data to find that SOE acquirers face less additional scrutiny in communities with high unemployment. This is because local stakeholders will prioritize economic opportunities in their region over ideological concerns in times of economic crisis.

As an example of the latter approach, the study highlighted the 2010 acquisition of Nexteer Automotive in Saginaw, Michigan, by China's Aviation Industry Corp—a major SOE. The region was suffering from job losses and economic decline, but the Chinese firm fought off competition from private firms and successfully navigated the regulatory process largely by committing to local employment.

"For managers of SOEs, when they go into a foreign country, they have to consider the social and political aspects right along with the economic aspects," Li says.

"For instance, if the local region or the target region has a high level of unemployment, and foreign SOEs have the reputation of taking jobs away, they can instead create jobs in the local regions." Not only will this strategy help mitigate additional regulatory scrutiny and related costs, Li says, but it can also set a good example for similar businesses to be successful in the future.

More information: Cheng Li et al, All politics starts local: Liability of stateness and subnational labor markets, *Global Strategy Journal* (2023). DOI: 10.1002/gsj.1500

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