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Does Hiring M&A Advisers Matter For Private Sellers?

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Editor's Note: The following post comes to us from **Anup Agrawal**, Powell Chair of Finance at the University of Alabama; **Tommy Cooper** of the Department of Finance at the University of Mississippi; and **Qin Lian** and **Qiming Wang**, both of the Department of Economics and Finance at Louisiana Tech University.

M&A transactions result from negotiations between buyers and sellers. In a negotiation, the outcome often depends on the relative bargaining strength of the two parties. A party's bargaining strength depends on some factors that are beyond its control and others within its control. In an M&A transaction, hiring an M&A adviser is a step that either side can take to increase its bargaining power. While the decision and the benefit of hiring an M&A adviser by a *public acquirer* have been examined extensively, to our knowledge, the decision and benefit of hiring an M&A adviser by a *private target* have not been empirically examined. In our paper, **Does Hiring M&A Advisers Matter For Private Sellers?**, which was recently made publicly available on SSRN, we investigate the determinants of private targets' choice of whether to hire M&A advisers (or top-tier M&A advisers) and the effect of this choice on deal valuations.

We focus on the hiring of M&A advisers by private sellers because advisers, especially more reputable ones, can be more beneficial to private sellers than to public sellers for at least three reasons. First, as financial intermediaries, M&A advisers have greater economies of specialization and information acquisition and lower search costs than their clients. An M&A adviser can generally help a seller identify and contact potential buyers, value the seller's business, negotiate with a potential buyer, and close a deal at a lower cost than the seller would incur on its own. These functions of M&A advisers are more critical for private firms, which usually lack deal-making experience, especially in complex transactions.

Second, in the M&A market, private targets are usually sold at significant valuation discounts relative to comparable public targets. Previous studies have found that valuation discounts are positively related to the degree of information asymmetry between acquirers and targets. This information asymmetry is likely to be more severe for private sellers because less information about them is publicly available relative to public sellers, which are subject to SEC disclosure regulations. While M&A advisers to both public and private sellers can reduce information asymmetry between bidders and sellers, advisers and their reputations are likely more valuable to private sellers because they can reduce the valuation discount that private sellers might otherwise receive.

Third, private sellers generally have less bargaining power relative to public sellers because they are lesser known and do not benefit from the mandatory disclosure and waiting period requirements of the Williams Act of 1968 that can increase the competition for takeover of public companies in tender offers. Because private sellers tend to receive fewer competing bids, it is easier for acquirers to capture gains when negotiating to buy them. The skills and efforts of M&A advisers can increase the number of competing bids that private sellers receive. We hypothesize that sell-side advisers can improve deal valuations for private sellers more than for public sellers because the hiring of M&A advisers by private sellers substantially increases their bargaining power.

We analyze a sample of 4,468 acquisitions of private sellers during the period 1980-2010 to examine the decision and the consequences of hiring sell-side M&A advisers. We start by identifying factors that affect the decision of private sellers to use M&A advisers and top-tier advisers. We then examine whether deal valuations are higher, on average, for private sellers that use M&A advisers than for those that do not, and whether private sellers tend to benefit more from hiring top-tier advisers rather than lower-tier advisers. We next examine whether top-tier advisers charge private sellers higher fees than do lower-tier advisers. Finally, we investigate whether private sellers' use of M&A advisers affects acquirers' announcement returns.

We find that private sellers choose whether to use advisers or top-tier advisers when the potential valuation benefit from hiring an adviser is greater. For example, larger private sellers are more likely to retain M&A advisers and choose top-tier advisers. This result is consistent with the notions that sellers have more at stake in larger deals and that financial advice is more critical in more complex deals. We find that private sellers are more likely to use M&A advisers (top-tier advisers) when acquirers use M&A advisers (top-tier advisers). We find that private sellers that are subsidiaries or are headquartered in states different from their acquirers are more likely to hire M&A advisers or top-tier advisers. These results are consistent with prior studies that find that information asymmetry about seller valuations is more severe in deals involving subsidiaries due to limited public information about them and higher costs of obtaining information for more distant buyers and sellers.

To control for private sellers' endogenous choice of using M&A advisers, we use five econometric approaches: Heckman's (1979) treatment effect model, two-stage least squares, endogenous switching regressions, Abadie and Imbens (2006) matching, and propensity score matching. The first three approaches require instrumental variables, while the last two do not.

After accounting for a private seller's endogenous choice of whether to hire an M&A adviser, we find that the seller benefits from hiring an adviser. On average, private sellers receive significantly higher valuations when they retain M&A advisers, though their valuations are still lower than those for comparable public sellers. We find that when a private seller hires a top-tier M&A adviser, there is a further improvement in its valuation. Using limited data on adviser fees, we find no evidence that top-tier advisers charge private sellers higher fees than do lower-tier advisers. Finally, the announcement returns of acquirers are significantly lower in deals where private sellers use M&A advisers, consistent with the idea that advisers increase the bargaining power of private sellers.

Even though acquisitions of private sellers are far more prevalent than deals involving public targets, relatively few studies analyze acquisitions of private firms. We provide new empirical evidence that financial advisers improve M&A outcomes for private sellers, which are more likely to lack deal-making experience and negotiating skills, and hence benefit more from M&A adviser expertise. The findings of this study should also be of interest to owners of private companies, investment banks, legal advisers, and other participants in the M&A market.

The full paper is available for download **here**.
