
ECGI GCGC 2018

Slutsky

“The Hidden Costs of Being Public: Evidence from Multinational Firms operating in Emerging Markets”

discussion by:

Pedro Matos



The Costs of MNCs Doing Business in EM:

- Currency controls / Inconvertibility
 - > *Argentina? YES!*
- Regulatory changes / Discriminatory regulation
 - > *Argentina? YES!*
- Breach of contracts / Expropriation / Nationalization
 - > *Argentina? YES!*
- Sovereign default
 - > *Argentina? YES!*

...

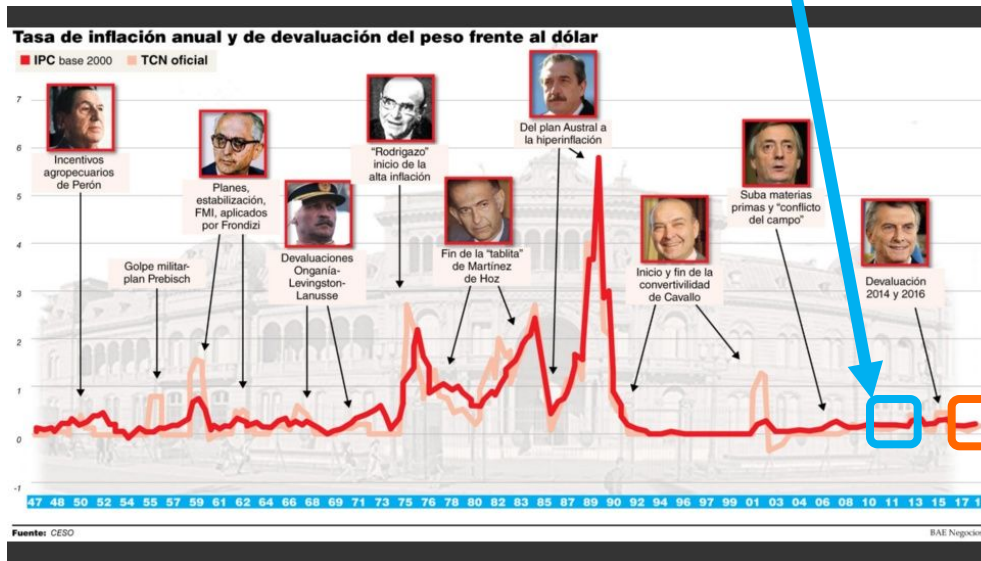
The Costs of MNCs Doing Business in EM:

- Currency controls / inconvertibility

-> Argentina? YES!



This paper: 2011's cepo cambiario (the "exchange clamp") => Argentine Ban on Profit Repatriation by MNCs



The Economist (2015) "**Argentina lifts controls on the peso**"
 "(...) In November **American Airlines** - which flies 27 times a week to Buenos Aires - stopped selling tickets in pesos because it was not allowed to repatriate the earnings. Coca-Cola, Clorox and Telefónica faced the same problem. (...)



The Costs of MNCs Doing Business in EM:

- Currency controls / Inconvertibility
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 - > *Argentina? YES!*

Protectionism in Argentina

Keep out

South America's two biggest economies are imposing heavy-handed trade restrictions. Our first article looks at Argentina, our second at Brazil

Sep 24th 2011 | BUENOS AIRES

Timekeeper

Like 494

Twot



The Economist (2011) “**Keep Out**”

“(…) On the import side, Argentina cannot raise tariffs on its own because it belongs to the Mercosur customs union. So it is resorting to informal tools. Its main method is “non-automatic licensing”, a tactic recognised by the World Trade Organisation that lets countries delay imports for 60 days. In January it expanded the list of products requiring licences from 400 to 600. It was a limit on phone imports that led Research in Motion to hire Brightstar to **make BlackBerrys in Argentina** (tax incentives then led the firm to Tierra del Fuego). (…)”

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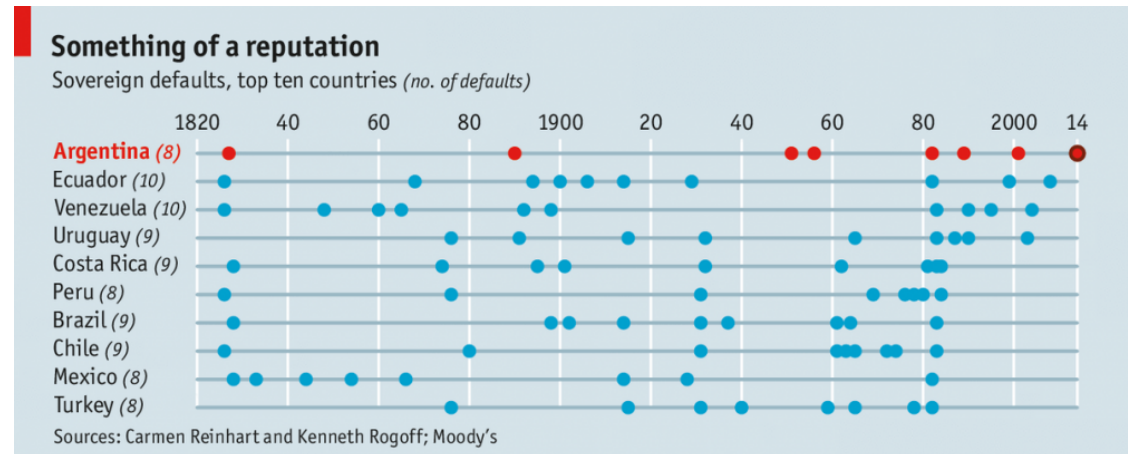
The Economist (2012) “**Fill'er Up**”

“(...) First they came for the pension funds. Then they went for the central-bank reserves. Argentines have wondered for years which kitty Cristina Fernández and her government would grab next to satiate their appetite for cash. On April 16th they got an answer, when she announced she would send a bill to Congress to nationalise 51% of YPF, the former state oil firm. It will exclusively target the shares that Spain's Repsol bought in 1999, six years after YPF was privatised. “We are the only country in Latin America, and I would say in the world, that doesn't control its natural resources,” she declared(...)”

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-> *Argentina? YES!*



The Costs of MNCs Doing Business in EM:

-> *Argentina is certainly a great “natural laboratory”! ...*



The Costs of MNCs Doing Business in EM:

-> BUT profit repatriation by MNCs not just an issue in Argentina! ...
 ex: listed MNCs listed subsidiaries in India (but also Mexico, Turkey, etc.)



MNCs

ROYALTIES V DIVIDENDS

MSCI
 MORE DATA
 MORE CONTEXT
 MORE INFORMED DECISIONS

- Royalty payments to the multinational parent company typically relate to the transfer of technology or licensing IP rights.



Source: Latest published annual reports available as at 8 February 2017, Notes to the Consolidated Financial Statements (Related Party Transactions). Any item noted as Royalty, Technical Service Fee, Professional, consultancy or other charges and paid to the parent company or fellow subsidiaries has been included. Net Profit is before any exceptional items. Dividend payout excludes any dividend taxes.

Note: Bosch declared a special dividend in February 2017.



Source: MSCI ESG Research, Feb 2017

Paper 1: Argentina Feb/2012: Rule A5264 Ban on Profit Repatriation (transfer royalties or earnings)

- Customs Data (2010-2014) for HTS codes 84.07, 84.08, 84.09

-> *why is it confidential data? can you list MNCs ?*

-> *why specific industry: automotive aftermarket (84.07-09)?*

Harmonized Tariff Schedule (2018 HTSA Revision 4.1)

Search Results : 68

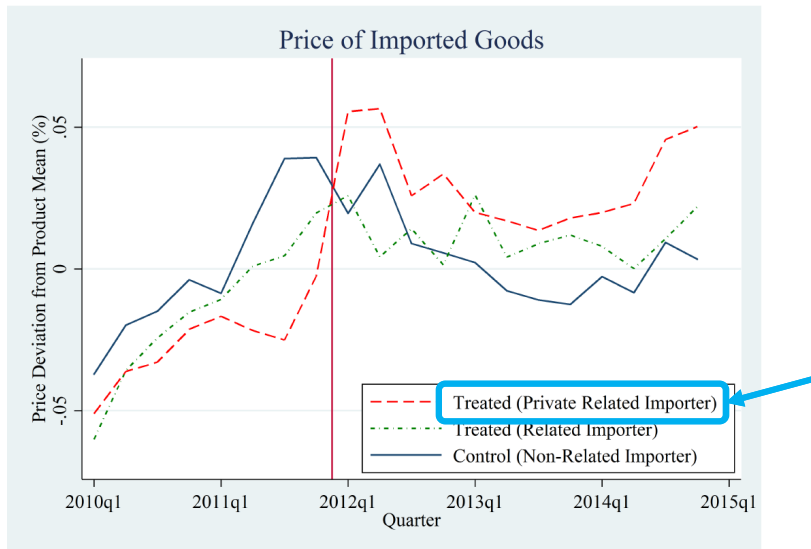
| Heading/ Subheading | Stat Suf fix | Article Description | Unit of Quantity | G |
|------------------------|--------------------|--|------------------------|------|
| 8407 | | Spark-ignition reciprocating or rotary internal combustion piston engines: | | |
| 8407.10.00 | | Aircraft engines | | |
| 8407.10.0020 | | Less than 373 kW | | Free |
| 8407.10.0040 | | 373 kW or over | | |
| 8407.10.0060 | | Used or rebuilt | | |
| 8407.10.0090 | | Other | | |
| | | Marine propulsion engines: | | |



Paper 1 (Cont.):

- Customs Data (2010-2014) for HTS codes 84.07, 84.08, 84.09
- WIPO Global Brand Database: identifying exporter
- 850,000 import transactions; 37 of 73 importers are MNC subsidiaries (23 listed companies, 14 private companies)

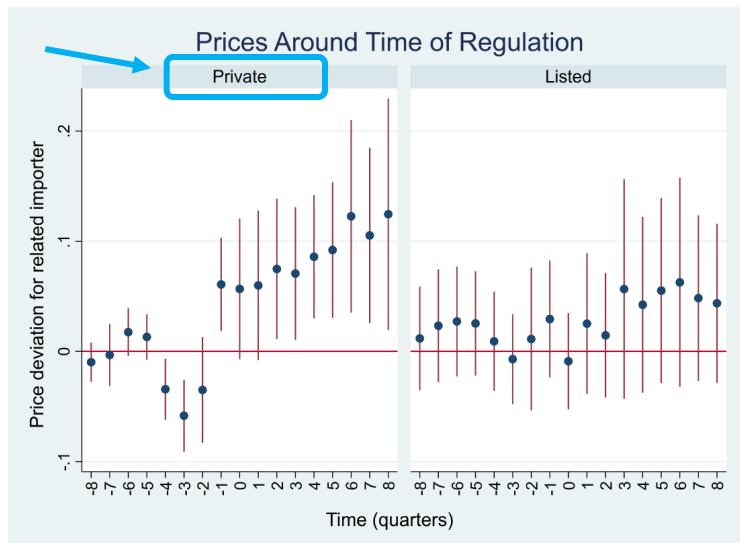
Figure 4: Price paid by related and non-related importers, before and after the regulation



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Figure 6: Quarter-by-quarter evolution of prices paid by private-related and listed-related importers



-> nice DiD setting:
“transfer over-pricing” as
repatriation mechanism for
private (non-listed) MNC
subsidiaries

Paper 1 (Cont.):

T1: DiD: Treated = (Private) “*Related*” MNC Subsidiary ($\beta_{pr} > 0$!)

$$P_{ijkt} = \alpha_i + \alpha_m + \beta_p * Post + \beta_r * Related_{jk} + \beta_{pr} * Post * Related_{jk} + \epsilon_{ijkt}$$

Table 1: Transfer Mispricing Mechanism

| Price | (1) Private firms | (2) | (3) Listed firms | (4) | (5) Difference (1) - (3) |
|----------------|-----------------------|-----------------------|----------------------|----------------------|-----------------------------|
| Post | 0.00376 (0.020) | 0.00172 (0.020) | 0.00861 (0.017) | 0.00810 (0.017) | -0.00485 |
| Related | -0.0530*** (0.018) | -0.0548*** (0.017) | -0.0889** (0.039) | -0.0892** (0.039) | 0.0359 |
| Post × Related | 0.0996*** (0.031) | 0.0990*** (0.031) | 0.0134 (0.017) | 0.0133 (0.018) | 0.0862*** |
| Product FE | Yes | Yes | Yes | Yes | |
| Month FE | No | Yes | No | Yes | |
| N | 430,846 | 430,846 | 787,591 | 787,591 | |

T2-T4: DiD controlling for size (\$ volume imports), concentrated ownership (10%), visibility (Factiva news), taxes

Paper 1 (Cont.):

Expand “Paper 1” on Profit Repatriation by MNCs ...

- > *Test further “transfer overpricing” mechanism with Argentinian data:*
 - . *beyond specific automotive aftermarket industry (84.07-09)?*
 - . *does it not work for commodities (ex: oil & gas industry)?*
 - . *do public firms circumvent repatriation ban another way?*

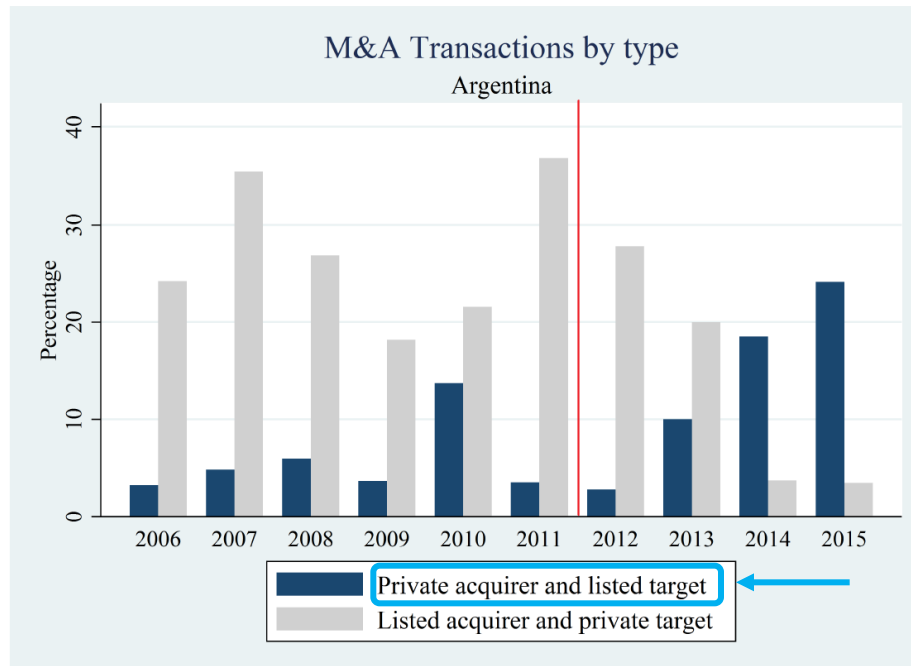
- > *Test other mechanisms using global sample:*
 - . *transfer royalties or earnings by listed subsidiaries of MNCs (India, Turkey, Mexico, etc.)?*
 - . *Income shifting vs. tax avoidance?*

Paper 2: Impact on M&A Market

Test 2-1: M&A in Argentina

- Data: Zephyr (2000-2015, 762 transactions)
- *Exposure* = Transfer of Earnings & Royalties for each of 18 industry categories tracked by the Argentine Central Bank

Figure 8: Type of Transactions before/after Ban on International Transfers



-> “Paper 2” (Public-Private M&A) is a good idea ... but seems separate from “Paper 1” (Profit Repatriation)!?

Paper 2 (Cont.) - Test 2-1:

T6: DDD: Treated = “*High Exposure*” x “*Listed*” MNC Subsidiary ($\beta > 0$!)

$$\begin{aligned}
 Sell_{s,l,t} = & \alpha + HighExposure_s + Post_t + Listed + \\
 & HighExposure_s \times Post_t + HighExposure_s \times Listed + Post_t \times Listed + \\
 & HighExposure_s \times Post_t \times Listed + \epsilon_{s,l,t}
 \end{aligned}$$

Table 6: The Impact of Exposure to a Ban on International Transfers on Firms' Selling Decision

| | (1) Likelihood of Selling |
|---|------------------------------|
| <i>HighExposure_s</i> | 0.291** (0.118) |
| <i>Post_t</i> | -0.0669 (0.044) |
| <i>Listed</i> | -0.104 (0.064) |
| <i>HighExposure_s × Post_t</i> | -0.194** (0.074) |
| <i>HighExposure_s × Listed</i> | -0.263* (0.118) |
| <i>Post_t × Listed</i> | 0.0771 (0.048) |
| <i>HighExposure_s × Post_t × Listed</i> | 0.171** (0.073) |
| N | 288 |
| R-Squared | 0.346 |

Standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

-> explain better “*High Exposure*”
(ex: oil & gas industry)?

Paper 2 (Cont.):

Test 2-2: M&A in EM

- Data: Zephyr (2000-2014, 281,000 deals)

- *Regulatory/Deregulatory Episode* = Standard Deviation Change in *Economic Freedom (EF index)* of the World Annual Report

Table 7: Deals by Region of the World

| Region | Deals | Deregulatory episodes | Regulatory episodes |
|---------------------------------|---------------|-----------------------|---------------------|
| Asia Pacific | 26,724 | 26 | 14 |
| North America | 36 | 2 | 2 |
| Africa | 2,801 | 51 | 33 |
| Latin America and the Caribbean | 5,093 | 18 | 19 |
| Europe | 17,204 | 14 | 10 |
| Total | 51,858 | 111 | 78 |

-> *very unbalanced sample (ex: North America)*
... is it because of regulatory/deregulatory definition based on EF index changes?

Paper 2 (Cont.) - Test 2-2:

T8: % M&A Transactions Listed -> Private (Private-> Listed) after *Regulatory Episodes* ($\gamma > 0$!)

$$\% TX_{c,t,L \rightarrow P} = \gamma_1 \times Episode_{c,t-1} + \gamma_2 \times Index_{EF_{c,t-1}} + \gamma_3 Episode_{c,t-1} \times Index_{EF_{c,t-1}} + \gamma_4 \psi_{c,t-1} + \delta_c + \delta_t + \varepsilon_{c,t,i}$$

Table 8: The Effect of a Sudden Reduction in the Level of Economic Freedom in the M&A market

| (a) Private acquirer and Listed target | | | | | | |
|--|----------|----------|-------------|----------|-------------|----------|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| | Mean | | Mean - 1 SD | | Mean - 2 SD | |
| <i>Regulatory Episode</i> _{t-1} | 0.0672* | 0.0546 | 0.178** | 0.170** | 0.289** | 0.286** |
| | (0.038) | (0.035) | (0.080) | (0.077) | (0.132) | (0.130) |
| EF Index (centered) | -0.0134 | -0.0153 | -0.0154 | -0.0153 | -0.0154 | -0.0153 |
| | (0.021) | (0.025) | (0.021) | (0.025) | (0.021) | (0.025) |
| <i>Regulatory Episode</i> _{t-1} × EF Index (centered) | -0.140** | -0.146** | -0.140** | -0.146** | -0.140** | -0.146** |
| | (0.070) | (0.070) | (0.070) | (0.070) | (0.070) | (0.070) |
| Region-Year FE | No | Yes | No | Yes | No | Yes |
| N | 704 | 704 | 704 | 704 | 704 | 704 |
| R-Squared | 0.172 | 0.277 | 0.172 | 0.277 | 0.172 | 0.277 |

| (b) Listed acquirer and Private target | | | | | | |
|--|-----------|----------|-------------|-----------|-------------|---------|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| | Mean | | Mean - 1 SD | | Mean - 2 SD | |
| <i>Regulatory Episode</i> _{t-1} | -0.0746** | -0.0581* | -0.0758** | -0.0988** | -0.0769 | -0.139* |
| | (0.029) | (0.030) | (0.037) | (0.047) | (0.055) | (0.072) |
| EF Index (centered) | 0.0136 | 0.0324 | 0.0136 | 0.0324 | 0.0136 | 0.0324 |
| | (0.050) | (0.055) | (0.050) | (0.055) | (0.050) | (0.055) |
| <i>Regulatory Episode</i> _{t-1} × EF Index (centered) | 0.00146 | 0.0513 | 0.00146 | 0.0513 | 0.00146 | 0.0513 |
| | (0.030) | (0.037) | (0.030) | (0.037) | (0.030) | (0.037) |
| Region-Year FE | No | Yes | No | Yes | No | Yes |
| N | 704 | 704 | 704 | 704 | 704 | 704 |
| R-Squared | 0.259 | 0.328 | 0.259 | 0.328 | 0.259 | 0.328 |

T9: *Deregulatory Episodes*

T10: *Listed Companies*

Paper 2 (Cont.):

“Paper 2” on Public-Private M&A...

-> Alternative mechanisms to M&A exit via selling local subsidiary – ex: Joint Ventures with local partners?

-> “Paper 2” could be a stand-alone paper examining international evidence of costs of being public! ... beyond M&A - ex: IPO activity, etc.