AN EXAMINATION OF

BANKERS' FEES IN ACQUISITION TRANSACTIONS

(EARLY DRAFT)

Key words: acquisitions, mergers, experts, abnormal returns

ABSTRACT

The use of experts such as investment bankers and legal advisors on acquisition transactions has steadily increased (Source: Securities Data Corp). This study investigates whether bankers' fees influence acquirers' abnormal returns surrounding acquisition announcement. The study examines a sample of 531 full-ownership acquisitions completed between January 1, 1988 and December 31, 1998.

Since the 1980s the number and size of acquisition deals has increased. So has the use of experts as advisors on acquisitions. Between 1981 and the year 2001, investment bankers advised an average 77% of deals, going from 78% in 1981 and reaching a peak of 88% in 1999 (Source: Securities Data Corp. (SDC)). Similarly, between 1981 and the year 2001, legal advisors advised an average of 50% of deals, going from 32% in 1981 to a peak of 82% in 2000 (Source: SDC). The widespread use of experts indicates it is common practice to employ experts on acquisition transactions. However, studies have questioned the use of experts, their professional influence over clients, and their ability to represent their clients' interests over their own interests (Hayward, 2003; Kesner, Shapiro, and Sharma, 1994; Kosnik and Shapiro, 1997; Servaes and Zenner, 1996). This study investigates whether bankers' fees affect abnormal returns.

Firms often employ experts because of their specialized knowledge in areas of professional expertise (Evans, 1988; Hayward, 2003; Hunter and Walker, 1988). Accordingly, when making acquisitions firms often look to investment bankers for strategic advice regarding the strategic and financial benefits of their acquisition choices (Evans, 1988). Bankers may help acquirers find potential targets or help targets find higher-bidding suitors (Evans, 1988). Bankers also help acquirers raise capital to finance deals and issue financial instruments (Blum, 1989; Hunter and Walker, 1988). Acquirers and targets utilize bankers for advice on and help with negotiating the best price for the deal (Blum, 1989; Evans, 1988). Additionally involving experts such as bankers and legal advisors may help firms gain legitimacy on their acquisition decisions with respect to the stakeholder community (Deephouse, 1996; DiMaggio and Powell, 1983; Hayward, 2003). Similarly, legal advisors advise firms and help firms navigate through the many legal issues related to acquisitions (Blum, 1989). Legal advisors may help firms parse through the

technical aspects related to acquiring, provide legal expertise and solutions related to deal financing, legalize agreements, help firms fulfill fiduciary duties, and help firms gain legitimacy for their transactions with respect to stakeholders (Blum, 1989; Deephouse, 1996; Landfeld, Sassalos, Arai, 2005). Summarily experts that act in the best interest of clients create market efficiency by allowing firms to rent specialized skills in fulfilling specialized functions (Bowers and Miller, 1988, 1990). Overall, experts' specialized skills likely add value to clients' acquisition decisions and ought to benefit clients helping them achieve better performance (Blum, 1989; Evans, 1988; Hunter and Walker, 1988).

However, researchers have expressed skepticism towards the use of experts, despite their many value-adding skills, because their influence and motives may at times be self-oriented rather than client-oriented. Studies have found that experts spread select practices via clients through their knowledgeable influence, which often leads to the development and diffusion of new organizational practices, finding new ways to apply their expertise (DiMaggio and Powell, 1983; Mezias, 1990; Haunschild, 1994). Hayward (2003) finds that professional firms lead clients to complex solutions with problematic outcomes so that experts can apply their expertise. Along similar lines, studies have investigated agency conflicts between experts acting as agents and their principals (Bazerman, Neale, Valley, Zajac, and Kim, 1992; Eisenhardt, 1989; Jensen and Meckling, 1976; Lax and Sebenius, 1986; Ross, 1973; Zajac, 1990). In the case of using bankers on acquisitions, acquirers' bankers may be motivated to let acquirers pay higher than necessary premiums because their commissions are a percentage of deal size (Kesner, Sharma, and Shapiro, 1994).

Investment bankers' fees are a percentage of deal size and increase if the deal is closed. Such a fee structure motivates acquirers' and targets' bankers to close deals irrespective of their benefit to clients and to increase deal size through higher premiums to increase their net fees (Kesner, Sharma, and Shapiro, 1994; Servaes and Zenner, 1996). Increasing deal value through higher premiums benefits targets as well as targets' bankers. However, acquirers' bankers may encourage acquirers to pay a higher premium, increasing their payoffs and the probability closing the deal. Although acquirers may hire bankers for their expertise in negotiating lower premiums, acquirers' bankers may be motivated to align their interests with targets' bankers and recommend acquirers pay higher premiums to increase their net gain (Kesner, Sharma, and Shapiro, 1994). As such, experts have been accused of advocating that their buying clients pay more, trying to close deals to generate larger fees, at the expense of principals' and shareholders' welfare.

In spite of the potential for self-oriented skill application, the use of experts in acquisitions remains a widespread practice. A preponderance of firms involved in acquisitions invite experts' specialized skills, defer to their professional judgment, and use their presence to create legitimacy to stakeholder audiences. Retaining experts, firms gain access to specialized expertise a firm-focused resource that is personalized, exclusive, and knowledge-based. Firms can use experts' specialized skills to assist in decision-making, strategic development and to gain competitive advantage (Amit and Schoemaker, 1993; Barney, 1991; Peteraf, 1993; Hitt, Bierman, Shimizu, and Kochhar, R. 2001).When applied to firm-specific prospects, experts' specialized skills can be beneficial to firms (Grant, 1996; Hitt, Bierman, Shimizu, and Kochhar, R. 2001). Furthermore, firms can selectively apply experts' suggestions and cooperatively evaluate and construct decisions and solutions with experts, reducing the potential for experts'

self-oriented advice. As such, experts ought to help firms examine and circumspect alternatives more thoroughly than firms could accomplish using solely in-house acquisition teams. Consequently, firms are more likely to benefit from employing experts than not employing experts. When applied to firm-specific problems, experts' contributions are a firm-specific resource in that they provide transaction-specific resources such as specialized skills, a network of useful relationships, and professional viewpoints.

In summary, this study examines whether fees generated through involvement of experts on acquisition transactions affects acquirers' abnormal returns. The widespread use of professional experts creates the need to investigate the effect of fees on acquisition transactions. Studies have investigated fees have mainly examined firms' use of acquirers' bankers to assess whether fee structures correlate with acquisition premiums, whether bankers lead firms toward complex solutions, and whether the involvement of top-tier bankers leads to greater returns (Bowers and Miller, 1990; Hayward, 2003; Hunter and Walker, 1990; Kale, Kini, and Ryan, 2003; Kesner, Sharma, and Shapiro, 1993; McLaughlin, 1990, 1992; Servaes and Zenner, 1996). Such studies mainly controlled for the presence of acquirers' investment bankers and have excluded targets' bankers and acquirers' and targets' legal advisors, all of which are present in most transactions. Thus, one contribution of this study and its examination of fees is that it allows for a more complete perspective by including variables that represent the confluence of acquirers' and targets' experts.

The study includes a sample of 531 full-ownership acquisitions completed between January 1, 1988 and December 31, 1998 by public American acquirers acquiring public American targets in

manufacturing. The next section presents hypotheses and following sections describe methodology and results, draw conclusions and discusses implications.

THEORY AND HYPOTHESES

Bankers' Fees

Investment bankers' professional expertise ought to benefit acquisition transactions. Investment bankers can quickly and effectively gather and process capital market information, reduce search costs by matching bidding and target firms, reduce information asymmetry between buying and selling firms, and provide technical and financial expertise that improves the efficiency and effectiveness of merger negotiations (Benston and Smith, 1976; Blum, 1989; Easterbrook, 1984; Evans, 1988; *Fortune*, 1991; Hansen and Torregrosa, 1992; Hunter and Walker, 1988, 1990; Smith 1986; Titman and Trueman, 1986). Investment bankers have the expertise necessary to get through a maze of transaction-related barriers that outsiders find complex. As such, investment bankers should make transactions more strategically and economically thorough (Hunter and Walker, 1988). Having specialized expertise and knowledge applied to their transaction firms can help ensure that their financial and strategic decisions are competitive and circumspect.

In addition to bankers' expertise, there are further reasons why bankers would benefit acquisition transactions. Firms' use of bankers provides legitimacy for transactions (Deephouse, 1996; DiMaggio and Powell, 1983; Hayward, 2003). Many acquisition studies confirm that acquirers' shares lose value upon announcement of an acquisition, so there is pressure for managers to create legitimacy for the transaction (Asquith, Bruner and Mullins, 1983; Bradley, Desai, and Kim, 1988; Fowler and Schmidt, 1989; Haleblian and Finkelstein, 1999; Hayward, 2002; Jarrell,

1989; Sirower, 1997; Varaiya and Ferris, 1987). Experts' presence on transactions may be a signal of deal quality, can symbolize informed and careful decision-making, and may increase investors' acceptance of and confidence in transactions (Deephouse, 1996). Acquirers and targets have accountability to stakeholders such as boards and investors so having professional experts such as investment bankers present on transactions, their decisions gain increased legitimacy in the stakeholder community.

Lastly, the use of experts can diminish managers' accountability in acquisitions (Hunter and Walker, 1988). Acquirers' managers often come under scrutiny for paying large premiums and for making acquisitions to build larger firms or to gain popularity thus acquirers' managers can ultimately share responsibility for their decisions with or shift accountability to their bankers (Bowers and Miller, 1988, 1990; Hayward and Hambrick, 1997; Morck, Schleifer, and Vishny, 1990; Roll, 1986). As such, experts provide a safety buffer in that managers can gain legitimacy from experts' presence and shift blame for poor outcomes onto bankers.

Applying experts' specialized skills to acquisition transactions is a resource that ought to add value to acquirers' decisions (Amit and Schoemaker, 1993; Barney, 1991; Peteraf, 1993; Hitt, Bierman, Shimizu, and Kochhar, R. 2001). Acquirers' ought to benefit by involving bankers due to bankers' specialized skills, competence in countering targets' bankers and targets' tactics, ability to increase legitimacy, and minimize managers' accountability in transactions.

However, studies have investigated fees and linked them with the potential for agency conflicts between acquirers and their bankers (Kesner, Sharma and Shapiro, 1994; Hunter and Walker,

1990). Investment bankers are notorious and have come under scrutiny for their large fees (Premium Payday, 1995). Fees can motivate bankers to have acquirers or targets complete deals that are not advantageous to each firm or to the investing public.

Investment bankers' fees are a percentage of deal size and increase if the deal is closed. For example such a fee structure motivates acquirers' and targets' bankers to close deals irrespective of their benefit to clients and to increase deal size through higher premiums to increase their net fees (Kesner, Sharma, and Shapiro, 1994; Servaes and Zenner, 1996). Increasing deal value through higher premiums benefits targets as well as targets' bankers. However, acquirers' bankers may encourage acquirers to pay a higher premium, increasing their payoffs and the probability closing the deal. For an acquirer serving as an advisory on a deal and increasing the dollar value of the deal, increases their ranking on league tables which often publically rank bankers and their firms. Although acquirers may hire bankers for their expertise in negotiating lower premiums, acquirers' bankers may be motivated to either not represent acquirers' best interests and align their interests with targets' bankers and recommend acquirers pay higher premiums to increase their net gain (Kesner, Sharma, and Shapiro, 1994). As such, experts have been accused of advocating that their buying clients pay more, trying to close deals to generate larger fees, at the expense of principals' and shareholders' welfare.

H1: Bankers fees ought to be negatively correlated with acquirers' abnormal returns.

H1a: Disclosing bankers' fees ought to be negatively correlated with abnormal returns.

METHODS

The sample consists of all acquisitions completed between January 1, 1988 and December 31, 1998 by public American acquirers making full-ownership acquisitions of public American targets in manufacturing. The industries include communications, computer and office equipment, drugs, electronics and equipment, medical equipment, computer software, food, tobacco, textile and apparel, wood, paper, chemicals, soaps, rubber, leather, and metals. The sample was limited to public acquirers and public targets so that financial data would be available on both firms. The total sample consisted of 584 firms before the exclusion of 53 firms due to missing data, leaving an effective sample of 531 firms. Of the firms removed, some had missing data and some acquirers were themselves acquired within one year of the acquisition. An investigation of the removed firms did not yield any significant findings. The data come from SDC's Acquisition Database, Compustat, and CRSP. I checked the data collected from the above sources for accuracy using Annual Reports, Bloomberg, Hoovers, Investext, Lexis Nexis, The Wall Street Journal, Mergers and Acquisitions Journal, and Datastream. In cases, where there was a discrepancy I consulted two additional sources.

The Dependent Variable: Acquirer's Cumulative Abnormal Return (CAR)

Acquirers' abnormal returns reflect investors' reactions to an acquirer's decision to acquire, evidenced through their buying and selling shares of acquirers' stock. The calculation of acquirers' abnormal returns uses an event-study methodology based on a market model and examines whether stock prices surrounding an event are above, below or equal to the expected return. Many studies have concluded that markets reflect all currently available information and stock prices change quickly in reaction to new information.

The dependent variable, measuring acquirers' abnormal returns, is the cumulative abnormal return (CAR) of the acquirer's stock price during an eleven-day event window beginning five days before the date of the acquisition announcement and ending five days after the date of the acquisition announcement.[1] The eleven-day window is commonly used (Campbell & Wasley, 1993; Haleblian & Finkelstein, 1999; Kale, Kini, and Ryan, 2003; Kaplan & Weisbach, 1992; Hayward, 2003). The CAR_i, is calculated based on returns.

$$R_{it} = a_i + B_{im}R_{mt} + E_{it}$$

Where R_{it} represents the return on security i on day t, a_i is a constant, R_{mt} represents the return on the market portfolio for day t, and B_{im} represents the Beta of security i, and E_{it} represents random error. The Center for Research in Security Prices (CRSP) value-weighted index with dividends represents the market portfolio. The coefficient Beta represents the linear relationship of the stock's return to the market return based on a market model. It has been conventional in finance to compute Beta on the basis of a pre-event time period of 252 trading days, approximately one year. The Beta for each security was calculated using days –313 to –60, where day 0 is the day of announcement.

$$AR_{it} = R_{it} – (a + B_{im}R_{mt})$$

Abnormal return of security i at time t, AR_{it} is the difference between the actual return and the expected return, with the expected return being a linear function of the market return. The magnitude of abnormal performance at the time the event actually occurs is a measure of the

impact of the event on the wealth of the firms' claimholders to the extent that the event is unanticipated (Brown & Warner, 1980; Brown & Warner, 1985). This methodology assumes that changes in the stock price are due to the event and not other factors.

The cumulative abnormal return, CAR_i, is the sum of abnormal returns over the event window.

$$CAR_i = \sum AR_{it}$$

However, to allow for continuous compounding when aggregating the abnormal returns, ln(1+R) is used in place of R.

$$CAR_i = \sum [\ln(1+R_{it)} - (a + B_{im}\ln(1+R_{mt)}))]$$

McWilliams and Siegel (1997) expressed concern for the findings of event studies because, they said, confounding events have often occurred during studied event windows. Confounding events are more of an issue with longer event windows, and this study uses a short event window. Moreover, McWilliams and Siegel classified some events as "confounding" inappropriately. For example, acquirers often announce acquisitions shortly before or after they issue favorable earnings reports. They do this because they expect the acquisition announcements to elicit negative reactions. Thus, issuance of favorable earnings reports is a frequent precondition of the timing of acquisition announcements.

Independent Variables

Bankers' fees are represented as the total dollar amount of reported fees per transaction. Because fees are voluntarily self-reported, including deals with data on fees in regressions leads to

[1] The analyses were repeated using windows of 1, 2, 3 and 4 days before and after the acquisition announcement and the results were quite similar to those presented here. Sirower (1997) and Haleblian and Finkelstein (1999) found similar results when

coefficients that represent only deals with reported fees. As such, these results will only apply to deals with self-reported fees if these deals are different from deals with non-reported fees.

To investigate the possibility that fees and not necessarily the involvement of bankers affect acquirers' abnormal returns, I run exploratory regressions including the total amount of investment bankers' fees. Doing so reduces the number of observations from 531 to 288. Models 1 and 2 of Table 4 show results of regressions including variables related to fees. Even after

Fee indicator variable indicates whether data on fees are reported (1) or not reported (0) for each deal in the sample. Note that this is different from available or not available as firms selectively decide on whether to report fees or not report fees and also self-disclose the fees as there is no official legislation organizing the reporting of fees and making fees comparable across firms.

Control Variables

Prior studies that have investigated the presence of acquirers' investment bankers on acquisition transactions include variables that represent transaction costs and asymmetric information (Kale, Kini, and Ryan, 2003; Servaes and Zenner, 1996). This study controls for the effects of variables found by these studies to be statistically significant.

Acquirer investment banker indicator is coded 1 if the acquirer used an investment banker and 0 otherwise (Bowers and Miller, 1990). Acquirer legal advisor indicator is coded 1 if the acquirer used a legal advisor and 0 otherwise. Target investment banker and target legal advisor are similarly measured. Experts' specialized skills ought to add value decisions and can affect

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testing the sensitivity of their findings to different event windows using acquirers' CARs.

abnormal returns therefore this study controls for the presence of experts (Amit and Schoemaker, 1993; Barney, 1991; Peteraf, 1993; Hitt, Bierman, Shimizu, and Kochhar, R. 2001).

Acquirer first-tier investment banker indicator is coded 1 if any of the investment bankers used by the acquirer were among the top five bankers by value of the transaction in league tables for the year prior to the transaction year. Acquirer first-tier legal advisor, target first-tier investment banker, and target first-tier legal advisor indicator are measured similarly (Bowers and Miller, 1990; Titman and Trueman; 1986; Rau, 2000). First-tier variables function as interaction effects. For example if an acquirer has used an investment banker and the banker is first-tier then, the first-tier banker indicator takes the value of 1. If the acquirer has used an investment banker and the banker is not first-tier, then the indicator takes the value of 0. Therefore, the first-tier banker indicator functions as the multiplicative of whether the acquirer has had a banker and whether the banker is first-tier.

Acquirers' transaction-related experience is measured by the number of acquisitions the acquirer engaged in during a four-year period preceding the acquisition announcement (Haleblian and Finkelstein, 1999; Hayward, 2002).

Relatedness between the acquirer and the target is the number of four-digit Standard Industrial Classification (SIC) codes they have in common, divided by the total number of SIC codes covered by the two firms (Sirower, 1997). The level of relatedness between the acquirer and

target may influence acquirers' ability to understand and integrate targets' businesses as well as stakeholders' beliefs about acquisition performance.

Cash only is an indicator variable coded 1 if the acquisition is 100% cash financed and 0 for any other hybrid form of financing. Cash acquisitions are simpler than those issuing new shares or debt. Firms are more likely to use experts such as bankers when they are using financial instruments to finance acquisitions (Eckbo, Giammarino, and Heinkel, 1990; Fishman, 1989; Hansen, 1987). Research has found that acquirer returns correlate with the form of payment, namely that stock-financed acquisitions have lower returns than those financed by cash (Datta, Narayanan, & Pinches, 1992; Travlos, 1987; Wansly, Lane, & Yang, 1983).

Value of transaction is the total amount of the transaction ($mil). Investment bankers' fees are directly related to the size of the transaction, therefore larger transactions may be associated with higher fees and fees can ultimately affect investors' perceptions of acquisitions' performance. As well, the size of the transaction is a potential indicator of transaction complexity and larger transactions may be more likely to require the use of experts (Kale, Kini, and Ryan; 2003; Servaes and Zenner, 1996).

Challenged deal is an indicator variable coded 1 if the acquisition was challenged by another bidder, and 0 otherwise. Challenged deals often require larger premiums and higher premiums may lead investors to be more skeptical about acquisitions' performance (Datta, Narayanan, and Pinches, 1992; Travlos, 1987). Furthermore, when deals are challenged acquirers or targets are more likely to employ experts (Kale, Kini, and Ryan, 2003).

Target high-tech is coded 1 if the target is a high-tech firm and 0 otherwise. Because of the knowledge intensive nature of high-tech firms, acquirers may find it more difficult to accurately value high-tech targets and therefore may be more likely to seek the help of an investment banker. High-tech targets had a primary SIC code in one of the following industries: communications, computer and office equipment, drugs, electronics and equipment, medical equipment, and computer software.

Relative size of the target relative to the acquirer is measured by the ratio of their sales. I also ran regressions with relative size measured by the ratio of assets and the results were similar. Studies have found that the ratio of firm size is related to acquirer abnormal returns (Asquith, Bruner, & Mulllins, 1983; Haleblian & Finkelstein, 1999; Sirower, 1997).

Acquisition premium is measured by the percentage increase between the price paid for the target and the target's share price four weeks before the acquisition announcement. The four-week period helps to avoid distortions in the target's share price attributable to information leakage before the acquisition announcement. High premiums often correlate negatively with abnormal returns to acquirers (Datta, Narayanan, and Pinches, 1992; Travlos, 1987).

Targets' transaction-related experience is the total number of acquisitions completed during the four years preceding the announcement. Experienced targets may be less likely to need experts' help during acquisitions or they may be more able to work with experts. As well, because

acquirers' transaction-related experience is used as an independent variable it is important to control for targets' acquisition experience.

Defense is an indicator coded 1 if the target has a defense for the takeover and zero otherwise. Defense measures make acquisitions more costly and such costs may adversely affect acquisition performance. As well, an acquirer buying a target with a defense measure in place may be more likely to need bankers and legal advisors for expertise in dealing with targets' defensive measures (Kale, Kini, and Ryan, 2003).

Target number of SIC codes is a count variable that indicates the number of businesses the target operates in. Targets that operate in a number of SIC codes may be more difficult for an acquirer to value and may cause acquirers to seek the help of an investment banker.

I controlled for period effects by entering years as a set of indicator variables for 1988 through 1997, omitting year 1998. Sensitivity analysis revealed that omitting any other year would have produced similar results. Coefficients of indicator variables were not statistically significant. To keep the results simple, the year indicator variables are not included in tables summarizing regression results.

RESULTS

Table 1 shows descriptive statistics and correlations among the variables.

Insert Table 1 about here.

The study uses ordinary linear regressions and Table 2 shows results of the ordinary linear regressions with CAR as the dependent variable. To test the robustness of the results and their sensitivity to outliers, I ran Robust MM and Least Trimmed Squares regressions. Robust MM regression limits the effect of outlying points, yet does not require removing them. Least Trimmed Squares regression trims a specified portion based on running several iterations. These methods yielded coefficients similar to the ones reported using ordinary linear regression, indicating that the reported coefficients are not sensitive to outliers and are robust.

Insert Table 2 about here.

Model 1 includes only general control variables. Model 2 includes the independent variable representing fees. Model 3 includes general control variables, expert variables, and the independent variable representing fees.

Effects of the control variables

This study includes several control variables, some of which have been used in previous studies examining acquisition performance (Haleblian and Finkelstein, 1999; Hayward, 2002). For Model 2, relative size ($p < 0.01$) and target number of SIC codes ($p < 0.01$) were each positive and significant. Method of payment ($p < 0.01$), value of the transaction ($p < 0.01$), challenged deal ($p < 0.01$), target is high-tech ($p < 0.01$), acquisition premium ($p < 0.01$), acquirers' acquisitions ($p < 0.05$), targets' acquisitions ($p < 0.10$), and defense measure ($p < 0.05$) coefficients were each negative and significant.

Model 1 shows that the intercept is positive and statistically significant. When banker fees is added, Model 2, the intercept goes from 2.169 down to 1.333 and the variable for total fees is positive and statistically significant. However this means that for the deals that reported fees, about half, on average the abnormal return was lower, yet the fees had a very slightly positive impact on the average abnormal return for those firms. Also adding fees increased the r-squared from 6.9% to 11.6%, nearly double, with both regressions statistically significant, but significance going from 3% to 0.71%.

Model 3 of Table 2 shows that adding controls for the presence of experts increases the intercept indicating the average abnormal return is higher for firms that have data on fees and are included in the regression, however the coefficients for bankers' and targets' legal advisors are negative and statistically significant, reducing the higher intercept, with the coefficient for fees being positive and statistically significant. Therefore it seems investors are weary of the presence of targets' and acquirers' bankers, view acquirers' legal advisors as beneficial, and the coefficient for fees is statistically significant and positively related to the average abnormal return. The regression is also statistically significant at 1% and the r-squared has slightly increased from 11.6% to 13.8%. In addition Model 3 shows that while the coefficient for targets' legal advisors and acquirer first-tier bankers are not statistically significant, targets' first-tier banker is negative and statistically significant. Also the coefficient for acquirers' and targets' first-tier legal advisors is positive and statistically significant.

However it is important to note that in interpreting the results of Model 2 and 3 that the results are only about the deals that included data on fees. Therefore the results of Models 4 and 5 that include whether fees are reported as an indicator variable allow a comparison between deals that report fees and deals that do not. Model 4 shows that when fees are reported there is a negative correlation with abnormal returns. In a sense this can indicate that deals that reported fees had a negative (-1.356) impact on average abnormal return compared to deals in the sample that did not report fees. Therefore this allows all the deals that have data for all included variables to be included in the regressions and it again comparable in sample size to Model 1. The coefficient for the indicator variable of reported fees is -1.356, which is 41% of the intercept for Model 4. Model 5 includes controls for the presence of experts and the results are similar, with variable indicating whether fees are reported having a negative and statistically significant impact on abnormal returns of -1.998.

Discussion

This study investigates the effects of investment banker fees on acquirers' abnormal returns. The results indicate that acquirer abnormal returns are affected by firms' bankers' fees. However there are many factors that need to be considered before interpreting the results.

The results of analyses indicate that when fees are reported there seems to be a slightly positive influence from the inclusion of the variable that represents fees, however the original sample is cut nearly in half as only 288 of the 531 firms that completed deals reported fees.

288 of the total sample variables that represent the presence of bankers and legal advisors are included the variables that represent bankers become more negative and seems to absorb some of the reaction to the dollar amount of fees. However when fees are included as an indicator, hence

whether or not the information is shared, there seems to be a more negative reaction toward the returns for acquirers whose transactions have disclosed the dollar amount of fees. These results are intriguing and there seems to be much more to fees than meets the eye.

It is somewhat surprising that fees would correlate positively with acquirers' abnormal returns, indicating that higher fees are correlated with higher acquirer abnormal returns. Although this result is somewhat counterintuitive, there are several situational factors that ought to be considered in unison with this finding. One is that this regression only includes 288 of the 531 deals in the study—the firms that reported fees. Thus, the results offer a partial picture mainly of abnormal returns of firms that voluntarily self-report bankers' fees. It may be that firms that do report bankers' fees, do so to have fees act as a positive signaling effect where fees are indicative of banker effort. Hunter and Walker (1990) examine a sample of 126 U.S. corporate mergers between 1979 to 1985 and find that merger gains relate positively to investment bank fees and that fees proxy for investment bank effort.

It is also interesting to consider the indicator variable that is coded 1 if firms chose to report fees. This finding implies that reporting fees (not considering the exact amount) or stakeholders having knowledge of the fee amount, negatively correlates with acquirer abnormal returns. Information related to paying experts high premiums is negatively related to acquirer returns. However, once reported, firms' high fees may signal greater expert effort. Although, further investigation is needed to determine the role of fees, these regressions do show that coefficients for variables representing bankers, are similar even after controlling for fees.

In this light, many studies report limitations to help interpretation of the results and offer a more truthful perspective. Herein, not only is discussion of limitations an important element toward understanding the results but the limitations of this study are a key to helping our interpretation and understanding fees and offer insight for future research and business practices. Historically fees have only been reported for less than half of the total dollar value of all transactions (*Mergers and Acquisitions*, 1990, 1995)! The lack of information on fees suggests that the majority of buyers, sellers, and experts prefer to keep fees confidential (*Mergers and Acquisitions*, 1990). A mergers and acquisitions banker from a large firm said "We actively will not disclose fees, nor will our clients. That's really just the tip of the iceberg. No one likes to talk about fees." (Porter, 1997). It is not clear why investment bankers would or would not report fees. One reason fees would be reported is that for large deals fees tend to be quite large and they would be material to either or both the acquirer and the target (*Mergers and Acquisitions*, 1995). One reason fees wouldn't be reported is that in smaller transactions they are not considered material (*Mergers and Acquisitions*, 1995). Another reason is that bankers may want to prevent clients from seeing how their fees undercut competitors' fees. Further adding to limitations and complications is the fact that fees are voluntarily self-reported. Therefore only firms that wish to disclose fees will, and there is no way to know whether the fees reported are accurate include the same billable items and services or have any benefits received that were waived or categorized differently.

Additional limitations of this study are discussed. This study includes only completed deals. Also fees are only available on public deals. Therefore this study cannot offer insight on deals that

were not completed or deals that were private. Perhaps experts' roles on deals that were not completed is different from their role on completed deals, as experts may have advised firms not to make acquisitions. Therefore the study does not include deals or fees for advisement of deals that did not go to completion where advisors may have advised to not conclude the deal. Second, these results pertain to a specific sample of completed deals in manufacturing during a specific time-period. Different industries, time-periods, and trends may cause different effects in another sample. For example, stock price changes surrounding acquisition announcements in the post-Enron time-period may differ from those observed during the time-period in the study. As well, acquisitions in services may have different characteristics than those in manufacturing and may require different skills from experts. Third, the study controls for the presence of experts and does not consider the behavioral aspects of these experts on the acquisition process. Future studies may investigate behavioral aspects and measure these aspects to have a better idea of how experts impact the acquisition process. For example, an aggressive acquirer may have gone against experts' advice and bought the target offering a steep premium and leading to larger reported fees, even though the bankers specifically advised the acquirer not to buy the target or not to buy the target at that overpayment. Finally in all acquisition studies there may be a slight undertone that the relationship between acquirer and target is adversarial but that may not be the case. Controlling for the type of relationship between dealmakers may be important as that may also affect bankers' influence, fees, and results.

In spite of its limitations, the study makes important contributions to the literature and offers important implications that enhance our understanding about fees and firms' use of experts. First, the study takes a look at how bankers' fees affect abnormal returns after controlling for the

presence of bankers and legal advisors on both sides of the transaction as well as general controls. Other studies had not controlled for targets bankers and legal advisors. Furthermore, there seems to be other effects that relate to fees that are obscured by not all firms having to report fees, the dollar amount of fees, and the disclosure of fees as an indicator variable.

Importantly, the results indicate there is a perception that experts and their fees do not always benefit the parties they represent. This finding has important implications as firms may unquestioningly assume that the experts they hire to represent them will benefit them. Although it may be intuitive that targets' experts are disadvantageous to acquirers' abnormal returns, it is less clear why acquirers' bankers are also disadvantageous to acquirers' abnormal returns. One explanation for this finding is that perhaps there is concern among investors that bankers aren't always carrying out investors' best interests as fee structures may align acquirers' bankers interests with targets' and targets' bankers' interests. Fee structures may motivate acquirers' bankers to let acquirers pay higher prices for targets and to advise acquirers to buy targets, as closing deals further increases bankers' payoffs. However if such is the case, there are remaining questions as to why acquirers would continue to use bankers or why legislature wouldn't stipulate changes to fee structures so they are more aligned with clients' and investors' best interests. While acquirers' involvement of bankers may be skill-based it may also be for symbolic or legitimacy-seeking purposes. Involving experts on acquisition transactions firms may garner increased legitimacy towards their decisions by creating balanced representation vis-à-vis their counterparts. Consequently, there may be benefits from legitimacy and symbolism that compensate firms for adverse abnormal returns.

Even though this study finds some interesting results, more investigation is needed to further understand the role of experts and the impact of fees. Also the benefits from using experts may depend on firms' abilities to work with experts, future studies may take a more qualitative approach to better understanding client-expert dynamics and how their fees motivate their interests toward clients.

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Table 1.
Descriptive Statistics and Correlations for Variables

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1	SIC Relatedness	1.000																				
2	Cash (1,0)	0.146**	1.000																			
3	Value of Transaction	-0.032	0.035	1.000																		
4	Challenged Deal (1,0)	-0.097	-0.146**	-0.016	1.000																	
5	Target is High-tech (1,0)	0.265**	0.168**	-0.067	-0.176**	1.000																
6	Premium	-0.064	-0.066	-0.063	0.139**	0.000	1.000															
7	Relative Size Target/Acquirer	0.024	0.054	0.011	-0.022	0.026	-0.049	1.000														
8	Acquirer's transaction-related experience	-0.062	-0.060	0.048	-0.004	0.054	-0.006	-0.049	1.000													
9	Target's transaction-related experience	0.144**	0.099*	0.059	-0.079	0.081	-0.060	0.017	0.046	1.000												
10	Defense (1,0)	-0.038	-0.162**	0.012	0.151**	-0.116**	0.045	0.030	0.051	-0.035	1.000											
11	Target number SIC	-0.232**	-0.063	0.210**	0.266**	-0.186**	-0.015	0.062	-0.025	0.053	0.130**	1.000										
12	Target Investment Bankers Indicator (1,0)	0.057	-0.048	0.088*	-0.008	0.027	0.003	-0.104*	0.030	0.045	0.038	0.034	1.000									
13	Acquirer Investment Bankers Indicator (1,0)	0.040	0.057	0.135**	-0.030	0.108	-0.055	-0.014	0.046	0.135**	0.053	0.095*	0.439**	1.000								
14	Acquirer Legal Advisors Indicator (1,0)	0.043	0.087*	0.139**	-0.049	0.048	0.027	0.015	0.090*	0.075	0.057	0.026	0.486**	0.498**	1.000							
15	Target Legal Advisors Indicator (1,0)	-0.020	-0.021	0.139**	0.009	-0.012	-0.015	-0.048	0.091*	0.070	0.043	0.073	0.538**	0.466**	0.681**	1.000						
16	Target 1st tier IB Indicator (1,0)	-0.075	-0.050	0.224**	0.166**	-0.158**	0.044	-0.015	-0.052	0.068	0.158**	0.226**	0.238**	0.156**	0.176**	0.263**	1.000					
17	Acquirer 1st Tier IB Indicator (1,0)	-0.061	-0.041	0.198**	0.047	-0.051	-0.027	-0.049	-0.005	0.006	0.022	0.168**	0.163**	0.355**	0.200**	0.200**	0.122**	1.000				
18	Acquirer 1st Tier LA Indicator (1,0)	-0.066	-0.062	0.216**	0.109*	-0.105*	0.078	-0.048	0.015	-0.021	0.203**	0.180**	0.190**	0.286**	0.343**	0.279**	0.205**	0.329**	1.000			
19	Target 1st tier LA Indicator (1,0	-0.075	-0.130**	0.060	0.103*	-0.109*	0.015	-0.014	0.070	-0.004	0.104*	0.209**	0.125**	0.088*	0.060	0.153**	0.179**	0.061	0.001	1.000		
20	Total Fees	-0.056	-0.006	0.873**	0.052	-0.083	-0.051	-0.020	0.041	0.074	0.048	0.358**	0.043	0.170**	0.123*	0.137**	0.324**	0.273**	0.247	0.152**	1.000	
21	CAR Acquirer (-5, +5)	-0.008	-0.102*	-0.012	-0.033	-0.093*	-0.091*	0.095*	-0.016	-0.053	-0.021	0.038	-0.091*	-0.068	0.008	-0.049	-0.059	0.000	0.011	0.019	-0.033	1.000

** $p < 0.01$

* $p < 0.05$

TABLE 2.
Regressions with CAR as Dependent Variable Including Total Investment Bankers' Fees

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	SE	Coefficient	SE	Coefficient	SE	Coefficient	SE	Coefficient	SE
Intercept	**2.169*****	0.577	**1.333***	0.683	8.884***	2.365	3.247***	0.634	3.773***	0.706
SIC relatedness	0.629	0.570	-0.209	0.671	-0.358	0.674	0.637	0.570	0.509	0.571
Cash (yes = 1)	-2.787***	0.320	-3.203***	0.381	-3.100***	0.389	-2.801***	0.319	-3.057***	0.325
Value of transaction	-0.001***	0.000	-0.001***	0.000	-0.001***	0.000	-0.001***	0.000	-0.001***	0.000
Challenged deal (yes = 1)	-2.394***	0.526	-6.697***	0.708	-6.650***	0.713	-2.577***	0.527	-2.343***	0.528
Target is high-tech (yes = 1)	-1.619***	0.316	-1.712***	0.389	-1.628***	0.399	-1.581***	0.316	-1.604***	0.320
Relative size target/acquirer	0.183***	0.030	0.189***	0.032	0.132***	0.036	0.185***	0.030	0.162***	0.031
Premium	-0.010***	0.004	0.003	0.005	0.001	0.005	-0.010**	0.004	-0.012**	0.004
Acquirer's transaction-related experience	-0.090	0.097	0.008	0.116	-0.075	0.117	-0.098	0.097	-0.174*	0.098
Target's transaction-related experience	-0.667**	0.249	-0.959***	0.281	-0.730**	0.283	-0.615**	0.249	-0.428*	0.251
Defense (yes = 1)	-1.093^	0.786	-1.350^	1.026	-1.151	1.040	-1.197^	0.785	-1.512*	0.792
Target number SIC	0.300***	0.071	0.409***	0.091	0.374***	0.092	0.285***	0.071	0.256***	0.073
Acquirer investment bankers (IB) (yes = 1)					**-2.062*****	0.508			-0.647^	0.412
Target IB (yes = 1)					**-7.761*****	2.178			-1.705**	0.574
Acquirer legal advisors (LA) (yes = 1)					1.788**	0.619			3.720***	0.493
Target LA (yes = 1)					0.212	0.643			-1.058**	0.486
Acquirer first-Tier IB (yes = 1)					-0.194	0.442			0.287	0.386
Target first-tier IB (yes = 1)					**-1.758*****	0.430			-1.394***	0.368
Acquirer first-tier LA (yes = 1)					**1.547*****	0.446			0.912**	0.410
Target first-tier LA (yes = 1)					0.835*	0.431			1.113**	0.367
Total fees			**0.080***	0.050	**0.147****	0.052				
Fee indicator variable							**-1.356*****	0.331	**-1.998*****	0.471
R squared	0.069		0.116		0.138					
F statistic p value	0.033		0.0071		0.01					
F statistic	1.663		1.95		1.71					
Change in R-squared										
Percentage change R-squared										
N	531		288		288		531		531	

^ p < 0.10
* p < 0.05
** p < 0.01
*** p < 0.001