# Considerations of the Acquisition of a Private Firm by an Enterprise That Is Either Wholly or Partially Owned by Government

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Merger and acquisition is no longer limited to private firms. The liberalization and globalization of telecommunications has made it more and more evident that a private firm maybe taken over by a fully or partially state-owned enterprise. The announced acquisition of VoiceStream Wireless by Deutsche Telecom in 2000, and the attempted take-over of Cable &. Wireless HKT by SingTel in the same year are just examples of these cases. This phenomenon,, as pointed out by Sidak (2002), raised the question of how public ownership may alter the incentives of a firm to engage in anticompetitive conduct. Will partial government ownership remove profit-maximization as the carriers' objective and thereby increase the risk of predatory behavior in the US and Hong Kong after their acquisition of the US or Hong Kong firms?

With reference to the case of Deutsch Telecom *v.s.* VoiceStream Wireless, key policy considerations are highlighted as follows:

## 1. Predation and Profit Maximization

In the US, a critical assumption of cross-subsidy argument is that Deutsche Telecom in the American market would use cross-subsidization to achieve a temporary competitive advantage over its rivals in the US wireless market and finally eliminate its competitors. The implication is that Deutsch Telecom would take a strategy resembling predatory pricing, namely a firm incurs a loss for the purpose of eliminating competitors and later raising prices to supra-competitive levels to recoup earnings after the rival left the market. The Supreme Court of the United States has stated its view that predatory pricing is unlikely to succeed for the following three reasons. First, there is little guarantee the recoupment is successful. Second, competitors can take similar strategy and incur losses in anticipation of future profits. Third, new entrants will appear if prices are raised after the existing competitors have exited the market.

Sappington and Sidak found that profit maximization necessarily becomes the objective of firm as soon as it is at least partly privatized and listed on a stock market. Because Deutsche Telecom has to fight with other firms for capital, Deutsche Telecom is not free to choose predatory prices (or any other prices) that cannot maximize the long-run profit. In other words, Deutsche has to take an approach of profit maximization.

Additionally, as Deutsch Telecom is also partly listed in New York's stock market, so it subject to the regulation of protecting shareholder's interests. German government's intervention would expose the company itself to the liability under American corporate law to the company's minority shareholders.

## 2. Capital-Subsidy from the Government

Another worry is that the Deutsche Telecom might receive very favorable financial aid from German government, consequently, it might take this advantage and leave its rivals in the US market in a vulnerable position.

In fact, Deutsche Telecom is a private law stock corporation subject to applicable German federal law, such as the German Stock Corporation Act and Germany Tax law (See Deutsche Telecom Annual Report). In this case, it is impossible for Deutsch Telecom to enjoy any privileges, such as low tax. European Union legislation also prevents this from happening as this might create distortion. The Bond Rating and Weighted-average Cost of Capital (CACC) analyses failed to find any privileges that Deutsche Telecom has benefited from its status of being owned by the government.

Based on above mentioned analyses and testing, the FCC finally approved Deutsche Telecom's acquisition of VoiceStream in April 2001.

3. Implications to Hong Kong

Partly and wholly stated-owned firms might participate the acquisition in Hong Kong's telecommunications market. The testing process of the US can be used as a reference. It seems a partly privatized firm is able to immune from government predation, especially those that have partly listed in Hong Kong's stock market. It is also necessary to conduct a review of regulatory framework of the investors' domestic market.

Reference:

Sidak, J.G. (2000) Capital Subsidies, Profit Maximization, and acquisition by partially privatized telecommunications carriers, *Telecommunications Policy,* Vol 26, pp. 287-294