Public and private sanctions: the case of cartels

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KEYWORDS:

Cartels, event study analysis, private sanctions, public sanctions, sentiment analysis

BACKGROUND

- Most illegal corporate behaviour faces two types of sanctions: (i) a public sanction, imposed directly by an administrative body or the court; and (ii) a market-based (private) sanction, which materialises indirectly through market mechanisms.
- The law and economics literature has long debated the relative effectiveness of these sanctions at deterring misconduct, but most debate has been limited by the fact that the private sanction is not directly observable.
- We propose a novel methodological framework to more directly estimate the severity of private sanctions.
- We then apply this framework to European cartels, to estimate the effect of public and private sanctions on the market valuation of cartel members, and to estimate their relative effect on deterring misconduct

METHODOLOGY

- Because private sanctions are not directly observable, previous literature used the residual effect on market valuation (having controlled for the public fine) as an approximation of the severity of the private sanction.
- We suggest estimating the reputational effect of misconduct as a measure of the private sanction, and suggest using *opinion mining* techniques for a more direct measurement of this reputational effect.
- We use the frequency of media exposure and the sentiment in this exposure for measuring the reputational effect. The former is based on the number of news items that cover the misconduct, and the latter is through sentiment analysis. Both of these measures are easily accessible from publicly available sources.
- Using this information on the reputational effect and data on the public fines, we estimate their impact on the market valuation of cartel members using an event study methodology.
- In our estimation, we distinguish between cartels that directly affect (a) the atomistic end-consumers (end-consumer cartels), and (b) cartels that are high up in the supply chain, that directly affect non-atomistic large customers (intermediary cartels).

KEY FINDINGS

- We find that the public sanction (cartel fine) negatively affects the market valuation of cartel members in intermediary cartels.
- In end-consumer cartels, the public sanction only has a negative effect if it is accompanied by a private sanction (high exposure and negative sentiment). We interpret this as evidence that, in end-consumer cartels, public and private sanctions complement one another in their effect of deterring corporate misconduct.
- Our findings are intuitive. Without exposure there is no reputational impact. Atomistic customers are less likely to be aware of the cartel conduct unless there is high media

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exposure. The exposure also affects the opinion formed on the cartel conduct (positive or negative).

POLICY ISSUES

- If private and public sanctions are indeed complements in cases with atomistic customers, the fining bodies have to do a lot more to publicise the misconduct and to alert the public of the damage caused by such conduct.
- We believe that our evidence would support an approach whereby the competition authority not only imposes a public sanction, but also carefully oversees media exposure to ensure it is sufficiently far-reaching.

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