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Information Production by Investment Banks: Evidence from Fairness Opinions

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Abstract

We analyze a direct product of the investment banking process: target firm valuations disclosed in the fairness opinions of negotiated mergers. On average, acquirer advisers exhibit positive valuation errors that are significantly greater than those of target advisers. Top-tier advisers produce more accurate valuations than lower tier advisers, but we find no relation between valuation accuracy and the contingency structure of advisory fees. The stock price reactions to merger announcements and to the public disclosure of target-sought fairness opinions are positively related to the difference between target firm valuations contained in the fairness opinion and the merger offer price. We conclude that investment banks produce information not previously available to market participants through the rendering of target-side fairness opinions.