

Comments on
Chen, Naranjo & Tang, “Keeping the Dragon
Out: Evidence on the Economic Consequences
of National Security Reviews”

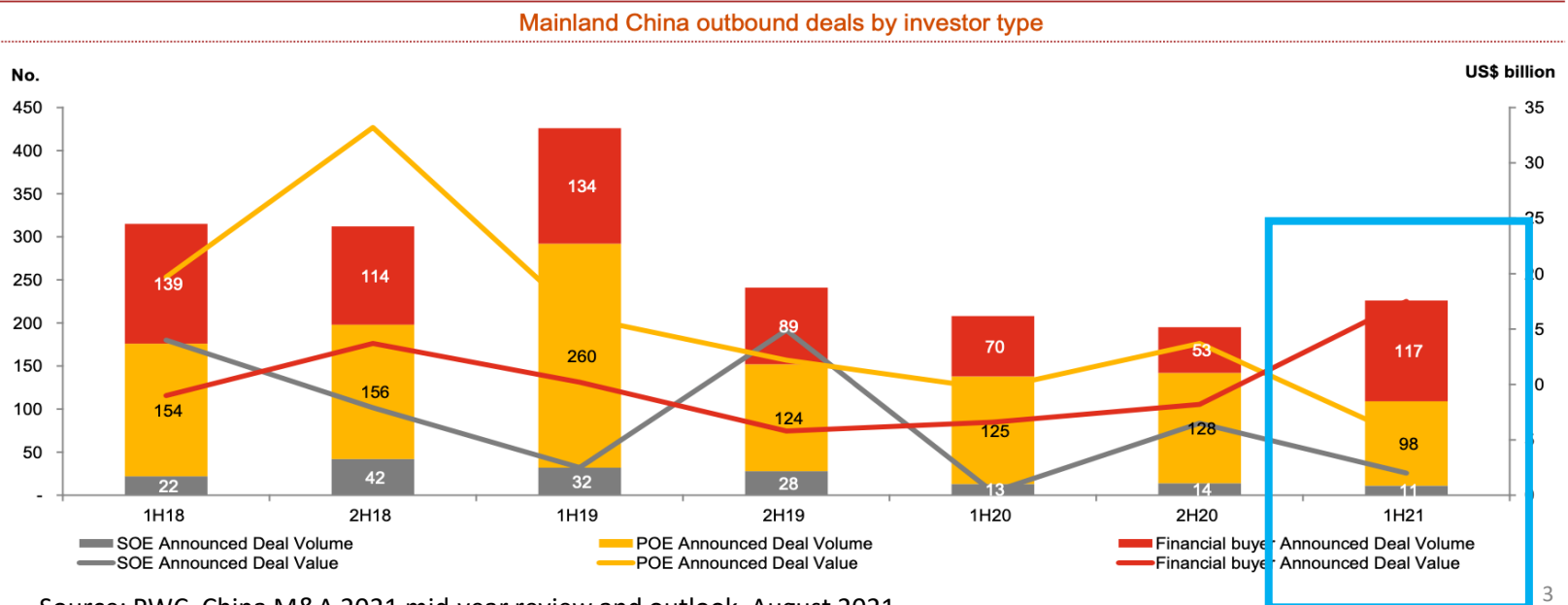
Pengfei LUO
Setsunan University

Background of this paper

- “Keep the dragon out”
 - Recently, the Committee on Foreign Investment in the United States (CFIUS) has rigorously screened foreign investment in the industrial sector based on the Investment Risk Review Modernization Act (FIRRMA) criteria.
- Amidst the COVID-19 pandemic and the growing tension between US-China relations, CFIUS is focusing on the following fields, which may pose a threat to national security:
 - (1) semiconductors (2) quantum computers (3) artificial intelligence (AI) (4) robotics (5) inspection technology (6) quality control technology (7) pharmaceuticals and medical equipment (8) biotechnology, etc.
- Therefore, M&A transactions related to China’s military-civilian fusion policy or Made in China 2025 may potentially fail due to the stringent CFIUS review. (Keidanren, 2021)

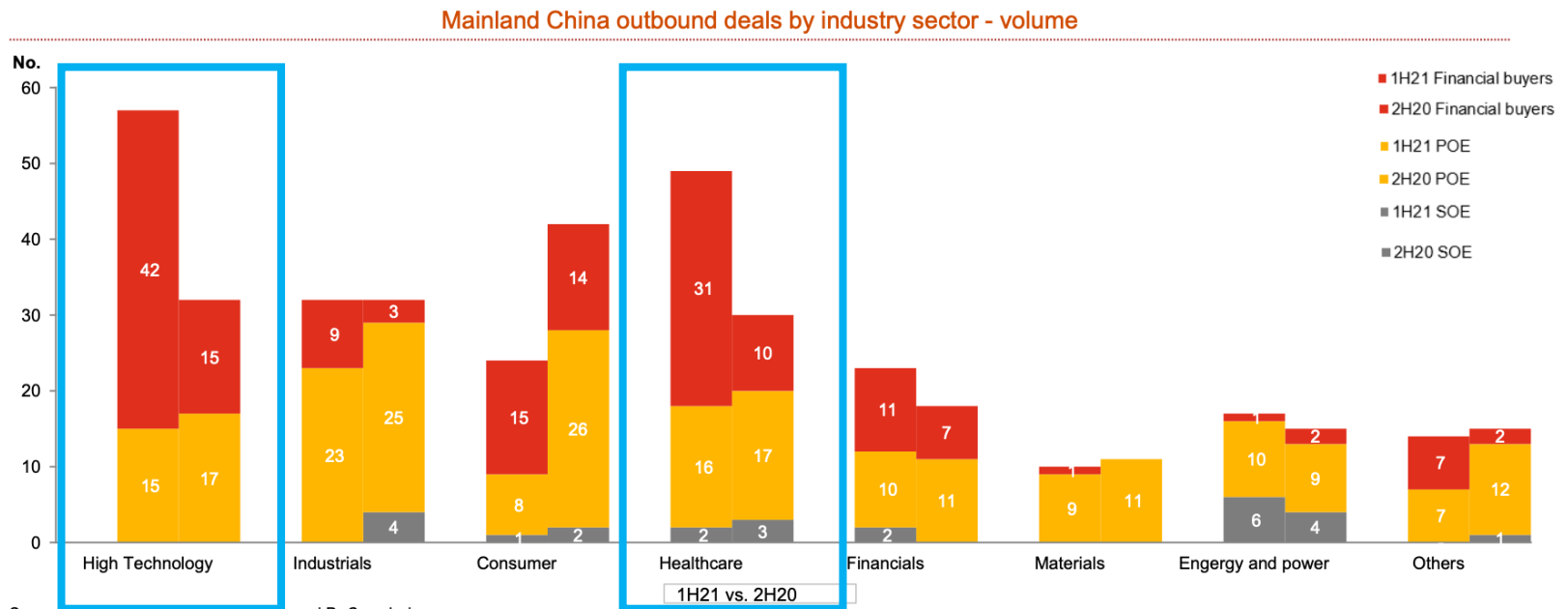
Recent China outbound M&A deals: overview

- Outbound M&As has been negatively affected both by COVID-19 and the geopolitical landscape.
- In terms of volume, financial buyers were the biggest players in the outbound space as China-based PEs looked for opportunities overseas; whereas SOEs tended to refocus on domestic market.



Recent China outbound M&A deals: by industrial sector

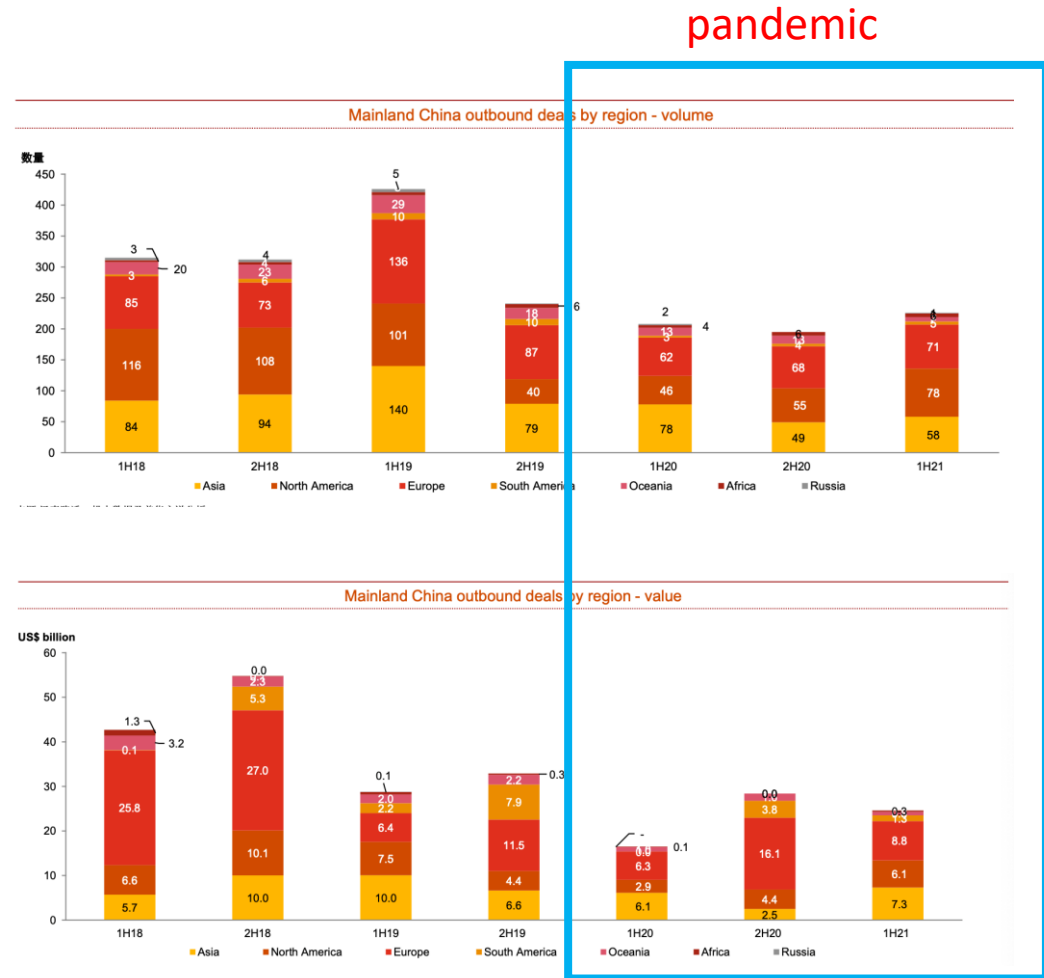
- Generally, high technology, industrial and consumer sectors continue to be the most favored sectors among Chinese buyers.



Source: PWC, China M&A 2021 mid-year review and outlook, August 2021

Recent China outbound M&A deals: by region

- In terms of value, outbound investments to major destinations such as North America, Europe, and Asia maintain low levels due to COVID-19 and geopolitical sensitivities



Source: PWC, China M&A 2021 mid-year review and outlook, August 2021

The targets of Chen et al.'s paper

- This paper mainly focused on two questions:
- What kind of M&A acquisitions tend to fail in the CFIUS review for US national security?
 - Employed Logit and OLS to analyze the determinants of failure cases in the CFIUS review.
 - Considering both economic (size, ROA, profit, cash, book-market ratio, etc.) and non-economic factors (CFIUS standards)
- When these acquisitions fail, what are the consequences for the US target firms and their peer firms?
 - Firm level: short-term stock price returns of target and peer firms
 - Macro level: effects on future foreign investment to the United States

The contributions of Chen et al. 's paper

Data:

- Due to insufficient official information disclosure by CFIUS, the authors compiled a dataset consisting of 318 CFIUS reviewed transactions from 2015-2018 (successful and failure cases/acquirors from China and other countries).

Key findings:

“What kind of M&A acquisitions tend to fail in the CFIUS review for US national security?”

Probability of failure in CFIUS review only depends non-economic factors including

- acquisitions from **(1) China** to target US firms **in (2) critical industries** during the **(3) Trump presidency**,

But not depend on economic factors

- (all economic factors are insignificant in regression).

The contributions of Chen et al. 's paper

Key findings:

“When these acquisitions fail, what are the consequences for the US target firms and their peer firms?”

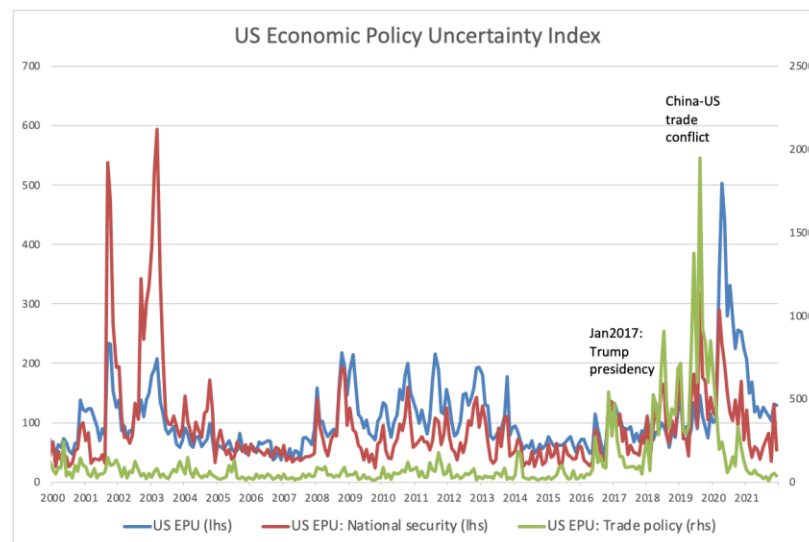
- Within short window (one week), failing the CFIUS review leads to
 - lower expected stock price returns of target firms.
 - lower expected stock price returns of peer, but is better than the cases of success in CFIUS reviews (because peer firms will be less competitive in product market)
 - Significant anticipation effect for future (difficulties for peer firms to attract foreign acquisition offers especially China)

Some questions

1. There are cases where transactions are finally approved (only 24/142 failed in this paper's dataset), showing that even under this circumstances, Chinese firms continue investing in the US firms (Keidanren, 2021":maybe take longer time in CFIUS review"). Also, the empirical analysis show the CFIUS review does not depend on economic factors
 - What can the Chinese acquirers learn when they want to improve their investment targeting US firms (or just walk away to other target firms in European and Asian countries)?
2. Mid-term and long-term effects of M&A failure in CFIUS reviews on target firms and peer firms are also crucial, besides short-term stock plunges.
 - Negative news shocks on stock prices may be very short-term
 - Failures in CFIUS review may lead to different business environment for US firms such as: stricter regulations on export, overseas market share, etc...eventually lower profit

Some questions

- Additionally, some possible ways for robustness check such as
 - Separating samples by China and non-China acquirors for comparison.
 - Using dummies: year, industrial sector,....
 - More explanatory variables (both economic and non-economic), for example: economic policy uncertainty (EPU) index



Reference

- EPU website

<http://www.policyuncertainty.com/>

- Keidanren, Recent trends of the Committee on Foreign Investment in the United States (CFIUS) (in Japanese, 経団連, 「対米外国投資委員会 (CFIUS) の近年の動向」), 2021.

https://www.keidanren.or.jp/journal/times/2021/0128_12.html

- PWC, China M&A 2021 mid-year review and outlook, August 2021

<https://www.pwccn.com/en/services/deals-m-and-a/publications/ma-2021-mid-year-review-and-outlook.html>