<u>**The Effect of Bank Mergers on Client Firm Value and Bank-Firm Relationships**</u>

Heather Montgomery*

Yuki Takahashi**

<u>Abstract</u>:

In this study we first confirm the result of Montgomery and Takahashi (2014) that the announcement of a bank merger yields large and highly statistically significant cumulative abnormal returns for bank shareholders, using an expanded and updated data set. As reported in our earlier research, this finding is especially true for banks involved in huge mega mergers (tables 3-4). This study then turns to examine a new research question: what are the effects of these bank mergers on the non-financial client firms of those banks?

Using event study methodology to estimate firms' abnormal returns around merger events, we find that large bank mergers *negatively* affect client firms' valuation. This is true for all firms, but the losses are statistically significantly larger for clients of target banks and banks involved in "mega mergers" forming financial institutions with total assets of over 80 trillion yen. (tables 5-7).

Why do we observe this difference in the response of bank and client firm value around bank merger events? One hypothesis might be that client firms face a higher probability of losing their special main bank-firm relationship in the aftermath of bank mergers. In table 8, we report some simple termination and delisting rates for client firms in the five years after a bank merger event. There are a couple of interesting observations to be made from this table. Termination and delisting rates tend to be higher for smaller firms, and for firms that are clients of the target in a bank merger event. However, termination and delisting rates are not significantly higher for clients of banks involved in mega mergers versus normal mergers. This is somewhat surprising given the robust and highly statistically

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* *Corresponding Author*: Senior Associate Professor, Department of Economics and Business, International Christian University. E-mail: montgomery@icu.ac.jp

** Ph.D. Student, Department of Economics, State University of New York at Stony Brook. E-mail: yuki.takahashi.1@stonybrook.edu

significant differences in the cumulative abnormal returns of client firms of banks involved in mega mergers.

Some of the patterns we observe looking at these simple averages are generally confirmed with hazard model analysis. For example, smaller firms have a higher probability of being terminated. Merger of the main bank, or even a mega-merger of the main bank, in general doesn't seem to influence the probability of relationship termination, which is surprising given our robust and highly statistically significant CAR results. However, clients of *target* banks in M&A events are nearly twice as likely to experience relationship termination. (table 9).

To closely look at the relation between CAR results and the results for the probability of relationship termination, we finally proceed to regression of client firm's cumulative abnormal returns. Somewhat surprisingly, the change in termination rate due to main bank merger leads to higher cumulative abnormal returns. In addition, higher main bank cumulative abnormal returns lead to lower client firm valuation in general. Client firm valuation is lower when the merger is mega-merger, and when the main bank is merger target (table 10).

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