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Code of conduct could ensure their opinions are not unfairly biased

CAI JIN

By GOH ENG YEOW
SENIOR CORRESPONDENT

AS FAR as many minority shareholders are concerned, it's a case of thanks, but no thanks, when independent financial advisers (IFA) weigh in on takeover offers.

Boards of directors of a target firm must appoint such advisers to help investors decide whether to take up a buyout offer or not.

Most minority shareholders don't have the resources or skills to run the rule over takeover offers themselves so they need some professional guidance, but such advice is routinely being ignored.

Time and again, the IFAs are getting flak for the lack of value in their advice – and for valid reasons, it seems.

Take the recent takeover offer for Sembcorp Development. Irate shareholder Vincent Khoo was annoyed enough to write to The Straits Times to ask if it was rather pointless for the IFA to advise short-term shareholders to accept the offer if the share was already trading way above the offer price.

He was also upset with the difference in the advice meted out to short-term and long-term shareholders.

"The market is saying that the offer price is definitely unfair. Why should there be a distinction between short-term and long-term shareholders? If the offer is not compelling, it is definitely not fair, regardless of how long a person intends to stay as a shareholder," Mr Khoo said.

Then there was the advice offered in United Industrial Corp's offer to buy up the rest of Singapore Land, which impelled even the Singapore Exchange (SGX) to ask for clarification.

It wanted ANZ, the IFA for the process, to explain how the offer could be fair and reasonable when it was priced at a hefty 33.1 per cent discount to SingLand's book value.

Yet, quibbles over the value of an IFA's opinions are nothing new. They crop up each time there is a spate of privatisation offers from major shareholders who want to gain 100 per cent of their firms by cashing out their minority shareholders.

The chorus of complaints was just as shrill in the last big round of privatisations just after the 2008 global financial crisis, with unhappy minority shareholders up in arms over offers by controlling shareholders who valued the target companies at well below their net asset values.

Singapore Management University Associate Professor Wan Wai Yee, who studied IFA opinions between 2008 and 2010, noted in an article two years ago that one major problem was the wide discretion that IFAs enjoy over the choice of methodologies and assumptions in evaluating the takeover offers.

"IFAs do not clearly explain why particular methodologies were chosen as appropriate when assessing the takeover offers," she said.

They also do not make an independent verification of the information provided by the target companies, with many of them saying that they rely on publicly available information and data furnished by the company's board.

Worse, there is no market practice for IFAs – unlike in the United States – to make any kind of financial projections on the target company's growth prospects or the economic benefits that may be reaped by the party staging the takeover.

Yet, such assessments would be very useful to minority shareholders when deciding whether to take up the offer or not.

Prof Wan's observations of the behaviour of IFAs are most damning. She noted that there is "the inherent bias of an IFA towards writing an opinion that is consistent with the views of the board of the hiring company or its controlling shareholder".

"The bias does not arise only because the target board pays for the IFA's opinion. The bias exists because of the IFA's hopes of rendering other professional services to the company or its controlling shareholder, or to some other companies on whose boards the directors of the target board may sit in future."

And because an IFA enjoys the discretion of being able to pick the methodologies and assumptions in evaluating the offer without having to independently verify the information provided, this makes it easier to write an opinion that tilts in favour of the target company's board or the controlling shareholder, she added.

Prof Wan flagged several measures to reform the framework. One is to have a code of conduct for IFAs to follow in evaluating if a takeover offer is "fair and reasonable" to shareholders. This would bring Singapore in line with the practice in other jurisdictions such as Britain, Hong Kong and Australia.

The code should also set out the level of due diligence and investigation that an IFA has to do before issuing its opinion. This would include independently verifying the accuracy of the data about the company, rather than assuming that all the information given to it is accurate.

And to underline the vital nature of the process, Prof Wan also suggested that IFAs be legally liable – and so, at risk of having to make damages payouts – for their opinions as a way to incentivise them to take due care in their investigations and be deterred from issuing biased opinions that they do not genuinely hold.

IFAs will surely argue that they have their good names to safeguard in making sure they give sound advice to minority shareholders in a buyout situation. But given the heated debate over the usefulness of their opinions, some may feel that sterner measures are needed to uphold the standards. Food for thought.

engyeow@sph.com.sg

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