

# Are Fairness Opinions Fair? The Case of Mergers and Acquisitions \*

**Darren J. Kisgen**  
Finance Department  
Boston College  
Chestnut Hill, MA 02467  
E-mail: [kisgen@bc.edu](mailto:kisgen@bc.edu)

**Jun “QJ” Qian**  
Finance Department  
Boston College  
Chestnut Hill, MA 02467  
E-mail: [qianju@bc.edu](mailto:qianju@bc.edu)

**Weihong Song**  
Finance Department  
University of Cincinnati  
Cincinnati, OH 45221  
E-mail: [songwg@uc.edu](mailto:songwg@uc.edu)

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## Abstract

With manually compiled data on a large sample of deals announced between 1994 and 2003, we empirically examine the role and effects of fairness opinions in mergers and acquisitions. Approximately 95% of deals have at least one fairness opinion on the target side, while 70% of deals have one or more opinion on the acquirer side. Transactions where two or more advisors conduct a fairness opinion for the *acquirer* have higher long-term stock performance, indicating this multi-opinion structure is favorable to acquirer shareholders. On the other hand, acquirers that have a top-tier advisor perform the fairness opinion pay lower premiums for the target, but have lower long-term stock performance. The inclusion of acquirer opinions is more likely when deal size is large, when tender offers are not used, and when the transaction is friendly. The existence of *target* fairness opinions, in particular, those performed by two or more advisors or by a reputable advisor, increases the likelihood for deal completion. Our results support the hypotheses that fairness opinions are used by management and boards to hedge legal risk but do not increase the overall quality of transactions.

**Keywords:** Fairness opinion, advisory, merger, tender offer, investment bank, abnormal returns.

**JEL Classifications:** G34, G24, J33.

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## Abstract

With manually compiled data on a large sample of deals announced between 1994 and 2003, we empirically examine the role and effects of fairness opinions in mergers and acquisitions. Approximately 95% of deals have at least one fairness opinion on the target side, while 70% of deals have one or more opinion on the acquirer side. Transactions where two or more advisors conduct a fairness opinion for the *acquirer* have higher long-term stock performance, indicating this multi-opinion structure is favorable to acquirer shareholders. On the other hand, acquirers that have a top-tier advisor perform the fairness opinion pay lower premiums for the target, but have lower long-term stock performance. The inclusion of acquirer opinions is more likely when deal size is large, when tender offers are not used, and when the transaction is friendly. The existence of *target* fairness opinions, in particular, ones performed by two or more advisors or by a reputable advisor, increases the likelihood for deal completion. Our results support the hypotheses that fairness opinions are used by management and boards to hedge legal risk but do not increase the overall quality of transactions.

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## I. Introduction

Fairness opinions are a prevalent component of mergers and acquisitions (M&As). From 1994-2003, over 95% of mergers and acquisitions had a fairness opinion on at least one side of the transaction. Fairness opinions (FOs hereafter) are opinions rendered, typically by an investment bank, on the fairness of an acquisition or merger, particularly with regard to price. The average fee paid for a FO is small however relative to the overall fees paid to investment banks on M&As.<sup>1</sup> Since the investment bank providing advisory services and the FO are often the same, a potential conflict of interest can arise since these banks have an incentive to see the transaction completed. Firm executives may also have an incentive to see a transaction completed, and therefore desire a favorable FO for the transaction.<sup>2</sup> On the other hand, when used properly a FO can provide value to managers and boards as an additional form of due diligence, and to shareholders as a mechanism to ensure quality transactions.<sup>3</sup>

Using manually compiled data on a large sample of deals announced between 1994 and 2003, this paper empirically tests several hypotheses regarding the use and effectiveness of FOs. First, we investigate which types of firms and transactions are more likely to have a FO to explore the hypothesis that FOs are used by management and boards of directors to hedge legal risk.

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<sup>1</sup> During the period 1994-2003, the median fee for a FO was \$312,000, while the median total advisory fees for a completed merger were \$2.24 million.

<sup>2</sup> For example, in its recent acquisition of Bank One Corp., J.P. Morgan's in-house bankers not only provided advisory service but also the FO on the acquisition. This alleged conflict of interest was cited as one of the reasons for a (J.P. Morgan) shareholder lawsuit. Another reason for the lawsuit was that Bank One's CEO offered to sell the company at a substantially lower price as long as he became the CEO of the joined firm, a proposal rejected by J.P. Morgan. See *Wall Street Journal* (12/29/04) for details.

<sup>3</sup> FOs became highly popular among merging firms, in particular, targets, after the 1985 case of *Smith vs. Van Gorkom* (488 A.2d. 858, 875-878 (1985)). The Delaware Supreme Court ruled that the Board of Directors of the target firm was liable for breaching its duty of care owed to the corporation and its shareholders. The court focused on the hasty process by which the Board approved the deal, despite the fact that the merger offer was made at a substantial premium over target price. FOs from outside financial experts are perhaps the easiest and cheapest method to defend that a merger is based on a sufficient due diligence process. By obtaining FOs boards take a significant step in effectively discharging its duty of care regarding the transaction.

Second, we examine whether the use of a FO leads to a deal being more or less likely to be completed. If a FO is an objective analysis of the quality of a transaction, the use of a FO should lead to fewer deals being completed if advisors reject certain deals as unfair. On the other hand, the inherent conflict of interest in conducting a FO could reduce the effectiveness of FOs implying little impact of FOs on deal completion. Third, we examine whether the use of a FO leads to differences in premiums paid to the target or different post transaction performance for the merged firm. If a FO provides value for acquirer shareholders by facilitating the completion of better deals, post transaction performance should be better for those acquiring firms that use a FO. If FOs provide value for target shareholders, target firms may receive more attractive valuations if they use a FO. Finally, we examine whether the reputation of the FO advisor, different structures in the use of the FOs (e.g., FOs conducted by multiple investment banks versus one bank), as well as potential conflict of interest of FO advisors (e.g., whether the FO advisor is also involved with the advisory group), leads to differing deal outcome, premiums paid, and performance.

Our empirical tests yield three major sets of results. The first set of results relate to the impact of FOs on the quality of transactions and the long-term performance of deals. The use of FOs on the target or acquirer side does not statistically significantly impact deal premiums or post-acquisition stock performance. However, we find that acquirers that have two or more FOs have statistically significant positive long-term stock performance. The positive performance for the deals with this multi-opinion structure indicates that this structure may be beneficial to acquirer shareholders. Relative to employing one FO advisor, having two or more advisors conduct a FO reduces the likelihood that conflict of interest will result in a non-objective FO, since two or more investment banks would have to produce a similarly biased opinion. We find that the acquirer is more likely to have one advisor and one FO instead of using the multi-opinion structure when the acquirer is conducting a smaller transaction or a friendly or related (target and acquirer in the same

industry) acquisition.

We also find that the reputation of FO advisors affects deal performance.<sup>4</sup> Acquirers that use a top-tier advisor to perform the FO pay lower premiums, but they have poorer long-term stock performance. On the other hand, we find the reputation of target FO advisors has no impact on deal premium or the long-term performance of merged firms. These results indicate that the intentions of a top-tier FO advisor may not be completely aligned with those of acquirer shareholders. These results also demonstrate the importance of examining both the transaction price (deal premium) and quality (post-acquisition performance) in evaluating the impact of the quality of FO and reputation of FO advisors. Further, the mixed results on the reputation of acquirer advisors also highlight the importance of the multiple-FO structure on the acquirer side, because the ‘checks and balances’ system with multiple FO advisors is useful in preventing the completion of potentially bad deals.

We also examine the fee structure of M&A transactions, including FO fees and contingency fees, to identify the potential conflicts of interest that financial advisors face in producing an objective FO. If a FO advisor is also part of the advisory group and receives an additional fee for the advisory service and/or deal completion, this “affiliated” advisor has a stronger incentive to see the transaction completed than an “unaffiliated” FO advisor (i.e., a FO advisor that does not receive additional fees). We find that when the acquiring firm’s FO is conducted by an unaffiliated advisor, the deal premium paid is lower (but it is not statistically significant, given the surprisingly small number of transactions with this structure). Compared to acquirers that hire unaffiliated FO advisors, we find that acquirers with affiliated advisors who receive an additional, constant (not

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<sup>4</sup> We rank all FO advisors by the number of deals in which they provide FOs, defining a more reputable advisor as one who has provided FOs in a larger number of deals. Thus, we have two sets of rankings of FO advisors, one on the acquirer side and the other on the target side.

contingent on deal completion) advisory fee pay significantly higher premiums for the targets.<sup>5</sup>

The second set of results relate to which firms use FOs. We find the use of FOs is prevalent; in almost every deal there is at least one FO on the target side, and in more than two-thirds of the deals one or more FOs are used on the acquirer side.<sup>6</sup> The use of an acquirer FO becomes less likely when (cash) tender offers are used or when the deal size is small. The outcome of a cash tender offer is determined by target shareholders and market forces, especially when there are competing bids for the target, which removes the risk of the acquirers' boards being accused of negligence and wrongdoing. However, in a friendly acquisition with stock being the main method of payment, the deal is more complicated and the acquiring firm's board must be more cautious in approving the deal. Thus FOs are used much more often with this structure, because the motive for such a merger is more likely to be agency problem driven.

Our third main finding is that the use of target FOs increases the likelihood for deal completion, whereas acquiring firms that use FOs do not have a significantly greater or lesser chance for deal completion. Further, a deal is more likely to be completed if a top-tier advisor or two or more advisors provide FOs for the target, but the reputation of an acquirer FO advisor does not impact deal completion. If FOs are effective tools for discriminating between good and bad transactions, some must recommend that a deal is not fair and thus lead to the deal being withdrawn. In this regard, our evidence on the positive relation between the use of a target FO and the likelihood of deal completion rejects the notion that FOs are used to determine good versus bad offers. Higher quality advisors should also be better at discriminating between good and bad transactions, yet the quality of the advisor providing the FO does not *decrease* the likelihood that the deal is completed.

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<sup>5</sup> We also find that acquirers with affiliated advisors who receive a contingent (on deal completion) advisory fee pay higher premiums for the targets, but this result is not statistically significant.

<sup>6</sup> We also go through the FO letters attached to the documents submitted to the boards prior to their voting on the deal. In almost every case the FO letter states that the proposed deal is 'fair' without much details about the analysis by which this conclusion is made.

Our data collection process begins with Security Data Corporation's (SDC) merger database, which specifies the identities of and fees paid for the financial advisors involved in a given deal. While information from SDC on advisors who perform the advisory task is adequate, information on the advisors performing the FOs is sporadic and inaccurate. To ensure that our sample is both comprehensive and accurate on FOs, for each deal from SDC we manually search and extract information from merging firms' online SEC filings (available for deals announced in 1994 or later). In more than one third of our initial sample of 1,100 deals, we either found at least one FO for the target and/or acquirer where the SDC database indicated no FO, or an additional FO and advisor to what was already indicated in the SDC database. We believe our manually collected data set provides a significantly more accurate representation of deal structure during this period.

Our paper relates to existing research on financial advisors in M&As. Previous literature has investigated the advisory role played by investment banks (e.g., Servaes and Zenner 1996; Rau 2000; Kale et al. 2003; Allen et al. 2004), and we extend this literature by studying the role of FOs and their issuing advisors (who may or may not be investment banks) in M&As. A few recent papers also examine FOs in M&As (e.g., Bowers 2002; Bowers and Latham 2004; Calomiris and Hitscherich 2005). These papers however rely on SDC data alone and thus miss a significant proportion of deals where we identified FOs not reported by the SDC. Further, Bowers (2002) and Calomiris and Hitscherich (2005) only examine the determinants of FOs on the target side, while our paper examines the use, structure and effectiveness of both target and acquirer FOs. Our paper is also the first to examine the impact of FOs on deal premium and long-term performance.

The rest of the paper is organized as follows. We review laws and theoretical arguments on the role of financial advisors in M&As and develop our hypotheses in Section II. In Section III we provide empirical tests using a large M&A sample. Finally, Section IV concludes, and Appendix A contains description of all the variables that we use in our empirical tests.

## II. Laws, Merging Firms, and Financial Advisors: Hypotheses Development

### II.1 Why do Firms Obtain Fairness Opinions?

Our first set of hypotheses concerns the decision of merging firms (acquirer and target) to obtain FOs. We begin with the legal responsibilities of firms' management and boards to their shareholders when making important corporate decisions. In this regard, the Business Judgment Rule establishes a Gross Negligent Standard for firms; while this standard largely remains vague in practice, it was clear that courts intended to advance a standard that requires some worse level of dereliction than ordinary negligence (e.g., Gevurtz 2000). The *Smith vs. Van Gorkom* (1985) case helped define the Gross Negligent Standard and the importance of an "outside" opinion on the pending deal – the following quote from court documents clarifies these issues:

“We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law. Often insiders familiar with the business of a going concern are in a better position than are outsiders to gather relevant information; and under appropriate circumstances, such directors may be fully protected in relying in good faith upon the valuation reports of their management.” (Smith, 488 A.2d. at 873)

While a FO is not required by law as indicated, firms that obtain such an opinion effectively remove legal risk resulting from their negligence in their duty of care regarding the merger decision. This argument is especially important for target management and boards. In selling the firm's assets and/or stock, it is important to obtain a FO regardless of the size or mode (cash tender offer vs. friendly stock merger) of the transaction, as the duty of care of the target board to the shareholders is to ensure that the final sale price is 'fair,' or high enough. For acquiring firms, the need for obtaining FOs depends on the size, complication, and mode of the acquisition. The outcome of a cash tender offer is ultimately determined by target shareholders rather than target management, which can launch anti-takeover measures; in the case that multiple bidders enter the control contest the bidding process is essentially a first-price auction. Since the bidding process unfolds in the

public and market forces dictate the final outcome, the risk of acquirers' boards being accused of negligence and wrongdoing is reduced. However, even in a cash tender offer a FO can still be useful for the acquirer, in that the FO advisor can specify (either prior to the announcement of the tender offer, or during the bidding process should one develop) the upper bound of the acquirer's bid, preventing the acquirer management to overpay for the target.

By contrast, in a friendly deal, the outcome of the deal is by and large determined by the two management teams, since with the support of target management, it is difficult for rival bidders to win the control contest compared to tender offers (e.g., Betton and Eckbo 2000). If the acquirer's stock is the main method of payment, then the deal is more complicated because stock prices for both firms (in particular the acquirer's stock) can fluctuate during the merger process. Therefore, the acquiring firm's board must be more cautious in approving the deal, because the motive for such a merger can be driven by agency problems (e.g., to 'rescue' target incumbent), and the risk of being regarded negligent of duty of care of acquirer shareholders and wrongdoing is much higher. Finally, all the above factors and concerns are magnified when the size of the deal is large, so that more than one FO may be needed to prove that the due diligence effort is sufficient.

In addition, corporate governance of the merging firms can factor into the decision of using FOs. For example, an independent Board of Directors can counteract an entrenched acquirer manager's decision to pursue a bad merger by demanding the use of a high-quality and objective FO. An ineffective board, on the other hand, can push for the hiring of a low-quality FO advisor so that their approval of a suspicious deal appears to be done with enough due diligence. While managerial entrenchment can be proxied by the tenure of the CEO and whether he is the Chairman of the Board of Directors, his ownership stake of the company's stock may partially correct his incentive to pursue private control benefits via bad mergers (e.g., Morck et al. 1988; Stulz 1988; Mikkelsen and Partch 1989; Servaes and McConnell 1990).

To summarize, our first set of hypotheses are: 1) target FOs are more likely to be included in merger offer than acquirer FOs; 2) the use of acquirer FO is more (less) likely when a friendly merger (hostile tender offer) or stock (cash) is used, or when the deal size is larger (smaller); 3) the use of high-quality FOs is more (less) likely in merging firms with strong (weak) governance.

## **II.2 Fairness Opinion Structure and Advisors**

Our second set of hypotheses concerns the identity, responsibilities, quality/reputation, and contracts of financial advisors who perform the FO task (and the advisory task) for the target and acquiring firms. While it is clear that the Board of Directors is liable to the company's shareholders as a fiduciary of sorts and thus has a duty of care responsibility to the shareholders as previously defined,<sup>7</sup> the relationship of the FO advisors and the company's shareholders is more difficult to describe legally. Shareholders are *third party* beneficiaries of the contractual relationship formed between the board and the FO advisors, but they are afforded some legal standing to hold liable FO advisors. This standing comes in the form of Securities Exchange Act 17 (C.F.R. § 240.14a-9(a)), which makes drafters of false statements provided in proxy solicitations, such as a FO letter submitted to the board prior to their voting of a merger, liable.<sup>8</sup>

In order to ensure 'fairness,' one may argue that advisors providing FOs should be different from those providing advisory services. This is because the latter advisors are hired by management and paid a fee (much higher than that for the FO) contingent on deal completion, and thus they have an incentive to conclude the deal is fair even if it is not. In the aforementioned acquisition of Bank One Corp., J.P. Morgan chose its own bankers to provide advisory service, and not surprisingly, the same advisors also endorsed the fairness of the deal. We rank the "objectivity" of the FOs, in

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<sup>7</sup> Further, it is by nature of contract that the board employs advisors to draft FO, and as such contract laws and theories of ordinary negligence control their relationship.

<sup>8</sup> Any statement or production of information that is reasonably believed to be relied on by shareholders is considered a proxy solicitation. See for example Gevurtz (2000) for more details.

descending order, as follows: FOs by unaffiliated or independent advisors; FOs by more than one advisor; FOs by an advisor(s) who also participate in the advisory service; FOs by advisor(s) who is also the lead advisor in the advisory group with a contingency fee; and finally no FOs. The empirical predictions are: 1) better FOs lead to more *efficient* merger outcome, i.e., good (bad) deals are more likely to be completed (terminated); 2) better FOs lead to better prices in the transaction; 3) better FOs lead to better performance of the merged firm after deal completion.

Previous literature documents that the reputation of the advisor (and/or the advisor's investment bank) performing the advisory task has a positive impact on the outcome and performance of M&As (e.g., Rau 2000; Kale et al. 2003). Since some advisors (and their consulting firms) specialize in providing FOs without involving with other aspects of M&As, it is interesting to compare the FOs provided by investment banks which also generate a much larger amount of fees by providing advisory services, with those provided by "unaffiliated" advisors. One view is that unaffiliated advisors are more likely to provide high-quality FOs than affiliated advisors because they do not face the conflict of interest problem that the affiliated advisors do. Another view is that affiliated advisors have more information about the firm and the pending deal and are more likely to provide high-quality and fair opinions because of reputation concerns, while the only reason an unaffiliated advisor is hired is because he will issue a "fair" opinion on the deal.

The positive impact of a high-quality FO advisor can be even larger when agency problem in the acquirer and/or target is more severe, because board members must rely on the FO advisors more in deciding whether to approve the deal. A related issue is the fee structure of the *advisory* service. If a larger fraction of the total advisory fee is contingent on the completion of the deal, then the (advisory) advisor has a stronger incentive to complete the deal just to get the fee so a bad merger is more likely to be consummated. In these cases, if the FO is conducted by the same advisor, then the conflict of interest problem may severely hinder the objectivity of the opinion.

While it is reasonable to assume that the quality and objectivity of the advisors affect the quality of the FOs, an alternative view is that the important fact is whether a FO (or number of FOs) is used, not the identity of the advisor or the analysis based on which the FO letter is rendered. For example, in the cases of *In Re General Motors (Hughes) Shareholder Litigation* (2005 WL 1089021 (Del.Ch.)) and *City Partnership Co. vs. Lehman Bros. Inc.* (344 F. Supp.2d 1241 (2004)), the FO advisors had potential conflict of interest since they were also involved with the advisory group and had long-term relationship with firms' management, but they were cleared of any wrongdoing because these advisors disclosed all existing and potential conflict of interest to the board and shareholders in their FO letters. In the cases of *City Partnership Co. vs. Lehman Bros. Inc.* and *Rosser vs. New Valley Corp.* (2005 WL 1364624 (Del.Ch.)), the FO advisors were accused of issuing incompetent opinions, but in both cases the courts held that while the FOs could have been better, they were not "outside the realm of reasonableness." In addition, as a practical matter, only the FO letter, which is typically 1-2 pages long and contains the conclusion of whether a particular advisor views the (price of) pending deal as fair or not, is given to the board prior to their voting. The actual evaluation process and related documents, while sometimes described verbally to the board, are usually not given to the board for direct examinations.

### **II.3 The Potential Impact of Fairness Opinions on M&A Transactions**

Our third and final set of hypotheses concerns the impact of FOs on the completion and performance of deals. If FOs are indeed used by merging firms' boards to hedge legal risk, then deals without any FOs on either side should be less likely to be completed. Regarding the respective roles of FOs on the target side vs. acquirer side, there are two different views. The first one holds that in value-increasing M&As both merging firms are beneficiaries, so that FOs from either side should facilitate the completion of the deal and have positive impact on the performance of deals. The second view, however, believes that acquirer and target FOs affect the completion and

performance of deals in *opposite* ways. This is because FO advisors have different objectives in evaluating the sale price: While target advisors attempt to push for the highest sale price, acquirer advisors hope to buy the target ‘on the cheap.’ Accordingly, target FOs will be positively associated with deal premium, but the opposite is true for acquirer FOs. An exception to this second view is again the J.P. Morgan-Bank One merger, in which Bank One (the target)’s CEO proposed to exchange a *lower* offer price for his position as CEO in the merged firm. This proposal was rejected by J.P. Morgan, and subsequently was cited as one of the reasons for a shareholder lawsuit because J.P. Morgan could have acquired the target at a much lower price.

FOs can also have impact on the post-merger performance of the merged firms. This is because information contained in the FOs may not be fully understood by the market immediately after the completion of the deal. More specifically, the process upon which a particular FO advisor is hired by a merging firm may convey information about the firm and the proposed deal; further, FO advisors have access to proprietary information on merging firms and the deal. Hence, the use and quality of FOs proxies for private information about the deal and merging firms, and in turn affect the performance of the merged firm after deal completion.<sup>9</sup> In particular, unlike target FO advisors, whose responsibilities of due diligence owed to target shareholders ends with the completion of the deal, acquirer FO advisors’ due diligence effort should lead to a higher quality acquisition in terms of better transaction price (lower deal premium) and higher post-acquisition performance.

Finally, given the quality of the FO report, its impact on deal completion and performance can be different across different types of transaction. In a hostile takeover/tender offer, the raider directly solicits shares from target shareholders and bypasses target management. In a friendly merger, the outcome is determined largely by the bilateral bargaining and target manager usually

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<sup>9</sup> This is the same assumption made in any long-term stock performance study following a corporate event (in our case, the completion of a merger); see, for example, Loughran and Ritter (1997) on long-run stock performance following SEOs and Ritter and Welch (2002) for a review on long-run stock performance following IPOs.

stays in the merged firm. Thus, the incentive of the *target*'s FO advisors can be different in a hostile bid vs. a friendly merger, in that they may be more inclined to solicit the highest bid in a bidding contest on behalf of target shareholders, as compared to taking a stand that is more pro-target incumbent during a friendly merger. On the other hand, the responsibility of an acquirer's FO advisor in both a hostile bid and friendly merger is to help acquirer shareholders determine whether the acquirer's managers overpays for the target, even though in a friendly merger the agency problem in the acquiring firm is more likely to come into play.

### **III. Empirical Results**

#### **III.1 Description of Data**

Our data collection begins with the SDC M&A database: All mergers and acquisitions announced between January 1984 and November 2003, with information on financial advisors of a given deal available, are included in our initial sample. SDC provides information on the identity and the contingency fees of advisors (name of company) who perform the advisory task, but information on the FO advisors is inadequate. To ensure accuracy, for each deal from SDC we manually search and extract information from merging firms' online SEC filings, which became available for deals announced in 1994 or later. We also rely on the Dow Jones News Retrieval Service, in particular the Dow Jones Interactive company filings database that began in 1996. As a result, M&As announced prior to 1994 are excluded.

In more than one third of our initial sample of more than 1,100 deals, we either found at least one FO in the target and/or acquirer from online documents that is missing from the SDC database, or an additional FO (and issuing advisor) to what is available from the SDC database. Our manually collected data set thus provides a more accurate representation of FO structure for deals announced

during the period 1994-2003. Applying other standard selection criteria, our final merger sample includes 906 mergers and acquisitions.<sup>10</sup>

**Insert Table I here.**

Panel A of Table I summarizes the advisory structure for the 906 transactions in our sample period. Only 39 (4.3%) transactions during this period did not have a FO conducted for the target firm, indicating that these opinions are for the most part a standard component of M&A transactions on the target side. Conditional on having at least one investment bank as advisor, the most common structure for the target firm is to have one advisor and one FO (770 out of 906 deals) with the same investment banker providing both advisory service and the FO (“T\_FO\_11”). The prevalence of this structure is perhaps surprising, since this structure is the one most likely to create a conflict of interest for the investment bank (as compared to an independent firm conducting the FO, or two or more firms providing the opinions). Firms may choose this structure however because the investment bank that conducts the advisory service already has substantial knowledge of the firm, thereby making a FO a relatively straightforward task. Firms may also be reluctant to disclose confidential information to an additional firm/investment bank. From Panel A, a significant numbers of target firms however choose alternate structures, which allows for the opportunity to test if one particular structure is more effective than another at providing objective evaluation of the price of a transaction.

Contrary to the target firm structures, a significant number of acquiring firms (23.8%) choose not to have a FO. Similar to target firms, the majority of acquiring firms (578 out of 906 deals) choose the “one advisor, one FO” structure (“A\_FO\_11”), and in most cases the same investment

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<sup>10</sup> Merger deals are also excluded from the final sample if no information on advisors of either side is available, the value of the transaction is lower than \$10 million, if either the target or the acquirer is not based in the U.S., or if the deal has pending status. Moreover, both the target and acquirer have to be included in the Center for Research and Security Prices (CRSP) database and in the Compustat Annual files for at least one year prior to the merger announcement date.

banker provides both advisory service and the FO.<sup>11</sup> Acquiring firms also choose different structures, such that for example 46 firms (5.1%) hire two or more investment banks and two or more of them conduct a FO (“A\_FO\_22”). With this multi-opinion structure, it is possible that at least one FO advisor is not affiliated with the advisory group and receiving an additional fee. With two or more advisors doing a FO, reputation effects are also likely to be present. An advisor will be less likely to provide an unsubstantiated report if he knows that his report will be compared to another investment bank’s report, and it is also more difficult for two or more advisors to collude to produce an incorrect or biased FO than it is for one advisor.

Panel B of Table I provides more information on the potential conflict of interest of the advisors (and their investment banks). Surprisingly (while consistent with the prevalence of the “one advisor, one FO” structure on both sides), in only 44 (4.9%) deals on the target side and 56 (6.2%) deals on the acquirer side the FO advisor is *not* affiliated with the advisory group. In the majority of deals (75% on the target side and 53% on the acquirer side), the FO advisor is affiliated with the advisory group and received a fee *contingent* on deal completion (“T\_FO&Adv\_CFee” and “A\_FO&Adv\_CFee”). In another 16% of deals on the target side and 17% of deals on the acquirer side, the FO advisor is also affiliated with the advisory group but received a constant fee (*not* contingent on deal completion; “T\_FO&Adv\_NCFee” and “A\_FO&Adv\_NCFee”). The objectivity of the FOs is likely to increase when the FO advisors are not paid to structure and complete the deal (goals of advisory service). In our subsequent tests, we include dummy variables to examine how the structure of FOs and the conflict of interest of FO advisors affect the quality of the opinions.

**Insert Table II here.**

Table II shows a univariate analysis of deal completion and the use of FOs. Since control variables are not included in this table, the results are merely descriptive, yet they provide insights

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<sup>11</sup> In a few deals, information on the identity (of advisor) and fees for the advisory service is not available.

into the relationships between FOs and deal completion. The table shows that target firms that have a FO are less likely to have their deal withdrawn than those that do not have an opinion. Higher quality transactions might engender FOs, so causality cannot be definitively asserted here, however this data does not support the notion that FOs are used to help eliminate bad deals. Likewise on the acquirer side, the use of FOs does not imply that deals are less likely to be completed.

The table also shows the average days to completion given the use of FOs. FOs might result in greater due diligence and might therefore imply a longer time to completion of a deal. This however also seems to be ruled out by the data. For target firms, those with FOs actually are completed faster than those without. While acquirer firms that use FOs take longer to complete, this has more to do with the fact that FOs are generally not used in tender offers (as will be evident in later tests). Since tender offers are faster to complete, once they are excluded from the sample the use of a FO has little impact on the average time to completion of a deal.

### **III.2 Empirical Tests on the Use of FOs**

Tables III and IV examine which types of firms and transactions are most likely to have outside advisors conducting FOs. Table III shows firm and transactions statistics based on the structure of FOs conducted for the target and acquirer firm. Larger deals (average deal size) in general have more FOs; for example, deals with two or more FOs (on either side) are approximately four times larger on average than those with the “one advisor, one FO” structure. A significant number of deals with no opinion on the acquirer side are tender offers (78.2%) or cash deals (at least 50% of consideration is cash) compared to deals with one or more FOs. Average M&A fees (per deal) for the overall transaction, including contingency fees, do not significantly differ for transactions with one FO versus no opinion; however transactions with two or more FOs have substantially larger overall fees. The average fee for a FO (median was \$312,000) is much smaller

compared to the average total advisory fees for a completed merger (median was \$2.24 million). The median FO fee (per deal) also increases when the target or acquirer has two or more opinions instead of one conducted. Finally, acquirers pay the highest premium (40.0%) for the target when no FO is used; however most of the deals in this group are tender offers. On the other hand, targets without FO conducted receive the lowest premium (23.90%) while targets with two or more FOs receive the highest (36.08%), suggesting that FOs might be valuable for target shareholders.

**Insert Tables III and IV here.**

Overall, preliminary evidence shown in Table III is consistent with the hypothesis that FOs are used by management and board to hedge legal risk on either side. On the target side, larger deals are associated with one or more FOs, because the risk of target management and/or boards being accused of insufficient due diligence and other forms of negligence is higher given that there is more “at stake.” On the acquirer side, non-tender offer acquisitions, acquisitions of larger size, supported by target management (most stock deals are “friendly”), or with a complicated structure (stock instead of cash) are associated with one or more FOs. In these types of acquisitions, the acquirer management and board are more likely to be accused of negligence or perverse motives for merger, and thus the use of FOs becomes more prevalent.

Table IV examines the determinants on the use and structure of FOs on the acquirer side. Since FOs are used by target firms in almost every deal, we do not perform similar tests on the target side. As shown in Table I, 23.8% of deals did not have an FO for the acquirer, so these tests identify which types of firms or transactions lead acquiring firms not to obtain a FO and to choose different FO structures. Panel A of Table IV presents results from probit regressions, where the dependent variable indicates the acquiring firm had at least one FO for the transaction (dummy equals 1; default outcome is no FO used). Panel B presents results from multinomial logit tests, where the dependent variable indicates one of the four possible structures of acquirer FOs as indicated in Table I (default

outcome is “one advisor, one FO”).

From Panel A, consistent with data from Table III, both the tender offer and friendly dummy variables are highly significant (significant at 1% in all models). In Column (3), when the mode of a transaction transforms from merger to a tender offer, the probability of having an acquirer FO decreases by 72.7%. In tender offers, the final outcome is determined by market forces (e.g., an auction), which implies a formal procedure of due diligence, accomplished and “verified” by the use of FOs, is not necessary. Again in Column (3), when the deal attitude changes from hostile to friendly, the probability of having an acquirer FO increases by 40.0%. During the sample period hostile transactions were not prevalent (3.4% of transactions); however the significance of this variable is striking. If FOs are used as a due diligence measure, this suggests that managers believe friendly deals require more due diligence than hostile transactions. If FOs are used to hedge legal risk, our result implies managers believe that lawsuits are more likely from a failed friendly deal than a failed hostile transaction. Since the coefficient on the friendly dummy is significant after controlling for other deal characteristics including the method of payment and the size of transaction, we conclude that hedging legal risk in friendly deals is the more reasonable hypothesis in using FOs.

Panel A also indicates that the coefficients on two size measures are also significant. Larger deals are more likely to have an acquirer FO, however larger acquiring firms, as measured by the market value of equity, are less likely to have an acquirer FO. This perhaps suggests that larger firms are more capable of conducting their own due diligence on a deal, however if the transaction itself is larger, the importance of the transaction dictates a firm will seek outside verification. As a robustness test (not reported in Table IV), we also replace the two size variables by relative size (acquirer size over deal size), and find that as acquirer becomes larger relative to the target (measured by deal size), the likelihood of having one or more acquirer FOs decreases; however, other results from Table IV still hold. We also find corporate governance variables generally do not

have explanatory power for having an acquirer FO.<sup>12</sup>

The most interesting results from Panel B are the comparisons of having the “one advisor, one FO” structure (“A\_FO\_11” is default outcome) vs. having two or more FOs (“A\_FO\_22” structure).<sup>13</sup> The latter, multi-opinion structure will be shown to be associated with better deal performance below. When an acquirer is conducting a smaller transaction (Dealsize; coefficient not significant in Model 2) or a friendly (significant in both models) or related (“Same\_Industry” dummy equals 1; significant in both models) acquisition, the acquirer is more likely to have the “one advisor, one FO” structure instead of using the multi-opinion structure. In a friendly and/or related acquisition, managers of the acquiring firm are familiar with the target and possibly have close relation with target managers, and thus having multiple FOs and advisors may be redundant. However, having two or more advisors conduct FOs creates a ‘checks and balances’ system that may increase the likelihood that the FO is objective, which can be crucial in determining the quality of the transaction if the merger is driven by agency problems in acquirer management.

### **III.3 Tests on the Impact of FOs on Deal Completion, Premium and Performance**

We hypothesize that the structure of FOs as well as the reputation of FO advisors can have an impact on the likelihood of deal completion, transaction price, and the post-acquisition performance. We examine the effects of FOs along these three dimensions in this subsection.

We first provide information on the identity of FO advisors and the rankings of these advisors based on our sample. Previous studies have provided several measures for the reputation of

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<sup>12</sup> However, we do find that when dealing with a more experienced target CEO (“t\_ceotenure”), acquirers are more likely to use FOs (Column 5 of Panel A), possibly because more experienced target CEOs are better at negotiating deals and thus the acquirer is more cautious and thorough in its due diligence effort. We will further discuss the impact of a more experienced target CEO on deal performance below.

<sup>13</sup> In addition, we find that when the acquirer’s leverage or the size of toehold increases, the acquirer is more likely to adopt the “two advisors, one FO” structure rather than the “one advisor, one FO” structure.

financial advisors.<sup>14</sup> Consistent with prior studies, in our empirical tests we use both a continuous ranking variable of the advisors providing FOs to our sample firms, and a discrete ranking variable based on a three-tier ranking system of the advisors. Unlike some previous rankings of advisors providing advisory services that are based on the total size (in dollars) of deals in which the advisors provide advisory, we rank FO advisors based on the *number* of deals in which they provide FOs.<sup>15</sup> Our ranking mechanism makes sense because, while advisory fees (usually contingent on deal completion) increase with deal size, the fees paid to each FO advisor are much lower on average and do not vary significantly with deal size. Therefore, a better measure for a more reputable FO advisor is how often he is asked to provide a FO in M&A deals.

**Insert Table V here.**

Our ranking procedure results in a list of 162 unique investment banks and consulting firms (FOs conducted by different subsidiaries of the same bank are credited to the bank) who have served as FO advisors for *acquiring* firms in our M&A sample, and 195 investment banks/consulting firms acting as FO advisors for *targets*. The market share of an FO advisor is defined to be the number of deals that this advisor (investment bank or consulting firm) provided FOs over the total number of deals in our sample (906).<sup>16</sup> We thus have two sets of rankings of FO advisors, one on the acquirer side and the other on the target side. Table V lists the top 30 financial advisors that have issued FOs in M&As from 1994 to 2003. These rankings are similar to other rankings based on the

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<sup>14</sup> For example, Megginson and Weiss (1991) use market shares of investment banks to measure reputation. Bowers and Miller (1991) and Servaes and Zenner (1996) divide financial advisors into two tiers, with the top tier comprised of the top five investment banks and the second tier including all the other advisors. Rau (2000) uses a three-tier ranking system based on the market shares of investment banks.

<sup>15</sup> In our tests below, we also use advisor rankings based on total deal volume (so that an advisor has a higher ranking if the total size of deals in which he provides FOs is larger). Our main results are robust to this alternative ranking system, while the coefficients on the ranking variables themselves (both continuous variable and the tier dummies) have lower statistical significance than the ones we reported in the tables.

<sup>16</sup> Rau (2000) finds that annual rankings of investment banks providing advisory service in M&As are stable over time.

regular advisory service in M&As provided by investment banks (e.g. League Tables from SDC; Rau 2000). Our rankings however also have some notable differences from previous rankings of advisors providing advisory service (e.g., Rau 2000). First-tier FO advisors on the *target* side include Goldman Sachs (provided FOs in 89 deals, or a market share of 9.82% of all deals), Merrill Lynch (69 deals), Morgan Stanley (52 deals), Donaldson Lufkin & Jenrette (44 deals) and Salomon Smith Barney (37 deals). On the *acquirer* side, Merrill Lynch (69 deals, or a market share of 6.62% of all deals) is the highest ranked FO advisor, while Salomon Smith Barney is replaced by Bear Stearns as the fifth ranked advisor.<sup>17</sup> Finally, third-tier advisors include all advisors not ranked in the top 20, but Table V only lists the ten highest ranked advisors within this tier to save space.

### ***Deal Completion***

Table VI shows results from probit regressions with the dependent variable being the dummy that equals 1 if a deal is completed and 0 otherwise. Consistent with previous studies, friendly mergers are more likely to be completed compared to hostile takeovers, while the presence of a competing bid makes it more difficult to complete the deal (e.g., Schwert 2000; Betton and Eckbo 2000). We also find that the acquiring firm's 1-year return prior to deal announcement is positively related to deal completion. A larger stock price runup leading up to the merger makes the acquirer (e.g., a growth firm in the 1990s) more appealing to the target and its shareholders, while if the method of payment is stock then this result is consistent with the argument of stock market driven acquisitions (Shleifer and Vishny 2003; Rhodes-Kropf and Viswanathan 2004; Rhodes-Kropf et al. 2005).

**Insert Table VI here.**

After controlling for firm and deal characteristics that have been shown to affect deal status,

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<sup>17</sup> Before the 1997 merger between Salomon Brothers and Smith Barney, Salomon Brothers participated in more M&A deals (as advisors) than Smith Barney, and the joint company (Salomon Smith Barney) enhanced its reputation mainly from the deals conducted by Salomon Brothers. As such, we list Smith Barney (with deals done prior to 1997) as a separate advisor while combine deals done by Salomon Brothers (prior to 1997) with those done by the merged firm.

we find that having a FO on the target side greatly facilitates the completion of the deal. The coefficient on target FO dummy is significantly positive (Column 1 on the full sample, and after controlling for governance measures in Column 2). Since in almost every deal there is at least one FO on the target side, in Columns 3 through 6, we drop the few deals without a target FO. We find that when the target has two or more FOs (“T\_FO\_22” in Columns 3 and 6; “T\_FO\_11” is the default outcome), the deal is more likely to be completed. On the other hand, FOs on the acquirer side (the single dummy in Columns 1 and 2, and the three dummies indicating different structures of FOs in Columns 3 and 6) do not have a significant impact on deal completion.

We also find the reputation of target FO advisor affects deal outcomes but acquirer advisor’s reputation does not. First, in Columns (4) and (6), the coefficients on the continuous variable indicating the market share of a target FO advisor are significant at 1%. In terms of implied probabilities, when the target FO advisor’s market share increases from the sample mean (3.25%) by 5% (i.e., to a market share of 8.25%), the probability of deal completion increases by 3.02%. Second, the dummy variable indicating the “top-tier” status of a target FO advisor is also significantly positive (Column 5). When the target FO advisor’s ranking rises from third tier (default) to the first tier, the likelihood of deal completion increases by 3.78%. We do not find that the conflict of interest variables of the acquirer FO advisors (Columns 7 and 8) or the target FO advisor (not reported in table) affects the likelihood of deal completion. Finally, we also examine measures of corporate governance on deal outcomes (e.g., Mikkelsen and Partch 1989). Among these measures, we find that target CEO tenure, which can proxy for the experience of the CEO in a firm with strong governance or a higher degree of entrenchment in a firm with weak governance, has a positive impact on deal completion (Column 2).

To summarize, we find that the use of target FOs increases the likelihood of deal completion, and in particular, employing either a multi-opinion FO structure or a top-tier FO advisor facilitates

the completion of the deal. However, FOs on the acquirer side, including the structure and the reputation of FO advisors, do not have a significant impact on deal completion. Our evidence on the positive relation between the use of a target FO and the likelihood of deal completion rejects the notion that FOs are used to filter out bad deals, but an alternative interpretation of our result is that higher quality transactions receive FOs. In order to differentiate these two arguments, we examine the price and performance of the transactions next.

### ***Deal Premium***

Table VII presents results from OLS regressions with acquisition premium (percentage premium of offer price over target price one week prior to deal announcement) as the dependent variable.<sup>18</sup> Consistent with prior studies, target shareholders in tender offers receive significantly higher premium than their counterparts do in friendly mergers, while the premium is significantly lower when the acquirer has a toehold (e.g., Betton and Eckbo 2000). Interestingly, acquiring firms with higher prior profit margins offer significantly lower premiums to targets (significant at 5% in all columns), and this relation is robust to tests including characteristics of CEOs and boards. In terms of marginal effects, when the acquirer's profit margin increases by 10% from the sample mean (i.e., from -2.03% to 8.03%), the deal premium falls by 0.6%. These results suggest that good companies tend to be more cautious during M&As and they are less likely to overpay for the targets.

**Insert Table VII here.**

In general we do not find a significant relation between the use and structure of FOs and deal premiums. Neither the reputation (Columns 2, 3, and 4) nor the conflict of interest (not reported in table) of the *target* FO advisors has an impact on whether the target receives a higher deal premium. However, we do find that when a top-tier advisor conducts a FO for an acquirer, the acquirer pays

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<sup>18</sup> We use relative size (acquirer size over deal size) rather than using deal and acquirer sizes separately to capture the fact that premium (%) decreases as acquirer becomes larger relative to the target. The coefficients on this variable are indeed negative in Table VII, but they are not statistically significant.

lower premiums for the target. For example, in Columns 2, 3 and 7, when a first-tier (ranked in the top five) rather than a third-tier (default) advisor provides the FO, deal premium falls by 6.3% to 6.74%. Similar results are found when we use the continuous ranking variable indicating the market share of FO advisors (Columns 5 and 6). These results suggest that having a reputable advisor conducting an FO allows acquirer shareholders to receive a better transaction price. However, caution is in place to interpret this result, in that a lower price does not necessarily imply a higher quality transaction. Due diligence conducted by acquirer FO advisors should lead to better acquisitions in terms of both pricing and performance. We test this hypothesis below in Table VIII.

We also find some evidence that the conflict of interest of acquirer FO advisors lowers the quality of the opinions and leads to higher transaction prices for the acquirers. In Column 5, acquirers with affiliated FO advisors who receive a *non*-contingent fee from advisory pay a premium that is 11.16% higher than acquirers that use an unaffiliated FO advisor (default). On the other hand, acquirers with affiliated FO advisors who receive a contingent fee from advisory also pay a higher premium but this result is not statistically significant. Further, an F-test on the two coefficients shows that they are significantly different ( $p$ -value is 7.4%), suggesting that the transaction price of acquirers is the highest (and worst) when the advisors are paid a constant fee to perform both the advisory and FOs. Our results extend the findings of Rau (2000), who finds that more reputable advisors providing *advisory* services are more likely to structure their advisory fee to be contingent on deal completion, a more incentive-laden contract than a constant fee.

Finally, corporate governance in the target firm does seem to have a significant impact on deal premium. Perhaps surprisingly, targets with their CEOs having longer tenure actually receive lower premiums (Column 3) and the  $p$ -value is less than 1%. This result, along with the result shown in Table VI, where target CEOs with longer tenure are more likely to complete deals, suggest that these CEOs care more about completing the deal than attempting to obtain the highest (and best)

possible price for their shareholders. As shown in other recent papers, this perverse incentive can be explained by a severe agency problem in the target firm.<sup>19</sup>

### ***Long-term Performance of Merged Firms***

We hypothesize that the structure of FOs can have an impact on the performance of merged firms following deal completion, due to the gradual process upon which information about the deal and merging firms gets impounded into market prices. In what follows we first discuss our empirical methodologies on long-term performance and then present results and discussions.

#### **A) Matching Firm Approach and Buy-and-Hold Abnormal Returns (BHAR)**

Similar to prior studies, we use control firms matched by size, book-to-market ratio, and one-year stock return prior to deal announcement as the benchmark for post-acquisition stock performance.<sup>20</sup> At the end of each month from January 1994 to December 2001,<sup>21</sup> all NYSE/AMEX common stocks (excluding the sample firms) listed on the CRSP tapes, without any equity offerings or merger announcements during the prior three-year period, are included in our pool of possible matching firms. We rank firms at each month-end by their market capitalization (size), book-to-market (B/M) ratio, and prior one-year stock returns. For each NYSE/AMEX-listed firm in the sample, we select the *first* matched firm from the pool of potential matches such that the

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<sup>19</sup> For example, Hartzell, Ofek, and Yermack (2004) and Grinstein and Hribar (2004) both acquirer and target CEOs receive large bonuses (e.g., a severance package for target CEO) upon deal completion. Recall in Panel A of Table IV we find that likelihood of the use of an acquirer FO increases when the acquirer deals with a more experienced target CEO. In light of the current results (from Tables VI and VII), a more reasonable explanation for the previous finding is that acquirer boards and management may be aware of the perverse incentive of the target CEO and hence have an incentive to use FOs to hedge legal risk of being accused of engaged in bad deals.

<sup>20</sup> For example, Barber and Lyon (1997) document that the control firm approach eliminates the skewness bias associated with the long-run buy-and-hold abnormal returns, and that the size-and-book-to-market-matched control firm approach yields well specified statistics. Rau and Vermaelen (1998) and Lyon, et al. (1999) show that the pre-event performance of the acquiring firms plays an important role in explaining the post-acquisition long-run abnormal performance. Finally, Fama (1998) suggests that abnormal returns can be estimated by using returns on matching firms or matching portfolios or by an asset pricing model.

<sup>21</sup> To ensure that our sample firms have a three-year holding period, we exclude deals completed after December 2001 in our long-term performance analysis.

*sum* of the absolute percentage differences between the sizes, book-to-market ratios and prior one-year stock returns of the sample firm and the matched firm is *minimized*. The set of potential matching firms is constrained so that they are not more than 10 percent smaller than the sample firm.

To ensure that the book value of a firm is available to the market at the time of our calculations, we do not use the book value of a given fiscal year until at least four months *after* the end of the fiscal year.<sup>22</sup> The B/M ratio is calculated by dividing the book equity value (COMPUSTAT annual data item 60) by the market capitalization (price per share times the number of outstanding shares from CRSP). For a sample firm, the B/M ratio is calculated on the day prior to the effective date of acquisition. We measure the prior annual stock return of the sample firm as the one-year buy-and-hold return beginning 252 trading days prior to the deal effective date and ending on the last trading day prior to the effective date. We use the same holding period to calculate the prior one-year return of the matching firms. We apply the same matching algorithm to choose matching firms for Nasdaq-listed sample firms.<sup>23</sup>

We calculate the three-year BHARs (buy-and-hold *abnormal* returns) for each firm using the size, book-to-market ratio and prior one-year return matched control firm as benchmarks for expected returns, as follows:

$$BHAR_i = \prod_{t=1}^{T_i} (1 + R_{i,t}) - \prod_{t=1}^{T_i} (1 + R_{benchmark,t}),$$

where  $T_i$  equals either 756 trading days in the 3-year holding period or the number of days from the acquisition effective date until the delisting date, whichever is smaller. We use the same holding

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<sup>22</sup> For instance, firms with a December 31 fiscal year-end begin using the book value of the current year-end for calculations done on or after April 30 of the following year.

<sup>23</sup> We retain the two closest matching firms for each sample firm. If a matching firm is delisted before the end of the three-year anniversary or the combined firm's delisting date, whichever is earlier, we substitute the second closed matching firm on the delisting date. If the second matching firm is delisted during the measurement period, the CRSP value-weighted return is substituted as the return of the control firm from the removal time.

periods to calculate the BHRs (buy-and-hold returns) of matching firms. Differences in the BHRs of the sample firms and their respective benchmarks are the BHARs.

### **B) Tests on Long-term Post-acquisition Stock Performance**

We first perform univariate tests on the (three-year) long-term abnormal stock performance based on different target/acquirer FO structures (not reported in table, results available upon requests). During our sample period (1994-2001), acquirers/merged firms significantly underperform their matched firms. If we partition our sample based on whether FOs are conducted on the target side, we find that merged firms with target FOs exhibit significant *underperformance* relative to their benchmarks three years after deal completion, while firms without target FOs do not show underperformance. On the acquirer side, merged firms significantly underperform their benchmarks regardless of whether (acquirer) FOs are used. Among firms with FOs, we further partition the subsample according to different FO structures. On the target side, we find that only the group of firms with the “one advisor, one FO” structure significantly underperforms their benchmarks. On the acquirer side, only the group of firms with two or more FOs does *not* show significantly negative abnormal returns relative to the benchmarks.

#### **Insert Table VIII here.**

In a multivariate context (Table VIII), we then examine whether the use of FO, the FO structure, and the reputation of FO advisors have an impact on the long-term post-acquisition stock performance of merged firms. The dependant variable, LAR ( $= \ln[(1+BHR_{SF})/(1+BHR_{MF})]$ ), is defined as the natural logarithm of one plus the sample firm’s three-year BHR minus the natural logarithm of one plus the matched firm’s three-year BHR (e.g., Lee 1997; Mitchell and Stafford 2000). As stated in Mitchell and Stafford (2000), this variable measures the abnormal stock performance of merged firms *relative to* matched firms. To estimate the differences based on the use of FO, FO structure, and FO reputation, we control for factors that have been shown to influence

the long-term abnormal stock performance, such as acquirer size, deal size, acquirer book-to-market ratio, acquirer stock price runup, method of payment and deal attitude. Consistent with previous studies (e.g., Loughran and Vijh 1997; Rau and Vermaelen 1998), we find that both acquirer size and acquirer book-to-market ratio are positively related to the long-term abnormal returns; deal size, on the other hand, is negatively related to long-term performance.<sup>24</sup>

We do not find the use and structure of FOs, or the reputation and conflict of interest of FO advisors on the *target* side to be related to the deal performance (some of these variables are not reported in the table to save space). However, we find a negative and significant relation between the reputation of an acquirer FO advisor and the post-acquisition performance. In Columns 2 and 6, when a top-tier advisor (ranked in the top five in terms of number of deals) provides the FO, the acquirer's post-acquisition performance is *lower* than that of an otherwise identical acquirer with a third-tier advisor (ranked 21 or lower) providing the FO. In terms of economic significance, when a third-tier FO advisor provides FO for an acquirer, a three-year "buy-and-hold" investment strategy (after deal completion) in the acquirer's stock yields a return that is 22% *less than* investing in a matching firm's stock; however, when the same acquirer hires a top-tier FO advisor, the same three-year investment will generate a return that is 44.6% *less than* investing in the matching firm. These results suggest that the previous finding from Table VII, where the use of a top-tier acquirer FO advisor is associated with lower deal premiums, is incomplete in evaluating the impact of advisor reputation. The negative relation between advisor reputation and post-acquisition performance implies that the intentions of a top-tier FO advisor may not be completely aligned with those of acquirer shareholders: While they do care about transaction prices (short-term gain to the target firm), which can probably get the advisors "off the hook" from being accused of being negligent or

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<sup>24</sup> Consistent with Datta et al. (2001) and Song (2005), we find cash deals (method of payment includes cash) actually have worse long-term stock performance. This is in contrast to the evidence in prior studies based on M&As from earlier periods (e.g., Loughran and Vijh 1997), which do not control for the price runup of acquirers.

biased, the quality of the acquisitions is actually worse than those evaluated by lower ranked advisors.

In Columns 3, 4 and 7, we introduce the dummy variables on various FO structures on the acquirer side (single advisor and single FO, multiple advisors and single FO, and multiple advisors and multiple FOs) while no FO used is served as the default group. After controlling for the reputation of FO advisors, only the coefficient on acquirer's multiple-FO structure is positive and significant. In terms of economic significance, when an acquirer has no FO, a three-year "buy-and-hold" investment strategy in the acquirer yields a return that is 31.03% *less than* investing in a similar matching firms; when the same acquirer now obtains two or more FOs, the same three-year investment will generate a return that is 33.72% *higher than* that from investing the matching firm. These results imply that this multiple-FO structure is valuable for acquirer shareholders in preventing the completion of potentially bad mergers, because the associated 'checks and balances' system can alleviate the conflict of interest problem embedded in the single-FO structure or from another FO advisor.

Finally, we also examine the impact of corporate governance variables on deal performance (not reported in table, available upon request). These variables include CEO tenure, whether CEO is the chairman of the board of directors, insider ownership of top five executives and the percentage of top five executives being board members.<sup>25</sup> The positive (negative) impact of acquirer's multi-opinion structure (reputation of acquirer FO advisors) is robust to the addition of these governance variables (reduces sample size). In fact, both the magnitude and statistical significance of the coefficient on the multi-opinion FO structure increase when we examine the smaller sample.

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<sup>25</sup> Consistent with Song (2005), we find a negative and significant relationship between the ownership stake of acquirer CEO and long-term stock performance of the merged firms. This result indicates the objective of the merger may be to hedge the personal portfolio risk of acquirer executives due to the granting of stocks and stock options in their compensation packages.

#### **IV. Summary and Conclusion**

This paper empirically examines the use of fairness opinions in mergers and acquisitions, and is the first to examine the effects of fairness opinions, as well as the reputation of issuing advisors, on the completion and performance of deals. Approximately 95% of deals between 1994 and 2003 have at least one fairness opinion on the target side, while 70% of deals have one or more opinion on the acquirer side. The inclusion of acquirer opinions is less likely when deal size is small, when the transaction is hostile, and when tender offers are used. When the acquisition is friendly, related or of larger size, the acquirer is more likely to have the same advisor performing both the advisory and FO tasks instead of using a multi-opinion structure.

We find little evidence that fairness opinions increase the overall quality of transactions, or that higher reputation advisors increase the quality of FOs. The existence of a fairness opinion for the target firm actually increases the likelihood for deal completion, and the use of an acquirer opinion has no impact on deal completion. Generally, the use of a fairness opinion on either side of a transaction does not affect deal premiums or long-term performance of the acquiring firm. However, transactions where two or more advisors provide fairness opinions on the acquirer side have higher long-term stock performance, indicating this structure is favorable to acquirer shareholders. The use of a top-tier advisor by the acquirer for a fairness opinion lowers the deal premium but leads to a worse long-term stock performance, which implies top-tier advisors' incentive is not completely aligned with those of acquirer shareholders. We conclude that fairness opinions are used by management and boards primarily to hedge legal risk, not to discriminate between good and bad transactions, and that acquiring firm shareholders would benefit from more managers choosing to employ a multi-opinion structure in M&As.

## Appendix A: List of Variables Used in Tests

1. **Acquirer Size:** the natural log of market value of equity of acquirer measured at one month prior to acquisition announcement;
2. **A\_profitmargin:** is the profit margin (net income/sales) for the acquirer;
3. **a\_fairness\_flag (t\_fairness\_flag):** dummy variable, 1 if one or more FO advisors are used, 0 otherwise;
4. **A\_FO\_11 (T\_FO\_11):** dummy variable that takes value of 1 if one FO with one financial advisor retained, 0 otherwise;
5. **A\_FO\_21 (T\_FO\_21):** dummy variable that takes value of 1 if one FO for acquirer (target) with at least two financial advisors retained, 0 otherwise;
6. **A\_FO\_22 (T\_FO\_22):** dummy variable that takes value of 1 if two or more FOs for acquirer (target) with two or more financial advisors retained, 0 otherwise;
7. **A\_FO\_mkt\_share (T\_FO\_mkt\_share):** market share of FO advisor of acquirer (target) that equals to number of deals an advisor provides FOs divided by total number of deals in the sample (906);
8. **A\_FO\_Unaffiliated (T\_FO\_Unaffiliated):** dummy that equals to 1 if the acquirer's (target's) FO advisor is not affiliated with the advisory group of the deal.
9. **A\_FO&Adv\_NCFee (A\_FO&Adv\_NCFee):** dummy that equals 1 if the acquirer's (target's) FO advisor also receives an advisory fee that is *not* contingent on deal completion.
10. **A\_FO&Adv\_CFee (A\_FO&Adv\_CFee):** dummy that equals 1 if the acquirer's (target's) FO advisor also receives an advisory fee that is *contingent* on deal completion.
11. **a\_tier1 (t\_tier1):** a dummy variable indicating the rank of acquirer's (target's ) FO advisor, 1 if rank is from 1 to 5 (top tier);
12. **a\_tier2 (t\_tier2):** a dummy variable indicating the rank of acquirer's (target's ) FO advisor, 1 if rank is from 6 to 20 (second tier);
13. **a\_tier3 (t\_tier3):** a dummy variable indicating the rank of acquirer's (target's ) FO advisor, 1 if rank is from 21 and lower (Third tier);
14. **a\_tier0 (t\_tier0):** a dummy variable with value of 1 if *no* FO advisor is used, 0 otherwise.
15. **BM:** Book-to-market is measured as book value of equity at the end of fiscal year prior to the acquisition announcement from COMPUSTAT divided by market value of equity one day prior to the announcement;
16. **Boom:** is a dummy indicating the period of 1997-2000;
17. **Cash:** is a dummy variable that takes value of 1 if at least 50% of transaction is paid by cash, 0 otherwise;
18. **Compete:** is a dummy variable equal to 1 if there is at least one competing bidder for the same target after the deal announcement and before the deal completion/termination;
19. **Deal size:** the natural log of transaction value reported by SDC;
20. **Duration:** is number of calendar days between the announcement and effective date;

21. **Friendly:** is a dummy variable indicating deal attitude, 1 if friendly, and 0 if hostile;
22. **Leverage:** is the leverage ratio (long-term debt/book assets) for the acquirer;
23. **Prior 1-y return:** is the one-year buy-and-hold return (BHR) of acquirer beginning 252 trading days prior to the effective date and ending on the last trading day prior to the effective date;
24. **Premium:** is the percentage difference between the offer price and target share price one week prior to the announcement date;
25. **Relative Size:** acquirer size (market value of equity) over deal size (transaction value).
26. **Same Industry:** a dummy variable equals to 1 if the acquirer and target have the same first 3-digits SIC;
27. **Tender:** is a dummy variable indicating that deals are identified as a tender offer by SDC;
28. **Toehold:** is the fraction of the target's stock held by the acquirer prior to merger announcement; deals in which the toehold is larger than 50% are dropped;

*The following variables are from proxy statements:*

29. **a\_ceotenure (t\_ceotenure):** indicates the tenure of acquirer's (target's) CEO;
30. **aceochair (tceochair):** a dummy variable indicating whether CEO of acquirer (target) is the chairman of board;
31. **aceoage (tceoage) :** age of CEO of acquirer (target);

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**Table I**  
**Investment Banks and Fairness Opinions in M&As**

This table presents the involvement of investment banks and their fairness opinions in mergers and acquisitions from 1994-2003, where both target and acquirer have financial advisors. The number of deals is shown where the particular investment banking/fairness opinion structure is as indicated for target firms or acquiring firms. Percentage is shown in parentheses.

*Panel A Structure of Fairness Opinions*

<b>FO Structure</b>	<b>Target Firm</b>	<b>Acquiring Firm</b>
One Advisor/Banker, one fairness opinion	703 (77.6%)	578 (63.8%)
Two or more Advisors/Bankers, one of which does a fairness opinion	99 (10.9%)	66 (7.3%)
Two or more Advisors/Bankers, two or more of which do the fairness opinion	65 (7.2%)	46 (5.1%)
No fairness opinion conducted	39 (4.3%)	216 (23.8%)
<b>Total</b>	<b>906</b>	<b>906</b>

*Panel B Role of Financial Advisors: Fairness Opinion vs. Advisory*

<b>Role of Advisors</b>	<b>Target Firm</b>	<b>Acquiring Firm</b>
<i>Unaffiliated</i> FO Advisor: Not involved in Advisory	44 (4.9%)	56 (6.2%)
<i>Affiliated</i> FO Advisor: Advisory, and paid a <i>Contingency</i> Fee	679 (74.9%)	480 (53.0%)
<i>Affiliated</i> FO Advisor: Advisory, and paid a <i>Non-contingent</i> fee	144 (15.9%)	154 (17.0%)
No FO advisor	39 (4.3%)	216 (23.8%)
<b>Total</b>	<b>906</b>	<b>906</b>

**Table II**  
**Deal Completion and Fairness Opinions**

This table presents the number and percentage of 906 deals where the deal was withdrawn sorted by whether the target or acquirer had a fairness opinion conducted, and the average number of days to completion for those deals that were completed. Data is for mergers and acquisitions from 1994-2003 where both target and acquirer have advisors, excluding deals still pending.

<b><u>Target has Fairness Opinion?</u></b>	<b><u>% and Number of Deals Withdrawn</u></b>	<b><u>Average Days to Completion</u></b>	<b><u>Average Days to Completion (non-tender offers)</u></b>
Yes	6.0% (52 out of 867)	147.0	162.7
No	12.8% (5 out of 39)	153.6	172.4

  

<b><u>Acquirer has Fairness Opinion?</u></b>	<b><u>% and Number of Deals Withdrawn</u></b>	<b><u>Average Days to Completion</u></b>	<b><u>Average Days to Completion (non-tender offers)</u></b>
Yes	4.6% (32 out of 690)	161.3	162.9
No	11.6% (25 out of 216)	99.2	165.9

  

<b><u>Both Sides Fairness Opinion?</u></b>	<b><u>% and Number of Deals Withdrawn</u></b>	<b><u>Average Days to Completion</u></b>	<b><u>Average Days to Completion (non-tender offers)</u></b>
Yes	4.4% (29 out of 655)	159.2	160.4
No	11.2% (28 out of 251)	113.9	187.1

**Table III**  
**Deal Characteristics by Use of Fairness Opinions**

This table presents characteristics of the 906 deals and merging firms, sorted by the structure of fairness opinions. Data is for mergers and acquisitions from 1994-2003 where both target and acquirer have advisors. Dollar amount (\$) are in millions, except otherwise noted. A “cash deal” is defined as deals where the consideration as *at least* 50% cash. % Tender is the percentage of deals where a tender offer was used. The number of non-missing observations for the particular variable is listed below the statistic.

<b>Acquirer FO Structure</b>	<b>Avg. Deal Size</b>	<b>Avg. Acquirer Size</b>	<b>% Hostile</b>	<b>% Tender</b>	<b>% Deal Cash</b>	<b>Avg. Premium</b>	<b>Avg. Acquirer Total Fee</b>	<b>Avg. Acquirer FO Fee*</b>	<b>Med. Acquirer FO Fee*</b>
No FO	\$1,357.64	\$7,816.21	12.0%	78.2%	74.5%	40.07%	\$4.14	N/A	N/A
	216	175	216	216	216	177	212	216	216
A_FO_11	\$2,000.61	\$3,140.38	0.5%	4.0%	9.5%	32.71%	\$3.51	\$601K	\$262K
	578	560	578	578	578	439	576	238	238
A_FO_21	\$5,759.35	\$6,440.94	0%	1.5%	12.1%	23.59%	\$6.50	\$891K	\$500K
	66	64	66	66	66	51	66	29	29
A_FO_22	\$10,658.74	\$16,619.29	4.3%	2.2%	8.7%	25.31%	\$14.47	\$3.16MM	\$1.25MM
	46	46	46	46	46	36	46	20	20

  

<b>Target FO Structure</b>	<b>Avg. Deal Size</b>	<b>Avg. Acquirer Size</b>	<b>% Hostile</b>	<b>% Tender</b>	<b>% Deal Cash</b>	<b>Avg. Premium</b>	<b>Avg. Target Total Fee</b>	<b>Avg. Target FO Fee*</b>	<b>Med. Target FO Fee*</b>
No FO	\$1,992.15	\$6,012.97	5.1%	28.2%	33.3%	23.90%	\$4.72	N/A	N/A
	39	35	39	39	39	28	39	39	39
T_FO_11	\$1,500.38	\$3,716.11	2.6%	19.9%	24.3%	34.07%	\$4.02	\$532K	\$250K
	703	658	703	703	703	546	701	271	271
T_FO_21	\$7,303.87	\$11,684.98	4.0%	26.3%	26.3%	31.51%	\$11.01	\$989K	\$500K
	99	89	99	99	99	79	99	41	41
T_FO_22	\$7,145.80	\$9,643.51	10.8%	26.2%	27.7%	36.08%	\$16.39	\$3.24MM	\$1.25MM
	65	63	65	65	65	50	64	29	29

\*: In some deals, the FO fee and the advisory fee (done by the same advisor) are reported as one single fee.

**Table IV**  
**Determinants of the Use and Structure of Acquirer Fairness Opinions**

In this table we examine the determinants on the use (Panel A) and structure (Panel B) of FOs on the acquirer side. Data is for mergers and acquisitions announced between January 1994 and November 2003, where both the target and acquirer have advisors. “Tender” (“Friendly”) is a dummy that equals to 1 if a tender offer is used (deal attitude is friendly). All other explanatory variables are defined in Appendix A. In Model (5) of Panel A and Model (3) of Panel B we added variables obtained from proxy statements and ExecuComp, which reduced the sample size. P-values are presented in parentheses below the coefficients.

**Panel A Probit Regressions on Whether Acquirer Fairness Opinions are used**

(Dependent variable is the dummy indicating one or more acquirer FOs are used; default is no acquirer FO)

	(1)	(2)	(3)	(4)	(5)
Constant	0.522 (0.299)	0.447 (0.369)	0.682 (0.210)	0.584 (0.279)	0.072 (0.941)
<b>Acquirer Size</b>	<b>-0.124</b> (0.052)	<b>-0.114</b> (0.084)	<b>-0.177</b> (0.015)	<b>-0.162</b> (0.014)	<b>-0.213</b> (0.008)
<b>Deal Size</b>	<b>0.123</b> (0.065)	<b>0.115</b> (0.095)	<b>0.164</b> (0.027)	<b>0.162</b> (0.019)	<b>0.178</b> (0.046)
<b>Tender</b>	<b>-2.391</b> (0.000)	<b>-2.376</b> (0.000)	<b>-2.330</b> (0.000)	<b>-2.362</b> (0.000)	<b>-2.592</b> (0.000)
<b>Friendly</b>	<b>1.111</b> (0.009)	<b>1.115</b> (0.008)	<b>1.202</b> (0.006)	<b>1.158</b> (0.011)	<b>1.620</b> (0.000)
Same_Industry	--	0.107 (0.426)	--	--	--
Toehold	--	-0.718 (0.289)	--	--	--
BM	--	--	-0.242 (0.282)	--	--
Prior 1-y return	--	--	-0.010 (0.895)	--	--
Leverage	--	--	--	-0.303 (0.426)	-0.253 (0.603)
A_profitmargin	--	--	--	0.080 (0.159)	-0.056 (0.534)
a_ceotenure	--	--	--	--	-0.005 (0.687)
<b>t_ceotenure</b>	--	--	--	--	<b>0.033</b> (0.086)
aceochair	--	--	--	--	-0.106 (0.615)
tceochair	--	--	--	--	-0.182 (0.376)
aceoage	--	--	--	--	0.018 (0.121)
tceoage	--	--	--	--	-0.010 (0.413)
Observations	845	845	778	799	549
Pseudo R-square	0.492	0.493	0.498	0.500	0.571

**Panel B Multinomial Logit Regressions on the Structure of Acquirer Fairness Opinions**

The dependent variable is one of four possible structures of acquirer FOs; default is “A\_FO\_11” or one advisor, 1 FO. “Same\_Industry” is a dummy that equals to 1 if the acquirer and target are in the same industry (with the same first 3-digits of SIC). “A\_profitmargin” is the profit margin (net income/sales) of the acquirer.

	Model (1)			Model (2)		
	No FO	A_FO_21	A_FO_22	No FO	A_FO_21	A_FO_22
<b>Acquirer Size</b>	<b>0.329</b> (0.015)	<b>-0.487</b> (0.009)	-0.135 (0.483)	<b>0.404</b> (0.016)	<b>-0.427</b> (0.073)	0.107 (0.712)
<b>Dealsize</b>	<b>-0.244</b> (0.089)	<b>0.574</b> (0.004)	<b>0.443</b> (0.030)	-0.318 (0.107)	<b>0.576</b> (0.015)	0.341 (0.217)
<b>Tender</b>	<b>3.992</b> (0.000)	-1.014 (0.368)	-0.874 (0.481)	<b>4.394</b> (0.000)	-33.776 (0.317)	<b>-32.964</b> (0.000)
<b>Friendly</b>	<b>-3.539</b> (0.000)	<b>-3.238</b> (0.000)	<b>-4.273</b> (0.000)	<b>-3.534</b> (0.000)	-1.266 (0.199)	<b>-2.491</b> (0.011)
<b>Same_Industry</b>	-0.121 (0.674)	-0.033 (0.910)	<b>-0.620</b> (0.061)	0.215 (0.577)	-0.269 (0.466)	<b>-0.804</b> (0.050)
<b>Toehold</b>	2.084 (0.152)	<b>5.884</b> (0.045)	3.856 (0.237)	1.410 (0.366)	5.171 (0.112)	2.814 (0.304)
<b>Leverage</b>	0.981 (0.224)	<b>2.593</b> (0.002)	0.219 (0.827)	0.919 (0.348)	<b>2.987</b> (0.003)	0.546 (0.689)
<b>A_profitmargin</b>	<b>-0.227</b> (0.026)	-0.177 (0.102)	<b>-0.254</b> (0.007)	0.050 (0.750)	-0.207 (0.155)	0.218 (0.534)
a_ceotenure	--	--	--	0.013 (0.572)	0.014 (0.626)	-0.017 (0.619)
t_ceotenure	--	--	--	<b>-0.066</b> (0.088)	-0.005 (0.868)	-0.007 (0.860)
tceochair	--	--	--	0.211 (0.629)	0.195 (0.633)	0.462 (0.382)
aceochair	--	--	--	0.398 (0.369)	0.042 (0.905)	0.236 (0.572)
aceoage	--	--	--	-0.029 (0.179)	-0.025 (0.306)	-0.014 (0.661)
tceoage	--	--	--	0.019 (0.331)	-0.024 (0.190)	<b>-0.046</b> (0.072)
Observations	799			549		
Pseudo R <sup>2</sup>	0.530			0.552		

**Table V**  
**Rankings of FO Advisors**

rank	Acquirer's FO Advisor	No. of acquisitions	market share	Target's FO Advisor	No. of acquisitions	market share
<b><i>Top tier (rank 1-5)</i></b>				<b><i>Top tier (rank 1-5)</i></b>		
1	Merrill Lynch & Co	60	6.62%	Goldman Sachs & Co	89	9.82%
2	Morgan Stanley & Co	49	5.41%	Merrill Lynch & Co	69	7.62%
3	Donaldson Lufkin & Jenrette	43	4.75%	Morgan Stanley & Co	52	5.74%
4	Goldman Sachs & Co	40	4.42%	Donaldson Lufkin & Jenrette	44	4.86%
5	Bear Stearns & Co	36	3.97%	Salomon Smith Barney	37	4.08%
		<u>228</u>	<u>25.2%</u>		<u>291</u>	<u>32.1%</u>
<b><i>Second tier (rank 6-20)</i></b>				<b><i>Second tier (rank 6-20)</i></b>		
6	Salomon Smith Barney	35	3.86%	Credit Suisse First Boston Corp	34	3.75%
7	Credit Suisse First Boston Corp	26	2.87%	Lehman Brothers	29	3.20%
8	Lehman Brothers	25	2.76%	Bear Stearns & Co	17	1.88%
9	Smith Barney Incorporated	14	1.55%	Keefe Bruyette & Woods	17	1.88%
10	Keefe Bruyette & Woods	14	1.55%	Sandler O'Neill Partners L.P.	17	1.88%
11	JP Morgan & Co	13	1.43%	Warburg Dillon Read	16	1.77%
12	Sandler O'Neill Partners L.P.	13	1.43%	JP Morgan & Co	15	1.66%
13	Piper Jaffray	11	1.21%	Smith Barney Incorporated	14	1.55%
14	Lazard Freres	10	1.10%	Alex Brown & Sons	14	1.55%
15	PaineWebber	10	1.10%	PaineWebber	13	1.43%
16	Alex Brown & Sons	10	1.10%	Lazard Freres	12	1.32%
17	Wheat First Securities	10	1.10%	Hambrecht & Quist	12	1.32%
18	BT Alex Brown	9	0.99%	Wasserstein Perella Group	11	1.21%
19	Hambrecht & Quist	9	0.99%	Robinson-Humphrey Co	11	1.21%
20	Montgomery Securities	8	0.88%	Prudential Securities	9	0.99%
		<u>217</u>	<u>24.0%</u>		<u>241</u>	<u>26.6%</u>
<b><i>Third tier (rank 21 and lower)</i></b>				<b><i>Third tier (rank 21 and lower)</i></b>		
21	Stifel Nicolaus & Co	8	0.88%	CIBC	8	0.88%
22	Chase Manhattan Corp	7	0.77%	McDonald Investments	7	0.77%
23	Warburg Dillon Read	7	0.77%	Houlihan Lokey Howard & Zukin	7	0.77%
24	Robinson-Humphrey Co	7	0.77%	Piper Jaffray	7	0.77%
25	Wasserstein Perella Group	6	0.66%	ABN AMRO	6	0.66%
26	Ryan Beck & Co	6	0.66%	McConnell, Budd & Downes	6	0.66%
27	Banc of America Securities	5	0.55%	Cowen & Co	6	0.66%
28	Robert W Baird & Co	5	0.55%	Deutsche Bank AG	5	0.55%
29	Jefferies & Co	5	0.55%	Hovde Financial	5	0.55%
30	McConnell, Budd & Downes	5	0.55%	Robertson Stephens & Co	5	0.55%

**Table VI**  
**Determinants of Deal Completion**

We run Probit regressions with the dummy indicating a deal is completed (default outcome is deal withdrawal) as the dependent variable. Data is a sample of acquisitions announced between January 1994 and November 2003. “Prior 1-y return” is the one-year buy-and-hold return of acquirer prior to deal effective date. “Compete” is a dummy that equals 1 if there is one or more competing bids for the target. We dropped the dummy “cash” in the regressions due to its high correlation with the dummy “Tender.” “t\_fairness\_flag” is a dummy that equals 1 if one or more FOs are used on the target side; “T\_FO\_22” is a dummy that equals 1 if the target has two or more advisors and FOs. Rankings on the FO advisors are defined in Table V, in particular, “T\_FO\_mkt\_share” is the market share (based on number of deals an advisor provided FOs) of a target advisor; “t\_tier1” is a dummy that equals 1 if a target advisor is ranked in the top 5. All the other control variables are defined in Appendix A. P-values are presented in parentheses below the coefficients.

In Models 1 and 2, we use the full sample of 906 deals (the addition of governance variables in Model 2 drops sample size). In Models 3 through 6, we use the subsample of deals where there is at least one FOs on the target side. In Models 7 and 8, we use the subsample of deals where there is at least one FOs on the acquirer side.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<i>Full Sample</i>		<i>Subsample: Deals with Target FOs</i>			<i>Subsample: Deals with Acquirer FOs</i>		
Constant	0.046 (0.939)	-0.490 (0.504)	0.703 (0.241)	<b>1.046</b> (0.047)	<b>1.135</b> (0.038)	0.780 (0.195)	<b>1.542</b> (0.100)	<b>2.001</b> (0.037)
Acquirer Size	0.119 (0.269)	0.113 (0.422)	0.152 (0.210)	0.145 (0.239)	0.169 (0.162)	0.162 (0.183)	0.158 (0.279)	0.153 (0.283)
<b>Deal size</b>	-0.166 (0.107)	-0.150 (0.253)	<b>-0.232</b> (0.048)	<b>-0.261</b> (0.026)	<b>-0.276</b> (0.014)	<b>-0.302</b> (0.012)	-0.176 (0.199)	-0.181 (0.196)
BM	-0.198 (0.408)	-0.489 (0.148)	-0.244 (0.371)	-0.322 (0.243)	-0.293 (0.289)	-0.331 (0.231)	-0.277 (0.290)	-0.285 (0.275)
<b>Prior 1-y return</b>	<b>0.453</b> (0.030)	<b>0.435</b> (0.075)	<b>0.496</b> (0.044)	<b>0.542</b> (0.028)	<b>0.561</b> (0.023)	<b>0.530</b> (0.034)	0.284 (0.253)	0.305 (0.204)
<b>Tender</b>	-0.039 (0.892)	-0.038 (0.914)	-0.015 (0.963)	-0.331 (0.136)	-0.001 (0.997)	-0.076 (0.816)	<b>-0.645</b> (0.041)	<b>-0.653</b> (0.039)
<b>Friendly</b>	<b>1.100</b> (0.000)	<b>1.174</b> (0.001)	<b>1.131</b> (0.000)	<b>1.236</b> (0.000)	<b>1.103</b> (0.001)	<b>1.208</b> (0.000)	0.408 (0.606)	0.426 (0.590)
<b>Compete</b>	<b>-0.810</b> (0.002)	<b>-0.967</b> (0.001)	<b>-0.762</b> (0.003)	<b>-0.751</b> (0.005)	<b>-0.751</b> (0.005)	<b>-0.738</b> (0.007)	<b>-1.088</b> (0.002)	<b>-1.085</b> (0.002)
Toehold	0.456 (0.690)	-0.298 (0.797)	0.474 (0.707)	0.164 (0.893)	0.159 (0.901)	0.418 (0.760)		
a_fairness_flag	0.260 (0.342)	0.304 (0.388)	--	--	--	--	--	--
<b>t_fairness_flag</b>	<b>0.608</b> (0.045)	<b>0.985</b> (0.010)	--	--	--	--	--	--
A_FO_11	--	--	0.378 (0.257)	--	--	0.500 (0.138)	--	--
A_FO_21	--	--	0.236 (0.573)	--	--	0.370 (0.403)	--	--
A_FO_22	--	--	0.580 (0.368)	--	--	0.740 (0.294)	--	--
T_FO_21	--	--	0.084 (0.729)	--	--	0.126 (0.635)	--	--
<b>T_FO_22</b>	--	--	<b>0.500</b> (0.097)	--	--	<b>0.517</b> (0.079)	--	--

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<i>Full Sample</i>		<i>Subsample: Deals with Target FOs</i>			<i>Subsample: Deals with Acquirer FOs</i>		
A_FO_mkt_share	--	--	--	-1.908	--	-4.245	-2.753	-2.950
	--	--	--	(0.656)	--	(0.327)	(0.502)	(0.478)
<b>T_FO_mkt_share</b>	--	--	--	<b>7.835</b>	--	<b>8.348</b>	--	--
	--	--	--	(0.004)	--	(0.003)	--	--
a_tier0	--	--	--	--	-0.482	--	--	--
	--	--	--	--	(0.181)	--	--	--
a_tier1	--	--	--	--	-0.303	--	--	--
	--	--	--	--	(0.242)	--	--	--
a_tier2	--	--	--	--	0.071	--	--	--
	--	--	--	--	(0.794)	--	--	--
<b>t_tier1</b>	--	--	--	--	<b>0.574</b>	--	--	--
	--	--	--	--	(0.010)	--	--	--
t_tier2	--	--	--	--	0.312	--	--	--
	--	--	--	--	(0.112)	--	--	--
A_FO_unaffiliated	--	--	--	--	--	--	0.411	--
	--	--	--	--	--	--	(0.268)	--
A_FO&Adv_NCFee	--	--	--	--	--	--	--	-0.533
	--	--	--	--	--	--	--	(0.182)
A_FO&Adv_CFee	--	--	--	--	--	--	--	-0.372
	--	--	--	--	--	--	--	(0.324)
a_ceotenure	--	0.002	--	--	--	--	--	--
	--	(0.868)	--	--	--	--	--	--
<b>t_ceotenure</b>	--	<b>0.039</b>	--	--	--	--	--	--
	--	(0.055)	--	--	--	--	--	--
tceochair	--	-0.142	--	--	--	--	--	--
	--	(0.506)	--	--	--	--	--	--
aceochair	--	0.025	--	--	--	--	--	--
	--	(0.913)	--	--	--	--	--	--
Observations	778	542	746	746	746	746	610	610
Pseudo R-square	0.172	0.229	0.187	0.194	0.202	0.210	0.117	0.119

**Table VII**  
**Determinants of Deal Premium**

We run OLS regressions with the deal premium (% premium of offer price over target market price at the time of the deal announcement) as the dependent variable. “Toehold” is the fraction of target shares held by the acquirer prior to deal announcement. We dropped the dummy “cash” in the regressions due to its high correlation with the dummy “Tender.” “A\_profitmargin” is the profit margin (net income/sales) of the acquirer. Rankings on the FO advisors are defined in Table V, in particular, “A\_FO\_mkt\_share” is the market share (based on number of deals an advisor provided FOs) of an acquirer advisor; “a\_tier1” is a dummy that equals 1 if an acquirer advisor is ranked in the top 5. “A\_FO&Adv\_NCFee” is a dummy that equals 1 if the acquirer’s FO advisor also receives an advisory fee that is not contingent on deal completion. All the other control variables are defined in Appendix A. P-values are presented in parentheses below the coefficients.

In Models 2 through 4, we use the subsample of deals where there is at least one FOs on the target side. In Models 5 and 6, we use the subsample of deals where there is at least one FOs on the acquirer side. Finally, in Model 7, we examine the merger subsample.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	<i>Full Sample</i>	<i>Subsample: Deals with Target FOs</i>		<i>Subsample: Deals with Acquirer FOs</i>		<i>Merger Subsample</i>	
Constant	35.812 (0.000)	53.857 (0.000)	59.404 (0.000)	46.234 (0.000)	47.430 (0.001)	53.043 (0.000)	65.938 (0.000)
Relative Size	-0.027 (0.178)	-0.029 (0.124)	-0.027 (0.363)	-0.029 (0.145)	-0.722 (0.118)	-0.697 (0.129)	-0.135 (0.576)
BM	2.592 (0.636)	0.171 (0.975)	-7.237 (0.187)	0.805 (0.884)	-1.529 (0.811)	-1.687 (0.792)	-0.765 (0.908)
Prior 1-y return	2.746 (0.112)	2.256 (0.188)	1.154 (0.527)	2.307 (0.184)	2.292 (0.194)	2.245 (0.213)	2.188 (0.219)
<b>Tender</b>	<b>12.636</b> <i>(0.001)</i>	<b>12.789</b> <i>(0.002)</i>	<b>9.988</b> <i>(0.054)</i>	<b>13.080</b> <i>(0.002)</i>	<b>10.134</b> <i>(0.044)</i>	<b>9.823</b> <i>(0.046)</i>	-- --
<b>Friendly</b>	<b>-15.066</b> <i>(0.006)</i>	<b>-18.036</b> <i>(0.001)</i>	<b>-13.749</b> <i>(0.033)</i>	<b>-17.145</b> <i>(0.003)</i>	-18.181 (0.184)	-16.847 (0.220)	<b>-29.731</b> <i>(0.001)</i>
<b>Toehold</b>	<b>-43.911</b> <i>(0.004)</i>	<b>-42.597</b> <i>(0.009)</i>	<b>-43.376</b> <i>(0.009)</i>	<b>-41.542</b> <i>(0.004)</i>	<b>-54.248</b> <i>(0.010)</i>	<b>-51.102</b> <i>(0.008)</i>	<b>-64.315</b> <i>(0.000)</i>
<b>A_profitmargin</b>	<b>-5.964</b> <i>(0.012)</i>	<b>-5.856</b> <i>(0.013)</i>	<b>-6.246</b> <i>(0.026)</i>	<b>-5.871</b> <i>(0.013)</i>	<b>-5.576</b> <i>(0.014)</i>	<b>-5.616</b> <i>(0.015)</i>	<b>-5.948</b> <i>(0.014)</i>
a_fairness_flag	0.031 (0.994)	-- --	-- --	-- --	-- --	-- --	-- --
t_fairness_flag	8.175 (0.216)	-- --	-- --	-- --	-- --	-- --	-- --
<b>A_FO_mkt_share</b>	-- --	-- --	-- --	-95.169 (0.123)	<b>-102.34</b> <i>(0.079)</i>	<b>-120.33</b> <i>(0.037)</i>	-- --
T_FO_mkt_share	-- --	-- --	-- --	-19.380 (0.626)	-- --	-- --	-- --
a_tier0	-- --	-4.037 (0.390)	1.659 (0.793)	-- --	-- --	-- --	-5.260 (0.464)
<b>a_tier1</b>	-- --	<b>-6.348</b> <i>(0.060)</i>	<b>-6.736</b> <i>(0.098)</i>	-- --	-- --	-- --	<b>-6.403</b> <i>(0.074)</i>
a_tier2	-- --	-1.613 (0.644)	-6.818 (0.087)	-- --	-- --	-- --	-1.836 (0.613)
t_tier1	-- --	-3.367 (0.276)	-1.341 (0.717)	-- --	-- --	-- --	-3.041 (0.399)
t_tier2	-- --	-5.667 (0.068)	-5.878 (0.092)	-- --	-- --	-- --	-4.586 (0.195)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	<i>Full Sample</i>	<i>Subsample: Deals with Target FOs</i>			<i>Subsample: Deals with Acquirer FOs</i>		<i>Merger Subsample</i>
A_FO_11	--	--	--	4.640	--	--	--
	--	--	--	(0.309)	--	--	--
A_FO_21	--	--	--	-0.304	--	--	--
	--	--	--	(0.962)	--	--	--
A_FO_22	--	--	--	0.834	--	--	--
	--	--	--	(0.904)	--	--	--
T_FO_21	--	--	--	-0.534	--	--	--
	--	--	--	(0.876)	--	--	--
T_FO_22	--	--	--	1.994	--	--	--
	--	--	--	(0.664)	--	--	--
A_FO_unaffiliated	--	--	--	--	--	-6.436	--
	--	--	--	--	--	(0.163)	--
<b>A_FO&amp;Adv_NCFee</b>	--	--	--	--	<b>11.157</b>	--	--
	--	--	--	--	<i>(0.041)</i>	--	--
A_FO&Adv_CFee	--	--	--	--	4.808	--	--
	--	--	--	--	<i>(0.303)</i>	--	--
a_ceotenure	--	--	0.114	--	--	--	--
	--	--	(0.624)	--	--	--	--
<b>t_ceotenure</b>	--	--	<b>-0.043</b>	--	--	--	--
	--	--	<i>(0.000)</i>	--	--	--	--
tceochair	--	--	-4.381	--	--	--	--
	--	--	(0.156)	--	--	--	--
aceochair	--	--	-4.270	--	--	--	--
	--	--	(0.236)	--	--	--	--
Observations	599	575	420	575	473	473	462
R-squared	0.067	0.081	0.135	0.075	0.066	0.059	0.063

**Table VIII**  
**Long-term Stock Performance of Merged Firms**

We run OLS regressions on the post-acquisition stock performance of merged firms using deals announced and completed between 1994 and 2001. The dependant variable, LAR, is defined as the natural logarithm of 1+ the sample firm's three-year BHR minus the natural logarithm of 1+ the matched firm's three-year BHR. "BM" is the acquirer's book-to-market ratio. "Cash" is a dummy that equals to 1 if at least 50% of deal consideration is cash. "Friendly" is a dummy on deal attitude that equals to 1 if it is friendly. "A\_FO\_mkt\_share" is the market share (based on number of deals an advisor provided FOs) of an acquirer advisor; "a\_tier1" is a dummy that equals 1 if an acquirer advisor is ranked in the top 5. "A\_FO\_22" is a dummy that equals 1 if the acquirer has two or more advisors and FOs. All the other explanatory variables are defined in Appendix A. P-values are presented in parentheses below the coefficients.

In Models 1 through 3 we use the full sample. In Model 4, we use the subsample of deals where there is at least one FOs on the target side; in Models 5 and 6, we use the subsample of deals where there is at least one FOs on the acquirer side. Finally, in Model 7, we examine the merger subsample.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	<i>Full Sample</i>			<i>Subsample: Deals with Target FOs</i>	<i>Subsample: Deals with Acquirer FOs</i>		<i>Merger subsample</i>
Constant	-0.637 (0.150)	-0.520 (0.221)	-0.723 (0.116)	-0.672 (0.183)	-0.877 (0.199)	-1.177 (0.096)	-1.165 (0.103)
<b>Acquirer Size</b>	<b>0.165</b> (0.007)	<b>0.174</b> (0.005)	<b>0.167</b> (0.008)	<b>0.183</b> (0.006)	<b>0.230</b> (0.023)	<b>0.237</b> (0.021)	<b>0.184</b> (0.062)
<b>Deal size</b>	<b>-0.096</b> (0.095)	-0.079 (0.174)	-0.085 (0.161)	<b>-0.140</b> (0.044)	-0.117 (0.197)	-0.114 (0.208)	-0.088 (0.333)
<b>BM</b>	<b>0.664</b> (0.002)	<b>0.642</b> (0.004)	<b>0.659</b> (0.003)	<b>0.642</b> (0.006)	<b>0.704</b> (0.006)	<b>0.682</b> (0.008)	<b>0.752</b> (0.005)
Prior 1-y return	-0.113 (0.298)	-0.131 (0.236)	-0.121 (0.268)	-0.128 (0.240)	-0.128 (0.268)	-0.138 (0.243)	-0.118 (0.302)
<b>Cash</b>	<b>-0.346</b> (0.062)	<b>-0.342</b> (0.065)	<b>-0.360</b> (0.054)	-0.342 (0.106)	<b>-0.455</b> (0.063)	<b>-0.448</b> (0.063)	-0.518 (0.117)
<b>Friendly</b>	<b>-0.527</b> (0.049)	<b>-0.521</b> (0.055)	<b>-0.497</b> (0.078)	<b>-0.539</b> (0.073)	-0.311 (0.569)	-0.351 (0.507)	-0.252 (0.626)
a_fairness_flag	0.120 (0.522)	-- --	-- --	-- --	-- --	-- --	-- --
<b>A_FO_mkt_share</b>	--	--	-4.836 (0.146)	-4.140 (0.225)	<b>-5.665</b> (0.099)	--	-5.215 (0.134)
T_FO_mkt_share	--	--	--	2.638 (0.178)	--	--	--
a_tier0	--	-0.279 (0.203)	--	--	--	--	--
<b>a_tier1</b>	--	<b>-0.342</b> (0.075)	--	--	--	<b>-0.369</b> (0.067)	--
a_tier2	--	-0.127 (0.487)	--	--	--	-0.172 (0.361)	--
A_FO_11	--	--	0.219 (0.288)	0.317 (0.178)	--	--	0.287 (0.378)
A_FO_21	--	--	-0.042 (0.909)	0.044 (0.913)	--	--	0.025 (0.955)
<b>A_FO_22</b>	--	--	<b>0.662</b> (0.061)	<b>0.777</b> (0.043)	--	--	<b>0.760</b> (0.091)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	<i>Full Sample</i>			<i>Subsample: Deals with Target FOs</i>	<i>Subsample: Deals with Acquirer FOs</i>		<i>Merger subsample</i>
T_FO_21	--	--	--	0.254 (0.158)	--	--	--
T_FO_22	--	--	--	-0.048 (0.829)	--	--	--
A_FO_unaffiliated	--	--	--	--	-0.322 (0.261)	--	--
A_FO&Adv_NCFee	--	--	--	--	--	0.416 (0.170)	--
A_FO&Adv_CFee	--	--	--	--	--	0.291 (0.323)	--
Observations	620	620	620	594	491	491	504
R-squared	0.032	0.038	0.042	0.047	0.045	0.049	0.047