Corporate finance under fire: How can boards and management seek refuge?

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At a glance

Corporate finance decisions involving mergers and acquisitions and capital markets have come under increasing scrutiny.

Boards of directors and management are looking for objective guidance to help them avoid the ire of shareholders, activist investors, and regulators regarding corporate finance decisions.

What qualities should boards and management look for when seeking independent corporate finance advice?

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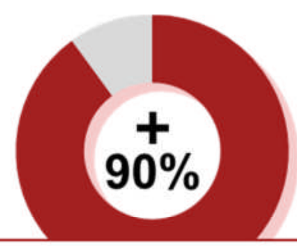
"Are you sure about that transaction?"

No less than 90% of mergers and acquisitions valued over $100 million have encountered shareholder litigation each year since 2010.[1] And the trend is only growing, with 237 companies having faced activist investor campaigns in 2013, a 9% increase over 2012.[2]

Satisfying the board's fiduciary responsibilities when it comes to transactions isn't getting any easier as a gamut of parties—shareholders, activist investors, and regulators—have all been taking corporate boards and management teams to task. The latest hot spot: corporate finance decisions involving M&A and capital markets.

Technology transactions have been especially fraught with litigation. In 2013, the Dell and Tellabs buyouts were subject to 26 and 16 lawsuits, respectively. But no industry is safe from litigation around transactions, with a dozen or more lawsuits being brought against individual transactions in sectors including finance, energy, and consumer goods.[3]

Why the growing wave of dissent? More and more, critics are questioning whether the decisions around transactions that impact shareholder value have been made with sufficient objectivity and are free from conflicts of interest.



of mergers and acquisitions valued at over $100 million have involved shareholder litigation – every year since 2010.[1]

Seeking refuge in objectivity

Value-related M&A questions

- How are alternative courses of action expected to affect shareholder value in the short term and over the long term?
- Which variables and assumptions have the potential to impact value the most?
- What specific value creation or destruction may result from different decision paths?
- How can the range of potential outcomes be influenced by the levers that the company can control?
- Is the company the right operator of a given target — i.e., will the company maximize value relative to other operators?

Corporate boards and management teams are increasingly trying to protect themselves from claims of poor decision-making in transactions by securing independent, objective advice and using it to guide or validate corporate finance decisions. A common example is the use of *fairness opinions* to help evaluate terms of a transaction. But recent lawsuits claiming fiduciary neglect for relying too heavily on fairness opinions show these evaluations are far from foolproof.

For much of this advice, businesses have naturally relied on third parties that are sometimes perceived to have conflicts of interest. Potential conflicts, even if more perception than reality, can trigger calls among shareholders and regulators for greater objectivity in advice about whether and how to complete transactions.

Boards are responding to these concerns by enlisting a new breed of objective independent advisors who don't have incentives to complete the transactions. Forward-looking analyses in corporate finance that probes value-related questions can help sufficiently weigh options and build consensus before decisions are finalized. Scrutinizing financial advisors' objectivity in handling questions like these (see box) can help keep the business out of sticky situations.

The analyses can also help executives answer questions about how to raise capital, such as:

- When should we raise the capital?
- What should the capital structure look like? Will it be based on equity? Or debt? What type of equity? What types of investors should we have?
- Which investment bank should we be using?
- Who are the right research analysts?
- What's the market story?

237

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Raising capital with care can help keep businesses from making commitments they regret. In one pharma deal, the acquirer's M&A advisor was also its exclusive source of financing and stood to make higher fees from financing than from advice. Separating the M&A advice from the financing role through a competitive process removes that kind of conflict of interest.

No guarantees, but peace of mind

Finding the right independent advisor to provide this objective corporate financial analysis is a challenge in itself. Here are some questions businesses should consider asking when choosing independent advisors.

- Are the advisors unattached to a financing source for the transaction?
- Are fee arrangements not contingent on the success or failure of a transaction?
- Do the advisors have a demonstrated track record of successfully implementing a range of leading-edge corporate finance practices?
- Can they provide high-quality, practical deliverables that give value observations for a range of potential decisions, including pursuing or not pursuing a given transaction?

Of course, no advisor can offer complete assurance regarding the outcome of corporate finance decisions. However, enlisting the support of an independent specialist can help boards and management teams demonstrate they've taken steps to protect shareholder interests and risen above potential biases.

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1. Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions—Review of 2013 M&A Litigation, 2014.
2. The Activist Insight, Activist Investing Annual Review 2014, 2014.
3. Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions—Review of 2013 M&A Litigation, 2014.

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Contacts

To have a deeper conversation about how this subject may affect your business, please contact:

Henri Leveque
U.S. Capital Markets and Accounting Advisory Services leader
h.a.leveque@us.pwc.com
678 419 3100

Aaron Gilcreast
Principal, Strategic Value Consulting
aaron.a.gilcreast@us.pwc.com
678 419 1080

Joseph Nuzzolo
Managing Director, Capital Markets
joseph.b.nuzzolo@us.pwc.com
646 471 3457

For a deeper discussion on deal considerations, please contact one of our practice leaders or your local Deals partner:

Martyn Curragh
Principal, US Deals Leader
martyn.curragh@us.pwc.com
646 471 2622

Scott Snyder
Partner, Deals
East Region Leader
scott.snyder@us.pwc.com
267 330 2250

Bob Saada
Partner, Deals
New York Metro Leader
bob.d.saada@us.pwc.com
646 471 4000

Mel Niemeyer
Partner, Deals
Central Region Leader
mel.niemeyer@us.pwc.com
312 298 4500

Brian Levy
Partner, Deals
brian.michael.levy@us.pwc.com
646 471 2643

Mark Ross
Partner, Deals
West Region Leader
mark.ross@us.pwc.com
415 498 5265

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