Andreas Krause

Advice in mergers & acquisitions

The role of investment banks in mergers & acquisitions

- Investment banks provide advice to companies seeking to merge with another company, acquire another company, or being acquired by another company, whether willingly or unwillingly
- The processes and specific tasks are different for each type of transaction, the principle remains the same
- Investment banks will in particular advise on the valuation of their own company and that of the other company involved
- Investment banks will also advise on reactions by capital markets to the merger, such as the likely reception by shareholders of a proposed merger
- Investment banks will advise on the strategy of making and accepting offers
- Investment banks only provide advice, they do not take a stake in any of the companies involved

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Investment banking contracts

- Investment banks provide advice for a fee, which is paid for by the company seeking it
- Contingent fee contracts are the most common contracts
- Clients pay the investment bank a fee in proportion to the value of the merger, provided the merger is completed
- In addition, often, clients have to pay the investment bank a fixed fee to cover their costs if the merger is abandoned

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The impact of contracts

- The advice will be such that it maximizes the profits of investment banks
- This advice might not always be in the best interest of their clients
- The resulting conflict of interest is affected by the way the fee is determined
- An investment bank offering a contract that has less conflicts of interest is at a competitive advantage
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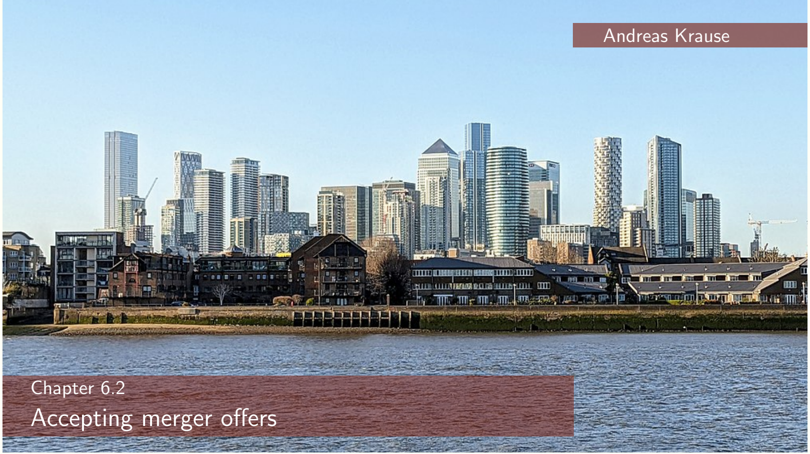

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Chapter 6.2

Accepting merger offers

Discussion of the model results

- Contingent fee contracts are showing the least conflicts of interest and are the most common form observed
- Conflicts of interest are still present in these contracts and cannot be fully eliminated
- Can investment banks knowingly advice clients to accept or make offers that are not in their best interest?
- Concerns about their reputation would limit their incentives to advice clients incorrectly, but wrong advice might never be detected as information is incomplete

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Introducing an additional contractual arrangement

- Contingent fee contracts are commonly found in mergers & acquisitions, but they do not align incentives fully, leaving a substantial difference in the interest of waiting for a better offer or making a lower offer themselves
- There is another common feature in the contract, a fee that is payable if the merger is not completed
- We will now look at such a contractual arrangement, where a smaller fee is payable if the merger is abandoned and assess how this affects the incentives
- Given the informational advantage of investment banks, they have the potential to distort advice in their favour and at the expense of their clients, making it important that incentives are aligned to maximize the benefits to their clients

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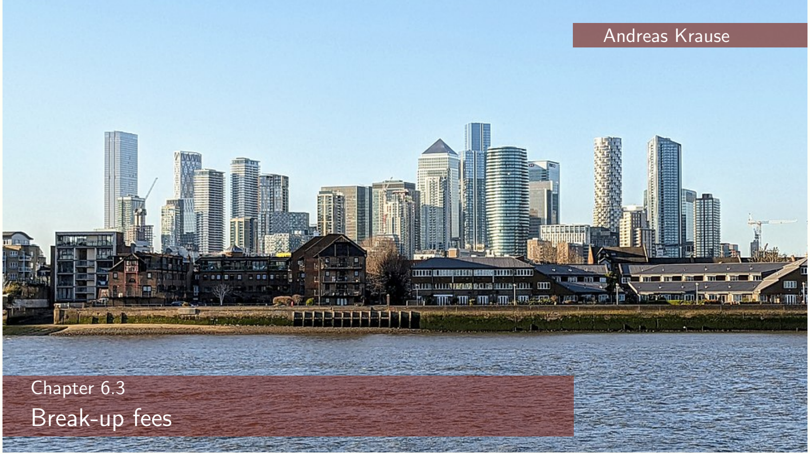

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Chapter 6.3

Break-up fees

Discussion of the model results

- Break-up fees provide incentives to investment banks to give unbiased advice on the commencement of mergers
- Higher costs to clients of abandoning mergers reduces their incentive to commence with a merger and the higher fee income increases the incentives of investment banks to recommend continuing with a merger, allowing the incentives to be perfectly aligned
- This model suggested that mergers should be pursued if the likelihood of it being completed was sufficiently high, while the previously model suggested that an offer should be accepted if a better offer was unlikely to be received. How can these two approaches be reconciled?
- We can interpret the abandonment of the merger in the second model as accepting a low offer or making a high offer and focus on the case where the company holds out for better conditions, which are uncertain to be accepted

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Summary of key results

- Advice in mergers & acquisitions is generally not in the best interest of their clients
- Using contingent fee contracts with a break-up fee aligns these interests
- A complex contract is used to ensure clients obtain unbiased advice, which is in their best interest

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