

Ethics and transparency in mergers and acquisitions

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The credit crunch in the USA and the slowdown in Western Europe have significantly affected the number of mergers and acquisitions in these regions. However, corporate buyers as well as private equity houses still show a lot of interest in companies in Central and Eastern Europe. What are the challenges involved in these transactions?

The process of these transactions offers many possibilities to show ethical as well as questionable behavior on the part of all the parties involved. These parties mainly include buyers, sellers, investment banks, and advisors on both sides of the transaction.

The buyer wants to pay as low a price as possible and the seller wants to get as much for their company as they can.

Theoretically, a willing buyer and seller should come to a quick agreement and understanding about the fair value of the subject of the contemplated transaction. The seller should provide all the necessary information to the buyer and the buyer should be willing to pay a "fair" price. However, this is nearly always not the case.

The buyer wants to pay as low a price as possible and the seller wants to get as much for their company as they can. This leads to different interests and often opposing behaviors throughout the transaction process. Several behavior patterns of the seller

and their advisors can be questioned from an ethical and transparency perspective.

Transactions, especially those of significant value, are usually run against the clock. Potential buyers have limited time to submit nonbinding and, afterwards, binding bids. This gives the sellers an opportunity to limit the buyer's ability to evaluate the target. They usually do this in order to limit the possibility that buyers will find out about significant issues, which could lead to a decrease in the purchase price or even the cancellation of the deal.

The way that this behavior manifests itself is that sellers set up a data room, which lacks a significant amount of information and/or includes information in a user unfriendly format (e.g. spreadsheets with a significant amount of data printed on paper rather than provided in soft copy etc.). Subsequently, the buyers pose an enormous number of questions and demand additional information, which, given the limited time period for due diligence, are not answered fully or they are answered in a user unfriendly way.

In addition, a great amount of information is withheld which is considered too commercially sensitive, which in many cases may or may not be the case.

This leads to the initial quotation of the share purchase price, which is based on far from ideal information, and can lead to the over-pricing of the target, which may be in the interest of the sellers but is certainly not in the interest of the buyers.

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Naturally, there is a solution to this problem that arises from the buyer's uncertainty regarding the potential risks related to the target company. When buyers pitch a share purchase price under the conditions described, they want to secure themselves against any potential risks embedded within the target company that they were unable to evaluate and that they have one final chance to do so – the sale and purchase agreement.

Buyers usually want to include heavy warranties and indemnities in this agreement. In many cases the sellers do not want to sign such warranties and indemnities. As a result of this, negotiations

regarding the final wording of the sale and purchase agreement may take a significant amount of time, and bring additional transaction costs to the process.

Although a certain level of confidentiality and an unwillingness to share detailed financial and commercial data with buyers is understandable, intentionally failing to disclose key financial data or intentionally prolonging the process and misleading buyers during their evaluation of the target is unethical and does not build trust between the parties, which in many cases involves multi-million Euro deals.

Sellers in our region are often individual entrepreneurs who have built their businesses up from zero or from a privatized business purchased during privatization. These sellers are often unprepared for the complexity of the transaction process.

It is the responsibility of advisors on the sale side to educate their client and to build an atmosphere of trust between all the parties involved in order to complete the transaction in the shortest possible timeframe, which naturally leads to the minimization of transaction costs and the bringing about of the smallest possible disturbance of the day to day business of the target.



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