Mergers, Acquisitions and Corporate Restructuring

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Dedication

Offered at the lotus feet of

Reverend Mother
Ma Indira Devi

Jai Guru

Pradip
Dr P.K. Sinha is an M.Com, LL.B and an A.C.A., F.I.C.W.A., A.C.I.S (London), A.C.S. and a Post Graduate in Management Accounting (ICA) and a PhD in Management.

He has more than thirty-four years’ senior level (GM/VP) experience in professionally managed Engineering Companies in Kolkata, Vadodara, Pune and Bangalore at VP/GM levels.

At Present Dr. Sinha is the Director of a Management Institute at Pune.
We live and work in a multi-polar world where sources of supply and demand are constantly evolving and shifting around the world. Organizing and growing a global business has never been so attainable, particularly in emerging economies; at the same time, it has never been so complex. The same interconnections between countries, companies and people that bring an abundance of opportunities, also bring with them new and multifaceted risks. In this competitive environment, M&A has grown to become a popular avenue to achieve rapid reach and scale.

The new dynamics of M&A by Indian companies put a premium on supply chain integration as a key contributor to successful M&A.

In this backdrop, Restructuring, rehabilitating, re-engineering, revising and re-incarnating—all for survival and growth. In chapter 1, various reasons, occasions and ambitions for restructuring have been discussed.

Chapter 2, begins with how restructuring can be done through amalgamation, Mergers and Acquisitions (M&As) and M&A's role in transformation of economy—United States and India. The chapter also covers stages of the Merger and Acquisition (M&A) Process both from buyers and sellers point of view.

Chapter 3 presents review of the planning process and the role of diversification and mergers in strategic planning.

Chapter 4 goes through motivations of Buying or Selling the Business including hostile takeovers.

Chapter 5 discusses what is due diligence about and the importance of cultural due diligence i.e. a look at corporate cultures and attempts to ascertain an organizational fit between the two merging companies.

Chapter 6 explains synergy value that is, various technical and financial aspects of the M&A transactions that can present opportunities to make one plus one equal to three.

It also presents ways in which transactions can be structured to capitalize on the synergistic opportunities. It also covers the estimated economic gains and costs from mergers and the area of Contract possibilities—a Generalized Model, The share exchange ratio, the Bargain Zone and the Valuation of the Merging Corporations.

Chapter 7 covers Deal types and Financing of Mergers and Acquisitions.

Chapter 8 deals with Accounting for Mergers and Acquisitions.

Chapter 9 explains in detail Tax Effective Structuring of Amalgamation, Merger or De-merger of Companies including Cross Border acquisitions.

Chapter 10 deals with Corporate Finance Framework i.e. restructuring and ownership changes involved in merger and tender offer activity often affect and are influenced by the financial structures of firms. To separate the effects of purely financial policy changes from other forms of restructuring, the chapter seeks to provide some perspectives on corporate financial policies and decisions.

Various methods of valuing a business enterprise, its assets are covered in Chapter 11.

Chapter 12 explains that M&A just like capital expenditure decisions involve huge capital outlay and difficult to reverse, hence needs to be handled with caution.

The chapter also covers four primary issues in strategic considerations of Mergers & Acquisitions i.e. M&A activity should come within the framework of Strategic Planning, Identification of synergies, Valuation and Integration. The chapter also covers the causes of risk in M&A and its preventive measures.

Chapter 13 covers Employee Stock Option Plan (ESOP).

Chapter 14 deals with Corporate Control Mechanism and Take Over Defenses.
Chapter 15 considers Final Stages of Mergers & Acquisitions i.e. stages to make the buy/sell decision and also methods of dealing with a decision to back out of the transaction. It also explains the areas of consideration when developing an integration strategy and specific steps of successful post acquisition integration.

Chapter 16 deals with Regulatory Framework of Mergers and Acquisitions i.e. procedure for Merger and Amalgamation and SEBI guidelines for takeover.

Chapter 17 covers Ethical Approach to Mergers and Acquisitions.

Chapter 18 deals with the important aspect-Why Mergers Fail? and steps to make them work.

Chapter 19 covers other Dimensions of Corporate Restructuring like Restructuring of a Sick Organization, Financial Aspects of Various Restructuring Exercises (For Various Purposes); Financial Strategies for the Emerging Multinational Corporations from the developing countries and Strategic Alliances and Joint ventures and how to make them work.

Chapter 20 covers Case Studies on various aspects of Mergers and acquisitions.

I would like to express my sincere thanks to Himalaya Publishers House Pvt Ltd and their staff for the encouragement and help in bringing out this publication.

Finally, I am grateful to my wife Shukla and children Pritish and Sanchari for their untiring support and patience without which the publication of this book was not possible.

Comments from the users are welcome.

– Dr. Pradip Kumar Sinha
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Chapter - 1

Corporative Restructuring

Learning Objectives

By reading this chapter one will be able to understand

- Meaning, scope, symptoms, motives behind corporate restructuring
- Kinds, forms and choices of Corporate Restructuring.
- Present Scenario of Corporate Restructuring – Global and Indian

Structure

1.1. Meaning
1.2. Scope for Corporate Restructuring
1.3. Symptoms for Corporate Restructuring
   1.3.1. Operational symptoms
   1.3.2. Strategic Symptoms
   1.3.3. Market, Economy-level and Global Symptoms
   1.3.4. Financial Symptoms
1.4. Motives behind Corporate Restructuring
   1.4.1. Motives behind expansion
   1.4.2. Motives behind Corporate control
   1.4.3. Motives behind Contraction
   1.4.4. Motives behind Change in Ownership
1.5. Significance of Corporate Restructuring
1.6. The Restructuring Plan
1.7. Kinds/Forms of Corporate Restructuring
1.8. Choice of Corporate Restructuring
   1.8.1. Expansion
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   1.8.3. Corporate Control
   1.8.4. Changes in Ownership Structure
1.9. Present Scenario of Corporate Restructuring
   1.9.1. Global Scenario
   1.9.2. Indian scenario
1.10. Limitations of Corporate Restructuring

Summary

Self-assignment
1.1 Meaning

Business restructuring may be defined as a conscious effort to restructure policies, programmes, products, processes and people to serve the redefined policies, programmes on a sustainable basis, because most of the restructuring policies are carried out with an impulsive reaction to the market variables or internal problems, without a serious attempt of looking at long-term (or sustainable) results.

1.2 Scope for corporate restructuring

Let us look at the comprehensive scope available to restructure, which defines various interesting dimensions of restructuring – The Purpose (Quantitative & Qualitative Results and their sustainability)

If the purpose decides the scope of restructuring, it should also decide the broad sequence of restructuring. Very often the purpose alone may not decide the sequence, the owners confidence, market variables of urgent attention etc. do decide the sequence of restructuring. The following may be alternative sequences –

**Sequence 1**

- Product Restructuring
- Organizational Restructuring
- Financial Restructuring
- Processes Restructuring
- People- related Restructuring
- Restructuring of Assets facilities
- Policies programmes to be restructured
- Restructuring of Core-competencies
- Sills, Knowledge, Wages, Relationships & Roles
- Restructuring of Market-related Variables & Responses
- Restructuring of Ownership Patterns, Entrepreneurial & Knowledge Workforce
- Restructuring of Value-chains, Prices, Territories, Value-drivers
- Process restructuring
- The Purpose (Quantitative & Qualitative Results and their sustainability)
**Sequence 2**

Restructuring of Core-competence and Competitive Advantages

Organizational Restructuring

Product Restructuring  
Process Restructuring

People-related Restructuring

Financial Restructuring

**Sequence 3**

Organizational Restructuring  
Processes Restructuring

Financial Restructuring

People-related Restructuring

Restructuring of Insignificant Product-related Specifics

**Sequence 4**

Restructuring of the Organizational System to respond to External Variables

Micro-level Organizational Restructuring

People-related Restructuring
1.3 Symptoms for Restructuring

1.3.1 Operational symptoms

1. Continuously reducing employee productivity
2. High employee turnover.
3. Growing incidences of industrial relations problems, production stoppages.
4. Delays in supply chain and distribution chain.
5. Weak market feedback on products, prices and promotional policies
6. Decline in new market development efforts.
7. High asset maintenance and repairs.
8. Distributed ratio between the number of core employees and support employees and the time and effort spent in core performances and support performances.
9. Uncomfortable relations with external stakeholders like contractors, vendors, government departments, consultants etc.
10. Increasing confusion in divisional, individual and territorial performance accounting, appraisals, etc.
1.3.2 Strategic Symptoms
1. Slowed down desire for perpetual growth and wealth acceleration.
2. Growing mismatch between strategy formulation by owners and managers.
3. Declining market leadership to influence the government, competitors, vendors, distributors and customers.
4. Imbalance of value-additions done by value-driving divisions, individuals and other strategic inputs.
5. Heavy subsidization of weak products and divisions, creating increased pressure on strong products and divisions.
6. Imbalance between short-term tactics and long-term strategies.

1.3.3 Market, Economy-level and Global Symptoms
1. Substantial change in the government’s policies towards tariffs, subsidies, tax-impositions, international trade, etc.
2. Sustained recession, shrinking international markets.
3. Cheaper funds availability from the international market.
5. Growing influence of networking and multinational corporations.
6. Increased international culture of branding anything and everything.
7. Domestic confusion with interest rate behaviour and other bank related products.
8. Hyper rate of ‘information technology advancement, resulting in the globe becoming one single market.
9. Increasing replacement of skill and system employees by knowledge employees and entrepreneurial employees.
10. Opening up of certain economies, regions and the growing scope of new businesses, government-private sector participation, international joint ventures, etc.
11. An economy’s transition from the core sector to service sector to information tech-sector to advisory sector.

1.3.4 Financial Symptoms
1. Increasing operating costs and cost of finance
2. Falling share prices in the market, without a near-future scope for correction.
3. Declining earning ratios for divisions, vendors, distributors and shareholders.
4. Increasing costs at the supply-side and demand side of the value-chain.
5. Increasing prices of licenses, copy-rights, patents, etc.
6. Growing costs on marketing operations and hence growing pressure on manufacturing costs.
7. Growing costs of corrective efforts, revisions or reincarnation of products and services.
8. Unusual cost of wastage, inefficiencies, idle time, insurance, maintenance, deliveries, etc.
9. Increasing mismatch between indirect taxes and direct taxes.
10. Increased costs of applied research, concept sale and take-off efforts.
11. Heavy cost connected with market development, restricting competitors entry to established or new markets, up-gradation of consumer tastes, etc.
12. Imbalance between core cost and support cost.
13. Serious drawbacks and problems in the implementation of transfer price mechanism.
1.4 Motives behind Corporate Restructuring

There are four separate sets of reasons for different choice of corporate structuring –

(a) Expansion, (b) Corporate control, (c) Contraction and (d) Change in ownership structure

1.4.1 Motives behind expansion

Important reasons for expansion can be subdivided as:

(a) **Growth**: Every company wants to grow and corporate restructuring provides ways for the companies to throw off cash flows beyond its internal needs. Present day of globalization demands an absolute level of size simply to be able to carry out the operations of the company.

(b) **Technology**: Technology plays an important role as a driver in expansion strategy. Generally a firm with improved and superior technology wants to engineer its technological superiority by acquiring firms of inferior technology. The reverse is also true as the firm with inferior technology may prefer to acquire technologically superior firm to sharpen its competitive edge.

(c) **Product Advantage and Product Differentiation**: This reason gets more relevance in expansion internationally when a firm finds acceptance for its product abroad.

(d) **Government policy**: Different regulations, tax burden and other restrictions imposed by the government also induce companies to increase size. To enjoy specific advantage in different zones and in different economies, company’s first choice goes for acquiring a firm with existing facilities in that place.

(e) **Exchange rates**: This reason is specifically identified with expansion leading to international mergers. Comparative strength or weakness of the domestic versus foreign currency makes a difference in price paid for acquisition, production costs and the value repatriated profit to the parent.

(f) **Political/Economic Stability**: Political stability, i.e., the frequency with which government changes, the order of transferring power and the change in the policy and outlook due to change in the administration becomes a decisive factor in expansion. Economic stability demands a low and predictable inflation rate controlled industrial relations, etc.

(g) **Differential labour costs, Productivity**: Difference in labour costs in different geographic region with its associated productivity certainly creates an impact in monitoring companies to expand.

(h) **Diversification**: One of the important drivers for expansion is the diversification both geographically and by product line. It may come in the form of vertical integration, both forward and backward, which also helps in reducing costs

1.4.2 Motives behind Corporate control

An important motive for corporate control is to ensure that a programme for the successful performance of the firm can be carried through without interruption. But there are several other motives to gain corporate control, such as

(a) **Improving Leverage Ratio**: To reinforce effective control, capital structure of the firm is changed. By adopting buyback mechanism, debt equity ratio or leverage ratio is improved. This is because even the debt is not changed, the amount of common stock is reduced resulting in increase in leverage ratio.

(b) **Utilization of Surplus Cash**: In order to increase the shareholders return and finally the wealth of the shareholders, the firm may undertake the strategy of distributing surplus cash and thereby enhancing the earnings per share.

(c) **Enhancement of Voting Power**: Another important motive of corporate control is to enhance the voting or controlling power of the promoters without spending own money.
(d) **Preventing Undervaluation** - If the management believes that the common stock of the company is undervalued in the market, they can enhance control on the valuation of shares by buyback of the shares with a view to recognize true value of those shares as the announce buyback price will invariably be higher than the prevailing market price.

(e) **Anti-takeover Defence** - If the insiders judge the firm to be undervalued, they may have concerns that the firm may be subject to takeover bid at relatively small premium. The large premium in repurchase tender offer may convey information to the on-insiders that the value of the shares is at least as high as conveyed by the premium and may be perhaps even higher in the future.

1.4.3 **Motives behind Contraction**

The companies, trimming size through de-merger anticipates the benefits of restructuring by outperforming the market indexes. Different mechanism shedding the business off through de-merger takes place with a number of motivations like –

1. **Improving Performance** - The accountability created by restructuring through de-merger often improves performance, and investors also benefit from the greater visibility of the de-merged entities to analysts and the public.

2. **Booming Independence** - De-merger is intended to promote independence as the separate company can operate freely at its own discretion. Often this kind of restructuring is done to move assets to owners who can utilize them more effectively. This helps the economic system to move assets to their highest valued users.

3. **Effort to Unlearn** - Some de-merger effort is an attempt to correct previous investment decisions materialized through mergers and acquisitions. The firms’ inability to effectively exploit the possible opportunities through consolidation, motivate them to salvage a portion of their investments by separating where the opportunities could be exploited more effectively.

4. **Strategic Adjustment** - Sometimes divesture involves selling to a value-increasing buyer, which is planned at the time of merger and acquisition activity. Such type of divestiture is preplanned because they may represent a poor fit to the acquiring firm.

5. **Increasing value** - De-merger represents harvesting value by unlocking the hidden value. By making financial and managerial resources available and concentrating on the core competency the firm is able to enhance shareholder’s value as well a value of the firm.

1.4.4 **Motives behind Change in Ownership**

Various motives act as drivers in restructuring activities that result in change in ownership structure. Some of them can be summarized as –

(i) **Manoeuvring Leverage**: The most important reason for changes in ownership structure, whether debt/preferred stock is exchanged for common stock, or conversely common stock for more senior claims to manoeuvre leverage of the firm.

(ii) **Alteration in the Control Structure**: By purchasing substantial percentage of shares or by initial public offerings the firms want to reshuffle the voting rights of the shareholders to change the control pattern of the firm.

(iii) **Providing fairness to minority Shareholders**: A critical element in restructuring activities through going private transactions is fairness to minority or outside shareholders to avoid accusations of security fraud against controlling shareholders.

(iv) **Changing the nature of Firm**: If a firm wants to come out of the regulations of Security and Exchange board of respective country it may prefer that a small group of investors buy the entire equity interest.
1.5 Significance of Corporate Restructuring

Corporate restructuring is a strategic decision leading to the maximization of company growth by enhancing its production and marketing operations, reduced competition, free flow of capital, globalization of business, etc. Some of the most common reasons of corporate restructuring are discussed briefly hereunder:

(i) **Economies of scale**: Economies of scale arise when increase in volume of production leads to a reduction in cost of production per unit. For instance, overhead costs can be substantially reduced on account of sharing central services such as – accounting and finance, personnel and legal, sales promotion and advertisement, top level management and so on. So when two or more companies combine, certain economies are realized due to the larger volume of operations of the combined entity. These economies arise due to increased production capacity, strong distribution networks, effective engineering services, research development facilities, data processing system and others.

(ii) **Operating Economies**: Various functions may be consolidated and duplicate channels may be eliminated by implementing proper planning and control system.

(iii) **Synergy**: Synergy refers to a situation where the combined firm is more valuable than the sum of the individual firms. It refers to benefits other than those related to economies of scale. Apart from operating economies, synergy may also arise from enhanced managerial capabilities, creativity, innovativeness, R&D, productivity improvements, improved procurement and the elimination of duplication.

(iv) **Reduction in Tax liability**: In India, a profitable company is allowed to merge with a sick company to set-off against its profits, the accumulated losses and unabsorbed depreciation. The conditions to claim this tax benefit have further been relaxed by amendment made in Section 72A of the Income Tax Act.

(v) **Managerial Effectiveness**: One of the potential benefits of merger is an increase in managerial effectiveness. This may occur if the existing management team, which has performed poorly, is replaced by a more efficient one.

(vi) **Other reasons of corporate restructuring are given below:**

(a) To return to the shareholders of the surplus cash, which is not required in the near foreseeable future.

(b) To enhance the earnings per share of the company.

(c) To provide to shareholders/investors that the company is presently undervaluing the share of the company in relation to its intrinsic value and the proposed buy back will facilitate recognition of the true value.

(d) To increase the promoters’ voting power.

(e) To maintain shareholders’ value in a situation of poor state of secondary market by return of surplus cash to the shareholders.

(f) Eliminate the takeover threats.

(g) An opportunity to grow faster, with ready-made market share.

(h) To eliminate the competition by buying it out.

(i) Diversification with minimum cost and immediate profit.

(j) To forestall the company’s own takeover by a third party.

1.6 The Restructuring Plan

If the purpose of restructuring is clearly decided, a restructuring plan could then have reasonable clarity and shape. Although each individual purpose would decide the details of the plan distinctively, a general structure may be summarised as follows –
1. Define the purpose further, with the maximum details of possible sustainability.
2. Decide the sequence of restructuring.
3. Check out all minute details of each operation (related to the soft and hard aspects of restructuring) under each phase of the sequence, with the use of PERT-CPM charts and details about major hurdles and tactics to overcome these hurdles.
4. Have a parallel cost-benefit chart along with the PERT-CPM chart of operations. The costs and benefits should be on both the scales-short and long.
5. Decide a lead team of key executives and owners to carry out the whole process of restructuring, decide on the action plan for each member of the team and ‘homogenous progress parameters’ to monitor the process.
6. Chalk out a detailed plan with soft and hard aspects, costs and crisis-management of change and result indicators.

1.7 Kinds/Forms of Corporate Restructuring

These are discussed below –

(a) **Portfolio Restructuring** - It includes significant changes in the mix of assets owned by a firm or the lines of business in which a firm operates, including liquidation, divestures, asset sales and spin-offs. Company management may restructure its business in order to sharpen focus by disposing of a unit that is peripheral to their core business and in order to raise capital or rid itself of a languishing operation by selling off a division. Moreover, a company can involve on an aggressive combination of acquisition and divestures to restructure its portfolio.

(b) **Financial Restructuring** - Financial structure refers to the allocation of the corporate flow of funds—cash or credit—and to the strategic or contractual decision rules that direct the flow and determine the value added and its distribution among the various corporate constituencies. It includes significant changes in the capital structure of a firm, including leveraged buyouts, leveraged recapitalizations and debt for equity swaps, mergers, acquisitions, joint ventures, strategic alliances, etc. The elements of the corporate financial structure include the scale of the investment base, the mix between active investment and defensive reserves, the focus of investment (choice of revenue source), the rate at which earnings are reinvested, the mix of debt and equity contracts, the nature, degree and cost of corporate oversight (overhead), the distribution of expenditures between current and future revenue potential, and the nature and duration of wage and benefit contracts. Financial restructuring generates economic value.

(c) **Organizational Restructuring** - Organizational restructuring includes significant changes in the organizational structure of a firm, including redrawing of divisional boundaries, flattening of hierarchic levels, spreading the span of control, reducing product diversification, revising compensation, streamlining processes, reforming governance and downsizing employment. It is observed that layoffs reforming unaccompanied by other organizational changes tend to have a negative impact on performance. Downsizing announcements combined with organizational restructuring are likely to have a positive, though small effect on performance.

(d) **Technological Restructuring** - An alliance with other companies to exploit technological expertise is termed as technological restructuring.

1.8 Choice of Corporate Restructuring

The term ‘Corporate Restructuring’ is quite wide covering various aspects. It may be chosen from among four broad groups Viz.

(a) Expansion
(b) Contraction
1.8.1 Expansion

The expansion strategy is followed when an organization aims at high growth by substantially broadening the scope of one of its businesses in terms of their respective customer groups, customer functions and alternative technologies—singly or jointly—in order to improve its overall performance. It generally includes mergers and acquisitions, tender offers, asset acquisition and joint ventures.

(a) Mergers and Acquisitions: A transaction where two firms agree to integrate their operations on a relatively co-equal basis is called merger. It is defined as the fusion of two or more companies through direct acquisition of the net assets of the other(s). It results when the shareholders of more than one company, usually two, decide to pool the resources of the companies under a common equity. Accordingly, in a merger two or more companies combine into a single unit and lose their individual identities.

Acquisition: An acquisition may be defined as an act of acquiring effective control by one company over assets or management of another company without any combination of companies. Thus in acquisition, two or more companies may remain independent, separate legal entity, but there may be change in control of companies.

Takeover: A takeover may also be defined as obtaining of control over management of a company by another. An acquisition or takeover does not necessarily entail full legal control. A company can have effective control over another company by holding minority ownership. Under the MRTP Act (Monopolies and Restrictive Trade Practices Act) takeover means acquisition of not less than 25 per cent of the voting power in a company. Sec. 372A of the Companies Act lays down the procedure for company’s investment in the shares of another company including loans and guarantees given provided it does not exceed 60% of the share capital and Free Reserves. If a company wants to invest beyond the overall limit it requires prior approval of the Central Government and requires approval through special resolution passed by the shareholders meeting.
Takeover is acquisition: Sometimes the distinction between takeover and acquisition connotes forced or unwilling or hostile acquisition (is called takeover) and friendly acquisition (is called acquisition). In an unwilling acquisition, the management of “target” company would oppose a move of being taken over when the management of acquiring and target companies mutually and willingly agrees for the takeover, it is called acquisition or friendly takeover.

(b) **Tender Offers:** In the case of a tender offer, a public offer is made for acquiring the shares of the target company. Here the acquisition of shares of the target company indicates the acquisition of management control in that company. For instance, India Cements gave an open market offer for the shares of Raasi Cement.

(c) **Asset Acquisitions:** Asset acquisitions imply buying the assets of another company. Such assets may be intangible assets like a manufacturing unit of a firm or intangible assets like brand, trade mark, etc. In the case of asset acquisitions, the acquirer company may limit its acquisitions to those parts of the firm which match with the needs of the acquirer company. For example, Laffarge of France acquired only the cement division of Tata Group restricted itself to only 1.70 million tonne cement plant and the assets relating to such divisions of Tata Group.

(d) **Joint ventures:** Joint ventures are a special case of consolidation where two or more companies form a temporary partnership (also called ‘consortium’) for a specified purpose.

Joint ventures may be useful to gain access to a new business mainly under four conditions.

1. When an activity is uneconomical for an organization to do alone.
2. When the risk of business has to be shared and, therefore, is reduced for the participating firms.
3. When the distinctive competence of two or more organizations can be brought together.
4. When setting up an organization requires surmounting hurdles, such as, import quotas, tariffs, nationalistic-political interests, and cultural roadblocks.

### 1.8.2 Contraction

Contraction is the second form of restructuring. In the case of contraction, generally the size of the firm gets reduced. Contraction may take in the form of spin-off, split-off, divestitures, split-ups and equity-carved out.

(a) **Spin-offs:** A spin-off occurs when a subsidiary becomes an independent entity. The parent firm distributes shares of the subsidiary to its shareholders through a stock dividend. Since this transaction is a dividend distribution, no cash is generated. Thus, spin-offs are unlikely to be used when a firm needs to finance growth or deals. Like the carve-out, the subsidiary becomes a separate legal entity with a distinct management and board.

Like carve-outs, spin-offs are usually about separating a healthy operation. In most cases, spin-offs unlock hidden shareholder value. For the parent company, it sharpens management focus. For the spin-off company, management doesn’t have to compete for the parent’s attention and capital. Once they are set free, managers can explore new opportunities.

Investors, however, should beware of throw-away subsidiaries the parent created to separate legal liability or to off-load debt. Once spin-off shares are issued to parent company shareholders, some shareholders may be tempted to quickly dump these shares on the market, depressing the share valuation.

(b) **Split-offs:** In the case of split-off, a new company is created in order to takeover the operations of an existing division or unit of a company. A portion of the existing shareholders of the company obtains stocks in the subsidiary (i.e., the new company) in exchange for stocks of the parent company. As a result, the equity base of the parent company is reduced representing the downsizing of the firm. Thus, shareholding of the new entity (i.e., subsidiary) does not imply the shareholding of the parent company. In the case of a split-off, there is no question of cash inflow to the parent company.
(c) **Divestures** is the outright sale of a company subsidiary. Normally, sell-offs are done because the subsidiary doesn’t fit into the parent company’s core strategy. The market may be undervaluing the combined businesses due to a lack of synergy between the parent and subsidiary. As a result, management and the board decide that the subsidiary is better off under different ownership.

Besides getting rid of an unwanted subsidiary, sell-offs also raise cash, which can be used to pay off debt. In the late 1980s and early 1990s, corporate **raiders** would use debt to finance acquisitions. Then, after making a purchase they would sell-off its subsidiaries to raise cash to service the debt. The raiders’ method certainly makes sense if the sum of the parts is greater than the whole. When it isn’t, deals are unsuccessful.

(d) **Equity Carved outs** more and more companies are using equity carve-outs to boost shareholder value. A parent firm makes a subsidiary public through an **Initial Public Offering** (IPO) of shares, amounting to a partial sell-off. A new publicly-listed company is created, but the parent keeps a controlling stake in the newly traded subsidiary.

A carve-out is a strategic avenue a parent firm may take when one of its subsidiaries is growing faster and carrying higher valuations than other businesses owned by the parent. A carve-out generates cash because shares in the subsidiary are sold to the public, but the issue also unlocks the value of the subsidiary unit and enhances the parent’s shareholder value.

The new legal entity of a carve-out has a separate board, but in most carve-outs, the parent retains some control. In these cases, some portion of the parent firm’s board of directors may be shared. Since the parent has a controlling stake, meaning both firms have common shareholders, the connection between the two will likely be strong.

That said, sometimes companies carve-out a subsidiary not because it's doing well, but because it is a burden. Such an intention won’t lead to a successful result, especially if a carved-out subsidiary is too loaded with debt, or had trouble even when it was a part of the parent and is lacking an established track record for growing revenues and profits.

Carve-outs can also create unexpected friction between the parent and subsidiary. Problems can arise as managers of the carved-out company must be accountable to their public shareholders as well as the owners of the parent company. This can create divided loyalties.

(e) **Split-ups**: in the case of a split-up, the entire company is broken up in series of spinoffs. As a result, the parent company no longer exists and only the new off-springs continue to survive. A split-up basically involves the creation of a new class of stock for each of the parent’s operating subsidiaries, paying current subsidiaries a dividend of each new class of stock, and then dissolving the parent company Stockholders in the new companies may be different as shareholders in the parent company may exchange their stock for stock in one or more of the spin-offs. Restructuring of Andhra Pradesh State Electricity Board (APSEB) is a good example of split-off. The power generating division and the transmission and distribution division of APSEB was transferred to two different companies namely APGENCo and APTRANACo respectively. As a result of such split-up the APSEB ceased to exist.

(f) **Tracking Stock**: A tracking stock is a special type of stock issued by a publicly held company to track the value of one segment of that company. The stock allows the different segments of the company to be valued differently by investors.

Let’s say a slow-growth company trading at a low **Price-Earnings ratio** (P/E ratio) happens to have a fast growing business unit. The company might issue a tracking stock so the market can value the new business separately from the old one and at a significantly higher P/E rating.

Why would a firm issue a tracking stock rather than spinning-off or carving-out its fast growth business for shareholders? The company retains control over the subsidiary; the two businesses can continue to
enjoy synergies and share marketing, administrative support functions, a headquarters and so on. Finally, and most importantly, if the tracking stock climbs in value, the parent company can use the tracking stock it owns to make acquisitions.

Still, shareholders need to remember that tracking stocks are class B, meaning they don't grant shareholders the same voting rights as those of the main stock. Each share of tracking stock may have only a half or a quarter of a vote.

In rare cases, holders of tracking stock have no vote at all.

1.8.3 Corporate Control

Corporate control is another method of restructuring which involves obtaining control over the management of the firm. Controlling here, is basically defined as a process through which top managers influence other related members of an entity to implement the predetermined organizational strategies. The top managers and promoters group who stand to lose from competition in the market for corporate control may use the democratic rules to benefit themselves. Ownership and control are not always separated. A large block of shares may give effective control even when there is no majority owners. Corporate control generally includes ant-takeover defence, share repurchases, exchange offers and proxy contests.

(a) Anti-takeover Defences – It is a technique followed by a company to prevent forcefully acquiring its management. With the high level of hostile takeover activity in recent years, various companies are resorting to the strategy of takeover defences. Such takeover defences may be pre-bid or preventive defences and post-bid or active defences. Pre-bid or preventive defences are generally employed with a view to prevent a sudden, unexpected hostile bid from obtaining control of the company. When preventive takeover defences become unsuccessful in preventing an unwanted bid, the post-bid or active defences are implemented. Such takeover defenses attempt at changing the corporate control position of the promoters.

(b) Share Repurchases – It involves repurchasing its own shares by a company from the market. Shares may be purchased by following either the tender offer method or through open market method. Shares repurchased also called Buyback of shares, lead to reduction in the equity capital of the company. Shares buyback helps in strengthening the promoters' controlling position in the company by increasing their percentage of stake in the equity of the company. It is also used as a takeover defence to reduce the number of shares that could be purchased by the potential acquirer.

(c) Exchange offers – Exchange offer generally provided one or more classes of securities, the right or option to exchange a portion or all of their holding for a different class of securities of the firm. The term of exchange offered necessarily involve new securities of greater market value than the pre-exchange offer announcement market value. Exchange offer includes exchange debt for common stock, which enhances the degree of leverage or conversely, exchange common stock for debt, which reduces leverage. Exchange offers help a company to change its capital structure while holding the investment policy unaltered.

(d) Proxy Contests – The proxy contest is a way to take control of a company without owning a majority of its voting right. So it is an attempt made by a single shareholder or a group of shareholders to undertake control or bring about other changes in a company by the use of the proxy mechanized of corporate voting. In a proxy fight, a bidder may attempt to use his voting rights and garner the support from other shareholders with a view to expel the incumbent board or management. Proxy contests are less frequently used than a tender offer for effecting transfer of control. It provides an alternative means of corporate control but cost of proxy challenges is high. Inefficiency in proxy context raises the question of adverse selections which is the main disadvantage of corporate restructuring through proxy contest.
1.8.4 Changes in Ownership Structure

The fourth group of restructuring activities is the change of ownership structure, which basically results in a change in the structure of ownership in the company. The ownership structure of a firm affects and is affected by other variables, and these variables also influence the market value. Such variables include the levels of principal agent conflicts and information asymmetry and their effects on other variables like the operating strategy of the firm, dividend policy, capital structure, etc. The various techniques of changing ownership are Leveraged Buyouts, Master Limited Partnerships (MLPs), Going Private and Employee Stock option Plan (ESOP).

(a) **Leveraged Buyouts** - Buyouts constitute another form of corporate restructuring. It happen when a group of persons gain control of a company by buying all or majority of its shares. There are two common types of buy out: Leveraged Buy Out (LBO) and Management Buy Out (MBO). LBO is the purchase of assets where the buyer uses a significant amount of debt and very little equity capital for payment of consideration for acquisition. Since LBOs cause substantial financial risk, it is desired that LBO acquisitions should have a relatively low degree of business risk.

As a concept management buyouts or MBOs as they are referred to are similar to LBOs. Though it is not necessary for managers to highly leverage the takeover bid rarely in practice do managers have the necessary resources in terms of own funds to finance the bid. The decision criterion in case of leveraging will be identical to that given in case of LBOs.

(b) **Master Limited Partnerships (MLPs)** - Master Limited Partnerships (MLPs) are formed of a general partner and one or more of limited partners. The general partner runs the business and bears unlimited liability. The Limited partnership provides an investor with a direct interest in a group of assets, usually, oil, coal, gas, etc. Master limited partnership units are traded publicly like stock and thus provide the investor more liquidity than ordinary limited partnerships. One of the most important advantages of MLP is its elimination of the corporate layer of taxation. In the case of a company, the owners are taxed twice on the investments-once at the corporate level and the other at the distribution of dividends. However, many companies use MLP to redistribute assets so that their returns are not subject to double taxation.

(c) **Going Private** - It is repurchasing of all of a company’s outstanding stock by employees or a private investor. As a result of such an initiative, the company stops being publicly traded. Sometimes, the company might have to take on significant debt to finance the change in ownership structure. Companies might want to go private in order to restructure their businesses (when they feel that the process might affect their stock prices poorly in the short run. They might also want to go private to avoid the expense and regulations associated with remaining listed on a stock exchange.

(d) **Employee Stock Option Plan (ESOP)** - The term Employee Stock Option Plan (ESOP) means the option to give the whole-time directors, or employees of a company the right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. The basic objective of ESOP is to motivate the directors or employees to perform better and improve firm's value. Apart from giving financial gains to employees, they also create a sense of ownership amongst directors and employees. ESOPs tend to develop an entrepreneurial spirit among top level management since they own stock and an increase in stock price, if the firm does well and to their wealth. ESOP also help companies to attract talent, motivate employees by enabling them to share the long-term growth of the company.

1.9 Present Scenario of Corporate Restructuring

Today, restructuring wave is sweeping the corporate sector all over the world, taking within its fold both big and small entities, comprising old economy businesses conglomerates and new economy companies and even in the infrastructure and service sector. Mergers, acquisitions and takeovers have become an integral part of new economic paradigm. Conglomerates are being formed to combine businesses and where synergies are not achieved, de-mergers have become the order of the day. With the increasing competition and the economy heading towards
globalization, the Corporate Restructuring activities are expected to occur at a much larger scale than at any time in the past, and are expected to pay a major role in achieving the competitive edge in international market place.

The process of restructuring through mergers and acquisitions has been a regular feature in the developed and free economy nations like Japan, the US and European countries with special reference to the UK where hundreds of mergers take pace every year. The mergers and takeovers of multinational corporate houses across the borders have become a normal phenomenon.

Corporate Restructuring being a matter of business convenience, the role of legislation, executive and judiciary is that of a facilitator for restructuring on healthy lines. In this era of intense competition and technological change, industrialists have realized that corporate restructuring are perhaps the best route to reach a size comparable to global companies so as to effectively compete with them. The harsh reality of globalization has dawned that companies which cannot compete globally must sell out as an inevitable alternative.

1.9.1 Global Scenario

During the past decade, corporate restructuring has increasingly become a staple of management life and a common phenomenon around the world. Unprecedented number of companies across the world have reorganized their divisions, restructured their assets, streamlined their operations and spun-off their divisions in a bid to spur the company's performance. It has enabled numerous organizations to respond quickly and more effectively to new opportunities and unexpected pressures so as to re-establish their competitive advantage. The suppliers, customers and competitors also have an equally profound impact while working with a restructured company.

Globalization gives the consumer many choices—technologies are changing, established brands are being challenged by value-for many products, the movement of goods across countries is on the rise and entry barriers are being reduced. As markets consolidate into fewer and larger entities, economies become more concentrated. In this international scenario, there is a heavy pronunciation on the quality, range, cost and reliability of product and services. Companies all over the world have been reshaping and positioning themselves to meet the challenges and grab the opportunities thrown open by globalization.

The management strategy in turbulent times is to focus on core competencies—selling loss making companies and acquiring those, which can contribute to profit and growth of the group. The underlying objective is to achieve and sustain superior performance. In fact, most of the companies in the world are merging to achieve an economic size as a means of survival and growth in the competitive economy. There has been a substantial increase in quantum of funds flowing across nations in search of restructuring and take over candidates. The UK has been the most important foreign investor in the US in recent years with British companies. In telecom, the biggest deals include AT&T-TCI, SBC-American, etc. There have been huge oil sector mergers, the biggest being Exxon-Mobile, BP-Amoco and Total-Petrofina. It is estimated that one in four US workers have been affected by the wave of mergers and acquisition activity.

1.9.2 Indian scenario

During last few years, India has followed the worldwide trends in consolidation amongst companies through mergers and acquisitions. Companies are being taken-over, units are being hived-off, joint ventures tantamount to acquisitions are being made and so on. It may be reasonably be stated that the quantum of corporate restructurings in the last few years must be more than the corresponding quantum in the six decades post-independence.

Today Indian economy is passing through recession. In such a situation, companies which are capable of restructuring can contribute towards economic revival and growth. Despite the sluggish economic scenario in India, merger and amalgamations deals have been on the increase. The reason is as the size of the market shrinks, it becomes extremely difficult for all the companies to survive, unless they cut costs and maintain prices. In such a situation, merger eliminates duplication of administrative and marketing expenses. The other important reason is that it prevents price war in a shrinking market. Companies by merging reduce the number of competitors and increase their market share.
Corporate India is facing new flexibility requirements due to restructuring some of which are discussed below:

(i) **Employment:** Companies are moving away from relying on workers on open-ended, full-time contracts and, increasingly, use part-time, temporary, contingent and contract workers;

(ii) **Jobs:** The content of jobs is being expanded to encompass a greater variety of tasks;

(iii) **Skills:** New work practices are raising skill levels and requirements and workers thus are required to continuously upgrade their skills so as to be able to cope;

(iv) **Workplace:** Home and tele-working is growing, thanks to new information and communication technologies.

(v) **Working time:** Increases in demand are met by overtime work or by a “more flexible approach as to when and how to work,” so as to extend operating hours without having to pay overtime rates;

(vi) **Remuneration:** Profit sharing, ESOPs and various types of bonuses are becoming more and more common.

(vii) **Management:** Indians are beginning to understand that a more flexible world is demanding a different kind of management philosophy; and

(viii) **Organization:** There is a trend towards flatter organizational structures. Corporate restructuring is a deep and pervasive phenomenon across India. The increasing trend of mergers and acquisitions is one of the clearest and most readily measurable manifestations of restructuring.

### 1.10 Limitations of Corporate Restructuring

Corporate Restructuring is essential for those companies which are in dire straits. The best thing for these companies is to restructure operations so that things may improve. Corporate Restructuring is not the panacea for all corporate ills. A number of limitations can be associated with Corporate Restructuring, they are:

(a) **Work Assurance:** Before the announcement of Corporate Restructuring, especially during integration the employees of the ailing firm feel relief, but in most cases the reality becomes better than the employees used to experience before integration. The management of the acquiring firm takes policy for performance improvement resulting closure of certain divisions or departments affecting a number of jobs.

(b) **Retention of Best Management:** Retaining the best management combination is always an uphill task, with differing pay scales, responsibility levels, product and service portfolios, and organizational vision. Companies pay more attention to the financial figures and benefit is weighed only numerically but they remain very unprofessional in handling the transition process, since new management provisions are rare, and often ineffective.

(c) **Delay in Deal Finalization:** New structures are announced after long delays and communication is woefully lacking. After initial announcement of Corporate restructuring it takes to finalize the deal as it involves so may issues like boardroom tussles, labour trouble and queries from the shareholders.

(d) **Executive Stress:** In some cases the divisions and products get closed after Corporate Restructuring. After restructuring the control of the companies goes to separate set of management creating a stress on the executives. While the restructuring takes place through contraction by way of separation the distribution of management brings a large number of denials from the management

(e) **Workers’ Woes:** At union levels, there is outright opposition to restructuring activities. Number of mergers awaits legal clearance months after announcements. This is because unions protest pay changes, proposed lay-offs, out sourcing and asset liquidation.
(f) **Cultural Mismatch:** The situation mostly arises in merger and takeovers when the organizational culture of one firm gets mismatch with other firm. This results in destroying efficiency of the worker as well as management of both the firms.

(g) **Inability to Create Value:** Corporate restructuring is aimed at generating value for the firm and finally for the shareholders. But frequently it is observed that the organizations could not create value instead they have destroyed it. Sudden change in the management and organizational vision creates a gap leaving certain capacity idle and promoting inefficiency in utilization of resources.

**Summary**

Restructuring, rehabilitating, re-engineering, revising and re-incarnating – all are for survival and growth. In this chapter, we discussed various reasons, occasions and ambitions for restructuring.

**Self-assignment**

1. What is Corporate Restructuring? Discuss the significance of Corporate Restructuring.
2. ‘Corporate Restructuring’ is a new concept of ‘Shareholder Value Generation’. Do you agree? Why?
3. List and explain the most common reasons of Corporate Restructuring.
4. Briefly explain the various elements of Corporate Restructuring?
5. Write a critical note on the present scenario of Corporate Restructuring, both from global viewpoint and Indian viewpoint.
6. Write short notes on:
   a) Joint Venture
   b) Leveraged Buyout
   c) Divestitures
   d) Equity carved out
   e) Employee Stock Option
7. What are the limitations of Corporate Restructuring? Discuss.
8. Distinguish between spin-offs and split-offs.
9. Explain the different forms of corporate control.
10. List and explain the various techniques of changing ownership?
11. Briefly discuss the various forms of Corporate Restructuring?
12. List and explain the various motives behind expansion, as part of mergers and Acquisitions.
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