Real effects of competition laws: International evidence

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Research objective

- Countries across the world are advocating for policies to tighten antitrust laws to address anti-competitive practices of firms (e.g., US, UK, Japan, China)
- The push for stricter antitrust laws raises questions on whether they are beneficial to firms and to the economy.
- We investigate this issue by assessing the effect of competition laws on firms' financing and investment decisions.
- We also examine how this association is conditioned on the strength of a country's legal institutions that protect creditors and enforce contracts.
- Why financing and investment? Financing and investment are corporate finance's most basic activity, depend on the competitive landscape (Dixit 1980; Stulz 2000) and are central to firms' value creation, and hence economic growth (Rajan and Zingales 1998; Tirole 2006).

Theoretical foundation

- Market frictions such as adverse selection costs and/or moral hazard makes the financing and investment decisions relevant and affects investors' welfare as well as the economy as a whole (Tirole 2006).
- Firms with quality governance can raise capital at a lower cost to exploit growth opportunities leading to higher valuations (La Porta et al. 2002; Gompers et al. 2003; Albuquerque and Wang 2008).
- Competition versus Corporate Governance
  - Spurs improvements in governance and reduces agency costs (Alchian, 1950; Fama, 1980; Fama & Jensen, 1983; Giroud & Mueller, 2010, 2011). Therefore, we hypothesize a positive association between the stringency of competition laws and firms' external financing and investment.
- Competition versus operational and liquidity risks
  - Intense competition has a detrimental impact on firms' information environment due to increasing proprietary cost (Verrecchia 1983; Verrecchia and Weber 2006), increases uncertainty and exacerbates default risk leading to higher cost of capital (Irvine and Pontiff 2009; Valta 2012). Stringency of competition laws may negatively affect corporate financing and investment.
- The relation between competition laws and corporate financing and investment is left as an empirical question.

Research design

- We exploit a new dataset on competition laws around the world compiled by Bradford and Chilton (2018).
- External financing as the sum of debt and equity issues and proxy for investment using capital expenditure (Shroff 2020).

Following Levine et al. (2020a, 2020b), we use the following ordinary least squares (OLS) regression specification.

$$Y_{f,c,t} = \alpha_0 + \beta \times CLI_{c,t-1} + \gamma Controls_{f,c,t-1} + FEs + \varepsilon_{f,c,t,}$$

where f, c, and t index firm, country, and year, respectively.
Y represents either External financing or capital expenditure
Controls denote a set of one- year-lagged time-varying firm and country characteristics.
We include firm and industry- by-year fixed effects
We cluster the standard errors at the country level

Main findings

- We find a positive and significant association between the stringency of competition laws and financing and investment
- Robust to several sensitivity tests.
- On average, a one-standard-deviation increase in the competition law index leads to 11% (3%) increase financing (investment).
- The positive effect is more pronounced for firms in countries with weaker investor protection laws.

Contributions

- Contributes to understanding the economic consequences of a crucial country-level regulation: competition law
- Documents evidence that differences in country-level institutional factors affect the nature of competition.
- Adds to the international business and finance literature on the important role of laws in international studies (Shleifer and Vishny 1997; La Porta et al. 1998; Cumming et al. 2017).

Sample estimations

Competition laws and corporate financing and investment

	External financing			*Capital expenditure*		
Variables	(1)	(2)	(3)	(4)	(5)	(6)
CLI	0.051***	0.050**	0.042**	0.010***	0.008**	0.006**
	(3.166)	(2.477)	(2.124)	(2.979)	(2.477)	(1.979)
Firm controls	No	Included	Included	No	Included	Included
Country controls	No	No	Included	No	No	Included
Firm FE	Included	Included	Included	Included	Included	Included
Industry-Year FE	Included	Included	Included	Included	Included	Included
Observations	206,713	206,713	206,713	206,713	206,713	206,713
Adj. R-squared	0.284	0.398	0.398	0.474	0.499	0.499

Competition laws and corporate financing and investment: Condition on the legal environment

	External financing				Capital expenditure			
Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
CLI	0.060***	0.065***	0.064***	0.068***	0.010***	0.010***	0.011***	0.008***
	(5.796)	(6.166)	(6.689)	(4.507)	(3.915)	(3.975)	(4.453)	(2.805)
CLI × Common law	-0.049**				-0.008**			
	(-2.480)				(-2.051)			
CLI × Enforcement		-0.060***				-0.009**		
		(-3.301)				(-2.251)		
CLI × High ADR			-0.051***				-0.010**	
			(-3.127)				(-2.451)	
CLI × Govt_Effectiveness				-0.075***				-0.005**
				(-4.079)				(-2.129)
Govt_Effectiveness				0.024				0.001
				(1.609)				(0.906)
Baseline controls	Included	Included	Included	Included	Included	Included	Included	Included
Firm FE	Included	Included	Included	Included	Included	Included	Included	Included
Industry-Year FE	Included	Included	Included	Included	Included	Included	Included	Included
Observations	205,799	205,799	205,799	186,585	205,799	205,799	205,799	186,585
Adj. R-squared	0.399	0.399	0.399	0.410	0.501	0.501	0.501	0.509