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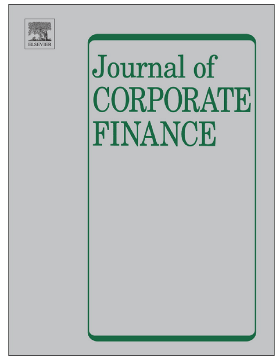

When does competition mitigate agency problems?

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ABSTRACT

This paper examines how the performance correlation of firms in an industry affects the degree to which product market competition mitigates agency problems. Consistent with theory, I find that in industries with high firm performance correlation, product market competition reduces the adverse effect of business combination (BC) laws on firm operating performance, while in industries with low performance correlation competition does not have such an effect. My results are robust to (i) the use of different measures of performance correlation, competition, and operating performance; (ii) excluding firms that are not exogenously affected by BC laws, (iii) dropping the years that are affected by the first-generation state antitakeover laws. I find similar results for stock prices when examining the stock market reactions to the first newspaper reports of BC laws. Overall, the disciplining effect of competition depends positively on an industry's performance correlation.

JEL Classification: G34, D40

Keywords: Product market competition; agency problems; corporate governance; performance correlation; antitakeover law

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