

# The Value of your Advisor's Advice: An M&A perspective

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## Abstract

This paper addresses the role of advising banks in firms' acquisition activities. The incentives of bankers are misaligned: they benefit from advising on larger and more numerous deals, while do not have direct monetary incentives to improve acquisition quality. Strong reputational considerations should offset this effect, and we investigate whether the pressure of losing market share compromises this trade-off. Our results point at the "fee generating" conflict in investment banking: advising bank's decline in League Tables position is related to (1) lower abnormal returns at bidding clients' acquisitions, (2) lower probability of subsequently withdrawing deals that produced negative abnormal returns at announcement, (3) less pronounced pre-announcement run-ups for both targets and bidders, indicating that conflicted bank are more likely to advise or initiate deals that the market does not believe are likely to happen. The magnitude of negative effect on acquisition returns increases among inexperienced bidders and recent IPO firms who retain the same investment bank. On the other hand, the negative effect of misalignment is mitigated if more analysts follow the bidder. We address the issues of reverse causality and omitted factors that could conceivably explain these differences. Our findings suggest that banks facing market pressures readily propose, advise and facilitate deals that are less profitable for their clients.

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# 1 Introduction

A large body of literature studies the determinants of the quality of corporate acquisitions. The key question intriguing the minds of practitioners and academicians, as well as greatly affecting the welfare of shareholders, is why M&A transactions lead to declines in market valuations undesirably often. In this work we study the contribution of investment bankers, who act as advisors and deal executors in M&A transactions, to the creation or destruction of value at acquisitions.

The main idea of our paper is that banks may have misaligned incentives when putting forward or evaluating possible M&A deals: the fees charged for the M&A advice increase in the size and number of acquisitions executed, but not in the quality of these acquisitions. Thus, bankers may recommend their clients to buy other companies even if a deal is likely to become a failure for the bidder. We conjecture that the conflict becomes particularly severe when banks are under pressure to boost the M&A advisory fees or market share, and that in this situation banks may start trading-off the interests of advisory clients for additional advisory revenue from deals that do not create value for acquiring firms. We test this conjecture by examining whether the declines in advisory banker's M&A business negatively affect acquisition outcomes of bidding clients.

Existing literature often refers to misaligned managerial incentives and market overvaluation arguments when explaining the sources of inefficient acquisitions. At the same time, a burgeoning literature has been documenting conflicts of interest in investment banking, while recent massive criticism by investment public and regulators has been underscoring bankers' ignorance of clients' interests and large costs created by their excessive orientation towards earning fees and bonuses. On the incentive mechanism in advisory banking, Bao and Edmans (2010) show that the concerns regarding acquisitions quality may be of secondary importance for bankers when deciding whether to advise on a prospective acquisition, while the volume of advised deals seems to be a single most important driver of future M&A market shares. Thus, the incentives

in advisory business seem to be suboptimal from the point of view of advisory clients; yet the conflicts of interest that bankers face when advising on a proposed acquisition have not been extensively examined in the existing literature.

The main task of this paper is thus to unveil the influence that M&A advisors have on the quality of acquisitions of their bidding clients. We analyze the pressure to which the banks may be exposed due to their declining competitive position in the M&A market, where the pressure is defined as decline in the volume of advised deals or in M&A market share. Our analysis proceed along the following lines. First, to assess how bankers' incentives impact the quality of proposed deals, we test whether declining M&A business negatively affects acquisition outcomes as measured by announcement cumulative abnormal returns. Second, to analyze how advisory incentives impact the termination probability of potentially suboptimal deals, we investigate the withdrawal frequency for deals that had negative abnormal returns upon announcement. We additionally assess how the presence of analyst coverage affects both the quality and probability of withdrawing acquisitions. Third, we investigate how acquisition characteristics, such as bidder and target pre-announcement run-ups and the mode of payment in acquisitions, change depending on the incentives of the bank advising the bidder. Finally, we extend our analysis to the issue of existing relationship between the bank and its clients established at IPO. We address potential endogeneity concerns by using alternative specifications of the pressure variables to rule out alternative explanations that the reverse causality or omitted factors may drive our results.

Our findings demonstrate that negative dynamic of an advisory bank's M&A business does lead to worse acquisition outcomes. In particular, as the pressure on investment banks gets stronger, 1) the quality of advised acquisitions declines, 2) the probability of withdrawing low quality deals (with negative CAR) decreases, and 3) deal announcements come more often as a surprise to the market (associated run-ups are less positive for the target and less negative for the bidder). The results on the lower quality of more conflicted acquisitions increase in magnitude

when the sample is constrained to bidders with no previous acquisition experience or recent IPO firms, which suggests that when dealing with less experienced firms, banks may have stronger leverage to impact acquisition-related decisions to their own advantage. In contrast, the link between bankers' misalignment and lower acquisition quality is mitigated if more investment analysts are covering the bidder, which suggests that if there is a stronger potential punishment in the form of a reputational loss due to advising on badly performing acquisitions of well-covered bidders, the banks may be less aggressive with their advice.

The economic effect of misaligned incentives in advisory banking is substantial. We estimate that due to the conflict stemming from negative M&A dynamics of advisory bank, the abnormal returns at acquisitions are lower by 0.6% in the whole sample, by 1.2-1.8% for acquisitions performed by younger and less experienced bidders, and by 5-7% for acquisitions of recent IPO companies that retain the same advisor for both underwriting and acquisition transactions. The corresponding dollar value change at acquisitions is \$78 mil in the broad sample of acquisitions and \$46 mil among inexperienced bidders. These dollar loss estimates exceed by orders of magnitude a typical M&A fee of \$5 mil for an acquisition of average size in our broad sample, which hints at striking net costs that misaligned incentives cause to the economy as a whole.

Our results complement growing literature on conflicts within investment banking by demonstrating that distorted bankers' incentives negatively influence acquisition outcomes of their bidding clients. Overall, our findings suggest that imperfect contracting between bankers and corporate clients, along with misaligned managerial incentives documented in the literature, can be an important factor leading to wealth destruction at acquisitions, which should be addressed in the industry practice.

The remainder of the paper is organized as follows. Section 2 discusses the incentives of investment bankers in acquisition advisory and outlines our research hypotheses. Section 3 describes the data. Section 4 analyzes the relationship between bank's M&A position and the quality of advised acquisitions, as well as other acquisition characteristics. Section 5 provides

robustness tests to address alternative explanations. Section 6 concludes.

## 2 Misalignment of Banks and its Implications for Acquisition Quality

Many investment banking activities conceivably can have serious incentive misalignment, whereby profits from aggressive orientation towards serving own interests may have no direct counterbalancing force in a form of monetary reward for doing business in the best interests of the client. Reputation can be a strong mechanism to align bankers' incentives with those of the client, but the effect of reputation does not seem to be absolute, as we review below. Instead, banks, as profit maximizing entities, likely determine an optimal trade-off between pursuit for higher profits, which may involve excessively aggressive and potentially inappropriate ways of generating revenues (e.g. via biased research coverage or nontransparent fee schemes), and serving the interests of the client, which should improve the value of investment bank's reputation.

With regard to advisory services, Morrison and Wilhelm (2007) note that as the value of reputational capital diminished over the last third of the twentieth century, bankers have had incentive to exploit their reputation while it lasted, by selling inappropriate and expensive products to customers who were still prepared to trust them. The problem of neglecting reputation was central to the decline of Bankers Trust, where employees showed little concern for the long-term reputation of the firm in 'aggressive pursuit of profits' that resulted in several scandals and reputational losses the bank has not been able to sustain.<sup>1</sup>

Besides the reputation of the bank that affects the franchise value of banks as a business entity, personal reputation of bankers may be an important incentive factor at least in some areas of investment banking. In fact, in the analyst research framework Fung and Yasuda (2008)

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<sup>1</sup>Morrison and Wilhelm (2007: 247-249).

show that while bank reputation improves overall forecast quality, personal analyst reputation concerns are more important for the provision of unbiased investment advice. As the authors report, during the high-tech bubble period, analysts with low personal reputation who worked at reputable banks decreased research quality most dramatically, which likely created benefits to banks' underwriting business. Intuitively, such analysts had most to gain (massive capacity of their banks to generate underwriting revenues, which translated into higher bonuses) and least to lose (low personal reputation).

However, the M&A advisory industry does not seem to feature any comparable personal reputation mechanisms as analyst coverage industry does (an All-American award for individual "star" analysts). Instead, purely quantitative measures of advisory team performance, such as League Tables published by Thomson Financial and other providers, are widely used as means of assessing qualification of banks in particular advisory areas. Clearly, personal connections play an important role for winning M&A advisory mandates, but here too the reputation seems to be substituted by quantitative measures of experience. As a former M&A executive of two major investment banks writes, "Bankers gain stature within organization by being associated with large, important transactions... refers to both the value paid and fee collected."<sup>2</sup> The result of the incentive structure geared towards quantitative performance can be indeed quite noticeable. The survey of UK bidders by Hunt, Lees, Grumbar, and Vivian (1987) showed that some acquirers felt they were hustled into closing the deals, were dissatisfied with bankers' excessive orientation towards deals and fee earning, and that banks featured 'scoring points' against each other in amicable deals.<sup>3</sup>

Our work contributes to the two strands of literature that study, on the one hand, the issues of suboptimal acquisition decisions that lead to value destruction and, on the other hand, the conflicts of interests in investment banking. The first line of literature analyzes inefficient actions of corporate management that cause value destruction, which is reflected in the negative stock

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<sup>2</sup>See *The Accidental Investment Banker*, Jonathan Knee.

<sup>3</sup>See Sudarsanam (1995: 114).

price reaction. Established theories, most prominently Jensen (1986), appeal to the excess cash flow and managerial misalignment resulting in empire building problems.

It is interesting to uncover the structure and source of inefficiencies in M&A transactions. The vast majority of acquisitions creates value for shareholders as measured by a three day abnormal market return, according to Moeller, Schlingemann and Stulz (2005). However, a relatively small number of disproportionately large and inefficient acquisitions outweighs the former ones, such that the total wealth change in all acquisitions turns negative (for example, the authors estimate the total loss to acquiring firm shareholders to be \$240 billion during 1998-2001). In light of the first line of literature, the explanation is that corporate managers do not serve the shareholders' interests and instead focus on pursuing private benefits of control. In particular, Jensen (2005) remarks that managers of large corporations with high valuations have enough discretion to make poor acquisitions after they have run out of good ones. This raises questions whether the managers are solely responsible for such value destructive actions and why corporate governance does not respond with efficient control mechanisms specifically in case of large companies.

The widespread use of options-based compensation in recent years was intended to make managers more concerned with maximizing shareholders' wealth and these incentive mechanisms should ideally encourage managers to choose only those acquisitions that create value for the acquiring company, although as Harford and Li (2007) show, it may well be that corporations with poor corporate governance grant to executives additional stock-based compensation following unsuccessful acquisitions.<sup>4</sup> Thus, managers may receive direct monetary compensation for executing suboptimal acquisitions – on top of perquisite consumption and personal satisfaction of managing 'empires'.

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<sup>4</sup>According to Harford and Li (2007) and Grinstein and Hribar (2004), excessive influence of executives on compensation committees may lead to the failure of incentive-based compensation in M&A setting: executives were shown to receive new sizable cash and stock-based compensation following acquisitions, offsetting possible declines in old options value.

A very important point here is that regularly the role of corporate executives as acquisition originators and executors is shared with investment bankers, and that banks receive hefty fees for their acquisition advice. Indeed, in practice M&A teams of investment banks play a key role in evaluating the efficiency of possible acquisitions that are under consideration of corporate executives. This gives us ground to conjecture that managerial misalignment might not be the only factor accounting for all inefficiencies observed. At this point, we refer to the second line of literature that documents mounting evidence of the conflicts within investment banking, where numerous papers show examples of imperfect contractual relationship, in which bankers may put their own profits ahead of clients' interests.

We quickly review examples from existing literature to motivate our main hypothesis that misaligned bankers may push their corporate clients into value-destructive acquisitions. An abundant literature analyzes the conflict of interest in an underwriter setting, where banks may benefit from keeping offer prices low to boost brokerage commissions. Initially the dominant view was that better underwriter reputation reduces the uncertainty related to a new stock becoming public, as higher prestige underwriters provide more professional services and have valuable reputation to sustain. However, findings in Michaely and Womack (1999), Ljungqvist, Marston and Wilhelm (2009), and Chemmanur, Hu and Huang (2009) amongst other papers, suggest that large banks accumulated considerable reputational capital and can now abuse their market power when providing investment recommendations on potential underwriting clients or determining IPO offer prices.

Thus, the bankers seemed to boost, on the one hand, their underwriting revenues at the expense of the investment research subscribers, and, on the other hand, their brokerage commissions from institutional investors at the expense of their IPO clients. Such "gift exchange" has triggered several discreditable investigations on inappropriate investment research, IPO allocations and brokerage practices, including the "Global settlement" that involved ten major investment banks.

On the role of analysts employed by banks advising on M&A transactions, Haushalter and Lowry (2010) show that if banks receive higher proportion of revenues from investment banking, their analysts tend to issue more positive recommendations on acquirers around acquisitions advised by their banks, which is similar to numerous findings in the IPO literature on optimistic analyst coverage as a mean of winning underwriting mandates. They further show that affiliated asset management divisions seem to recognize potential conflicts and rely on analyst recommendations to a higher degree when perceived conflicts are less severe.

On the client side of advisory business, the corporate managers seem to neglect such important information as investment banks' previous advisory experience and the realized quality of advised acquisitions, which means that shareholders value maximization is not a guideline in the practice of choosing an M&A advisor. Bao and Edmans (2010) show that even if banks underperform in acquisition quality, they still improve their position in the M&A rankings if they performed well in terms of deal volume. They find that both the abnormal return and its residual part unexplained by deal characteristics are persistent for individual banks over time, which suggests that corporate executives do not take advantage of such important characteristic of investment banks as bank-specific acquisition performance. Other potential quality measures, such as acquisition success rate or time to completion, do not appear to be substitutes for the quality of acquisitions as evaluated by the market return. Finally, they show that high abnormal returns at advised acquisitions do not improve bank's competitive position, while the most important driver of future advisory market share is current market share. This striking result hints at the importance of size and number of advised deals for the bankers, and that reputational concerns may not be the first priority for investment bankers.

On the inside information aspect of the conflict of interest, Bodnaruk, Massa and Simonov (2010) show that investment banks benefit from advantageous information that M&A divisions have regarding takeover plans by changing stakes (through proprietary trading divisions) in advised bidders and their targets. Moreover, the outcome and profitability of takeover attempts

are altered due to banks' indirect participation. As a result, banks earn lucrative returns, while performance of the bidding firms in acquisitions is inferior. These results indicate that managerial hubris and empire building are not the only factors driving value destruction in acquisitions. As Bodnaruk and coauthors suggest, the bankers are exploiting managers' bidding ambitions to their own advantage, which justifies our hypotheses. As an indication of this phenomenon from another angle, Guner, Malmendier and Tate (2008) show that the presence of investment bankers on corporate boards is associated with the undertaking of poorly performing acquisitions.

These findings are in contrast to a more traditional view that "reputations are hard to build and they are the source of all of the investment bank's profits".<sup>5</sup> A possible explanation is that in the new era of standardized and depersonalized banking, reputation is no longer associated with a successful track record of deals and personal experience, but rather with a position in widely publicized market rankings and reviews. Thus, the position in the League Tables seems to be perceived by executives as the key measure of advisor's quality, and the CEOs may use it to easily choose top banks in order to show the shareholders that they 'did their best' when preparing an acquisition, referring to the certification role of 'leading banks'.

Similarly to the results in Fung and Yasuda (2006), misaligned incentives within advisory banking may also have roots in the personal interests of investment bankers. M&A team considering a potentially inefficient acquisition may be tempted to trade off the bank's reputation with their own bonuses at the end of the year. Of course, bank's inflated fee targets and philosophy of struggling for the leadership in the M&A league tables have the same direction of influence, and we aim to capture the joint effect of conflicts within M&A advisory banking.

That is, on the one hand, bank's reputation concerns should help to align advisors' incentives with those of the acquirer. On the other hand, advisory team's bonus pool and bank's desire to advance in the League Tables via doing larger and more numerous deals, drastically diverge with the value-creating interests of acquirer's shareholders. On top of that, personal career concerns

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<sup>5</sup>Morrison and Wilhelm (2007: 92)

may induce bankers to aim at orchestrating large acquisitions, as this is one of the key measures of bankers' usefulness to a bank. Thus, the incentive structure of advisory teams seems to be strongly dominated by quantitative characteristics of performance rather than by the quality of acquisitions.

It seems that until the last two decades, the opportunity to abuse oligopolistic power of major banks<sup>6</sup> was balanced with the tendency of establishing long-term relationship and with the practice of maintaining one bank-one corporation client structure,<sup>7</sup> that created sufficient reputation building incentives for banks. This balance has deteriorated with the weakening of relationship banking in the 1990s and following the repeal of the Glass-Steagall act that released new competitive forces into the M&A advisory business from the side of commercial banks, intensifying the competition for the pool of profitable acquisitions in the economy. The emergence of a large number of new participants in the M&A advisory sector coupled with the drastically increased turnover amongst advisory banking professionals<sup>8</sup> weakened the motives to build long-term reputation and increased the shortsightedness of investment bankers, making the race for fees perhaps the dominant driving factor in the industry. Our further analysis also shows that as a relationship banker experiences higher pressure to do M&A deals, the efficiency of its clients' acquisitions gets lower.

In this paper we explore what other factors, besides the free cash flow problem, distorted managerial incentives and possible revelation of firm-specific information, led to massive declines in value at acquisition announcements as documented in Moeller et al (2005). The main aim is to verify whether the investment bankers, acting as experts and advisors in M&A, can abuse

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<sup>6</sup>Hayes et al. (1988): investment banking exhibited an oligopolistic industry structure... [dominated by] a handful of powerful firms. See Anand and Galetovic (2006).

<sup>7</sup>See Eccles and Crane (1988: 53-54).

<sup>8</sup>The last two decades witnessed several episodes of whole advisory teams changing the employer. An eye-catching example was the move in 1988 of star-bankers Wasserstein and Parella followed by 21 banker, who left First Boston with a handful of major clients. See Morrison and Wilhelm (2007: 285-286, 307).

their influence on corporate executives by encouraging them to undertake “bad” acquisitions – along with value-creating ones – due to the conflict of interests and “fee generating” motive. Referring to Jensen’s (2005) hypothesis, it can be the case that it equally applies to investment bankers: if there’s scope for abusing one’s influence on corporate managers, the bankers may start pitching value-destroying acquisitions once they run out of value-creating ones.

As was reviewed in the previous part, banks often advise on M&A that do not create value for acquiring firm’s shareholders, and yet manage to improve competitive positions in the M&A market (see Bao and Edmans, 2010). This observation coupled with the structure of compensation in investment banking clearly shows that bankers’ incentives are misaligned, and that promoting all, even value destructive acquisitions, may be optimal behavior for bankers: each additional acquisition boosts fees and current market share, thus increasing the odds of improving the future position in the League Tables. At the same time suboptimal client performance does not seem to have any significant effect on future market share. In contrast to Bao and Edmans’ paper, the purpose of our work is to study how the bank’s incentives in M&A advisory influence the quality of acquisitions its clients undertake, rather than to analyze the quality of advised acquisitions as a driver of future M&A market share.

## 2.1 Testable Hypotheses

Investment banks, whose advisory market share is falling relatively to previous period, are more eager to catch up in their competitive position, and thus may have stronger incentive – *ceteris paribus* – to win advisory mandates. Thus, in a situation with falling competitive position a bank can start to (marginally) trade-off own short-term benefits (such as League Tables position improvement and advisory fees) for the quality of advisory services for its client. In this paper we refer to such banks pressured by the market as more *conflicted* or *misaligned*. Empirically, we expect that firms hiring more conflicted banks will perform acquisitions with lower announcement returns, thus destroying more value in acquisitions. To capture the pressure of M&A market

dynamics on investment banks, we use U.S. M&A deal volume and market shares as reported in SDC Platinum M&A League Tables. These variables capture how successfully an M&A advisory team performs, and our conjecture is that during the periods of falling M&A revenues a bank's advisory team is under stronger pressure to generate advisory fees.

We expect that for a banker the opportunity to promote acquisitions is better if a client firm has smaller acquisition experience, thus we will repeat our tests in a subsample of firms with no announced acquisition during three years prior to a given acquisition announcement (referred to as *inexperienced bidders* sample, in contrast to the *broad* sample). Finally, we also investigate how misalignment of banks influences the quality of acquisitions in a setting of both lack of experience and established relations with investment bank. To capture the established relationship, we restrict our sample to firms that went public recently prior to acquiring and that hire the same investment bank for both IPO and M&A transactions (referred to as *relationship advisor* sample).

Besides analyzing the effect of misalignment, we also explore how misalignment affects withdrawals of deals with negative abnormal returns at announcement and other aspects of acquisitions.

Our discussion can be formalized in a set of testable hypotheses:

**H1.** CAR at acquisitions advised by more conflicted banks are smaller.

This hypothesis formulates the conjecture that an investment bank hired as M&A advisor plays an important role in acquisition-related corporate decisions and has an opportunity to put significant pressure on its executives; and that more conflicted banks presumably do so more often. Given the scarcity of value-creating acquisitions, some of the suggested transactions are suboptimal and do not create value for the acquiring firm's shareholders. As the variable capturing the pressure to generate more M&A advisory, we employ both specifications of dummy for a negative change in total dollar volume of deals advised by the bank, or its market share. As a decline in volume of deals (relatively to previous period benchmarks or competitors) endangers

both the bank's position in the League Tables, and the bonus pool of the M&A division, we expect that the bankers will be more likely to exercise particularly high efforts in order to engage their clients into more transactions, and client's wellbeing is more likely to be traded off for bank profits. As detailed above, we investigate the influence of possible misalignment both in broad and inexperienced samples.

The next hypothesis investigates whether the current pressure variables affect the odds of withdrawing acquisitions that were perceived by the market negatively (with negative abnormal returns at announcement). The idea here is that if acquisition advisors are under higher pressure to generate deals, they will be more eager in persuading the acquirer to complete an acquisition even if the market discourages the firm from doing so, which would result in lower incidence of subsequent withdrawals conditional on negative abnormal returns at announcement.

**H2.** Negative CAR deals are withdrawn less frequently if advisors are under higher pressure of their M&A market position.

We should note that completion frequency is perceived as one of the quality features in advisor's work: if a corporation engages into a costly and time-intensive acquisition negotiation process, it views higher completion frequency as one of quality characteristics of investment bank's work (see Bao and Edmans, 2010, who treat completion rate and speed as alternative quality characteristics in M&A advisory, besides announcement returns). However, completing acquisitions that the market disliked and greeted with negative stock price reaction rather puts a question of whether executives and bankers aim at pursuing their own interests instead of maximizing shareholder value. Thus, we investigate how the withdrawal probability is affected, conditional on negative CAR at announcement.

We additionally test hypothesis H1 and H2 along the dimension of covering investment analysts, whereby we interact the explanatory variable capturing the conflict with the number of analysts covering a bidder's stock.

Finally, we posit the auxiliary hypotheses on other characteristics of acquisitions.

**H3.** Deals are initiated less expectedly and thus pre-announcement run-ups are smaller in magnitude if advisors are under higher pressure of their M&A market position.

This hypothesis reflects the fact that if the deals are motivated by the desire of advisory teams to generate fees, rather than by economic or strategic need for the bidder, the deals will be less likely to be expected by the market. The alternative interpretation would involve the insider trading aspect, according to which more conflicted banks (with conflicting interests in different departments) could engage into speculative trading before acquisition announcement. We discuss this issue in the related section below.

**H4.** Deals are more likely to use stock consideration if advisors are under higher pressure of their M&A market position.

Hypothesis four reflects the fact that using stock payment in acquisitions can solve the problem of finding a funding source for the acquirer, and thus makes acquisitions possible even if no other party is ready to provide financing for a bid and if internal funding is insufficient. Additionally, the argument of stock financing can be used to persuade management to acquire other firms by appealing to temporary overvaluation of the stock, which is a subjective and hard to verify matter.

Finally, we address the issue of conflicted incentives in the setting of established relationship between corporate management and investment banking teams. Morrison and Wilhelm remark that M&A advisory work rests almost exclusively upon relationship and market information.<sup>9</sup> In order to capture the existence of close relationship between advisors and managers, and thus the possibility to abuse this access to corporate executives, we also repeat out tests in a setting where important business links exist between advisors and executives before an acquisition. The dimension under focus is establishing close relations with firm management through underwriting its IPO.<sup>10</sup>

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<sup>9</sup>Morrison and Wilhelm (2007: 90).

<sup>10</sup>Relationship between investment banks and firms provide banks with access to firm-specific information that can be used to structure deals. (As Crane and Eccles (1993: 131-136) describe, without

To give an intuitive example, we can consider a firm that goes public with a bank which has substantial M&A business. Such a bank would actively seek potential takeover combinations for its former IPO client and would be particularly eager to promote these. Existing evidence shows that firms tend to keep underwriter in future transactions.<sup>11</sup> Thus, our conjecture is that after conducting an IPO, the bankers will more frequently contact firm executives to pitch possible takeover targets and propose advisory services, and in general will have an opportunity to abuse this preferential access to management, as well as superior knowledge of firm-specific information.

In the light of the misaligned incentives that deteriorate as market pressure increases, such opportunity to abuse may be exploited once a “hot” deal appears on the horizon. In other words, a deal that promises high fees to the investment bankers, even if it does not necessarily increase shareholders’ value, can be deliberately advertised to the former IPO client and it will have higher chances of being initiated at a given firm. Of course, for the case of client-initiated deals, a conflicted advisory team enjoying higher level of trust will also be in a better position to facilitate deal completion, even if investment bankers perceive the low quality of the proposed transaction. To assess the effect of misalignment in this setting, we will test this extended version of hypothesis *H1.b* on a sample of firms that announce acquisitions soon after going public and who retain the same investment bank for M&A advisory services (acquisitions with a *relationship advisor*).

As pressure metrics, we construct dummy variables capturing change in M&A deal value and market share values relatively to the previous year in order to capture the pressure on advisory teams to “chase deals”: if a bank’s M&A business is declining, the bankers face prospects of such relationship and information, the banks would be ‘making virtually random blue-book pitches with little chance of hitting the target’.) On the other hand, prior relationship, particularly those established through an IPO, is a primary reason for choosing an investment bank (Anand and Galetovic (2006)).

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<sup>11</sup>James (1992) shows that following IPO 72% of firms retain the same bank for the next stock issuance; for debt offerings, 65% of issuers do not switch banks.

having lower or no bonuses at the end of the year, and potentially face prospects of being fired, while the bank is losing its position in the League Tables; thus, the eagerness to promote acquisitions ‘whatever it takes’ and misalignment. Previous year level of M&A revenues (or market share) is taken as reference point in our main specifications, as last year performance is the most natural and readily available benchmark for investment banks. Obviously, banks whose advisory business is exhibiting upward sloping trend will set higher targets for consecutive year, but clearly what hurts most is losing the market share to competitors. Hence, we employ previous year levels as a natural benchmark and code dummy variables of negative change in M&A market value (alternatively, share) relative to the previous period.

In order to measure the efficiency of acquisitions, we employ the standard measure of cumulative abnormal returns at announcement, which allows us to capture the wealth change to acquiring firm shareholders. We are concerned primarily with the change in acquiring firm valuation, thus, we do not measure the change in the combined market valuation of the bidder and the target. Our main task is to unravel how advisory bank’s incentives affect its client’s performance, so we do not analyze additional issues of combined wealth change or wealth redistribution between shareholders of the two companies, for example due to the hubris hypothesis or overconfidence. We control for customary deal characteristics, accounting and valuation variables.

In the next section we describe our data sample and the variables employed to capture the effect of the “deal generating” phenomenon within investment banks, and in subsequent section we report the empirical results.

### **3 Data and Variables**

Our paper examines the differential in quality of acquisitions depending on the incentives of the investment bank a firm hires as M&A advisor. Our initial dataset includes all U.S. acquisition

announced between 1990 and 2008. We focus on acquisitions with increase in ownership from below 50% to above 50%. In most cases, the acquisitions in our sample are characterized with acquiring 100% ownership of the target.

The acquisition related data are from the M&A section of SDC Platinum database. To test our hypothesis H1 in the relationship advisor sample, we also track all acquisitions made by recent IPO firms performed within a period of up to three years following an IPO, and check whether the identities of the underwriting bank and the subsequently hired advisory banks are the same. Relevant IPO data come from the IPO section of SDC database. The stock and index returns data are from CRSP tapes and we complement firm-specific data from Compustat database: total assets, common equity, shares outstanding, sales, cash holdings, income, and debt. We have 2944 acquisition announcements with complete stock and accounting data in the broader sample.

The following two variables capture a potential pressure that investment banks experience: yearly change in dollar volume of all acquisitions performed with advisor involvement and market share of advised acquisitions. To keep sample size manageable and at the same time to have a sufficient number of observations for each bank, we first determine the list of banks that belonged to top 50 by the total volume of advised deals in a period of either 1990-1999 or 2000-2009. We carefully track acquisition records between investment banks themselves over this period, and add up U.S.-related M&A revenues when the same bank appearing in historical SDC tables under different names in a given year. Yearly M&A deal values and market shares for these top advisors proxy the overall importance of M&A advisory business for banks and are from SDC Platinum M&A database League Tables. We calculate yearly change in advisory market share and deal volume for the chosen banks for all years of the sample period.

To construct an additional metric for the robustness section, we follow a similar methodology to calculate quarterly metric (both dollar value of acquisitions and advisory market share) to calculate a lagged variable of performance over recent quarters. Quarterly changes are more

volatile than their yearly counterpart, and to capture an evolving dynamic of advisory incentives over the course of deal origination and structuring, we calculate a change in the market position over the two most recent years excluding the deals performed in the current quarter (we discuss this alternative specifications in more detail in the robustness section).

As a measure of value-creation at acquisitions we use the cumulative abnormal return over three-day window at acquisition announcement dates, with the value-weighted CRSP raw return as benchmark in the baseline specification.

Finally, we calculate for each year the number of analysts following a bidder's stock, as reported in IBES database. For any given acquisition, we use the number of analysts following the stock in a previous year (the number of analysts in a current year potentially could increase following a successful acquisitions, so we prefer using a previous year coverage).

We present descriptive statistics for 2944 acquisitions of the broader sample in the first two columns of Table 1, while the last four columns provide comparisons between acquisitions depending on the competitive position of an advisory bank (increasing versus declining value of all acquisitions advised). We see that abnormal returns in the whole sample have positive mean and median, but the change of bidder capitalization has negative mean and is negatively skewed. This parallels the results in Moeller et al (2005), who show that despite mean abnormal returns being positive, the combined dollar change in acquisitions is negative due to negative skewness in dollar change at acquisitions. In our sample, the bidder CAR is smaller (with significant mean difference) and bidder capitalization change is more negative (median difference test is significant) in the subsample of acquisitions advised by misaligned banks.

Average bidder pre-announcement run-up is negative, mean target run-up is positive, and both types of run-ups are less pronounced in subsamples of conflicted advisors. Acquisitions advised by misaligned banks have somewhat lower probability of withdrawing deals that had negative announcement CAR and the withdrawal probability is also smaller without conditioning on CAR, but in both cases the difference is insignificant. Cash-based consideration is less

frequently used in acquisitions advised by banks that have declining M&A advisory business. As for accounting variables, we see that firms that use advisory service of misaligned banks are larger by capitalization, assets and sales, have lower recent sales growth and somewhat lower return on equity (albeit this latter difference is insignificant). Finally, premiums in such acquisitions tend to be higher.

As we see, the univariate comparison results hint at higher incidence of lower quality acquisition decisions if the advising bank faces higher pressure to generate M&A revenues. In the next section we investigate the drivers of these inefficiencies and find evidence suggesting that misaligned incentives of investment bankers contribute to poor performance at acquisitions.

## 4 Empirical Methodology and Results

This section presents our identifying strategy of capturing the effect of M&A market pressures on the quality of acquisition advice, and our empirical findings. The ideal way to quantify the effect of this pressure would be to compare outcomes of acquisitions advised by banks in otherwise identical setting, where the only difference in the incentive structure would stem from an exogenously driven shock to the competitive position of each bank. As long as an advisory team is subject to the shock at the time of providing its advice, conducting due diligence and negotiations with a (potential) target, a negative shock may pressure the team to provide advice that is biased in favor of completing the acquisition. Biased advice would on average translate into lower abnormal returns at otherwise identical acquisition announcements, and we would have direct evidence of conflict in advisory banking due to competitive pressures of individual banks. Clearly, an ideal specification is hardly ever achievable beyond the control experiment setting, and we discuss below what issues the departures from a desired benchmark specifications pose.

In our main specifications that test H1 in the next subsection, the outcome variable is the

abnormal return at acquisitions, and the key explanatory variable is the dummy of advisory bank facing deteriorating market share prospects (where the latter is either in dollar value of advised acquisitions or in market share units). It is conceivable that the abnormal returns at large acquisitions, particularly if they attract attention of media or corporate executives, may affect future advisory market shares. This poses a concern of the reverse causality effect, and we discuss in the Robustness section that our results in alternative specifications with lagged explanatory variable, as well as the timing of a typical acquisition preclude this alternative explanation from driving our results.

Unobserved variables are also an important concern in this setting. We discuss below how our results on the deal completion probability help to rule out an alternative interpretation that our findings are due to the changes in unobserved quality of banking professionals.

#### **4.1 Deteriorating advisory incentives and acquisition quality**

We start presenting our empirical findings with the results of regressing acquisition returns on the conflict variable of advisory bank, and then we explore another aspect of acquisition quality, the withdrawal frequency for potentially suboptimal deals. Our measure of the conflict in advisory banking utilizes fluctuations in banks' M&A competitive position over time. We calculate annual changes in each M&A advisor market share and deal volume. These variables capture the changes in bankers' incentives: firstly, the utmost goal of each advisory banking team is to increase its ranking in the League Tables as this measure is widely used as the most important statistics by banks when competing for advisory mandates. Secondly, bankers' bonuses increase monotonically in the volume of the deals advised; they are also likely to be positively related to the market share. Intuitively, for a given level of long-term incentives to preserve and accumulate reputational capital, the bank will be more tempted to cash in (in terms of bonuses, fees, or market share) on existing reputation, when market conditions are more stringent, and bank's M&A business and revenues decline.

## Abnormal returns

Thus, in order to test our hypothesis H1, we run our tests with three day acquisition CAR as a dependent variable and a dummy of negative change in advisory banking market position as the explanatory variable of interest. The results are reported in Table 2. The first two specifications are estimated on the whole sample, and the second two specifications on the subsample of acquisitions performed by inexperienced bidders. Specifications (1) and (3) employ falling M&A position in dollar value, while (2) and (4) use M&A market share as variables of bidder's bank M&A business.

[Insert Table 2 Here]

In three out of four specifications, the conflict of interest dummy is significant and it has negative sign in all four specifications, which is consistent with the conflict hypothesis: acquisition returns are worse when bidder's advisor has deteriorating dynamics of market share (or volume of deals) in advisory business. The economic impact of advisor's conflict on bidder returns is negative 0.6% in the broad sample, but the effect becomes stronger and reaches negative 1.2% (1%) in the subsample of inexperienced bidders. For mean (median) capitalization of \$13 bln (\$1.9 bln) in the whole sample this translates into 78 mil (10.9 mil) incremental decline in value. In the sample of inexperienced bidders the average capitalization is 3.8 bln (0.7 bln), so the corresponding decline in value is 46 mil (8.4 mil). These estimates can be interpreted as bidder shareholder losses stemming from the pressure of falling market position that advisor experiences. While moderate in percentage terms, the dollar value of the loss is quite substantial, especially if one assesses it relative to average transaction size or potential advisory fees for the investment bank. Mean (median) transaction value in the broader sample is \$1.0 bln (230 mil) and with common fee structure in the industry<sup>12</sup> average success fee for the bank is about 5 mil (2 mil for a median transaction), so that the average value loss of 78 mil (10.9 mil) stemming

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<sup>12</sup>A typical success fee compensation of advisory bank is 1% of the transaction for a medium size deal, and 0.5% for a billion-value transaction. See Iannotta (2010), p. 121

from advisor's misalignment is strikingly larger than the average contingent compensation an advisor earns.

The negative influence of pressure is estimated to be stronger in the inexperienced bidders sample, where it is plausible to expect that banks have better chances of exploiting to their own advantage the lack of executives' experience in a relatively immature firm or a firm with no M&A experience. At the same time, the univariate comparison shows that abnormal returns at acquisition announcements are generally higher among the inexperienced bidders group: 0.8% vs. -0.02% in the group of firms that did perform acquisition in the recent past (this difference is highly significant with p-value of 0.005). The estimates on control variables indicate that returns are worse in case of public targets (about 3% decline in CAR), higher for cash-financed deals, and lower for stock-financed deals (the latter result is significant in the larger sample only). The returns are smaller among large acquirers (log assets) and those with increasing sales, but improve with higher leverage.

The results in Table 2 show that if an investment bank advising a bidder is losing M&A market share, the returns at client's acquisitions are lower. According to the conflict of interest hypothesis, this implies that advisory banks may facilitate lower-quality acquisitions in order to generate advisory fees. An alternative interpretation could be, however, that banks that advised on poorly performed acquisitions harm reputational capital and subsequently lose M&A market share. We address this issue of reverse causality in section 5 by analyzing the timing of a typical acquisition and by employing lagged variables of the pressure on M&A advisor. The results that the misalignment of advisory bankers have negative effect on abnormal returns remain robust to the reverse causality explanation, which helps to show that pressured incentives of advisors contribute to value destruction in M&A.

### **Withdrawing negative CAR deals**

The results on abnormal returns demonstrate that banks with declining M&A businesses are associated with worse returns at announcements. However, the participation of the advisory

team does not end at the deal announcement, and the bank continues to be involved in the acquisition process until the deal is resolved. Thus, having observed that the initiated deals tend to be worse, we have to investigate what follows following an announcement. Announced deals have to undergo a phase of intensive negotiations, due diligence by both sides and obtain all applicable regulatory approvals, and transactions that appear to be less favorable to the bidder can still be withdrawn. We further test how the pressure of falling M&A business impacts the withdrawal frequency conditional on deals being negatively met by the market, i.e. deals with negative abnormal returns at announcement. The results are presented in Table 3, where similarly to the previous tables we report results for the whole sample in specifications (1) and (2) and for the subsample of inexperienced bidders in (3) and (4).

[Insert Table 3 Here]

In all four specifications, the dummy of advisor's falling business has significant negative impact on the probability of withdrawing deals that were met with negative abnormal returns at announcement. The effect has order of magnitude of 8 to 11%, which is very considerable relative to 15% unconditional mean withdrawal probability for negative CAR deals. This result shows that advisory teams that are under pressure to generate advisory revenue are more likely to be involved in deals less sensitive to the negative market reaction. It comes in line with the previous result on abnormal returns and demonstrates that advisory banks under pressure are more likely to trade-off their client's well-being and hence the bank's reputational capital for the sake of short-term goals such as receiving contingency fees upon deal completion and rebounding in the League Tables positions.

The finding that negative CAR deals are less likely to be withdrawn also helps us to rule out the concern raised in the beginning of this section that our results could be driven by lower banker qualification. The previous finding on abnormal returns could be consistent with an alternative explanation that declining expertise of advisory bankers (e.g. due to departure of best bankers to competing banks) leads to lower quality advice, and at the same time also leads

to declines in M&A market shares. Due to unavailability of complete data on the turnover of executive bankers, it is hardly possible to directly test this alternative explanation for the relation between lower returns and lower market shares. However, higher completion rate among banks that lose M&A market share is indirect evidence against the lower qualification explanation, as we would expect lower quality bankers to deliver lower completion rates. Thus, the two results taken together show that less profitable deals are more likely to be initiated and less likely to be withdrawn due to the fee generating incentives of advisory bankers, rather than due to the alternative explanation of best bankers leaving the advising bank.

Estimates for other variables show that an announced deal with negative CAR is more likely to be withdrawn if transaction value is large relative to the bidder (Relative size), target is more complex as measured by the number of SIC codes, and bidder's leverage is higher. It shows that corporate management is more attentive to stock price reaction in case of larger and more complicated deals, and if financial and monitoring discipline imposed by higher leverage is present. Further, transactions are more likely to be withdrawn if a bid is unsolicited and stock consideration is offered. Interestingly, toehold dummy also positively relates to the withdrawal probability. On the one hand, accumulating shares before the announcement should increase the chances of a successful takeover, and in general is indicative of a serious attitude of the bidder - keeping all other factors equal. However, by construction the variable of having accumulated shares as a toehold (with positive values reported usually for public targets only) is positively associated with the probability of an unsolicited or challenged takeover, hence, the negative effect on the success probability. In the inexperienced bidder sample, higher market to book is related to higher probability of canceling a deal – intuitively, firms with higher valuations were hurt more by negative CAR at announcement, while more solid sales growth is related to smaller probability of withdrawal. Finally, in the whole sample asset size is negatively related to withdrawal frequency, either reflecting classical agency problems in larger corporations or their stronger capacity to overcome target resistance and competing offers.

## Discussion

The results in this section show that banks facing declines in their market shares have lower quality of acquisitions, which is related both to abnormal returns at acquisitions and withdrawal frequency of potentially value-destructing deals. Additional tests reported in the robustness section below, where we use lagged pressure variables, reinforce our interpretation that distorted incentives of the advisory bank are driving subsequent poor client performance at acquisitions, and not vice versa.

Thus, our findings show that poorly aligned M&A bankers can be another important factor contributing to inefficiency of acquisitions – besides, and possibly on top of, distorted managerial incentives that are well documented in the literature. At the same time we cannot give a full account on whether advisory banks intentionally mislead bidder executives to initiate sub-optimal transactions, or rather simply exploit the bidding desire of overconfident and empire building managers in order to increase advisory revenues. The higher magnitude of our results in subsamples of inexperienced bidders can be consistent with the version of passive managerial involvement (bankers enticing naive managers to acquire unreasonable targets or to overpay), but we can not rule out that this effect also derives from stronger desire of such firms to acquire.

As we discussed previously, stock-based compensation aligns managerial incentives with those of shareholders and makes managers motivated to undertake only those acquisitions that positively affect shareholder value, in which case our results are consistent with the interpretation that conflicted bankers inspire and push executives into suboptimal acquisitions. Executives with strong influence on compensation committees, however, may have an implicit insurance of their stock holdings against adversely performing acquisitions (see Harford and Li, 2007), in which case conflicted bankers can play a role of tacit collusion partners and act merely as executors of suboptimal deals.

Importantly, executives' wealth is negatively affected by inferior stock performance, while negotiating new stock option grants following poorly performing merger is presumably costly

for managers. Thus, managers have direct monetary exposure to stock price performance in acquisitions – unlike bankers, who typically receive contingency fee upon deal completion, do not have direct exposure to deal performance and have what seems to be limited reputational discipline (see Edmans and Bao, 2010). Thus it is plausible to interpret our findings as indicating the presence of more than mere exploitation of corporate executives’ bidding ambitions by advisory bankers. In either case, the advisory bank is hired to maximize the value and serve the interests of corporate shareholders, so managerial traits and ambitions should not itself be a reason to let the market position pressures compromise the interests of ultimate clients and readily advise on value-destroying deals.

In the next subsection we assess the relation of analyst presence to both the abnormal returns and withdrawals of negative CAR deals; then we explore additional aspects of acquisitions such as bidder and target stock run-ups and mode of payment, and their relation to M&A advisor’s incentives.

## **4.2 The mitigating role of analyst coverage**

Our results on the abnormal returns and withdrawal of negative CAR deals show that the quality of acquisitions is lower if bankers are more misaligned. In our discussion of incentives in banking we conjectured that a potential conflict may arise when a bank’s trade-off between maximizing own revenues and pursuing the interests of clients deteriorates, which may happen when the immediate payoff of deviating exceeds the discounted future benefit of doing the business in the best interests of clients, what we can refer to as reputational considerations.

Here we investigate one of possible dimensions that directly affect the reputational costs of neglecting client value maximization interests – the analyst coverage. As Kelly and Ljungqvist (2010) mention, equity research analysts are among the most influential information producers in financial markets. This research industry affects the level of information asymmetry related to stock prices, which in our case can imply that either at the time of acquisition announcement,

or in subsequent periods, the analysts would expedite the discovery of negative information if advised deals do not create value to the bidder. Thus, the presence of research analysts strengthens the monitoring role of financial markets and increases public scrutiny that acquisition decisions can be subject to.

We test whether the presence of analysts covering the bidder changes the negative effect of deteriorating incentives on abnormal returns and withdrawal probability. We do so by repeating our tests of H1 and H2 with the additional variable of the number of analysts covering the firm in the year preceding each acquisition, which is interacted with both specifications of our pressure variable.

[Insert Table 4 Here]

The results for the abnormal return regressions are reported in Table 4. Paralleling our previous results on acquisition CAR, the dummy of advisor's negative business dynamic has significant negative estimates in three out of the the four specifications. Of our main interest here is the interaction between the pressure dummy and the number of analysts following the bidder, which has positive coefficient significant in the same three specifications. This indicates that in the case of bidders with higher coverage the conflict is mitigated and becomes insignificant, which suggests that bankers let the market pressures influence the quality of acquisition advice only if reputational costs are not too high, i.e. when there is not much investor attention to the bidder and its acquisitions. The analyst coverage as a stand-alone variable is negatively related to acquisition CAR, although the estimates are significant in broad sample regressions only; which may indicate either poorer growth prospects in more covered (and larger) firms, or agency problems in these more mature companies. Estimates on all control variables are very close to those in Table 2.

Next, we turn to the withdrawal probability tests, where we add the analyst coverage variable and its interaction with the pressure dummy. Here we conjecture that better analyst coverage should facilitate the withdrawal of deals that are perceived by the market as value destructive

(deals with negative announcement returns). The regression estimation results are in Table 5, where we see that the results on the lower withdrawal frequency among deals advised by more conflicted banks continue to hold.

[Insert Table 5 Here]

More importantly, we observe that the interaction of the conflict dummy and the number of covering analysts has positive and significant estimates.<sup>13</sup> Thus, together with the previous result on abnormal returns, our next important finding is that the negative effect of advisory incentives is mitigated if more analysts are covering the bidder. Again, the stand alone variable of analyst coverage has negative relation with the probability of withdrawing negative CAR deals (this time the estimates are highly significant in the inexperienced sample, and are outside of significance level in the broader sample), which again may hint at size effect or agency problems in better covered firms. Control variables generally have the same signs and significance as in the previous regressions of withdrawal frequency, although Target complexity, Sales growth and Leverage have lower significance now in most specifications.

Our findings on the mitigating role of analyst coverage provide interesting evidence on the value of analyst research. Investment research, despite having own conflicts as documented by Michaely and Womack (1999) and others, was shown to be an important source of investment-related information, which reduces information asymmetry between firms and investors, and thus creates value for the financial markets (See Kelly and Ljungqvist, 2010, and references therein). We find that M&A market pressures of advisory banks affect acquisition outcomes negatively only among firms with low analyst coverage, which demonstrates that the presence of research analysts is associated with better discipline that precludes suboptimal acquisitions.

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<sup>13</sup>We also estimated the corrected interaction coefficients and standard errors for each observation (see Norton, Wang and Ai (2004)). The corrected estimates for interaction effects are always positive and have similar significance levels to those estimated with regular probit routines on most of the range of the predicted withdrawal probability.

As we do not address potentially important systematic differences in corporate governance between firms with low and high coverage, we do not interpret this result causally: that better coverage causes better acquisitions; and this would be outside of the research agenda of this paper. We should mention, though, that assuming better corporate governance in better covered firms would be inconsistent with lower abnormal returns and lower withdrawal probability among these firms. What we can however claim is that in the presence of better analyst coverage, the trade-off that bankers face shifts in favor of client value maximization, and conflicts that bankers have are less likely to negatively affect the quality of their acquisition advice. In other words, a stricter investor attention to the firm's business seems to substitute for the lack of monetary and reputational incentives to put client interests ahead, and it can alleviate the temptation of bankers to promote suboptimal deals.

A conclusion that we can make based on the analyst coverage results is that bankers seem to avoid advising on poorly performing acquisition if perceived reputational costs of doing so are high. This helps us to further discard the alternative interpretation of lower quality of bankers that could simultaneously drive lower acquisition quality and lower M&A advisory shares. As the acquisition quality falls due to deteriorating incentives only among less-covered bidders, it is unlikely consistent with the explanation that high quality bankers left the bank: when investor scrutiny is stronger, the pressures of competitive position *do not* lead to declining acquisition quality. Thus, similarly to the withdrawal probability findings, the analyst coverage result helps us to rule out the alternative interpretation that our findings are driven by unobserved advisory quality, and reinforces the interpretation of causal effect of advisory incentives on acquisition quality.

### **4.3 Pre-announcement run-ups; mode of payment**

We start this subsection with exploring the influence of an advisor's declining market pressure on pre-announcement dynamic of bidder and target stock price. When the market anticipates

a takeover, a classic arbitrage strategy is to go long the target and short the bidder; insider trading, if present, would illegally attempt to profit from the same strategy. Hence, we observe negative average pre-announcement run-up in the bidder and positive one in the target stock. Next we proceed with testing hypothesis 3 and analyzing how an advisor's incentives affect the pre-announcement behavior of 60 trading day bidder's stock run-up.

[Insert Table 6 Here]

As we observe in Table 6, in all four specifications the relation between the run-up in the bidder's stock and the dummy of advisor's declining M&A position is positive. The coefficient on falling advisory business dummy is significant in all but the third specification, where p-value is slightly above 10%. The size of the effect is 2-3% in the whole sample, which is close in magnitude to unconditional -3.2% average bidder run-up in the whole sample. In the inexperienced bidder subsample, the magnitude of the effect is of the order of 4-5%, even larger than the absolute value of the unconditional run-up (-3%) in the respective sample. Putting the insider trading issue aside for a moment, we can interpret this result as lower ability of the market to predict deals that are put forward by more conflicted advisory bankers or their bidding clients. As the market participants (e.g. hedge funds with event-driven strategies) are likely to continually evaluate potential takeover transactions, less predictable deals can also mean that such deals make less economic and strategic sense for acquirer, and thus deal announcements come more often as a surprise to the market and the run-ups are less negative than for bidders with non-conflicted advisors.

An alternative explanation for more positive bidder price change prior to announcement can be that conflicted banks often succeed at convincing firms with better recent stock market dynamics to go for acquisitions, and we capture part of this effect (even though we control for market to book and other firm characteristics). While this explanation is quite plausible and part of the coefficient may indeed reflect better recent stock performance, it does not rule out the fact that the market still appears to be less able to predict these (possibly more imminent)

acquisitions by companies that did relatively well in the recent past.<sup>14</sup> Finally, the market to book value itself is insignificant in explaining the run-ups – also in alternative specifications, where the dummy of falling M&A business was interacted with the market to book (unreported).

As for the insider trading aspect, we know from Bodnaruk et al (2010) that banks with conflicted intersection of advisory and asset management divisions appear to engage in the insider trading more often. We do not address this type of conflict in our paper and can only note that our misalignment stems from a decline in own advisory revenues, while theirs comes from the presence of other businesses with conflicted interests (for instance, desire of proprietary trading desks to take long positions in potential targets of advisory banking clients). The two types of conflict are drastically different in their source and are unlikely correlated, hence our results add different evidence and shed light on another type of misalignment in investment banking.

Among the control variables, accumulated toehold seems to make the run-up more negative (albeit the significance is outside 10% level), which marginally reflects that accumulating stock of the target can shift its price before announcement. Sharing same SIC code (and higher free cash flow, in the whole sample only) makes the run-up less negative, although we could expect that acquisition predictability would be higher (and then run-ups more negative) for firms acquiring within the same industry or having higher cash reserves at their disposal. Higher acquirer leverage also makes the run-up less negative, which reflects lower anticipation of takeovers by firms with higher debt burdens. Finally, higher ROE is related to more negative run-ups in whole sample regressions.

[Insert Table 7 Here]

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<sup>14</sup>Yet another alternative explanation that deals advised by banks with falling M&A business are actually higher quality and thus pre-announcement stock performance is more positive is not plausible in light of more negative performance at announcement of such acquisitions.

Pre-announcement target run-up results are presented in Table 7. Mirroring the bidder run-up result above, the run-ups in the target stock are smaller (here less positive) in deals advised by more conflicted advisors. The coefficient is negative in all four specifications and is significant in three of them. The effect is of the order of 6 to 12%, which compares to unconditional mean target run-up of 3.4% and univariate comparison results of 4.7% run-up among advisors with positive dynamics viz-a-viz 1.1% run-up for deals advised by banks with falling M&A position. This finding shows again that deals advised by banks with deteriorating business come more as a surprise to the market, and as such are more likely to make less economic sense.

Similarly to the bidder run-up setting, we can not rule out that banks with falling business are systematically more likely to persuade bidding clients into acquiring targets that relatively underperformed or become undervalued in the recent past, which can partly explain the effect we document. This, however, does not change the fact that the market seems to be less able to identify (potentially more underpriced and thus more imminent) takeover announcements that result in mean unconditional three day target CAR of 18% in the whole sample. Univariate comparison shows that target abnormal returns at announcements are on average three percent higher in case of more conflicted advisors, indicating that a strategy of going long the potential target may bring lucrative profits to arbitrageurs, and if any different, the potential arbitrage profit is higher in deals advised by misaligned banks, but it appears to be overlooked and come as a surprise to the market.

Finally, if this result is driven by relative undervaluation of the target, it would imply that the bidder has chance to buy it at a bargain price. However, to reconcile the relative undervaluation explanation with the finding of more negative announcement abnormal returns at acquisitions advised by misaligned banks, it has to be that M&A combinations advised by conflicted bankers do systematically make less economic sense for the bidder, which supports our hypothesis that advisory bankers become less concerned with economic value creation for their client when bank-specific market conditions become more adverse.

Among the control variables, strong positive effect on target run-up has free cash variable of the bidder, which reflects higher predicted (by the market) probability of a takeover move by a cash-rich acquirer. Merger dummy and higher bidder ROE also positively relate to the run-up, but only in the broad sample of acquisitions.

Finally, we turn to analyzing the mode of payment. We report here the results on stock financing mode only, but in unreported regressions on choosing cash financing these results are repeated in terms of direction (advisors under pressure associated with more frequent stock and less frequent cash financing) and significance. The results appear in Table 8.

[Insert Table 8 Here]

As the results suggest, if an advising bank has negative dynamics of its M&A business, the stock mode of financing is more often dominant in acquisitions and the corresponding impact is between 2 and 6 percentage points. With the unconditional probability of using stock financing of 21% this implies an increase of 10 to 30% in the frequency of stock financing in the case of more misaligned advising bank. As for the choice of cash-dominant mode of financing, the results (untabulated) mirror the stock-financing findings. More misaligned banks are associated with *lower* probability of choosing cash mode of financing, and the coefficient is at least 5% significant with coefficient value between 8 and 15%, which compares to 37% unconditional probability of choosing cash mode of financing.

Thus, the results in Table 8 show that advisory banks seem to offer their clients (or support their desire) to use stock financing in acquisitions. Using stock financing may be in the interest of bidder shareholders, if executives optimally decide to exploit temporary overvaluation of own stock to pursue attractive opportunities, but at the same time it may imply that in pursuit to generate new revenues banks have better chances of persuading corporate management to opt for stock-financed deals for a number of reasons. First, the firm may simply lack needed funds to acquire, and using own stock is a useful alternative to finding outside financing – particularly so if there are no apparent benefits for the bidder from doing a transaction and

banks would be reluctant to offer financing. Second, stock-financed transactions tend to be more complex, less transparent and requiring additional working hours of investment bankers to perform additional calculations, which may justify higher fees related to such transactions. Finally, due to its higher opaqueness, it is harder to find hard evidence of a stock-financed deal failure. For example, negative stock price reaction can be alleged to be due to temporary overvaluation of share price, which managers or bankers may claim was used in the best interest of shareholders as acquisition currency. At the same time our bidder CAR regressions control for the mode of transaction, and the negative effect of banker misalignment is reported net of the typical positive effect of cash consideration and negative effect of stock consideration.

Bidder complexity and unsolicited deals are negatively related to stock financing – the former effect reflecting easier access of conglomerate bidders to internally generated cash for acquisitions, and the latter possibly implying that unsolicited deals are easier to complete if cash consideration is offered instead of stock. Merger and geographically focusing transactions increase the odds of stock financing. Size and free cash variables proxy for easier access to internal funding and make stock financing less likely. Market to book proxies for the overvaluation of own stock and increases the odds of stock-based consideration. Interestingly, higher leverage negatively relates to both cash and stock financing (significant only in broad sample regressions), implying that more leveraged firms use cash or stock financing more seldom and instead opt for alternative (possibly hybrid or asset swaps) types of consideration.

#### **4.4 Relationship banking: assessing the effect of advisory pressure in the setting of a former IPO underwriter**

Besides observing the negative impact of advisor’s deteriorating incentives, we also saw that this impact was somewhat stronger in the subsample of inexperienced bidders. Indeed, if banks are to propose suboptimal deals, or to facilitate the completion of deals that executives initiated, the

scope of influence can be stronger in case of firms that are less experienced in M&A. Often such firms are younger firms that recently went public, so firm maturity is one of important factors determining lack of experience. On the other hand, established relationship between the advisory bank and the firm can also give bankers higher degree of influence on corporate acquisition policy and thus facilitate potential for proposing suboptimal acquisitions, when pressure to generate advisory revenue is higher. In this case the subsample of firms that recently went public and that are awarding an M&A mandate to the former IPO underwriter is an ideal setting to assess how distorted bank's incentives impact deal outcomes.

[Insert Table 9 Here]

To test our hypothesis H1.b that CAR at acquisitions are worse if advising banks is misaligned, we use the sample of acquisitions performed by firms within two years following IPO with the same advisory bank. (Changing this threshold to one or three years does not change the direction or significance of the results.) Regression results appear in Table 9. Both estimates on the dummy of falling M&A business are negative indicating similar adverse effect of distorted incentives of the advisor on the acquisition quality. As for the control variables, the overall significance level is notably lower in this setting, reflecting smaller sample size (165 deals). Besides the positive effect of cash consideration, relative size of the target also positively impacts CAR of the bidder. The magnitude of the falling M&A business dummy coefficients is higher than in both broader and inexperienced bidder samples, which indicates that established relationship is another important factor allowing advisory bankers to push forward acquisitions that are less profitable for the acquirer. This parallels the results in Bao and Edmans (2010), who show that retaining a past M&A advisor leads to worse future performance in acquisitions, particularly if the bank advised on negative-CAR transactions in the past.

We should note that in the setting of the former IPO underwriter subsample, the reverse causality issue is a minor problem, as such acquisitions constitute only a small proportion of all M&A advisory business. Thus, we are less concerned that following an announcement of a low

abnormal return deal (in this small subsample) the overall market share of the advisory bank will go down. Overall, the results of this part show that the established relationship can be used by advisory teams for pursuing aims of increasing advisory revenues if the bank is under pressure of falling market conditions. Thus, if a bank's trade-off between own profits and long-term reputation deteriorates, an established relationship with a firm presents an easier way for the bank to initiate deals that bring advisory fees but do not create value for shareholders of bidding firms.

## 5 Robustness: the reverse causality

The results of testing hypothesis 1 show that the negative pressure on M&A advisor is related to more negative performance as measured with announcement abnormal returns. This association can, on the one hand, result from a conflicted banker's incentive to have more deals completed in order to generate fees, hence, such pursuit for quantity performance can negatively negatively impact acquisition quality, as acquisitions can be unnecessary for the bidder, target may be unsuitable, or consideration paid can exceed the value of the target and the synergy. On the other hand, it can be the case that managers of future bidders carefully analyze the performance of investment banks in most recent transactions, and try to avoid choosing advisors involved in deals with negative CAR. This alternative explanation would also lead to higher incidence of observing ex post lower CAR deals and poorer performance (and vice versa) in the same year. For better understanding of which explanation is valid, it is critical to know how long before the announcement a typical transaction is initiated and at which stage an advisory bank is hired.

By examining corporate reports with descriptions of M&A negotiations (Schedule 14A forms in Edgar), it becomes clear that typically several months pass between deal initiation and its subsequent announcement. If we imagine a hypothetical bad acquisition initiated in the beginning of a calendar year (e.g., due to the involvement of a conflicted M&A advisory team that had no other perspective mandates in the beginning of the year), such a deal may become publicly

known by the middle of the year. And if the alternative explanation is valid, prospective clients may start avoiding a bank that advised on a bad acquisition, but this will be only observed in the data once deals initiated in the middle of the year become announced later in the year or even in the following year. Thus, a considerable time lag between deal inception and its announcement likely precludes an alternative explanation of reverse causality from being a major driving force in our results. Even if some negative information is known at the time of choosing an advisor, Bao and Edmans (2010) show that past underperformance in qualitative characteristics of deals is of insignificant influence on the choice of advisor and on future market share.

It is desirable, however, to test in our sample whether this alternative explanation may be viable – particularly in the broader sample, where low announcement returns of all deals could potentially preclude an investment bank from winning new advisory mandates. As collecting a precise timing of related negotiations and resulting announcements is very tedious if not impossible, we employ an alternative specification of the falling M&A business variable, which relies on lagged quarterly dynamics of advisors' business. In the main specifications, we employ a dummy indicating whether in a year of acquisition announcement an advisor's M&A business was falling relative to the previous year. To the extent that acquisition returns of deals announced in the first half of the year may drive the market share of advising bank in the second half of the year, we want to have in an alternative specification the pressure that a bank is subject to *prior* to acquisition announcement. For example, we could employ our main measure of the conflict, the change relative to the previous year, but lagged by an additional year. In this case, for an acquisition announced in 2008 we would have a variable measuring the growth of advisory business in 2007 relative to 2006. While being an intuitive metric, this variable would likely not represent the current pressures that an advisory team faces (we may cite here a very dynamic pace of this business and high turnover of bankers), so a more recent metric is desirable.

To accommodate the need to have past pressure which is yet topical enough at the time when an acquisition is being prepared for announcement, we use a dummy variable capturing whether

there is a decline in the business of advisory bank in the three pre-announcement quarters relative to its business in the preceding year. Thus, we still use a dummy that indicates the dynamics of advisor's M&A business over the most recent two years (here: up to the quarter of the announcement), but we exclude the quarter of the announcement itself in calculating the pressure variable. For an illustration, a deal announced in the fourth quarter of 2008 is considered to be advised by a conflicted bank if this bank has smaller average market share in the first three quarters of 2008, relative to its average market share during the four quarters of 2007. For example, deal NN initiated under higher pressure (during preceding three quarters with relatively low advisory revenues) will be announced in the current quarter and will appear in the data as being possibly a suspect for a conflicted deal.

We should note that this metric has a certain degree of conservatism, as for instance the negotiations on deal NN are in reality impacted not only by the deal flow announced in the past three quarters, but also by deals currently in the pipeline of the advisory team, which are not yet announced (in contrast, our main measure of pressure will account for most of such deals as long as these are announced during the current year). If anything, this conservatism would be against us finding significant results as compared to using our main variables of pressure.

Employing this variable capturing the M&A dynamics over most recent two years at the quarterly level gives us advantage of resolving the issue of contemporaneously low CAR and low M&A dynamics, and yet to reflect a reasonably current pressure the M&A team is facing. The estimation results with this alternative measure are reported in Table 10. As previously, the pressure variable is calculated both for dollar values of all deals advised (specifications (1) and (3)) and the share of involvement by M&A transaction volume ((2) and (4)).

[Insert Table 10 Here]

The estimated coefficients on the falling quarterly dynamics dummies are quite close in size to the estimates with yearly pressure variables in Table 2. All four estimates are negative, although now the coefficient on quarterly share change has significance outside of conventional

significance (p-value of 0.14). The lower significance of the advisory share specifications may reflect the fact that we use only announced deals, but not the transactions in the pipeline that investment bank is advising (that are also important determinant of pressure on the advisory team), which may lower the predicting power of these lagged specifications. With this caveat in mind, our main findings are nonetheless unchanged: falling M&A business of the advisor is related to poorer bidder stock performance at subsequent acquisitions, and the construction of these alternative pressure variables rules out the alternative explanation of reverse causality. Estimates on other variables are in line with those in Table 2: CAR are lower for public targets and larger bidders, and higher for cash consideration and higher leverage.

Thus, an important result of this section is that the reverse causality does not appear to drive our results, and indeed higher pressure on advisory teams leads to poorer client abnormal returns at acquisition announcements.

## 6 Conclusions

In this paper we present novel results on misalignment in advisory banking. The compensation structure in M&A advisory provides strong incentives to have more deals originated and completed, with little direct attention to the quality of executed acquisitions. We focus on the situations where the pressure on M&A teams to increase advisory revenues is stronger. We conjecture that banks with falling M&A revenue (or falling share in the M&A market) are subject to stronger misalignment, and we assess whether it changes the quality of advised acquisitions for bidding clients.

Our results reveal that the efficiency of acquisitions indeed depends on the advisor's incentives driven by its position in M&A business. We document that a bank's declining position in the M&A League Tables causes lower announcement returns to client's acquisitions. Our results are stronger in subsamples of inexperienced acquirers, and among bidders who recently underwent an IPO and retained the same bank as acquisition advisor. A reverse causality concern

could be that banks that advised on poorly performing deals subsequently lose client base, but our findings continue to hold in an alternative specification with lagged competitive pressure variable. Pressures that advisory teams experience immediately before the deal announcement are negatively related to abnormal returns.

Further, we show that for acquisitions with negative announcement returns the withdrawal probability is smaller when advisory banks experience declines in their M&A market position. On the one hand, it shows that banks that are under stronger pressure to generate advisory revenues are more likely to facilitate the completion of deals that the market dislikes. On the other hand, this finding rules out the qualification-driven alternative explanation to our result that abnormal returns are worse when advised by banks with deteriorating M&A business. Completion rate – if any different – would have to be lower to be consistent with the explanation of lower qualification of bankers at losing banks. These results taken together show that the shareholder value outcomes are worse if deals are advised by more conflicted banks.

Additionally we show that the results on lower abnormal returns and lower withdrawal rates among more conflicted bankers are driven by bidders with relatively low analyst coverage. As the number of following analysts increases above average, both effects taper off, which indicates that market scrutiny creates reputational costs for the bankers from being associated with suboptimal deals. The presence of analysts is not related to higher quality of deals on its own.

Finally, by analyzing further characteristics of the deals, we find that stock price run-ups are less pronounced both for the bidder and for the target, when banks are under stronger pressure to generate advisory revenues. This indicates that deals advised by misaligned banks are more unexpected by the market and as such may make less economic and strategic sense for the buyer. Rather, such deals appear to be more often motivated by the advisory bankers' desire to propose some acquisition opportunities that are less suitable for the acquirer. As for the mode of consideration, we find that stock is more likely to be used (and cash less likely) if advisory banks are under higher pressure. This suggests that using stock financing helps advisory

teams and their clients to overcome the issues of funding at deal inception and potentially also helps to disguise the true stock market reaction to such deals following deal announcement and completion.

Taken together, our results suggest that there is indeed a conflict of interest in investment banking, namely that bankers may have incentives to exert pressure on executives in pursuit of acquisitions or provide advice in favor of suboptimal acquisitions, thus generating high advisory fees, but not necessarily creating value for the shareholders of acquiring firms. We leave out the issue of whether executives being misled regarding the true quality of acquisitions, or whether bankers readily satisfy the acquisitive appetites of managers who are subject to empire building ambitions or overconfidence biases. What we can, however, conclude is that advisory banks can compromise their long-term reputation and interests of their clients' shareholders for the sake of reviving own competitive position, improving advisory revenues and bankers' bonuses.

Our results support several findings in the recent literature on the deterioration of the value of relationship banking, conflicts of interest and distorted incentive mechanism in banking. The novelty of the paper is in documenting the adverse effect of investment banks' misalignment and resulting biased advice on the quality of acquisitions that their clients undertake.

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Table 1: Sample description and univariate comparisons in the broader sample  
The first two columns describe the whole sample, and the last four columns compare acquisition and firm-related characteristics depending on an advising bank's M&A volume being positive vs. negative. CAR represents 3-day abnormal return net of value-weighted CRSP return, and bidder cap change represents (excess) change in bidder capitalization calculated based on CAR above. Run-up variable represents excess of value-weighted CRSP 60 trading day target stock price return up to the 4th trading day prior to acquisition announcement. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Premium describes by how much transaction exceeded market value of the target 1 week (4 weeks) prior to announcement.

	mean	median	M&A volume dynamics:			
			positive	negative	mean diff	median signif
Observations	2944	.	1832	1112		
Bidder CAR	0.003	0.003	0.006	-0.001	-0.007**	
Bidder cap change, \$ Mil	-112	2.6	-90	-148	57	*
Bidder Run-up	-0.032	-0.01	-0.032	-0.016	-0.016**	
Target CAR	0.18	0.17	0.17	0.20	0.031**	*
Target Run-up	0.034	0.037	0.047	0.011	0.036**	
Withdrawing   $CAR < 0$	0.15	.	0.17	0.14	0.028	
Withdrawing	0.15	.	0.15	0.14	0.006	
Cash-based consideration	0.37	.	0.384	0.356	0.029*	
Stock-based consideration	0.21	.	0.21	0.21	-0.002	
Bidder assets, \$ Mil	21037	1402	17836	26311	-8474*	***
Bidder cap, \$ Mil	12849	1852	11218	15534	-4315***	***
Bidder sales, \$ Mil	6576	1095	5559	8253	-2694***	**
Bidder sales growth	0.23	0.14	0.24	0.21	0.02	*
Bidder ROE	0.096	0.122	0.115	0.064	0.051	
Premium 1 wk	0.382	0.306	0.36	0.42	-0.061**	
Premium 4 wk	0.450	0.365	0.43	0.49	-0.071	
Covering analysts	8.3	4	8.1	8.6	-0.5	

Table 2: Bidder's CAR and advising investment bank's M&A business dynamics.

The table presents an OLS cross-sectional regression of acquisition CAR on the indicator variable of M&A advisor losing the League Tables position relative to the previous year, and control variables. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values reported in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: 3-day CAR	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	-0.006 (0.308)		-0.012* (0.070)	
Falling share d		-0.006** (0.040)		-0.010** (0.048)
Relative size	-0.009 (0.297)	-0.009 (0.268)	-0.010 (0.268)	-0.010 (0.266)
Bidder complexity	-0.000 (0.207)	-0.001 (0.144)	-0.000 (0.660)	-0.000 (0.661)
Target complexity	0.001 (0.292)	0.001 (0.252)	0.002 (0.213)	0.002 (0.160)
Same state d	0.002 (0.656)	0.003 (0.578)	-0.008 (0.271)	-0.007 (0.280)
Unsolicited d	-0.003 (0.635)	-0.002 (0.736)	-0.001 (0.924)	-0.001 (0.932)
Public Target d	-0.028*** (0.000)	-0.029*** (0.000)	-0.030*** (0.003)	-0.030*** (0.003)
Merger d	0.000 (0.951)	0.000 (0.954)	-0.001 (0.927)	-0.000 (0.962)
Cash consideration d	0.011*** (0.002)	0.011*** (0.004)	0.013** (0.023)	0.013** (0.027)
Stock consideration d	-0.014** (0.033)	-0.015** (0.026)	-0.010 (0.274)	-0.010 (0.276)
ROE	0.000 (0.610)	0.000 (0.570)	-0.000 (0.647)	-0.000 (0.627)
Market to book	0.000 (0.323)	0.000 (0.252)	0.001 (0.362)	0.001 (0.355)
Assets, log	-0.006*** (0.000)	-0.006*** (0.000)	-0.010*** (0.000)	-0.010*** (0.000)
Sales growth	-0.012 (0.100)	-0.013* (0.087)	-0.027** (0.021)	-0.027** (0.020)
FCF	0.006 (0.876)	0.002 (0.962)	0.010 (0.837)	0.009 (0.844)
Leverage	0.042*** (0.003)	0.040*** (0.003)	0.045** (0.037)	0.045** (0.040)
Constant	0.054*** (0.00)	0.053*** (0.00)	0.078*** (0.00)	0.072** (0.01)
Year dummies	✓	✓	✓	✓
Observations	2944	2944	1149	1149
R <sup>2</sup> -adjusted	0.074	0.075	0.073	0.074
p-val	0.000	0.000	0.000	0.000

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 3: Withdrawing negative CAR deals and advising bank's M&A business.

The table presents a probit regression of acquisition withdrawal dummy (conditional on negative 3 day bidder CAR at announcement) on the indicator variable of M&A advisor losing M&A business. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Premium4wk is percentage premium of the offer price over the market price four weeks prior to the offer. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). Marginal effects and p-values (in parentheses) are reported, corresponding s.e. adjusted to clustering at advising bank level.

Dependent variable: Withdrawal d	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	-0.086** (0.04)		-0.108*** (0.00)	
Falling share d		-0.080*** (0.00)		-0.077** (0.04)
Premium4wk	-0.001 (0.11)	-0.000 (0.20)	0.000 (0.37)	0.001* (0.09)
Relative size	0.076*** (0.00)	0.071*** (0.00)	0.042 (0.11)	0.055 (0.21)
Bidder complexity	0.003 (0.39)	0.003 (0.44)	-0.004 (0.61)	-0.007 (0.40)
Target complexity	0.015*** (0.00)	0.016*** (0.00)	0.018** (0.05)	0.023** (0.02)
Toehold d	0.210** (0.03)	0.243** (0.01)	0.863*** (0.00)	0.776*** (0.00)
Same state d	-0.058** (0.03)	-0.051* (0.05)	0.009 (0.83)	0.012 (0.82)
Unsolicited d	0.427*** (0.00)	0.420*** (0.00)	0.892*** (0.00)	0.753*** (0.00)
Cash consideration d	0.028 (0.58)	0.026 (0.60)	0.057 (0.56)	0.064 (0.54)
Stock consideration d	0.086** (0.04)	0.092** (0.03)	0.070** (0.02)	0.090** (0.02)
ROE	-0.045 (0.37)	-0.045 (0.36)	-0.124 (0.24)	-0.120 (0.23)
Market to book	0.002 (0.67)	0.002 (0.70)	0.010** (0.03)	0.013** (0.02)
Assets, log	-0.022** (0.01)	-0.023** (0.01)	-0.033 (0.21)	-0.027 (0.27)
Sales growth	-0.047 (0.32)	-0.049 (0.30)	-0.172** (0.02)	-0.190*** (0.01)
FCF	0.029 (0.87)	0.038 (0.83)	-0.033 (0.85)	-0.026 (0.89)
Leverage	0.163* (0.09)	0.147 (0.13)	0.307*** (0.00)	0.305*** (0.00)
Year dummies	✓	✓	✓	✓
Observations	524	524	132	132
$R^2$ -pseudo	0.255	0.259	0.425	0.400

(d) for discrete change of dummy variable from 0 to 1

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

Table 4: Analyst coverage and the influence of advising bank's business on CAR.

The table presents an OLS cross-sectional regression of acquisition CAR on the indicator variable of M&A advisor losing the League Tables position and its interaction with Analyst coverage (CA) variable, representing number of following analysts in a year before acquisition. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values reported in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: 3-day CAR	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	-0.004 (0.40)		-0.016** (0.05)	
Falling value*CA	0.000 (0.30)		0.001 (0.17)	
Falling share d		-0.011** (0.01)		-0.015** (0.02)
Falling share*CA		0.001** (0.04)		0.001* (0.09)
Covering analysts (CA)	-0.000** (0.01)	-0.000*** (0.00)	-0.000 (0.22)	-0.000 (0.17)
Relative size	-0.009 (0.27)	-0.009 (0.27)	-0.010 (0.27)	-0.010 (0.27)
Bidder complexity	-0.000 (0.20)	-0.000 (0.21)	-0.000 (0.65)	-0.000 (0.71)
Target complexity	0.001 (0.26)	0.001 (0.25)	0.002 (0.20)	0.002 (0.16)
Same state d	0.003 (0.59)	0.003 (0.60)	-0.008 (0.28)	-0.008 (0.28)
Unsolicited d	-0.002 (0.78)	-0.002 (0.81)	-0.001 (0.96)	-0.000 (0.98)
Public Target d	-0.029*** (0.00)	-0.029*** (0.00)	-0.030*** (0.00)	-0.030*** (0.00)
Merger d	-0.000 (0.96)	0.000 (0.93)	-0.001 (0.94)	0.000 (0.99)
Cash consideration d	0.011*** (0.00)	0.010*** (0.00)	0.013** (0.03)	0.013** (0.03)
Stock consideration d	-0.014** (0.03)	-0.014** (0.03)	-0.010 (0.27)	-0.010 (0.28)
ROE	0.000 (0.52)	0.000 (0.58)	-0.000 (0.64)	-0.000 (0.63)
Market to Book	0.001 (0.22)	0.001 (0.22)	0.001 (0.36)	0.001 (0.36)
Assets, log	-0.006*** (0.00)	-0.006*** (0.00)	-0.010*** (0.00)	-0.010*** (0.00)
Sales growth	-0.013* (0.08)	-0.013* (0.07)	-0.027** (0.02)	-0.027** (0.02)
FCF	0.003 (0.94)	0.002 (0.96)	0.010 (0.84)	0.009 (0.85)
Leverage	0.039*** (0.00)	0.038*** (0.00)	0.044** (0.04)	0.043** (0.05)
Constant	0.051*** (0.00)	0.054*** (0.00)	0.078*** (0.00)	0.073** (0.01)
Year dummies	✓	✓	✓	✓
Observations	2944	2944	1149	1149
R <sup>2</sup> -adjusted	0.063	0.064	0.072	0.073
p-val	0.000	0.000	0.000	0.000

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 5: Analyst coverage and withdrawals of negative CAR deals.

The table presents a probit regression of acquisition withdrawal dummy on the indicator variable of M&A advisor losing M&A business and its interaction with Analyst coverage (CA) variable, representing number of following analysts in a year before acquisition. The sample is constructed conditional on negative 3 day bidder CAR at announcement and observing bid premium. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Premium4wk is percentage premium of the offer price over the market price four weeks prior to the offer. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). Marginal effects and p-values (in parentheses) are reported, corresponding s.e. adjusted to clustering at advising bank level.

Dependent variable: Withdrawal d	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	-0.121*** (0.01)		-0.271*** (0.00)	
Falling value*CA	0.004* (0.08)		0.010** (0.03)	
Falling share d		-0.122*** (0.00)		-0.175** (0.05)
Falling share*CA		0.005* (0.10)		0.013*** (0.01)
Covering analysts (CA)	-0.003 (0.10)	-0.003 (0.16)	-0.012*** (0.00)	-0.014*** (0.00)
Premium4wk	-0.001 (0.12)	-0.000 (0.19)	-0.001 (0.25)	-0.001 (0.27)
Relative size	0.079*** (0.00)	0.071*** (0.00)	0.100*** (0.00)	0.096*** (0.00)
Bidder complexity	0.004 (0.35)	0.003 (0.41)	0.005 (0.62)	-0.001 (0.92)
Target complexity	0.014*** (0.00)	0.016*** (0.00)	0.007 (0.58)	0.013 (0.34)
Toehold d	0.199** (0.04)	0.226** (0.01)	0.834*** (0.00)	0.740*** (0.00)
Same state d	-0.058** (0.03)	-0.055** (0.03)	0.012 (0.80)	-0.009 (0.85)
Same sic2 d	0.044 (0.18)	0.045 (0.16)	0.110 (0.15)	0.086 (0.26)
Unsolicited d	0.434*** (0.00)	0.441*** (0.00)	0.552*** (0.00)	0.516*** (0.00)
Cash consideration d	0.030 (0.54)	0.025 (0.60)	0.258* (0.06)	0.237* (0.06)
Stock consideration d	0.089** (0.04)	0.100** (0.02)	0.346*** (0.00)	0.335*** (0.00)
ROE	-0.038 (0.44)	-0.040 (0.42)	-0.125 (0.12)	-0.167* (0.10)
Market to Book	0.002 (0.70)	0.002 (0.71)	0.009 (0.60)	0.003 (0.85)
Assets, log	-0.021** (0.01)	-0.020** (0.01)	-0.025 (0.28)	-0.010 (0.49)
Sales growth	-0.047 (0.31)	-0.053 (0.25)	-0.170 (0.13)	-0.180 (0.15)
FCF	0.031 (0.86)	0.013 (0.94)	0.350 (0.37)	0.413 (0.33)
Leverage	0.155 (0.11)	0.144 (0.14)	0.184 (0.38)	0.132 (0.51)
Year dummies	✓	✓	✓	✓
Observations	524	524	169	169
R <sup>2</sup> -pseudo	0.261	0.266	0.331	0.308

d for discrete change of dummy variable from 0 to 1

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 6: Bidder stock run-up and advising bank's M&A business dynamics.

The table presents an OLS cross-sectional regression of bidder stock run-up on the indicator variable of M&A advisor losing the League Tables position relative to the previous year, and control variables. Dependent variable: 60 trading day target stock price run-up (up to the 4th trading day prior to acquisition announcement). For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Toehold dummy indicates bidder's holdings of at least 3% of the target prior to announcement, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Same sic2, and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values reported in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: Bidder run-up	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	0.018** (0.021)		0.038 (0.103)	
Falling share d		0.029*** (0.000)		0.050*** (0.006)
Relative size	0.018 (0.170)	0.018 (0.161)	-0.007 (0.652)	-0.007 (0.673)
Toehold d	-0.044 (0.108)	-0.043 (0.111)	-0.083 (0.140)	-0.081 (0.160)
Bidder complexity	0.000 (0.886)	0.000 (0.863)	0.005* (0.066)	0.005* (0.065)
Target complexity	-0.002 (0.461)	-0.002 (0.406)	-0.005 (0.296)	-0.005 (0.291)
Same state d	0.006 (0.666)	0.005 (0.709)	0.024 (0.367)	0.023 (0.390)
Same sic2 d	0.016** (0.046)	0.016** (0.044)	0.030* (0.087)	0.032* (0.069)
Unsolicited d	0.002 (0.940)	0.002 (0.917)	0.011 (0.856)	0.019 (0.746)
Merger d	0.004 (0.592)	0.003 (0.670)	0.021 (0.286)	0.018 (0.344)
Stock consideration d	0.006 (0.727)	0.006 (0.728)	-0.018 (0.553)	-0.017 (0.580)
Cash consideration d	0.004 (0.610)	0.005 (0.569)	0.003 (0.883)	0.006 (0.728)
ROE	-0.002*** (0.001)	-0.002*** (0.003)	-0.011 (0.515)	-0.010 (0.549)
Market to book	0.001 (0.508)	0.001 (0.482)	0.002 (0.306)	0.002 (0.314)
Assets, log	-0.003 (0.171)	-0.003 (0.176)	-0.007 (0.238)	-0.007 (0.252)
Sales growth	-0.006 (0.708)	-0.005 (0.736)	-0.028 (0.284)	-0.026 (0.313)
FCF	0.097* (0.067)	0.100* (0.055)	-0.040 (0.647)	-0.037 (0.666)
Leverage	0.083*** (0.004)	0.084*** (0.003)	0.135** (0.019)	0.136** (0.017)
Constant	-0.066* (0.057)	-0.065* (0.063)	-0.036 (0.661)	-0.050 (0.527)
Year dummies	✓	✓	✓	✓
Observations	2936	2936	964	964
R <sup>2</sup> -adjusted	0.012	0.015	0.001	0.006
p-val	0.000	0.000	0.000	0.000

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 7: Target stock run-up and advising bank's M&A business dynamics.

The table presents an OLS cross-sectional regression of target stock run-up on the indicator variable of M&A advisor losing the League Tables position relative to the previous year, and control variables. Dependent variable: 60 trading day bidder stock price run-up (up to the 4th trading day prior to acquisition announcement). For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Toehold dummy indicates bidder's holdings of at least 3% of the target prior to announcement, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Same sic2, and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values reported in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: Target run-up	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	-0.063** (0.027)		-0.117** (0.042)	
Falling share d		-0.027 (0.184)		-0.073* (0.069)
Relative size	-0.042 (0.173)	-0.044 (0.153)	-0.026 (0.601)	-0.029 (0.565)
Toehold d	-0.031 (0.484)	-0.026 (0.561)	-0.052 (0.518)	-0.046 (0.587)
Bidder complexity	-0.001 (0.728)	-0.001 (0.651)	-0.006 (0.169)	-0.005 (0.229)
Target complexity	-0.000 (0.887)	0.000 (0.928)	0.006 (0.173)	0.008* (0.082)
Same state d	-0.014 (0.512)	-0.011 (0.607)	-0.016 (0.631)	-0.012 (0.696)
Same sic3 d	0.001 (0.973)	-0.002 (0.938)	-0.003 (0.956)	-0.004 (0.930)
Unsolicited d	-0.035 (0.132)	-0.036 (0.124)	0.013 (0.763)	0.003 (0.934)
Merger d	0.123*** (0.002)	0.125*** (0.002)	0.054 (0.341)	0.053 (0.350)
Stock consideration d	-0.018 (0.473)	-0.019 (0.445)	-0.066 (0.210)	-0.072 (0.172)
Cash consideration d	0.021 (0.222)	0.022 (0.202)	0.002 (0.964)	0.005 (0.914)
ROE	0.010*** (0.000)	0.009*** (0.000)	-0.040 (0.424)	-0.054 (0.299)
Market to Book	0.004 (0.272)	0.004 (0.204)	0.013 (0.103)	0.014* (0.067)
Assets, log	0.000 (0.997)	-0.001 (0.923)	-0.001 (0.958)	-0.003 (0.851)
Sales growth	-0.017 (0.597)	-0.018 (0.563)	0.057 (0.396)	0.051 (0.469)
FCF	0.185* (0.074)	0.191* (0.057)	0.312*** (0.007)	0.350*** (0.002)
Leverage	0.050 (0.307)	0.050 (0.306)	0.048 (0.603)	0.044 (0.647)
Constant	-0.070 (0.642)	-0.109 (0.443)	-0.143 (0.625)	-0.193 (0.501)
Year dummies	✓	✓	✓	✓
Observations	962	962	348	348
R <sup>2</sup> -adjusted	0.028	0.023	0.019	0.013
p-val	0.000	0.000	0.000	0.000

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 8: Mode of payment in acquisitions and advising bank's M&A business. The table presents a probit regression of stock consideration dummy (taking value of one if stock constitutes at least 80% of total consideration) on the indicator variable of M&A advisor losing M&A business. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). Marginal effects and p-values (in parentheses) are reported, corresponding s.e. adjusted to clustering at advising bank level.

Dependent var: Stock payment d	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Falling value d	0.039** (0.028)		0.061** (0.034)	
Falling share d		0.019* (0.085)		0.037** (0.048)
Toehold d	-0.016 (0.573)	-0.017 (0.549)	-0.044 (0.369)	-0.044 (0.360)
Bidder complexity	-0.004** (0.037)	-0.004** (0.041)	-0.008* (0.094)	-0.009* (0.093)
Target complexity	0.002 (0.333)	0.002 (0.404)	-0.004 (0.575)	-0.005 (0.436)
Same state d	0.077*** (0.000)	0.076*** (0.000)	0.082*** (0.010)	0.081*** (0.009)
Same sic2 d	-0.009 (0.593)	-0.009 (0.598)	0.003 (0.903)	0.004 (0.874)
Unsolicited d	-0.091*** (0.000)	-0.091*** (0.000)	-0.097*** (0.000)	-0.097*** (0.000)
Merger d	0.251*** (0.000)	0.250*** (0.000)	0.263*** (0.000)	0.262*** (0.000)
FCF	-0.159*** (0.000)	-0.158*** (0.000)	-0.148*** (0.004)	-0.145*** (0.005)
ROE	-0.002 (0.609)	-0.002 (0.600)	-0.002 (0.303)	-0.002 (0.297)
Market to Book	0.010*** (0.001)	0.010*** (0.001)	0.015*** (0.008)	0.015** (0.011)
Assets, log	-0.010** (0.028)	-0.009** (0.032)	-0.023*** (0.001)	-0.022*** (0.002)
Sales growth	0.017 (0.212)	0.017 (0.218)	0.016 (0.484)	0.016 (0.508)
Leverage	-0.116*** (0.000)	-0.116*** (0.000)	-0.040 (0.515)	-0.042 (0.496)
Year dummies	✓	✓	✓	✓
$R^2$ -pseudo	0.308	0.307	0.292	0.290
Observations	3258	3258	1227	1227
p-val	0.000	0.000	0.000	0.000

(d) for discrete change of dummy variable from 0 to 1

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 9: Bidder's CAR when advisory bank is former underwriter of the bidder.

The table presents an OLS cross-sectional regression of acquisition CAR on the indicator variable of M&A advisor losing the League Tables position relative to the previous year in the sample of acquisitions, where a former IPO underwriter is hired as M&A advisor within two years after IPO. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same sic2, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on bidder's common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values reported in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: 3-day CAR	Acquisitions with relationship M&A advisor	
	(1)	(2)
Falling value d	-0.048*	
	(0.08)	
Falling share d		-0.069***
		(0.00)
Relative size	0.028**	0.026**
	(0.05)	(0.02)
Bidder complexity	0.005	0.004
	(0.19)	(0.21)
Target complexity	-0.002	0.006
	(0.81)	(0.31)
Same sic2	0.035	0.041**
	(0.11)	(0.03)
Unsolicited d	0.008	-0.036
	(0.89)	(0.50)
Public Target d	-0.041	-0.021
	(0.17)	(0.41)
Merger d	0.026	-0.004
	(0.38)	(0.88)
Cash consideration d	0.087***	0.060**
	(0.00)	(0.01)
Stock consideration d	0.002	0.005
	(0.94)	(0.86)
ROE	0.009	-0.002
	(0.58)	(0.93)
Market to Book	-0.000	-0.002
	(0.79)	(0.43)
Assets, log	-0.009	-0.010
	(0.31)	(0.24)
Sales growth	0.004	0.002
	(0.81)	(0.91)
FCF	-0.022	0.009
	(0.78)	(0.90)
Leverage	0.108	0.021
	(0.86)	(0.73)
Constant	-0.099	-0.093
	(0.41)	(0.35)
Year dummies	✓	✓
Observations	165	165
R <sup>2</sup> -adjusted	0.068	0.128
p-val	0.081	0.015

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Table 10: Bidder's CAR and advising bank's M&A business dynamics (lagged).

The table presents an OLS cross-sectional regression of acquisition CAR on the indicator variable of M&A advisor losing the League Tables position in previous three quarters relative to preceding four quarters, and control variables. For specifications (1) and (3) competitive position is measured as total dollar value of all US transactions, while for (2) and (4) it is the share of all transactions an advisor was involved in. Relative size is ratio of transaction value to bidder cap, Bidder (Target) complexity is the number of bidder (target) sic codes appearing in SDC. Same state, Public Target and Merger are self-explanatory dummies, Unsolicited dummy denotes transactions classified as unsolicited or hostile by SDC. Cash (stock) consideration dummy equals one if cash (stock) constituted at least 80% of total consideration. Bidder's accounting variables are ROE (return on common equity), Sales growth (percentage increase in sales from year  $t - 2$  to year  $t - 1$ ), Market to book, log Assets, Free Cash Flow (scaled to assets), and Leverage (value of debt to entity market value). P-values are in parentheses (corresponding s.e. adjusted to clustering at advising bank level).

Dependent variable: 3-day CAR	All acquisitions		Inexperienced Bidders	
	(1)	(2)	(3)	(4)
Qrt value falling d	-0.008* (0.06)		-0.018*** (0.00)	
Qrt share falling d		-0.006* (0.10)		-0.008 (0.14)
Relative size	-0.010 (0.27)	-0.010 (0.27)	-0.010 (0.29)	-0.010 (0.28)
Bidder complexity	-0.000 (0.16)	-0.000 (0.17)	-0.000 (0.75)	-0.000 (0.74)
Target complexity	0.001 (0.31)	0.001 (0.30)	0.002 (0.17)	0.002 (0.18)
Same state d	0.002 (0.64)	0.003 (0.63)	-0.008 (0.27)	-0.009 (0.25)
Unsolicited d	-0.002 (0.82)	-0.002 (0.81)	-0.002 (0.90)	-0.002 (0.86)
Public Target d	-0.029*** (0.00)	-0.029*** (0.00)	-0.029*** (0.01)	-0.028*** (0.01)
Merger d	0.000 (0.97)	0.000 (0.96)	-0.002 (0.82)	-0.002 (0.83)
Cash consideration d	0.011*** (0.00)	0.011*** (0.00)	0.014** (0.02)	0.014** (0.01)
Stock consideration d	-0.013* (0.05)	-0.014** (0.04)	-0.008 (0.43)	-0.008 (0.37)
ROE	0.000 (0.49)	0.000 (0.48)	-0.000 (0.69)	-0.000 (0.74)
Market to Book	0.000 (0.82)	0.000 (0.87)	0.002* (0.09)	0.002 (0.10)
Assets, log	-0.006*** (0.00)	-0.006*** (0.00)	-0.011*** (0.00)	-0.010*** (0.00)
Sales growth	-0.011 (0.14)	-0.011 (0.15)	-0.027** (0.02)	-0.027** (0.02)
FCF	-0.003 (0.95)	-0.004 (0.92)	0.023 (0.62)	0.020 (0.67)
Leverage	0.037*** (0.01)	0.036*** (0.01)	0.051** (0.02)	0.051** (0.03)
Constant	0.058*** (0.00)	0.054*** (0.01)	0.083*** (0.01)	0.069** (0.02)
Year dummies	✓	✓	✓	✓
Observations	2880	2880	1120	1120
R <sup>2</sup> -adjusted	0.062	0.062	0.077	0.074
p-val	0.000	0.000	0.000	0.000

p<0.10, \*\* p<0.05, \*\*\* p<0.01