
Bryane Michael
What Determines M&A Legal and Financial Advisors’ Competitiveness in an International Financial Centre

Bryane Michael

Disclaimer: this presentation reflects a lively attempt to make difficult economics and legal material interesting and understandable. Nothing in this presentation attributes (of course) to the University of Hong Kong or any of the public and/or private organisations to which the author advises.
Disclaimer

The following presentation represents my ideas and interpretations alone. Even if I refer to co-authored work, I am presenting my own views which may (or may not) reflect the content of such work.
Argument in Brief

Big, IFC-based Law Firms and I-Banks

Smaller advisors

Legal complexity externality

Blue ocean differentiation

Advisory competition balances two forces – with LAW SCHOOLS providing sustainable competitive advantage to law firms and I-banks alike

China’s Going Out M&A allows us to see trends clearly
Going Out A Phenomenon

- Around 2000, PRC govt sent companies on buying spree
- State-owned led
- Different types
  - Direct
  - Portfolio
  - M&A
- What about legal/financial advisors?

Mega M&A flows let us see advisor patterns
Without large movement, difficult to see what variables causes shifts in advisors’ competitiveness...
The IFC Circuit – neither here nor there

- Advisors’ geographically divorced from their clients
- Form own network relations
- Law firms and I-banks on buyer and seller side reconfigure at will

What drives advisors’ ability to grab mandates?
Rarely together at all

Figure 4: Most Target Companies Do Not Deal with Advisors from their Same City or Country
(same city/country shown in bold)

<table>
<thead>
<tr>
<th>Target Company’s City</th>
<th>City of major advisors to either acquirer or target company</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>London (46%), New York (23%)</td>
</tr>
<tr>
<td>New York</td>
<td>New York (50%)</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>New York (30%), New York (20%), London (20%) <strong>Hong Kong</strong> (10%), Paris (12%), Zurich (10%)</td>
</tr>
<tr>
<td>Singapore</td>
<td>New York (30%), London (30%), Hong Kong (15%)</td>
</tr>
<tr>
<td>Sydney</td>
<td>Sydney (50%), London (41%)</td>
</tr>
<tr>
<td>Calgary</td>
<td>Toronto (40%)</td>
</tr>
<tr>
<td>Georgetown*</td>
<td>New York (20%), <strong>Hong Kong</strong> (15%), London (15%)</td>
</tr>
<tr>
<td>Hamilton*</td>
<td>New York (30%), London (12%), Hong Kong (12%)</td>
</tr>
<tr>
<td>Brussels</td>
<td>New York (55%), London (15%), Paris (15%)</td>
</tr>
<tr>
<td>Melbourne</td>
<td>Sydney (22%)</td>
</tr>
<tr>
<td>Kazinczya (HU)</td>
<td>London (50%), New York (30%)</td>
</tr>
<tr>
<td>Vancouver</td>
<td>Toronto (61%)</td>
</tr>
<tr>
<td>Perth</td>
<td>Sydney (70%)</td>
</tr>
<tr>
<td>Washington DC</td>
<td>New York (50%), London (15%)</td>
</tr>
<tr>
<td>Paris</td>
<td>London (37%), New York (25%)</td>
</tr>
<tr>
<td>San Francisco</td>
<td>New York (67%)</td>
</tr>
<tr>
<td>Milan</td>
<td>Milan (30%)</td>
</tr>
<tr>
<td>West Perth</td>
<td>London (30%), Sydney (30%)</td>
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Wild and weird advisor locations
Many advisors coming from unusual locations, suggesting that IFCs and advisor dominance not fixed. Indeed, we find a shift from 2000 to 2014 toward smaller places and local service.

Why no local global talent for advisors – and how to bust in?
IFC greatness isn’t for oft-assumed reasons

No difference in types of transactions

A detailed look at lack of sectoral specialisation

No difference in sectoral Specialisation or type of client

Slippery ranking by cities

“Gravity” (big because big) not factor
Big Boys of Chinese Advisory

- Financial advisors and legal advisors’ power law
- No gravity *per se*
- Little seeming relationship between
  - Advisor
  - Advisee
  - Transaction

International Financial Centres Dominate Advisory Work
Maybe Chinese Advisors Bad?

Many large Chinese cities not in China!
China’s advisors big and bad enough
Even “recycling” doesn’t explain

China CAN compete, but so can Istanbul
Revenge of smaller advisors

local, smaller advisors getting more competitive...

Figure 15: The Evaluation Away from International Financial Centre Centric Bulge-Bracket/Big-Law Advisory in China’s Going Out

More competitive over time...

Figure 10: A Picture of Going Out Companies and their M&A Advisors Over Time

Biggest of big not profiting “like they should”

Figure 19: Deal Sizes Drew Smaller for Top Financial Advisors in Going Out Deals than for Top Advisors Globally

winner takes less...

Figure 20: The Top Financial and Legal Advisors to China’s Going Out Companies Handled Less Than Their Fair Share of Deal Values over the Years

Winner hasn’t taken all in advisory
Global Competition Among Advisors

- Non-IFC, non-elite advisors increased market
- Advisor (and IFC) ranking depends on inter-play of two factors
  - quality of financial law
  - extent of service differentiation

Figure 10: The Geography of Going Out M&A Advisory Tied to Strategy Space of Its Advisors

Figure 21: Top Tier Financial Advisors Profited Less from Going Out Over Time, While Bottom of the Tier Legal Advisors Improved Their Performance

Legal complexity
Legal Complexity vs. Differentiation

Both advisors and their clients look for best mix for market
Strategic Substitutes and Complements

Figure 39: Advisors in Jurisdictions with More Legal Complexity Choose Less Differentiation

The figure shows the relationship between the Going Out advisors' jurisdictions' complexity of financial law and the extent of differentiation in their competitive behavior. We show the apparent relationship (from bivariate analysis) and the "real" relationship from multi-variate analysis. See paper for regression methodology.

Source: authors

Figure A5: Could Supply and Demand for Going Out Mandates Better Explain the Data?

The figure shows (again) the relationship between the Going Out advisors' jurisdictions' complexity of financial law and the extent of differentiation in their competitive behavior. This time, we draw in several "production possibilities frontiers" by eye and for illustrative purposes only. As advisors move northeast, their probability of obtaining Going Out work clearly increases. See paper for regression methodology. Source: authors
What is this about law school?

- Law school impacts on
  - legal quality
  - lawyer quality (diff.)
  - quality of advice?

Finance departments (economics faculties) have little impact – suggesting that FAS doesn’t really matter.

Law schools, not economics grad school, drives IFC rankings.
A New Way of Thinking About the “Geography of Finance”

Old skool
Lat, Long, country valley

New skool
Position in differscification dimension

“Location” of advisors’ IFC isn’t lat and long, but array of values along various dimensions like legal complexity, differentiation etc. Still a unique coordinate system. Better because
- unique (doesn’t also describe other things)
- transitive
- dynamic
- uber-communitative

Same concepts, different “dimensions”
Conclusion

- Lots of studies focus on M&A advisors
  - profit effect
  - specialisation
- Few studies agree
- Geography of advice
- Super-important question for Goldman Sachs/ Baker-Mckinzies of world
- What's new about our study?
  - new factor – law school quality
  - new externality
  - quantify management guru talk

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Figure 23: Strands of Literature Looking at the Way M&A Activity Impacts on Advisory Demand

<table>
<thead>
<tr>
<th>What determines choice of adviser?</th>
<th>Description</th>
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<td>Completion rate</td>
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Appendix: Our Model

demand side

\[ p = \frac{q C^d \psi D^s X^a}{(wL)^t} \]
\[ p_s = [(q \psi) C^d D^s X^a] \]

supply side

\[ \pi = p(C, D, X)Q - \eta \]
\[ \pi = (C^d D^s X^a) - (t_c C + t_D D + t_s X) \]

equilibrium

\[ C^* = \left( t_d D X^a - (q \psi) t_D D X^a - D \right) + \frac{1}{2} \left( q \psi X \left(t_c C X^a - (t_c \psi X)^a \right) \right) \]
\[ D^* = \frac{1}{2} \sqrt{C^2 - \frac{4(t_d \psi C X^a - (q \psi) t_d C X^a - D)}{(\psi X^a + (t_d t_c \psi X)^a)}} = 0 \]