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1 Introduction

On May 27, 2010, Malaysia's sovereign wealth fund (SWF) Khazanah initiated a hostile takeover of Asia's largest healthcare chain, Singapore-based Parkway.[1] The surprise move was implemented through Khazanah's newly established healthcare firm, Integrated Healthcare Holdings (IHH). Such an aggressive move by a SWF was nearly unheard of, and it was the first time that a SWF attempted a hostile takeover of a foreign firm.[2]

The acquisition was provoked by the actions of two billionaire brothers, Malvinder and Shivinder Singh, who controlled the largest private hospital chain in India through their firm, Fortis.[3] Two months earlier, Fortis bought just enough shares in Parkway to overtake Khazanah's dominant ownership position.[4] On hearing that the Singh brothers were sending out feelers to other stakeholders about selling their shares, Khazanah initiated its hostile takeover.[5] But before Khazanah's offer could be finalized, it would require approval by the shareholders, creating the potential for a bidding war.[6]

1 Mathew (2010).
2 Venkat, Holmes, and Tudor (2010). According to Dealogic, the only previous hostile bid by a SWF was a failed bid by Temasek for United Overseas Bank's property arm in 2004.
3 Mathew (2010).
4 The stake was bought from US buyout firm TPG for $685 million. Fortis, the firm owned by the Singh brothers, bought a 23.9 percent stake at $3.56 per share, a 14 percent premium over its closing price of $3.12. This amount was just enough to overtake Khazanah's 23.32 percent stake, which was bought in 2008.
5 Hun (2010). At $3.78 per share, Khazanah's offer for a 51.5 percent ownership stake was committing the SWF to an additional $835 million.
6 The *Edge Financial Daily* (2010). Most of the other shareholders were asset management companies, including Bank of New York Mellon Corp. (5.94 percent), Franklin Resources, Inc. (4.01 percent), Matthews International Capital (3.21 percent), BlackRock Investment Management LLC (1.69 percent), Ocean, Inc. (1.4 percent), and Mellon Global Management, Inc. (1.05 percent).

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At stake was a big and rapidly growing medical tourism market.[7] In the eyes of Fortis and Khazanah, Parkway was worth fighting for as the only Pan-Asian medical care provider, making it an ideal foundation for a regional healthcare platform.[8]

After a series of offers and counteroffers, Khazanah finally prevailed.[9] The deal was the fifth-biggest acquisition of a Singaporean company in history.[10] Parkway would now be owned by Khazanah via IHH. About a month later, a new chairman and two non-executive directors were appointed to Parkway, leading to the departure of numerous top managers in subsequent months.[11]

This episode illustrates an important new trend in the global economy – state-owned entities that engage in increasingly aggressive foreign investment behavior. The government entity that has attracted the greatest attention is the SWF. SWFs are state-owned investment vehicles that invest globally in various types of assets ranging from financial to real to alternative assets. Notable examples include Singapore's Temasek, the China Investment Corporation, and Norway's Pension Fund Global.[12]

[7] Huifen (2010). After Thailand, Malaysia, India, and Singapore were the top destinations in Asia for medical tourists. Over the previous five years, the number of medical tourists to Asian countries had increased by approximately 20 to 30 percent each year, and medical tourism in Asia was estimated to be worth $4 billion by 2012 (Confederation of Indian Industries and McKinsey 2002).

[8] Hun (2010). Parkway had a network of sixteen hospitals in Singapore, Malaysia, China, India, Brunei, and the Middle East. Outside of China, Parkway was the largest healthcare group by market cap with a capitalization of S$3.4 billion (US$2.44 billion). Other major healthcare service providers in the region included Bangkok Dusit Medical Services PLC with a market cap of US$970 million, followed by Apollo Hospitals Enterprise in India (US$973 million), Fortis (US$989 million), and Bumrungrad International Hospital, also in Bangkok (US$688 million). Khazanah already held stakes in Pantai, Malaysia's largest hospital chain, and Apollo, the main rival to Fortis in India. Khazanah also owned IMU Health, which owns the International Medical University in Kuala Lumpur.

[9] Venkat, Holmes, and Tudor (2010). On July 1, the Singhs made a counteroffer to acquire 100 percent of Parkway at $3.80 per share, 2 cents more than Khazanah's offer of $3.78. The thin margin between the offers provoked Khazanah to raise its price. On July 26, Khazanah responded with an offer of $3.95 per share, prompting the Singh brothers to abandon their takeover efforts and relinquish control of the company. Fortis sold its stake to Khazanah for a profit of $84 million.

[10] Dealogic. [11] Dow Jones International News (2010); Khalik (2011).

[12] The International Working Group of Sovereign Wealth Funds provides a more detailed definition of SWFs: SWFs are "special-purpose investment funds or arrangements that are owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer

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In 2000, SWF assets amounted to approximately US$1 trillion. By 2007, they had increased to over US$3.3 trillion, with shares held in one of every five listed firms worldwide.[13] By 2015, SWF assets had risen to US$7.2 trillion. Moreover, seventeen of the twenty largest SWFs, accounting for approximately 75 percent of total SWF assets, are currently located in authoritarian regimes.[14] By comparison, private equity firms managed assets of around US$2.4 trillion, while hedge funds managed about US$3.2 trillion in assets in 2015, and they are primarily located in the United States and the United Kingdom.[15] Figure 1.1 shows the surge in the number of SWFs initiated since the late 1990s.

SWFs becoming more, rather than less, prominent in the global economy is both surprising and puzzling because such growth contradicts theories about the global diffusion of liberalizing reforms, as manifested by several waves of privatization since the 1980s.[16] According to this line of argument, regimes of all stripes should be reducing the state's role in the economy, including in the corporate sector, as liberalizing reforms spread across the world. However, many states have used the diffusion of liberalizing reforms to expand state investment. For example, from 2001 to 2012, governments acquired more assets through stock purchases ($1.52 trillion) than they sold through share issue privatizations and direct sales ($1.48 trillion),[17] with much of this state investment channeled through SWFs.[18]

assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets" (International Working Group of Sovereign Wealth Funds 2008). General government includes both central government and subnational government. The definition was developed in the context of drafting the Santiago Principles, which delineate generally accepted principles and practices for SWF activities.

13 Fernandes (2009); Alhashel (2015). The average size of their stake is 0.74 percent of the outstanding shares of a firm.

14 The top ten SWFs by assets control approximately 75 percent of total SWF assets, and nine of the ten are located in authoritarian regimes. Data come from the Sovereign Wealth Fund Institute (updated November 2017).

15 Preqin (2016), Global Private Equity and Venture Capital Report; Preqin Global Hedge Fund Report, 2016.

16 On the diffusion of liberalization, see Elkins and Simmons (2004), Simmons, Dobbin and Garrett (2006), Büthe and Mattli (2011), and Bach and Newman (2010).

17 Reported in Megginson (2013), based on data from the Thomson Reuters SDC Platinum M&A database and Privatization Barometer, available at www.privatizationbarometer.net.

18 Megginson and Fotak (2015).

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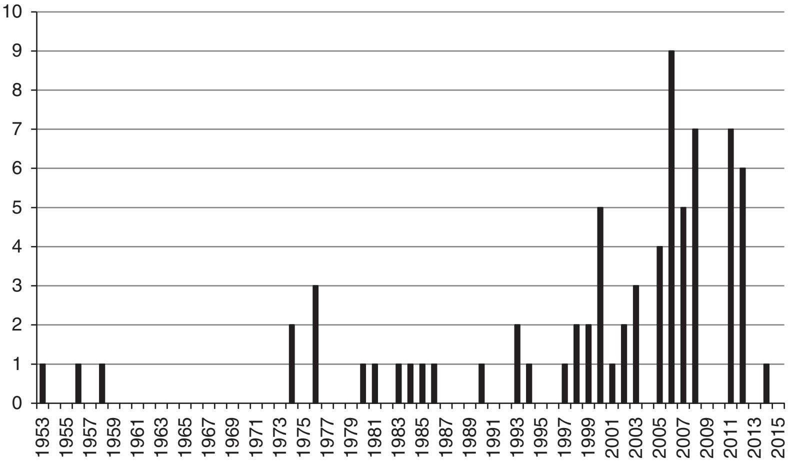

Figure 1.1 Number of SWFs established over time, 1953–2015.
Sources: Sovereign Wealth Fund Institute (2016) and Preqin Sovereign Wealth Fund Review (2016).

The rise of SWFs and other state-owned entities poses serious risks because of the tremendous scale of the assets they control, the risk that political objectives might influence their management, and their potential to influence or even control the most economically important corporations of foreign countries. Among advanced and most emerging economies, the firms of greatest importance to the national economy are usually publicly listed. Large-scale capital requirements lead these firms to sell shares to raise financing, in addition to other benefits associated with listing on a stock market (e.g., adopting market-oriented reforms to improve corporate governance and performance). However, this situation can also create the opportunity for investors with sufficient capital to buy a large enough stake in the firm to alter how it is governed. Because of their vast resources, SWFs are uniquely positioned to engage in these types of activities with regard to the world's largest firms. Understanding what drives this type of state investment behavior is this book's core research question: why do some states engage in more aggressive corporate intervention in foreign listed firms than others?

The hostile takeover initiated by Khazanah, Malaysia's SWF, is a prime example of aggressive state intervention. This type of investment behavior is indicative of the strategies employed by private equity

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firms.[19] Such firms purchase large stakes in target companies in order to implement value-enhancing strategies over the course of several years, often through management changes, streamlining operations, or expansion. Immediately following its takeover of Parkway, Khazanah appointed a new chairman and directors and integrated Parkway into its regional healthcare network. However, most SWFs act in a passive manner that involves exiting the investment when the SWF disagrees with management decisions. For example, the Brunei Investment Agency, which is headquartered next door to Malaysia, rarely takes large ownership positions and consistently adheres to a passive investment strategy.[20]

To explain the investment behavior of state entities such as SWFs, we must consider both the *capacity* of the state that owns them to engage in aggressive corporate interventions and whether the state possesses the *motivation* to do so. The capacity of a state to intervene aggressively in a foreign company depends on three attributes. First, the state must have a vehicle capable of initiating large ownership stakes that are held over an extended period of time, thereby enabling the implementation of major changes to target firms. This normally occurs either via SWFs or state-owned enterprises (SOEs; often owned by a SWF), but SWFs can facilitate this process by centralizing control over the activities of sprawling corporate assets, pooling resources and information, and identifying and assisting with investment opportunities on behalf of SOEs. But as I will discuss below, not all SWFs are equally suited to engaging in large, long-term holdings of foreign corporations. Second, the state must provide adequate transparency about the vehicle initiating the investment so that private investors can properly value the risk associated with co-investing with it and so that host country officials can decide whether to permit the investment. Third, the state investment vehicle must be capable of and willing to manage its ownership stake alongside other private investors (in a public-private co-ownership arrangement). This setup can be challenging for some states and private investors when the state entity seeks to intervene in firm governance.

State capacity is a necessary, but insufficient, condition. For example, some SWFs may take a large position in a listed firm but are unwilling to

19 Armour and Cheffins (2011).
20 Chapter 2 provides a detailed discussion of the range of activist tactics that SWFs (and SOEs) can deploy.

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put pressure on managers to alter firm strategy. States must also be motivated to intervene aggressively. The most fundamental motivation driving state investment behavior regards leaders' desire to remain in power. For democratic leaders, institutional constraints normally restrict the duration of their position, granting an opportunity for members either of the same party or an opposing party to hold the position. For authoritarian rulers, institutional constraints are normally weaker, thereby granting political incumbents the opportunity to hold on to power for a longer, potentially indefinite, duration. Thus the strongest motivation to intervene arises from threats to authoritarian rulers' hold on power.[21] To the extent that such authoritarian leaders rely on state ownership of large corporations to maintain their rule, two threats are of particular salience – the crowding-out effects that accompany economic development and economic liberalization. Both of these threats enhance the ability of private capital to challenge incumbent rulers and the SOEs they rely on to preserve their rule. To account for the varying capacity and motivation of states to intervene aggressively in foreign listed firms, I offer a novel political explanation.

A New Political Explanation

I argue that the propensity for a state to engage in aggressive foreign corporate interventions depends on the structure of its political regime. My argument differs from the existing literature on SWFs and SOEs in two important ways. First, I focus on common underlying political determinants of SWFs and SOEs. Because both of these entities are controlled by the government, with SOEs often owned by a SWF, similar political pressures influence their behavior. Yet the literature on the political determinants of SWFs examines them separately from SOEs.[22] Moreover, the literature on SOEs largely developed before the rise of SWFs.[23] A common political explanation is therefore lacking.

The second difference concerns the political determinants themselves. The literature on both SWFs and SOEs has overlooked an important political development since the end of the Cold War – the

21 For discussions on autocrats, see Tullock (1987), Wintrobe (1998), and Haber (2006); on democracies, see Mayhew (1974).
22 For a review of the literature on SWFs, see Megginson and Fotak (2015) and Alhashel (2015).
23 For an overview of the literature on SOEs, see Megginson and Netter (2001).

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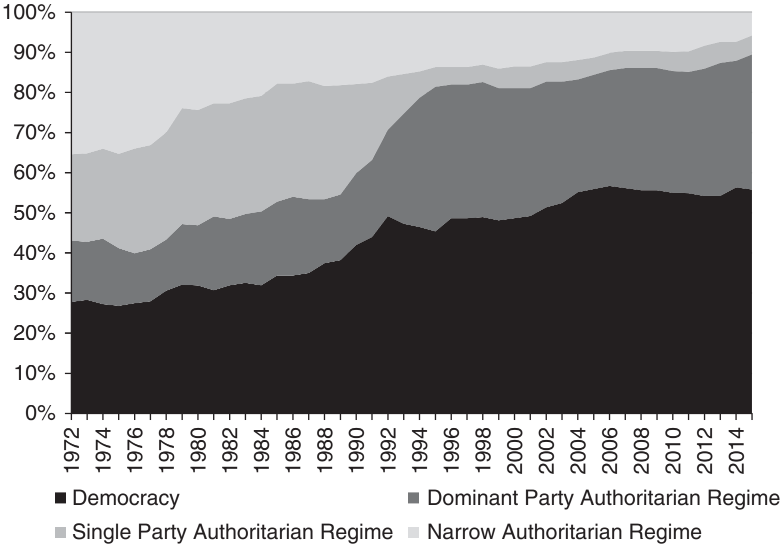

Figure 1.2 The prevalence of political regimes, 1972–2015.
Note: Narrow authoritarian regimes have an *ifhpol* score lower than 7 out of 10 without the representation of multiple parties in a legislature; single-party authoritarian regimes have an *ifhpol* score lower than 7 and a legislature with a single party; dominant-party authoritarian regimes have an *ifhpol* score lower than 7 and a legislature with multiple parties; democracies have an *ifhpol* score of 7 or above. The *ifhpol* score combines the Freedom House and Polity IV scores to generate a democracy index that encompasses more countries than either index alone. It comes from Hadenius et al. (2007), Authoritarian Regimes Data Set, version 5.0. Whether countries have a legislature with multiple parties is based on the *lparty* variable from Cheibub, Gandhi, and Vreeland's (2010) Democracy and Dictatorship Revisited data set for data from 1972 to 2008. Both variables have been updated to 2015. For additional details, see Chapter 3.

rise of dominant-party authoritarian regimes (DPARs). Few would have predicted that the "third wave" of democratization, which came to a halt in the mid-1990s, would be eclipsed by the diffusion of DPARs into the first decade of the twenty-first century.[24] However, DPARs are now the most common type of authoritarian rule, constituting one-third of the total number of regimes in the world, as illustrated in Figure 1.2. Given the contemporary importance of DPARs, it is critical

[24] Huntington (1991).

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to understand the relationship of these regimes to the corporate sector and to SWFs and SOEs more specifically.

I argue that characteristics specific to each political regime affect the capacity and motivation of a state to intervene in the corporate sector. I place political regimes into one of four categories: (1) narrow authoritarian regimes (NARs), (2) single-party authoritarian regimes (SPARs), (3) dominant-party authoritarian regimes (DPARs), and (4) democracies.[25] NARs are those in which no meaningful competition for political office occurs, such as a monarchy or those ruled by the military (e.g., Brunei and Myanmar until 2012). To secure their rule, political elites in these regimes monopolize the control of information and resources – unlisted SOEs are one manifestation of this. SPARs are those in which a ruling party monopolizes the political arena by occupying all the seats in the national legislature and proscribing political opposition (e.g., China, Vietnam, and Laos). Competition for political office occurs within the party but not between parties, yielding a modest loosening of the control over information and resources. Consequently, partially state-owned enterprises are more likely to arise. DPARs hold elections in which competing political parties vie for public office, but rarely do these elections result in the handover of power. The usual result is a dominant ruling party with opposition parties holding a small minority of legislative seats (e.g., Malaysia and Singapore). The ruling party dominates the control of politically sensitive information and resources, though opposition parties also gain limited access, which corresponds to an increased reliance on partially state-owned enterprises. Finally, democracies are those in which competitive elections occur between candidates from multiple parties. Access to politically sensitive information and resources is not restricted to members of any single group or political party, and this corresponds to relatively few corporations with state ownership (e.g., Japan, South Korea, and the Philippines).

I argue that among the four political regimes, DPARs have the greatest capacity and motivation to intervene aggressively in foreign listed firms. With regard to capacity, DPARs are relatively more likely

[25] For discussions on the classification of democratic regimes, see Lijphart (1999), Przeworski et al. (2000), and Golder (2005). On the classification of authoritarian regimes, see Geddes (2003), Gandhi and Przeworski (2006), Gandhi (2008), Hadenius and Teorell (2007), Magaloni (2008), and Magaloni and Kricheli (2010).

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to host mixed public-private corporations, corresponding to their semirestricted control of information and resources. Because of their capacity to host hybrid SOEs in the home market, DPARs can more easily engage in public-private ownership in foreign markets. Compared with other authoritarian regimes (i.e., SPARs and NARs), DPARs can also meet the transparency requirements of a larger set of foreign countries in order to acquire a large position in a target firm. Additionally, DPARs are more likely to have a strong motivation to intervene in the corporate sector compared with other regimes because they permit opposition parties to compete in elections but are unwilling to hand over power. As the threat of political opposition rises, DPAR leaders will engage in more aggressive tactics to protect their rule. An implication of this argument is that China's SOEs and SWFs are not as aggressive with their foreign investments as they can be; instead, Malaysia's SOEs and SWFs display more aggressive behavior compared with any other state entities in East Asia. This behavior is attributable not only to their regime differences but also to China's lack of a fully functional savings SWF. To appreciate why this matters, we must consider the varying types of SWFs and their role in mediating government involvement in the corporate sector.

The Importance of Savings SWFs to State Intervention

SWFs are conventionally categorized as foreign exchange reserve funds, stabilization funds, pension reserve funds, or savings funds.[26] As the name suggests, foreign exchange reserve funds are funded by foreign exchange reserves. Their purpose is to invest these funds overseas to reduce the negative carry costs of holding reserves or to earn higher returns on ample reserves through sizable allocations to equities and alternative investments.[27] However, a stockpile of reserves must be available at short notice to defend the value of the currency; thus these funds generally do not take large positions to be held for a long period. Therefore, reserve funds are invested in a relatively passive, diversified

[26] These categories are based on IMF and Santiago Principles taxonomies. Development funds are sometimes identified as a separate category, but following IMF economists (Kunzel et al. 2011), I group them together with savings funds. See IMF (2007, 2008).

[27] For example, up to 50 percent of reserves in South Korea and 75 percent for Singapore's GIC.

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manner that generally maintains a small ownership stake in any one company.[28]

The purpose of stabilization funds is to buffer the economy – usually the financial markets – from external shocks. To this end, stabilization funds will invest in equities to buffer stock market volatility (e.g., Taiwan's Stabilization Fund), but this is normally short-lived because it is simply intended to stabilize the market. When they are not invested in domestic equities, stabilization funds invest primarily in a highly liquid portfolio of assets, such as fixed-income and government securities, that are not strongly correlated with boom/bust cycles.[29]

By comparison, the purpose of pension reserve funds is to invest so as to meet future expenditures associated with an aging population. In essence, pension reserve SWFs act as a commitment mechanism for politicians who might prefer to spend their countries' wealth today instead of saving it for future generations (e.g., Australia, Ireland, and New Zealand). These funds are more likely to initiate long-term ownership positions through equities purchases, but they are unlikely to pursue political objectives at the expense of prudent portfolio allocation. They differ from traditional pension funds in that they have no designated claimants on the available assets; rather, the legal or beneficial owner is the institution that administers the public pension system (social security reserve funds) or the government (sovereign pension reserve funds). This feature exposes them to potentially greater state influence than pension funds,[30] but because the purpose of these funds is specifically intended for the aging population and they are located primarily in Organisation for Economic Co-operation and Development (OECD) countries, pension reserve funds exhibit the highest levels of transparency and compliance with the Santiago Principles concerning SWF best practices compared with other types of SWFs.[31] Hence discretionary investment strategies are significantly curtailed.

The aim of savings funds is to share wealth across generations. This objective leads to investments via a high risk-return profile, including

28 Al-Hassan et al. (2013).
29 The IMF Global Stability Report (2012) indicates that fixed-income securities occupy 80 percent of the portfolio of these funds, with government securities consisting of around 70 percent of total assets.
30 Yermo (2008).
31 Bagnall and Truman (2013).

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