Journal of Economics and Business 74 (2014) 40–56

Contents lists available at ScienceDirect

Journal of Economics and Business

Investment banks as intermediaries in asset sell-offs

Kien Cao [a], Jeff Madura [b,*]

[a] Foreign Trade University, Faculty of Business Administration, Foreign Trade University, 91 Chua Lang Street, Hanoi, Viet Nam
[b] Florida Atlantic University, Finance Department, Florida Atlantic University, 777 Glades Road, Boca Raton, FL 33431, USA

ARTICLE INFO

Article history:
Received 18 June 2013
Received in revised form 23 April 2014
Accepted 24 April 2014
Available online 6 May 2014

JEL classification:
G32
G34
G38

Keywords:
Asset sell-offs
Investment banks

ABSTRACT

Based on a sample of asset sell-off transactions from January 1992 to December 2010, our results show that buyers are more likely to hire investment banks when the asset sell-off transactions are larger in both relative and dollar terms, when they use equity as payment, when they are in the technology sector, when they are in a different industry than the seller, and when the counterparty (seller) is in a foreign country. On the other hand, sellers are more likely to hire an investment bank when they are in a different industry than the buyer and the asset sell-off transactions are larger in both relative and dollar terms. Moreover, the overall economic conditions have marginal effects on the decision of the sellers to hire a top-tier investment bank. We also show that the hiring of an investment bank advisor influences the wealth effects of asset sell-off transactions. Both the buyer and seller are benefit from hiring their own investment banks.

1. Introduction

An asset sell-off is one of the most important methods of corporate restructuring. Chemmanur and Yan (2004) suggest that a firm can maximize its equity value through an asset sell-off, as the sum of the

* Corresponding author. Tel.: +1 561 866 1892.
E-mail addresses: caokien@ftu.edu.vn (K. Cao), jeffmadura@bellsouth.net (J. Madura).

http://dx.doi.org/10.1016/j.jeconbus.2014.04.003

equity values of the parent and the divested unit may be greater when separated than when combined. Asset sell-offs are motivated by: (i) a quest for efficiency, in which specific assets are shifted to units that can operate them most efficiently; (ii) an increase in the focus; and (iii) financing intended to relax credit constraints. However, Johnson, Hoskisson, and Margulies (1990) state that asset sell-offs often cause an increase in uncertainty for the buyer and seller's performance. Moreover, the uncertainty might be especially crucial for cross-border asset sell-off transactions because of an increased level of uncertainty that results from the information asymmetry between the buyer and seller. In addition, the integration of assets is more difficult due to cultural differences that may influence how business is conducted. Therefore, asset sell-offs might only be feasible if sellers and buyers can overcome the potential problems caused by asymmetric information.

When there is asymmetric information between the buyer and seller, the use of investment banks should be considered. Servaes and Zenner (1996) investigate the decision by firms to use an investment bank as financial advisor in mergers. They find that the decision depends on the complexity of the transaction, the type of transaction, the bidder's prior acquisition experience, and the degree of diversification of the target firm. Forte, Iannotta, and Navone (2010) identify the factors that influence the choice by target firms (in mergers) to hire an investment bank for advisory purposes. They find that the decision to hire an advisor depends on the intensity of the previous banking relationship, the reputation of the bidder company's advisor, and the complexity of the deal. The empirical evidence on a sample of mergers cannot be used to make direct inferences about the factors that influence the hiring of investment banks in asset sell-offs, because of distinct differences between mergers and asset sell-offs. Gole and Hilger (2008) suggest that while the integration of a merger occurs after the transaction is consumated, an asset sell-off requires intense preparation and rapid separation of the unit being sold from the seller. The parties who participate in an asset sell-off must execute under a much tighter time constraint. Hence the role of investment banks as financial advisors could be more important in asset sell-offs than in mergers. Our main objective is to fill the research void by identifying characteristics of the participants or the deal that lead to the hiring of investment bank advisors in asset sell-off transactions. We also assess how the hiring of investment banks affects the wealth effects in response to asset sell-off transactions.

Sicherman and Pettway (1992) argue that the gains for buyers in asset sell-off transactions result from the benefits they can extract from the sellers in the negotiation process. To the extent that investment banks can alleviate the asymmetric information, they may enable sellers and buyers to benefit from asset sell-offs. An investment bank can improve the asset sell-off because it may have more complete information to help the buyer identify prospective sellers, or to help the seller identify prospective buyers. Second, its expertise in integrating businesses might allow for suitable matching of the buyer and seller. Third, its expertise in valuation may be beneficial to sellers that wish to sell assets for which there is no market value, and to buyers that wish to buy assets for which there is no market value. Many asset sell-offs involve assets that are difficult to value and lack financial statements.

Along with these advantages, one obvious disadvantage of hiring an investment bank for an asset sell-off transaction is the expense. Hunter and Walker (1987, 1988, and 1990) document that investment bank fees in corporate restructuring are substantial, and the high fees might discourage some parties engaged in asset sell-off transactions from hiring an investment bank. Despite the potential benefits that investment banks may offer to buyers in asset sell-offs, only 34 percent of buyers involved in an asset sell-off hire an investment bank as a financial advisor, while only 42 percent of sellers involved in an asset sell-off hire an investment bank as a financial advisor.[1] Yet, no research to our knowledge has investigated why some buyers (or sellers) hire investment banks as advisors in asset sell-off transactions, while others do not.

We find that buyers are more likely to hire investment banks when the asset sell-off transactions are larger in both relative and dollar terms, when they are paid for with equity, when the seller is in a different industry, and when the seller is in a foreign country. On the other hand, sellers also are more likely to hire an investment bank when they are in a different industry than the buyer and the asset sell-off transactions are larger in both relative and dollar terms.

[1] This information is extracted from our sample.