Do state owners constrain or facilitate corporate strategies of internationalisation?

A changing landscape

The global sources of foreign direct investment is changing, and state-owned enterprises (SOEs) are an increasingly large proportion of the pool of available global capital. In 2013, SOEs invested $US160 billion internationally, representing 11 per cent of global foreign direct investment flows, despite making up 1 per cent of total multinational corporations.

SOEs also dominate cross-border M&As: out of the fourteen largest foreign investments of Chinese financial institutions, nine were undertaken by state-owned entities. While we traditionally think of China and perhaps the other BRIC (Brazil, Russia, and India) countries as sources of SOE foreign direct investment, listed SOEs are a much wider phenomenon: they are common in many emerging economies, and play important niche roles in several West European countries as well as Japan, the US and indeed Australia.

Over the last decade, there has been a significant increase in Chinese SOE investment in Australia, with SOEs accounting for nearly 90 per cent of $20.8 billion of total Chinese investment in Australia, while other foreign SOEs – including from Japan, South Korea, Singapore, and Malaysia – have a history of investing in Australia.

State-owned enterprises (SOEs) differ from wholly privately owned firms (POEs) in terms of their governance, attitude to risk and access to resources. Moreover, the processes owners use to shape the strategies of their firms depend upon the institutional framework under which they operate. Hence, even firms with similar types of ownership may make different strategic choices when institutional contexts vary. So we set out to investigate the following: under what institutional conditions do state owners facilitate or constrain corporate strategies of internationalisation?

Motives for international investments and invest behaviour

There are three mechanisms through which owners create incentives to invest internationally: (1) they set objectives, (2) they shape the governance structure, and (3) they appoint management teams that eventually design and implement their strategies.

The primary objective of private-owned enterprises (POEs) is the maximisation of profits. SOEs, however, may introduce non-commercial motives into firm objectives. SOEs are also necessarily subject to more complex governance structures than POEs, which can create dysfunctional incentives for decision makers in SOEs. In particular, SOEs are subject to two mutually reinforcing agency conflicts: the first between the public and the government, and the second between the government and the SOE management.

What this essentially means is that state ownership introduces the possibility of diversion of company resources from outcomes that would pertain under private ownership, introducing a bias in favour of domestic over overseas investments.

In our cross-country comparison* of state-owned and privately owned firm's foreign direct investment behaviour, we found that strong controls will limit the ability of representatives of the state to impose objectives upon the SOE that (1) deviate from the interests of minority shareholders; (2) limit the ability of managers to exploit principal–principal conflicts to their own benefits; and (3) ensure that managerial qualifications rather than political alignment drive the selection of top management teams.

If, on the other hand, institutional control mechanisms are weak, strategies of listed SOEs and POEs with respect for example to internationalisation will diverge; SOE managers will use their insider power to pursue personal objectives to the detriment of profitability, such as displaying a home country bias.

Managers around the world increasingly face new types of competitors, especially from emerging markets that are state owned. To fully appreciate the motivations and strategies of an SOE, managers need to evaluate and understand the institutional environment of its country of origin.

If the cultural traditions of a country support strong controls over elites, or reforms strengthen formal institutions or governance arrangements, then state ownership may not imply great deviation in behaviour from what would occur under private ownership.

However, where institutions do not provide adequate controls over the state apparatus and management, listed SOE internationalisation strategies are likely to substantively differ from those of their privately owned counterparts. Specifically, SOEs under weak control institutions are likely to exploit domestic opportunities, including rent seeking opportunities, and pursue foreign investments primarily where they can leverage their political assets. This may influence how managers of Western private firms can interact strategically with state owned competitors in the global market place.

**Cross-country sample of 153 majority state-owned listed firms matched (compared) with 153 wholly privately owned listed firms of similar size and from similar industries, representing 20 different countries, both developing and developed. All firms are among the 5000 largest multinational firms in the World.*

Notes:

- *To read more about this topic check 'Home country institutions and the internationalisation of state owned enterprises: A cross-country analysis'.*

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