

Master in Finance

Negotiation techniques in M&A processes

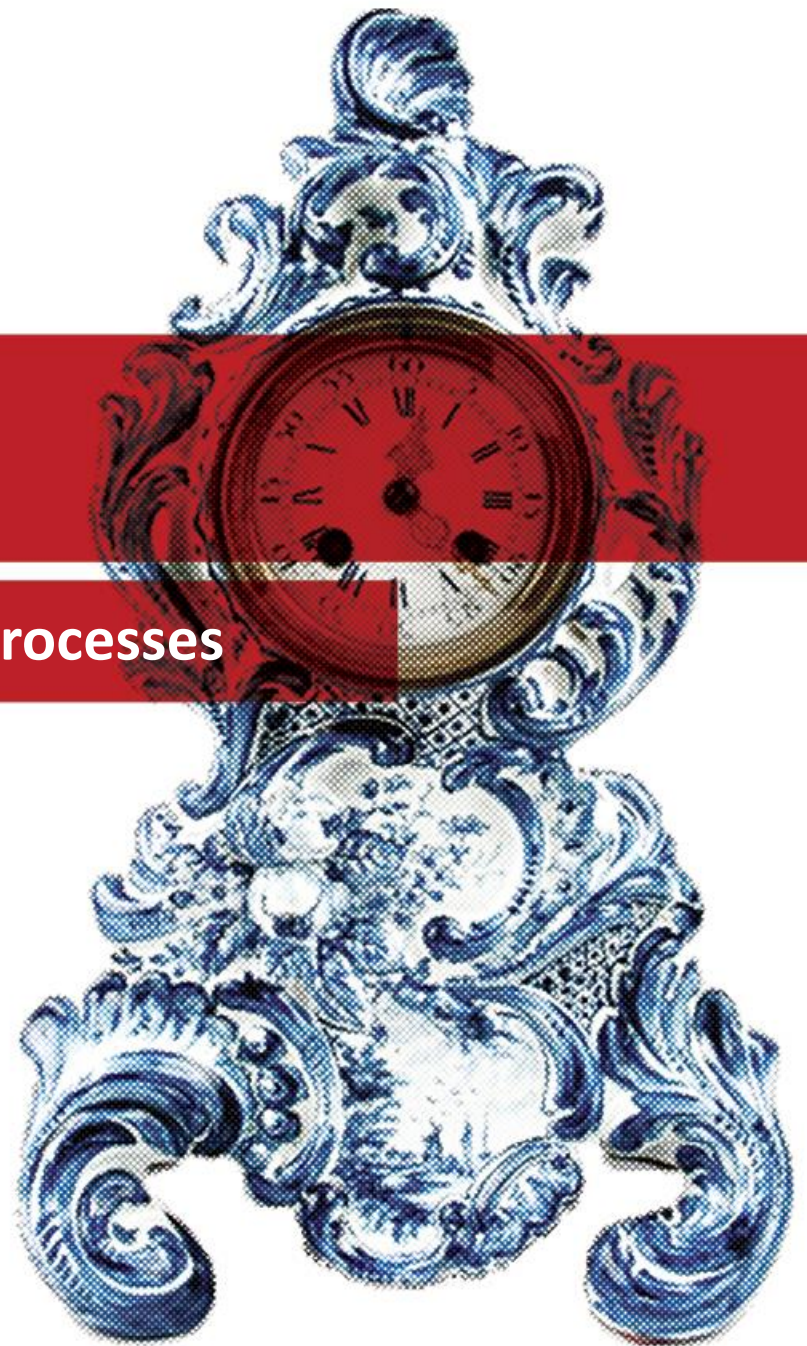
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What is to negotiate?

It is the understanding and the convergence between parts in order to establish an agreement that create counterparts for the involved players.

How is the way to negotiate?

- Unlike the exact science that find an exact solution in response to a problem formulation, the **negotiation is a not an exact process** and the final result can not be predicted with absolute certainty at the beginning.
- The uncertainty can not be a dominant characteristic of a decision process. Therefore, the **setting of a number of preparation and development steps are essential** to guarantee the highest or the lowest predictability of the results, or as another way, to ensure the success of the negotiating.

The Steps of the Negotiation Process



The Steps of the Negotiation Process:

1. Preparation
2. Presentation
3. Consideration of mutual interest
4. Preliminar investigation / Due Diligence
5. Negotiation
6. Conclusion

The steps of the negotiation process



The Steps of the Negotiation Process



1. Preparation

The preparation for the business:

- This step is included in the period of pre-release of the acquisition offer, when the acquiring company makes a SWOT analysis:
 - It is analyzed the strong and weak points of the target company, having into account the opportunities and threats of the environment.
- The **selection** process is, with no doubt, the most important one.
 - First of all it is essential **to know what are the motivations for the acquisition** which will help to set the first contact with the target company.

The Steps of the Negotiation Process



1. Preparation

What is going to help us to decide ?

- The target company is essential for the production chain for the acquiring company.
- The target company is essential for the commercial structure of the acquiring company.
- What are the expected earnings after acquiring the target company, and why is better to acquire than subcontract or expand ?
- The customer portfolio of the target company allows to reach objectives of market share that the acquiring company intends to achieve.
- The target company has the pretended products for the diversification strategy of the acquiring company.

The Steps of the Negotiation Process



1. Preparation

What is going to help us to decide (cont) ?

- The target company is well managed, it is getting the market, but its dimension does not allow it to grow more without being integrated in a larger organization.
- The target company is cheap.
- The acquisition of the target company will allow to achieve considerable economies of scale and will increase the competitiveness of the acquiring company.
- Any other relevant motivation.

The Steps of the Negotiation Process



1. Preparation

What are the criteria for the selection?

- Dimension
- Results
- Legal Structure
- Products portfolio diversification
- Research & Development
- Certificates of quality (or others certificates or rules)
- Distribution Channels
- Customers Portfolio
- Image
- Equipments
- Facilities
- Location
- Other

The Steps of the Negotiation Process



1. Preparation

What is the strategic planning for the driving up of the business?

- Who are the possible candidates?
- Who should be the candidates?
- What are the roles of each candidate?
- What is the profile of each candidate?
- What is the expected vision of each one?
- Who are the advisors? Were they expected?
- Who is the decision maker?
- Who influence positively on the decision maker?
- Who influence negatively on the decision maker?

The Steps of the Negotiation Process



1. Preparation

Briefly, enunciate the next points :

- The motivations
- The variable of critical analysis
- The possible players and their roles

The Steps of the Negotiation Process



2. Presentation

The Acquiring Company Identify

- Its intention of purchase
- Its motivations
- Why, from its perspective, it is a positive operation
- Its career
- Its business portfolio
- Its sphere of action
- Its references (clients, suppliers, banks...)
- Etc.

3. Consideration of mutual interest

Consideration of mutual interest:

- This is the phase where both parts involved in the process confirm between them if there are motivations part to part and if there are some expectations (mainly of the acquiring company) if keeps intact and/or if are increasing.

3. Consideration of mutual interest

Criteria of interest confirmation of the acquiring company:

- Extent of a range of products
- The complementarity of the economical activity, being vertical or horizontal
- The confirmation of expectations concerning the market share
- The dimension
- The required profitability of the investment
- The continuity or not of the management team
- Other...

3. Consideration of mutual interest

At the same line, the target company should take into account:

- The financial health of the acquiring company
- The way of financial implementation
- Cultural proximity
- Possibility of the use of services with higher performance level
- The effective analysis regarding the sale of the shareholders' participation

The Steps of the Negotiation Process

3. Consideration of mutual interest

With the confirmation of the **Mutual Interest**, it is common that both parts grant **Intention Letters (Memorandum of Understanding – MOU)**.



Objectives:

- Setting a moral obligation, although without legal force between the parts;
- Setting the main points of the agreement, which will avoid conflicts in the next phases.



3. Consideration of mutual interest

Intention Letters

It is recommended because:

- It is required that the parts spend time thinking about the base principles of the agreement
- Separate “decision” of “small interest”
- Its execution come to be very difficult to change the terms of the letter without offer a better alternative
- Define initial positions, that is, in which step we are

The Steps of the Negotiation Process



3. Consideration of mutual interest

Intention Letters

From the buyer perspective:

- Definition of interest (total/partial acquisition...)
- Price and conditions of payment
- Requests access to a due diligence

4. Preliminary Investigation / Due Diligence

Preliminary Investigation

- According to the mentioned before, the content of the intention letter usually includes the due diligence, that is, the collection of the necessary information in order to make the valuation of the company and this way, to define:
 - **First:** The price and the respective acceptable business range of the acquiring company;
 - **After that:** Legal, Financial and Taxes positions.

The Steps of the Negotiation Process



5. The Negotiation

“Good Gentlemen always flavor the finest tea around a business table”.

That means:

- Learn to be elegant
- Know the process and want to conciliate
- Value added for all parts



5. The Negotiation

Meeting Preparations

Assuming that the previous steps had the detail and the necessary planning, managers should know:

- What is the essential information for the meeting
- Who are the intermediaries and its motivations
- What is the base price
- What is the limit price

5. The Negotiation

Location to carry out the negotiation

In your own field:

- ✓ It is easy to plan strategic interruptions.
- ✓ It is easy to request the specific collaboration of the company staff to provide inputs.
- ✗ It is difficult to avoid interruptions not planned.

In the other field:

- ✓ The decisions can be postponed with the point that it has to be asked someone of the company.
- ✓ It does not feel as you are in your environment.
- ✗ There is no control on the logistic.

5. The Negotiation

Location to carry out the negotiation

Neutral field:

- ✓ As a whole, none of the parties feel restricted or with more power on the situation.
- ✗ However, it is always difficult for both parties to go sufficiently prepared with all the information.

- The most important is never to be prisoner nor with pre-designed ideas.
- Being in a business is also learning to be and to learn to be versatile or, at least, versatile enough to reach the goal.

5. The Negotiation

Fundamental Aspects

1. To consider the personality of the other part, particularly:

- Is the seller adverse to the risk, or prefer to maximize the profitability ?
- Verify if there are convergent interests or disagreement in the other part;
- Verify the “Degree of confidence/ mistrust” of the other part;
- Verify the quality and readiness of the answers in the meeting concerning our requirements;
- In what concerns the requirement of the detailed and confidential information;
- Equally, to be well prepared and to provide information with quality, in a complete, paused and objective way.

5. The Negotiation

Fundamental Aspects

2. For the success, the company must:

- Start and keep a soft, diplomatic and gentle position avoiding arrogance or demonstrations of prepotency.
- The acquiring company must not attribute too much importance to the price.
- Develop a post-acquisition planning. With special emphasis in the business integration planning, but also taking into account all the functional areas of the company, its human resources and its organization.

5. The Negotiation

Fundamental Aspects

3. Equally the target company must be proactive:

- It should not create pre-conceived judgments and not assume that the acquiring company has the only objective of minimization of the sale price.
- Make a due-diligence to the acquiring company, in case of a M&A exchanging for shares.
- Ask to management, legal, taxes and accounting consulting in order to avoid some mistakes (Ex. Vendor Due Diligence).
- Not use the price as a excuse, if you are not interested in the sale.
- Cooperate with the acquiring company focusing in solving questions linked to human resources, capital structure and the integration with organizational character (for products or services).

The Steps of the Negotiation Process



5. The Negotiation

Fundamental Aspects

4. Principles of Agreement:

- Define the heading lines to the progress.
- It just makes sense if the basic structure of the business was defined including price and payment terms.

5. The Negotiation

Fundamental Aspects

5. Contracts with Managers:

- It is easy to realize that the managers and seniors of the target company want to know the conditions and offers of the acquiring company.
- In bad-leading or bad-defined situations, the managers will feel uncomfortable because their future are in the air, so they will try to block the agreement.

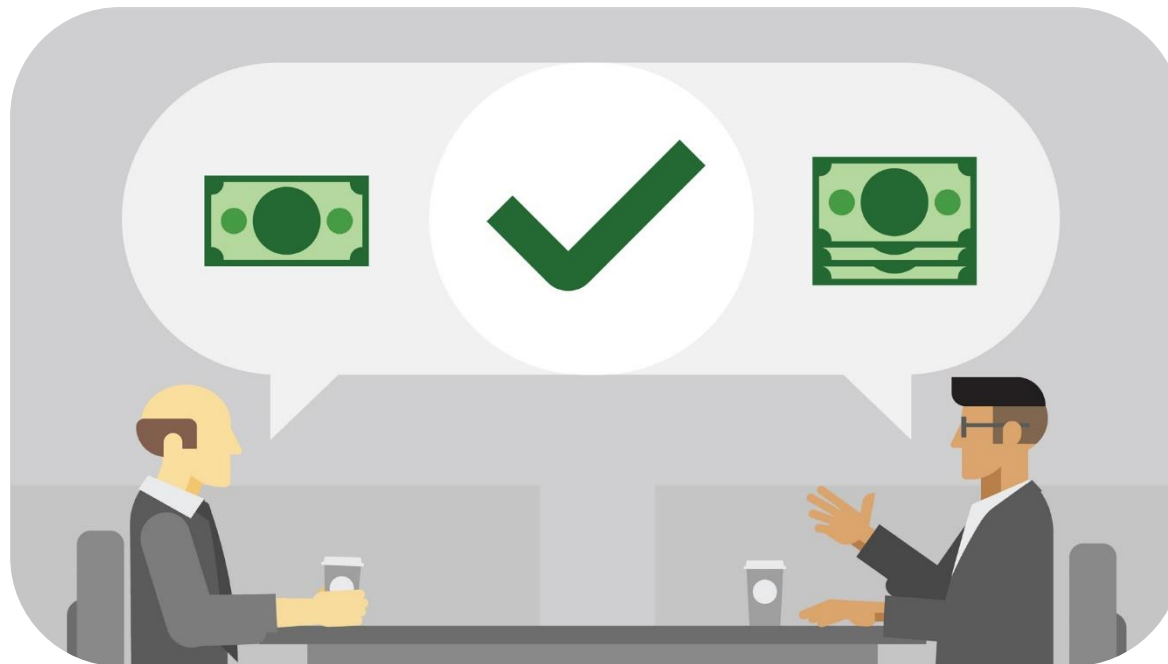
6. Conclusion

Conclusion and Contract

Some inherent aspects to the conclusion:

1. Restriction to how will run the future
2. Agreements of training and familiarization
3. Contracts of work/consulting
4. Earn-out clauses
5. Making control decisions beforehand
6. Period of operational transition and acquisition management

Negotiation Strategies



Negotiation Strategies

In **business** the strategy will be always formed around: I want to buy cheap – I want to sell expensive. And this way, designs itself the **two ways** of getting this objective:

- **The first**, keep the statement exactly the same: “What I earn, you lose and we do final accounts now”.
- **The second** modify softly: “I give and you give and despite giving both less, we will pick what we want tomorrow”.

These are the **two key strategies** in the M&A negotiating process.

1. WIN-LOSE MODEL:

Characteristics:

- Each part involved tries to maximize its results;
- The result is null: the earnings of one part are the same amount that the loose of the another part.

Negotiations adopting the Win-Lose Model:

- Each part involved try to maximize in detriment of the another part.
- Consider that the interests are opposites.
- Vision from the opposite part and not from the partner part.



2. WIN-WIN MODEL:



Reciprocity Negotiation:

- Demands and concessions made in a rational and equitable way;
- There is a positive convergence of both sides for the agreement.
- "Demand" done on the basis of reciprocity.
- The problem is when some of the parties do not move with the win-win assumption.

Soft Negotiation:

- Gentleness and sympathy;
- Creating positive attitudes and responses both sides.

2. WIN-WIN MODEL:

Characteristics :

- Search for points of common interest
- Seeking synergies
- Looking for partnerships, alliances and increase in value
- Form a positive sum game.

Jiu Jitsu attitude or flexibility attitude:

- The negotiator seeks to know which power of the other party, controlling the pace and maintain a respectful relationship.
- Establish or raise key issues and find solutions by mutual agreement rather than rigid solutions.
- It establishes a broad view of all key points, and not only on price, to identify common views and enhance value creation.
- All elements have an interest in the generation of negotiated solutions.

3. Negotiation with Arbitration - Advisor:

Characteristics:

- Mediator in the search for consensus, establishing points of convergence between the parties;
- Useful when both parties need support towards factors that do not dominate;
- Resolute with any problem that can be an obstacle for closing the deal;
- Negotiations conducted with the most professional way;
- Increase the possibility of success of the negotiation related with the higher distance and independence of the advisor in relation to the operation.

In preparing the rounds of negotiation, the buyer and seller should reflect on:

- What the common agreement points are
- What the differences of interest are
- What the points of separation or degree are
- How to re-define the negotiation and keep the cooperative attitude

That is:

ACT IN ACCORDANCE WITH THE PRINCIPLES OF AN INTEGRATIVE MODEL

Key Elements of the Efficient Negotiation



To get that, it is essential to:

- Define a cooperative strategy;
- Define objectives that satisfy both parties;
- Create solutions for problems and divergences;
- Focus the negotiation in the interests of each one and not take a rigid position;
- Separate problems of business;
- Be able to separate personal interests of negotiable interests;
- Be able to hear;
- Be able to question.

Danger Signals

The breaking of the business can happen at any moment. The reason could be anything. Anyway, the causes are usually the next ones:

- The credibility
- The confidence
- The timing

Danger Signals - Warnings

- In key areas specialized personal is not used;
- The information requested, being simple or complex, is always delayed;
- The answer to the information requested concerns other different things, or still going around without satisfying us;
- There is missed information;
- There is not cooperation coming from the other part;
- There are meetings delayed without an acceptable reason.

Danger Signals – Warnings (cont)

- Appear new actors in the meetings;
- The seller establishes limitations to access to people, documents, places or assets;
- The attitude of the counter-part denotes “something hidden” or, from the other hand, pushes the business “ahead at any price”;
- Any other that do not to leave us well impressed.

Situations of Impasse

- The impasses happen when there is lack of agreement in one or several points considered essential for the actors in the negotiation process.
- The price will always be the most relevant point.

Conditions of payment

- Value of the tranches;
- Temporal distance between payments
- Acquisition value subject to future restrictions

Kinds of payments

- Part in material form
- Transference of assets

Situations of Impasse (cont)

Incorporation / Transference of staff

- Not desired people;
- Desired people;
- Distribution of places (mainly relevant in case of the mergers/ incorporations of SME involving, for instance, familiar members);
- Exclusion of the seller from the economic activity.

Situations of Impasse (cont)

Analyzing the most common situation: Price

- It appears in the difference of the asset transference from the acquiring company to the acquired company's owners.
- It appears in the difference of not transferring all the assets of the acquired company to acquiring company (for instance, a commercial link, not sell a room keeping it under the control of the present owners)
- Etc. (open always the imagination and find creative solutions)

Situations of Impasse (cont)

Analyzing the conditions of payment:

- In order to solve, it must be taken into account all the hypotheses referred and remember the elementary rules that all businessman knows:
 - If it is paid at head...later it will be paid the rest
 - If it is paid less at head ... Later it will be paid the rest
- Another hypothesis when it is pretended to pay low tranches, it is proposed the payment kind of “leasing”. A solution potentially interesting in SME for the acquired company, but with the risk involved of failure.



It can be overcome if the seller request, and the buyer accept, a **bank guarantee**.

Situations of Impasse (cont)


Earn-Out: Way to resolve impasses

- The Earn-Out is a method of compensation for the seller.
- The Earn-Out can be used when both parties do not get to find a price of common agreement. If between both parties there is a climate of mutual confidence then, part of the price could be established of a contingent way or postponed subject to results.
- This way, keep determined in a contract that part of the price of the sale will be done with the contingent way, to be paid wholly or partly depending on the level of performance of the acquired company.

Ex. Situations which exist a low confidence level in the accounts of the goal company.

Earn-Out

For the earn-out payment it is necessary to:

- Exists a transparent relation and confidence
 - The negotiating have advanced in an integrative way (Win-Win Model)
 - Define the way of the contingent price: monetary, shares, etc...
 - The criteria of the performance measurement
-  This is the most sensitive because it expresses the conditions of analysis results that will form part of the price paid as contingent. **It can be based in:**
- Estimation by the operational result;
 - Estimation by the liquid result;
 - Estimation by the operational cash-flow;
 - Whatever the method should be set out the formula for calculation of the price contingent;
 - It also should be written the period of analysis that will be defined as one in which the assessment results will form the price contingent.

Some formal aspects underlying the negotiation process



Some Formal Aspects

Letters of intent - *MOU*

- Description of the transaction way. Merger, buy of shares, assignment of shares, etc.
- Important details for the purchase: For instance, the **assessment method**.
- Protection clauses – for instance in the case of companies in difficult situation.
- Special agreements: Such as labor contracts.
- “No shop” clauses: Making difficult for the seller to find other buyers in a specific period.
- Commission for compensation (bust-up): Being payed to the buyer in case the seller desires sell the acquiring company to third parties.

Some formal aspects underlying the negotiation process



Some Formal Aspects

Confidentiality agreement

- After or at the same time that the signature of the intentions letter is elaborated the **confidentiality agreement** in which the parties agree that the released information during the process will serve only for the original purpose – to proceed to the acquisition, and that the information will be kept as **confidential**.
- Usually it is also defined a limit term for the agreement

Some formal aspects underlying the negotiation process



Some Formal Aspects

Acquisition agreement

Main goals:

- Define the structure and the terms of the transaction;
- Release the main legal and financial aspects of the goal company, as well as other relevant information about the parts involved in the business;
- Requiring the seller not to change offeror company before the deal is closed;
- Indicate what happens if, before or after the deal closes, the parties uncover issues that should have been discovered or in the agreement or before the closing, but that were not properly discovered.

Some formal aspects underlying the negotiation process



Some Formal Aspects

Acquisition agreement

Main parts:

- Presentation of the parties
- Assumptions
- Securities traded
- Declarations and guarantees
- Price promised for the purchase and sale
- Due Diligence / Audit
- Administration and management of the acquired company
- Competitive activities
- Responsibility
- Failure
- Expenditure
- others

Negotiation Exercises



Exercise 1



The Pink Cadillac case





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