Can State and Shareholder Capitalism Combine?

The structural “liabilities” of state-owned enterprises can, in fact, be creative assets that privately owned firms can emulate.

Intellectuals and top business leaders are increasingly united in urging a transition to stakeholder capitalism – an economic model favouring the common good over value delivered exclusively to shareholders. What this new model would look like in reality, however, is anyone’s guess.

Renowned economist Mariana Mazzucato lays out one interesting option in her new book Mission Economy. She argues today’s “wicked problems” call for a reinvigorated, entrepreneurial state sector working hand-in-hand with Big Business. Yet her far-thinking proposal opposes the traditional view that state-owned enterprises are too bureaucratic and inefficient to hold their own alongside private-sector companies.

How true is that view, though? My previous research into the relative competitiveness of state-owned multinationals (SOMNCs) and private firms found that ownership structure made no significant, consistent difference to business performance, when compared across companies of similar sizes and contexts. However, performance is not necessarily a proxy for the sort of technological inventiveness that would allow the public sector to play the leading economic role Mazzucato suggests. As the Covid-19 pandemic has proven, devising new-to-the-world tech solutions for unforeseen problems is rapidly becoming a requirement for lasting business relevance.

Gauging inventiveness

In a recent paper for the Journal of International Business Studies, my co-authors and I apply a similar methodology to the one we used in our competitiveness research to compare the inventiveness of SOMNCs and that of their privately owned peers. We assembled a sample set comprising 274 SOMNCs with either minority or majority state ownership, and 247 similar private firms spanning 43 countries and 22 industries. That is, we matched private and public firms based on financial characteristics such as total and fixed assets, as well as characteristics of their home countries such as GDP per capita and rule of law.

Looking at patent activity for all observed firms during the period 1987-2012, we were able to compare how pioneering (i.e. original as opposed to incremental), frequent and impactful (as measured by citations) their respective inventions were.

We found, surprisingly, that – under certain conditions (more on those below) – public-sector patents were more frequent and pioneering than those of their privately owned peers. We also found that patents across the two groups of firms were equally impactful.

Visit INSEAD Knowledge
http://knowledge.insead.edu
Our findings essentially confirm our initial hypotheses. We reasoned that the presumed “negatives” of state ownership, including the need to serve both political and profit-based imperatives, actually work to promote inventiveness. Reduced pressure to realise short-term returns on R&D investment translates into greater autonomy for scientists, engineers and other knowledge workers employed by SOMNCs. Left to their own devices, these employees prefer to break new ground rather than sticking to areas of proven marketability. All else being equal, the resulting inventive output will often be higher in volume and novelty than that of firms answering solely to the marketplace.

**Interventions of the “grabbing hand”**

However, the inventiveness advantage of SOMNCs was not universal. It was attenuated where governments could intervene into the affairs of state-owned enterprises more freely. In many developing countries – e.g. Brazil, which has 12 government-owned firms in our sample – governments can direct SOEs to political objectives or to missions that serve their political careers. But this does not imply developed countries boast robust checks and balances. Italy and Greece are examples of advanced European nations with shaky protections against government interference.

When the boundaries between the state and its firms are too porous, there is a greater danger of political capture. The “helping hand” of the state can more easily be pushed aside by the “grabbing hand” that ransacks public resources instead of using them to grow the economy. For example, the autonomy of inventors can suffer if critical leadership positions are granted to individuals whose political connections outstrip their qualifications, or if corrupt officials help themselves to coffers earmarked for innovation.

There is yet another complicating factor here. In industries that are especially invention-heavy, e.g. biopharma and telecommunications, the lack of political constraints has less of a negative effect on state-owned firms’ inventiveness. In other words, the “grabbing hand” is disciplined to some extent when the competitive environment demands a high degree of ingenuity. In such contexts, corruption is a luxury the state cannot afford.

**Can shareholder capitalism and state capitalism join forces?**

Joining the dots of our research, we conclude that while SOMNC managers appear to enjoy an advantage over private-sector peers when it comes to inventiveness, that advantage is not baked into the ownership structure. It can be eaten away by the “grabbing hand”. Therefore, policymakers should think seriously about introducing a system of checks and balances where multiple, independent state units (such as regulatory agencies, audit offices, shareholder protection bureaus, etc.) make it more difficult for governments to directly interfere in SOEs. It’s important to reiterate that this is not an issue reserved for emerging markets; many developed economies have this problem as well. Wherever rules shielding state-owned firms from excessive state meddling are absent, we see some negative effect on inventiveness.

Because the inventiveness advantage of SOMNCs stems from managerial autonomy rather than some quality inherent to the ownership structure, there is no reason private-sector firms cannot catch up. A good first step towards lengthening the managerial leash would be to heed the oft-proffered advice to reduce short-termism and the ensuing pressure to produce quick returns.

While my prior research cautioned private-sector managers not to underestimate SOMNCs as competitors, the new paper implies that the private and public sector may be ideal collaborators, with the former possibly emphasising pioneering technologies and the latter pursuing their subsequent development and commercialisation. In addition, our argument differs from general ones on the merits of state-sponsored invention such as those made by Mazzucato in her book. We show the need for appropriate institutional conditions so governments avoid the temptation to intervene and thwart the innovative efforts of SOMNCs.

If this sounds radical, consider the number of blockbuster innovations – from the iPhone to pharmaceutical patents – that derive directly from the inventive output of government agencies and bureaucracies. Kickstarting stakeholder capitalism may require wider recognition of states’ entrepreneurial credentials.

Felipe Monteiro is a Senior Affiliate Professor of Strategy at INSEAD. He is also the Academic Director of the Global Talent Competitiveness Index. He is the Programme Director for INSEAD’s partner programme with Fundação Dom Cabral, Advanced Management Program (PGA).

INSEAD Knowledge is now on LinkedIn. Join the conversation today.

Follow INSEAD Knowledge on Twitter and Facebook.

[1] Co-authored by Sergio G. Lazzarini (Insper Institute of Education and Research), Luiz F. Mesquita (W.P. Carey School of Business), and Aldo Musacchio (Brandeis).