THE ABFER DIGEST
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Influencing Control: Jawboning in Risk Arbitrage

Wei Jiang (Columbia), Tao Li (WBS) and Danqing Mei (Columbia)

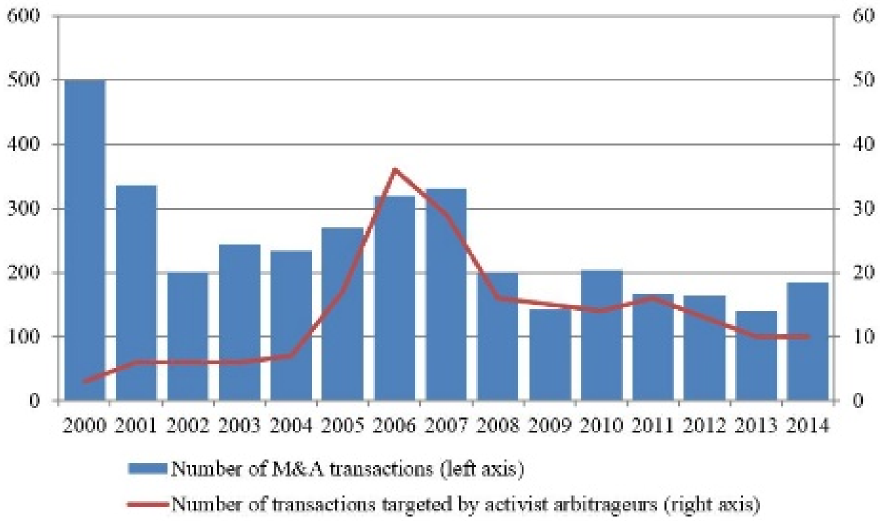
The paper **Influencing Control: Jawboning in Risk Arbitrage by** *Wei Jiang (Columbia), Tao Li (WBS) and Danqing Mei (Columbia)* examines activist versus passive risk arbitrage and looks at the similarities and differences between them. While the passive guys would like the deal to be closed so that they can make some money, activist involvement would lengthen the deal making by several days.

The authors say that this is the first study on the relatively new phenomenon of "activist risk arbitrage" during 2000-2014, in which some shareholders attempted to change the course of an announced M&A deal through public campaigns and interventions in order to profit from the improved terms for either the target or the acquirer shareholders.

Compared to conventional or passive risk arbitrageurs, activist arbitrageurs are more likely to select deals that are susceptible to managerial conflicts of interest, including going-private deals, "friendly" deals, and deals with lower announcement premiums. While activists modestly increase deal withdrawal risk, their selective targeting results in an increase in the sensitivity of deal completion to market price signals. Finally, activist risk arbitrage yields significantly higher returns than passive arbitrage, after incorporating incremental deal risk.

The study highlights that activist arbitrage activities have been on the rise since the early 2000s. They were seen in 0.6 per cent of all M&A deals in 2000. For 2013 the figure was 13 per cent and in 2014 it was 6.5 per cent of all deals. The authors say that however the academic literature has not formally analyzed the full process, characteristics, or the impact of activist risk

Figure: M&A Transactions and Activist Arbitrageur Activities, 2000-2014



Source: Authors

arbitrage on the market for corporate control.

As shareholder activism launched by institutional investors becomes an increasingly more common form of corporate governance, its blend with a popular, traditionally non-activist, arbitrage strategy is instructive. The authors say that a signature of institutional investor activism has been that it strives to influence corporate policies and governance, but does not aim to control. The activist arbitrage strategy, by instilling shareholder activism into corporate control events, thus bridges the two by "influencing control."

The authors say that their analyses reveal similarities as well as dissimilarities between the two forms of risk arbitrage strategies. The results suggest that activist risk arbitrage is potentially an important form of governance in guarding investors' interests during corporate control changes that are susceptible to management self-dealing or other forms of managerial conflict of interest.

The study finds that activist arbitrageurs earn much higher average returns than passive ones, compensating for the "jaw pain" as well as for the assumption of the higher risks – both legal and deal risks. By threatening to block an announced deal in order to extract a higher price, the activist arbitrageurs stand ready to assume higher deal failure risk than the passive arbitrageurs who simply vote their shares in favour of the deal.

In conclusion, the authors say that activists decrease the probability that deals will be completed with the current bidder. However, their presence increases the probability that deals welcomed by the market will be completed. Activist risk arbitrage yields significantly higher returns than passive arbitrage, taking into account the incremental deal risk. Overall, the evidence suggests that activist risk arbitrage plays a positive role in guarding investor interests in corporate control events, while delivering good returns for themselves, the study finds.

Politician Family Networks and Electoral Outcomes: Evidence from the Philippines

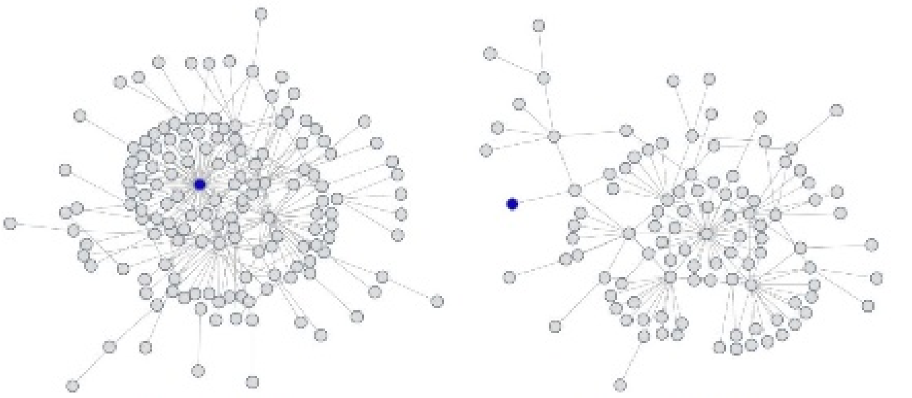
Cesi Cruz (UBC), Julien Labonne (Oxford) and Pablo Querubin (NYU)

Politician families play an important role in the politics of many countries. The electoral importance of politician family networks in the Philippines is shown by *Cesi Cruz, Julien Labonne and Pablo Querubin* in their paper **Politician Family Networks and Electoral Outcomes: Evidence from the Philippines**.

Using a dataset of 20 million people in over 15,000 villages and 709 municipalities in the Philippines, they show that politician family networks are strong predictors of both candidacy in municipal elections and of electoral success. Candidates for public office are disproportionately drawn from more central families in the network of intermarriages among different families. In addition, controlling for a large number of candidate characteristics, the authors establish that candidates receive more votes in villages where they are more central. Figure 1 shows the results graphically. The left panel displays the family network of a village where the candidate (in blue) received 60 percent of the vote while the right panel display the family network where the same candidate received only 20 percent of the vote.

The authors establish that family networks provide advantages for pursuing clientelist electoral strategies, such as vote buying. They present evidence showing that effects of centrality do not operate through popularity, name recognition or through the choice of policies more aligned with their constituents' preferences. Further, the results are not driven by the fact that people vote for their relatives, nor by reverse causality---i.e. that politicians are able to arrange strategic marriages for their family members once they are in office.

Among the implications of the findings is that since family networks are relatively slow to change, this could explain why political power tends to be concentrated among a few families in a number of consolidating democracies. Also, central candidates may be able to circumvent having to closely monitor their brokers by hiring people to whom they are closely connected.



Candidate received 60% of the vote   Candidate received 20% of the vote

Figure 1: Family networks in two villages in the same municipality. The blue dot represents the winning candidate's family.

Source: Authors

The authors show that while it might have been expected that family networks matter for politics, the reason why they matter is less intuitive. The importance of networks has less to do with status, popularity or name recognition than with the organisational and logistical advantages that these ties can confer.

The study finds that clientelistic relationships – extended networks of trust and loyalty – among brokers and politicians is situated in a rich social context which is often difficult to account for empirically.

And while earlier studies have indicated the importance of personal relationships, this is the first large scale evidence of the substantial role that they play.

The effect of anti-corruption campaign on shareholder value in a weak institutional environment: Evidence from China

Bin Ke (NUS), Na Liu (NTU) and Song Tang (SUFE)

While China's anti-corruption campaign launched by President Xi Jinping in December 2012 continues to be in the news, this study seeks to better understand the consequences of the government-led drive on publicly listed companies in the country from the shareholders perspective.

In their study, **the effect of anti-corruption campaign on shareholder value in a weak institutional environment: Evidence from China,** authors *Bin Ke, Na Liu and Song Tang* find that the anti-corruption campaign reduces the profitability of the firms that sell luxury goods and services. The anti-corruption campaign helps reduce excessive perk consumption of luxury goods and services consuming state-owned enterprises (SOEs). But the authors find no evidence that the campaign affects excessive perk consumption by luxury goods and services consuming non-SOEs. Overall, the study does not find any evidence that the campaign had a positive or negative impact on net shareholder value for luxury goods and services consuming SOEs and non-SOEs.

The authors adopt two complementary approaches to assess the impact of China's anti-corruption campaign. The first is an event study to examine the stock market reactions to the announcements of the eight major events associated with the launch and implementation of the anti-corruption campaign. The second approach compares the accounting performance of the test firms versus control firms for the two years before (2011-2012) versus two years after (2013-2014) the launch of the anti-corruption campaign.

The anti-corruption campaign's aim is to regulate the excesses of government officials, reduce bureaucracy and get government officials to keep closer contacts with the grassroots. The authors say that both the event study and the accounting return analyses show that the anti-corruption campaign significantly reduced the profitability of the publicly listed firms that sell luxury goods and services in the alcohol, catering and hotel industries relative to the publicly listed firms that sell non-luxury goods and services in the same industry.

Interestingly, the study found no evidence that the overall impact of the anti-corruption campaign on shareholder value appears to be significantly different from zero for the SOEs operating in the regulated industries relative to the SOEs operating in the competitive industries. Further, there was little evidence from either the excessive perk consumption analysis or the net shareholder value analysis that the anti-corruption campaign significantly affected the behaviour of the non-SOEs operating in the regulated industries relative to the non-SOEs operating in the competitive industries.

The authors say that overall their study's results suggest that despite the visible negative impact of China's anti-corruption campaign on luxury goods and services selling firms, there is still a long way to go before China can claim victory for its anti-corruption campaign. The authors say in conclusion that the results of their study imply that further structural reforms may be necessary to change managerial incentives, root out corruption and improve firm performance of publicly listed Chinese firms.

Peer Effects of Corporate Social Responsibility

Jie Cao (CUHK), Hao Liang (SMU) and Xintong Zhan (CUHK)

For firms to engage in corporate social responsibility (CSR) has for long been desired, recognized and discussed. Many consider CSR as a way of gaining competitive advantage so that a firm can increase its "social capital" by being involved in activities that help it to build good relationships with its key stakeholders. Others consider CSR as a way of signalling product market quality and generating a good corporate image that makes investors and consumers more attached to the company.

In their study **Peer Effects of Corporate Social Responsibility,** *Jie Cao, Hao Liang and Xintong Zhan* build on the competitive advantage perspective of CSR and examine whether and how a firm's adoption of CSR can affect the CSR practice and value of its peer firms. To investigate the product market peer effects of CSR, they compare the effects of a firm's shareholder-sponsored CSR proposals that pass or fail by a small margin of votes in annual meetings on its peer firms' stock returns and subsequent CSR practice.

The authors find that on the days immediately before and after a shareholder meeting, a CSR proposal that passes by a narrow margin of votes yields a cumulative abnormal return of its non-voting peer firms that is -0.6% to -1% higher compared to a CSR proposal that fails marginally. The study further finds that the competitive relationship between voting-firms and non-voting firms plays an important role in influencing the peer effects, which are stronger when the competitive pressure is higher.

Consistent with the competitive pressure argument, the study finds that peers with more severe financial constraints experience more negative abnormal returns and less CSR adoption following the passage of the voting firm's CSR proposal. In addition, such peer effects are stronger in peer firms with greater information transparency and are followed by more financial analysts.

The empirical results of this study lend additional support to the competitive advantage hypothesis of CSR. By documenting a lower market return of firms when their peer firm passes a CSR proposal, the authors confirm that increased CSR in a firm creates competitive threats to its product market peers. By documenting a higher subsequent CSR performance in the passing peers compared with the failing peers, the study shows how CSR activity interacts with product market competition and that peer effects can promote good practice among peers.

Taken together, this study echoes the literature that takes a positive view on CSR and considers it to be a strategically valuable tool. The study's findings also have policy implications in that policymakers aiming at promoting corporate socially responsible behaviours could initiate such activities in a few firms and the competitive nature of the market would leverage the impact of the policy and help achieve an overall improvement in CSR on the market.

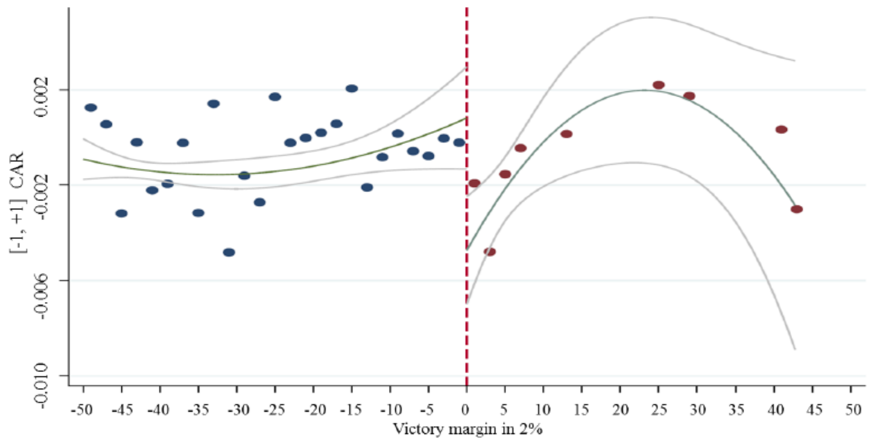


Figure 3a. Three-Day Cumulative Abnormal Returns of Peer Firms around the 50% Majority Threshold of the CSR Proposal

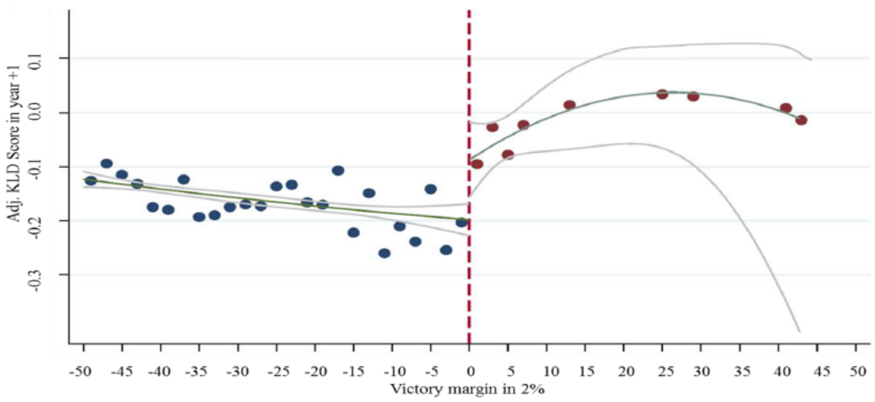


Figure 3b. Following-Year KLD Scores of Peer Firms around the 50% Majority Threshold of the CSR Proposal

Source: Authors

Can Twitter Help Predict Firm-Level Earnings and Stock Returns?

Eli Bartov (NYU), Lucile Faurel (ASU) and Partha Mohanram (U of T)

As the question whether information on Twitter can help predict a company's future earnings and stock returns has not been explored before, a new study fills the gap. In their paper **Can Twitter Help Predict Firm-Level Earnings and Stock Returns?** *Eli Bartov, Lucile Faurel and Partha Mohanram* investigate whether analysing the aggregate opinion in individual tweets about a company's prospects can predict its earnings and the stock price reaction to them.

The dataset consists of nearly a million tweets by individuals in the nine trading day period leading to firms' quarterly earnings announcements in four years from 2009 to 2012. The study finds that the aggregate information in individual tweets helps predict quarterly earnings. Using four alternative measures of aggregate opinion in individual tweets, the authors find that the aggregate opinion successfully predicts the company's forthcoming quarterly earnings. Controlling for other determinants of earnings, the authors find a strong positive association between aggregate investor opinion written before the earnings announcements and ensuring market earnings surprise.

Further, the study finds that aggregate investor opinion predicts abnormal returns around earnings announcements. This means that investors can potentially profit from the information in aggregate Twitter opinion as this information does not appear to already be impounded in stock prices. Furthermore, the relationship between the aggregate information in tweets and abnormal returns is strongest for firms in the weakest information environments, smaller firms with lower levels of analyst following and lower levels of institutional ownership.

This suggests that social media can be a particularly valuable conduit of information for firms in weak information environments. Finally, the authors provide evidence that their results are not driven by concurrent information from sources other than Twitter, and in particular press articles or reports posted on web portals. Overall, the study highlights the importance for capital market participants to consider the nature of information in tweets sent by individuals when assessing the future prospects and value of companies.

The paper makes a meaningful and distinct contribution on the impact of social media on the capital market in two ways. First, the results have important implications for the role Twitter plays in the investing community. While investing can be viewed as a non-cooperative, zero-sum game, the results show that individuals use Twitter to share information regarding companies' future prospects for their mutual benefit.

Second, the results of this study are important for regulators. The authors say that sceptics may argue that self-serving individuals exploit social media tools such as Twitter by disseminating misleading and speculative information to investors, and thus call for regulating social media. However, the results of the study show the opposite in that the information on Twitter can in fact help investors in their investment decision making. Thus, Twitter can play a role in making the market more efficient by uncovering additional value-relevant information, especially for firms in weak information environments, and regulatory intervention is not needed.

Measuring Economic Policy Uncertainty

Scott R. Baker (Northwestern), Nicholas Bloom (Stanford) and Steven J. Davis (Chicago Booth)

Concerns about economic policy uncertainty (EPU) have increased significantly since the global financial crisis, the many eurozone crises and partisan policy disputes in the United States. To investigate the role of policy uncertainty, *Scott R. Baker, Nicholas Bloom and Steven J. Davis* in their study **Measuring Economic Policy Uncertainty,** first develop an index of economic policy uncertainty for the US and examine its evolution since 1985 reflecting the frequency of articles in 10 leading American newspapers.

The authors say that several types of evidence, including the reading of 12,000 articles in the 10 major US newspapers, indicate that their index proxies for movements in policy related economic uncertainty. Their US index spikes near tight presidential elections, Gulf Wars I and II, the 9/11 attacks, the failure of Lehman Brothers, the 2011 debt ceiling dispute and other major battles over fiscal policy.

Using firm level data, the study finds that policy uncertainty is associated with greater stock price volatility and reduced investment and employment in policy sensitive sectors like defence, healthcare, finance and infrastructure construction. The authors say that firm-level results suggest a causal impact of policy uncertainty on investment and employment in sectors that rely heavily on government spending and in sectors like healthcare and finance with strong exposure to major changes in regulatory policy. However, the firm-level results offer limited guidance about the magnitude of aggregate effects, in part because they capture only a limited set of potential policy uncertainty channels.

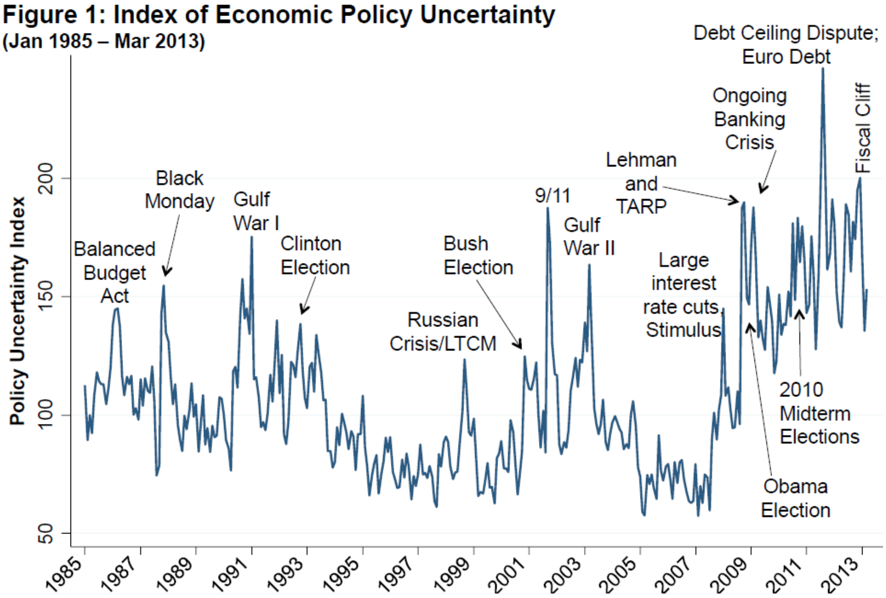
At the same time, the authors find that at the macro level, innovations in policy uncertainty precede declines in investment, output, and employment in the United States and for 12 major economies.

The authors say that their audit study and comparison with other text sources and types of data shows that their newspaper based EPU indices have useful information about the extent and nature of economic policy uncertainty. When compared to other policy uncertainty measures, newspaper-based indices have the advantage that they can be extended to many countries and backwards in time.

Overall, the paper's findings are broadly consistent with theories that highlight negative economic effects of uncertainty shocks. The authors say that the results of their study suggest that elevated policy uncertainty in the US and Europe in recent years may have harmed macroeconomic performance. They also point to sizeable effects of policy uncertainty on the cross-sectional structure of stock price volatilities, investment rates and employment growth.

From a methodological perspective, the authors show how to tap newspaper archives to develop and evaluate new measures of interest to macroeconomists, financial economists, economic historians and other researchers. They say that it is worth stressing that newspapers are available for most countries around the world and have been around in similar form for a long time. Thanks to modern databases and computers, newspaper archives can be used to deepen the understanding of broad economic, political and historical developments through systematic empirical inquiries.

Figure 1: Index of Economic Policy Uncertainty
(Jan 1985 – Mar 2013)



Notes: Index of Policy-Related Economic Uncertainty composed of 4 series: monthly news articles containing uncertain or uncertainty, economic or economy, and policy relevant terms (scaled by the smoothed number of articles containing 'today'); the number of tax laws expiring in coming years, and a composite of IQ ranges for quarterly forecasts of federal, state, and local government expenditures and 1-year CPI from the Phil. Fed Survey of Forecasters. Weights: 1/2 Newsbased, 1/6 tax expirations, 1/6 CPI disagreement, 1/6 expenditures disagreement after each index normalized to have a standard-deviation of 1. Data from Jan 1985-Mar 2013. Index normalized mean 100 from 1985-2009. Data at www.policyuncertainty.com. *Source: Authors*

The Information in Fire Sales

Sheng Huang (SMU), Matthew C. Ringgenberg (WUSTL) and Zhe Zhang (SMU)

It has been observed that asset prices remain depressed for prolonged periods of time following fire sales by mutual funds. In their study **The Information in Fire Sales,** *Sheng Huang, Matthew C. Ringgenberg and Zhe Zhang* show that this price pressure from fire sales is partly due to asymmetric information which leads to an adverse selection problem for arbitrageurs.

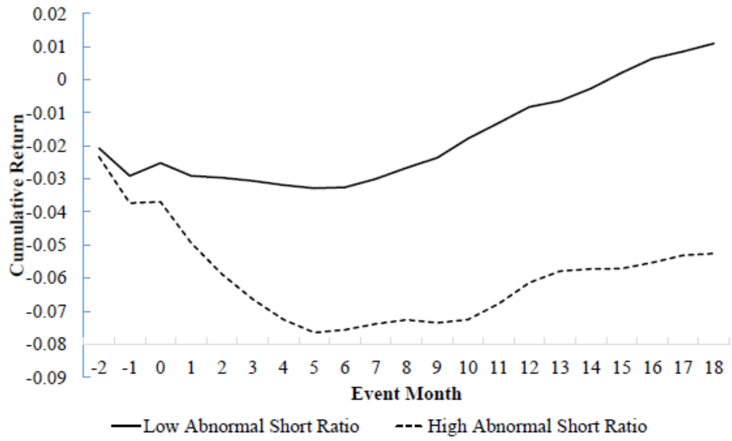
To study the persistence of price pressure from fire sales, they first examine the trading motivation of managers following a flow shock. Using short interest as a proxy variable for negative information, they find strong evidence that mutual fund managers have some stock selling ability. Following a flow shock, fund managers are significantly more likely to sell high short interest stocks. In other words, fund managers do not simply sell a prorated fraction of each stock in their portfolio, but instead sell more of those stocks which have negative fundamental information. This means that fund managers *choose* to sell low-quality stocks.

In this paper, the authors show that selective selling by fund managers can partly explain the long-lasting impact of price pressure from fire sales. Usually it takes about two years for the price pressure from fire sales to completely reverse. However, for stocks with high short interest, the study finds that depressed prices persist for much longer. The evidence suggests that prices of high short interest stocks remain low for much longer than two years, while prices for low short interest stocks revert to normal in about a year. Moreover, using a linear probability model, the study finds that high short interest stocks are significantly less likely to revert to their pre-fire sales prices. The authors say that their paper makes several contributions. First, it gives an explanation for the long-lasting impact of price pressure from fire sales. They are the first to show that following a flow shock, fund managers choose to sell stocks with negative fundamental information. Therefore arbitrageurs face an information asymmetry which makes it difficult for them to disentangle pure price pressure from negative fundamental information. As a result, price pressure takes a long time to correct.

Second, and more generally, the results suggest that information asymmetries may help explain the slow moving capital phenomenon. While arbitrage capital has been shown to be slow to react in a wide variety of contexts, this study's results show that information asymmetries can explain the reluctance of arbitrage capital to correct mispricing.

Further, the results provide indirect evidence that fund managers do have some skill, even though academic studies consistently fail to document that. In the study's context, flow shocks leave mutual funds temporarily out of equilibrium which allows the authors to document new evidence of stock selling skill by managers. In other words, fund managers have stock selling ability which leads to an adverse selection problem for other investors.

The study's findings explain the tendency of asset prices to remain depressed following fire sales: information asymmetries make it hard for arbitrageurs to sort out pure price pressure from negative information.



Source: Authors

Figure 2. Cumulative Abnormal Returns in Event Time around Fire Sales for High and Low Short Interest Stocks
Each quarter, intensive buy pressure (IBP) stocks and intensive sell pressure (ISP) stocks are grouped into two event portfolios, IBP portfolio and ISP portfolio. Within each portfolio, stocks are further sorted into High short ratio (High SR) and Low short ratio (Low SR) portfolios, based on whether the abnormal SR measure is above (below) the cross-sectional median among all IBP (ISP) stocks. The event quarter is the portfolio formation quarter, and the event month 0 is the last month of the event quarter. For each portfolio, the equal-weighted returns for each portfolio from 3 months before event month 0 till 24 months afterwards. The average mean portfolio abnormal returns in excess of the market returns are calculated, and the 3-month moving average of cumulative abnormal returns (CAR) are reported. Panel solid black line displays results for low short interest stocks, while the dotted-black line displays results for high short interest stocks.

About ABFER

The Asian Bureau of Finance and Economic Research is an institute founded by academics from Asia, North America, and Europe. The Bureau intends to create a virtual and independent network of high-quality academics akin to the NBER/CEPR, as well as conferences and workshops.

The purposes of the Bureau include:

- to promote Asia-Pacific oriented financial and economic research at local, regional and international levels;
- to connect globally prominent academic researchers, practitioners and public policy decision-makers on Asia-Pacific related financial and economic issues;
- to enhance the research capabilities and development of strong clusters of finance and economic research groups in academic institutions and other institutions in Singapore and Asia-Pacific.

This Digest summarizes selected papers presented in the ABFER's 4th Annual Conference which was held in May 2016 at the Shangri La Hotel, Singapore. More information on the conference can be found here.

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