Sixth Annual Mergers and Acquisitions Research Centre Conference Report

27th June 2022

Bayes Business School

Session 1:

Tom Griffin: *Does Regulatory Exposure Create M&A Synergies?* (with Eli Fich and Joseph Kalmenovitz)

Companies must comply with thousands of federal regulations, which affect virtually every aspect of their activities such as competition, taxation, and pollution. By some accounts, the median firm spends up to 4.1% of its market capitalization on compliance. Consequently, regulation is believed to have an adverse effect on corporate investment, since resources that could have been used for fund investment must be redirected towards regulatory compliance. By using novel firm-level exposure to all federal regulations, **Tom Griffin** presented a paper that studies the impact of regulation on acquisition investment. Highly regulated companies issue more acquisition bids, invest more in those transactions, and earn higher M&A announcement returns. Moreover, highly regulated acquirers exhibit better long-term performance, greater M&A synergies, and a significant reduction in their regulatory exposure after merger completion. The benefits are stronger in deals with small transaction values and in those involving private targets. Overall, their findings uncover a new link between M&A and regulation, highlighting synergy opportunities, which materially affect corporate investment choices.

In his discussion, **Ronald Masulis**, first challenged the sample selection. He would like to know whether the subsample of firms with high regulatory exposure significantly differs in major economic dimensions from those firms with lower exposure. He questioned whether these differences in regulatory exposure could be used to proxy for acquirer size or its level of diversification. Moreover, he advised showing more direct evidence which can support the hypothesis that acquirers are able to diversify away regulatory exposure through acquisitions. He pointed out other alternative hypotheses that can potentially explain the impact of regulation on acquisitions. These hypotheses include 1) regulations can create barriers to entry; 2) if regulations have significant fixed components and when two firms in the same environment (same industry) combine, there should be large regulatory savings as only a single fixed cost must be borne, not two. Additionally, the authors should provide more clarification on the regulatory index and evidence on the validity and reliability of this index are expected to be provided.

Eric de Bodt: *"The (Un)intended Consequences of M&A Regulatory Enforcements"* (with Micah Officer, Jean-Gabriel Cousin and Richard Roll)

Regulatory agencies regularly intervene in the M&A market. In the U.S., the Department of Justice and the Federal Trade Commission (DOJ/FTC) actively monitor M&A transactions, and are in charge of "preventing mergers and acquisitions that are likely to reduce competition and lead to higher prices, lower quality goods or services, or less innovation." (DOJ/FTC Horizontal Mergers Guidelines). Do these regulatory enforcements generate significant uncertainty, causing potential acquirers to refrain from engaging in acquisition attempts? By using DOJ and FTC interventions in the M&A market, **Eric de Bodt** presented a paper investigating whether uncertainty around regulatory enforcements also matters. Their results support this conjecture. Using the Hoberg and Phillips (2010) similarity scores to identify product market competitors, they confirm a clear and significant DOJ/FTC regulatory enforcements' deterrence effect on future M&A transaction attempts, a result robust to many alternative specifications and confirmed in additional tests. This deterrence effect is (at least partly) driven by the length of the regulatory process, a factor that exacerbates enforcement uncertainty. The paper identifies an (un)intended channel through which M&A regulation hampers efficient resource allocation.

In his discussion, **Andrey Golubov**, first expressed his hesitations on the contribution of the paper. He suggested that the authors clarify what mechanism drives the results. The authors should use more direct proxies for the uncertainty about future enforcement and further clarify the definition of uncertainty in the paper. Moreover, in terms of econometrics concerns, he suggests the authors control for past M&A activity using the Arellano-Bond estimator. Additionally, for a proper placebo test in table 5, the paper needs to include a large N of Monte Carlo permutations (e.g., 1,000), not just 1. Finally, he noted that the authors ought to provide more evidence on whether M&A regulation hampers efficient resource allocation.

Session 2:
Tingting Liu: *"Winner's Curse in Takeovers? Evidence from Investment Bank Valuation Disagreement"* (with Tao Shu and Jasmine Wang)

Theories of the winner's curse in takeovers suggest that because bidders fail to fully account for the overbidding associated with the uncertainty about target value, winning bidders overpay and earn poor returns. Using a unique setting where target firms hire multiple investment banks as advisors, **Tingting Liu** presented a paper that constructs a novel measure of target valuation uncertainty based on the disagreement of investment banks on target valuation. They find that in the presence of high valuation disagreement, bidders on average pay significantly higher acquisition premiums, and bidders who pay higher premiums have lower returns around merger announcements and in the long run. These bidders also create lower merger synergies. Their results are robust to the control for selection bias using Heckman two-stage model with an exclusion restriction. Moreover, the winner's curse is more pronounced when bidders have overconfident CEOs. Overall, the findings suggest that the winner's curse does exist in takeovers and causes distortions in resource allocation.

In his discussion, **Henri Servaes**, first provided some suggestions on the measure of uncertainty, for example, 1) combining various traditional measures of uncertainty together; 2) using the price range itself, rather than the standard deviation of low/median/high across multiple banks. He questioned whether target firm advisors are supposed or allowed to use information on merger synergies assumptions since synergies are made by bidders instead of targets. He pointed out that the authors were studying the valuation uncertainty of the target, however, the data in the paper are about the targets' banks. He suggested comparing and contrasting results by using data on bidder's bank's estimates. Moreover, he pointed out that the higher premium for observed deals with multiple banks may be due to target's higher bargaining power or willing to bargain, but not the level of valuation certainty. Finally, he advised to control for bidder experience and clarify the reason why the premium paid is not related to completion likelihood.

Jarrad Harford: *"Mergers under the Microscope: Analyzing Conference Call Transcripts"* (with Sudipto Dasgupta, Fangyuan Ma, Daisy Wang and Haojun Xie)

Mergers and acquisitions are often a black box for empirical researchers. Apart from standard information provided by the established data sources on the merging entities and the financial terms of a deal, very little is known about the issues that matter most to the managers proposing the deal and the shareholders evaluating the deal. Many M&A deal announcements are accompanied with a conference call to discuss deal details and address market participants' demand for information. **Jarrad Harford**, presented a paper which finds that calls are associated with positive market reactions and a higher likelihood of deal completion. Using a topic modelling approach, the paper uncovers 20 highly interpretable topics from the call transcripts. Market reactions are more positive when the call communicates more "hard" information as opposed to "soft" information, revealing different disclosure strategies depending on deal quality. Governance-related issues, although not significantly correlated with stock returns, are prominently discussed and related to the latent motivation for holding calls.

In his discussion, **Peter Haslag**, first pointed out that the costs and benefits are potentially not monotonic in deal quality and that most public-public deals have a negative market reaction. He suggested controlling for other news in the paper. The authors should emphasize Q&A differences more and include a shorter event window as well. In terms of instruments, authors are advised to clarify what the instruments are capturing. He recommended using alternative instruments in the paper, for example, peer likelihood (similar vein as current instrument) and active institution ownership. In addition to showing that more information is positive on average; the authors can utilize absolute value (CAR) to provide more evidence on information in general. In addition, he advised clustering standard deviation at year or industry-year level.

Session 3:
Stefan Obernberger: *"Post-merger Restructuring of the Labor Force"* (with Britta Gehrke, Ernst Maug and Christoph Schneider)

A large literature analyzes the sources of synergies in mergers, usually by associating the pre-acquisition characteristics of the merging firms with their short-run and long-run stock returns. Little is known about how firms restructure their operations to realize synergies after mergers. Yet, much can be learned from analyzing how acquirers integrate the target by changing the composition and size of the workforce of the combined firm, reassigning employees to new jobs, and moving them to different plants. **Stefan Obernberger** presented a paper that studies the restructuring of the labor force after M&As. They found that the net employment of targets declines by half within two years after acquisitions relative to matching firms. Employee turnover increases, particularly for managers, and jobs migrate to acquirers. Acquirers have a better-educated, better-paid, and more qualified workforce than targets. Acquirers hire new employees who are younger and less expensive. Mergers create internal labor markets. However, most hiring is external, especially for managers. Their results are consistent with a framework in which acquirers seek business opportunities from targets and provide the organizational and managerial capacity to produce more efficiently.

In his discussion, **Dirk Jenter** first pointed out that deals are done for a wide variety of reasons, for example, economies of scale, economies of scope, relationship-specific investments, reducing competition and so on so forth. Different motivations may have different implications for workforce changes. The results show a minimum of two completely different deal types: in 30% of deals, the target completely shut down (i.e. 100% decline in target workforce); in the other 70% of deals, no decline in target workforce. Therefore, the authors should compare the employee changes in each kind of deal type. He further questioned whether the proposed model fits the data well and suggested the authors could use deal synopses and deal pitches to identify the heterogeneity in synergy strategies. Additionally, in terms of causality, he addressed that all changes are relative to a set of matched control firms and that the authors should use the nearest-neighbor matching, within industry x year x region x number of establishments, based on similarity of workforce. He further emphasized that deals are endogenous, – there is a reason why, between two similar-looking firms, one does a deal, and one does not. The observed changes might not be caused by the deal; especially on the acquirer side, significant restructuring might have happened in any case. Finally, he showed his concern that since many post-deal employee departures appear to be voluntary; some observed changes might not be an intentional restructuring, but an undesired side effect of the deal.

Keynote Speech

Giovanni Amodeo: *"H2 Trends on M&A, Debt Issuance and Fund Raising"*

Giovanni Amodeo first delivered a brief introduction of himself and ION Group. He explained why data is important. He then intorduced different roles in the capital market econsytem and their needs for different categories of data. For example for corporations, they need the information to look for potential targets, negotiate the terms, identify the market competition and market trends, and so on so forth. Data market participants use information and analytics to facilitate growth. He also showed data of 1) EU and US 10-year yield; 2) US and EU unemployment; 3) EU and US CPI; 4) Crude oil, and concluded that: 1) EU set to embargo further Russian oil imports with likely continuing upward pressure on oil prices; 2) Central banks announce intention to continue with rate increases until inflation subsides. Eurozone annual inflation running at 8% - an all-time high. 3)Banks begin to signal cost containment and headcount cut intentions. 4) Inflation and war dominate mindshare. He concluded that there is fear, uncertainty and doubts in the overall economy, however, there are also opportunities in the market as well.

In terms of private market fundraising in 2021, he suggested that 1) European PE fundraising forges ahead amidst macro uncertainty; 2) Chinese (Renminbi) fundraising has moved in the opposite direction; 3) Limited Partners (LPs) are increasing their allocation to alternatives with a critical focus on PE and VC; 4) Increased capital pools for established fund managers; 5) Inaugural funds are on the rise; 6) Substantial amount of dry power to be put to work – increase in LBO values, mega deals to continue.

Moving to debt capital markets, he stated that after 2 years soaring issuance volumes triggered by monetary authorities' intervention (due to the pandemic), the market is going through a severe correction. Political and commodity market uncertainties are keeping inflation levels high and High Yield bond sales are the first to take the hit in this volatile environment. Additionally, Central banks will need to keep interest rates high to counter the effects of inflation.

Finally, for Special Purpose Acquisition Companies (SPACs), he presented that six blank check companies have busted so far this year. Other US-listed SPACs to liquidate this year include Cascade Acquisition, Mallard Acquisition, Alberton Acquisition, CHP Merger and Burgundy Technology Acquisition. There are 591 remaining SPACs that need to complete a merger. US-China worsened relations puts pressure on cross-border SPAC investors. Moreover, over the last year, US regulators have clamped down on all SPACs, foreign or domestic, proposing stricter financial reviews and making it easier for shareholders to file lawsuits.

Session 4:
Fei Xie: *"Climate Laws and Cross-border Mergers and Acquisitions"* (with Dragon Yongjun Tang and Tong Li)

Climate change is one of the most pressing challenges of our time. As efforts to combat climate change, governments around the world have adopted various regulations. It is underexplored how climate regulations influence corporate decisions. **Fei Xie** showed that climate regulations are relevant to cross-border mergers by exploiting cross-country variations in the timing of introducing climate laws. After a target country adopts climate laws, the acquisition activity between two countries declines. This effect is more pronounced among industries with high law exposure and countries with strong law enforcement. However, acquirers' concerns about climate change mitigate the relation. Climate laws also reduce synergies and offer premiums. Moreover, announced bids are more likely to be cancelled after the target country adopts climate laws. Their findings suggested national climate laws have unintended consequences on cross-border acquisitions and, thereby, capital allocation.

In his discussion, **Filippos Papakonstantinou**, firstly he stated that there are 45K deals in total used in the paper, however, 1.5K observations are used in table 14. In this case, the authors should check the data. He pointed out that the interpretation of ln(1+#Deal) is difficult, and he suggested using the Poisson model and including ln(#Deal) in G20 subsample. Additionally, he advised including time-variation control variables that affect both acquisitions and the climate law adoption, for example, GDP of the target country. Furthermore, the treatment effect could be heterogeneous across cohorts because: 1) More countries adopt climate laws (i.e. fewer alternatives); 2) More companies adopt green values (i.e. less avoidance of countries with climate laws). Moreover, the effect of climate law on acquisitions is stronger at +2 years, but the effect is marginally significant after 4 years. He questioned whether the effect of climate law adoption would remain significant if [-3,+3] years are excluded. He recommended including more robust tests and additional analyses in the paper.

Muhammad Farooq Ahmad: *"The Innovation Arms Race"* (with Eric de Bodt and Jarrad Harford)

Baumol (2002) argues that the innovation engine is the core feature of modern capitalism, fueling exponential economic growth for two centuries. According to the author, the innovation engine is fed by a mixture of oligopolistic competition, innovation routinization, sharing and licensing, and fierce arms races between rivals. However, such an arms race implies value-loss at the firm level and rent transfers to consumers—is that the correct characterization of the side-effects of competitive innovation? **Muhammad Farooq Ahmad** presented a paper that explores how firms change their innovation when their rivals acquire innovative targets. Firms appear to increase innovation investment, both internally through R&D and externally through the acquisition of innovative targets, yet their market value decreases. The results are consistent with an "Innovation Arms Race", where firms compete for market share by innovating, thus somewhat paradoxically leading to rent transfer to consumers (rather than increased rents for firm). These results are robust to endogeneity and are driven by the high-technology industry. This arms race process appears stronger for leaders and neck-and-neck firms. Initial patents and patent citations based evidence shows no sign of innovation investment efficiency decline, and this suggests that the innovation arms race generates a transfer of economic rent favorable to consumers.

In her discussion, **Juanita Gonzalez-Uribe** expressed her concern on econometrics issues. To measure innovation responses, the authors use the simultaneous equation model. However, the authors failed to address the endogeneity problem and other econometrics concerns like bad controls. She stated that authors should further explain the model and provide some more in-depth explanations. Additionally, she suggests including a stronger result for innovative acquisitions and strengthening the "innovation arms race" interpretation. She advised using the standard Kogan's data in the paper, instead of NBER older files, to provide updated results. Finally, she stated that the authors should provide more clarification on the measurements used in the paper.