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Investment bank market share, contingent fee payments, and the performance of acquiring firms[☆]

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Abstract

This paper investigates the determinants of the market share of investment banks acting as advisors in mergers and tender offers. In both mergers and tender offers, bank market share is positively related to the contingent fee payments charged by the bank and to the percentage of deals completed in the past by the bank. It is unrelated to the performance of the acquirors advised by the bank in the past. In tender offers, the post-acquisition performance of the acquiror is negatively related to the contingent fee payments charged by the bank, suggesting that the contingent fee structure in tender

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1. Introduction

In this paper, I investigate the determinants of market share for investment banks advising acquirors in mergers and tender offers. I also examine the relation between the market share of an investment bank and the fee incentive structure it faces. Finally, I examine the consequences of this relation for the performance of the acquirors advised by these investment banks in mergers and tender offers.

I investigate two contrasting hypotheses on the determinants of the market share of an investment bank acting as an advisor to acquirors involved in mergers or tender offers. The *superior deal* hypothesis argues that the performance of the acquiror in the mergers and tender offers advised by the investment bank is an important determinant of the bank's market share. It predicts that acquirors advised by top-tier investment banks (with a high market share) should earn higher announcement-period excess returns on average than acquirors advised by lower-tier investment banks. The *deal completion* hypothesis, on the other hand, argues that the valuation of the deal is of secondary importance. Because investment banks advising acquirors in mergers and tender offers face strong deal completion incentives in their fee structure, their role is simply to complete the deal, in which case the market share of the investment bank will depend on the number of deals it completes. This hypothesis further predicts that there should be no positive relation between the excess returns earned by the acquiror and the market share of the investment bank advising the deal. Note that this hypothesis does not have any implications about whether investment banks are chosen by acquirors to complete deals for targets already selected by the acquirors or whether the banks self-select to choose targets that have a better chance of being completed.

I measure the average market share of each investment bank as a fraction of the total value of transactions advised by investment banks in any single year. This measure yields a stable ranking across the years 1980–1994. Classifying the top five banks every year as 'bulge bracket' or first-tier banks shows that these banks remain in the bulge bracket for a majority of the years the study covers. They are also almost never out of the takeover market in any year. Similarly, the next 15 banks, classified as 'major bracket' or second-tier banks, are hardly ever classified as bulge bracket. The remaining banks, the third-tier banks, also

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