

**Legal Advisors:**  
**Popularity versus Economic Performance**  
**in Acquisitions**

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# Legal Advisors: Popularity versus Economic Performance in Acquisitions

## ABSTRACT

Law firms provide extensive intermediation in corporate acquisitions, including negotiation, certification, and drafting of contracts and agreements. Using a broad sample of U.S. acquisition offers during 1994-2000, we find that a few large-market-share law firms are regularly called upon to facilitate completion of large, legally-complex offers. Complex offers are often withdrawn but, controlling for complexity, we find the large-share law firms are associated with enhanced deal completion. Further, we document that some law firms are consistently associated with deal completion over time, and that acquirers with good deal completion experience use fewer different law firms. Acquirers' long-run returns, though, are lower and often negative following offers advised by large-share law firms. We find no evidence of firms being consistently associated over time with strong returns. Our conclusion is that large law firms enhance deal completion in difficult situations, consistent with the aims of acquirer management. However, we find no systematic evidence that more-popular legal advisors enhance the long-run value created in acquisitions.

**Keywords:** Law firms, Market-share, Deal completion, Long run returns

**JEL Classification Codes:** G24

## 1. Introduction

Parties to mergers and acquisitions engage law firms to advise on the structure of the deal, on the negotiation and drafting of contracts, and on corporate law, regulatory and antitrust issues. Such work supports an industry with more than 2000 firms and around 14,000 lawyers as of 2002. The largest market-share merger and acquisitions (M&A) law firm of the last decade, Skadden Arps Meagher & Flom, employed more than 1600 lawyers and generated gross revenue of more than a billion dollars in each of the two most recent calendar years.

The prominence of the M&A legal advisory industry is perhaps not surprising. Due to extensive information asymmetries, skilled intermediaries are expected to be important in deal situations. The two central intermediaries involved in M&A deals are investment bankers acting as financial advisors and law firms acting as legal advisors. Deal characteristics have been found to be material to the engagement of investment bankers (Servaes and Zenner (1996)), and their incentives have been found to be material to deal outcomes (Rau (2000)). However, little evidence has been brought to bear on the role played by legal advisors. The dearth of systematic evidence is all the more striking given our casual impression of voluminous and multifarious opinions on lawyers' effects. For example, the actual intermediation activities of lawyers seem likely to be material to the process of closing or failing to close an acquisition. Are legal advisors mere tools of managers, finding a way to complete any deal, as suggested by the fact that acquirers' lawyers are hired by managements that initiated these deals? Or are the activities of lawyers, necessary though they may be, actually impediments to getting the deal done?<sup>1</sup>

Some have suggested that M&A lawyers' activities are material even beyond deal completion, to the value created or destroyed in a deal. Generally, in the

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<sup>1</sup> See, for example the quote at the beginning of Coates and Subramanian (2000). This point of view has additional force given that lawyers' compensation is determined by hours worked rather than deal-completion results.

presence of transactions costs, the Coase theorem implies that processes for the allocation of property rights can affect real outcomes. Gilson (1984) draws on this Coasian tradition to propose that lawyers are (or can be) “transaction cost engineers,” adding to the value created in a transaction by virtue of their central role in crafting acquisition agreements. Others have suggested that lawyers themselves are a significant source of transactions costs.

Beyond its importance for understanding the role of intermediaries in M&A, our study of the economic outcomes associated with lawyers’ activities contributes to the literature on law and financial outcomes (see La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) and the extensive literature following that paper). That literature emphasizes the strong statistical associations of pre-established legal systems on corporate governance, investor protection and financial system development in general (see Macey and O’Hara (2000)). A common interpretation is that systems after the tradition of British common law inherently possess more extensive protections for arms-length investors that facilitate systemic development. Yet common law nations have not always been more financially developed (Rajan and Zingales (2003)) and not all systems with strong protections have developed in similar ways (Roe (2003)). Friedman (2002) emphasizes that any characterization of a legal system ought to include not only its structure but also the activities of its actors. By measuring the economic effects associated with lawyers’ actions in M&As, our paper is a step in this direction.

Specifically, this article provides empirical evidence on industry structure and economic effects of legal advisors in mergers and acquisitions, based on an extensive sample of offers announced over 1994-2000.

We find that legal advising is an industry characterized by a very small number of dominant firms with 2 to 8 percent share of the announced value of offers, a few prominent contenders with 1 to 2 percent market-share, and many smaller players. These market-share cohorts are relatively stable over time, suggesting that only a few firms have the capability to advise on many large and complex offers, even though many firms can and do handle one or two offers in a year. The largest

firms, as a group, increase their market-share somewhat at the end of the 1990s, although very few small firms become large firms.

The large market-share law firms are engaged in more legally complex deals as compared to the small and medium market-share law firms, and, after controlling for deal complexity, they complete these deals efficiently. These deals involve large and profitable acquirers. However, the long-run stock returns of the acquirers are significantly negative after announcements of offers in which the big market-share law firms are involved. The law firms that are associated with the most shareholder value creation ex-post are in the group that advise on several offers in a year but do not have more than 1 percent of the acquisitions market-share. We find that some law firms are able to consistently cause or be associated with high rates of deal completion over time, but we find no evidence of such consistent performance when it comes to long-run returns. Finally, we find that bidders whose bids were not all successful tend to employ a significantly greater number of different law firms than bidders who have had a 100 percent success rate, suggesting that acquirers whose bids had been unsuccessful tend to shop around for law firms that can close deals more efficiently. On the other hand, we find that negative post-acquisition long run returns do not cause bidders to spread their business across a greater number of law firms.

These cross sectional and time series patterns fit together sensibly. Large, profitable acquirers engage large law firms for difficult deals, and those law firms build their businesses by enhancing their deal completion skills. Deal completion is something acquirer managements seem to value highly, judging by their penchant to change law firms when they experience less than 100% deal completion success. We find no evidence that law firms possess any consistent value-added “transaction cost engineering” capability that gets reflected in returns. Nor do we find any evidence that managers expect or require this capability from their legal advisors.

The remainder of this paper is organized as follows. Section 2 explains why law firms are economically important in mergers and acquisitions. Section 3 describes the industry structure of M&A legal advisors. Sections 4 and 5 respectively analyze

the deal completion efficiency and the long-run economic effectiveness of the big and small market-share law firms. Section 6 reports on the time-series relations between law firm market-share and deal completion/long run returns. Section 7 concludes.

## **2. The importance of legal intermediaries**

In mergers and acquisitions lawyers act as intermediaries between the acquirer and the target. They compose and negotiate the legal documents underlying the merger. Lawyers also act as intermediaries between the firms and government entities. They organize the necessary regulatory compliance and disclosure activities. Both types of intermediary roles are emphasized in casebooks used in the training of business lawyers (see, for example, Gilson and Black (1995)). Lawyers are also increasingly involved in intermediary roles that have traditionally been considered the domain of bankers, such as deal generation and financing (Welsh (2000)).

Prior research in finance and law has identified several ways that intermediaries in general might add or subtract value to M&A transactions. Servaes and Zenner (1996), for example, suggest that investment bankers can collect, convey, and/or certify information that needs to pass between the parties, thereby enabling deal completion. Investment banks effectively rent their skills in valuation and financing, as well as their reputations, to a deal. While investment bankers certify the value of the transaction, lawyers' explicit certifications generally pertain to matters within their legal expertise (valid and binding procedures and forms etc.) In specific cases, these direct certifications may be crucial, as in the case of a target with substantial and difficult-to-assess environmental liabilities.

Michaely and Shaw (1994) show that the high reputation investment banks screen the initial public offerings (IPOs) they bring to the market. Thus, the involvement of a high profile investment bank in an IPO has a signaling effect for the common investors. Indeed, they find that the long-run post-IPO performance is significantly related to investment bank reputation. Similarly, indirect certifications

of law firms may also be important—that is, the mere fact that a top-tier law firm is willing to be involved. Some anecdotal evidence suggests this may be so—some top-tier business law firms of the 1970s are said to have avoided the hostile takeovers of the 1980s out of concern for their reputations.

Gilson (1984) argues business lawyers are transactions cost engineers, crafting agreements that allow the parties to behave as if perfect-market assumptions apply—this will create value by minimizing the deadweight costs of transacting. Specifically, lawyers can add value by writing contracts that align the expectations of the parties, minimize the incentives for opportunistic behavior, and set incentives to supply useful information at lowest cost.

Thus, lawyers, through their roles as deal certifiers and transaction cost managers, may have the potential to affect the economics of mergers and acquisitions. Although the role of business lawyers has not been studied much in the finance literature, a significant exception is Beatty and Welch (1996) in the context of IPOs. They find that prominent lawyers charge more for IPO work, on a size adjusted basis, than the investment bankers, and that the use of such well-paid lawyers is associated with less underpricing and less investment banker compensation. These results suggest that lawyers may be useful intermediaries between a firm and its banker, or else that the presence of high-reputation lawyers help provide quality assurances to the firm's banker.

If these or other mechanisms for economic effects do operate, their tracks should be evident in deal outcomes. Clearly, given the central roles often played by legal advisors during the negotiation and contracting process, efficient deal completion is one important outcome that might be affected. The acquiring firm management, at least, would prefer a high likelihood of deal completion. Further, if effective lawyering helps the parties achieve perfect market outcomes, as Gilson argues, then the likelihood of completing good deals might be increased, where good deals are those that add value. From the point of view of acquiring firm shareholders, the tendency to add value in this way can be assessed with long-run returns following the announcement.

Our major focus is therefore to study the statistical associations of law firms with deal completion and ex-post return. If legal advisors have economic effects on these economic outcomes, then it is interesting to know whether the prominence or success of the law firm is affected. Therefore, we relate law firms' market-share to "efficiency," in closing deals and "effectiveness" in post-announcement returns.

Given the lack of any systematic evidence on the roles played by legal advisors in mergers and acquisitions, we begin by laying out the industry structure of legal advisors in the mergers and acquisitions market.

### **3. Law firm market-shares in M&A advisory work**

In this section, we study the market-shares of law firms that are active in mergers and acquisitions, examine who the biggest players are and who their clients are, and how their market-shares change from year to year.

We use data from the Thomson Financial SDC Platinum "Mergers and Acquisitions" database. We first screen for all M&A offers for the period 1994-2000, resulting in 86,487 offers. We stop with the year 2000 because we require post-acquisition returns data for our long-run returns analysis. Many SDC records include little or no information beyond the identities of the parties, and we discard all records that do not contain valid data for the value of the proposed deal. We are left with 44,759 offers. Many records do not identify the acquirer's legal advisor. Other records identify more than one advisor to an offer.

When calculating market-share league tables, it is common practice to give full credit to each advisor when an offer is advised by more than one firm. Considering this shared credit, our 44,759 offers count as 47,021 legal advisor engagement events. We define a law firm's market-share as the dollar value of the engagements on which it advises as a proportion of the dollar value of all engagements in a calendar year, whether or not the offer is subsequently withdrawn. Of our 47,021 engagements, the names of the legal advisor(s) are included in only 10,028 engagements corresponding to 7766 distinct offers. We

nonetheless believe that market shares give a more appropriate impression when the  $47,021 - 10,028 = 36,993$  no-name offers are included as part of the market, in view of the fact that no-name engagements altogether account for 37.5 percent of market share in an average year.

To obtain a sample with data fields for cross-sectional analysis, additional screens are necessary. Our next screen requires all M&A offer particulars including offer characteristics and acquirer particulars from Compustat to be available for each offer. This reduces the sample to 9895 engagement events corresponding to 7640 distinct offers (i.e., a reduction of 126 offers versus the less-stringent sample described above). We use this cross-sectional sample of offers for several analyses that do not require stock returns data. When we aggregate data by law firms within a calendar year for this cross-sectional sample, we use all 9895 engagement events to credit each of multiple advisors with the offer (i.e., consistent with common practice in computing league tables). When aggregated this way, the cross-sectional sample contains 1820 law firm/year combinations.

Because stock returns and financial statement data are needed for some of our analyses, we must subject the sample to an additional screening in which we require CRSP data for acquiring firms. This results in our final sample. We want to compute returns covering 750 days from the day of the offer. For acquiring firms that do not have sufficient CRSP returns data, we nonetheless require a minimum 24 months of consecutive returns data to calculate the long-run post-acquisition returns. When we analyze the cross-section of offers in this final sample, we use the 3042 distinct offers to count each deal once, averaging market shares across all lawyers on a deal if necessary.<sup>2</sup> For comparison with less-restrictive samples above, we note that our final sample of 3042 distinct offers corresponds to 3805 engagements advised by/in 1088 law firm/years, under the convention of full credit for the offer to each of multiple advisors.

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<sup>2</sup> From our cross-sectional sample of 7640 offers, we lose 3827 offers that do not have corresponding acquirer CRSP permno's. We lose an additional 132 offers that have no CRSP data around the date of the offer. Finally, we lose an additional 639 offers which have less than 24 non-missing months of CRSP data for the period just after the offer. Thus, our cross-sectional sample of 7640 offers differs from our final sample of 3042 offers by  $4598$  offers  $= 3827 + 132 + 639$ .

For reporting purposes, we initially classify law firms in each year as: “one-deal firms”, those that are involved in just one acquisition offer; “small firms”, those that are involved in more than 1 acquisition offer in a year but which have market-share less than or equal to 1 percent; and “large firms”, those that have more than 1 percent market-share. Table 1 provides descriptive statistics on the volume of advisory work during the period 1994-2000 for each of these market-share cohorts.

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Table 1 here

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Panel A shows that there are 20 large law firms that advise on roughly the same number of offers in an average year as do all the small firms combined, even though there are about five times as many small firms. Even more striking, the average market-share of a big law firm is almost 19 times the average market-share of a small law firm.

Panel B shows that the number of offers per year and law firms in both cohorts tends to grow over the years. More striking, the market-shares of typical firms in the large law firm cohort grow somewhat over the years, at the expense of the small firm cohort. For example, the average large firm advises on 2.21 percent of announced offer value in 1994, but on 2.69 percent in 2000—an increase of about 20 percent over starting year’s figure. This impression is confirmed by a *t*-test (not shown in the table): the mean year-over-year change in share for small firms is significantly negative, and the mean change in share for large firms is significantly positive, both at the five percent level. Even so, Table 1 is evidence the market for advisory services is not concentrated during the sample period. The Herfindahl index (sum of squared market-shares, not shown in the table) is below 400 for every year, which is far below conventional standards for even a moderately concentrated industry.<sup>3</sup> The impression of an unconcentrated industry is not driven by the presence of one-deal law firms or offers with no named legal advisors: the

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<sup>3</sup> Industries for which the Herfindahl Index is between 1000 and 1800 points are considered to be moderately concentrated, and those in which this index is in excess of 1800 points are considered to be concentrated (see the U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines, 1997).

Herfindahl index is also small when computed using data on the Small firms and Large firms alone.

Panel C shows that the market-share changes evident in Panel B do not detract from the appropriateness of our characterization of the industry in terms of market-share cohorts. Only a few firms change from one cohort to the other over time; the industry structure is stable. This stability is consistent with the notion that it takes a long time to build up the human capital, networks and reputation necessary to run a large M&A advisory practice.

The large firm cohort contains some disproportionately dominant firms. Table 2 shows that Skadden Arps is the most dominant firm in the acquisitions market, holding a 3- $\frac{1}{2}$  to 8- $\frac{1}{2}$  percent share in every sample year.<sup>4</sup> Simpson Thacher and Sullivan Cromwell often hold similar shares, especially in recent years. These three firms have generally increased their market-shares over the years in our sample period. A few other large law firms become contenders for dominant status every once in a while—for instance, Fried Frank in 1995, Wachtell Lipton in 1997 and Davis Polk in 1999.

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Table 2 here

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These dominant firms and others that are nearly in their class are also large by standards other than market-share. For example, the 10 firms with the largest average market-share over all the years of our sample employ an average of 600 lawyers per firm and generate average revenue of \$600 million in 2000, or about \$1 million per lawyer.<sup>5</sup>

Table 3 provides a different view of large vs. small firms, in terms of the nature of the clients and investment bankers with which they work. The clients of large

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<sup>4</sup> For conciseness, we follow the convention of identifying law firms by two names. This is often consistent with common practice for referring to firms, though their formal names are generally longer.

<sup>5</sup> These firms are Cleary Gottlieb, Cravath Swaine, Davis Polk, Dewey Ballantine, Fried Frank, Shearman Sterling, Simpson Thacher, Skadden Arps, Sullivan Cromwell, and Wachtell Lipton. Data on number of lawyers is from the Martindale Hubbell Directory on Lexis Nexis, and data on revenues is from the *American Lawyer*.

law firms are also large, having nearly \$170 billion in assets and 30 thousand employees on average, significantly more than the clients of small law firms. The investment banks with which they work are prestigious, having an average league table score that is significantly greater than that of the investment banks that work with the small law firms.

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Table 3 here

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Overall, the tabulation of market-shares for acquirer legal advisors results in several general characterizations.

1. The advisory industry is not concentrated overall, but there are a few dominant firms with shares of 2 to 8 percent of a year's announced offer value. These dominant firms are generally the same ones from year to year. About 10 to 15 additional firms advise on 1 to 2 percent of announced offer value in any given year.
2. The advisory industry does not show any strong tendency to become more concentrated, although the largest 20 or so firms have experienced modest increases in market-share during the sample period. This tendency is especially strong for the 4 to 6 dominant firms.
3. Large market-share firms are engaged by larger and more profitable acquirers and work with more reputable investment bankers.

Why do large profitable acquirers prefer to employ large market-share law firms, and why are they successful in maintaining and even enhancing their market-share over the years? The most obvious conjecture is that they are capable of providing the appropriate services, given the internal human capital and networks of relationships they have developed over a long period of time. After all, it seems plausible that the small law firms, and especially those that advise on only one deal, would not be capable of handling the negotiation and drafting issues for a large acquisition. Moreover, they would have little experience or reputation to bring to bear to encourage or certify the sorts of information flows between the parties that is envisioned for "transaction cost engineering." Among other things,

management probably hopes to engage a legal advisor of sufficient competence to handle specific legal dimensions of the situation, of sufficient reputation and skill to either reduce or exploit the information barriers between the parties, and of appropriate stature and cost to be a defensible choice should there be subsequent problems.

In subsequent sections, we go beyond this conjecture to examine whether the large law firms actually are associated with different economic outcomes than the smaller firms. We begin by examining their success on a criterion that is clearly of central concern to acquirer management: deal completion.

## **4. Deal completion efficiency**

In this section, we show that large market-share law firms are more effective in completing the offers for which they are called upon to advise, considering the nature of those deals. This relationship is not a simple one, however, because large firms tend to advise on more complex deals that are inherently more likely to fail. To accomplish our goal in this section, we begin by developing observable indicators of a deal's legal complexity, and working out an overall measure of deal complexity. We next show that large firms advise on more complex deals by this measure, and that firms which complete all their deals advise on less complex deals. Finally, we show that the large law firms complete deals efficiently after controlling for deal complexity.

### *4.1 Deal complexity and large law firms*

From the point of view of acquirer management, who makes the decision on engaging an advisor, deal complexity has many dimensions. Our goal in this section is not to fully explore all the aspects of complexity, but rather to develop a list of observable indicators for a usable index of deal complexity. Most obviously, legal deal complexity ought to be correlated with economic deal complexity. To advise, negotiate and draft appropriately, lawyers must understand the scope of the

situation. First, Servaes and Zenner (1996) establish that economic deal complexity is positively correlated with the size of the transaction. Second, legal deal complexity ought to be correlated with the proportion of a target sought to be acquired in a transaction. Acquiring less than 100 percent of the target presents a more difficult situation to structure, since multiple claimants will remain afterward. Third, cash deals may be more complex from the legal advisor's point of view. Since the establishment of "Revlon duties" by Delaware courts in the mid 1980s, directors of companies considering a cash offer have been cast into something like the role of auctioneers, with the responsibility to obtain the highest short-term shareholder value (Coates and Subramanian (2000)). Directors considering stock or stock and cash mixed deals are held to a looser standard—they need not maximize immediate shareholder value provided they have a plan for maximizing value over a longer period (Klein and Coffee (2000)). Fourth, tender offers are more complex, in part simply because they involve a formal approach to shareholders and in part because this form of offer triggers special bidder obligations under the Williams Act (Klein and Coffee (2000)). Additionally, the acquirer's board requires advice in the process of determining and justifying the adequacy of the offer. Fifth, deals are more legally complex when the target is a public company because the law stipulates that shareholders be given some ability to affect the outcome of the acquisition bid. An acquirer's legal advisor can increase the probability of success by negotiating lockups of various sorts (e.g., stock or asset lockups, and/or breakup and termination fees). Finally, earnout provisions are an indicator of more complex deals, since earnout provisions are most often required when there are mismatches in incentives (Gilson (1984)). Earnout provisions are terms that call for escrows until such time as complete information on crucial cash flows or accounting outcomes becomes available.

For our analysis, we use (a) *SIZE*, the dollar size of the transaction, (b) *PCTDES*, the percentage of target ownership desired, as expressed in the offer (c) *CASH*, a dummy variable equal to one in cases where the offer is for cash, (d) *TENDER*, a dummy variable equal to one in cases where there is a tender offer, (e) *TPRIVATE*, a dummy variable equal to one in cases where the target is a private

company, and (f) *EARNOUT*, a dummy variable equal to one in cases where earnout provisions are part of the proposed transaction. These six indicators correspond, respectively, to the aspects of deal complexity discussed above.

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Table 4 provides descriptive statistics on each of these measures. Large market-share law firms are involved in significantly larger deals, in a significantly higher proportion of cash offers, tender offers and deals that involve earnout provisions than the small market-share law firms. Large law firms are also involved in significantly higher proportion of deals in which the target is a public firm and in deals in which less than of the target is desired. Thus, across all our indicators of deal complexity, large market-share law firms are involved in significantly more complex offers than the small law firms.

Next, we investigate whether large law firms are able to efficiently complete deals. If they do, then we have one explanation for their market-shares, and why they continue to remain big year after year.

#### *4.2 Deal Completion Efficiency*

For each law firm each year, we compute deal completion efficiency, measured as the percentage of offers on which the firm advises that are *not* subsequently withdrawn.

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Table 5 shows the average deal completion efficiency of the large and small market-share law firm cohorts over the years 1994-2000. A difference of means test shows that the deal completion efficiency of the large market-share law firms is significantly lower than that of the small market-share firms. At this level of analysis, it is not possible to say whether the reason is that large firms impede deal

completion or whether their lower completion rates are the natural result of the more complex deals on which they advise.

Figure 1 depicts the relationship of deal completion rate to market-share with scatter-plots of deal completion efficiency against the market-share of law firms—measured both as a proportion of the number of offers announced and of the dollar value of deals announced in a year. The plots suggest that one statistical reason for the lower deal completion rates of large firms is that extremely small share firms tend to complete all their deals. If we were to ignore this group of perfectly efficient law firms, deal completion efficiency appears to be *positively* related to market-share in a curvilinear fashion. Therefore, to understand the relation between deal completion efficiency and market-share, we must account for deal complexity and also understand the “perfect” law firms, i.e., those that have 100% deal completion efficiency and which seem to follow their own distribution, based on the scatter-plots. In the following subsections, we describe our analyses that provide such an understanding.

#### 4.3 A summary measure of complexity

To account for deal complexity, we compute a summary measure of complexity for each deal. The measure is built on the notion that more complex deals are more likely to be withdrawn, without conditioning on the nature of the legal advisor. To begin, we estimate a binomial logit using data on all acquisition offers in our final sample, based on the model:

$$\begin{aligned} \text{Probability}(WITHDREW) &= \beta_0 + \beta_1 \ln(SIZE) + \beta_2 PCTDES + \beta_3 CASH \\ &\quad + \beta_4 TENDER + \beta_5 TPRIVATE + \beta_6 EARNOUT + \varepsilon \end{aligned} \quad (1)$$

where *WITHDREW* is an indicator variable equal to 1 for deals that are withdrawn and 0 otherwise. Table 6 shows the results.

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Table 6 shows that the probability of a deal not being completed is significantly positively related to the size of the deal, negatively related to the proportion of the target that is desired, and negatively related to whether the target is a private firm. In other words, a deal is more likely to be withdrawn if it is a “complex” deal by three of our complexity indicators: large deals, public targets, and less than 100 percent acquisitions.

Next, the deal-specific estimates of complexity are computed as the fitted value of the logit. Finally, these deal-specific complexity estimates are averaged across all the deals for each law firm/year to obtain a law firm/year specific estimate of the complexity of the deals on which each firm advises. We denote that as *COMPLEXITY*, and use this measure of deal complexity for each law firm each year in further analysis.

#### 4.4 Perfect efficiency and very small market-share law firms

To gain insight as to what makes some law firms “perfect”, we run two binomial probit regression specifications, in which an indicator variable for these firms is regressed on market-share and deal complexity. The indicator is *PERFECT*, defined as 1 for law firms that have 100% deal completion efficiency in a year and 0 otherwise. In Specification A, *PERFECT* is regressed on the log of market-share and the complexity of the deals done by a law firm. The reason for the log specification is that it allows us to additively break down a firms’ log market-share, using the definition of a market-share, into three log components: average deal size, number of deals, and the value of deals advised by all law firms in a year. A probit using the breakout version of market-share is Specification B, allowing each component to have its own separate effect. Formally, the specifications are:

$$\begin{aligned} \text{Probability}(\text{PERFECT}) = & \\ & \delta_0 + \delta_1 \ln(\text{SHARE}) \\ & + \delta_2 \text{COMPLEXITY} + \omega \end{aligned} \tag{2a}$$

$$\begin{aligned}
\text{Probability}(\text{PERFECT}) = & \\
& \delta_0 + \delta_{1,1} \ln(\text{AVG SIZE}) + \delta_{1,2} \ln(\text{NUMDEALS}) + \delta_{1,3} \ln(\text{TOTMKT}) \\
& + \delta_2 \text{COMPLEXITY} + \omega
\end{aligned} \tag{2b}$$

where variables not previously defined are *SHARE* is a law firm's market-share in a year, *AVG SIZE* is the average dollar value of acquisitions on which it advises, *NUMDEALS* is the number of deals on which it advises, *TOTMKT* is the total value of all acquisition offers in the sample that year. The  $\delta$ s are probit slope coefficients and  $\omega$  is an error term.

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Table 7 shows the probit estimates. In Specification A, the results indicate that the perfectly efficient firms (those with 100% deal completion efficiency) are the small law firms that are involved in the less complex deals. Specification B confirms this result by showing that the perfectly efficient firms are the ones that do fewer, less complex deals. Specification B adds the finding that these deals tend to occur in hot markets, that is, years in which the value of acquisition deals is large. We conjecture that one reason these firms are able to complete their deals is that the market is very anxious to have them completed. These results explain the clustering of perfect deal completion efficiency that we found in the scatter plots from Figure 1: deal completion perfection is more likely when a law firm does a small number of less complex deals. This is also consistent with our earlier finding (Table 4) that large law firms tend to be involved more in more complex deals. Finally, the probit confirms what is suggested by the scatter-plots: there is something economically different about the perfect firms. Therefore, we track them separately in our final analysis of the relation between market-share and deal completion efficiency.

#### 4.5 Market-share, deal completion efficiency and complexity

To examine the relation between market-share and efficiency, we use the following regression specification using firm by firm data:

$$\ln(\textit{SHARE}) = \gamma_0 + \gamma_1 \ln(\textit{EFFICIENCY}) + \gamma_2 \textit{COMPLEXITY} + \gamma_3 \textit{PERFECT} + \nu, \quad (3)$$

where *EFFICIENCY* is the proportion of the acquisition offers on which a firm advises in a given year that are not subsequently withdrawn and other variables are as previously defined. The  $\gamma$ s are regression slope coefficients and  $\nu$  is an error term.

Given that we are interested in understanding the marginal effect of law firm stature, as measured by market-share on deal completion *EFFICIENCY*, the form of the regression (with *SHARE* on the left hand side) seems backwards, at first glance. We configure the regression this way because we are interested in understanding the relationship between *SHARE* and *EFFICIENCY* for firms that are both sizable and do some complex deals, which requires a control for the *PERFECT* firms. *PERFECT* is, of course, correlated with *EFFICIENCY* in a mechanical way, so we do not want to regress one on the other due to the difficulties in interpretation that would result. Mechanically, a regression of *SHARE* on *EFFICIENCY* can effectively uncover the partial correlation we are after. The results are shown in Table 8.

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Table 8 here

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In Specification A, which does not control for the *PERFECT* law firms (which are small and do fewer and less complex deals), the coefficient on market-share is negative. In Specification A, market-share is the proxy indicator for the *PERFECT* firms. Once we explicitly control for these law firms in Specification B, the  $R^2$  of the regression increases sharply, and specification tests reject the restricted

regression. In this regression, the relationship between efficiency and market-share is significantly positive; the large market-share law firms are more efficient. This ties in with the pattern we observe in the scatter plots shown in Figure 1—once we segregate the small cluster of perfect firms, there is a curvilinear positive relationship between market-share and efficiency.

To provide confidence that these findings are not artificially induced by the set-up of the regression, we note that, among non-*PERFECT* firms doing deals of more than median *COMPLEXITY*, the mean *EFFICIENCY* for law firms with more than 1 percent market-share is 0.90, whereas the mean efficiency for smaller firms is only 0.81.

To summarize the findings of this section, large market-share law firms are involved in more complex deals. Deals are less likely to be withdrawn, *ceteris paribus*, when large firms are advising. This result fits well with our earlier finding that large firms are engaged by larger and more profitable clients. Large law firms enhance the production of something that is quite important to acquirer management, a successfully concluded acquisition, and so tend to be engaged by the management of well-heeled acquirers. The ability to facilitate deal completion is arguably of substantial benefit to law firms in sustaining large market-shares. What we have not yet shown, and proceed to examine next, is whether large-share legal advisors tend to be associated with acquisitions that are beneficial to the shareholders as well.

## 5. Post-deal returns effectiveness

As discussed earlier, Gilson (1984) argues that legal advisors in acquisitions deals might add value to transactions in three major ways. First, they can write contracts that align the expectations of the parties, or else find ways to make such alignment unnecessary. Second, they can write contracts that minimize the incentives for opportunistic behavior. Third, they can engage in an agreement negotiation process that provides incentives to develop the proper set of common information at lowest cost. Legal advisors could also be associated with shareholder

value enhancing deals indirectly, in much the same way that top investment banks are thought to be associated with high-quality IPOs—they can try to associate themselves only with deals that they perceive to be value-creating. They are likely to do so if they judge that this will protect or enhance their market-shares. In this section, we examine how the shareholders of the acquirers fare in the long run after the announcement of acquisition offers advised by large versus small market-share law firms. Long-run stock returns will therefore be our measure of law firm “effectiveness.”

### *5.1 Measuring effectiveness*

Appropriate measurement of long run stock returns has generated substantial controversy in recent years, and each particular measure in the literature has its drawbacks. Buy-and-hold abnormal returns are appealing because the implied investment strategy is both simple and representative of the returns a long horizon investor might earn. However, Fama (1998) and Mitchell and Stafford (2000) argue that cumulative abnormal returns and calendar time methods are less likely to yield spurious rejections of market efficiency than buy-and-hold returns, partly because buy and hold returns can exaggerate small initial differences through compounding. Moreover, distributional properties of parametric test statistics for cumulative abnormal returns are better understood (though we use non-parametric tests to evaluate buy-and-hold returns).

In view of these concerns and our desire for robust inferences, we therefore employ three different measures of long run abnormal returns. Informally, we refer to these together as “effectiveness” in producing long run returns. We measure abnormal returns as a) *BHAR*, buy-and-hold market-adjusted returns with compounding, b) *CAR*, cumulative market-adjusted returns without compounding, and c) *FFAR*, calendar-time Fama French three-factor-adjusted returns. We use the CRSP value-weighted NYSE/AMEX market index for market adjustments.

Our market-adjusted returns,  $BHAR$  and  $CAR$ , are not risk-adjusted returns. They are nonetheless of special interest because performance relative to the market may be prominent in the eyes of acquirer managers.

From investors' point of view, recent work by Fama and French (1992, 1993, 1995, 1996) indicates that a three-factor model of risk-adjustments may explain the cross section of stock returns. Their three factors are  $RM$ , the excess return on the market portfolio,  $SMB$ , the return on a zero investment portfolio formed by subtracting the return on a small firm portfolio from the return on a big firm portfolio, and  $HML$ , the return on a zero investment portfolio calculated as the return on a portfolio of high book-to-market stocks minus the return on a portfolio of low book-to-market stocks.<sup>6</sup> The Fama and French time-series regression model is

$$r_{it} = \alpha_i + b_i \times RM_t + s_i \times SMB_t + h_i \times HML_t + \zeta_{it}, \quad (4)$$

where  $r_{it}$  is the excess return on stock or portfolio  $i$  over period  $t$ , and  $\zeta$  is an error term. The coefficients  $b$ ,  $s$  and  $h$  are time-invariant risk-loadings. We follow Fama (1998) and Mitchell and Stafford (2000) in using this model in calendar-time fashion. Specifically, a calendar time regression is computed by adding each acquirer's stock to a virtual portfolio on the offer announcement date, and then estimating the Fama and French regression model using the time-series of portfolio returns. In this case, the regression intercept  $\alpha$  measures the mean per-period risk-adjusted abnormal return for the portfolio. As Gompers and Lerner (2003) emphasize, the resulting  $\alpha$  estimates have an interpretation analogous to that of Jensen's alpha in a CAPM framework.

For all our effectiveness measures, we calculate returns beginning with, alternatively, the day prior to the announcement of the acquisition offer or the 26<sup>th</sup>

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<sup>6</sup> We obtain the necessary factor returns from Ken French's web site at [http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

trading day after the announcement. We do not generally know whether the identity of the legal advisor is public information at the time of the announcement, so our intention is to compute returns assuming that the advisor is known at the same time as the offer and, alternatively, that the advisor is not known until one month later. Our results are generally about the same in either case.

### 5.2 Law firms and effectiveness

In this subsection, we show that larger-share law firms exhibit less effectiveness in being associated with large returns: the larger the market-share, the lower the clients' long-run return. Moreover, the long run abnormal returns associated with the largest law firms' clients tend to be negative. The nature of the deals themselves, as opposed to the legal advisors, is at least part of the reason, for the most negative returns are also associated with the most complex deals.

Table 9 provides the details. For this table, we measure the long-run abnormal return for each offer in our final sample, and then average across legal advisor market-share cohorts. Each offer (i.e., not each law firm/year) counts as one data point in this analysis. When an offer is advised by multiple law firms, we average their market-shares, in effect, treating the team as a single firm. The table reports each three effectiveness measures (*BHAR*, *CAR*, and *FFAR* calendar time returns) for each of two long run windows around acquisition offers (alternatively, including and subsequent to the event date). Both windows end 750 trading days after the announcement, or roughly 3 years, given sufficient data. To present a more detailed picture, Table 9 breaks out the large firm and small firm cohorts into more specific market-share buckets.

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Table 9 here

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Effectiveness is generally lower for larger market-share cohorts. Depending on the measure, some large-share cohort effectiveness measures are significantly negative. Large-share cohort measures are most often significantly lower than

small-share cohort measures. The table shows a consistent pattern in which the post-offer returns experience of large-share firms' clients is worse.<sup>7</sup>

Most certainly, there is no evidence that larger market-share cohorts are associated with superior transactions cost engineering that results in stronger long-run returns effectiveness. This is so whether or not the offer announcement period is included in the measure of effectiveness.<sup>8</sup>

It is interesting to consider examples of firms that are associated with most and least effectiveness. From among the law firms that were involved in an average of at least 10 deals a year, the top in effectiveness (across all our measures of effectiveness) across all years in our data sample are Brobeck Phleger, Bryan Cave, Cooley Godward, Gray Cary, and Morrison & Foerster. All of these firms have an average dollar market-share of around or less than 0.5%. However, these are not very small law firms either—all of them appear on the *American Lawyer* list of top 100 law firms by gross revenue.

To summarize our findings, big market-share law firms are called upon by the large successful firms to facilitate the completion of complex acquisition deals. After controlling for deal complexity, these law firms are efficient in bringing these deals to successful conclusions. However, these deals are the ones that create the least shareholder value ex-post.

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<sup>7</sup> This finding also holds when we employ Fama and French's adjustment in traditional event study fashion, with risk loadings computed from data during an estimation period ending 45 days prior to the announcement. In this case, the estimated risk-loadings computed with the pre-announcement data, along with post-announcement data on the factor portfolios, are applied to risk-adjust the post-event returns for each acquirer stock  $i$ . From these post-event risk-adjusted returns, *FFARs* for each stock is computed (not reported in the paper). Additionally, we note that this finding is not driven by the more detailed cohort breakout used in this table. Difference of means tests for the cohort with greater than 1 percent share versus the 0.1 to 0.5 percent share cohort also reject the null for *BHAR* and *CAR* measures of effectiveness, and nearly so for *FFAR* measures.

<sup>8</sup> The pattern of returns across market-share cohorts is similar around offers from acquirers with less than 24 months of post-offer CRSP data, which have been excluded from our final sample. For the 639 offers where some CRSP data is available, even though not enough to meet our requirement, mean *CAR*, computed with the available data, is significantly lower in the large firm cohort (by both standard and heteroskedasticity-robust  $t$ -tests), consistent with the results we report. Mean *BHAR* and *FFAR* are insignificantly different across large and small firm cohorts.

## 6. Can law firms succeed via efficiency and effectiveness?

Thus far we have demonstrated that large market-share law firms are asked to advise on legally complex acquisition offers. They are associated with enhanced deal completion efficiency, but not with enhanced long-run returns effectiveness. Thus, they appear to be efficient at producing one outcome of great interest to acquirer management—deal completion. However, they are not effective at producing valuable transaction cost engineering (at least not as reflected in subsequent stock performance), though this would presumably also be of interest to management.

In this section, we show why. In a nutshell, some law firms appear to be able to consistently associate themselves with efficient deal completion. On the other hand, there is no evidence that any cohort of law firms can consistently cause or associate themselves with effectiveness in the sense of strong long run returns. Given no evidence of persistent success in effectiveness, we cannot establish or even suggest that transaction cost engineering of a type that affects returns is something that particular law firms can excel at producing. Firms that want to build market-share could then reasonably concentrate on deal completion efficiency, something that they can produce. Furthermore, their employers care about deal completion efficiency- we find that acquirers that have had unsuccessful bids tend to employ significantly more different law firms than acquirers that are always successful in their bids. This implies that unsuccessful bidders tend to change their legal advisors more often than the successful bidders. On the other hand, we do not find that acquirers who experience negative post-acquisition abnormal stock returns employ more different law firms than acquirers who experience positive post-acquisition abnormal stock returns.

To demonstrate persistence (or the lack thereof) in efficiency and effectiveness, we work with the restricted set of offers in our data set for which there is a unique, single legal advisor. We remove deals advised by several firms to avoid crediting any one of them with time series effects that might actually be due to one or more of the others. If these advisor “teams” were stable over time, we could credit effects to the team, but they are not. This issue does not arise in our earlier cross-

sectional analysis, where we do treat a team on any deal as a law firm with average characteristics. In the time series setting, this approach is conservative—we will only report effects if they are evident with our cleanest, most restrictive data. This most-restricted sample is a panel of 851 law firm/years, in which the firms act as the sole advisor on offers in at least two years over 1994-2000.

Table 10 reports our results. Panel A shows efficiency results, and Panel B shows effectiveness results. In Panel A, we report several regression tests of the general form:

$$\begin{aligned}
 \text{EFFICIENCY INDICATOR} = & \\
 & \theta_{0,effic} + \theta_{1,effic} \text{LAGGED EFFICIENCY} \\
 & + \theta_{2,effic} \text{COMPLEXITY} + \eta_{effic},
 \end{aligned} \tag{5}$$

where *EFFICIENCY INDICATOR* is either the proportion of non-withdrawn offers for a law firm in a year, in which case estimation is by ordinary least squares, or, alternatively, *EFFICIENCY INDICATOR* is *PROBABILITY(PERFECT)*, our indicator for zero deals withdrawn, in which case estimation is by maximum likelihood probit. *LAGGED EFFICIENCY* is the proportion of last year's deals completed, and *COMPLEXITY* is the same as defined earlier. The  $\theta$ s are coefficients, and  $\eta_{effic}$  is an error term. We estimate various versions of (5), excluding some coefficients in some versions.

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Table 10 here

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Panel A shows that the coefficient on *LAGGED EFFICIENCY* is always positive and strongly statistically significant, whatever the measure of current efficiency. The first two specifications show this point without any additional control variables, whereas the third and fourth specifications show that the point also holds when controlling for *COMPLEXITY*. In all these tests, last year's more efficient firms tend to be this year's more efficient firms. The conclusion is that law

firms can produce, or at least consistently associate themselves with, deal completion efficiency.

In Panel B, we report similar regression tests, but where long-run returns effectiveness is the focus. We estimate six regressions of the form:

$$\begin{aligned}
 & \textit{EFFECTIVENESS INDICATOR} = \\
 & \theta_{0, \textit{effect}} + \theta_{1, \textit{effect}} \textit{LAGGED EFFECTIVENESS} + \eta_{\textit{effect}}, \tag{6}
 \end{aligned}$$

where *EFFECTIVENESS INDICATOR* is one of our three long-run returns measures (*BHAR*, *CAR*, or *FFAR*) measured over one of two time periods relative to the offer, either day -1 to +250, or days +26 to +250. We use shorter windows for this analysis than for our previous analyses in order to avoid overlapping returns periods in this time-series analysis. *LAGGED EFFECTIVENESS* is the same returns measure and time period as for the left-hand side, but applied to the same firm's deals in the *previous* year. Thus, the regression tests for persistence over time in law firm's long-run returns effectiveness.

None of the six specifications reported in Panel B shows any evidence of persistence in producing or being associated with strong long-run returns. All the regression slope coefficients are near zero and statistically insignificant. Overall, law firms do show evidence of being able to produce, or at least consistently be associated with, efficient deal completion. This is not the case when it comes to long-run returns effectiveness.

In Table 11, we provide some suggestive evidence that deal completion efficiency is valued by clients. The table compares the number of *different* law firms used by acquirers that experience no withdrawn deals (i.e., 100 percent deal completion effectiveness) to the number of different law firms used by bidders with lower deal completion success. Acquirers that have had unsuccessful bids use a significantly larger number of different law firms, on average—more than three as compared to about one and two-thirds for bidders that had 100 percent success, over the full sample period. This result suggests the possibility of acquirers shopping for law firms that can improve deal completion. Since this result could be

affected by systematic differences in the number of deals, type of deals, and so on, we have investigated several normalized versions of the number of different lawyers, with no change in the conclusion. In particular, we normalized the number of different law firms employed by a bidder by the number of deals attempted by the bidder, the average number of law firms employed by the bidder per deal, and by both number of deals and the average number of law firms employed per deal. Our result does not change.

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Table 11 here

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The table also reports the number of different lawyers used by acquirers that experience positive versus negative post-acquisition long run returns. For two of three returns measures (*CAR* and *FFAR*) the difference is insignificant, and for the third measure (*BHAR*), the difference, though statistically significant, is small and opposite to the hypothesized direction. Thus, acquirers do not appear to shop for law firms to create post-acquisition shareholder value.

Our earlier finding that large market-share law firms are associated with deal completion but not long run returns thus seems natural. Table 10 shows that law firms are able to consistently produce only deal completion. Table 11 suggests that clients care only about deal completion. Thus, large law firms produce what their employers seem to care about the most – deal completions. This helps the law firms to build their businesses.

## 7. Conclusion

The process of attempting to combine two corporations is fraught with information asymmetries and other difficulties, so intermediaries can be important. Prior research has examined the role of investment bankers (Servaes and Zenner (1996) and Rau (2000)), but not that of legal advisors. There are several reasons to suspect that legal advisors are also economically important intermediaries. First, prior research finds that legal advisors are material to economic outcomes in IPOs (Beatty and Welch (1996)); if anything, the potential for lawyers to make a

difference would seem greater in acquisition situations than in the tightly-prescribed process of the IPO of an S.E.C.-regulated client. After all, in merger situations, a wide variety of tactics, responses, forms, and constraints may apply under State and Federal corporate laws as well as the laws of non-U.S. jurisdictions. Second, a large body of research beginning with La Porta et al. (1998) finds that broad legal institutions are material to economic outcomes. Some of this evidence shows that particular legal institutions are material to acquisition-related outcomes (e.g., Coles and Hoi (2003), Nowak (2001)). It seems reasonable to expect that the activities of the agents most closely associated with these institutions might be associated with economic effects.

In this paper, we first characterize the market for legal advisory services in terms of size and market-shares. This characterization provides a ranking of firms in terms of their prominence, which is useful for our other investigations. The advisory industry has one perennial largest firm, Skadden Arps, which often advises on more than five percent of the value of all offers in our sample. Sullivan Cromwell and Simpson Thacher generally carry a two- to four-percent share, and a few other large firms are almost as large in market-share. Around a hundred other “small” firms in any year advise on several-to-many deals totaling to less than a one percent market-share apiece. Firm-specific market-shares are fairly stable across years. Bigger firms do larger deals, work with more prominent investment bankers, and work for larger, more profitable clients.

Legal intermediaries play a central role in the negotiation and drafting of the documents that define a deal, from non-disclosure agreements near the start of the process to the eventual acquisition agreement. Given this role, a clear possibility exists that lawyers’ activities could be material to the eventual closure or withdrawal of the deal. Knowing this, clients interested in completing a deal might reasonably engage higher-quality legal talent for more difficult deals. We investigate, and find that, after accounting for the influence of variables correlated with the difficulty of the legal issues involved, large market-share law firms are significantly more likely to be associated with successful deal completions. This suggests that market-share is an index of the ability to facilitate deal completion,

and measures law firm quality in this sense. Even if high-share law firms are hired in situations that are difficult in ways that we cannot observe (as is likely), the fact that they complete more of such deals is direct evidence of economic effects of their activities.

Lawyers may also be associated with the post-acquisition value creation. Gilson (1984) suggests that lawyers, as “transactions cost engineers,” could structure agreements and negotiations to mitigate asymmetric information, thereby enabling counter-parties to act as they would in a frictionless market. Presumably, then, the better deals would tend to be completed and structured in an economically advantageous manner. We find that clients of large market-share law firms tend to experience lower long-run returns, and that there is little consistency over time. The market for M&A advisory services does not exhibit evidence of Gilson’s conjecture, at least as reflected in stock returns. This seems natural, for the clients are really the managers of large and profitable corporations, not their shareholders. The law firms with large market-shares in the M&A business are associated with delivering what their managerial clients want—deal completion—not necessarily what their clients’ principals presumably want—shareholder value creation.

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Table 1  
Summary Statistics for Acquirer Legal Advisors: Market shares

The table describes market shares of legal advisors to acquirers in our sample of 10,028 engagement events during 1994-2000, where full credit is given to each of multiple advisors to an offer. The sample is from the SDC Mergers and Acquisitions database. Names of acquirer legal advisors for an additional 36,993 offers are missing from the database. No-name offers are included when computing shares of known firms. PANEL A shows descriptive statistics for each of several law firm cohorts. “Small” firms advise on more than one acquisition deal in a year and have a dollar market-share of less than or equal to 1 percent in the year. “Large” firms advise on more than 1 percent dollar market-share in a year. PANEL B shows the year-by-year number of firms that comprise the small and large law firm cohorts, the number of deals per firm, and the average dollar market-share for the small and large law firms. PANEL C shows the proportion of law firms that migrate each year from the small (large) law firm cohort to the large (small) law firm cohort.

PANEL A. Summary statistics by market-share cohort across all sample years															
Law firm cohort		Number of advising law firms, Average per year					Number of offers advised by all firms, Total during 1994-2000					Percentage market-share per firm, Average during 1994-2000			
One-deal firms		144					1003					0.02 percent			
Small firms		104					4572					0.14 percent			
Large firms		18					4453					2.61 percent			
All, excluding no-name offers		266					10028					2.77 percent			

  

PANEL B. Summary statistics by market-share cohort for each year															
Law firm cohort	1994		1995		1996		1997		1998		1999		2000		
	No. firms (deals)	Mean share	No. firms (deals)	Mean share	No. firms (deals)	Mean share	No. firms (deals)	Mean share	No. firms (deals)	Mean share	No. firms (deals)	Mean share	No. firms (deals)	Mean share	
Small firms	92 (351)	0.13%	104 (438)	0.15%	73 (388)	0.15%	109 (760)	0.14%	130 (975)	0.11%	137 (995)	0.12%	79 (665)	0.19%	
Large firms	16 (403)	2.21%	13 (415)	2.66%	16 (433)	2.43%	15 (588)	2.71%	18 (685)	2.94%	21 (898)	2.78%	20 (1031)	2.69%	

(This table continues on the next page.)

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PANEL C. Stability of law firm cohorts

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Proportion migrated to the other cohort during year

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Law firm cohort (FROM cohort)	1995	1996	1997	1998	1999	2000
Small firms	0.00%	4.21%	5.97%	1.98%	5.79%	2.34%
Large firms	7.41%	2.11%	4.48%	6.93%	1.65%	3.13%

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Table 2  
Descriptive statistics for very large share legal advisors

The table shows the dollar market-shares of six of the largest law firms in our sample, referred to in the text as “dominant” firms, each year from 1994 through 2000, drawn from the SDC Mergers and Acquisitions database. The sample contains 10,028 engagement events, where full credit is given to each of multiple advisors to an offer. Names of acquirer legal advisors for an additional 36,993 offers are missing from the database. No-name offers are included when computing shares of known firms. All figures represent percentages of the value of all offers announced that year, including deals that are subsequently withdrawn. Legal advisors are identified by the first two proper names in the law firm name.

Law firm	Market-share						
	1994	1995	1996	1997	1998	1999	2000
Davis Polk	2.55	2.92	2.48	2.41	2.64	5.47	1.94
Fried Frank	1.67	5.48	1.89	2.19	2.46	2.02	2.61
Wachtell Lipton Simpson	1.31	2.32	3.36	4.71	4.84	4.58	3.37
Thacher Sullivan	2.11	2.86	2.25	3.33	5.85	5.89	5.08
Cromwell	2.44	3.21	2.88	3.85	3.67	4.40	6.30
Skadden Arps	4.49	5.31	5.31	4.47	8.59	3.88	6.22

Table 3

Summary statistics on legal advisors' clients and on associated financial advisors

The table shows the average acquirer firm size (as measured by total assets in billions on dollars), the average acquirer firm profitability (as measured by operating income as a percentage of sales) and the average number of employees in thousands, as well as the average investment bank league table score, averaged across all "small" and "large" law firms in our final sample of acquisition offers. The investment bank score is based on the bank's dollar market-share of acquisition offers announced in a year; it ranges from 1 through 10, based on decile rank, with 10 denoting the most reputable investment banks in the sense of being in the top market share decile. The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 legal advisor engagements. The cross-sectional sample analyzed in the table consists of 7640 offers, which generate 9895 legal advisor engagements for/in 1820 law firm/years.

Law firm cohort	Number of law firm/years	Average acquirer total assets	Average acquirer profitability	Average number of acquirer employees	Average investment bank score
Small firms	711	82.03	-14.60	14.25	2.78
Large firms	121	168.41 <sup>***</sup>	9.80 <sup>***</sup>	29.81 <sup>***</sup>	4.48 <sup>***</sup>
All firms, including one-deal firms	1820	112.61	0.00%	20.69	3.07

<sup>\*\*\*</sup> denote significantly different from the other category at the 1 percent level.

Table 4  
Legal advisors and deal complexity

The table shows the average acquisition size (*SIZE*), the average percentage of target desired to be acquired in a deal (*PCTDES*), average cash deal indicator (*CASH*), average tender offer indicator (*TENDER*), average private target indicator (*TPRIVATE*), and average earnout provision indicator (*EARNOUT*), for the two market-share cohorts. The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 legal advisor engagements. The cross-sectional sample analyzed in the table consists of 7640 offers, which generate 9895 legal advisor engagements for/in 1820 law firm/years.

Law firm cohort	Number of law firm/years	Average acquisition size (\$ million)	Average <i>PCTDES</i>	Average <i>CASH</i>	Average <i>TENDER</i>	Average <i>TPRIVATE</i>	Average <i>EARNOUT</i>
Small firms	711	322.9	0.946	0.359	0.118	0.263	0.127
Large Firms	121	1217.5 <sup>***</sup>	0.907 <sup>***</sup>	0.524 <sup>***</sup>	0.171 <sup>***</sup>	0.167 <sup>***</sup>	0.187 <sup>***</sup>
All firms, inc. one-deal firms	1820	381.2	0.943	0.325	0.121	0.247	0.009

<sup>\*\*\*</sup> denote significantly different from the other category at 1 percent level.

Table 5  
Deal completion efficiency of legal advisors

The table shows the average deal completion efficiency of the small and big law firm cohorts over the years 1994-2000. Deal completion efficiency is computed for each law firm each year as  $\left(1 - \frac{\text{Offers withdrawn}}{\text{Offers advised}}\right) \times 100$ . The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 legal advisor engagements. The cross-sectional sample analyzed in the table consists of 7640 offers, which generate 9895 legal advisor engagements for/in 1820 law firm/years.

Law firm cohort	Number of law firm years	Average efficiency: Proportion of deals completed
Small firms	711	96.76 percent
Large firms	121	90.80 percent <sup>***</sup>
All firms, including one-deal firms	1820	97.38 percent

<sup>\*\*\*</sup> denotes significantly different from the other category at the 1 percent level.

Table 6  
Offer withdrawal as a function of deal complexity indicators

The table shows coefficient estimates (with  $t$  statistics in parentheses) for the binomial logit specification:

$$\begin{aligned} \text{Probability}(\text{WITHDREW}) &= \beta_0 + \beta_1 \ln(\text{SIZE}) + \beta_2 \text{PCTDES} + \beta_3 \text{CASH} \\ &+ \beta_4 \text{TENDER} + \beta_5 \text{TPRIVATE} + \beta_6 \text{EARNOUT} + \varepsilon \end{aligned}$$

where *WITHDREW* is an indicator variable equal to 1 for deals that are withdrawn and equal to 0 otherwise, *SIZE* is the dollar size of the proposed acquisition, *PCTDES* is proportion of target ownership desired, *CASH* is a cash deal indicator, *TENDER* is a tender offer indicator, *TPRIVATE* is a private target indicator, and *EARNOUT* is an earnout provision indicator. The sample is screened from the SDC M&A database. The cross-sectional sample analyzed in the table consists of 7640 unique offers with complete SDC records.

Explanatory variables	Coefficient estimate
$\ln(\text{SIZE})$	0.2472 (8.688) <sup>***</sup>
<i>PCTDES</i>	-0.0052 (-2.587) <sup>**</sup>
<i>CASH</i>	-0.1674 (-1.444)
<i>TENDER</i>	0.0567 (0.359)
<i>TPRIVATE</i>	-0.8794 (-5.230) <sup>***</sup>
<i>EARNOUT</i>	-0.7266 (-1.235)
<i>Pseudo R</i> <sup>2</sup>	0.20

\*, \*\*, and \*\*\* denote significantly different from zero at the 10, 5 and 1 percent level respectively.

Table 7  
Analysis of the likelihood of perfect deal completion efficiency

The table shows coefficient estimates (with  $t$  statistics in parentheses) for two probit specifications:

$$\text{Probability}(\text{PERFECT}) = \delta_0 + \delta_1 \ln(\text{SHARE}) + \delta_2 \text{COMPLEXITY} + \omega$$

$$\begin{aligned} \text{Probability}(\text{PERFECT}) = & \delta_0 + \delta_{11} \ln(\text{AVGSIZE}) + \delta_{12} \ln(\text{NUMDEALS}) + \delta_{13} \ln(\text{TOTMKT}) \\ & + \delta_2 \text{COMPLEXITY} + \omega \end{aligned}$$

where *PERFECT* is an indicator variable equal to 1 for a law firm that completes all deals on which it advises in a year, *SHARE* is the firm's market-share, *AVGSIZE* is the average dollar value of acquisition offers on which it advises, *NUMDEALS* is the number of offers on which it advises, *TOTMKT* is the total value of acquisition offers in the sample that year, and *COMPLEXITY* is a computed measure of the firm's average deal complexity based on Table 6. The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 offers covered in the database. The cross-sectional sample analyzed in the table consists of 9895 law firm engagement events associated with 7640 unique offers with complete SDC records.

Explanatory Variable	Coefficient estimate	Coefficient estimate
$\ln(\text{SHARE})$	-0.624 (-14.89)***	
$\ln(\text{AVGSIZE})$		0.115 (1.16)
$\ln(\text{NUMDEALS})$		-0.991 (-14.12)***
$\ln(\text{TOTMKT})$		2.347 (4.59)***
COMPLEXITY	-12.117 (-4.95)***	-18.412 (-3.71)***
Constant	-4.137 (-11.96)***	-17.591 (-3.95)***
Pseudo $R^2$	0.47	0.51

\*\*\* denotes significantly different from zero at the 1 percent level.

Table 8  
The relation between efficiency and market-share

The table shows ordinary least squares estimated regression coefficient, with White  $t$  statistics in parentheses, for the specification:

$$\ln(SHARE) =$$

$$\gamma_0 + \gamma_1 \ln(EFFICIENCY) + \gamma_2 COMPLEXITY + \gamma_3 PERFECT + \nu,$$

where  $SHARE$  is a law firm's market-share of M&A advisory business in a particular year,  $EFFICIENCY$  is the proportion of offers on which a firm advises in a year that are not withdrawn,  $COMPLEXITY$  is a computed measure of the firm's average deal complexity based on Table 6, and  $PERFECT$  is an indicator variable equal to 1 for a law firm that completes all deals on which it advises in a year. The  $\gamma$ s are regression coefficients and  $\nu$  is an error term. The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 offers covered in the database. The cross-sectional sample analyzed in the table consists of 9895 law firm engagement events associated with 7640 unique offers with complete SDC records.

Explanatory Variable	Specification A	Specification B
$\ln(EFFICIENCY)$	-4.83 (-5.05)	6.564 (16.61) <sup>***</sup>
$COMPLEXITY$	52.95 (21.83)	44.536 (25.18) <sup>***</sup>
$PERFECT$		-4.137 (-40.41) <sup>***</sup>
Constant	-11.15 (82.02)	-6.938 (-45.48) <sup>***</sup>
Adjusted R <sup>2</sup>	0.42	0.63

\*\*\* denotes significantly different from zero at the 1 percent level.

Table 9

## Legal advisor market-share and long-run returns effectiveness following acquisition offers

The table shows the average effectiveness (long-run abnormal returns for acquirers) associated with various law firm market-share cohorts over the years 1994-2000. Effectiveness is measured as either market-adjusted buy-and-hold abnormal returns (*BHAR*), market-adjusted cumulative abnormal returns (*CAR*), or cumulative Fama French three-factor-model-adjusted abnormal returns from a calendar time regression. Effectiveness is measured over days -1 to +750 or, alternatively, +26 to +750 around the announcement of an acquisition offer. In previous tables, firms with market-share of 1 percent or less are referred to as “small firms,” and those with greater market-share are referred to as “large firms.” Market share corresponding to a deal is the mean market share in the year of the offer for all law firms engaged on that particular deal. Market shares are computed based on 47,021 offers covered in the SDC database. The final sample analyzed in the table consists of 3042 unique offers with required SDC and CRSP data. In parentheses are sign-test *z* statistics (for *BHAR*) and White heteroskedasticity-consistent *t* statistics (for *CAR* and *FFAR*) to test the null hypothesis of zero abnormal return.

Cohort of law firms with market-share	Number of deals	Effectiveness (average long run abnormal returns, as percentages) for 3 returns measures and 2 returns windows measured in days relative to the offer					
		<i>BHAR</i>		<i>CAR</i>		<i>FFAR</i>	
		-1, 750	26, 750	-1, 750	26, 750	-1, 750	26, 750
0.1 to 0.5 percent	1013	9.08 (4.57) <sup>***</sup>	8.98 (4.19) <sup>***</sup>	14.13 (5.55) <sup>***</sup>	13.99 (5.81) <sup>***</sup>	16.2 (1.80) <sup>*</sup>	16.2 (2.00) <sup>**</sup>
0.5 to 1 percent	380	-13.99 (-5.80) <sup>***</sup> [-3.50] <sup>***</sup>	-12.12 (-5.90) <sup>***</sup> [-3.23] <sup>***</sup>	7.41 (0.60) [-1.21]	6.37 (0.32) [-1.38]	7.80 (0.58) [-2.28] <sup>**</sup>	7.80 (0.83) [-2.19] <sup>**</sup>
1 to 1.5 percent	273	-6.13 (-3.62) <sup>***</sup> [-2.05] <sup>**</sup>	-7.37 (-4.83) <sup>***</sup> [-2.31] <sup>**</sup>	-4.24 (-0.16) [-2.71] <sup>***</sup>	-4.08 (-0.18) [-2.75] <sup>***</sup>	-7.23 (-1.31) [-1.49]	-7.23 (-0.82) [-1.43]
1.5 to 2.5 percent	283	-12.68 (-3.62) <sup>***</sup> [-3.13] <sup>***</sup>	-9.63 (-2.29) <sup>**</sup> [-2.81] <sup>***</sup>	-1.52 (-0.42) [-3.04] <sup>***</sup>	-0.31 (0.00) [-2.83] <sup>***</sup>	-13.9% (-1.57) [-0.40]	-13.9 (0.63) [-0.29]
> 2.5 percent	606	-0.52 (-3.54) <sup>***</sup> [-1.38]	-0.56 (-3.13) <sup>***</sup> [-1.52]	-2.29 (-0.35) [-3.85] <sup>***</sup>	-2.25 (-0.42) [-3.87] <sup>***</sup>	-7.23 (-0.05) [-1.50]	-7.23 (-0.68) [-1.46]
All firms including the 1 deal Law firms	3042	-0.43 (-9.16) <sup>***</sup>	-0.27 (-8.87) <sup>***</sup>	6.73 (4.70) <sup>***</sup>	6.54 (4.72) <sup>***</sup>	7.80 (0.75)	7.80 (0.85)

<sup>\*</sup>, <sup>\*\*</sup>, and <sup>\*\*\*</sup> denote significantly different from zero at the 10, 5 and 1 percent level respectively.

Table 10  
Tests of consistency over time  
in deal completion efficiency and long-run returns effectiveness

Panel A reports regression tests of the general form:

$$DEAL\ COMPLETION\ INDICATOR =$$

$$\theta_{0,effic} + \theta_{1,effic} LAGGED\ EFFICIENCY + \theta_{2,effic} COMPLEXITY + \eta_{effic}$$

where *EFFICIENCY INDICATOR* is either *EFFICIENCY*, the proportion of non-withdrawn offers for a law firm in a year, in which case estimation is by ordinary least squares, or, alternatively, *EFFICIENCY INDICATOR* is *PROBABILITY(PERFECT)*, our indicator for zero deals withdrawn, in which case estimation is by maximum likelihood probit. *LAGGED EFFICIENCY* is the proportion of last year's deals completed, and *COMPLEXITY* is the legal complexity of the deal as measured in Table 6. Panel B reports regression tests of the form:

$$EFFECTIVENESS\ INDICATOR =$$

$$\theta_{0,effect} + \theta_{1,effect} LAGGED\ EFFECTIVENESS + \eta_{effect}$$

where *EFFECTIVENESS INDICATOR* is one of our three long-run returns measures (BHAR, CAR, or FF) measured over one of two time periods relative to the offer, either day -1 to +250, or days +26 to +250. *LAGGED EFFECTIVENESS* refers to the same returns measure and time period as for the left-hand side, but applied to the same firm's deals in the *previous* year. The  $\theta$ s are coefficients, and  $\eta$ s are error term. The sample is screened from the SDC M&A database. In both panels, the tests are applied to a panel sample of 851 law firm/years where each observation summarizes offers in a year from our final sample for which a particular law firm is the unique legal advisor. For regressions, White heteroskedasticity consistent *t* statistics are in parentheses. For probits, standard maximum-likelihood-based *t* statistics are in parentheses.

Panel A. Tests of consistency over time in deal completion efficiency						
DEAL COMPLETION INDICATOR		EFFICIENCY	PERFECT	EFFICIENCY	PERFECT	
Regressor:						
LAGGED EFFICIENCY		0.839 (12.92) <sup>***</sup>	21.711 (15.09) <sup>***</sup>	0.825 (11.11) <sup>***</sup>	20.230 (13.68) <sup>***</sup>	
COMPLEXITY				-0.088 (-0.74)	-12.940 (-3.95) <sup>***</sup>	
INTERCEPT		0.152 (2.40) <sup>**</sup>	-20.355 (-14.58) <sup>***</sup>	0.170 (2.21) <sup>**</sup>	-18.169 (-12.26) <sup>***</sup>	
Panel B. Tests of consistency over time in long-run returns effectiveness						
EFFECTIVENESS INDICATOR	BHAR (-1, 250)	BHAR (26, 250)	CAR (-1, 250)	CAR (26, 250)	FFAR (-1, 250)	FFAR (26, 250)
Regressor:						
LAGGED EFFECTIVENESS	-0.004 (-0.05)	-0.062 (-1.13)	-0.052 (-0.86)	-0.076 (-1.18)	-0.028 (-0.47)	-0.034 (-0.51)
INTERCEPT	0.022 (0.31)	0.013 (0.33)	0.005 (0.22)	0.005 (0.25)	-0.166 (5.99) <sup>***</sup>	-0.149 (-6.07) <sup>***</sup>

\*, \*\*, and \*\*\* denote significantly different from zero at the 10, 5 and 1 percent level respectively.

Table 11  
 Tests of relationship between acquirers' law firm choices to law firm  
 efficiency/effectiveness

The table reports means and difference of means tests for the number of different lawyers used by acquirers represented in our final sample of 3042 acquisition offers over 1994-2000. The sample is screened from the SDC M&A database. The table reports on several subsamples, described in the table, formed by distinguishing GOOD versus BAD acquirer outcomes of various types. GOOD acquirer outcomes are defined, alternatively, as acquirers experiencing no withdrawn offers, experiencing positive long-run market adjusted cumulative abnormal returns (CAR(-1, 750)), experiencing positive long-run market adjusted buy-and-hold returns (BHAR(-1, 750)), and experiencing positive Fama-French-factor adjusted returns (FFAR(-1, 750)). BAD acquirer outcomes are defined, respectively, as acquirers outside the GOOD subsample on each criterion.

	No withdrawn offers vs. some withdrawn offers	Positive CAR(-1, 750) vs. negative CAR(-1, 750)	Positive BHAR(-1, 750) vs. negative BHAR(-1, 750)	Positive FFAR(-1, 750) vs. negative FFAR(-1, 750)
Total number of <i>different</i> law firms used by acquirers that experience BAD efficiency or effectiveness outcome	3.22 <i>N</i> = 101	1.67 <i>N</i> =668	1.63 <i>N</i> =951	1.73 <i>N</i> =947
Total number of <i>different</i> law firms used by acquirers that experience GOOD efficiency or effectiveness outcome	1.69 <i>N</i> = 1457	1.70 <i>N</i> =890	1.77 <i>N</i> =607	1.63 <i>N</i> =611
Difference	1.53	-0.03	-0.14	0.10
t statistic	(9.44) <sup>***</sup>	(-0.48)	(-2.41) <sup>**</sup>	(1.85)

\*, \*\*, and \*\*\* denote significantly different from zero at the 10, 5 and 1 percent level respectively.

Figure 1  
 Scatter-plots of law firms' deal completion rates versus market-shares

The scatter-plots show deal completion efficiency (on the vertical axis) against law firm's market-share of number of offers in a year (the left scatter plot) and against law firm's market-share of the dollar value of offers in a year (the right scatter plot). The market-value-based definition of market share in the right plot is the definition used in other the analyses in this paper. The sample is screened from the SDC M&A database. Market shares are computed based on 47,021 offers covered in the database. The cross-sectional sample analyzed in the table consists of 9895 law firm engagement events associated with 7640 unique offers with complete SDC records.

