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 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

• Citibank invested 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.
• Banks in the same group are the only M&A advisor to the target company.

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

• There is a 30% increase in the probability of advising the same bank if it has invested in the venture capital market.
• Following their VC investments, they have an increased probability of advising the same company later in its lifetime.
• Banks invest in bigger companies and in later stages of the VC market.

Data

• Prequin: All VC investments for target portfolio companies located in the US between 1990 and 2015.
• Definitive: 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 add an IV and FE robustness approach in the paper.

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.

Table 1: Probit Results

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<th>Dependent var.:</th>
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<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
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<tr>
<td>Investor</td>
<td>0.22**</td>
<td>0.082***</td>
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<td>Advisor Share</td>
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<td>Constant</td>
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<td>Pseudo R²</td>
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<td>VC Year FE</td>
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<tr>
<td>M&amp;A Year FE</td>
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<td>Industry FE</td>
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</table>

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.

Conclusion

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 seem to be key innovation sponsors, especially in regions lacking traditional VC investments, outside the main entrepreneurial clusters. This paper can be found.[link]

References


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Forthcoming Research

• Target companies pay more for this subsequent advisory service, consistent with a certification effect story.

Contact Information:
Finance Department
Frankfurt School of Finance & Management
Website: https://sites.google.com/view/ccondrea
Email: c.condrea@fs.de

Frankfurt School of Finance & Management
Cristian M. Condrea
Frankfurt School of Finance & Management