5. R&D and Corporate Takeovers

The impact of corporate takeovers or restructuring on R&D can be interpreted taking either the viewpoint of managers or the raiders. The managers' view considers the market myopic: overly concerned with short-term survival at the expense of long-term profitability of the company. When the threat of takeovers increases, as in the 1980s, companies are forced to raise their indebtedness to fend off takeovers. This makes the companies more vulnerable to default if the economy slows down, so the managers cut back on investments in R&D or related areas where the payoffs are long-term rather than short-term. This view concludes that recent changes in the financial strategies of corporations have had an adverse effect on R&D.

The raiders' viewpoint stresses that managers may mis-direct their company's cash flow into investments that do not promise an adequate payoff. Managers want to build their own empires and increase the size of their own companies by investing in R&D even when the technological opportunities are not all that good. It is better for the economy if these funds are paid out to shareholders or bondholders and can then be reallocated to growing and more profitable companies. Corporate restructuring means that a larger share of the company's cash flow will be earmarked for debt service and cannot be used for empire building by managers. The raiders' viewpoint, therefore, also concludes that increases in debt will reduce R&D spending.

Hall[84] examines data on about 2,500 U.S. firms from 1959 to 1987. When a company goes private by means of a leveraged buyout (LBO), there is no major direct effect on R&D investment. She finds that, as a result of mergers, companies performing R&D reduced their R&D intensity (R&D as a proportion of gross output) by about half a percent following an acquisition. This decrease in R&D is not, Hall checks this, a result of the elimination of duplicate R&D after a merger or acquisition. Do companies that shift their financial structure toward greater debt rather than equity reduce their commitment to R&D? Hall reports strong evidence that companies increasing their leverage do reduce their R&D intensity, and this reduction reflects a long-term change. Moreover, the effects can be pronounced: For companies that increase their debt by amounts equal to 50-100 percent of the size of their capital stock (there are 220 such cases in her sample), R&D intensity drops between a quarter and a third.

[84] Bronwyn H. Hall, "The Impact of Corporate Restructuring on Industrial Research and Development", *Brookings Papers: Microeconomics*, 1990: 85-135.