Bank Investments in Venture Capital and Subsequent M&A Advisory Services

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Abstract

I examine the relationship between bank venture capital investments and subsequent M&A advisory services. The literature suggests that banks are strategic investors seeking complementarities between their different divisions. I find evidence that banks use venture capital investments as a way to build future M&A advisory relationships. I show that there is a 30% increase in the probability of being an M&A advisor conditional on investing in a company in the VC market. I find that banks make investments in sectors which have relatively high debt levels, likely due to inter-temporal cross-selling opportunities. In line with prior literature, I show that banks benefit from relationships built at the VC stage through higher fees charged to the target companies in the subsequent M&A transactions. This is consistent with a certification role that the bank plays. This paper adds to the debate on the benefits and drawbacks of bank cross-selling activities and universal banking.

Motivating Example

- Citi Capital invests in Ignition Venture Partners II which is a VC fund managed by Ignition Venture Partners with a vintage year of 2001.
- In 2002, Ignition Venture Partners II invests $6 mil. in a series A round in Intelligent Results, Inc.
- In 2006, First Data Corp acquires a 100% stake in Intelligent Results, Inc in a deal where Citi was the only M&A advisor to the target

Research Questions

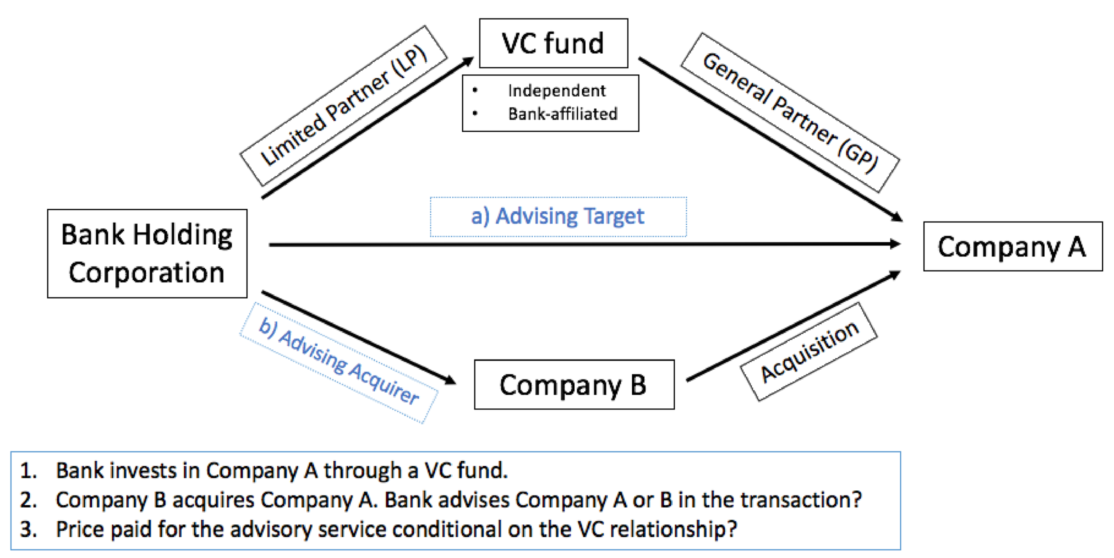
Primary:

1. How likely are banks to advise target companies in M&A transactions if they invested in them at the venture capital stage?
2. Are they also more likely to advise the buyer (other side) in an M&A transaction if they invested in the target at the venture capital stage?

Secondary:

3. Do banks charge favorable advisory fees for companies in which they invested in the venture capital market?

Mechanism

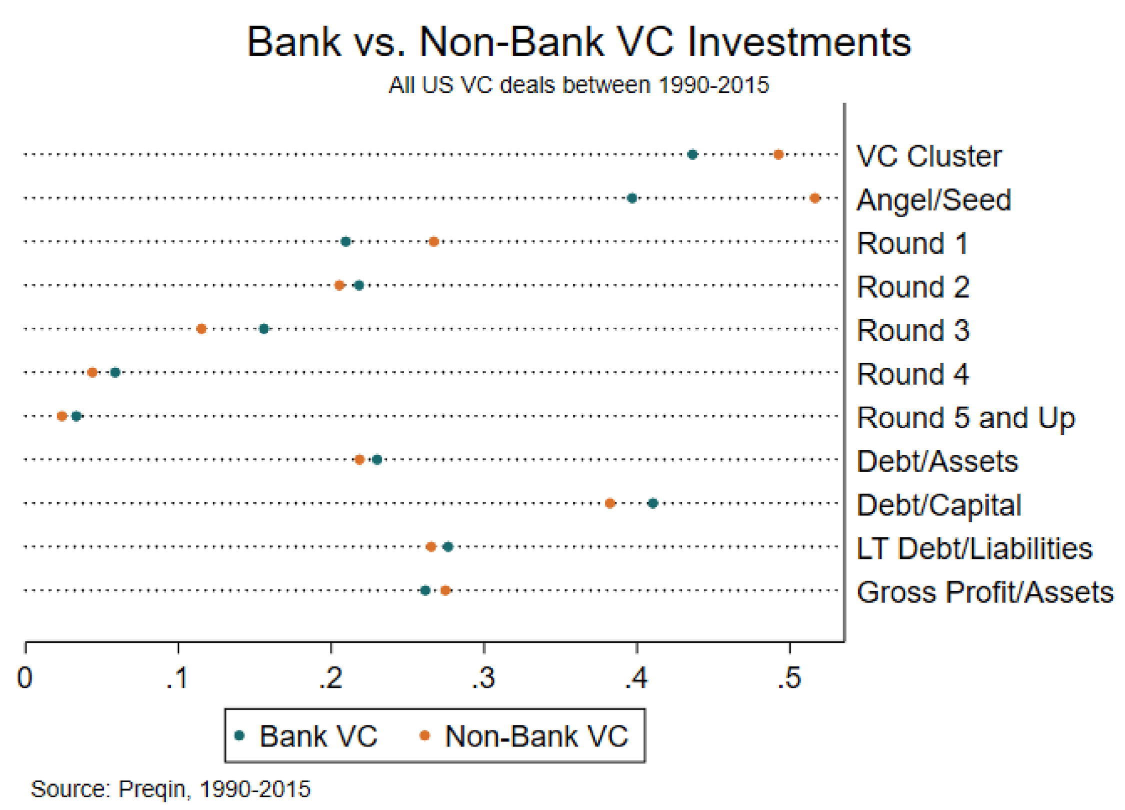


Data

- **Preqin**: All VC investments for target portfolio companies located in the US between 1990 and 2015
- **Refinitiv**: M&A data for target companies located in the US between 1990 and 2019 and available financial advisors
- **FED NIC** and **FDIC** data for Bank Holdings Companies
- **WRDS**: Industry level data on financial ratios

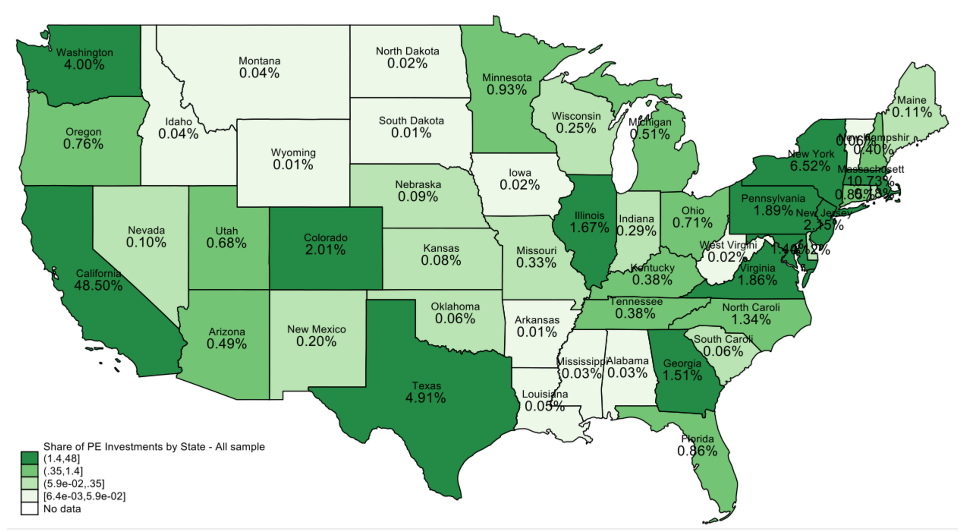
Bank VC Investments

- Bank VC firms invest in larger amounts and in later rounds at the fundraising stage
- They also target companies operating in industries with **high debt levels**



VC Clusters and Investment Dispersion

- California, Massachusetts and New York are the main clusters of VC investments
- Bank VC firms tend to invest more outside these areas relative to independent VCs



Empirical Specification

- I explore the probability of banks advising either side of the M&A transaction after a VC investment
- I use the following base specification and I add an IV and FE robustness approach in the paper:

$$
\begin{aligned}
Pr.(\textbf{Advisor Target/Acquirer})_{ij} = \;& \beta \times Target\ Investor_{ij} \\
& + \psi \times Bank\ Characteristics_{j} \\
& + \gamma \times Company\ Characteristics_{i} \\
& + \phi \times Deal\ Characteristics_{ij} + e_{ij}
\end{aligned}
$$

Main Result

- There is a **30% increase** in the probability of being advised by the same bank if it has invested in the company at the VC stage
- There is **no effect** on the probability of advising the other side of the transaction

Dependent var.:	(1) Probit Adv. Target	(2) Margins	(3) Probit Adv. Acquirer	(4) Margins
Investor	0.225***	0.002***	-0.143	-0.001
	(2.716)	(2.713)	(-1.348)	(-1.337)
Advisor Share	30.751***	0.257***	26.431***	0.123***
	(30.002)	(24.362)	(24.171)	(12.930)
Early Stage	-0.073**	-0.001**	-0.010	-0.000
	(-2.348)	(-2.343)	(-0.187)	(-0.187)
Constant	-3.014***		-2.350***	
	(-10.458)		(-9.466)	
Observations	81000	81000	81000	81000
Pseudo R^2	0.1916	-	0.2085	-
Controls	Included	Included	Included	Included
VC Year FE	Included	Included	Included	Included
M&A Year FE	Included	Included	Included	Included
Industry FE	Included	Included	Included	Included

M&A Deal Pricing

- I find that companies pay a **0.33% higher** fee relative to deal value for relationship advisors
- This is consistent with a certification effect where the bank serves as a positive signal for the quality of the company

Estimator:	(1) Difference in Fee between Relationship and Non-Relationship M&A deals	(2) Number of matches
Near Neighbor (5)	.0033*	33
	(1.76)	
Near Neighbor (10)	.0032*	33
	(1.71)	
Near Neighbor (20)	.0030*	33
	(1.66)	
Near Neighbor (30)	.0029*	33
	(1.62)	
Nr. of deals:	5,563	
Propensity score matched on:	Deal Size, Deal Year, Industry, State	

Conclusion

- Banks invest in bigger companies and in later stages of the VC market
- Following their VC investments they have an increased probability of advising the same company later in its lifetime
- This increased probability does not apply to the buyer in the M&A transaction
- Target companies pay more for this subsequent advisory service, consistent with a certification effect story

Forthcoming Research

A subsequent working paper called "Banks as "Anchors": The Role of Banks in Funding Innovation" looks into the role that banks play in attracting additional investors for individual companies. In that paper, I find that banks play the role of "anchors" in the VC market, attracting larger future rounds likely due to the cross-selling activities documented here. Furthermore, banks seems to be key innovation sponsors, especially in regions lacking traditional VC investments, outside the main entrepreneurial clusters. This paper can be found **here**.

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