

**Memorandum**

Sky Air Inc.

To: Samuel Kaplan  
From:  
Date:  
Subject: Enhanced negotiations through minimization of valuation discrepancies

This memo's intent is to illustrate how realistic negotiation expectations can minimize company valuation discrepancies. Successful corporate capital investment negotiations entail elastic demands and trade-off agreements that improve company value from the perspective of outside sources. The initial discussion will concern the significance of principle-agent relationships. Then the argument will shift focus to control and incentive issues, buyer and seller risks, explanation of valuation difference, opportunities to reduce the valuation differences, and summary negotiation recommendation.

**PRINCIPLE-AGENT RELATIONSHIPS**

Given Sky Air is currently a sole proprietorship, no principal-agent relationship exists. If sole ownership is relinquished, asymmetric information may lead to conflicts of interest between the contracting parties. Introducing an outside investor shifts the ownership from a self concerned sole proprietor to a manager that must evaluate how relevant actions may affect the additional party.

**CONTROL/INCENTIVES ISSUES**

Thyestean Venture's purchase of Sky air would cause a separation of ownership and control, potentially resulting in incentive changes. The desire to signal positive future expectations creates incentive adaptations including the acceptance of riskier projects promising potentially higher growth. In addition, a reduced equity stake may result in the acceptance of projects promising greater personal gain.

**BUYER AND SELLER RISKS**

Relinquishing partial ownership, seller risks potential control loss irregardless of the refusal for outside board representation. The seller also risks possibility that a capital investment project will fall short of growth expectations. As a buyer Thyestean Ventures face the risk of capital loss due to asymmetric information, lack of specific knowledge and minimal control.

### **EXPLANATION OF VALUATION DIFFERENCE**

Calculation of value is a personal judgment tied closely to an individual's perception of risk. Current ownership may overstate the actual market value of Sky Air because of intrinsic value and specific knowledge of the company's operations. As potential buyers, Thyestean Ventures will likely understate the value of Sky Air because of limited knowledge and an inability to appreciate true company potential.

### **OPPORTUNITIES TO REDUCE THE VALUATION DIFFERENCES**

To reduce valuation discrepancies contrasting parties must be willing to accept trade offs in order to reconcile their conflicting interests. To decrease this difference in valuation contracting parties might consider actions to eliminate asymmetric information, and specific knowledge in an attempt to better align interests.

### **SUMMARY NEGOTIATION RECOMMENDATION**

The proposed negotiation recommendation involves utilizing contingency and incentive contracts based on staged capital infusions. Regarding the aforementioned recommendations, further contract negotiations may result in a smaller valuation gap between buyer and seller. With staged capital infusions, the proposed agreement will appear more valuable and less risky to Thyestean Ventures because they would then have the ability to disperse their stake in the investment. Additionally, reduction of Valuation discrepancies will result from Thyestean

Ventures option to abandon the project at any time. Agreeing to passive board presence would allow Thyestean Ventures to observe company operations.

Discussion of the principle-agent relationship, control and incentive issues, buyer and seller risks, valuation difference, opportunities to reduce the valuation differences, and the final summary negotiation recommendation will lead to a more informative decision for both buyer and seller. Combining the preceding recommendations may further eliminate asymmetric information and result in a more desirable offer for both contracting parties.