CIRIEC International Conference

THE FUTURE OF PUBLIC ENTERPRISE

Role and Governance in the Implementation of Innovative Strategic Policies and Economic Development

Paris, February 25th 2015
Centre "Pierre Mendès France" in Bercy

Public Enterprises in a Global Perspective

Massimo Florio
Università degli Studi di Milano, Italy

Synthesis of the presentation

There is a renewed interest in public enterprises for at least five reasons:

1) *Despite mass privatization since the 1980s governments still own and manage substantial productive assets in many countries.* According to *The Economist:*

> "State-owned enterprises in OECD are worth around USD 2 trillion. Then there are minority stakes in companies, plus USD 2 trillion or so in utilities and other assets held by local governments." (January 11-17, 2014, p. 7)

Thus, the first reason to study public enterprises is simply that they exist, and are vital economic organizations. An OECD paper by Kowalski *et al.* (2013) offers some evidence related to companies included on the Forbes Global 2000 list in 2010, augmented with the Orbis database. They consider sales, profits, assets, and market value, equally weighted to rank global firms, and they attribute the SOE label to those companies for which, according to Orbis, the ultimate ownership is more than 50.01% of the shares. Forbes Global 2000, however, excludes from the list some organizations which are in fact among the largest in other world rankings. Moreover, some of the core SOEs in the world, particularly in Europe, are effectively controlled by governments with a stake 25% (or even less), to be compared with much more dispersed equity owned by other shareholders (another OECD paper, by Christiansen and Kim, 2014, uses a more flexible definition of State invested enterprises, SIEs). Around ten percent of the companies of Forbes in 2010 (204 out of 2000) are SOEs. 'Forbes' SOEs (under the most strict definition of absolute majority holding) would represent:

- 11.15% of total sales in the Forbes top global companies list
- 13.51% of total profits
- 16.38% of total assets
- 13.36% of total market value.

Given that, as mentioned, the share of SOEs in the list is 10.02%. In terms of number, it seems safe to conclude that the average SOE performs *better* than the average Forbes company in the list, as follows:

- 11.28% more in terms of sales per firm
- 34,83% more profits per firm
- 63,47% more assets per firm
- 33,33% higher market value per firm.

There are three other indicators that might be interesting. Taking ratios of profits and sales, we can get a crude ROS estimate around 2010; and the ratio of profits and assets, or market value, respectively, would give us a crude estimate of ROA and ROE. Under this perspective, the average ROS in the list is 5.10%, while SOEs show a brilliant 8.77%. ROA in the total list is 1.69%, while it is 1.40% in the SOEs; and ROE is respectively 6.33% and 6.41%. Thus, using the most common financial ratios, the large SOEs outperform the world league of major companies in terms of ROS; slightly also in terms of ROE; while they underperform in terms of ROA (given the substantial assets they own). This picture, while crude and partial, may contribute to explain the survival and activism of SOEs: they simply perform well, even better than private (listed) firms, at least in the league of major global players, own substantial assets and earn profits. Firms in the top league are located in countries as diverse as Brazil, Russia, India and China (BRIC) but also in advanced economies as Norway, France, Switzerland and others.

In more recent research at the University of Milan (Clo' *et al*. 2015, available in REPEC), by merging the Forbes and Orbis (BVD) data, back from 2013 to 2004, we study the performance of 1069 top listed companies of the world over ten years and we find that public enterprises (defined in this sample where the top shareholder is government) *grow faster than their private counterpart in terms of sales, assets, employees*. The return on sales for the median public enterprise is higher than for the median private one, while return on assets (ROA) and on equity (ROE) are not significantly different. In other words, major public enterprises are performing at least as well as their private counterparts, particularly in important sectors as energy and telecoms.

Research is needed to understand what, to a certain extent, seems to be a new feature of the contemporary economy. What is the importance of public enterprises in a global perspective? Why do governments still own productive capital? Are these enterprises efficient and innovative compared with their private counterparts? Are they distorting markets or performing a useful role?

Table 1. Performance of top listed global companies (2004-2013)*

Variables	**Ownership**		
	Total	**Public**	**Private**
Total Assets (Euro)**	13	18	13
Sales (Euro)**	8	7	8
Employees	26.615	30.722	26.358
ROS (Ebitda/Sales)	18,7	26,3	18,4
ROE before taxes	19,2	19,1	19,2
ROA before taxes	6,8	6,6	6,8
Total Asset/Employees***	0,5	0,5	0,5
Sales/Employeee***	0,3	0,2	0,3

Source: Clo' et al. 2015 from Forbes Global List 2000 and Orbis (BvD) data

Non-missing observations.

** Mediana over years for unbalanced sample*

*** Billions Euro*

**** Million Euro per Employee*

2) *A second reason of the current renewed interest in public enterprises is the evidence that, following the Great Recession since 2008, nationalization or other forms of State control were the immediate response by several governments to the collapse of a range of corporations.* Core banks in the UK, as the *Royal Bank of Scotland*, top car companies in the US as *General Motors*, and several other large organizations in the US and in the UK had to be rescued by governments of countries where the dominant neo-liberal thinking was hostile to state-owned enterprises (SOE). The simple fact that these governments (and others) have considered and implemented such nationalizations, even if admittedly as exceptional and temporary emergency solutions, is similar to what happened during the Great Depression in the 1930s, when many SOEs were created for similar reasons. The fact that managers appointed by governments, and capital provided by governments, had to rescue private enterprises, has focused the attention to the fact that ultimately governments still perceive to have certain responsibilities and capacity when confronted with the possible breakdown of organizations of systemic economic importance. This has shifted the previous consensus according to which it was never desirable for governments to take the control of firms.

3) *A third issue is re-publicization of formerly privatized firms providing services of general interest, or re-municipalization of local public services.* There is wide evidence that particularly municipal governments, after the experience of concessions or other form of involvement of private capital in water or other local services, concluded that such arrangements were not in the interest of citizens, and reverted to direct management of public services. In the case of water, examples of re-municipalization can be found in countries as diverse as France, Germany, US, and several ones in Latin America, etc. (see *http://www.remunicipalisation.org*) What are the drivers of these changes?

4) *Fourth*, there is wide evidence in network industries, particularly in energy and telecoms, in the European Union as elsewhere, of a good performance of SOE or of firms where governments are shareholders. In the EU, where the market has been opened to competition, major enterprises controlled or at least considerably invested by governments can be observed in electricity in France, Italy, in Nordic countries and in the Central and Eastern Europe. Even in the telecommunications, the industry where privatization started in the UK with the divestiture of *British Telecom*, the government is an important shareholder of some important players, in Germany, France, in the Scandinavian countries, etc. Research at the University of Milan (Florio, 2013, *Network Industries and Social Welfare. The experiment that reshuffled European Utilities*, Oxford University Press) shows that often consumers enjoy lower prices and higher satisfaction in countries where there is a public enterprise in the market. Moreover, these public enterprises are profitable. How can we explain this performance? How was the management of the public enterprises able to react to the transition from monopoly to market opening? Are the regulators more lenient with public enterprises, as somebody suspects, or, simply, is their management good?

5) *Fifth*, research at the University of Milan and with CIRIEC[1] as well as at the OECD[2] have noticed the new acquisition activism of State-owned enterprises, from China to Brazil, from France to Italy, which have been involved in important acquisition deals involving as targets private firms, including often abroad. An important finding of this novel research line is that public enterprises as acquirers do not violate the inefficient management hypothesis.

[1] http://www.publicenterprise.unimi.it/
[2] http://www.oecd.org/daf/ca/soeworkingparty.htm

Clo' *et al*. 2014 have constructed a new database on 13.475 deals that took place worldwide during the period 2004-2012 among private and public enterprises, based on data from two global databases managed by Bureau Van Dijk. As expected, in general, acquirers are larger than their respective targets, much in line with previous literature. Similar conclusions are reached when considering financial performance indicators, suggesting that acquirers out-perform their targets. This result is also in line with previous literature, which has focused on M&As among privately-owned enterprises only. Interestingly, these results are confirmed when focusing on public acquirers, a distinction which is entirely novel to the literature. Public acquirers are both larger (in terms of assets, employment and turnover), and characterized by higher financial performance indicators (ROS and EBIT, but not ROA), than their private and public targets. This finding confirms that government ownership of firms, even in the relatively narrow perspective of financial performance, does not contradict the 'inefficient management hypothesis'. Managers of some more efficient SOEs target and acquire less efficient (in the conventional meaning of the financial literature focusing on profitability) private and public firms, similarly to what managers of more efficient private firms do in deals involving private or public firms as targets. In this perspective, some SOEs as acquirers are contributing to the efficiency of the market for ownership, according to the standard framework. This may be considered a surprising result if SOEs were systematically associated with pervasive inefficiency. These new findings thus seem to reject the widely held view that SOEs are always inefficient compared to private firms, or that their acquisitions are mainly politically motivated, i.e. without due consideration of efficiency.

Finally, with respect to the dynamics of deals, we can notice that both public-private deals and privatizations seem to have been influenced by the current economic crisis. In detail, public-private deals have peaked around 2009-2010, while privatizations, around the same years, have experienced a slow-down, then increasing again. While we are not able to evaluate the underlying mechanisms, a possible explanation of the apparent cycle is related to both the governments' responses to the crisis and the behavior of the stock market. We cannot offer forecasts about the future of such trends.

Thus, how did it happen that SOEs, a supposedly moribund type of organization, one that would have been supplanted as an anachronism by privatization, is in fact able to shop assets around the world?

Summing up and further reading

The five reasons for a renewed interest in public enterprises presented above, explain the increasing interest on the topic by researchers. Further material can been found in the recent special issue of international scholarly journals: the *Journal of Economic Policy Reform* (2014)[3], and in previous special issues of *Annals of Public and Cooperative Economics* (2012)[4] and of *International Review of Applied Economics* (2013)[5]. CIRIEC's *Annals* are also going to publish a new special issue based on papers presented at CIRIEC seminars. See also the special issue by the *Journal of International Business Studies* (2014)[6].

Six European universities (Università degli Studi di Milano (IT), Åbo Akademi University School of Business and Economics (FI), University of Greenwich (UK), Universität Leipzig (DE), Université de Rouen (FR), WU Wirtschaftuniversität Wien (AT)) have also been awarded, after a selective process, a co-funding by the European Commission to involve students and civil society in the debate on public versus private provision of services of general interest (see *http://users.unimi.it/eusers/about-us/eusers-network/*).

[3] Available at http://www.tandfonline.com/toc/gpre20/17/3#.VNDfx2iG9qU
[4] Available at http://onlinelibrary.wiley.com/doi/10.1111/apce.2011.82.issue-4/issuetoc
[5] Available at http://www.tandfonline.com/toc/cira20/27/2#.VNDfb2iG9qU
[6] Available at http://www.palgrave-journals.com/jibs/journal/v45/n8/abs/jibs201443a.html

CIRIEC's International Scientific Commission "Public Services / Public Enterprises" has currently planned additional research on these topics. The XIV Milan European Economy Workshop (June 25-26, 2015) will focus on the Major Public Enterprises through country studies. More than twenty national teams have already expressed their interest and a call for paper is still open (*http://www.ciriec.ulg.ac.be/fr/telechargements/Call%20for%20papers_Major%20PE_25%20July.pdf*). The EUsers Jean Monnet Network plans 45 seminars in three years, a Summer School, and a final conference (Université de Rouen, 2017). The proposal of a 'Handbook of Public Enterprise' is also being considered by CIRIEC for the future, building on both positive analysis and theory.[7]

References

CIRIEC (2012), The future of public enterprise mission, performance and governance: Learning from success and failures. A research agenda 2012-2014. Paper drafted by Massimo Florio and adopted by the Steering Committee of the Project: available at http://www.ciriec.ulg.ac.be/fr/telechargements/CIRIEC_project_FUTURE%20of%20PE2012-2014_%20with%20template.pdf

Clo' S., Fiorio C., Florio M. (2014), "Ownership and Performance in the Market for Corporate Control: The Role of State-Owned Enterprises", Working Paper n. 2014-17, Department of Economics, Management and Quantitative Methods at Università degli Studi di Milano.

Clo' S., Del Bo C., Ferraris M., Fiorio C., Florio M., Vandone D. "Publicization versus Privatization: Preliminary Findings 2000-2012", CIRIEC working papers, http://www.ciriec.ulg.ac.be/en/pages/6_2working_papers.htm

Clo' S., Ferraris M., Florio M. (forthcoming 2015), "L'impresa pubblica in prospettiva globale nell'ultimo decennio/Public enterprises in a global perspective in the last decade", Working Paper, Department of Economics, Management and Quantitative Methods at Università degli Studi di Milano.

Cuervo-Cazurra A., Inkpen A., Musacchio A., Ramaswamy K. (2014), "Governments as owners: State-owned multinational companies", *Journal of International Business Studies*, 45, 919-942 doi:10.1057/jibs.2014.43.

Florio M. (2013), *Network Industries and Social Welfare. The Experiment that Reshuffled European Utilities,* Oxford University Press.

Florio M., ed. (2013), "Public enterprises and quality of institutions: alternatives to privatization", *International Review of Applied Economics*, Special Issue, Vol. 27, Issue 2.

Florio M., ed. (2014), "Critical Issues in Public Enterprise Reform", *Journal of Economic Policy Reform*, Vol. 17, Iss. 3.

Florio M. and Fecher F. (2011), "The future of public enterprises: contribution to a new discourse", *Annals of Public and Cooperative Economics*, Vol. 82, n. 4.

Christiansen H. and Y. Kim (2014), "State-Invested Enterprises in the Global Marketplace: Implications for a Level Playing Field", *OECD Corporate Governance Working Papers*, No. 14, OECD Publishing. http://dx.doi.org/10.1787/5jz0xvfvl6nw-en

Kowalski, P., *et al*. (2013), "State-Owned Enterprises: Trade Effects and Policy Implications", *OECD Trade Policy Papers*, No. 147, OECD Publishing.

The Economist (2014), January 11-17, p. 7.

[7] On the theoretical perspective see: Del Bo C., Florio M. (2012), "Public enterprises, planning and policy adoption: three welfare propositions", *Journal of Economic Policy Reform*, 15 (4), 263-279.