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The big foreign challenge in a shrinking corporate world

HENRY ERGAS THE AUSTRALIAN NOVEMBER 30, 2013 12:00AM

In blocking the GrainCorp takeover, Treasurer Joe Hockey has offered too few answers to the transition Australian businesses have to face. Picture: Kym Smith Source: TheAustralian

IT was hardly a marriage made in heaven: the suitor's track record was mixed and the parents might well have hoped for a more attractive match. But that doesn't mean Archer Daniels Midland's $3.4 billion takeover of GrainCorp should have been blocked. And by blocking it, Treasurer Joe Hockey has raised any number of questions, while providing all too few answers.

At the heart of those questions lies the transition Australian business has to face. Asia's rapid growth is reshaping the opportunities we face; to make good use of those opportunities requires not merely access to capital, but also integration into the global supply chains that increasingly structure world markets.

Moreover, it is not the capital as such that is the crucial constraint: on the contrary, the world is awash with savings, while global investment is at historic lows. Rather, what really matters is the combination of finance with the international skills and linkages typically embodied in multinational enterprises.

We are, in that sense, experiencing a transformation of the corporate landscape, with domestic firms being absorbed into global entities. As that transformation unfolds, it raises contentious issues about national ownership. Whether we can manage those issues sensibly is critical; for if we don't, the future will be one in which our current woes with the auto industry seem a mere bagatelle.

The changes under way are, of course, far broader than Australia. Rather, they are the third wave of a process that began in the 19th century. That first era of globalisation, which stretched through to World

War I, saw both the emergence of international capital markets, largely centred on London, and of pioneer multinationals such as the Singer sewing machine company.

At that time, distance and the difficulties of communications meant it was mainly the colonial governments that could bear the costs of accessing the new sources of finance and provide lenders with the confidence they sought: as a result, by 1890 the Australian colonists had accumulated more public debt per capita than the residents of any other country in the world, with almost all of it owed to foreigners.

We were therefore exceptionally vulnerable to changes in sentiment, as was painfully clear when financial markets became convinced that (in the words of London's Investors Monthly) "the Australian colonies are too dependent on borrowed money and are unfortunately under the domination of labour parties, whose policy is to spend lavishly".

With Australia losing the warm welcome wealthy British savers had once given it, difficulties in refinancing existing debt and raising new debt contributed to the prolonged slow growth which accompanied federation.

But even that first phase of globalisation saw substantial foreign investment, including in Australian agriculture. After all, by 1891, getting freight from Melbourne to London was roughly as cheap as getting it from Scotland to London had been a century earlier. And just as is now happening in Asia, growing incomes transformed British eating habits, with per capita consumption of butter and meat more than doubling in the course of the 19th century.

Global "beef barons" such as the Vesteys played a pivotal role in creating the virtual bridge that linked the Australian outback to the butcher shops of London.

The transformation wrought by the second wave of globalisation was, if anything, even greater, as the spectacular expansion of international trade and investment that began in the early 1950s brought a new generation of multinational corporations on to the world scene. From science-based ventures such as Boeing to producers of mass consumer goods such as Colgate, manufacturing became an activity that largely took place within global firms, with American multinationals seizing the lead in the scope and pace of their expansion.

Unlike globalisation's first phase, this time it was companies, not governments, that played the primary role in transferring foreign capital into Australia. And bound up with that capital were skills and technologies that helped propel post-war prosperity. But those skills were mainly inward-looking, particularly in manufacturing. Dependent on tariff protection, they left a legacy for which we have paid a high price.

Now the world economy is in a third phase of corporate restructuring. Mobilising savings not merely in the advanced economies but also in Asia and the Middle East, the geography of the third wave is far more complex than that of its predecessors, which were primarily centred in Britain and the US respectively. It also extends across a broader range of activities, going from resource-based industries to services. While it began with outsourcing and loose corporate alliances, the networks on which it rests are being brought under tighter, more unified financing and control. That unlocks large economies of scale and integration, allowing the new corporate entities to better compete in world markets; for Australia, it promises greater efficiencies in our exports and imports. But it inevitably brings with it controversies about foreign ownership, with the GrainCorp takeover a flashpoint.

To say that is not to exaggerate the significance of Hockey's decision; far from being a monopolistic behemoth, as was claimed in the controversy, GrainCorp is merely a medium-sized firm that operates in an increasingly competitive domestic market for grain-handling services. Moreover, Hockey would be neither the first nor the last treasurer to block a foreign takeover while welcoming sustained foreign investment. But the ambiguities in Hockey's decision highlight the dangers to which it gives rise.

The most immediate dangers relate to the future of GrainCorp. Hockey's message was that although this is not the right time for a complete acquisition of the GrainCorp assets, he was willing to consider ADM increasing its stake from 20 per cent to just under 25 per cent.

But should ADM take up that offer, it would likely have effective control, acquired without having paid the premium for that control built in to its original bid. And control without full ownership could make potential conflicts of interest more acute than had ADM's takeover been accepted.

After all, had the takeover proceeded, ADM would have borne the entire consequences of any decisions which sacrificed GrainCorp's interests to those of other parts of ADM's business. However, with effective control but only partial ownership, ADM could impose those decisions on GrainCorp, securing their full benefit, while suffering only a small share of the resulting losses.

That is not to dispute Hockey's goal, which was to cushion the blow, not least to GrainCorp, of his veto. In reality, however, a 5 per cent increase in ADM's stake will do little to bolster the market's confidence in GrainCorp's long-run value; its effect on GrainCorp's overall access to capital is therefore likely to be marginal at best.

And GrainCorp's problems in that regard are aggravated by the growing competition it faces, as it seeks to sell its services to growers who will readily switch away from it to save a mere 50c a tonne. The Liberal member for Hume, Angus Taylor, may be right that "the threat of a takeover has galvanised the Australian grain growing industry into action"; but there is no sign that involves a greater commitment to GrainCorp's fortunes.

Faced with that situation, GrainCorp will have no choice but to accelerate its rationalisation plans, closing the small up-country silos whose costs now exceed their revenues. And any suggestion that GrainCorp will be in a position to fund the overhaul of our collapsing grain lines is fanciful. Rather, if that overhaul is to occur, both the capital and operating costs will likely need to be financed by the commonwealth; but that risks reintroducing the inefficiencies that fatally damaged those lines' viability in the first place.

We could therefore be left with the worst of all worlds: a weakened GrainCorp; and an inefficient export infrastructure that drains taxpayers' funds from more worthwhile uses.

That scenario is all the more worrying as similar issues now arise with Qantas. There is no doubt Qantas finds it difficult to compete with carriers such as Etihad. Nor is there any doubt the restrictions on Qantas's ownership increase its cost of capital, harming its competitive position. And whatever purpose those restrictions may have played when Qantas dominated Australia's international aviation, they are impossible to justify when it struggles to secure the custom of a quarter of the Australians travelling overseas.

Moreover, international aviation is leaving behind it the days when every country from Afghanistan to

Zaire had its flag carrier; and those countries which are reluctant to adapt already find themselves paying an increasingly steep price in terms of sky-high subsidies for rock-bottom services.

Whether Qantas will get to the point where it ceases to be viable as an Australian-based carrier is uncertain; but there is no better way of ensuring that outcome than to perpetuate the current capital-raising restrictions. Were that to happen, it would be only a matter of time before Qantas would have to be re-nationalised: a prospect every bit as tempting to Tony Sheldon and Paul Howes, who could then suck at the public teat, as it is entirely obvious to them.

With Qantas too, in other words, we face a choice between adjusting to global change and its opportunities, or retreating into capital xenophobia and taxpayer-funded corporate life-support.

Yet simply removing the restrictions on Qantas, as the government should, will be controversial. And that makes it especially unfortunate that one of Hockey's reasons for vetoing the ADM acquisition was that it was unpopular with grain growers. For it is hardly desirable to suggest the national interest will be determined by means of popularity tests.

But if decisions are to be determined by such a test the government must do far more to shape its direction. That is what good governments do: they don't just competently steer the ship but intelligently set its course. And with the changes our corporate landscape will face, improving public understanding is vital and urgent.

ADM's offer for GrainCorp, which Hockey inherited from Labor, was a missed opportunity to make a start on that process. With a Qantas decision looming, he now has a chance to show he can do better.