

26087: Labor and Finance - Mergers and Acquisitions

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Welcome to the Lecture Week!

	Date	Time	Location	Type
Introduction (mandatory)	04.11.2024	12.30 - 14.00	Teams (online)	Lecture
Mergers and Acquisitions	18.11.2024	12.30 - 14.00	A403	Lecture
	18.11.2024	14.15 - 15.45	A403	Presentations
Corporate Ownership	19.11.2024	12.30 - 14.00	A403	Lecture
	19.11.2024	14.15 - 15.45	A403	Presentations
Firms and New Technologies	20.11.2024	08.30-10.00	A307	Lecture
	20.11.2024	10.15-11.45	A307	Presentations
Capital Structure and Bankruptcy	21.11.2024	08.30-10.00	A308	Lecture
	21.11.2024	10.15-11.45	A308	Presentations
Booms and Busts	22.11.2024	08.30-10.00	A303	Lecture
	22.11.2024	10.15-11.45	A303	Presentations

Important Deadlines and Material

- **Course consists of three elements:**
 1. Introductory lecture + sign-up for paper presentation
 2. Lecture Week + Paper Presentation + team and topic choice for Course Assignment
 3. Submission of Course Assignment (and referee reports)

- **Key deadlines:**
 1. 08.11: Sign up for student paper presentation
 2. 15.11: Presentation submission deadline
 3. **18.11-22.11**: Lectures and presentations
 4. **25.11**: Team and topic deadline for Course Assignment
 5. **13.12**: Course Assignment deadline (and DL for PhD student reports)

- All course material can be found on **Moodle**

Objectives

- **This lecture:** Mergers, acquisitions, and human capital
- **Understanding M&As:** Crucial in the context of labor and finance
 - Often is a key corporate finance-related decision
 - Large discrete change in human capital inside firms compared to hires and firing that are often marginal
 - Can have substantial effects on careers
- **Objective:** Give you an overview of the various dimensions on how mergers and acquisitions interact with human capital inside firms and the careers of workers

Outline

An Overview of Mergers and Acquisitions

Human Capital Motivations for M&As

- Corporate Governance Through M&As

- Expanding Internal Labor Markets

- Acquiring Monopsony Power

- Acqui-hiring

How do M&As Affect Human Capital?

Government Policy and Merger Activity

Takeaways

An Overview of Mergers and Acquisitions

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What are M&As?

- **Merger:** The combination of two companies to form a new entity.
- **Acquisition:** One company takes over another, absorbing it.
- **M&As can be:**
 - Vertical or Horizontal
 - Hostile or Friendly
 - Strategic (incumbents) or Financial (buyouts)
- **Key Dimensions:**
 - Strategic alignment
 - Financial considerations
 - Legal implications

Why Do M&As Take Place?

- **Financial Motivations:**
 - **Economies of Scale:** Reduce per-unit costs by increasing production.
 - **Asset Acquisition:** Obtain valuable assets at a lower cost.
 - **Tax Benefits:** Utilize tax shields or loss carry-forwards.
- **Strategic Motivations:**
 - **Synergies:** Cost savings, **human capital**, revenue enhancements, comparative advantages, and efficiency gains.
 - **Market Expansion:** Enter new markets or increase market share.
 - **Diversification:** Spread risks by entering different industries.
- **Takeover Premia:** A lot of research in finance has focused on documenting the sources of takeover premia

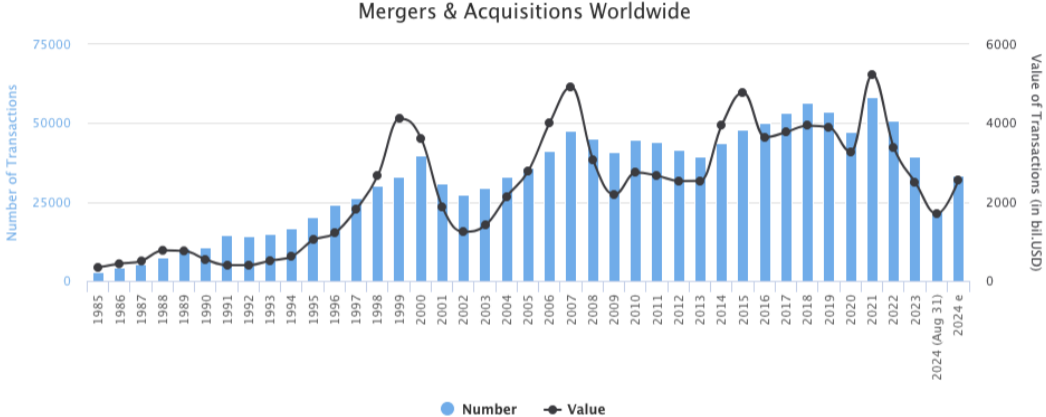
The Incomplete Contracting View of M&As

- **Nexus of Contracts:** The firm works as a nexus of contracts (Coase 1937, Fama and Jensen 1983, Grossman and Hart 1986, Hart and Moore 1990, Hart 1995)
 - Contracts (explicit and implicit) draw the boundaries between the firm and the market (i.e., what is done in-house and what is acquired through the open market)
 - These contracts determine the organizational form
- **M&As redraw the boundaries of the firm**
 - in response to changes in the environment
 - to move the firm closer to the optimal organization of firm (division of tasks between in-house and market production)

M&As as a Response to Change

- **Market and Industry Changes:**
 - **Technological Disruption:** Adaptation to new technologies.
 - **Regulatory Changes:** Compliance with new laws and regulations.
 - **Economic Cycles:** Defensive or opportunistic responses to economic downturns.
- **Internal Firm Changes:**
 - **Leadership Transitions:** Changes in management strategy.
 - **Operational Challenges:** Addressing inefficiencies or capacity issues.

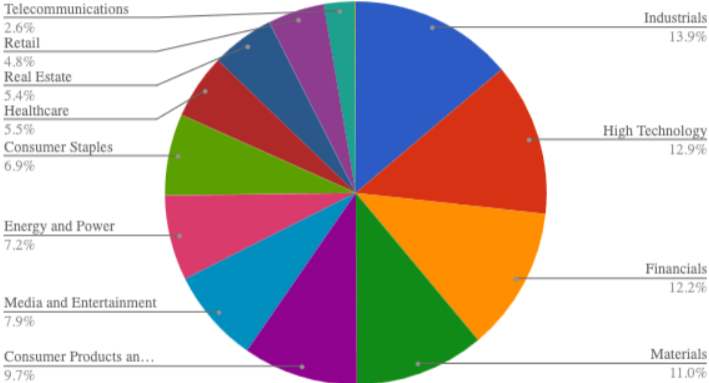
M&As are Cyclical



Source: IMAA analysis; imaa-institute.org

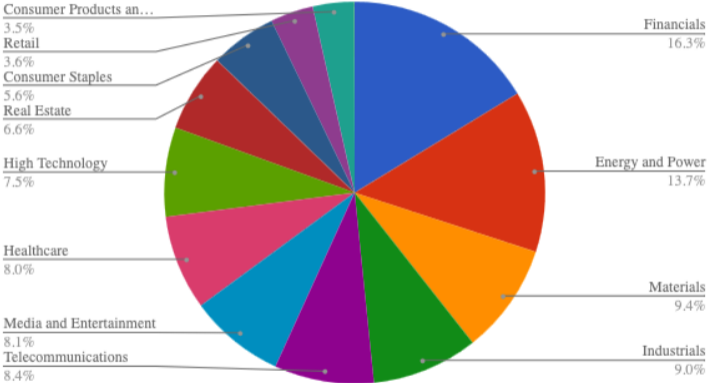
M&As are Everywhere...

M&A by Industries in Numbers (since 1985)

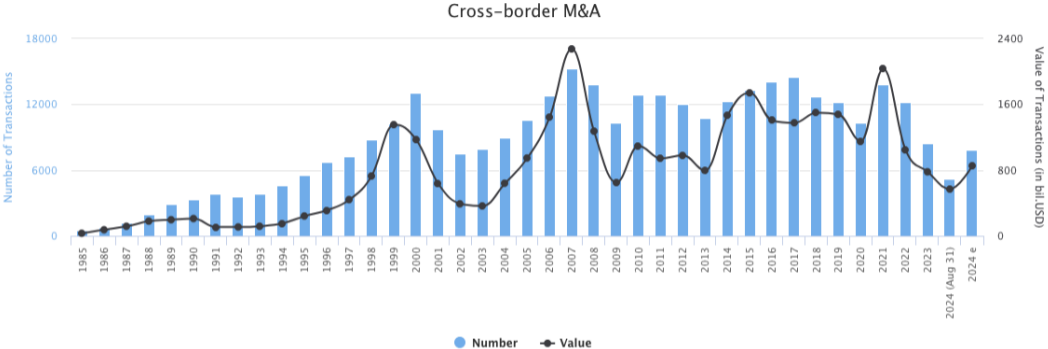


...but More Prevalent in Some Industries

M&A by Industries in Value (since 1985)

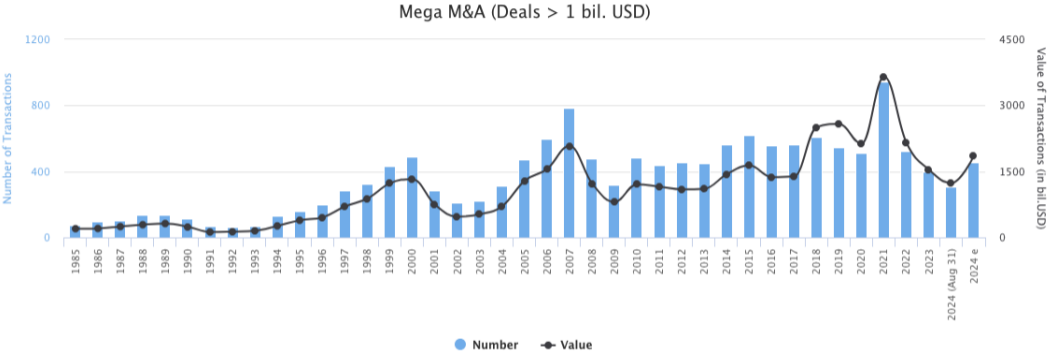


Globalization drives cross-border M&As



Source: IMAA analysis; imaa-institute.org

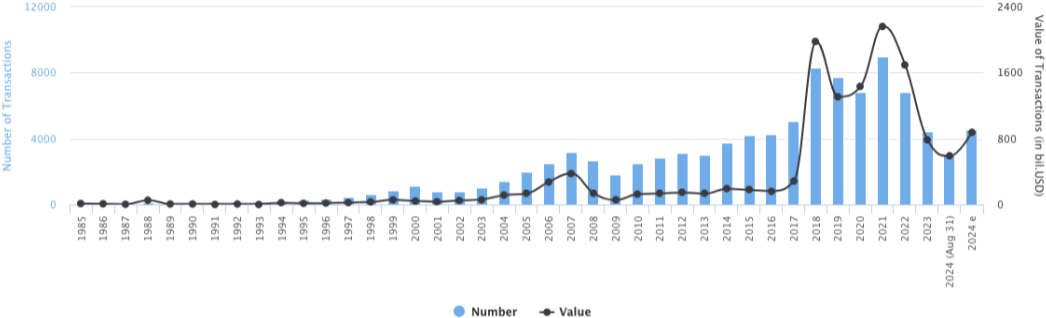
Mega Deals are more Common



Source: IMAA analysis; imaa-institute.org

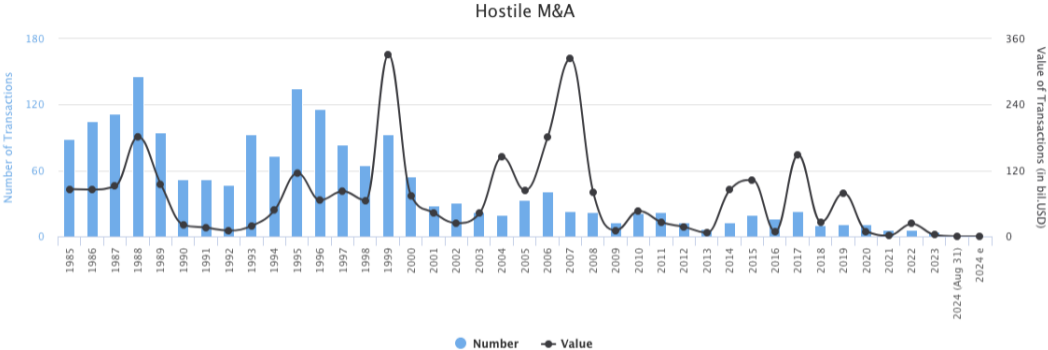
The Rise of the PE Industry...

M&A by Financial Investors



Source: IMAA analysis; imaa-institute.org

...and the decline of hostile M&As



Source: IMAA analysis: imaa-institute.org

Examples of M&As: Amazon and Whole Foods (2017)

- **Deal Value:** \$13.7 billion
- **Key Motivation:** Entry into the grocery sector and enhancement of Amazon's physical retail presence.
- **Outcome:** Integrated Whole Foods into Amazon's delivery network, boosting Amazon's market reach.

Examples of M&As: Microsoft and Nokia (2014)

- **Deal Value:** \$7.2 billion
- **Key Motivation:** Boosting Microsoft's mobile hardware capabilities and competing in the smartphone market.
- **Outcome:** Ultimately considered a failed acquisition; Microsoft wrote off the value, and Nokia refocused on network infrastructure.

Examples of M&As: Facebook and WhatsApp (2014)

- **Deal Value:** \$19 billion
- **Key Motivation:** Strengthening Facebook's position in mobile messaging.
- **Outcome:** Expanded Facebook's user base and enhanced its global communication network.

Key Takeaways on M&As

- M&As are driven by both **financial and strategic** motivations, often in response to market, industry or internal firm changes. → "re-optimizing of the boundaries of the firm"
- M&As often involve large **discrete** changes in a firm's human capital
- M&A activity **varies considerably** over time and across industries. Has trended toward larger, cross-border deals, more often involving financial buyers

Human Capital Motivations for M&As

Overview

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- Corporate Governance Through M&As

- Expanding Internal Labor Markets

- Acquiring Monopsony Power

- Acqui-hiring

How do M&As Affect Human Capital?

Government Policy and Merger Activity

Takeaways

Why Human Capital Matters

- **Definition:** Human capital refers to the skills, knowledge, and experience possessed by individuals within an organization.
- Several ways in which human capital motivates M&As. Here we will cover:
 1. Corporate Governance Through M&As
 2. Expanding Internal Labor Markets
 3. Acquiring Monopsony Power
 4. Acqui-hiring

Human Capital Motivations for M&As

Corporate Governance Through M&As

Corporate Governance Though M&As

- A firm may become an **attractive M&A target** because it is not run a way that maximizes profits due to **agency costs**
 - Managers usually own little of the firm they manage
 - The objectives of shareholders and managers do not align
- Instead of maximizing profits, managers may:
 - **Engage in empire-building:** hire or acquire too many people
 - **Enjoy the quiet life:** golf and pay workers too much to keep them happy
 - **Also:** buy corporate jets, keep pet projects, relocate close to family etc...
- Note that:
 - Many activities tend to **favor workers over shareholders**
 - M&A motivation be about **value creation AND/OR value capture**
 - Historically, this was hostile M&As, now more commonly done through PE buyouts

Bertrand and Mullainathan 2003: Ending the Quiet Life

- **Research Question**

- How do weakened corporate governance mechanisms, such as antitakeover laws, influence managerial behavior?

- **Data and Identification**

- U.S. state antitakeover laws as exogenous variation in governance strength
- Plant-level data and firm-level data from Compustat (1980s–1990s)
- DiD approach to compare firm and plant outcomes

- **Key Findings**

- **Higher Wages:** Wages rise for blue-collar (+1%) and white-collar workers (+4%)
- **Plant Dynamics:** Decrease in plant creation and destruction
- **Efficiency:** Productivity and profitability decline, supporting the "quiet life" hypothesis over empire-building.

Shleifer and Summers 1988: Breach of Trust

- **Breach of Implicit Contracts in Hostile Takeovers:**
 - Classic reference on "Value Capture From Workers" vs "Value Creation"
 - Can occur through the breach of implicit contracts
- **Implicit Contracts:**
 - Unwritten agreements and expectations between managers and employees (culture, reputations etc)
 - Can include wage premia, efficient dynamic wage contracts, perks, or task assignments, and pension obligations
- **Observations:**
 - Bigger point is that **Private value** in takeovers need to imply **social value**
 - **Inefficient value capture** can occur due to externalities (e.g. large plant closures)
 - Breach often requires **management turnover** (e.g. Olsson and Tåg 2024)

Human Capital Motivations for M&As

Expanding Internal Labor Markets

Expanding Internal Labor Markets

- **Internal Labor Markets (ILMs):** The system of job positions and career pathways within a firm.
- **M&As may be motivated by expanding the ILM:**
 - To access and better utilize the target firm's internal talent pools by combining them with the acquirers talent pool
 - To expand opportunities for career development inside firms, encouraging investment in firm specific human capital
 - To **cut costs** by firing low quality and redundant workers
 - Hiring **within the firm** lowers transaction costs due to better information flows
- **Note:** Extensive research on role internal capital markets in allocating capital between divisions inside firms, but there is comparatively less research on ILMs

Lee et al. 2018: Human Capital Relatedness and Mergers and Acquisitions

- **Research Question**

- Does human capital relatedness between firms influence the likelihood of mergers and the resulting merger performance?

- **Data and Identification**

- Sample of M&A deals (1997–2012) with human capital constructed using BLS
- Uses "human capital relatedness" (HCR) to measure workforce similarity
- Empirical strategy includes regressions with interaction effects

- **Key Findings**

- Mergers are more likely and synergies stronger when firms share human capital
- In unrelated M&As, higher HCR leads to more layoffs and wage reductions, enhancing efficiency.
- HCR has limited impact in horizontal mergers due to greater retention of both workforces.

Tate and Yang 2023: The Human Factor in Acquisitions

- **Research Question**

- Do acquisitions between industries with high human capital transferability lead to better productivity outcomes?

- **Data and Identification**

- Census data on employer-employee matches, covering 11.5 million job changes (1995–2007)
- Human Capital Transferability (HCT) Index constructed based on observed job flows
- Identification strategy leverages variation in state-level noncompete agreement enforcement to measure the impact of internal labor markets

- **Key Findings**

- Firms are more likely to diversify into industries with high HCT
- High-HCT diversifying acquisitions see a 18% productivity increase
- Higher retention and internal reallocation of skilled employees following high-HCT

Human Capital Motivations for M&As

Acquiring Monopsony Power

Monopsony Power as a Motivation for M&As

- **Definition:**

- Monopsony power occurs when a firm becomes the dominant employer in a labor market, giving it significant control over wages and employment conditions

- **Motivation for M&As:**

- By reducing competition for employees, firms can suppress wage growth and gain greater control over employment terms

- **Observations:**

- Specially important when there are few options for employers in a **region** or within an **occupation**
- Often reduces overall welfare (value capture rather than value creation)
- This is currently a **growing literature** due to increased pressure to consider monopsony in anti-trust law

Prager and Schmitt 2021: Employer Consolidation

- **Research Question**

- Do M&As that increase market concentration slow wage growth?

- **Data and Identification**

- DiD analysis of U.S. hospital mergers (2000–2010) using hospital and wage data.
- Comparison of wage growth between hospitals in markets affected by mergers and those in unaffected markets

- **Key Findings**

- Wage growth declines significantly for skilled and healthcare workers in high-concentration mergers
- Unskilled workers see no significant wage effects, suggesting that industry-specific skills amplify merger impacts
- Union presence and pro-union policies mitigate negative wage effects, highlighting the role of labor power

Human Capital Motivations for M&As

Acqui-hiring

Acqui-hiring

- **Acqui-hiring:** The acquisition of a company primarily for its talent rather than its products or services.
- **Firms Pursue Acqui-hires to:**
 - Hire talent when talent is scarce ("sign-on bonus")
 - Quickly gain access to skilled employees knowledgeable about the (intangible) assets they are buying
 - Circumvent non-competes and trade secrets law
 - Preempt future competition from start-ups
- **Observations:**
 - Reduces the time to market for new products by integrating a pre-existing, highly skilled workforce

Chen et al. 2023: Hiring High-Skilled Labor Through Mergers and Acquisitions

- **Research Question**

- Do firms respond to shortages of high-skilled workers by acquiring firms?

- **Data and Identification**

- U.S. H-1B visa lottery data used as a natural experiment
- LinkedIn profiles and visa microdata track high-skilled labor acquisition across firms (2008–2017)

- **Key Findings**

- Firms that lose H-1B visa lotteries increase acquisitions by 4.4%, targeting firms with similar-skilled workers
- The effect is strongest in firms with high human capital needs and in regions with strict noncompete laws

Key Takeaways on Human Capital Motivations for M&As

- Human capital is a **critical driver** in many M&As:
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 4. Acqui-hiring
- A key question in the research on M&As is where the sources of **takeover premia** in M&As come from. Is there evidence of **value capture** or **value creation**?
- M&As can involve **externalities**: privately optimal M&As may not be socially optimal → regulation comes into play

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Takeaways

How do M&As Affect Human Capital?

- Re-optimization of the **boundaries of the firm** may change what is produced in-house and acquired through the market:
 - Cutting redundant labor (implicit contracts, overlapping roles)
 - Modernization and technological change
 - Flattening of the firm
- **Career impacts** vary:
 - Layoffs can lead to **unemployment/health problems** with substantial negative career externalities (though not always)
 - Productivity gains may be **shared through higher wages/lower layoff risk**
 - Investments may have **positive spillovers** on careers (knowledge transfer)
 - **ILM career options** may open up (specially for startups)

Gehrke et al. 2023: Post-merger Restructuring of the Labor Force

- **Research Question:**

- How do M&As impact the restructuring of the labor force, including turnover and reallocation between acquirer and target firms?

- **Data and Identification:**

- M&As in Germany using employer-employee linked data
- Matched DiD comparing acquirers and targets to control firms

- **Findings:**

- Acquirer establishments grow by 14.5%, driven by external hiring not internal
- High employee turnover, with 60% moving to higher-paying jobs
- Significant restructuring at the managerial level

Lagaras 2023: M&As, Employee Costs, and Labor Reallocation

- **Research Question:**

- How do M&As impact the earnings, employment, and reallocation outcomes (careers) of employees in target firms?

- **Data and Identification:**

- Employer-employee data from Brazil
- DiD approach with matched controls

- **Findings:**

- Earnings decline by 5.6 log points over five years post-merger, with the drop primarily affecting displaced employees.
- Low-skilled, older, and managerial employees are the most negatively impacted.
- Wage losses stem from transitions to lower-paying firms and the loss of firm-specific wage premiums

Gardberg et al. 2024: Technology Transfer in M&As and Careers

- **Research Question:**

- How does technology transfer during M&As affect the long-term careers and wages of workers in target firms?

- **Data and Identification:**

- Matched employer-employee data from Sweden and foreign M&As
- Stacked DiD and DiDiD on worker wages

- **Findings:**

- Technological specificity matters. Wage declines (up to -15%) post-acquisition by tech-intensive firms for substitutable workers
- Managers and complementary workers see career boosts (up to 6%)
- Technology transfer through M&As has significant, heterogeneous exposure-dependent impacts on careers

Bach et al. 2023: How Do M&As Affect the Mental Health

- **Research Question:**

- How do M&As impact the mental health (stress, anxiety, and depression) of employees?

- **Data and Identification:**

- Swedish employer-employee matched data linked with health records
- (Stacked) DiD regressions

- **Findings:**

- M&As lead to a 9% increase in stress, anxiety, and depression
- The most affected groups are blue-collar workers, lower-skilled employees, and those experiencing negative career developments post-merger
- Corporate restructuring during mergers has long-term effects on worker well-being and firm performance

Key Takeaways on how M&As Affect Human Capital

- Re-optimization of the **boundaries of the firm**:
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- M&As likely involves substantial positive or negative **career externalities** → policy interest and regulation

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- Government should get involved to fix **market failures** by forcing agents to internalize **externalities**
- **Some key policy areas relating to M&As:**
 - Employment Protection Legislation (EPLs)
 - Anti-Trust and Monopsony Regulations
 - Cross-Border M&A Regulations

Employment Protection Legislation (EPLs)

- **What are EPLs?**

- **Definition:** Laws designed to protect employees
- **Purpose:** Ensure job security, fair severance, and continuity of employment terms. They help **limit externalities from corporate policies.**

- **Impact on M&As**

- Strong EPLs can make M&As more challenging and costly as it limits human capital reallocation
- Firms may reconsider M&As due to potential legal and financial burdens → potential for productivity loss

Dessaint et al. (2017): Employment Protection and Takeovers

- **Research Question:**

- How do employment protection regulations impact takeover activity and synergy gains in M&As?

- **Data and Identification:**

- Panel data on 45,696 M&As across 21 developed countries (1985–2007).
- DiD design leveraging major employment protection reforms

- **Findings:**

- Increased employment protection reduces takeover activity by 14-27% and synergy gains by 50-80%
- Tighter employment protection increases wage costs and impedes workforce restructuring, leading to lower combined firm returns
- Labor market rigidity is a major factor influencing global M&A activity and outcomes

Anti-Trust and Monopsony Regulations

- **Purpose of Anti-Trust Laws**

- **Objective:** Prevent monopolistic practices and maintain competitive markets.
- **Focus Areas:** Market dominance, consumer harm, and maintaining diversity of choice.

- **Anti-Trust and M&As**

- **Regulatory Scrutiny:** M&As are reviewed to ensure they do not reduce competition
- **Preventing Acqui-hiring Issues:** Anti-trust laws can block M&As that would concentrate specialized talent and reduce labor market competition
- Increasing attention being paid to **common ownership** and **monopsony power**

Cross-Border M&A Regulations

- **Complexities of Cross-Border M&As**
 - **Jurisdictional Challenges:** Compliance with multiple legal frameworks across different countries
 - **Regulatory Overlap:** Navigating different national laws, including EPLs and anti-trust regulations
- **National Security and Strategic Industries**
 - **Government Scrutiny:** Some M&As are blocked or heavily scrutinized to protect national security or strategic industries (infant industry, geopolitics etc)
- **Foreign acquisitions can bring investment**, technology transfer, and job creation, but also **risk job losses** due to restructuring or offshoring.

Key Takeaways on M&As and Policy

- **EPLs:** Protect employees but add complexity to M&As.
- **Anti-Trust Laws:** Prevent monopolistic and monopsonistic practices and ensure fair competition in product and labor markets
- **Cross-Border Regulations:** M&As involving firms from different countries face additional regulatory challenges.

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