

# 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.

## KEY FINDINGS

- We find that the public sanction (cartel fine) negatively affects the market valuation of cartel members in intermediary cartels.
- If media exposure is very low the marginal effect of the fine is negative (larger fine, larger loss in market valuation) irrespective of the sentiment of the news coverage. Put differently, if businesses are not exposed much on the media pillory, then the only thing that affects the market valuation of the misbehaving business is the amount of fine they receive.
- With larger negative exposure, the public fine loses its effectiveness. On the other hand, with larger positive exposure the effect of the public fine becomes more negative.
- The above can be looked at as evidence that public and private sanctions work as substitutes in deterring cartel misconduct.

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## POLICY ISSUES

- Competition authorities can affect both the size of the public (by setting the fine) and the private sanction (by paying for increased media exposure).
- If private and public sanctions are indeed substitutes, then the competition authority might want to account for the reputational damage before imposing a fine to avoid over-enforcement.

## SUGGESTED CITATION

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