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Government ownership and the cost of debt: Evidence from government investments in publicly traded firms[☆]

Ginka Borisova[a], Veljko Fotak[b,c], Kateryna Holland[d], William L. Megginson[e,*]

[a] Iowa State University, 3224 Gerdin Business Building, Ames, IA 50011-1350, USA
[b] School of Management, University at Buffalo, 236 Jacobs Management Center, Buffalo, NY, 14260-4000, USA
[c] Sovereign Investment Lab, Baffi CAREFIN Centre, Bocconi University, Via Guglielmo Roentgen 1, 20136 Milano, Italy
[d] Purdue University, 403 W. State St., KRAN 522, West Lafayette, IN 47907-2056, USA
[e] Price College of Business, 307 West Brooks, 205A Adams Hall, The University of Oklahoma, Norman, OK 73019-4005, USA

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ABSTRACT

We investigate how government equity ownership in publicly traded firms affects the cost of corporate debt. Using a sample of bond credit spreads from 43 countries over 1991–2010, we find that government ownership is generally associated with a higher cost of debt, consistent with state-induced investment distortions, but is associated with a lower cost of debt during financial crises and for firms more likely to be distressed, when implicit government guarantees become the dominant effect. Our results are robust to controls for the endogeneity of government ownership, and we find these effects to be specific to domestic government ownership.

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* Corresponding author. Tel.: +1 405 325 2058; fax: +1 405 325 7688.
E-mail addresses: ginka@iastate.edu (G. Borisova), veljkofo@buffalo.edu (V. Fotak), khollan@purdue.edu (K. Holland), wmegginson@ou.edu (W.L. Megginson).

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1. Introduction

Contrary to public perceptions and despite the worldwide success of state privatizations, from 2003 to 2013, governments have acquired more assets through stock purchases ($1.52 trillion) than they have sold through privatizations ($1.48 trillion).[1] This is puzzling, since extensive research shows dramatic performance improvements for privatized enterprises, suggesting that states should be reducing their ownership of corporate equity, rather than increasing it.[2] Part of the recent surge in state ownership resulted from firm rescues that began with the 2008 financial crisis, but an even larger fraction resulted from government purchases of stock as investments unrelated to the crisis. While a vast literature examines the impact of government shareholdings on firm behavior and equity valuation (examples include Eckel and Vermaelen, 1986; Shleifer, 1998; Chen, Firth, and Xu, 2009; Ben-Nasr, Boubakri, and Cosset, 2012), little attention has been given to the impact on the cost of debt.

The influence of government ownership on the cost of debt is especially complex, as governments impose non-profit-maximizing social and political objectives yet also offer implicit guarantees against default. Given these conflicting channels of influence and the predominant role of debt in corporate financing, we investigate the impact of government equity ownership on the cost of corporate debt.[3] The current study is the first, to our knowledge, to explicitly test this impact and to examine whether this effect is due to implicit debt guarantees.

We collect annual spreads for publicly traded bonds and stock ownership data over 1991–2010, focusing on stakes of at least 1% per shareholder, for a sample of firms identified as targets of investments by government entities in the Thomson Reuters SDC Platinum M&A database. Since government owners can purchase additional shares or completely divest stakes over time, our panel data include firm-years both with and without government ownership. Our final sample consists of 6,670 yearly credit spreads from 1,723 bonds issued by 226 companies from 43 countries. The main analysis relies on panel regressions in which we model bond credit spreads as a function of government ownership, while controlling for factors found in previous research to affect the cost of debt and including year and firm fixed effects. We distinguish between the recent 2008 financial crisis and previous non-crisis years, as government guarantees are likely to be more valuable during times of economic hardship when defaults are more probable (Ivashina and Scharfstein, 2010). Our initial results indicate that government ownership is associated with an increase in the cost of debt during non-crisis years—each percentage point increase in government ownership is associated with about a one basis point (bp) increase in the cost of debt. During the financial crisis, however, government ownership is associated with lower spreads, and each additional percentage point of government ownership translates into a 0.21 bp decrease in the cost of debt.

We recognize that government ownership is not random. Indeed, governments invest selectively, which could lead to reverse causality between government ownership and the cost of debt. To ensure that our results are not affected by the government's selection of investment targets and to test the generalizability of our findings, we identify a benchmark sample of firms subject to acquisitions by non-government investors and that have never been owned by the government. We confirm our main findings by using the full benchmark sample in models with Heckman treatment effects and instrumental variables to control for the potential endogeneity of government ownership. Next, we establish that the relation between government ownership and the cost of debt is not driven by the divergence between the largest shareholder's voting and cash-flow rights, as studied by Lin, Ma, Malatesta, and Xuan (2011), or by the post-privatization residual holdings examined by Borisova and Megginson (2011). Finally, to ensure the generalizability of our results to other types of debt financing besides publicly traded bonds, we examine the relation between syndicated loan spreads and government ownership and again confirm our results.

Our findings are not specific to the 2008 financial crisis; we obtain similar results during national banking crises identified by Laeven and Valencia (2013) and Reinhart and Rogoff (2011). Analogous to its impact during macroeconomic distress, government ownership could also reduce the cost of debt when individual firms have a relatively higher default risk. We examine firm-specific measures of risk by investigating firms issuing non-investment-grade bonds, as well as firms classified as financially constrained and small (based on total assets). We find that credit spread reductions associated with government ownership are larger in these firms, consistent with the greater value of implicit government guarantees during times of distress.

Government ownership can manifest itself in both local and cross-border forms, as highlighted by Karolyi and Liao (2015). We hypothesize that social goals are less likely to be imposed on foreign targets, as employment maximization, for example, is not typically a goal sought by foreign government owners. Accordingly, we find that only domestic government ownership is associated with higher spreads in non-crisis years, consistent with state investors diverting corporate resources to meet local social and political goals. However, implicit government guarantees should also be strongest for domestic targets, as the default of a foreign investment target is less likely to carry the "political stigma" associated with failures of domestic state-owned companies. We find that the implicit debt guarantee during the recent financial crisis is specific to domestic government presence, as no such relation is documented for foreign government ownership.

Our paper contributes to the literature on how ownership structure affects the cost of debt (Anderson, Mansi, and Reeb, 2003; Lin, Ma, Malatesta, and Xuan, 2011) and the impact of government ownership on firm value and

[1] Based on data from the Thomson Reuters Securities Data Corporation (SDC) Platinum Mergers and Acquisitions (M&A) database.

[2] Early privatization studies are summarized in Megginson and Netter (2001). More recent research includes Boubakri, Cosset, and Guedhami (2005), Gupta (2005), and Estrin, Hanousek, Kočenda, and Svejnar (2009).

[3] According to data from Thomson One Banker, 82.8% of the $121 trillion of global corporate security issuance over 1991–2010 is debt-related.