Journal of Banking & Finance 34 (2010) 44–54

Contents lists available at ScienceDirect

Journal of Banking & Finance

journal homepage: www.elsevier.com/locate/jbf

Managerial rights, use of investment banks, and the wealth effects for acquiring firms' shareholders

Weishen Wang [a], Ann Marie Whyte [b,*]

[a] Marshall University, One John Marshall Drive, Huntington, WV 25755, United States
[b] University of Central Florida, 4000 Central Florida Blvd., Orlando, FL 32816-1400, United States

ARTICLE INFO

Article history:
Received 7 January 2008
Accepted 5 July 2009
Available online 9 July 2009

JEL classification:
G24
G30
G34

Keywords:
Investment banking
Mergers and acquisitions
Shareholder rights
Wealth effects
Managerial rights

ABSTRACT

We examine the relation between managerial rights in acquiring firms and the decision to use an investment bank in merger and acquisition deals, and explore whether this relation impacts the wealth effects for acquiring firms' shareholders. We find that acquiring firms whose managers have relatively strong rights are more likely to use investment banks to facilitate deals and are more likely to use reputable banks. The wealth effects to acquiring firms are inversely related to the use of investment banks when managerial rights are relatively strong. However, the wealth loss is mitigated when acquiring firms use reputable investment banks.

© 2009 Elsevier B.V. All rights reserved.

1. Introduction

Investment banks perform many important functions within the economy including underwriting securities, providing venture capital, conducting capital market research, and facilitating mergers and acquisitions (M&As). Theoretical models show that the general functions of financial institutions include reducing transaction costs (Benston and Smith, 1976), alleviating asymmetric information in imperfect markets (Leland and Pyle, 1977), and simultaneously producing information (Campbell and Kracaw, 1980). Consistent with these theoretical models, empirical studies document the positive contributions of investment banks in several functional areas such as underwriting and venture capitalism. Whether investment banks also add value as financial advisors in M&As remains unclear in the finance literature.

We address this issue by analyzing how managerial rights in acquiring firms impact the decision to use an investment bank in M&As, and examining the value consequence of the interaction between managerial rights and the use of investment banks for acquiring firms' shareholders. We draw on key studies from two strands of the existing literature in developing our hypotheses. The first strand examines the role of investment banks in M&As and is best exemplified by Servaes and Zenner (1996). They find that investment banks are more likely to be used in complex deals where their knowledge and expertise are needed to facilitate deal completion. The second strand focuses on whether antitakeover provisions, a measure of managerial rights, impact the market for corporate control. For example, Gompers et al. (2003) find that firms with more antitakeover provisions (ATPs) are more likely to undertake M&As. Masulis et al. (2007) find that acquirers with more ATPs experience lower announcement period abnormal returns compared to firms with less ATPs during the merger announcement period. Combining the two sets of studies we argue that managerial rights may influence both the propensity to use an investment bank in M&As and the resulting wealth impact for acquirers. Acquirers with strong managerial rights may be more likely to use an investment bank, since investment banks are skilled in deal completion and the fee contract between the investment bank and the acquirer stresses deal completion (Rau, 2000). On the other hand, investment banks need to maintain their reputation capital and may focus on adding value. We investigate whether managerial rights in the acquiring firm dominate the quality of the investment banks' service.

* Corresponding author. Tel.: +1 407 823 3945; fax: +1 407 823 6676.
E-mail addresses: wangw@marshall.edu (W. Wang), annmarie.whyte@bus.ucf.edu (A.M. Whyte).

0378-4266/$ - see front matter © 2009 Elsevier B.V. All rights reserved.
doi:10.1016/j.jbankfin.2009.07.002

We find that strong managerial rights in acquiring firms are positively associated with the use of investment banks in M&As. This relation holds after controlling for deal and firm features such as transaction size, method of payment, type of transaction, and firm performance. Acquiring firms with relatively strong managerial rights are also more likely to use reputable banks. Further, the wealth effects to acquiring firms are inversely related to the use of investment banks when managerial rights are relatively strong. However, this effect is mitigated when acquiring firms use reputable investment banks.

Our study makes two important contributions to the literature. First, we document the contingent nature of investment banks' service: investment banks may help managerial empire building at the expense of shareholders when they are hired by acquiring firms with strong managerial rights. Stated differently, the participation of an investment bank, per se, does not have a negative impact on shareholders – the negative effect only arises when investment banks interact with managers with strong rights. Second, we show that the investment bank's reputation capital does have an impact on the acquiring firm. It seems that investment banks use their reputation capital to counter the negative side of strong managerial rights to some extent. To the best of our knowledge, these results have not been documented in the literature.

The remainder of the paper is organized as follows: Section 2 develops the hypotheses, Section 3 discusses the methodology and data, Section 4 presents empirical results, and Section 5 provides concluding remarks.

2. Hypotheses

In this section, we develop hypotheses regarding the possible relation between managerial rights in the acquiring firm and the decision to use an investment bank, and the wealth impact of using investment banks.

2.1. Managerial rights and use of investment banks

The separation between ownership and management allows managers to maximize their interests at the expense of shareholders (Jensen and Meckling, 1976). Managerial empire building is one manifestation of the agency problem, a well documented merger motive in the literature (Trautwein, 1990). Gompers et al. (2003) find that firms with more severe agency problems (relatively strong managerial rights) are more likely to pursue M&As. Masulis et al. (2007) find that deals that firms with strong managerial rights enter are associated with poor market reactions. Deals with poor market reactions may confront strong resistance from shareholders and may be more difficult to complete. Since the investment bank has skills to facilitate deal completion (Rau, 2000), managers with strong rights may be more likely to use investment banks.

Managers may also be motivated to use investment banks because they receive personal benefits for granting business to investment banks. For instance, they may receive an allocation of initial public offerings (IPOs) underwritten by these investment banks.[1] Since the use of investment banks typically costs millions of dollars in advisory fees, managers with strong rights may have more freedom to consume excessive perquisites, and can easily expense these fees without the concern of being disciplined (Shleifer and Vishny, 1989). Managers not only receive direct cash bonuses for successfully completing the deal (Grinstein and Hribar, 2004), their total compensation may also be adjusted upwards as firm size increases (Bliss and Rosen, 2001). The pursuit of increased compensation may affect the market reaction and also the use of investment banks. Alternatively, when managerial rights are weak (i.e. shareholders have strong rights relative to managers), agency problems are mitigated since managers are more easily disciplined in such an environment. Therefore, we expect that when shareholder rights are strong, managers are less likely to enter value-destroying deals. They may choose not to enter a deal (Gompers et al., 2003) or enter less complex deals, since complex deals are not in the interests of shareholders (Servaes and Zenner, 1996). Indeed, Masulis et al. (2007) find that firms with weak managerial rights lose less during merger announcements. If the deal is relatively simple or fundamentally sound, it may be more easily executed making the use of investment banks less necessary. These arguments suggest that firms with weak managerial rights may be less likely to use investment banks in M&As. Thus, we formulate hypothesis 1 as follows:

> Acquiring firms with strong managerial rights are more likely to use investment banks to facilitate M&A deals.

Admittedly, it is also possible that managers may still use investment banks to facilitate the deal even when managerial rights are weak; that is, when agency problems are less severe. Investment banks provide many valuable services including optimizing accounting, tax, and legal treatment for the deals (Stouraitis, 2003) and managers may still require their expertise to complete the deal. Thus, the impact of managerial rights on the use of investment banks is an empirical question.

2.2. Managerial rights and the use of reputable investment banks

The participation of a reputable investment bank may have a certifying effect on the quality of the deal. This may be especially meaningful for deals motivated by managerial self-interest. A reputable bank enables the manager to make a strong case to obtain shareholder approval. In fact, Rau (2000) reports that first-tier banks complete a higher percentage of deals than third-tier banks. Thus, based on the bank's expertise in completing the deals and their certification effect, we expect that strong managers are more likely to use reputable investment banks. This gives rise to hypothesis 2:

> Acquiring firms with strong managerial rights are more likely to use reputable investment banks because of the certification effect and their superior deal completion skills

However, reputable banks may be unwilling to participate in deals that are not value maximizing. A bank may self-select to avoid the deals motivated by managerial self-interest because of reputation concerns. This mutual selection between the banks and the deals has been documented in the IPO market (Fernando et al., 2005). Indeed, reputation is one reason that IPO firms switch underwriters in their follow-up seasoned equity offerings (SEOs) (Krigman et al., 2001). Probably also because of reputation concerns, prestigious underwriters are associated with good quality IPOs (Beatty and Ritter, 1986; Carter et al., 1998). Investment banks may constrain managerial agency behaviors and advise them to increase value for shareholders. If self-selection and monitoring are more prevalent among top-tier investment banks, firms with strong managerial rights may use less reputable investment banks. However, it is likely that managers with strong managerial rights are likely to do more deals in the future, which may offset

[1] Piper Jaffray was fined $2.4 million and censured by the National Association of Securities Dealers (NASD) for allegations related to the allocation of IPOs from 1999 to 2001. In agreeing to the penalty, Piper Jaffray neither admitted nor denied the charges. The NASD alleged that Piper Jaffray developed a tiered system for awarding shares to the executives of corporate clients. A "0" ranking, according to NASD, meant "no stock for you". (Forbes, Wall Street Fine Tracker, 07.15.04.)

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات