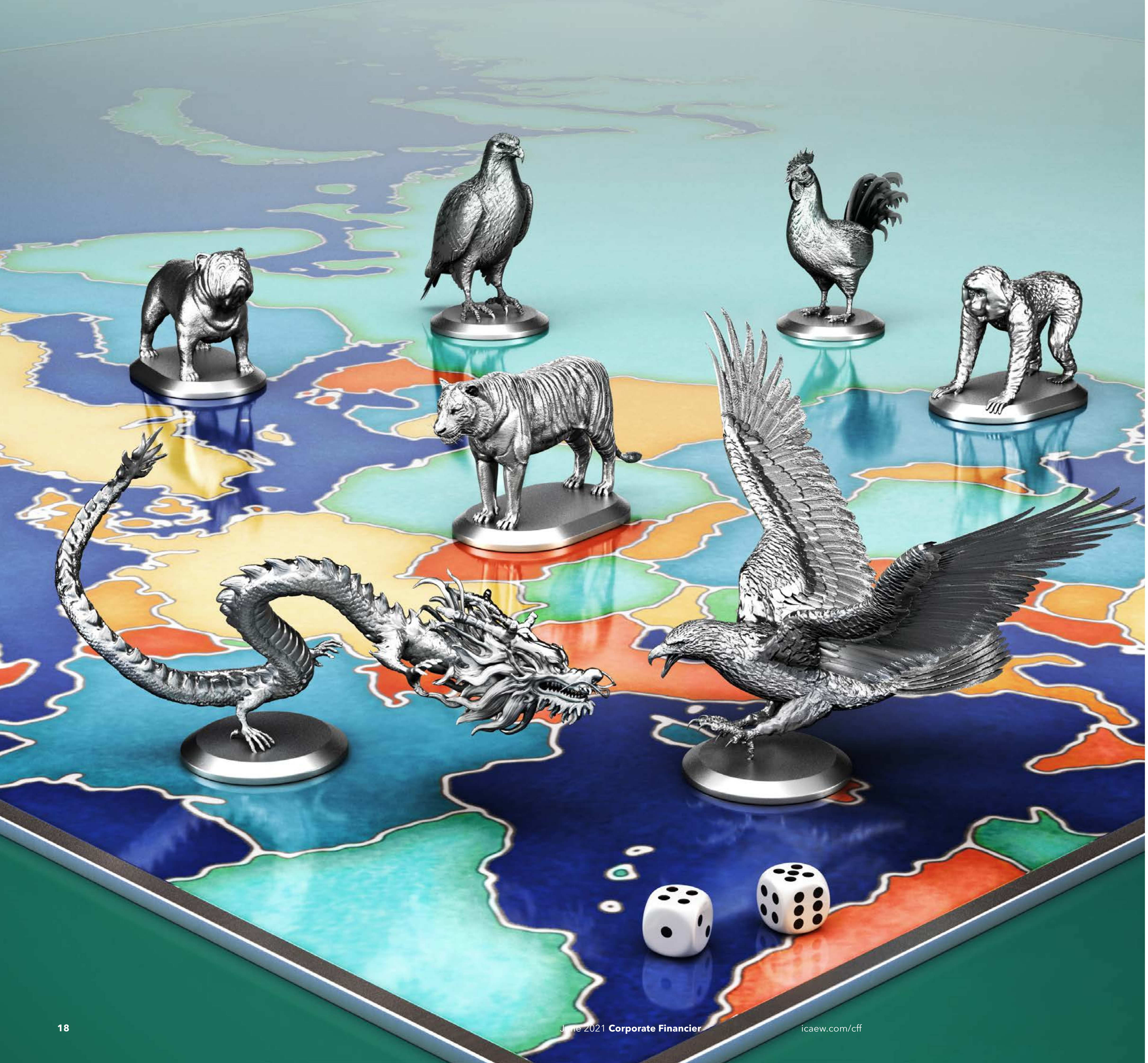


GAMES WITH FRONTIERS

How much has the geopolitical landscape changed over the past two years? Brexit has been completed. COVID-19 has circled the globe and still remains. President Trump has been and gone, and not quietly. As we move into a new era defined by these events, Jason Sinclair looks at the impact on M&A

ILLUSTRATION BY HITANDRUN

The multidimensional jigsaw of cooperation and opposition over trade, security and climate continues to be shuffled, broken and reassembled. The constants, occupying the thoughts of legislators worldwide, are the continued rise of China and the shifting definitions of national security. However, there is more to consider.

"The geopolitical dynamics are not really limited to the US and China. It's just that they seem to carry the heaviest weight," says Christine Chow, who joined IHS Markit in March as global head of strategic governance and environmental, social and governance (ESG) integration. She moved from Federated Hermes, where she was global head of tech, Asia and emerging markets.

The Committee on Foreign Investment in the United States (CFIUS) and Australia's Foreign Investment Review Board (FIRB) keep an eye on overseas investment into their countries. France and Germany have equivalent schemes. The UK's National Security and Investment Act (which received royal assent in April) is a codified UK equivalent. It effectively oversees business investments by other foreign states – including, but certainly not exclusively, China.

This was the first legal update to the UK screening process in 20 years. Conservative MP Tom Tugendhat chairs the Foreign Affairs Select Committee. He told *Corporate Financier* that the Act is not designed to turn the UK into a protectionist environment, at least not in the traditional sense of 'protectionism': "It's intended to protect Britain from what it would otherwise be, which is an exposed economy, while others are putting their barriers up.

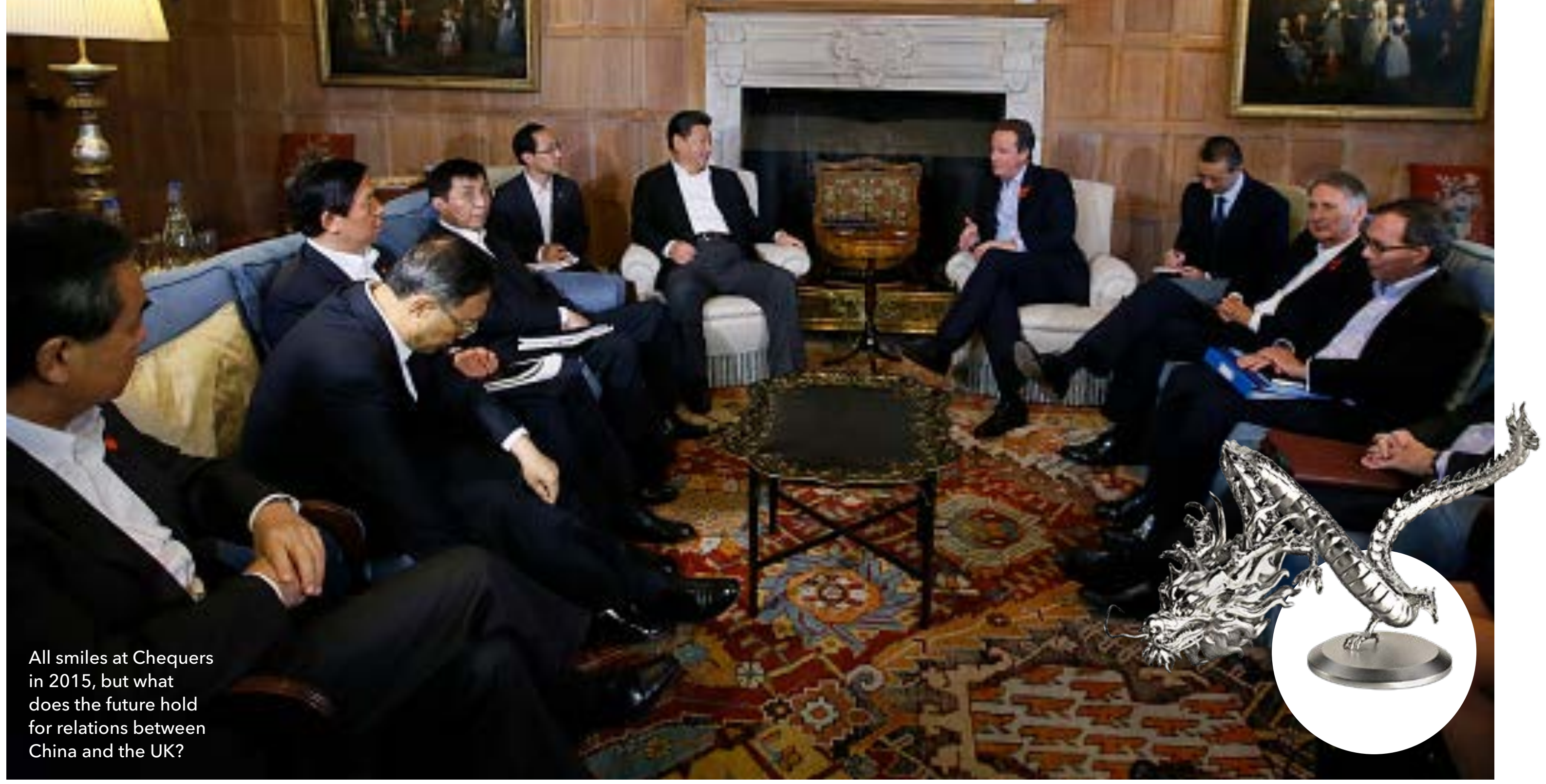
"If you look at the way CFIUS works, or FIRB in Australia, the thinking is that if the UK was the only country to be completely open, then anywhere state capital is underwriting companies, they would be able to snap up anything without regard to a fair market. Countries like China stand out, but there are many others as well that could leave the UK economy exposed."

New thinking?

To illustrate current government philosophy, consider ARM Holdings, the Cambridge-based semiconductor business. It was controversially sold to Saudi sovereign wealth-backed SoftBank for $32bn in 2016. Now the UK government has called in its proposed sale to US company Nvidia on national security grounds. What's changed?

Tugendhat thinks the initial 2016 decision was a mistake but, he argues: "Clearly, there's an element of this government taking a different approach, but also the situation has changed. COVID-19 looks likely to have empowered those able to draw on the depth of the state and has led to people viewing sovereign capabilities in a different way. There's a different understanding of where we are."

One area in the spotlight post COVID-19 is that of supply chains. Raoul Ruparel OBE was an adviser to Theresa May's government on Brexit,



All smiles at Chequers in 2015, but what does the future hold for relations between China and the UK?

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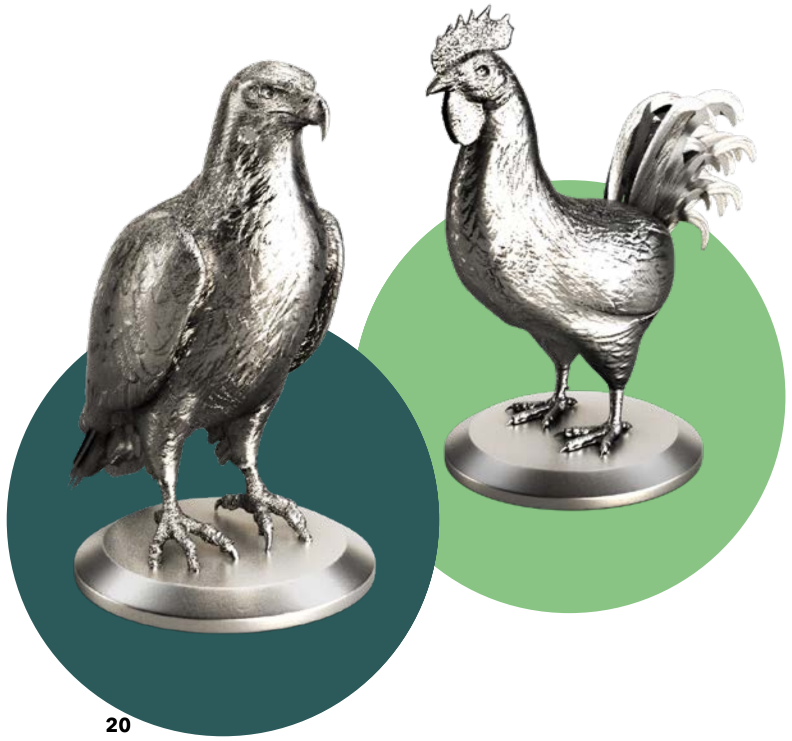


'Large conglomerates are better equipped than SMEs to navigate these challenges'

Hugo Parson
head of origination, Deloitte

and is now Deloitte's director of trade and investment policy. He says that since Brexit, and throughout the pandemic, supply chains have shown themselves to be fairly resilient.

"They faced some challenges in terms of higher costs and admin, but overall they've held up and as yet we haven't seen a massive realignment. I don't see much desire to move back to re-onshoring supply chains. So, in that sense, in terms of M&A, deal flow and investment, I don't think we'll see a massive shift. I think most people have been pleasantly surprised by how well global trade and supply chains have held up despite COVID-19, Brexit and other potential shocks."

Ruparel's Deloitte colleague Hugo Parson, head of origination, does however point out: "Large conglomerates are better equipped than SMEs to navigate these challenges and if you look at some of the market commentators, they're predicting a wave of restructurings and insolvencies in SMEs."

But he sees favourable financing conditions and significant amounts of dry powder as being strong deal-drivers: "Private equity deal flow in Europe reached £50bn in four of the past five quarters and this activity is unlikely to slow. The available capital to invest significantly exceeds the investment opportunities right now."

This may seem counter-intuitive, given the geopolitical uncertainty. But perhaps this uncertainty is now simply built into a market that's hungry for higher returns.

Safety first

Tugendhat – a China hawk by nature – does not view the National Security and Investment Act as incompatible with an open economy: "The Foreign Affairs Committee is constantly considering business because the point of foreign affairs is about how we protect the interests of British people, how we keep ourselves safe. Central to that is ensuring we have a prosperous future. That's about industry and enterprise, not just ideas."

The committee has examined Russian activity in the UK's financial system and foreign interest in the UK's education system, he says.

Regarding the EU, he observes: "The past 3,000 years of British history are about how we deal with European partners – that's the fundamental. Sometimes we deal with them well, sometimes not so well. This has literally been the nature of British policy for many, many years."

Unlevel playing field

Even with the somewhat newer dynamic between the UK and China, Tugendhat says: "The reality is we do need to have shared cooperation, we do need to have some elements of joint action." However, he adds, "Let's not pretend that the markets are equally open in both directions. The way in which China's responses have changed, how it behaves towards us and the effect this has on all of us is really problematic."

At the beginning of May this year, the *Sunday Times* published an investigation into Chinese investment in UK companies. At £134bn, it includes Tencent's investment in healthtech unicorn Oxford Nanopore and state-owned China General Nuclear's one-third stake in Hinkley Point power station. The newspaper reiterated that with general opacity, there is concern about the extent to which even individual investors or privately owned Chinese companies are agents of the state. "We look at trade in a commercial way – the Chinese government sees it as national strength," Professor Steve Tsang, director of the China Institute at SOAS told the *Sunday Times*.

In 2015, then prime minister David Cameron, his chancellor George Osborne and Chinese president Xi Jinping enjoyed pints of Greene King beer at The Plough at Cadsden, Buckinghamshire, heralding a new era of Sino-Anglo trade and relations. Within a year of that meeting, the pub had been bought by a Chinese investor. Two years

TRADING PLACES
A NEW US?

TOM TUGENDHAT
Conservative MP, chair of the Foreign Affairs Select Committee

"Trade deals with federal states are difficult. Most of the deals we want are service-level agreements and federal states often do services at a provincial or state level, rather than the federal level. US lawyers can't practise in every state and financial services need separate licences. Countries such as India and Australia have similar internal barriers. So, I don't think there is some epic US trade deal around the corner.

"How much does it matter? Probably not quite as much as you might think. The reality is that between the US and the UK, we have two of the most open economies. We've got so much going on between us already, in terms of all of our cooperation, that we know we can work together closely without getting too wrapped up in trade deals."

LORD TIM CLEMENT-JONES CBE
Liberal Democrat peer and member of the Corporate Finance Faculty's board

"People make a big mistake thinking macro American policy changes with the political parties. Not having Trump tweeting at 6am is wonderful, but Joe Biden is going to be as pragmatic over the American trade policy and is not going to suddenly rush into a deal with us.

"CFIUS has been around for an awfully long time. In a sense, you could say that our National Security and Investment Act is an imitation of CFIUS. America isn't going to suddenly cave in on demands for agricultural imports, for instance, but again, it may be that the climate-change agenda will be more important to them.

"Then there's the whole area of regulations. There is a rather different American culture to regulation, but now there's more of an appetite for it around climate and the environment than there was under Trump."

THE NATIONAL SECURITY AND INVESTMENT ACT

DAVID PETRIE, head of corporate finance, ICAEW, sits on the government's new Expert Panel

"The Corporate Finance Faculty has been actively engaged with government on the Act throughout its passage. We responded to the Green Paper and the White Paper, and we also assembled consultative round tables with leading market participants and arranged a number of personal meetings with ministers and officials, so that the government can understand more about the practical implications – for advisers and also for investment – of screening deals in the middle of a transaction.

"While we recognise that only a small proportion of transactions are likely to be blocked or adjusted by the secretary of state, the government is trying to solve a difficult problem. Its solution is to cast a wide net – capturing, in its own estimates, between 1,000 and 1,830 transactions a year. This will be a shock – and a step-change – for many M&A advisers, when, for the first time, they have a deal captured by the new screening regime.

"Under the terms of the Act, a transaction can, in the extreme, be declared null and void by the secretary of state. Some very severe sanctions are included in the Act, including fines and even imprisonment for the directors of companies, so it's certainly not legislation to be ignored or taken lightly.

"But what the government is trying to deal with here are hostile actors, with the resources of the state at their disposal. Trying to legislate against people who have those kinds of resources and that sort of intent is an extremely challenging task.

"The complex Bill was subject to a good deal of scrutiny at committee review stage in the Lords. Lord Leigh, former chair of the Corporate Finance Faculty, Lord Clement-Jones, a current faculty board member, and other peers tabled a very large number of extremely helpful amendments. These included a notable successful amendment from Lord Leigh, which lifted the ownership trigger threshold up to 25%.

"As well as seeking certain important amendments to the legislation, our approach at ICAEW has been focused on ensuring the government provides adequate resources to the Investment Security Unit (ISU), which is the brand-new department at the Department for Business, Energy and Industrial Strategy. With 1,000 transactions, that's roughly four per working day for the whole year. Compare this to what we are used to with referrals to the government regulator under competition law. The CMA might review 10 to 15 deals a year.

"I've had a number of meetings with politicians and ministers to discuss the practical implications and what market participants need from the ISU to get this to work effectively. We've continued to engage with government as it publishes market guidance notes, and one of our major campaigning themes has been to ask the ISU for quality guidance for all market participants.

"Transactions don't happen in a vacuum. For the vast majority of deals, it's necessary to try to maintain competitive tension. Before you grant exclusivity to one party, the ISU should be happy to talk to sellers' advisers, allowing them to understand whether what they're selling is likely to be caught by the legislation and whether or not potential buyers for the business are likely to be required to notify."

For more information and additional resources visit icaew.com/nationalsecurity

after that, the brewery itself was snapped up by Hong Kong tycoon Li Ka-shing in a £4.6bn deal.

This was the era in which China's Belt and Road Initiative was spreading money and soft power around Asia, Africa – and Europe. There seemed to be less interest in any definitions of national security at that time.

Known unknowns

Chow remarks: "Uncertainty in policies is usually one of the reasons why deals stop, because in order to identify suitable deals a lot of work needs to go into preparation, evaluation, and getting lawyers and accountants involved. If there is uncertainty about what type of deals might or might not be welcome, that will be what stops the deal flow."

Thinking about blocked deals involving Huawei, as well as the Microsoft/ByteDance collapsed takeover, Chow explains: "The US and UK want to work with China in certain areas such as climate, but at the same time are very protective of certain industries, such as tech. The dynamics around impact on global M&A are very unclear because of the fact that in one sense, the sovereign or the government wants to strengthen their global position, and to establish allies.

"But then at the same time, they've tried to be much more protective of certain industries. And sometimes you don't know why a leather industry or food or paper industry is included on that list as well (in the case of Japan). Why is one company a national security issue, but another not? It's very unclear. I think it's best to monitor and understand the different aspects and viewpoints of sovereign risk."

Ruparel argues that the key point is how national security is defined. "That means clarity around the criteria, when and how certain takeovers might be assessed, and also the certainty and stability in there being a long-term definition, and it being in place for a substantial period. You need a swift system for triage and funnelling the different takeovers, and making quick decisions about what is and is not subject to any kind of scrutiny."

The right environment

While acknowledging the importance of cooperation with China, Tugendhat sees greater problems with the superpower's ownership from both national security and ESG perspectives. ESG is increasingly important in how businesses position themselves.

Ruparel echoes this, believing that, if the UK becomes an agenda-setter in ESG, "there are plenty of opportunities to leverage that".

In the end, says Tugendhat: "The challenge with ESG is to make it count. That's where the work we're doing on the committee about Xinjiang [home to the Uighurs], for example, is important because that work is fundamentally about ESG. How can you be ESG-compliant if one of your principal clients is a brutal dictatorship?"

'Uncertainty in policies is usually a reason why deals stop'

Christine Chow global head of strategic governance and ESG integration, IHS Markit

'You need quick decisions about what is subject to scrutiny'

Raoul Ruparel director of trade and investment policy, Deloitte

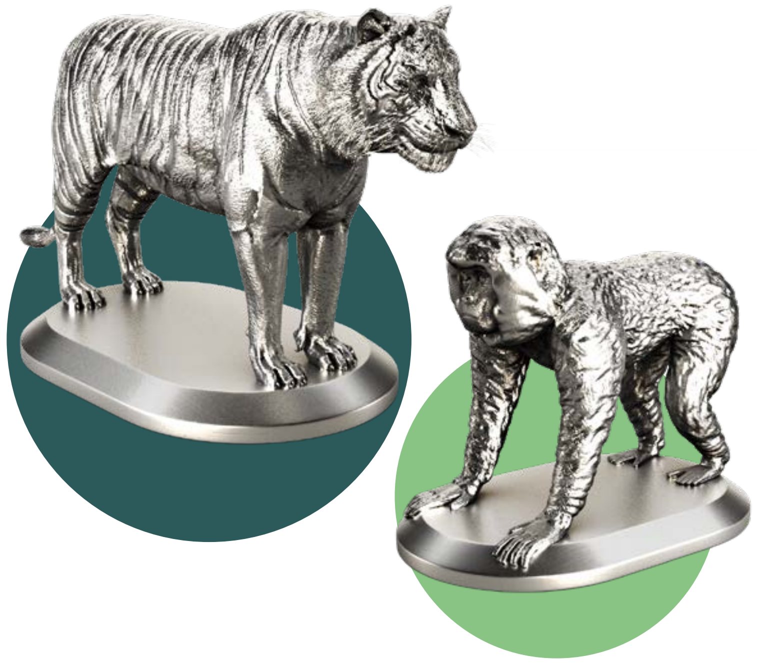
Balancing act

Liberal Democrat peer Lord Tim Clement-Jones CBE, who is deputy chair of the All-Party Parliamentary Group on China and an ICAEW Corporate Finance Faculty board member, says: "There's quite a tension between investment and national security. With the new legislation and dynamics around trade, businesses will have to be politically advertent. They'll have to look up the 17 sectors that the government thinks are sensitive. They must consider the market guidance – which is being produced as a direct result of the ICAEW's representations – and think quite carefully and geopolitically about who's in and who's out."

Clement-Jones does see supply chains as a potential concern: "Globally, I think repatriation of supply chains will become an issue. Navigation will be key for business. These things ebb and flow. Over the 20th century, they expanded, shrank and expanded again. But, especially as a result of Brexit, the pandemic and people's understanding of how the vaccinations were manufactured – and as a result of our new, much poorer relationship with China – repatriation is going to be the impulse.

"Businesses can't suddenly say, 'Sorry, we're not going to source from China.' But there's a lot of political anger about Hong Kong and the Uighurs. So," he asks, "what is the best way of engaging with China? The obvious things are not sourcing from sensitive provinces and not dealing with issues that could give rise to the sort of national security concerns that Huawei did. But I would say there are positive ways of engaging, because we have to. If we don't, we won't see net zero by 2050.

"China isn't suddenly going to disappear as a trading and investment partner. But we need to pick and choose. And that's what I mean by navigation," he says.



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