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The Choice of Target's Advisor in Mergers and Acquisitions: the Role of Banking Relationship

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The Choice of Target's Advisor in Mergers and Acquisitions: the Role of Banking Relationship

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INDEX

Abstract

   In this paper we analyze the factors that influence the target companies' choice of a bank advisor during a merger or acquisition process. Particularly we analyze the choice of hiring an advisor in the first place (non trivial since for more than one third of the mergers in our sample the target company chose not to hire an advisor), and the choice to hire, as advisor, a bank with a strong prior relationship with the company. Using data on 473 M&A European transactions completed the 1994-2003 period we find evidence that the choice of the bank advisor depends on three main factors: i) the intensity of previous banking relationships of the target company, ii) the reputation of the bidder company's advisor, and iii) the complexity of the deal. We also investigate the impact of a bank advisor on shareholders' wealth. We find that the abnormal return of target companies' shareholders increases with the intensity of previous banking relationships, thus indicating a "certification role" of investment banks.

   Keywords: Relationship banking, investment banking, mergers, acquisitions
   JEL Classification Numbers: G21

1.
INTRODUCTION

During the last decades M&A activity increased noticeably, generating a relevant amount of business for the investment banking industry. Investment banks are hired by the merger participants (both the bidder and the target firm) as financial advisors in order to help them to navigate through the acquisition process. For this service they charge an advisory fee. It is well known among investment banks that in a M&A transaction it is better to be sell side; that is, an investment bank will normally seek to be the financial advisor of the target company rather than of the bidder. This preference is generated by the relevance, in the typical fee arrangement, of a component contingent upon the successful completion of the deal (the so called success fee). While the closing price is uncertain throughout the sale process, it is quite sure that the target company will be sold. As a consequence, once an investment bank gets a mandate from the target, it can be reasonably certain that it will gain the success fee. In contrast, the bidder's financial advisor cannot rely on such an expectation: indeed, even though it is quite sure that the target will be sold, the acquirer's identity is uncertain[1]. Regardless of investment banks' preferences, since they make relevant profits acting as targets' advisors, it is reasonable to assume that they fulfill an important role in the sale process; at least as important as the one fulfilled by the bidder's advisors.

Academic literature on the advisor choice in mergers and acquisitions has mainly investigated two issues: the factors affecting the choice of the advisors and their effect on the shareholders' wealth on one side, and the determinants of merger advisory fees and on their impact on the transaction outcome on the other.

As far as the first branch is concerned, while there are several papers concerning the effects of advisor choice on the buy side of an acquisition, almost no attention has been paid to the sell side of the deal, that is, to the factors driving the choice of an investment bank by the *target* firm. Moreover, little attention has been paid to the effect of banking relationships on both the choice of the advisor and its shareholders' wealth. Bowers and Miller (1990) examine the choice of the investment bank in M&As, finding that the investment bank's reputation affects shareholder returns. They find evidence supporting the idea that more reputed investment banks have better expertise identifying firms with whom an acquisition would produce greater economic benefits. When these first-tier investment banks (including First Boston, Goldman Sachs, Merrill Lynch, Morgan Stanley, and Salomon Brothers) are hired by either counterparts, the total wealth gains are larger. However, in their work, they focus on the effect of investment banks' reputation on the shareholders' wealth, while they don't look at the factors driving the choice of the investment bank. Servaes and Zenner (1996) examine this issue and find that bidders are more likely to hire an advisor when the transaction is more complex and suffers from information asymmetry, thus proving banks' ability in information production. Nevertheless, their results suggest that the presence of an advisor (as opposed to in-house staff) seems not to affect the return to the bidder's shareholders around the deal announcement. Kale et al. (2003) investigate the role of financial

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[1] *This is especially the case when the sale is in the form of an auction.*

advisors in tender offers, documenting that when a firm (either bidder or target) employs a more reputable financial advisor it enjoys a greater wealth. More recently, Allen et al. (2004) investigated the role of commercial banks (as opposed to investment banks) as advisors to M&As participants (both bidders and targets). They argue that commercial banks have a comparative advantage in serving as M&A advisors for their customers (especially those with a prior lending relationship), because they can provide a certification effect; however, the potential conflict of interest arising from a bank acting as both merger advisor and lender might countervail the certification effect. They measure the certification effect in terms of shareholders' return, finding evidence of a net certification effect for target firms only. However, they find that the more intense the lending relationship with the bidder, the greater the likelihood that a commercial bank will be chosen as merger advisor.

As far as the second branch of literature is concerned, Hunter and Walker (1990) find that most merger fee contracts include a payment contingent on the completion of the merger. This contractual structure provides an incentive to the advisors, which results in larger merger gains. McLaughlin (1992) uses several measures of tender offer outcome to evaluate the effects of different fee contracts, providing evidence that the fee structure does influence the offer's final outcome. Rau (2000) investigates the factors affecting the market share for investment banks advising bidders in mergers and tender offers, finding that the incentive fee structure charged by investment banks is positively related to their market shares and to the percentage of deals they completed in the past, but unrelated to the post-acquisition performance of the bidders advised in the past. He also finds than more reputed investment banks charge higher proportions of their fees contingent on the successful completion of the deal. Saunders and Srinivasan (2001) find that bidders pay higher advisory fees to investment banks with whom they have had a continuing relationship, measured in terms of prior debt, equity, and M&A transactions. They document that bidders are more likely to switch to another bank if their advisor is not a top-tier investment bank, but switching does not produce any significant difference in the shareholders' return. Finally, Hunter and Jagtiani (2003) empirically investigate the factors affecting the probability and the speed of a successful deal completion, the fees charged by investment banks to both bidders and targets, and the post-merger gains realized by the bidders. They find that more reputed investment banks results in a more likely and faster deal completion. A higher portion of fees contingent on the deal completion also helps in speeding up the process, while prior bidder relationship with its advisor seems not to influence the time to deal closing. They also document that larger fees are associated with larger post-merger gains.

This paper focuses on the target's choice of the financial advisor and is in the spirit of the first branch of literature, in that it investigates the factors affecting the choice of the advisors in M&A transactions. It also examines whether financial advisors influence the wealth of the target's shareholders at the announcement date. This study extends the existing literature as it looks at the inter-temporal relationship among advisors and client firms. In particular, we try to answer three questions: does an intense relationship with an investment bank result in a higher likelihood of hiring an advisor? Further, conditional on having an advisor, does a close previous relationship with a given bank (the so called "main bank") increase the likelihood of hiring that particular bank? Finally, does the intensity of the past relationship between the target company and its advisor result in higher abnormal returns at the announcement date relative, to a target without any prior relationship with its current advisor?

We find evidence that the target's decision to use an investment bank is not influenced by the tightness of its relationship with its main bank. But we also find that, conditional on the fact that

an advisor is hired, the intensity of the relationship increases the probability of choosing the main bank as advisor. Coherently with previous literature on the choice of bank advisors on the buy side, we also find that different variables that capture the complexity and the relevance of a deal influence these choices. As a third result we also find that the probability of hiring an advisor on the sell side is positively influenced by the reputation of the *bidder's* advisor.

Looking at the effect of banking relationship on the wealth of the target company's shareholders at the announcement date, we find a positive and significant result: hiring an advisor with a strong prior relationship significantly increases the average cumulated abnormal return up to forty days after the announcement of the deal.

The paper proceeds as follows. Section 2 describes the empirical methodology. Section 3 describes the data sources and summarizes sample characteristics. Results are discussed in Section 4. Section 5 concludes.

2.
EMPIRICAL METHODOLOGY

Theory suggests that banks specialize in information production and processing. As advisors in M&As, banks can analyze the deal at lower cost than other firms, thus reducing the information asymmetry between the bidder and the target in a cost-effective way. The greater the complexity of the deal, the greater the information asymmetry is. Moreover, advisors can use their information-gathering expertise to signal the deal quality, thus providing a certification effect. Thus, deal complexity and need for certification should explain the choice of using a bank advisor versus not hiring an investment bank.

We proxy the deal complexity with the following variables:

PERC is the percentage of the target's equity capital involved in the deal. The higher the value the more complex is the deal: a minority acquisition, where no control issues are involved, can more likely be managed by the target management without any advisor.

CASH is a dummy variable set equal to one if the acquisition is fully paid in cash. In this case there are less valuation-related complexities involved in the deal[2].

CB is a dummy variable set equal to one if the country of the bidder is different from the country of the target company. We expect a higher likelihood of advisor involvement for cross-border transactions, for which information asymmetries should be higher.

SIC3 is a dummy variable set equal to one if the 3-digit sic code of the target is different from the code of the bidder. This dummy captures asymmetric information depending on industry

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[2] *As a robustness check we also defined this variable in terms of the actual percentage of the acquisition paid in cash. The results do not change significantly. We prefer the dummy definition because the need to evaluate the bidder's equity is not influenced by the percentage of the deal paid cash (as long as this is lower than 100%).*

relatedness between merger participants. We expect a higher likelihood of advisors' involvement for cross-industry acquisitions.

TOP_BID and TOP_MB are two dummy variables that proxy the reputation of the bidder's advisor and the target's main bank respectively. We consider top banks the ones in the first three positions of the Thompson Financial leagues table. As far as the first variable is concerned, we would expect the target company to feel more pressure to hire a qualified advisor when the bidder is advised by a top bank. This expectation is based on the evidence provided by Kale et al (2003), who show that the share of the total takeover wealth captured by the bidder's shareholders increases as the relative reputation of the bidder's advisor versus the target's increases. For the same reason we would expect a positive effect of the reputation of the main bank on the probability of hiring the main bank as advisor.

We also include time fixed effects (2004 is the omitted variable) and country fixed effects (both for bidder an target, dropping UK).

2.1.
The role of banking relationships

There is a growing body of literature showing that prior banking relationships affect the pricing of financial services. We analyze the effect of prior relationships on the decision to hire an advisor on the sell side of an M&A process. Since one of the possible channel through which previous relationships can affect the price (and the demand) of services is via a reduction of information asymmetry and a subsequent reduction in the cost of providing the service[3], we measure existing previous relations in a comprehensive way: a bank can have acquired information about a company by acting as advisor in a prior acquisition (both on the buy or the sell side), but also by having underwritten a bond or equity issue or by having arranged a syndicated loan.

Using data from Security Data Corporation (SDC) we define the intensity of previous relationships of the target with a given bank as the ratio of two values. The denominator is the total dollar value (time weighted) of all transactions of a given type completed by the target over the previous 5 years[4]. The numerator is the sum of the dollar value of all transactions where the given bank was retained as lead manager (for stock, bond, and loan transactions) or advisor[5] (for M&A transactions). Thus, the relationship intensity measure will always lie between zero and

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[3] One may think at the cost of providing the certification effect in case of a bond or stock issue or the cost of evaluating a company in case of an acquisition.

[4] The current M&A transaction is excluded in all calculations of relationship intensity.

[5] For transactions where more than one lead manager or bank advisor was retained, all banks are given full credit for the deal. In the event of a merger between two or more banks, the numerator is the sum of the dollar value of the transactions where al least one of the merged banks was retained.

one. A value of one indicates the strongest possible intensity and a value of zero indicates no prior relationship[6].

A precise definition of "intensity of relationship" between the target and its bank advisor is given by:

$$D_i^q = \frac{\sum_{j=1}^{i-1} value_j^D \cdot (date_i - date_j)^{-1} \cdot Q_j}{\sum_{j=1}^{i-1} value_j^D \cdot (date_i - date_j)^{-1}}$$

Here, D_i^q is the relationship intensity between *the target and bank q* at the time of deal *i*. Subscript *j* indicates the target's various transactions over the previous 5 years; Q_j is an indicator variable which takes the value one when the bank advisor/lead manager of transaction *j* was *q*. $date_i$ and $date_j$ are the dates (expressed in years) of issue *i* and issue *j*.

At the time of every transaction *i* we calculate the variables REL_MB as the strongest previous relation that the target company has with a bank. We call this bank the "main bank" of the target. Notice that the main bank might not be the advisor of the current deal. This variable only measures the fact that in previous years the target company has been able to develop a strong relationship with a single bank.

2.2.
The models

In order to evaluate the importance of every factor in the choice of the target to hire an advisor we run a logistic regression where we model the probability (p_i) of hiring an advisor for the acquisition *i* as

$$\ln\left(\frac{p_i}{1-p_i}\right) = \alpha + \beta_1 PERC_i + \beta_2 REL\_MB_i + \beta_3 TOP\_MB_i + \beta_4 CB_i + \beta_5 CASH_i + \beta_6 TOP_i + \beta_7 SIC3_i + \varepsilon_i$$

We add to this basic specification year and country control variables.

We are also interested in understanding the actual choice of an advisor, and specifically why the company should hire, as advisor, its main bank, i.e. the bank with which it has the strongest

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[6] *For transactions where more than one bank advisor was retained, the bank with the strongest relationship intensity is used in the empirical analysis.*

relationship. In modeling this second choice we face a typical sample selection problem: the choice to hire the main bank, versus another bank, is actually observed only for the deals where the target company chooses to hire an advisor. Unmeasured variables that influence the choice to hire an advisor could bias the result on our model. This problem can be solved using an Heckman Selection Model where (a variation of) our previous logistic model is used as selection equation: the dependent variabile of this selection equation is equal to one when we an advisor exists, that is, when we can observe the value of the dependent variable of our main equation (equal to one if the target's main bank is chosen as advisor). We will use a probit extension of the classical Heckman model that allows for a binary dependent in the main equation.

The reader should note that our relationship measure is based on transactions completed in the previous 5 years. If a company hasn't participated in the market during this period, the relationship measure be set to zero (the company actually does not have a main bank, because it has not dealt with any bank in the last five years); since such a firm, by definition, cannot hire the main bank as advisor in the present deal, a spurious correlation could be generated between the intensity of the relation with the main bank and the decision to hire the main bank as an advisor. In order to avoid this problem, we run our second model also on a reduced dataset that only contain 265 observations where the target company has completed at least a transaction in the previous five years and therefore has a main bank. As a robustness check, we also run our first model (the logistic one) on this reduced dataset, and the main results hold.

2.3
The analysis of the abnormal returns

The last part of our analysis is aimed at measuring the effect of the variables influencing the choice of the advisor on the post-acquisition performance of the target company. We measure the standardized average cumulated abnormal return at six different time horizons (1, 5, 10, 20, 40 and 60 days), after estimating "normal" returns with a market model based on the MSCI indices for every European country. We then run the following linear regression

$$CAR^i_{t-1,t+x} = \alpha + \beta_1 DUM\_MB_i + \beta_2 TOP\_MB_i + \beta_3 DUM\_ADV_i + \beta_4 PERC_i +$$
$$+ \beta_5 CB_i + \beta_6 CASH_i + \beta_7 TOP\_BID_i + \beta_8 SIC3_i + control\ variables + \varepsilon_i$$

where DUM_MB is a dummy variable equal to one if the main bank is hired as an advisor. A positive value of β_1 would suggest that hiring a bank with a strong prior relationship increases the welfare of the shareholders of the target company. Of course, this coefficient could be influenced by the simple fact that the target company has decided to hire an advisor (as opposed to navigate alone trough the M&A process). In order to isolate this effect we include DUM_ADV, a dummy variable equal to one if an advisor has been hired. In a second version of this model we interact DUM_MB with the relationship variable REL_MB, to get a better understanding of the

relationship between abnormal returns and the intensity of the previous relationship between advisor and target company.

The expected sign of DUM_MB and REL_MBX is, a priori, not clear. We can in fact identify two conflicting hypothesis: on the one side, if the role of the advisor in an M&A is to certify the quality of the company, we have that the main bank, having the strongest prior relationship and thus the deepest knowledge of the company, should be able to provide a better certification and thus increase the value of the deal. On the other side we could also envision an hold-up situation, where a company that in the past rested heavily on a given bank for its access to the capital market, and trough the years has shared a relevant amount of information with this bank, may find it expensive to switch to a new bank. In this case, we should see a tendency to hire the main bank even if this does not produce any significant wealth effect, and the coefficients should not be statistically different from zero.

Table 1

Variables Definition

The table reports a brief description of the meaning of the variables used in the regressions.

REL_MB	Intensity of the relation of the target company with its main bank (see main text for details).
TOP_MB	A dummy set equal to one if the main bank of the target company is in the first three positions of the Thompson Financials League Tables.
PERC	Percentage of shares involved in the acquisition
CB	A dummy, set equal to one if the observation is related to a cross-border operation
CASH	A dummy, set equal to one if the observation is related to an acquisition fully paid in cash.
TOP_BID	A dummy, set equal to one if the advisor of the bidder company is in the first three positions of the Thompson Financials League Tables.
SIC3	A dummy, set equal to one if the 3-digit sic code of the target is different from that of the bidder.
Year Fixed Effects	Nine dummy variables for years from 1995 to 2003. The null case is that of acquisitions made before 1995.
Country Fixed Effects	For the nationality of target company we use specific dummy variables for the two countries with the highest number of acquisitions (France and Germany) and a dummy variable for other countries, the null case is the UK. For bidder nationality we use again two specific dummy variables (France and Sweden), a dummy for other countries and the null case is again the UK.
$CAR_{t-1,t+x}$	The average (standardized) cumulated abnormal return from day *t-1* to day *t+x,* where t is the announcement date of the deal.

3.
DATA SOURCES AND SAMPLE CHARACTERISTICS

The data are from Security Data Corporation (SDC). SDC reports information on M&A, equity, bond, loan transactions. All non-hostile M&As involving European listed firms over the period January 1, 1994, through December 31, 2003, were identified. We excluded all transactions involving financial firms as either target or bidder. The sample has 473 transactions.

To measure banking relationships we select all debt (both bond and loans), equity and M&As transactions completed by both bidder and target firms from the beginning of 1989 to the end of 2003. Data about stock prices are from Datastream.

In our sample bidders are always assisted by an advisor. In 174 transactions target companies have no advisor. Out of the remaining 299 transactions, target firms are assisted by their main bank in 55 cases.

During the 90s, competition in the European investment banking industry has remarkably increased, thus possibly affecting firm-bank relationships. Nonetheless, there is no clear pattern in the evolution of the relationship measure, nor in the other variables, over time with the possible exception of an increase of the market share of top banks. (Table 2).

Table 2

Sample Descriptive Statistics – Distribution by Year

The table reports sample descriptive statistics for 473 M&A involving European listed companies from 1994 to 2003. The first three columns report the total number of deals *(Total)*, the number of deals where the target company has not employed an Advisor *(No Advisor)* and the number of deals where the advisor was the bank with the strongest previous relationship with the target company *(Main Bank)*. Columns number four and five report the average intensity of the relation with the main bank *(REL_MB)* and the average percentage of stocks of the target company involved in the deal *(PERC)*. The last five columns report the percentage of deals where the bidder's advisor *(TOP_BID)* or the main bank of the target company *(TOP_MB)* are in the top three positions of the Thompson Financials league tables, the percentage of cross-border deals *(CB)*, the percentage of deals where target and bidder belong to different sectors according to the 3-digit SIC code *(SIC3)* and the percentage of deals that only involved cash payments *(CASH)*.

	Number of				Average			Percentages				
	Total	No Advisor	Main Bank		REL_MB	PERC		TOP_BID	TOB_MB	CB	SIC3	CASH
1994	24	9	4		39.22	62.63		20.83	20.83	41.67	37.50	79.17
1995	38	17	3		49.18	65.44		13.16	10.53	31.58	26.32	71.05
1996	48	12	9		50.05	59.73		12.50	18.75	25.00	29.17	75.00
1997	45	17	4		38.31	59.33		22.22	13.33	40.00	26.67	86.67
1998	48	10	7		35.96	86.51		12.50	16.67	37.50	37.50	70.83
1999	97	30	13		47.02	70.86		25.77	18.56	27.84	36.08	72.16
2000	80	36	5		47.05	61.43		22.50	17.50	37.50	53.75	78.75
2001	40	19	4		60.69	52.41		22.50	22.50	42.50	45.00	77.50
2002	35	15	4		37.86	54.64		28.57	20.00	28.57	51.43	80.00
2003	18	9	2		54.95	41.21		33.33	33.33	50.00	33.33	77.78
Total	473	174	55		45.94	63.89		21.14	18.18	34.46	38.69	76.32

Table 3 reports sample summary statistics by advisor type . The REL_MB variable is considerably higher in the sub sample where the target firm hires its main bank as advisor for the current transaction: in these cases the bank with the strongest relationship holds significantly more information than the average bank in the system. The presence of an advisor (either the main bank or any other institution) is associated with a higher percentage of shares purchased and a lower proportion of deals settled completely in cash.

Based on an unconditional comparison, two main results seem to emerge: i) the main bank as advisor is associated with strong firm – main bank relationship, ii) the presence of an advisor is associated with more complex deals.

Sample Descriptive Statistics – Distribution by Type of Advisor

The table reports sample descriptive statistics for 473 M&A involving European listed companies from 1994 to 2003. The first column reports the total number of deals *(Total)*. Columns number two and three report the average intensity of the relation with the main bank *(REL_MB)* and the average percentage of stocks of the target company involved in the deal *(PERC)*. The last five columns report the percentage of deals where the bidder's advisor *(TOP_BID)* or the main bank of the target company *(TOP_MB)* are in the top three positions of the Thompson Financials league tables, the percentage of cross-border deals *(CB)*, the percentage of deals where target and bidder belong to different sectors according to the 3-digit SIC code *(SIC3)* and the percentage of deals that only involved cash payments *(CASH)*. The last three lines report the p-values of t-tests for equality of means between the indicated sub-samples.

	Number of Deals	Average			Percentages				
		REL_MB	PERC		TOP_BID	TOB_MB	CB	SIC3	CASH
No Advisor	174	45.04	40.16		16.67	17.24	40.80	40.80	87.93
Other Bank	244	37.77	78.19		22.95	15.57	29.51	40.16	68.85
Main Bank	55	85.02	75.49		27.27	32.73	36.36	25.45	72.73
Total	473	45.94	63.89		21.14	18.18	34.46	38.69	76.32
t-test (No Advisor - Other Bank)	0.094	0.000		0.109	0.652	0.018	0.896	0.000	
t-test (No Advisor - Main Bank)	0.000	0.000		0.117	0.030	0.557	0.031	0.023	
t-test (Main bank - Other Bank)	0.000	0.595		0.517	0.014	0.342	0.031	0.567	

4.
RESULTS

The choice of an advisor on the sell side can be analyzed from different standpoints. The obvious one is to look at the elements that bring the target to require the services of an investment bank rather than walking alone through the acquisition process. In our sample, around one third of the transactions are completed without the assistance of an advisor on the sell side. Such a high percentage makes the choice non trivial and worth being analyzed.

Table 4

Logistic Regressions on the advisor choice

The table reports the results of six logistic regressions (standard errors in brackets). The dependent variable is a dummy, equal to one if the target company has hired an advisor for the operation and zero otherwise. The definitions of the independent variables are in Table 1. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels.

	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Constant	-1.009	-0.132	-1.144	-0.227	-1.191	-0.359
	(0.390)***	(0.724)	(0.408)***	(0.734)	(0.412)***	(0.740)
REL_MB			0.311	0.267	0.161	0.022
			(0.260)	(0.300)	(0.279)	(0.324)
TOP_MB					0.463	0.741
					(0.318)	(0.365)**
PERC	0.030	0.025	0.030	0.025	0.031	0.026
	(0.003)***	(0.004)***	(0.003)***	(0.004)***	(0.003)***	(0.004)***
CB	-0.214	0.087	-0.219	0.078	-0.231	0.064
	(0.230)	(0.285)	(0.230)	(0.285)	(0.231)	(0.287)
CASH	-0.306	-0.219	-0.330	-0.239	-0.327	-0.222
	(0.299)	(0.343)	(0.300)	(0.343)	(0.302)	(0.348)
TOP_BID	0.841	1.243	0.814	1.224	0.773	1.167
	(0.286)***	(0.335)***	(0.287)***	(0.337)***	(0.288)***	(0.337)***
SIC3	0.197	-0.088	0.194	-0.088	0.179	-0.124
	(0.229)	(0.267)	(0.229)	(0.267)	(0.230)	(0.270)
Year FE	No	Yes	No	Yes	No	Yes
Country FE	No	Yes	No	Yes	No	Yes
Observations	473	473	473	473	473	473
Pseudo R-squared	0.206	0.347	0.208	0.348	0.212	0.355

Table 4 reports the results of a logistic regression on a dummy variable equal to one if the target has chosen to be assisted by an advisor. In the first two models, we do not consider the intensity of the relation with the main bank, nor its reputation, and we see that the probability of requesting the assistance of a bank is positively related, as expected, to the transaction complexity (proxied by PERC, the percentage of equity capital involved in the transaction) and to the reputation of the bidder's advisor (TOP_BID). Contrary to our expectations, other variables related to deal complexity are not significant: none of the dummies for cross-border transactions, cash payment and industry relatedness have any significant effect[7]. Moreover, the intensity of the relation with the main bank seems not to be relevant in this context: the fact that in the previous five years the company has relied mainly on the services of a single bank for debt and equity transactions does not increase the probability of hiring a bank for the current deal. It seems that a close relationship does not yield the main bank the ability to influence the decision process of the company. On the contrary, a positive impact is found for the reputational variable for the main bank (TOP_MB), when added to the model with country and time fixed effects. Most of these results are robust to inclusion of control variables for the years and home countries of both target and bidder companies.

[7] *As far as the cash variable is concerned we see a significant negative relation between the percentage of stocks purchased and the frequency of cash payment. The two effects cannot be fully disentangled. Dropping the PERC variable increases the significance of the cash variable, with a negative coefficient significant at the 1% level. Both effects point to the same direction: as the complexity/relevance of the transaction increases the target company is more willing to request the services of an advisor.*

On a second line of thoughts, we focus our analysis on the choice of hiring the main bank, the bank with the strongest previous relationship, as advisor for the specific deal (Table 5).

Table 5

Heckman Selection Model on the choice of hiring the Main Bank

The table reports the results of four Heckman selection models (standard errors in brackets). The dependent variable of the main equation is a dummy that takes a value of one if the target company hires its main bank as advisor for the current deal. The dependent variable of the selection equation is a dummy that takes a value of one if the target chooses to hire an advisor for the current deal. The independent variables a re described in Table 1. ***, ** and * indicate statistical significance at the 1%, 5% and 10% level.

	(1)		(2)		(3)		(4)	
	Main Bank	Advisor	Main Bank	Advisor	Main Bank	Advisor	Main Bank	Advisor
Constant	-2.003	-0.164	-1.577	1.006	-1.356	-0.176	-1.245	1.107
	(0.709)***	(0.345)	(0.707)**	(0.587)*	(0.440)***	(0.344)	(0.328)***	(0.296)***
REL_MB	1.335		1.123		1.353		1.177	
	(0.457)***		(0.476)**		(0.446)***		(0.368)***	
TOP_MB	0.084		0.196		0.069		0.130	
	(0.220)		(0.235)		(0.224)		(0.221)	
PERC	0.006	0.018	0.008	0.015		0.018		0.013
	(0.007)	(0.003)***	(0.004)**	(0.004)***		(0.003)***		(0.003)***
CB	0.298	-0.238	0.483	-0.407	0.362	-0.222	0.820	-0.336
	(0.262)	(0.182)	(0.294)	(0.239)*	(0.239)	(0.182)	(0.341)**	(0.228)
CASH	-0.152	-0.453	-0.227	-0.625	-0.078	-0.456	0.186	-0.596
	(0.253)	(0.277)	(0.261)	(0.332)*	(0.260)	(0.277)*	(0.236)	(0.290)**
TOP_BID	0.037	0.537	0.155	0.762	-0.101	0.535	-0.214	0.799
	(0.268)	(0.216)**	(0.273)	(0.265)***	(0.233)	(0.216)**	(0.251)	(0.250)***
SIC3	0.527	0.019	0.373	-0.237	0.516	0.001	0.434	-0.221
	(0.224)**	(0.188)	(0.248)	(0.231)	(0.224)**	(0.187)	(0.227)*	(0.207)
Year FE	No		Yes		No		Yes	
Country FE	No		Yes		No		Yes	
Log likelihood	-227.734		-183.105		-227.924		-183.621	
Chi2 LR Test of and.	0.17		2.98		0.42		2.48	
P-Val	0.683		0.084		0.515		0.115	
Observations	265		265		265		265	

Also in this case we find the choice to be influenced by the complexity of the deal, proxied by the percentage of shares involved (PERC, model 2) or by the fact that the deal involves two companies that operate in different countries (CB, model 4) or in different industries (SIC3, models 1, 3 and 4). We also see that the intensity of the relationship with the main bank is now

highly significant and positive. This result is expected because this variable proxies the benefits that can be earned by choosing the main bank as advisor[8].

4.1
Abnormal Return Analysis

The results above suggest that the relationship between the target company and its main bank is one of the key variables influencing the advisor choice. One could reasonably argue that there are many possible explanations for this effect: on the one hand, the relationship between the advisor and the target lowers the information asymmetry, thus making the advisor able to provide a better service. Target companies are therefore willing to hire an advisor, as the expected benefits are higher. On the other hand some sort of hold-up problem could be envisioned: a bank that has been in the previous years almost the only link between the company and the capital markets can influence the target company, thus increasing the probability to be hired. The best way to disentangle these two alternatives is to look at the effect of the target-advisor relationship on the post announcement abnormal returns of the target company. If the first hypothesis is true, we should observe a positive effect because of the higher quality service provided by an advisor with a deep knowledge of the company. In contrast, if the second hypothesis is true, we would expect no significant effect of the past relation on the stock performance.[9]

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[8] *Again a second possible explanation could be found: the intensity of the relation measures the bargaining power of the main bank.*

[9] *Theoretically one could even expert a negative relation because the fee paid to the advisor would not be justified by the transaction complexity. However, we do not expect the market being able to detect and discout this effect.*

Table 6

Main Bank and Abnormal Returns

The table reports the results OLS regressions where the dependent variable is the average standardized cumulated abnormal return calculated over the period indicated in the column heading (ranging from one day in column 1 to sixty days in column 6). Standard errors are in brackets. DUM_MB is a dummy variable set equal to one if the target company has hired its main bank as advisor for the present deal. Definitions of the other independent variables can be found in Table 1. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels.

	CAR t-1, t+1	CAR t-1, t+5	CAR t-1, t+10	CAR t-1, t+20	CAR t-1, t+40	CAR t-1, t+60
	(1)	(2)	(3)	(4)	(5)	(6)
Constant	-0.003	0.071	0.044	-0.031	-0.049	-0.025
	(0.164)	(0.229)	(0.259)	(0.244)	(0.236)	(0.233)
DUM_MB	0.132	0.205	0.181	0.134	0.121	0.066
	(0.063)**	(0.088)**	(0.100)*	(0.094)	(0.091)	(0.090)
TOP_MB	0.126	0.155	0.138	0.149	0.200	0.191
	(0.056)**	(0.079)*	(0.089)	(0.084)*	(0.081)**	(0.080)**
DUM_ADV	0.011	-0.011	0.072	0.100	0.043	0.009
	(0.069)	(0.097)	(0.109)	(0.103)	(0.099)	(0.098)
PERC	0.002	0.003	0.003	0.002	0.004	0.003
	(0.001)**	(0.001)***	(0.001)*	(0.001)	(0.001)***	(0.001)**
CB	0.078	0.080	0.027	0.096	0.051	0.096
	(0.065)	(0.091)	(0.103)	(0.097)	(0.093)	(0.092)
CASH	0.066	0.127	0.073	0.050	0.046	0.025
	(0.062)	(0.086)	(0.098)	(0.092)	(0.089)	(0.088)
TOP_BID	0.047	0.070	-0.029	-0.041	-0.040	-0.107
	(0.054)	(0.075)	(0.085)	(0.080)	(0.077)	(0.076)
SIC3	-0.069	-0.109	-0.089	-0.140	-0.091	-0.046
	(0.051)	(0.071)	(0.081)	(0.076)*	(0.073)	(0.072)
Observations	265	265	265	265	265	265
R-squared	0.391	0.392	0.334	0.342	0.381	0.384

Table 6 reports the results of the regression of the standardized average abnormal returns calculated on six different time frames (from one to sixty trading days). On the right hand side of this model we use the same variables used before to proxy the complexity of the transaction. We are particularly interested in the sign of the two dummy variables that describe the advisor choice. DUM_ADV, set equal to one if the target company employs the services of an advisor, is (almost) always positive but non significant, meaning that the simple presence of an advisor does not guarantee a superior performance. On the contrary, hiring the main bank as advisor (DUM_MB) has a positive and significant effect up to day *t+10*. Is important to note that even if we remove this variable from the regression DUM_ADV still is not significantly different from zero. Another interesting result is the positive effect of the reputation of the main bank (TOP_MB) on the abnormal return of the target company. This result probably capture two different effects: on the one side there is the reputation effect depicted by Kale et al (2003) and on the other side we could also assume that top banks can cherry-pick the best companies, generating an endogenous selection effect. Since this paper is about relation and not reputation we do not investigate further in this area.

Table 7

Intensity of the Relation and Abnormal Returns

The table reports the results OLS regressions where the dependent variable is the average standardized cumulated abnormal return calculated over the period indicated in the column heading (ranging from one day in column 1 to sixty days in column 6). Standard errors are in brackets. REL_MBX is the interaction between REL_MB and a dummy variable set equal to one if the target company has hired its main bank as advisor for the present deal. Definitions of the other independent variables can be found in Table 1. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels.

	CAR t-1, t+1	CAR t-1, t+5	CAR t-1, t+10	CAR t-1, t+20	CAR t-1, t+40	CAR t-1, t+60
	(1)	(2)	(3)	(4)	(5)	(6)
Constant	-0.001	0.074	0.050	-0.025	-0.043	-0.018
	(0.164)	(0.228)	(0.257)	(0.242)	(0.233)	(0.231)
REL_MBX	0.179	0.266	0.284	0.227	0.220	0.167
	(0.072)**	(0.101)***	(0.113)**	(0.107)**	(0.103)**	(0.102)
TOP_MB	0.127	0.157	0.139	0.150	0.202	0.192
	(0.056)**	(0.078)**	(0.088)	(0.083)*	(0.080)**	(0.079)**
DUM_ADV	0.004	-0.019	0.057	0.086	0.028	-0.007
	(0.069)	(0.096)	(0.109)	(0.102)	(0.099)	(0.098)
PERC	0.002	0.003	0.003	0.002	0.003	0.003
	(0.001)**	(0.001)***	(0.001)*	(0.001)	(0.001)***	(0.001)**
CB	0.075	0.076	0.021	0.091	0.047	0.092
	(0.065)	(0.091)	(0.102)	(0.096)	(0.093)	(0.092)
CASH	0.062	0.121	0.066	0.044	0.039	0.019
	(0.062)	(0.086)	(0.097)	(0.091)	(0.088)	(0.087)
TOP_BID	0.049	0.073	-0.027	-0.040	-0.039	-0.107
	(0.054)	(0.075)	(0.084)	(0.079)	(0.076)	(0.076)
SIC3	-0.069	-0.109	-0.091	-0.142	-0.094	-0.050
	(0.051)	(0.071)	(0.080)	(0.075)*	(0.072)	(0.072)
Observations	265	265	265	265	265	265
R-squared	0.398	0.398	0.347	0.353	0.393	0.393

Using a dummy variable to capture the main bank effect does not allow to gauge entirely the extent to which the intensity of the relationship is responsible for the abnormal return of the target company. In order to refine our result, in Table 7 we report the same regressions where the main bank dummy variable is interacted with the intensity of the relationship between target company and main bank. the resulting variable, REL_MBX is equal to the intensity of the relation if the advisor is the main bank and zero otherwise. From the results we see that the effect is even stronger and more persistent, lasting until *t+40*.

This result seems to give more credit to our first hypothesis: since there is a positive effect of the past relation on the abnormal return, the target company is willing to pay an advisory fee when the relation is stronger because of the larger expected benefits in term of shareholders' value.

5.
CONCLUSIONS

This paper examines the factors affecting the target's choice of the advisor in M&As. If the role of a bank in a M&A transaction is to provide information, then the likelihood of hiring an advisor should be related to the intensity of the previous banking relationship. The access to information generated by past transactions (loans, bond and equity underwriting, M&As) can be used in M&As to certify the quality of the transaction. We empirically analyze 473 M&A transactions completed from January 1, 1994, through December 31, 2003. We find that the probability of hiring an advisor, as opposed to walk alone through the acquisition process, is mainly influenced by the complexity of the deal and the reputation of the advisor of the bidder company. Moreover we find that the probability of hiring an advisor with a strong prior relationship with the company (the so called main bank) is influenced by the complexity of the deal and by the intensity of the previous relationship. This last result may be originated by the fact that the main bank can provide a better certification of the quality of the company or by a hold-up problem where the target company, having depended heavily on a given bank in the past may find difficult to switch to a new provider of financial services. The positive effect of a closer firm – bank relationship on the target stock performance at the announcement of the deal, seems to confirm the certification effect hypothesis.

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