International Review of Law and Economics 42 (2015) 88–104

Contents lists available at ScienceDirect

International Review of Law and Economics

The economic impact of merger control legislation

Elena Carletti [a], Philipp Hartmann [b], Steven Ongena [c,*]

[a] Bocconi University, IGIER, CESifo and CEPR, Milano, 20100, Italy
[b] European Central Bank and CEPR, Frankfurt Am Main, 60640, Germany
[c] University of Zurich, Swiss Finance Institute and CEPR, 8032 Zurich, Switzerland

ARTICLE INFO

Article history:
Received 24 July 2014
Received in revised form 13 January 2015
Accepted 18 January 2015
Available online 25 January 2015

Keywords:
Merger control
Legal institutions
Financial regulation

JEL classification:
G21
G28
D4

ABSTRACT

We investigate the impact of legislative reforms in merger control legislation in nineteen industrial countries between 1987 and 2004. We find that strengthening merger control decreases the stock prices of non-financial firms, while increasing those of banks. Cross sectional regressions show that the discretion embedded in the supervisory control of bank mergers is a major determinant of the positive bank stock returns. One explanation is that merger control introduces "checks and balances" that mitigates the potential abuse and wasteful enforcement of supervisory control in the banking sector.

© 2015 Elsevier Inc. All rights reserved.

1. Introduction

Merger control refers to the set of procedures and regulations dealing with the reviewing of mergers and acquisitions under antitrust (or competition) law. With the exception of the United States, Canada and Germany, most industrial countries have introduced or strengthened this policy over the last three decades. In all cases, the reforms of merger control legislation have marked an important shift in the economic policy of the countries involved as they imply limits on industry structure and firm growth in concentration and market shares.

The importance of merger control has also increased due to the large number and the high value of the mergers and acquisitions that took place during the last three decades in the United States (Andrade et al., 2001) and other countries (Evenett, 2004). The European Commission for example adopted final decisions in 270 cases during 2010 only, including many that attracted widespread media attention (e.g., Oracle/Sun Microsystems, Monsanto/Syngenta and Unilever/Sara Lee Body). The UK Office of Fair Trading dealt with 77 cases in the same year[1].

Despite the importance of merger control in practice, its economic impact on firms' valuation is much debated in the academic literature. Most studies focus on the effects of actual regulatory actions, such as the decision of an antitrust enforcer to investigate a merger proposal in greater detail or to impose conditions (Ellert, 1976; Aktas et al., 2004, 2007; Duso et al., 2007). Not surprisingly, these studies confirm that regulatory actions affect firms' valuation, but the effects are somewhat mixed in terms of their economic relevancy and time of realization. In particular, it remains controversial whether all effects on firms' valuation are anticipated on the announcement day or realized later during the antitrust investigation.

One potential reason for the mixed findings is that these studies only look at the actual enforcement of merger policy (an exception is Brady and Feinberg, 2000), thereby ignoring the effects that the introduction or changes in the policy itself may have on investors' expectations and thus stock prices. Some studies have indeed shown that the effects at the time of regulatory reforms can

* Corresponding author.
E-mail addresses: steven.ongena@bf.uzh.ch, steven.ongena@gmail.com (S. Ongena).

[1] Merger notification is voluntary in the U.K. This means that the OFT decides on cases that are either voluntarily notified by the parties or are opened on its own initiative.

http://dx.doi.org/10.1016/j.irle.2015.01.004
0144-8188/© 2015 Elsevier Inc. All rights reserved.

be important and even larger than those at the time of the merger announcements. For example, Becher (2009) finds that this was the case with the passage of the Riegle Neal Act of interstate bank deregulation in the US in 1994, although the Act itself was the culmination of almost two decades of state-by-state reform (Kroszner and Strahan, 1999). Another potential reason for the mixed findings on the impact of merger control legislation is that the existing studies do not distinguish across different sectors. Therefore, they disregard sector specificities and the potentially important interaction between merger control and sector regulation.

In this paper we contribute to the existing literature by investigating further the economic impact of merger control. Our focus is to analyze the impact on firms' valuation of the legislative changes introducing or substantially reforming merger control regulation rather than of its actual enforcement. As mentioned above, this allows us to measure investors' expectations about the potential future effects of merger control on the competitiveness of industries. To do this, we study merger control legislation in detail and we construct a unique data set covering 19 industrialized countries over the last three decades.

Our interest is twofold. On the one hand, we analyze the impact of merger control on investors' evaluation. On the other one, we explore potential differences across sectors and the interaction between merger control and sector specific regulation by distinguishing between regulated and non-regulated sectors. In particular, we analyze separately the effects of the reforms of merger control legislation on non-financial firms (henceforth, also firms) and banks. Our choice is motivated by the fact that the financial sector – and in particular the banking sector – is the most regulated sector of the economy. Banking regulation is pervasive and, differently from the regulation in other industries, it includes a specific supervisory control of mergers and acquisitions among banks for reasons of financial stability. Moreover, as banking regulation dates back in all our sample countries to well before the reforms of merger control, the sector is particularly suited to analyze the effects of the introduction of merger control in a regulated sector.

Our analysis is based on a stock market event study. As a first step, we construct four indices – defined as Criteria, Enforcer, Overturning and Mandatory Notification – that describe the most important institutional characteristics of merger control. We rank these indices from 0 to 1, with higher values corresponding to a more competition-oriented design and enforcement of merger control, and study their variation across country and time. Then, we analyze in an event study the impact of the changes in these indices on the stock prices of non-financial firms and banks.

In line with the monopolistic hypothesis that a properly enforced merger control prevents anticompetitive mergers and thus future monopolistic rents (Ellert, 1976), we find that the introduction or the strengthening of merger control lead to negative excess returns on the stocks of (non-financial) firms. In contrast to this, however, we find that bank stock returns are positive. The difference in excess returns on firm and bank stocks is both statistically significant and economically relevant, and is robust to the use of either sector price indices or firm-level data in the event study.

To exploit sector characteristics further, we then investigate the reaction of stocks of firms in other regulated industries including insurance, telecommunication, utilities and healthcare sectors. Again, we find negative excess returns in response to the changes in merger control legislation in all sectors except in the insurance sector, where excess returns are positive. This suggests that there may be something specific to the financial industry that induces investors to react differently.

We then turn again to the banking sector, and perform a cross sectional analysis to investigate what can explain the differential effects on firm and bank stocks. We find that the characteristics of the supervisory control are the main explanatory variables of investors' reactions. In particular, the potential discretion embedded in the supervisory control deriving from unspecified valuation criteria and lack of disclosure of formal decisions is a key driver of the positive reaction of bank abnormal returns. This suggests that the more the supervisory control can be implemented with discretion, the higher is the valuation gains of banks in anticipation of changes in merger control.

The results are consistent with different hypotheses. One possibility is that, in line with the political economy literature, investors anticipate the strengthening of the merger control in the banking sector as the creation of a value-increasing "separation of powers" and "checks and balances" mechanism to the supervisory control. This would mean that merger control represents an efficient regulation which reduces the potential for abuse of power and wasteful outcomes of the supervisory decisions, in particular when these are not transparent. However, a second interpretation is that the strengthening of merger control creates inefficiencies, thus weakening previously efficient bank regulation. This would suggest a fall in the stock prices of firms, which are now burdened by a new regulatory apparatus, but a rise in the stock prices of banks as these can play regulators off against each other to increase rents in a so-called "race to the bottom".

To shed some light between the two hypotheses, we analyze in detail the well-known takeover battle that occurred in 2005 between *ABN AMRO* and *Banca Popolare Italiana* for the control of the Italian bank *Antonveneta*. The results support the "checks and balances" explanation over the "race to the bottom" explanation, although they must be read within the context of a case study.

Our paper makes three distinct contributions to the literature. First, differently from existing studies, it constructs a very detailed cross-country data set capturing the main institutional characteristics of merger control legislation. The data document the existence of considerable variation in the institutional design of merger control across countries and time. Second, it shows how the documented variation in the design of merger control affects firms' valuation. Third, it examines and explains how these valuation effects may differ across sectors. In particular, we focus on the difference between non-financial firms and banks, and we closely investigate the role that banking sector-specific regulation may have in explaining these differential effects. Our estimates highlight the importance of sector characteristics and existing sector regulation for the effects of legislative changes in merger control.

The paper relates to several strands of literature. First, it fits in a vast literature that studies the role of the legal architecture for the functioning of financial systems (La Porta et al., 1998), including its impact on the volume of M&As and the direction of cross-border deals (Rossi and Volpin, 2004). Second, it relates to studies by Jayaratne and Strahan (1998), Demirgüç-Kunt et al. (2004), Guiso et al. (2006), Barth et al. (2006) and Donzé (2006), which provide evidence that excessively restrictive, inefficient or discretionary banking regulation weakens the banking sector and leads to substantial welfare costs. Finally, our paper is connected to the literature on the "specialness of banks" (Dewatripont and Tirole, 1994; Goodhart et al., 1998; Herring and Litan, 1995), competition in banking (Keeley, 1990; Hellman et al., 2000; Boyd and De Nicolo, 2005; Claessens and Laeven, 2005; Beck et al., 2006; see Carletti, 2008 for a survey), and the causes and consequences of banking consolidation (Berger et al., 1998; Boyd and Runkle, 1993; Demsetz and Strahan, 1997; Carletti and Hartmann, 2003; Carletti et al., 2007; see Berger et al., 1999 for a survey).

The rest of the paper is organized as follows. Section 2 summarizes briefly the history and institutional arrangements of merger control, and it describes the main economic hypothesis driving the evaluation of its economic impact. Section 3 describes the data and the methodology we use in our econometric exercise.

Download English Version:

https://daneshyari.com/en/article/5085597

Download Persian Version:

https://daneshyari.com/article/5085597

Daneshyari.com