Mergers and Acquisitions

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Brief Contents

Foreword *v*

Preface *vi*

1. Corporate Restructuring 1

2. Takeovers 55

3. Mergers and Acquisitions 80

4. Due Diligence 133

5. Legal Issues in Mergers and Acquisitions 171

6. Valuation and Accounting Issues 230

7. Post-merger Issues 270

8. Cross-border Acquisitions 286

9. Alternatives to Mergers and Acquisitions 296

Case Study 1: Hindalco–Novelis Merger 318

Case Study 2: Tata–JLR Acquisition 324

Case Study 3: RIL and RPL 330

Case Study 4: Procter & Gamble and Gillette 335

Appendix A: Due Diligence Checklist 339

Appendix B: Draft Scheme of Amalgamation 342

Appendix C: Draft Scheme of Demerger 347

Appendix D: Draft of Forms as per Companies Act, 1956 356

Appendix E: Draft Resolution of the Board Approving the Scheme of Amalgamation 377

Index 378

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Detailed Contents

Foreword *v*
Preface *vi*
Brief Contents *ix*

1. CORPORATE RESTRUCTURING **1**

1.1 Introduction 1
1.2 Concept of Corporate Restructuring 2
1.3 Conceptual Framework 2
1.4 McKinsey 7S Model 3
1.5 Reasons for Restructuring 7
1.5.1 Change in Fiscal and Government Policies 7
1.5.2 Liberalization, Privatization, and Globalization 8
1.5.3 Information Technology Revolution 8
1.5.4 Concept of Customer Delight 8
1.5.5 Cost Reduction 8
1.5.6 Divestment 9
1.5.7 Improving Bottom Line 9
1.5.8 Core Competencies 10
1.5.9 Enhancing Shareholder Value 10
1.5.10 Incompatible Company Objectives 10
1.5.11 Evolving Appropriate Capital Structure 10
1.5.12 Consistent Growth and Profitability 10
1.5.13 Environmental Changes 11
1.5.14 Meeting Investors' Expectations 11
1.5.15 Resolving Conflict 11
1.5.16 Transferring Corporate Assets 11
1.5.17 Bifurcating Business 11
1.6 Barriers to Restructuring 12
1.6.1 Inadequate Commitment from Top Management 12
1.6.2 Resistance to Change 12
1.6.3 Poor Communication 12
1.6.4 Absence of Requisite Skills 13
1.6.5 Scepticism 13
1.6.6 Failure to Understand Benefits of Restructuring 13
1.6.7 Lack of Resources 13
1.6.8 Organizational Workload 13
1.6.9 Non-adherence to Time Schedule 14
1.6.10 Lack of Clear and Visible Leadership 14

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1.7 Key Elements of Restructuring Process 14
1.7.1 Portfolio Management 14
1.7.2 Corporate Functions 14
1.7.3 Operational Performance 14
1.7.4 Value Structure 14
1.8 Types of Corporate Restructuring 15
1.8.1 Financial Restructuring 16
1.8.2 Portfolio Restructuring 16
1.8.3 Organizational Restructuring 16
1.9 Strategies for Restructuring 16
1.9.1 Hardware Restructuring 17
1.9.2 Software Restructuring 17
1.10 Strategic Options in Corporate Restructuring 17
1.10.1 Cost Leadership Options 19
1.10.2 Product Excellence Options 20
1.10.3 SWOT Options 21
1.10.4 Assets Reorganization 22
1.10.5 New Ownership Relationships 23
1.10.6 Reorganizing Financial Claims 24
1.10.7 Other Options 26
1.11 Buyback of Shares in India 31
1.12 Where do the Resources for Buyback Come from? 32
1.13 Conditions to be Fulfilled for Buyback 32
1.14 Leveraged Buyouts 34
1.14.1 Types of LBOs 41
1.15 Why are LBOs No Longer Popular? 41
1.16 Management Buyouts 42
1.17 Implications of Corporate Restructuring 43
1.17.1 Investors 43
1.17.2 Customers 43
1.17.3 Management 44
1.17.4 Employees 44
1.17.5 Others 44
Case Study: India Yamaha Motor 49

2. TAKEOVERS 55

2.1 Introduction 55
2.2 Concept of Takeover 55
2.3 Forms of Takeover 57
2.3.1 Legal Perspective 57
2.3.2 Business Perspective 58
2.3.3 Reverse Takeover 59
2.4 Takeover Defences 59
2.4.1 Bank Mail 59

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2.4.2 Greenmail 60
2.4.3 Crown Jewel Defence 60
2.4.4 Poison Pill/Super Poison Put 60
2.4.5 Flip-over 61
2.4.6 Grey Knight 61
2.4.7 Jonestown Defence/Suicide Pill 61
2.4.8 Killer Bees 61
2.4.9 Leveraged Recapitalization 61
2.4.10 Lock-up Provision 62
2.4.11 Nancy Reagan Defence 62
2.4.12 Non-voting Stock 62
2.4.13 Pac-Man Defence 63
2.4.14 Pension Parachute 63
2.4.15 People Pill 63
2.4.16 Lollipop Defence 63
2.4.17 Macaroni Defence 63
2.4.18 Lobster Trap 64
2.4.19 Shark Repellent/Porcupine Defence or Provision 64
2.4.20 Poison Put 65
2.4.21 Safe Harbour 65
2.4.22 Scorched-earth Defence 65
2.4.23 Showstopper 65
2.4.24 Staggered Board of Directors 66
2.4.25 Standstill Agreement 66
2.4.26 Targeted Repurchase 66
2.4.27 Top-up 67
2.4.28 Treasury Stock 67
2.4.29 White Knight 67
2.4.30 White Squire 68
2.4.31 Voting Plan or Voting Rights Plan 68
2.4.32 Whitemail 68
2.5 Benefits of Takeovers 68
2.6 Disadvantages of Takeovers 69
2.7 Takeover Code 69
Case Study: Imperial Chemical Industries' Failed Attempt to Takeover Asian Paints 72

3. MERGERS AND ACQUISITIONS 80

3.1 Introduction 80
3.2 Concept of Merger 80
3.2.1 Merger through Absorption 81
3.2.2 Merger through Consolidation 81
3.3 Genesis of Mergers and Acquisitions 82
3.3.1 First Wave (1897–1904) 83

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3.3.2 Second Wave (1916–1929) 84
3.3.3 The 1940s 85
3.3.4 Third Wave (1965–1969) 85
3.3.5 The 1970s 86
3.3.6 Fourth Wave (1984–1989) 86
3.3.7 Fifth Wave (1992 onwards) 87
3.4 Traditional and Modern Views 87
3.5 Classification of Mergers 88
3.5.1 Horizontal Merger 88
3.5.2 Vertical Merger 89
3.5.3 Conglomerate Merger 90
3.5.4 Accretive Merger 92
3.5.5 Dilutive Merger 92
3.6 Concept of Acquisition 92
3.7 Strategies for acquisition 93
3.8 Types of Acquisitions 94
3.8.1 Assets Purchase 94
3.8.2 Stock Purchase 95
3.9 Tools for Analysis 95
3.9.1 SWOT Analysis 95
3.9.2 BCG Matrix 101
3.9.3 GE Matrix 103
3.9.4 Porter's Five Forces Model 104
3.10 Distinction between Mergers and Acquisitions 107
3.11 Motives behind Mergers and Acquisitions 108
3.11.1 Synergy 108
3.11.2 Acquiring New Technology 109
3.11.3 Improved Profitability 109
3.11.4 Acquiring a Competency 109
3.11.5 Entry into New Markets 109
3.11.6 Access to Funds 110
3.11.7 Tax Benefits 110
3.12 Identifying Value Drivers in Mergers and Acquisitions 110
3.12.1 Increase in Synergy 110
3.12.2 Decrease in Premium 110
3.13 Reasons for Failure of Mergers and Acquisitions 113
3.13.1 Unrealistic Price Paid for Target 113
3.13.2 Difficulties in Cultural Integration 113
3.13.3 Overstated Synergies 114
3.13.4 Integration Difficulties 114
3.13.5 Inconsistent Strategy 114
3.13.6 Poor Business Fit 114
3.13.7 Inadequate Due Diligence 114
3.13.8 High Leverage 114

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3.13.9 Boardroom Split 115
3.13.10 Regulatory Issues 115
3.13.11 HR Issues 115
3.14 Process of Mergers and Acquisitions 115
3.14.1 Planning Phase 116
3.14.2 Implementation Phase 116
3.15 Financing Mergers and Acquisitions 120
3.15.1 Cash 121
3.15.2 Equity Capital 121
3.15.3 Loan Capital 121
3.16 Reverse Merger 121
3.16.1 Process of Reverse Merger 122
3.16.2 Myths about Reverse Mergers 123
3.16.3 Examples of Reverse Mergers 124
3.17 Concept of Earn-outs 124
3.17.1 Criteria for Determining Earn-outs 125
3.17.2 Advantages of Earn-outs 126
3.17.3 Weaknesses of Earn-outs 126
3.18 Mergers and Acquisitions in India 127
3.18.1 Examples of Mergers and Acquisitions in India 128

4. DUE DILIGENCE 133

4.1 Introduction 133
4.2 Concept of Due Diligence 133
4.3 Need for Due Diligence 135
4.4 What does Due Diligence Involve? 136
4.5 Transactions Requiring Due Diligence 137
4.5.1 Mergers and Acquisitions 137
4.5.2 Partnerships 139
4.5.3 Joint Ventures and Collaborations 139
4.6 People Involved in Due Diligence Process 140
4.6.1 Legal Professionals 140
4.6.2 Financial Professionals 140
4.6.3 Operational Professionals 140
4.7 Parties Interested in Due Diligence 141
4.7.1 Employees 141
4.7.2 Trade Unions 141
4.7.3 Shareholders and Creditors 141
4.7.4 Vendors 142
4.7.5 Customers 142
4.7.6 Government 142
4.7.7 Society 142
4.8 Steps in Due Diligence 142
4.8.1 Planning Phase 143

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4.8.2 Data Collection Phase 145
4.8.3 Data Analysis Phase 145
4.8.4 Report Finalization Phase 146
4.8.5 Due Diligence Reporting 146
4.9 Types of Due Diligence 146
4.9.1 Financial Due Diligence 146
4.9.2 Legal Due Diligence 147
4.9.3 Operational Due Diligence 148
4.9.4 Intellectual Property Due Diligence 150
4.9.5 Information Technology Due Diligence 155
4.9.6 Human Resource Due Diligence 157
4.10 Litigation Analysis 158
4.11 Does Due Diligence Insure against M&A Failure? 160
4.11.1 Due Diligence Involving Financial Issues 160
4.11.2 Due Diligence Involving Organizational Records 161
4.11.3 Due Diligence Involving Legal Compliance 161
4.11.4 Due Diligence Involving Interaction of Contracts 162
4.11.5 Due Diligence Involving Information Systems 162
4.11.6 Due Diligence Involving Key Customers and Suppliers 162
4.12 Due Diligence Team 162
4.13 Why does Due Diligence Fail? 163
4.13.1 Failure to Focus on Key Issues 164
4.13.2 Failure to Identify New Opportunities and Risks 164
4.13.3 Failure to Allocate Adequate/Right Resources 164
Case Study: Advent Limited and Pourshins Limited 167

5. LEGAL ISSUES IN MERGERS AND ACQUISITIONS 171
5.1 Introduction 171
5.1.1 Concepts of Appointed Date and Effective Date 172
5.2 Companies Act, 1956 172
5.2.1 Introduction 172
5.2.2 Section 390 173
5.2.3 Section 391(1) 173
5.2.4 Section 391(2)–(7) 173
5.2.5 Section 393(1) 173
5.2.6 Section 393(2) 173
5.2.7 Section 394 174
5.2.8 Section 394A 174
5.2.9 Section 376 175
5.2.10 Section 395 175
5.3 Powers of Court 175
5.4 SEBI (Buyback of Securities) Regulations, 1998 176
5.4.1 Introduction 177

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5.4.2 Concept of Buyback 177
5.4.3 Provisions of Section 77 (of Companies Act, 1956) 177
5.4.4 Amendments to Section 77 177
5.4.5 Why do Companies Opt for a Buyback? 178
5.4.6 Sources for Buyback 178
5.4.7 Prerequisites of Valid Buyback 179
5.4.8 Modes of Buyback 180
5.4.9 Prohibited Modes of Buyback 181
5.4.10 Advantages of Buyback of Shares 182
5.4.11 Disadvantages of Buyback of Shares 182
5.5 SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 184
5.5.1 Introduction 184
5.5.2 Concept of Substantial Acquisition of Shares 184
5.5.3 Procedure for Substantial Acquisition of Shares 186
5.5.4 Other Provisions of the Act 188
5.6 Listing Agreement Norms 189
5.6.1 Introduction 189
5.6.2 Concept of Listing 189
5.6.3 Objectives of Listing 190
5.6.4 Guidelines for Listing in India 190
5.6.5 Benefits of Listing 197
5.7 SEBI (Delisting of Securities) Guidelines, 2003 198
5.7.1 Introduction 198
5.7.2 Terminology 198
5.7.3 Applicability of Voluntary Delisting 199
5.7.4 Voluntary Delisting of Securities of Listed Company 199
5.7.5 Procedure for Voluntary Delisting 199
5.7.6 Public Announcement for Voluntary Delisting 200
5.7.7 Exit Price for Voluntary Delisting of Securities 200
5.7.8 Public Announcement of Final Price 200
5.7.9 Delisting from Exchanges not Having Nationwide Terminals 201
5.7.10 Minimum Number of Shares to be Acquired 201
5.7.11 Delisting of One or All Classes of Securities 203
5.7.12 Compulsory Delisting of Companies by Stock Exchanges 203
5.7.13 Rights of Securities Holders in Case of Compulsory Delisting 204
5.7.14 Delisting Pursuant to Rights Issue 205
5.7.15 Reinstatement of Delisted Securities 205
5.7.16 Rights of Promoters 206
5.7.17 Restrictions Imposed on Company Proposing Delisting 206
5.8 Corporate Governance Issues 207
5.8.1 Introduction 207
5.8.2 Concept of Corporate Governance 207
5.8.3 Clause 49 of Listing Agreement 208

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5.9 Provisions of Income Tax Act, 1961 212
5.9.1 Introduction 212
5.9.2 Merger as Defined under Income Tax Act, 1961 212
5.9.3 Important Tax Provisions for Mergers and Acquisitions 213
5.10 Foreign Exchange Management Act, 1999 216
5.11 Competition Act, 2002 216
5.11.1 Introduction 217
5.11.2 Combinations under Competition Act, 2002 217
5.11.3 Mergers and Effects 218
5.11.4 Threshold Limits under Competition Act, 2002 219
Annexure: Indian companies that have opted for buyback of shares through open market purchase 222

6. VALUATION AND ACCOUNTING ISSUES 230
6.1 Introduction 230
6.2 Concept of Valuation 231
6.2.1 Going Concern Value 231
6.2.2 Liquidation Value 231
6.2.3 Market Value 231
6.3 Factors to be Considered for Valuation 232
6.4 Methods of Valuation 233
6.4.1 Asset-based Valuation 234
6.4.2 Earning-based Valuation 235
6.4.3 Market-based Valuation 236
6.4.4 Book Value Approach 236
6.4.5 Stock and Debt Approach 237
6.4.6 Direct Comparison Approach 237
6.4.7 Discounted Cash Flow Method 239
6.5 Is DCF Same in Valuation of All Investment? 242
6.5.1 Valuation of Assets 242
6.5.2 Valuation of Going Concern 243
6.5.3 Valuation of Equity 243
6.6 Introduction to Accounting Issues 243
6.7 Accounting for Amalgamations 244
6.7.1 Amalgamation in Nature of Merger 244
6.7.2 Amalgamation in Nature of Purchase 246
6.8 Provisions of Accounting Standard 14 246
6.8.1 Non-cash Consideration 246
6.8.2 Future Events 247
6.8.3 Treatment of Reserves 247
6.9 International Financial Reporting Standards 3—Business Combinations 247
6.10 Solved Examples 249

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7. POST-MERGER ISSUES **270**

7.1 Introduction 270
7.2 Concept of Integration in Mergers 270
7.3 Issues Involved in Integration 272
7.4 Tools for Integration 273
7.4.1 Mission and Vision 274
7.4.2 Ensuring Communication 274
7.4.3 Selecting the Right Leader 274
7.4.4 Welcoming New Culture 275
7.4.5 Team-building 275
7.4.6 Capturing Value from Different Sources 275
7.5 Strategies for Post-merger Success 276
7.6 Post-merger Growth Strategies 277
7.6.1 Effective Human Resource Strategies 278
7.6.2 Social and Cultural Integration 278
7.6.3 Reliable Environment for Employees and Customers 278
7.6.4 Well-informed Stakeholders 278
7.6.5 Expectations Management 278
7.6.6 Change Agent 279
7.6.7 Effective Schedule 279
7.6.8 Detailed Market Research 279
7.7 Human Side of Mergers and Acquisitions 279
Case Study: Key to Successful Integration 283

8. CROSS-BORDER ACQUISITIONS **286**

8.1 Introduction 286
8.2 Concept of Cross-border Acquisitions 286
8.3 Need for Cross-border Acquisitions 286
8.4 Benefits of Cross-border Acquisitions 287
8.4.1 Expansion of Markets 287
8.4.2 Possibility of Raising Funds Abroad 287
8.4.3 Synergistic Benefits 287
8.4.4 Technology Transfer 287
8.4.5 Tax Planning and Benefits 287
8.4.6 Foreign Exchange Earnings 288
8.4.7 Countering Recessionary Pressures 288
8.4.8 Greenfield Investments 288
8.5 Difficulties in Cross-border Acquisitions 288
8.5.1 Legal Problems 288
8.5.2 Accounting Issues 289
8.5.3 Weak Understanding of Fundamentals of Acquired Business 289
8.5.4 Technological Differences 289
8.5.5 Strategic Issues 289

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8.5.6 Fundamental Differences across Countries 290
8.5.7 Tendency to Overpay 290
8.5.8 Failure to Integrate 291
8.5.9 HR Issues 291
8.6 Integrating Cross-border Acquisitions 291
Case Study: Sony vs Matsushita 293

9. ALTERNATIVES TO MERGERS AND ACQUISITIONS 296

9.1 Introduction 296
9.2 Concept of Divestitures 297
9.3 Types of Divestitures 297
9.3.1 Voluntary Divestitures 297
9.3.2 Involuntary Divestitures 298
9.4 Reasons for Divestiture 298
9.4.1 Unprofitable Division 298
9.4.2 Bad Fit 298
9.4.3 Reverse Synergy 298
9.4.4 Failure to Generate Hurdle Rate of Return 299
9.4.5 Capital Market Factors 299
9.4.6 Generation of Cash Flow 299
9.4.7 Abandoning Core Business 300
9.5 Benefits of Divestitures 301
9.6 Strategic Alliances 302
9.7 Why do Companies Enter into Strategic Alliances? 303
9.7.1 Internal Reasons 303
9.7.2 Competitive Goals 303
9.7.3 Strategic Reasons 303
9.8 Types of Strategic Alliances 303
9.9 Implications of Strategic Alliance 304
9.9.1 Formal Structure of Relationship between Partners 304
9.9.2 Internationality of Alliance 305
9.9.3 Value Added Chains 305
9.9.4 Profit/Ownership-related Issues 305
9.9.5 Orientation of the Alliance 305
9.10 Benefits of Strategic Alliances 305
9.11 Weaknesses of Strategic Alliances 306
9.11.1 Harmony-related Issues 306
9.11.2 Implementation Issues 306
9.11.3 Problems of Coherence 306
9.11.4 Changes in Business Environment 306
9.12 Strategic Management of Alliances 306
9.12.1 Clear Understanding between Partners 307
9.12.2 Avoiding Excessive Stress on Legal Contract 307

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9.12.3 Avoiding Greed 307

9.13 Internal Development 307

9.13.1 Venture Capitalists 307

9.13.2 New Venture Incubator 308

9.13.3 Idea Generation and Transfer Programme 308

9.13.4 Intrapreneurship 308

9.14 Conclusion 309

Case Study: Strategic Alliance—Kingfisher and Jet Airways 311

CASE STUDIES

Case Study 1: Hindalco–Novelis Merger 318

Case Study 2: Tata–JLR Acquisition 324

Case Study 3: RIL and RPL 330

Case Study 4: Procter & Gamble and Gillette 335

APPENDICES

Appendix A: Due Diligence Checklist 339

Appendix B: Draft Scheme of Amalgamation 342

Appendix C: Draft Scheme of Demerger 347

Appendix D: Draft of Forms as per Companies Act, 1956 356

Appendix E: Draft Resolution of the Board Approving the Scheme of Amalgamation 377

Index 378

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1 Corporate Restructuring

LEARNING OBJECTIVES

After studying the chapter, you will be able to understand

- the concept of corporate restructuring
- the framework of corporate restructuring
- the reasons for restructuring, barriers to restructuring, types of restructuring, and strategies for restructuring
- the strategic options in corporate restructuring
- the conditions to be fulfilled by a company going in for a buyback
- the concept and types of leveraged buyouts (LBOs)
- the reasons behind growing unpopularity of LBOs
- the concept of management buyouts

1.1 INTRODUCTION

The global economy is undergoing major transitions and paradigm shifts. As a result, several corporate giants of yesteryears are either disappearing or undergoing massive restructuring exercises. Restructuring is the modern mantra of survival. While very little can be done with regard to permanent closure of business, the strategy of restructuring is an attempt to revive the operations of the entity and make it profitable once again. In addition, expansion of markets hitherto unknown to many entities can be profitably milked with the help of a partner who knows the tide, and can help new entrants sail through with ease. Mergers and acquisitions (M&As) are looked upon as instruments of successful corporate restructuring and fulfilment of corporate goals.

In the era of liberalization and globalization, entities compete in unfamiliar markets. In addition, the protection provided by high tariffs and other trade barriers are no longer available, making it difficult for an entity to yield a steady output of goods, services, and even profits year after year. Managers have to continuously work towards improvements in the quality of goods and services produced, reduction in costs, and maintenance of output prices at competitive levels.

Change is inevitable, and the magnitude and speed of change differs from case to case. Under normal circumstances, change in the work environment occurs

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in a gradual and predictable manner. As such, enough time is available to assess the impact. On the contrary, when change assumes the velocity of a hurricane, routine tinkering with policies, structure, and managerial practices is of no use. In such a scenario, organizations need to adopt a result-oriented approach that not only keeps the organization on course, but also enables it to target new destinations and new heights of achievement. The change approach adopted 'to ring out the old and ring in the new' should be in tune with the circumstances and the environment. It is thus important to note that restructuring is a continuous process driven by corporate vision.

1.2 CONCEPT OF CORPORATE RESTRUCTURING

The concept of restructuring focuses on change. The Oxford Dictionary (2007) defines restructuring as 'giving a new structure, to rebuild/rearrange'. Taking a cue from this definition, one can say that corporate restructuring is a structured decision-making exercise undertaken to evaluate the current endowments of a company by fine-tuning the available skills, machinery, and technology to meet the challenges of tomorrow.

Restructuring is a corporate management term that stands for the act of partially dismantling or otherwise reorganizing a company to make it more efficient and therefore more profitable. It generally involves selling off portions of the company and making drastic staff reductions. Restructuring is often undertaken as part of a bankruptcy or takeover by another firm, particularly a leveraged buyout (LBO) by a private equity firm. It may also be done by a new CEO hired specifically to effect difficult and controversial decisions required to save or reposition the company.

Different authors present different views on the concept of corporate restructuring. Let us examine some views:

- Corporate restructuring refers to a broad array of activities that expand or contract a firm's operations or substantially modify its financial structure or bring about a significant change in its organizational structure or internal financing (Chandra 2007).
- Corporate restructuring is the reorganization of a company to attain greater efficiency and to adapt to new markets (www.financialdictionary.com).
- Corporate restructuring refers to liquidating projects in some areas and redirecting assets to other existing or new areas (Weston et al. 2005).

At its most general level, the term corporate restructuring can and has been used to mean almost any change in operations, capital structure, and/or ownership that is not part of the firm's ordinary course of business (Marshall et al. 2004).

1.3 CONCEPTUAL FRAMEWORK

Liberal doses of restructuring have sparked off a series of academic deliberations into the phenomenon of corporate restructuring. A closer look at the concept of

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restructuring reminds one of what Alfred P. Sloan Jr once said, 'The strategic aim of a business is to earn a return on capital and if in any particular case, the return in the long run is not satisfactory, then the deficiency should be corrected or the activity abandoned for a more favourable one.'

Bowman and Singh (1997) are of the opinion that the current spate of restructuring exercises is induced by the simultaneity of changes in the product and the capital markets. According to them, changes in the product markets stem largely from domestic and foreign competition, accelerated technological change, and the competitive pressures faced in the global markets. Changes in capital markets, on the other hand, originate from new debt instruments, new tolerance for increased level of debt in the capital structure of the firm, and institutional innovations and aggressiveness.

Muller (1988) argues that the changing culture and image of the company are the most important rationale influencing restructuring. He also states that the human dimension is imperative in any such exercise.

Donaldson (1994) has systematically chronicled the instances in corporate America where takeover bids have forced a company to restructure to ward off hostile takeover threats.

Gibbs (1993) expressed the view that corporate restructuring is needed under three conditions: the presence of free cash flow, ineffective corporate governance, and the threat of takeover.

Finally, Bethel and Liebeskind (2007) argued that shareholders often exert influence over managers and press for restructuring the business.

If one tries to analyse the restructuring models, the basic question that remains is, what are the factors that one should study, to position the organization to achieve the intended objectives? Various models and theories have been propagated in this regard. Some models look only at the internal factors, others only at the external factors; some combine these perspectives and others look for congruence between various aspects of the organization being studied. There is no unanimity on the factors that a company needs to study for effective positioning in the market.

1.4 McKINSEY 7S MODEL

Keeping in mind the complex nature of the restructuring process, McKinsey undertook a study towards the end of the 1970s. The main objectives were to diagnose the causes of original problems and to formulate programs for improvement. This framework came to be known as McKinsey's 7S framework for restructuring. Developed in the early 1980s by Tom Peters and Robert Waterman, two consultants working at McKinsey & Company, the 7S model is based on the premise that there are seven internal aspects of an organization that need to be aligned, if the organization has to be successful.

The 7S model can be used in a wide variety of situations where an alignment perspective is useful:

- Improving the performance of a company
- Examining the likely effects of future changes within a company

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- Aligning departments and processes during a merger or acquisition
- Determining how best to implement a proposed strategy

The McKinsey 7S model involves seven interdependent factors, which are categorized as either 'hard' or 'soft' elements. 'Hard' elements are easier to define or identify and the management can directly influence them. These are strategy statements, organization charts, reporting lines, formal processes, and IT systems. They include strategy, structure, and systems.

'Soft' elements, on the other hand, are more difficult to describe, less tangible, and often more influenced by culture. However, the soft elements are as important as the hard elements for the organization to succeed. The soft elements include shared values, skills, style, and staff.

Figure 1.1 depicts the interdependency of the elements and indicates how change in one affects all the others.

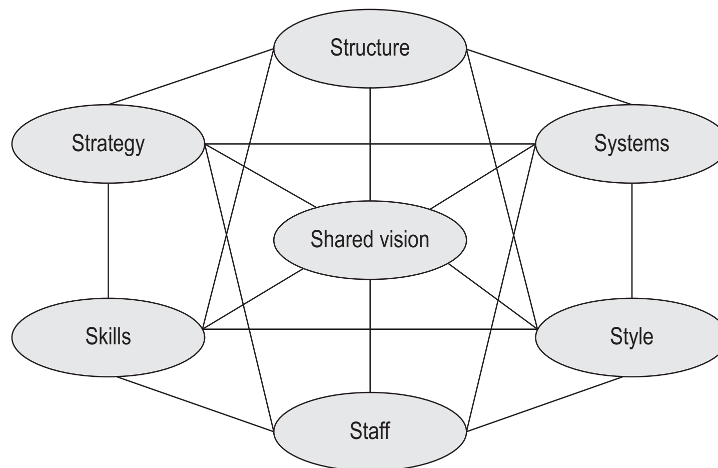

Figure 1.1 McKinsey 7S model

Let us look at the elements in brief:

Strategy Every entity wants to be 'one up' on its competitors. It has to evolve plans that will help to attain its newly-defined objectives and help to maintain and build competitive advantage in the markets that are getting increasingly competitive.

Structure Structure represents the way an organization is structured, and depicts the reporting relationships. Effective functioning requires an appropriate organizational structure that would have clearly defined relationships. A good structure is one that facilitates smooth flow of information across levels.

Systems While goals are the guiding light in an entity, they need to be pursued in an effective and efficient manner. It is important that every individual knows the daily activities to be performed. Thus, systems represent the activities and

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procedures that employees across hierarchies should engage in to get the job done.

Shared values Every entity has/propagates certain values and culture that are effectively built into the system. These get reflected in the corporate culture and the general work ethics of individuals. Also known as 'superordinate goals', these are the core values of the company and are evidenced in the way the entity responds to environmental changes and ethical dilemmas.

Style This deals with the style of leadership adopted by the leader of the team. To a great extent, the success of an entity depends on the quality of leadership. An organization where the leader 'walks the talk' attains its objectives with greater ease, for a leader successfully inspires his team and allows the work culture and values to percolate to all the strata in the organization.

Staff While inspiring leadership is a key to success, the ultimate attainment of goals and objectives depends on the employees and their general capabilities. Every organization recruits the best available human resource. Recruitment is not just about hiring the right employees. An important mantra for success is the ability to retain and groom human resource, to enable them to adapt to the changes with ease and remain focused. Thus, a successful HR policy calls for the following:

- Right person for the right job
- Right policies to retain talented and skilled employees
- Right and regular training and grooming
- Right strategy for getting rid of deadwood

Skills This deals with the actual skills and competencies of the employees working for the company. Very often, this is misinterpreted as skills possessed by employees at the time of recruitment. While skills are critical to performance, regular and continuous upgradation is necessary to ensure that they are in tune with the prevailing practices and meet the requirements of the environment.

The 7S model is based on the fundamental theory that an organization can perform well when all the seven elements are aligned and mutually reinforcing. The model is very important in the modern business environment. It helps to identify what needs to be realigned to improve performance and how to maintain alignment (and performance) during change. The change could relate to restructuring, introduction of new processes, organizational merger, introducing new systems, change of leadership, and so on. The model can be used to understand how the organizational elements are interrelated. It is also helpful in assessing the impact of changes in one area on the other areas. For example, to analyse the current situation point A and the proposed future situation point B, one needs to identify the gaps and inconsistencies between them. Once these are identified, it is a matter of adjusting and tuning the elements of the 7S model to ensure that the organization works effectively and attains the desired objectives.

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This adjustment and tuning of the different elements of the organization is not as easy as it seems to be. This is where the 7S model proves beneficial. It helps the organization ask the right questions, although the answers to these questions may be elusive. It is here that the organization needs to bring together the right knowledge, skills, and experience.

One could consider some sample questions pertaining to each element. These questions need to be supplemented with specific situational questions based on circumstances and accumulated organizational wisdom. Some of the sample questions for each element are as follows:

Strategy

- What is our strategy?
- How do we intend to achieve our objectives?
- How do we deal with changes in customer demands?
- How do we deal with competitive pressure?
- How do we adjust strategy for environmental issues?

Structure

- What is the hierarchy?
- How is the company/team divided?
- How do different departments coordinate their activities?
- How do the team members organize and align themselves?
- Where are the lines of communication—explicit and implicit?
- Is decision making and controlling centralized or decentralized? Is this as it should be, given what we are doing?

Systems

- What are the main systems that run the organization? (Consider financial and HR systems as well as communication and document storage.)
- Where are the controls and how are they monitored and evaluated?
- What are the internal rules and processes used by the team to stay on track?

Shared values

- What are the fundamental values that the company/team has been built on?
- What are the core values?
- How strong are the values?
- What is the corporate/team culture?

Style

- How participative is the management/leadership style?
- How effective is the leadership?
- Do employees/team members tend to be competitive or cooperative?
- Are there real teams functioning within the organization or are they just nominal groups?

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Staff

- What are the positions or specializations represented within the team?
- What are the positions that need to be filled?
- Are there gaps in the required competencies?

Skills

- What are the strongest skills represented in the company/team?
- How are skills monitored and assessed?
- Are there any skill gaps?
- What is the company/team known for doing well?
- Do the current employees/team members have the ability to do the job?

Once these questions have been listed, the organization evolves a matrix to ascertain whether the elements are in alignment with one another.

- The organization can start with shared values and ascertain whether they are consistent with the structure, strategy, and systems.
- If they are not, what needs to change so that the organization can reach the desired objectives?
- Next, the organization needs to look at the hard elements to ascertain whether these support each other.
- If they are not mutually supportive, changes needed are to be identified.
- Finally, the organization can analyse the soft elements to determine whether these support the desired hard elements or not.
- If they do not support the hard elements, the organization needs to identify the changes required.

After adjusting and aligning the 7S, one needs to constantly re-analyse the elements to understand how a change in one element impacts the other elements and what further adjustments are needed to align them. As this process continues, deficiencies get highlighted and performance improves.

1.5 REASONS FOR RESTRUCTURING

The entire debate on the corporate restructuring process brings to focus the following basic reasons that compel companies to opt for restructuring.

1.5.1 Change in Fiscal and Government Policies

Changed fiscal and governmental policies such as deregulation/decontrol have led many companies to tap new markets and customer segments. A few sectors have been hit hard by the withdrawal of government patronage as they have to look after their own financial requirements and at the same time face competition from powerful global giants. To prepare themselves to survive in the changed business environment, companies have to pursue restructuring so as to adapt their structure to the new challenges and meet their financial requirements.

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1.5.2 Liberalization, Privatization, and Globalization

Liberalization, privatization, and globalization have changed the rules of the game. The only way to survive in the changed business environment is to change the way business is conducted. These three factors have compelled companies to restructure their operations because only the most cost-effective producers can survive in the present global markets. In addition, these three stimuli have given rise to a whole new set of laws and regulations. Survival has become a function of adapting to these stimuli.

1.5.3 Information Technology Revolution

Information technology (IT) has become the lifeline of modern business enterprises. Most of the business is carried out using modern tools of communication and IT. Information technology drives corporate performance. Companies have to adopt and adapt to the ever-changing IT environment, by tweaking their organizational structure. In addition, a lot of investment flows into creating an appropriate IT infrastructure, including familiarizing people working in the organization with the tools of IT. This obviously calls for a major restructuring in the operations of the enterprise.

1.5.4 Concept of Customer Delight

The competitive global environment has brought to the fore the new concept of 'customer delight', which states that only those companies that can understand and fulfil the needs and expectations of the customer shall survive. Modern customers are knowledgeable, clear about their needs and expectations, and are increasingly demanding and very often unpredictable about their consumption habits. The changing customer profile has intensified competition and companies have to reshape their activities to survive in business. Many giants of yesteryears have been forced out of the market or have merged with another company, for either they were reluctant, or very slow to change. Some companies have undergone major restructuring processes to survive. For example, General Motors, Lakme, Tata Oil Mills Company (TOMCO), Premier Automobiles, and Mahindra and Mahindra have changed to satisfy the needs and expectations of the customers.

Figure 1.2 shows how successful companies deliver value.

1.5.5 Cost Reduction

Customers not only expect quality products, but also affordable prices. Companies have to make continuous efforts to reduce costs and improve quality. Quite often, companies resort to downsizing—one of the tools of corporate restructuring—to become cost-effective. In a perpetually changing competitive environment, there is no place for inflexibility, an obsession with activity rather than results, bureaucratic functioning, and high overheads. Cost reduction and cost control are the new mantras of success.

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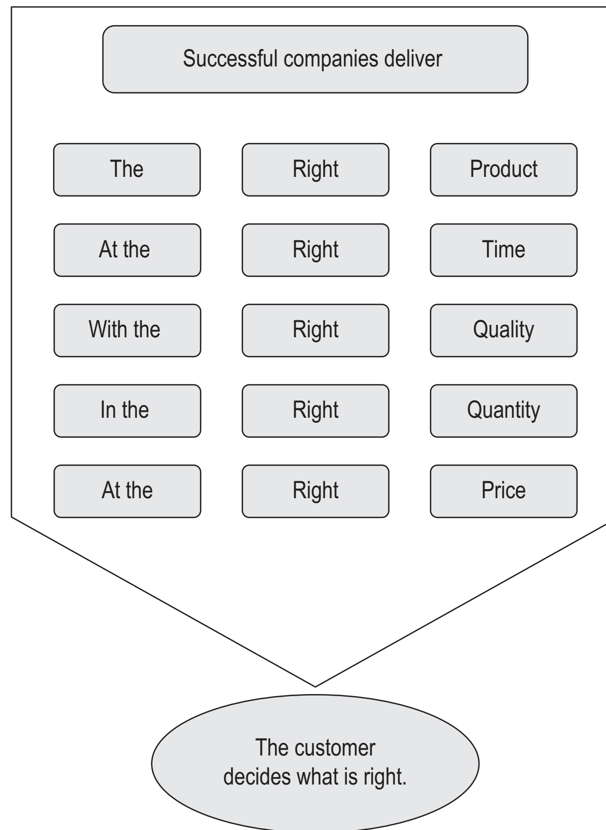

Source: Siemens Limited Case, *'Customer is the King; Restructuring is Change'*, AIMA, New Delhi, 23 August 1997

Figure 1.2 Value delivery by successful companies

1.5.6 Divestment

Many companies have either divisionalized their operations into smaller businesses, or have sold off units or divisions that do not have a strategic fit with the business. Divestment is often done to get out of activities that do not add value to the business, or sometimes destroy value. It is also a way of releasing capital resources that have been blocked in activities where the company does not enjoy core competency or competitive advantage. For example, Larsen and Toubro's (L&T) sale of L&T Cement, Tata's exit from Tata Oil Mills Co. (TOMCO), etc.

1.5.7 Improving Bottom Line

The basic business objective shall always be maximizing profits. It is the only way to keep all the stakeholders happy. To achieve it, companies have to narrow down the gap between the attainable and the attained. Restructuring becomes necessary to realize the full potential of the company.

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1.5.8 Core Competencies

Prof. C.K. Prahalad's concept of core competency also results in restructuring. Core competency is a specific factor that a business perceives to be central to its functioning. It provides recurring consumer benefits, is not easy for competitors to imitate, and can be leveraged widely across many products and markets. A core competency can be technical—a reliable process, a close relationship with customers and suppliers, product development and/or culture, such as employee dedication. The concept is integral to the strategic vision of the company as it provides the fundamental basis for the provision of added value.

Core competencies are the collective learning in organizations, involving coordination of diverse production skills and integration of multiple streams of technologies. Core competencies often provide impetus for many companies to restructure.

1.5.9 Enhancing Shareholder Value

Every company aims at enhancing shareholder value. This is necessary for the capital inflows to continue. Shareholders shy away from companies that do not provide adequate returns. Such companies cannot execute their growth plans and stagnate, resulting in further decline in returns and erosion of shareholder value. When a company is not able to generate adequate returns, restructuring can bring about effective allocation and use of resources.

1.5.10 Incompatible Company Objectives

When company objectives are no longer compatible with the current portfolio, restructuring is planned. Decline in demand, high competitive pressures, and quicker product-line obsolescence signify such incompatibility. Such companies face a declining revenue and market share, and difficulty to survive.

1.5.11 Evolving Appropriate Capital Structure

Companies that are either over-capitalized or under-capitalized opt for restructuring. The process helps the company to evolve a balanced capital mix. It not only minimizes the cost of capital, but also increases earnings.

When companies expand their operations, the capital base grows and the capital mix changes. This also affects the cost of capital. The capital requirements change during different stages of the organizational life cycle and the capital mix often becomes inappropriate and unbalanced. Therefore, companies adopt restructuring to evolve an appropriate financial structure and achieve reduction in the cost of capital.

1.5.12 Consistent Growth and Profitability

The expectations of customers have changed over the years. Today, they demand quality at a reasonable price. They do not mind spending, but always look out for products that offer value for money. This aspiration of the customers is not

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unwarranted, as customer is the king. To meet customer expectations, companies have to adopt improved production techniques and effective cost control measures. If a company is not ready for this change, it should restructure its operations so that these objectives can be achieved.

1.5.13 Environmental Changes

The business environment in which companies operate is prone to changes. This, very often, results in changes such as decline in demand, increased competitive pressures, quicker product obsolescence, increasing stakeholder expectations, changed legal framework, and increasing need for innovation. These changes are often drastic, and more often than not render the company's present set of objectives incompatible with the changed business environment, leading to failure to meet the stakeholders' expectations. This forces the company to initiate restructuring, to attain compatibility between company objectives and the environment.

1.5.14 Meeting Investors' Expectations

Every company requires regular and steady inflow of capital to pursue its organizational objectives. Investors provide the required capital but expect safety of their investment and ever-increasing returns. If the company fails to meet investors' expectations, investors shy away from the company. Keeping this in mind, companies need to take steps that will increase returns. This goal is often pursued by restructuring the operations of the company.

1.5.15 Resolving Conflict

Companies often experience conflict between the management and the shareholders' perception of the prevailing state of affairs. The management often perceives that all is well with the company, whereas shareholders think otherwise. To resolve this conflict, companies often initiate restructuring.

1.5.16 Transferring Corporate Assets

Companies often have assets that they are unable to use efficiently. They choose restructuring to transfer their assets to a more efficient user. The efficient user may be its own division/segment or another company. This transfer benefits the company by making the operations cost-effective and by increasing the company's returns.

1.5.17 Bifurcating Business

There is a common belief that the sum of returns of two businesses is often greater than that of a single entity. This happens as bifurcation results in increased efficiency due to a focused approach. Companies often opt for restructuring with the aim to bifurcate the company into two or more entities so that it can achieve the objectives of increased returns.

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While these arguments indicate that restructuring generates positive results, it may not always be true. The success or failure of the process of restructuring depends on factors such as management approach, core competencies present, prospect of the existing line of business, prospects of the proposed line of business, coordination between various functional heads, communication initiated, etc. Organizations should not let the fear of failure prevent restructuring, for death then becomes inevitable.

1.6 BARRIERS TO RESTRUCTURING

Companies often opt for restructuring to attain the benefits mentioned so far. However, the process is never a smooth ride. The process may also involve a number of impediments.

1.6.1 Inadequate Commitment from Top Management

This is one of the biggest barriers to restructuring. Managers are quite unsure about the outcome of the process, and the support needed from the top management is often missing. In addition, they often go by the dictum, 'What is in it for me?' When the change process does not get the support of the top management, the process often fails.

1.6.2 Resistance to Change

The managerial mindset of resisting change is another barrier to the process of restructuring. Managers resist change mainly because they are never taken into confidence before initiating the process. This instils fear in their mind and they feel that the only possible outcome of the process would be downsizing and loss of jobs. When managers resist change, the employees working under them follow suit. It is, therefore, necessary to have an open dialogue with the managers and employees about the need and reasons for initiating restructuring.

The employees should expect the following changes:

- Changed work environment
- Unfamiliar technology
- Cost-cutting measures resulting in layoffs
- Stringent performance targets

These elements create a fear psychosis and result in resistance to change.

1.6.3 Poor Communication

Poor communication is another hurdle in the process of restructuring. The top management often fails to communicate the reasons and objectives of the restructuring process. This activates the grapevine, which results in prejudice and negativity among the employees. Making changes without communicating with the people who implement the changes at the operational level and are likely to be affected the most sabotages the restructuring effort. Research shows

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that companies that communicate with their employees about the proposed restructuring, more often than not, face no resistance to the process.

1.6.4 Absence of Requisite Skills

Restructuring is more a science than anything else. People who need to initiate this process should be familiar with the processes and methodology involved. Companies often do not hire the services of experts as they consider it a routine internal matter, and think everybody is capable of carrying out the task. This approach results in failure to carry out the process in a professional manner, and the objectives are never attained.

1.6.5 Scepticism

Quite often, people in charge of the restructuring exercise show scepticism about the outcome of the process. As a result, the process is never executed effectively. The negativity with which the process is carried out spells disaster for the organization and the desired objectives remain on paper.

1.6.6 Failure to Understand Benefits of Restructuring

Restructuring is carried out to attain the objectives of cost reduction and proper allocation of resources. Employees often look at it as an attempt to get rid of workforce. Though some deadwood may be sacrificed, it may not be the ultimate aim of the process. The stakeholders need to understand that it is wiser to sacrifice deadwood than jeopardize the whole company and its employees. The process of dealing with redundancy should be gradual and provide for smooth exit of employees. Rather than enforcing compulsory retirement, voluntary retirement options for people expected to be laid off and golden handshakes for surplus staff is more fruitful in gaining employee acceptance. The key is to keep the communication channels open with the stakeholders on the course of action intended to be followed by the company.

1.6.7 Lack of Resources

The total process of restructuring is time-consuming and resource-intensive. Business entities often look upon it as a natural process and hence do not earmark resources for the process. For example, if the company proposes to lay off certain employees, they need to be adequately compensated, for which financial provisions have to be made. Absence of such provisions is bound to create a financial strain on the company and even invite legal proceedings at times. Therefore, it is advisable to evolve a clear plan of restructuring, which ascertains and provides for adequate resources to facilitate smooth completion of the process.

1.6.8 Organizational Workload

Failure to anticipate the effects of restructuring on organizational workload often acts as a barrier. Employees are likely to perceive restructuring as a pretext to reduce workforce and transfer the workload of those laid off to those who

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continue to retain their jobs. The labour leaders interpret it as a case of workforce exploitation and hence instigate workers against restructuring.

1.6.9 Non-adherence to Time Schedule

The process of restructuring calls for strict adherence to time schedules. Failure to stick to the scheduled timeframe results in cost increase, increased legal hassles, and failure to attain planned objectives, among other things. Hence, it is critical to ensure that the company moves into the renewal or revitalization phase without delays.

1.6.10 Lack of Clear and Visible Leadership

A strong and formidable leadership is of prime importance to lead the process of restructuring. Absence of clear and visible leadership results in vague, ambiguous environment and misdirects the entire process.

1.7 KEY ELEMENTS OF RESTRUCTURING PROCESS

Corporate restructuring involves assessing the value addition and value annihilation caused by different business divisions (Blatz et al. 2008). To complete the analysis, the following variables are studied.

1.7.1 Portfolio Management

This element aims at determining how each business division fits into the overall business strategy of the company. This exercise involves evolving strategies to position the company in a competitive environment and ascertaining the impact of strategic decisions on the contribution of the company. Portfolio management is concerned with the potential of the redefined strategy on achieving synergy in goals and objectives.

1.7.2 Corporate Functions

Analysing corporate functions involves determining the extent of centralization or decentralization adopted by the company and its impact on the day-to-day functioning of the entity. The purpose of this analysis is to identify and adopt the most cost-effective organizational structure.

1.7.3 Operational Performance

The basic objective of this analysis is to determine the amount of available reserves and channelizing the same in restructuring activities. The objectives sought to be attained may be revenue growth, cost reduction, and improving the liquidity position of the company.

1.7.4 Value Structure

This element focuses on achieving optimized linkages of existing locations and competencies. It decides whether the company should pursue vertical integration

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or forward integration. The purpose of the assessment is synergy utilization, cost reduction, and improved utilization of available technical know how.

The aforementioned variables of the restructuring process revolve around four key elements—customer focus, core business processes, cross-functional teams, and IT. Unless these are taken care of, the process falters.

Customer Focus

Customer focus—on both internal customers and external customers—is one of the key business compulsions of today's environment. If the top management fails to commit itself to offering better and improved customer service, survival of the business is near impossible. Customer focus is the driving force of any restructuring exercise. Companies need to capture, cultivate, cosset, coddle, and ultimately captivate the customer for survival (Kuriakose 1997).

The strategy for success for a restructured entity is 'don't just sell, satisfy; don't just satisfy, pamper; don't just pamper, charm your customers'. Satisfied customers bring rich dividends. They form a loyal customer base, which leads to repeat business, increased market shares, higher revenues, and better returns (Kuriakose 1997).

Core Business Processes

The process of restructuring should always involve identifying the core competencies of the organization. As stated above, it is about deciding what the company is good at and focusing on the strengths to attain the business goal. Once the core competencies are identified, achieving customer delight becomes easier and the processes become logical and efficient.

Cross-functional Teams

Once the core competencies are identified, the available manpower should be reorganized around the core competencies. The change process can succeed only when people in the company show commitment, coordination, and competence. To attain the best results, teams need to be empowered to think, interact, use judgment, and make decisions. One should remember that empowered teams do not need bosses; they need facilitators and enablers.

Information Technology

Companies pursuing restructuring should focus on IT, which is one of the most crucial components of the restructuring process. It facilitates paperless work, just-in-time (JIT) applications, online manufacturing, i.e., manufacturing using enterprise resource planning (ERP), etc. Care should be taken that before replacing systems, the thought process should be changed, so that people do not resist change.

1.8 TYPES OF CORPORATE RESTRUCTURING

Restructuring is a strategic process that provides companies with the much needed launching pad to improve their performance and profitability. However, the

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objective to improve performance does not always ensure success. While results have been mixed, companies have often found new direction and drive to perform. Restructuring can be carried out in any one of the following lines.

1.8.1 Financial Restructuring

Financial restructuring involves changes in the capital structure and capital mix of the company to minimize its cost of capital. It deals with infusion of financial resources to facilitate mergers, acquisitions, joint ventures (JVs), strategic alliances, LBOs, and stock buyback. It is to be noted that all these initiatives depend on availability of free cash flows, takeover threats faced by the company, and concentration of equity ownership.

Companies opt for financial restructuring for the following reasons:

- Generate cash for exploiting available investment opportunities
- Ensure effective use of available financial resources
- Change the existing financial structure to reduce the cost of capital
- Leverage the firm
- Prevent attempts at hostile takeover

1.8.2 Portfolio Restructuring

Portfolio restructuring involves divesting or acquiring a line of business perceived peripheral to the long-term business strategy of the company. It represents the company's attempt to respond to the market needs without losing sight of its core competencies.

Portfolio restructuring involves the following:

- Restructuring as a result of some strategic alliance
- Responding to the shareholders' desire to downsize and refocus the company's operations
- Responding to some outside board's suggestion to restructure
- Responding to strategies adopted as a response to exercising call or put options

1.8.3 Organizational Restructuring

Organizational restructuring is a strategy designed to increase efficiency and effectiveness of personnel through significant changes in the organizational structure. It is a response to changes in the business and related environments. Such restructuring takes the form of divestiture and acquisitions.

1.9 STRATEGIES FOR RESTRUCTURING

Organizations differ in terms of work culture and value systems. There can be no single standardized restructuring strategy that will help all organizations attain their restructuring objectives. In view of this fact, the following restructuring strategies have been evolved.

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1.9.1 Hardware Restructuring

When the structure of the organization is redefined, dismantled, or modified, the restructuring is termed hardware restructuring.

The focus of hardware restructuring is on the following elements:

- Identifying the core competencies of the business to pursue the growth objectives
- Flattening the organizational layers to improve organizational responsiveness towards planned strategies
- Initiating downsizing to reduce excess workforce, so that overheads can be reduced
- Creating self-directed teams that do not wait for instructions and guidance, and practice autonomy in functioning
- Benchmarking against the toughest competitors so that best practices are adopted

1.9.2 Software Restructuring

Software restructuring involves cultural and process changes to establish a collaborative environment that facilitates growth and restructuring.

Software restructuring focuses on the following:

- Adopting an open and transparent communication mechanism, whereby the strategy is communicated to all levels of the organization without any difficulty
- Building a culture of guidance and coaching
- Building an environment of trust, so that individuals are assured of all support in carrying out their tasks
- Raising the aspiration levels of individuals, commonly referred to as 'stretch' in management terminology
- Empowering people and encouraging decentralized decision making
- Helping individuals develop foresight, that is, understanding changes and getting ready for the anticipated changes
- Training people to accept new ideas and challenging assignments

1.10 STRATEGIC OPTIONS IN CORPORATE RESTRUCTURING

An organization that is passing through a bad patch needs to restructure its operations to get rid of the existing inefficiencies. The restructuring process requires certain strategies. The strategies adopted are expected to lead to the following results:

- Improve operations
- Alter the relative strength of the organization to face competition
- Facilitate creation of competitive advantage
- Provide better customer satisfaction

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- Generate profits in a free market economy
- Help the organization differentiate itself from competitors
- Ensure that it delivers value to the customers

Figure 1.3 highlights the strategic options available to the organization to initiate the process of restructuring.

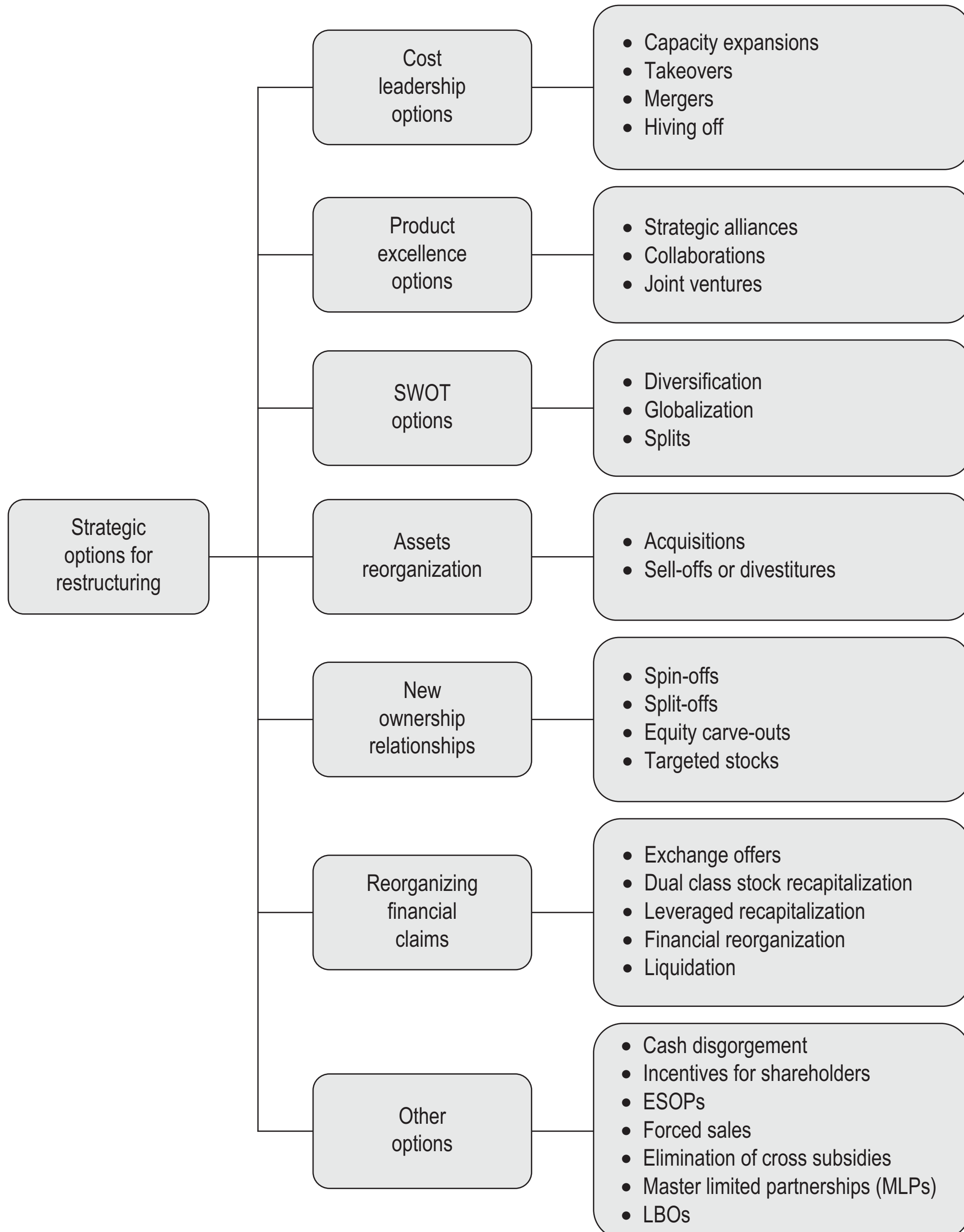

Figure 1.3 Strategic options for corporate reorganization

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1.10.1 Cost Leadership Options

Some strategic options for corporate reorganization are termed cost leadership options, as they focus on reduction in the overall cost, resulting in rise in profits. The different strategies under this group are given in Fig. 1.3.

Capacity Expansion

This strategy involves expansion in the production capacity, resulting in higher trading volumes and hefty margins. This strategy works when the market is starved for goods and services, and gleefully accepts all the output. For example, during 2008, Holcim commissioned 1.5 million tonnes of cement capacity group-wide. By the end of 2008, Holcim also had capacity expansion projects underway involving 25.9 million tonnes. By the end of 2011, plant expansions and new facilities will have increased group capacity to around 218 million tonnes of cement (Holcim Group 2009).

But capacity expansion is a mixed blessing because if the cost of expansion is not kept under control, it can exceed the profitability. It can also result in excess capacity as competition increases. For example, steel and cement.

Takeovers

In takeovers, the ownership and consequently the right of management stands transferred from one company to another without dissolution of the existing unit (More details in Chapter 2). Takeovers can be friendly or hostile.

Friendly takeovers are those where the current owners agree for the transfer of the business at a mutually acceptable share price. For example, Ashok Leyland by Hindujas, German telecommunications and engineering group Mannesmann AG by UK-based mobile phone group Vodafone AirTouch, and GoodKnight by Godrej.

Hostile takeovers, on the other hand, involve acquiring the controlling number of shares without the concurrence of the existing controlling interest. For example, Kwality ice creams by Hindustan Uniliver (HUL), and Ahmedabad Electric Company by Bombay Dyeing.

While takeovers have merits and demerits, one cannot contradict the fact that they provide fast growing companies an easy and quick solution for the acquisition of the much needed capacity.

Mergers

Mergers involve the coming together of two or more companies and pooling of resources for the purpose of achieving certain common objectives (More details in Chapter 3). Mergers presumably result in a bigger, more cost-effective, and efficient new entity. The new entity might assume the name of one of the merging entities or may assume a new name altogether. For example, merger of Lipton and Brooke Bond into Brooke Bond India Limited (BBIL), which was subsequently merged with HUL.

Mergers are also used as an effective tool for reviving sick or potentially sick units. For example, merger of Hyderabad Allwyn with Voltas.

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Hiving Off

Hiving off is a process wherein an existing company sells a particular division to reduce unproductive expenditure. It also helps an entity to reap the benefits of core competencies, competitive advantage, and optimum capacity. Examples are the hiving off of the yarn division of Modern Woollens to Modern Threads, Dollops of Cadbury to HUL, Kissan and Dipy brands of UB Group to HUL, and Dr Reddy's, Sun Pharma, Ranbaxy, and Nicholas Piramal hiving off their R&D divisions.

1.10.2 Product Excellence Options

The strategies adopted here focus on improving the profitability of the company by changing the product mix and product quality.

Strategic Alliances and Collaborations

Strategic alliances represent a long-term agreement between two or more entities to co-operate with each other in specific areas of interest (see Chapter 9 for more details). Some areas of common interest include access to new technology, product range, and markets. A big advantage of strategic alliances is that they do not involve investment of funds in the share capital of the entities and neither do they involve any changes in the hierarchies of the participating companies. For example, strategic alliance between Wipro and IBM, whereby Wipro will market and integrate in India IBM's wide range of server and storage products such as pSeries (UNIX servers), xSeries (Intel-based servers), iSeries, and zSeries. In addition, IBM's full portfolio of storage products covering Enterprise Storage Systems (ESS), Linear Tape Open (LTO), Network Attached Storage (NAS), and iSCSI products also will be offered.

Similarly, Bridge Mobile Alliance is a business alliance of eleven major mobile companies in Asia and Australia. Members include Singtel (Singapore), Airtel (India), AIS (Thailand), CSL (Hong Kong), CTM (Macau), Globe (Philippines), Maxis (Malaysia), Optus (Australia), SK Telecom (S. Korea), Taiwan Mobile (Taiwan), and Telkomsel (Indonesia) (Membrillera et al. 2009).

Joint Ventures

A joint venture is generally a technical and financial collaboration either in the form of greenfield projects, takeovers, or alliances with existing companies (Nabhi 1997).

Joint ventures may take any one of the following three forms:

- Two parties, which may be individuals or companies, one of them non-resident or both residents, incorporate a company in India. The business of one party is transferred to the company and as a consideration, shares are issued by the company and subscribed by that party. The other party subscribes for the shares in cash.

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- Alternately, the two parties subscribe to the shares of the JV company in an agreed proportion, in cash, and start a new business.
- The promoter shareholder of an existing Indian company and a third party, who/which may be an individual/company, one of them non-resident or both residents, collaborate to jointly carry on the business of that company and its shares are taken by the said third party through payment in cash (Sheth Associates 2003).

Joint ventures are preferred because they facilitate transfer of technology, quality improvement, efficiency, and productivity. Joint ventures are very common in automobile, customer electronics, telecommunications, insurance, IT, and engineering sectors. For example, Motorola's JVs in India will develop telecom and IT applications and solutions with Tech Mahindra and Wipro Technologies. The JV with Tech Mahindra, known as Canvas M, will focus on developing a variety of mobile IT solutions, including end-user applications, content services and frameworks for delivery and management. The JV with the IT services arm of Wipro Ltd., known as WMNetServ, will provide outsourced telecom services to public and private network operators. Some other examples of JVs in India include Hero–Honda, Tata Motors–Fiat, Bharti–Wal-Mart, Modi–Xerox, Godrej–GE, and HDFC–Standard Life.

1.10.3 SWOT Options

These are strategies that focus on a given element of SWOT. The purpose behind such restructuring is to exploit the strengths and opportunities prevalent in the market.

Diversification

Diversification is a strategy whereby a company enters different product or market segments to increase market penetration. The main objective behind diversification is to exploit the new avenues available and add to the group profits.

Diversification is a mixed blessing. While some companies succeed, others are often forced to re-evaluate their decisions. Companies fail to achieve the desired results because they enter areas where they do not have core competencies and competitive advantage.

Some of the well known groups that have diversified into unchartered waters include Godrej, Tata, the Anil Dhirubhai Ambani group, the UB group, Larsen and Toubro, and the Bharti group.

Globalization

This is a trend where companies set up businesses in other countries. The trend is on the rise since the Indian economy has been liberalized. Many Indian companies from the power, telecommunications, financial services, entertainment, and consumer products industries have gone global.

Some well-known examples include the Taj group, TCS, Infosys, Bharti group, Tata group, Mukesh Ambani group, Wipro, and Ranbaxy.

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Splits

Splits involve the breaking up of a business into independent entities to exploit opportunities of growth, raise capital, achieve efficiency, and derive taxation benefits. Splits also provide benefits of synergy, competence, and revival.
Splits can be of two types:

- In the first type, the existing unit is broken up and a number of units are regrouped in viable subgroups. Here, the success of the new subunits cannot be safeguarded. Example: Bajaj group, Reliance group
- In the second type, the assets of the entity are regrouped on a rational basis to ensure future success of the new subunits. Example: Tata group

1.10.4 Assets Reorganization

An organization's assets can be reorganized by acquisitions or by divestitures. Let us now discuss these methods of reorganizing assets.

Acquisitions

Acquisitions represent purchase of new entities to utilize the existing strength and capabilities or to exploit the untapped or underutilized markets. It is also carried out to grow in size and prevent possibilities of future takeover attempts. Example: Tata Steel's decision to acquire Corus.

Acquisitions are also looked upon as a way of moving from industries/markets with unfavourable outlook to industries/markets with more favourable opportunities. For example, Airtel's efforts to acquire companies abroad.

Sell-offs or Divestitures

Sell-off or divestiture is an attempt to come out of a product segment or sector to adjust the operations to the changing economic and political environments. These are voluntary decisions implemented to attain shareholder wealth maximization.

Divestitures are resorted to for the following reasons:

- Dismantling conglomerates
- Abandoning one's core business
- Changing the group's strategic focus
- Adding value by selling the entity to a company that could exploit opportunities more effectively
- Making huge investments that are beyond the company's capacity
- Harvesting the past success
- Discarding unwanted segments and generate resources for acquiring new businesses
- Warding off takeover attempts
- Fulfilling statutory requirements
- Reversing past buyout mistakes

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1.10.5 New Ownership Relationships

These strategic options result in change of ownership of the entity, which is expected to add value to the entity and result in improvement in profitability.

Spin-offs

In a spin-off, a company creates a subsidiary whose shares are distributed on a pro-rata basis to the shareholders of the parent company to generate positive returns.

Schipper and Smith (1983) conducted a study on the effects of spin-offs and found that they generate 2.84% abnormal returns to the parent company. A similar study by Hite and Owers (1984) concluded that the abnormal returns were 3.8%. They also found a positive relation between the size of the spin-off and the announcement effect. Both the studies concluded that there was no negative effect on the bondholders.

Similar results were also found by Copeland, Lemgruber, and Mayers (1987) who conducted an extended study on the subject. The study measured the market performance of spin-offs and their parent company for three years following the completion of the spin-off. They found that the mean return during the three-year period was 76%. The study also concluded that such firms were more actively involved in takeovers, which often generated abnormal returns compared to normal returns by other firms in the industry.

Other examples of spin-offs are Marriott Corporation's decision to spin off Marriott International, Kodak's decision to spin off Eastman Chemical, etc. (Finegan 2010).

Split-ups

Split-ups represent a restructuring process, where companies split themselves into two or more parts. Split-ups have some common reasons:

- The company wants to reduce the business risks.
- A certain sector is facing intense competition.
- The valuation of the core business would improve.
- The unit that is split is making continuous losses.
- The split-up would allow the company to focus on key sections/products.

Some famous examples of split-ups are National Medical (later auctioned to Hercules) and Allegis Corporation, Dole Foods' decision to split off Castle & Cooke, Sears' decision to split off Dean Witter, Quaker Oats' decision to shed Fisher-Price Toys, etc. (Finegan 2010).

Equity Carve-outs

An equity carve-out is a process whereby an IPO of a portion of the common stock of a wholly owned subsidiary is offered to raise resources. Equity carve-outs are also known as 'split-off IPOs'. This process initiates trading in a new and distinct set of equity claims on the assets of the subsidiary.

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An equity carve-out can result in the following changes:

- It helps in restructuring the operations of the assets.
- It helps in establishing a public value for the operations of the subsidiary.
- The subsidiary publishes separate financial reports on its operations.
- The flow of information on the subsidiary has a positive impact on the operations.
- It facilitates evaluation of the performance of the subsidiary independently.
- It helps the employees get performance-linked incentives.
- It facilitates sale of the subsidiary to an outsider.

Targeted Stock

Under targeted stock, an entity's operations are split into two or more common equity claims, but the businesses remains wholly owned segments of a single parent. Here, the targeted stock is regarded as common stock of the consolidated company, and not that of the subsidiary.

In targeting stock, the voting rights and dividends are based on the relative values of each target stock segment. However, the liquidation rights are in proportion to the relative market values of each target stock segment.

Target stock segments generate the following benefits:

- The financial markets value different businesses based on their own performance.
- It increases the ability of the parent company to raise capital.
- Each target stock segment can be offered incentives based on their individual performance.
- There is no change in the management of the segments.
- The operating synergies are maintained.

1.10.6 Reorganizing Financial Claims

This strategy involves bringing about changes in the financial claims of the stakeholders. The stakeholders are motivated to accept the change only when the exchange offers them greater market value than that of the existing securities.

Exchange Offers

An exchange offer provides one or more classes of security and the right or option to exchange part or all of their holdings for a different class of securities of the entity. To induce the security holders to accept the exchange offer, the terms of exchange offered involve securities of a greater market value than the existing securities. The average life of the offer is about seven weeks.

Exchange offers are subject to certain conditions:

- Specification of the maximum number of securities that are offered in exchange
- Specification that the exchange offers are contingent upon acceptance by a minimum number of securities to be exchanged

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Exchange offers may generate positive or negative returns. It is generally observed that exchange of debt and preferred stock for common stock generates positive returns and vice versa.

Dual Class Stock Recapitalization

Under this head, the entity creates a second class of common stock that carry limited voting rights and usually preferential claim to the entity's cash flows. This is done by distributing limited voting shares on pro-rata basis to the existing shareholders. Such stocks usually carry higher rates of dividend.

In most entities having dual class stock, the founding families have control over the entity, as they own stock of the company. The second class stock is offered to outsiders. Such companies do not generally face takeover threats as they are closely held entities. The shares are owned by family members or close relatives and friends, and only a small fraction of the total capital floats in the market.

Leveraged Recapitalization

A firm that is low levered is often vulnerable to takeover by an entity that is seeking to recapture the tax benefits of debt capital. On the other hand, a high levered entity does not often find bidders, as prospective bidders are reluctant to face the task of returning the firm to leverage ratios that are closer to industry norms.

Leverage decisions represent potential for value enhancement or defence against acquisition. Leverage recapitalization often results in operating improvements. The large overhang of debt stimulates the management to improve operations for generating sufficient cash flows to repay the debt.

The market response to announcements of leveraged recapitalization depends on whether the action is proactive or defensive. Proactive action aims at improving the performance of the entity, whereas defensive actions are initiated in response to actual takeovers or possible takeover bids.

Financial Reorganization

Entities facing financial distress usually adopt financial reorganization. Financial distress is a condition where the liquidation value of the firm's assets is less than the total face value of the creditor's claims.

Financial reorganization may take any one of the following forms:

Out of court procedure Here the entity is either liquidated or continues with its operations. If the operations continue, a part of the equity claim may be substituted with debt or the maturity of the debt may be postponed. The idea behind this strategy is to provide time to the entity to improve its performance and stabilise earnings.

Merger with another firm This involves merging of the firm in financial distress with a financially healthy entity. Research indicates that takeover of firms facing financial distress is likely to be more successful than takeover of firms

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whose operating performance is poor. Though there is no concrete evidence that takeover always helps restructure a distressed entity, it certainly is the best option under the given circumstances.

Formal legal proceedings This process involves adoption of legal procedures to restructure a distressed entity, such as referring the case to the Board for Industrial and Financial Reconstruction (BIFR) under Indian laws for reconstruction.

Liquidation

Liquidation is the last option available to the entity. It involves initiating bankruptcy proceedings. Here, all the assets are discarded and all the liabilities are repaid, after which the entity ceases to exist. Liquidation may be voluntary or involuntary.

1.10.7 Other Options

There are also options that are general in nature and do not fit into the categories discussed so far. However, this does not take away the crucial role they play in the process of corporate restructuring.

Cash Disgorgement

The basic objective of business is to utilize financial resources effectively and generate wealth in a more assured and rapid manner. Cash disgorgement is the principle where accumulated cash resources of a business are spent or reinvested effectively. Having cash but not being able to use it defeats the purpose, for the entity is missing out on profitable investment opportunities or might be spending cash frivolously on things that are not necessary (Childers 2009).

Just sitting on cash with no interest earnings or low interest earnings makes no sense. The company should identify and adopt ways of using the resources productively to attain long term wealth accumulation objectives.

A company's capital structure includes both equity and debt. When a company borrows, it has to manage its resources in such a way that it is able to repay its debt on a regular basis by channelizing surplus cash. This obligation may prevent a company from reinvesting its surplus cash in new projects or profitable opportunities.

Whenever a company comes across projects and acquisitions that make business sense from a long-term wealth accumulation perspective, it should explore the possibilities of investing in such projects. If the surplus cash is being utilized for repaying debt, there is no harm in pursuing expansion through new capital. This is advisable because the proposed investment plan is put to test at the market. A positive market feedback provides an insight into the risk involved in the project and reiterates the manager's confidence in going ahead with it. It also encourages managers to shun their discretionary approach to investment, and ensures that available resources are put to proper use.

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While we have stressed on two major options, let us list out all the options available to a company for cash disgorgement:

Repayment of debt A company that has debt in its capital structure should utilize the available surplus cash to repay the debt. Debt repayment would reduce the interest burden of the company and also free its assets from existing mortgages/claims.

Buyback of shares The company can also utilize the surplus cash for buying back its common stock from the open market. Buyback reduces the number of shares floating in the market and leads to rise in the prices of the floating stock.

Partnerships The company can also explore the option of reinvesting its cash flows by entering into partnerships/strategic alliances/JVs. Such arrangements require limited investment but can generate good long-term returns.

Dividends A company can also disgorge cash by paying increased dividend. No company likes to cut the dividend rate once it has been raised. Increased dividend payment is interpreted positively by the market as a commitment to pay the same or higher rate of dividend in future. Of course, one needs to ensure that future cash flows stay healthy so that company is not forced to cut dividend.

Employee Stock Option Plans

Employee stock option plans (ESOPs) are contracts between a company and its employees that give employees the right to buy a specific number of the company's shares at a fixed price within a specified period of time.

If an employee is granted the option to purchase 1,000 shares of the company's stock at the current market price of ₹50 per share, called the 'grant' price, he can exercise the option at ₹50 per share. The exercise price would typically be equal to the price when the options are granted. Employee stock option plans allow employees to exercise their options after a specified number of years or when the company's stock reaches a certain price. If we assume that the stock price increases to ₹200 per share, and the employee exercises his option to buy 1,000 shares at ₹50 per share and then sell the stock at the current market price of ₹200.

The basic objective of ESOP is to motivate employees to perform better and thus help improve shareholder value. Employee stock option plans create a strong sense of belongingness and ownership among the employees, apart from bringing them financial gains. They can be done in two ways:

Creating a special purpose vehicle Here, a trust or special purpose vehicle (SPV) is formed and the company issues shares or options to the trust. The trust is required to pay for these shares and needs funds for the same. To ensure that the SPV has funds to buy the options, the company may either give soft loans

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from its own funds or can allow the trust to raise loans through other sources to meet its financial requirement.

In case the trust decides to raise funds through loans, the company acts as a guarantor to the lender. The trust acquires the shares/options required. Subsequently, when the employees purchase the shares, they pay the necessary amount to the trust for the same. The funds so generated are used by the trust to repay its loans.

Giving options directly to employees Here employees showing extraordinary performance are offered shares directly. The selection of the employees is based on their personal and performance criteria:

- Performance of the employee as indicated by the annual performance appraisal
- Minimum period of service
- Present and potential contribution of the employee
- Other factors deemed to be relevant for the success of the company

Every employee is not offered an equal number of options. The same is determined taking into consideration the grade, level to which the employee belongs, years of service, salary drawn, etc. The variables are determined on the objective the company wants to attain through the ESOP.

Employee stock option plans can be of different types depending upon the objectives that the company wants to achieve. The most common forms of ESOP include the following:

Employee stock option scheme Under the employee stock option scheme (ESOS), the company grants an option to its employees to acquire shares at a pre-determined price at a future date. The employees eligible under the scheme are free to acquire shares within the period stipulated. Once the shares are acquired, employees are free to dispose them subject to lock-in period, if any. Here the price at which ESOS is offered—exercise price—is lower than the prevalent market price so that employees find the offer attractive and take benefit of the same.

Employee stock purchase plan Employee stock purchase plans (ESPP) are very popular among listed companies, where the employees are given the right to acquire shares of the company immediately and not at a future date as in ESOS. The shares are again offered at a price lower than the prevailing market price to make the scheme popular.

The scheme has certain built-in restrictions such as lock-in period and hence shares cannot be sold during the period. In addition, the employee should continue to work with the employer for a specified number of years after the allotment of the shares.

Share appreciation rights/phantom shares In the share appreciation rights (SAR)/phantom shares scheme, the employees are not offered or allotted any

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shares of the company. Instead, they are given an incentive or performance bonus based on the appreciation in the value of shares between two specified dates. The basis of this scheme is that the increase in the value of shares is attributed to the improved performance by the employees and so they need to be suitably rewarded.

The Companies Act (1956) states that stock options can be issued only after getting approval of the shareholders by a special resolution. In case of a private company, stock options can be issued under the approval by the board of directors and the approval of the shareholder is not mandatory.

Employee stock option plans also have tax implications both for the employer and the employee. Until recently, the difference between the cost of the share to the employees and market value on the date on which an employee got the share would be treated as perquisite and taxed in addition to capital gains tax payable by the employee on sale of those shares.

After the removal of the perquisite tax, the employee is not required to pay tax on the difference in the cost of share and its market value. However, the capital gains tax is still payable under the changed rules.

The SEBI norms say that the company allotting ESOP can treat the amount as an expense and account for the same accordingly. However, there is still no clarity whether the amount accounted as expense will be allowed as deductible expense by the income tax authorities.

Forced Sales

The capital structure of a company includes both equity and debt. When debt exceeds equity, the entity becomes high leveraged and often finds the debt load intolerable. To manage the situation, the company often decides to sell unrelated and underperforming assets and businesses. This is called a forced sale.

It is a simple case of ‘fit’ and ‘focus’ for the buying and selling entity. It helps the selling entity to divest unrelated activities and helps the management to focus on the remaining business divisions that offer better growth opportunities.

While the assets may be unrelated and underperforming for the company selling them, they may be worth much more to the buying entity. As such, the assets are sold for a value greater than the value they represent for the selling company.

Forced sales should not be construed as failure of the selling entity. It represents a true case of reaping the benefits of past successful investments and good management. It also helps the company to eliminate unwanted layers in the organizational structure and speed up the decision-making process.

Organizational Imperatives

‘Cash is king’ is a common organizational imperative. It again draws us towards the capital structure, which includes debt and equity. Having a proper blend of equity and debt is crucial as it offers flexibility and balance to the capital structure and also brings down the overall cost of capital.

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While payment of dividend is not mandatory, the overall cost of capital is very high. This fact is often overlooked by the company and reality dawns when the earnings start declining.

Debt, on the other hand, carries a fixed rate of interest that has to be paid whether the company earns profits or incurs losses. Confronted with debt, the management has to make untiring efforts to improve the earnings of the company. Since debt carries an obligation, there is no room for inefficiencies and mistakes. The management has to ensure that adequate cash surplus is generated to pay the interest and principal amount regularly. To prevent default in payment of debt-related liability, the management needs to avoid mistakes and eliminate inefficiencies. It is imperative for the company to generate cash, hence the dictum 'Cash is king'.

Elimination of Cross Subsidies

A company often has numerous divisions/departments, each specializing in specific products and services. All the divisions are expected to create value by exploiting available opportunities. However, all the divisions do not create value. Some divisions incur losses and destroy value. Such departments are able to continue because the profit-making divisions absorb the losses of the loss-making divisions/departments. As a result, the consolidated bottom line of the company remains 'black'. The process where profit-making divisions facilitate continuation of loss-making divisions is called cross subsidization.

The element of cross subsidy can be identified by valuing the assets and the business separately and ascertain which is more valuable. When the assets that support a business are worth more than the business itself, it indicates that the assets have alternative use and are not being fully exploited and utilized. Once this is identified, the company should start looking at alternatives whereby the assets can be deployed more effectively to create value.

Buyback of Shares/Tender Offers

Tender offer is a public offer made by a potential acquirer to purchase some or all the shareholders' shares in a company. The price at which these shares are offered to be purchased is higher than the current market value of the shares. It is assumed that the premium would induce the shareholders to show willingness to sell their holdings.

The acquirer offers to purchase the shares at a premium because it allows him to acquire control over the company. The sellers obviously are interested in the offer as it helps them to earn significant profits on their holdings. Tender offers have to be made within a stipulated time frame, subject to a minimum and maximum number of shares. If a company comes out with a tender offer to purchase shares of a company for say ₹150 per share, the prevailing market price of the shares may be ₹120. This means that the tender offer has been made at a premium of ₹30 per share. In the tender offer, the minimum number of shares has been stated as say, 50 and the maximum at 500 shares. Accordingly no seller

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would be able to sell less than 50 shares or more than 500 shares through the tender offer.

Tender offers may be friendly or unfriendly. When the acquirer fulfils the legal provisions for the tender offer and expresses his desire to purchase the shares with the endorsement of the company, the offer is friendly. On the other hand, when the offer is made directly to the shareholders without the endorsement of the company, the offer is unfriendly.

In the US, tender offers are regulated by the Williams Act. The Securities Exchange Commission's SEC regulations 14E also govern tender offers (Weston et al. 2003). The regulations focus on the following:

- The minimum length of time for which a tender offer must remain open
- A procedure for modifying tender offers after the same has been issued
- Governing insider trading in the context of tender offers
- Whether one class of shareholders can receive preferential treatment over another

The buyer should disclose certain facts pertaining to the tender offer (SEC regulations) (Weston 2003):

- Material terms of the tender offer
- The bidder's identity and background
- The bidder's history with the target company

1.11 BUYBACK OF SHARES IN INDIA

Buyback of shares in India is regulated through Section 77A, 77AA, and 77B of the Companies Act, 1956. These sections were inserted by the Companies (Amendment) Act, 1999. The Securities and Exchange Board of India (SEBI) has also stipulated relevant norms under SEBI (Buyback of Securities) Regulations, 1999. Another set of statutes have been evolved by the Department of Company Affairs, which framed the Private Limited Company and Unlisted Public Company (Buyback of Securities) Rules, 1999, pursuant to Section 77A(2)(f) and (g) respectively.

These regulations give the following reasons for buyback of shares by companies:

- To increase promoters holding
- To increase the earning per share
- To rationalize the capital structure by writing off capital not represented by available assets
- To support share value
- To thwart takeover bids
- To utilize surplus cash not required by the business

Financial experts say that buyback from the open market at a premium over the prevailing market price is the best strategy to maintain the share price in a

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bear run. This offers incentives to shareholders and helps maintain interest in the scrip. It also helps the company to utilize the available surplus cash effectively.

A company can buy back shares through the following routes:

- From existing shareholders on a proportionate basis. In such a case, the company is required to make a tender offer for buyback to shareholders. The shareholders who respond to the buyback offer are required to fill the requisite form transferring the shares to a special account created for the purpose, known as escrow account.
- Through open market using the book building process or stock exchanges
- Through odd lots. In case of a listed company, if the lot of the shares proposed to be bought back is smaller than the marketable lot as specified by the stock exchange, the company can go ahead with the buyback by purchasing the odd lots.
- Employees who have been issued shares pursuant to a scheme of stock option or sweat equity.

1.12 WHERE DO THE RESOURCES FOR BUYBACK COME FROM?

A company proposing to go in for buyback of shares can seek funds from any of the following sources:

- Free reserves
- Share premium account
- Proceeds from any shares or other specified securities

Here, an amount equal to the nominal value of the share intended to be bought back has to be transferred from these heads to the capital redemption reserve. The company is required to provide the details of transfer of free reserves to the redemption reserve in the balance sheet. What is important to remember is that a company cannot buyback its shares or other specified securities out of the proceeds of an earlier issue of the same kind of shares or specified securities.

1.13 CONDITIONS TO BE FULFILLED FOR BUYBACK

A company should ensure that the following conditions are fulfilled before it initiates the procedure of buyback:

- Buyback should be authorized by the Articles of Association.
- A special resolution should be passed in the general body meeting of the company. The notice of the meeting at which special resolution is proposed to be passed should be accompanied by an explanatory statement stating all the material facts about the buyback offer, reasons for opting for a buyback, the class of security intended to be purchased, the amount to be invested under the buyback offer, and the timeframe for the completion of the buyback.
- A listed company has to take the approval to the special resolution through a postal ballot.

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- If the amount of shares to be bought back is 10% or less of the paid-up capital and free reserves, a board resolution is adequate to go ahead with the buyback.
- The shares that are being bought back should be free from lock-in period/ non transferability clause.
- The buyback of equity shares in any financial year should not exceed 25% of the total paid-up equity capital in that financial year.
- The debt–equity ratio—the ratio of debt owed to share capital and free reserves—should not exceed the ratio 2:1 after the buyback.
- A company going for buyback should not have defaulted in the following:
  - Repayment of deposit or interest payable thereon
  - Redemption of debentures
  - Redemption of preference shares
  - Payment of dividend, if declared, to all shareholders within the stipulated time of 30 days from the date of declaration of dividend
  - Repayment of any term loan or interest payable thereon to any financial institution or bank
- The company should not have violated the provisions of the Income Tax Act and the Companies Act with regard to the form and contents of annual accounts.
- The shares or other specified securities intended to be bought back should be fully paid up.
- If the company is listed on any recognized stock exchange, adherence to the regulations made by SEBI for buyback by listed companies is mandatory.
- A private and closely held company also needs to adhere to the regulations prescribed for buyback of shares.
- After passing of resolution but before going ahead with the buyback, a listed company is required to file a declaration of solvency in Form 4A with the Registrar of Companies and SEBI. The declaration must be accompanied by an affidavit by the board certifying that the company is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the board. This affidavit has to be signed by at least two directors of the company, one of whom has to be the managing director.

A company whose shares are not listed on any recognized stock exchange is not required to file the declaration of solvency with SEBI.

- Once the buyback is completed, the company is required to maintain a register of the securities/shares bought and enter the following details in the register:
  - The consideration paid for the shares/securities bought back
  - The date of cancellation of securities

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  - The date of extinguishing and physical destruction of securities. The provisions say a company has to extinguish and physically destroy the securities bought back within seven days of the last date of completion of buyback.
  - Any other details such prescribed
- Every buyback has to be completed within 12 months from the date of passing the special resolution or board resolution, as the case may be.
- A company which has bought back shares/securities cannot make any public or rights issue of the same kind of security up to six months from the date of completion of buyback.
- A company should not directly or indirectly purchase its own shares or securities through any subsidiary company including its own subsidiary companies or investment company or group of investment companies.

If a company defaults in complying with the provisions pertaining to buyback of shares, then the company or any officer of the company who is responsible is punishable with imprisonment for a term up to two years, a fine of ₹50,000, or both.

1.14 LEVERAGED BUYOUTS

When a company acquires another company using a significant amount of borrowed funds such as bonds or loans to pay the cost of acquisition, the transaction is termed a leveraged buyout. It is worth noting that the assets of the target are offered as collateral security for the purpose of raising loans in addition to the assets of the acquirer. A leveraged buyout or high leveraged transaction or bootstrap occurs when a financial sponsor gains control over the target company's equity through the use of borrowed funds.

Since LBO involves use of debt, the assets of the company being acquired, in addition to the assets of the acquiring company, are used as collateral for securing loans. Leveraged buyouts are popular for they allow companies to make large acquisitions without having to commit a lot of capital. For example, HCA Inc. was acquired in 2006 by Kohlberg Kravis Roberts & Co. (KKR), Bain & Co., and Merrill Lynch, which paid around $33 billion for the acquisition.

An LBO most often involves a ratio of 70% debt and 30% equity, although the ratio of debt can reach as high as 90% to 95% of the target company's total capitalization. Because of this high debt/equity ratio, LBOs pose a very high risk of bankruptcy. For example, the LBOs of 1980s resulted in the bankruptcy of several prominent acquirers such as Federated Department Stores, Revco drug stores, Walter Industries, FEB Trucking and Eaton Leonard, etc.

The reason was that in some cases, the leverage ratio was nearly 100% and the interest payments were so large that the company's operating cash flows were unable to meet the obligation. For example, the bondholders of US newspaper company *Tribune* sued large Wall Street banks, including JPMorgan Chase and

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Citibank, on the grounds that the 2007 leveraged buyout of the publisher that the banks arranged and financed caused its bankruptcy less than a year later. The company proposes to repay the bondholders after paying the banks that lent money for the LBO. The bondholders have filed a lawsuit seeking that they be moved up the list of priorities in which various parties are being repaid (Bullock et al. 2010).

The borrowings include a combination of pre-payable bank facilities and/or public or privately placed bonds, which are classified as high yield debt, also called junk bonds. This debt appears in the balance sheet of the acquired company, whose free cash flows are used to repay the debt. The use of significant amount of debt brings in an obvious risk of financial distress. An unforeseen event such as recession, litigation, and changes in regulatory environment can create problems and the company may struggle to meet its scheduled interest obligations or outright liquidation.

It may be interesting to understand how an LBO secures the debt capital. An LBO is financed with multiple tranches of debt that include the following (Jonathan 2002):

Revolving credit facility Also known as revolver, it is a source that the bought-out firm relies on to secure its working capital requirements. It serves as a line of credit that allows the firm to make certain capital investments, deal with unforeseen costs, or cover the increases in working capital without having to raise additional debt or equity financing.

Bank debt This represents finance secured by mortgaging the assets of the bought-out firm. This source carries the first claim over the cash flows of the business.

Mezzanine debt This is termed as mezzanine debt, for it exists in the middle of the capital structure and is next to bank debt with regard to priority in repayment. Since it is lower on the list of priority in repayment, it is compensated with a higher interest rate.

Subordinated or high yield notes These notes carry a very high rate of interest and low security. They are also referred to as junk bonds due the high risk involved. Each tranche of debt financing has different maturities and repayment terms. For example, some sources of financing require mandatory amortization of principal and scheduled interest payments.

In addition to debt financing, there is also an equity component in financing an LBO. The amount of equity is typically provided by a pool of private equity capital, thus reducing the amount of capital exposed to any one investment. Private equity is an asset class consisting of equity investment in companies that are not traded on a public stock exchange. This investment typically involves a transformational, value-added, and active management strategy.

Why do private equity firms invest in LBOs? The answer is that private equity firms receive a return on their investments through an IPO, a sale or merger of

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the company they control or a recapitalization. The unlisted securities are often sold to investors through private offerings or to a private equity fund—a capital pool of contributions from smaller investors. The private equity firms own 70–90% of the common equity of the bought-out firm. The remainder is generally held by the management and former shareholders.

Another source of financing an LBO is preferred equity. This source is popular as it offers attractive dividend payments on the preferred equity component and also allows holders to participate in any equity upside.

Leveraged buyouts are often termed ruthless as the huge assets of the target can be used against it as collateral in a hostile takeover. Yet LBOs are very popular due to the wealth they create for all the parties involved. Shareholders receive large take-out premiums, participating managements earn enviable returns, and investment funds receive over 30% compounded annual returns (Mohan 1990).

Leveraged buyouts have certain benefits:

- Heavy interest and principal repayments force managements to improve performance and operating efficiency.
- Debt may encourage managements to focus on initiatives such as divesting non-core businesses, downsizing, cost cutting, and investing in technological upgrades. These are very often postponed or rejected outright.
- LBOs are able to generate healthy returns for they focus on reducing unnecessary overheads and selling unrelated business units, thus cutting the company down to a productive core. For example, Beatrice Foods Inc., soon after an LBO, was split up and repackaged as several distinct companies. The same break-up strategy was applied to Uniroyal, Dr. Pepper, and Metromedia (Mohan 1990). LBO companies are repackaged as individual units for these are more valuable and are run more efficiently.

A question very often asked is, why do companies prefer debt financing for LBOs? There are two reasons:

- The use of debt increases the financial return to the private equity sponsor. This view has been expressed in the postulates of Modigliani Miller. The second postulate states, all other things being equal and within strict restrictive assumptions, the total return of an asset to its owners remains unaffected by the structure of financing. As the debt in LBO is relatively fixed, any returns in excess of the cost of capital flow through the equity holders.
- The Modigliani Miller theorem also states that the tax shield available on debt increases the value of the firm. This enables the private equity sponsor to pay a higher price than would otherwise be possible. Since income flowing through equity is taxed but interest payments on debt are not, the capitalized value of cash flowing to debt is greater than the same cash stream flowing to equity.

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In a recent report, Standard and Poor's (S&P) looked at a selection of past leveraged buyouts and divided them into three categories: the good, the bad, and the ugly (www.businessweek.com). A good LBO is one that restores credit quality and returning the rating on the company to investment grade after the buyout. A bad LBO is one that faces significant financial stress after the deal, often ending in bankruptcy over a period of time. The ugly LBOs are companies whose financial performance deteriorated very quickly after the LBO, typically ending up in bankruptcy in three years or less.

The summary of the S&P analysis is given in the Table 1.1.

Table 1.1 S&P's list of the best and worst leveraged buyouts over the past few decades

Acquirer	Target	Value	Status at the time of LBO	Post-LBO status
		The good		
Kohlberg Kravis Roberts (KKR)	Amphenol (APH)	$1.4 billion	It increased the company's leverage and the corporate credit rating declined to B+ from BBB–.	In December 1999, APH filed for a public offering of 2.75 million common shares and used the proceeds to pay down debt and reduce leverage leading to upgrade of the corporate credit rating to BBB–
ARAMARK	First LBO in December 1984	$900 million	Rating dropped to B from A–.	In August 1994, company returned to investment grade of BBB–
	Second LBO in May 2006	$8.3 billion	Rating was lowered to B+ from BBB–.	
KKR	Kraft (Duracell)	$1.8 billion	Duracell actually got a positive rating as market for batteries was expected to grow rapidly.	• Less than three years after its LBO, Duracell was assigned investment grade (BBB). • In 1997, Gillette acquired it in a deal valued at more than $7 billion. • Subsequently, Gillette was acquired by Procter & Gamble. • Debt reduced through IPO
Castle Harlan	Ethan Allen	$385 million	B+ rating was assigned due to an aggressive financial structure.	• Planned IPO led to a BB+ rating in February 1993. • Two years later, rating was upgraded to BBB– due to debt reduction and continued strengthening of operating result. • Rating raised to BBB in 1997, to BBB+ in 1998, and to A– in 2002.
Harley-Davidson			• B+ corporate credit rating was assigned in 1986. • Over the next 20 years, rating was upgraded six times, and the company reached investment grade in 1992.	In 1996, Harley was upgraded to A– from BBB+ and then to A+ in October 2004.

(*Continued*)

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Table 1.1 (*Continued*)

Acquirer	Target	Value	Status at the time of LBO	Post-LBO status
			The good	
KKR	Safeway (SWY)	$4.2 billion	Credit rating fell from A to B+.	• Safeway unloaded assets valued at about $2.3 billion over two years to reduce debt. • It achieved success in terms of both credit quality improvement and return on investment. • It reentered the investment-grade category, with a current rating of BBB–.
Viacom	MTV and Showtime National Amusements		Rating was downgraded to below investment grade i.e. BB+. Rating was lowered to B+ in May, 1987.	• It maintained its energetic style, with a CBS merger, and picked up two more upgrades, rising to A– in February 2001. • In 2005, it decided to split into two separate entities, i.e. an entertainment and a broadcasting company, to enhance shareholder value. • Rating moved up to BBB in January 2006.
			The bad	
KKR	Amstar	$450 million	• Amstar agreed for takeover to avoid potential hostile takeover by dress pattern maker Simplicity Pattern; lowered the rating to BB–. • Rating was cut to B+ in February 1987, because total debt rose to $630 million from $235 million.	• Amstar Sugar business best known for its Domino brand was sold for about $310 million at the end of 1988. • Credit rating was lowered to CCC+ in July 1991, as financial flexibility reduced.
KKR	Evenflo & Spalding Holdings		• The group was assigned a B+ rating that was cut further to B– due to poor operating performance and negative discretionary cash flow.	• Evenflo & Spalding split into two standalone companies. • Evenflo and Spalding rated D. • Operations were renamed TopFlite Golf Co. and filed for Chapter 11 in mid-2003. • Evenflo was sold to Western Presidio in February 2007. • Evenflo now has a B– rating.
R.H. Macy	I. Magnin and Bullocks	$1.1 billion	Macy's was already sitting on a mountain of debt, and adding a little more, in retrospect, was financially imprudent.	• The company started to struggle, and Santa was a no-show in the 1991 Christmas season. • Rating was never upgraded after the LBO.

(*Continued*)

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Table 1.1 (*Continued*)

Acquirer	Target	Value	Status at the time of LBO	Post-LBO status
			The bad	
				• It put the company on the ropes early in 1992. • By January 1992, the rating was down to CCC+, and by the end of the month, bankruptcy filed.
Northwest Industries	Farley Industries	$1.5 billion	Debt rating was down- graded to B from BBB in June 1985.	• CEO Farley made a run on textile and apparel giant West Point-Pepperell. • He was forced to give up some of his stake in Fruit of the Loom. • Fruit of the Loom filed for bankruptcy in late 1999.
Private investment firm Gibbons, Green, van Amerongen	Ohio Mattress	$1 billion	• Investment bank First Boston provided $457 million bridge loan. • Company was unable to sell its proposed $475 million in junk bonds. • It needed outside assistance in the form of a capital injection from Credit Suisse, which ultimately cost it its independence.	• Company was a victim of an overpriced buyout and poor timing, but it managed to hang on. • Renamed Sealy, it went through a few ownership changes before being acquired by KKR in 2004 for $1.5 billion. • It is rated BB– today, but has never made it close to its former investment-grade rating
			The ugly	
Federated Department Stores	Campeau	$6.6 billion	• Rating was downgraded to B from AA– at the time of its LBO in 1988. • Rating on the company fell further to CCC in 1989.	• It filed for Chapter 11 bankruptcy after 21 months of LBO • Emerged from bankruptcy, and in 1994 it bought Macy's. • Performance improved, and reached investment grade and further to BBB+. • $17 billion acquisition of May Department Stores in 2005 brought the rating back to BBB.
Grand Union			• Any company that can make three trips to the bankruptcy courts deserves a special place in the LBO Hall of Shame. • It was taken private in 1989 by an investor group headed by Miller Tabak Hirsch and Salomon Brothers.	• Grand Union filed for bankruptcy for the first time. • It emerged in June 1995 with a $600 million reduction in debt, a new CEO, and a rating of B. • Operating problems continued and in February 1998; it defaulted on a loan payment and once again filed for bankruptcy.

(*Continued*)

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Table 1.1 (*Continued*)

Acquirer	Target	Value	Status at the time of LBO	Post-LBO status
		The ugly		
				• It was assigned a B rating after it emerged from the second bankruptcy. • It filed for bankruptcy for the third and last time in October 2000.
KKR, Hicks, Muse, and Tate & Furst	Regal Cinemas	$2 billion	• The company merged with KKR-owned Act III Theatres to create the largest U.S. exhibitor. • Debt increased by almost $500 million, resulting in a downgrade to BB– from BB.	• The company couldn't fully exploit its size advantage, and the industry faced a tough operating environment. • The highly leveraged capital structure only magnified the decline in profitability and eventually led to multiple downgrades in 1999 and 2000. • After a bankruptcy restructuring, it currently operates as Regal Entertainment Group with a BB– rating.
Revco Discount Drug Centers		$1 billion	Rated BBB+	• The plan for closing stores and reducing costs sounded reasonable but timing wasn't very good. • Rating on the company was down to CCC– by April 1988. • In July 1988, it filed for Chapter 11 bankruptcy.
Thompson Family	Southland	$4.9 billion	BBB rating fell to B.	• The company sought to avoid bankruptcy by selling a controlling interest to Ito-Yokado of Japan • It planned restructuring of debt and preferred stock failed, and the rating fell to D. • It filed for bankruptcy in October 1990 • It exited Chapter 11, and ultimately returned to investment grade in 1993 based on improving profitability and debt ratios and on strengthened financial support after it was made a wholly owned subsidiary of AA-rated Seven-Eleven, Japan.

Source: *LBOs: The Good, the Bad, and the Ugly*, www.businessweek.com, last accessed on 12 December 2009

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1.14.1 Types of LBOs

In countries such as the US, private equity firms have yielded huge returns for investors through LBOs using the tools of financial engineering. LBOs can be classified into two, namely sponsored and non-sponsored.

Sponsored LBOs

Under sponsored LBOs, the private equity firms offer to buy a controlling stake in a company using leverage obtained from banks based on the financials of the company. The strategy is simple—commit very little of own money to purchase the business. This is the secret behind the spectacular returns, for there is very little cash invested.

The process of buyout is very interesting. The buyout firms collect large fees up front and additional advisory fees for operating a company acquired. The returns do not end here. They take away a big share of the investment profits as well. The buyout firms give management ownership that is usually less than 20% of the company. This type of buyout is called sponsored leveraged buyout, where the equity player is the sponsor.

Non-sponsored LBOs

This strategy is adopted in case of financially healthy businesses, where the financing techniques are similar, but the management gains operating control with around 85% to 100% ownership depending on the situation. These buyouts are called non-sponsored leveraged buyouts. Such buyouts are preferred over sponsored buyout even if the buyers have to overpay, for the buyers will be the ultimate owners.

The process of a non-sponsored leveraged buyout is similar to any other kind of business financing. The key requirements for a successful non-sponsored leveraged buyout include the following:

- Quality company and management team that helps gain would-be lenders or investor's confidence.
- Proactive management that is not reluctant to venture into unfamiliar territory.
- Agreement on purchase price could be based on a multiple of 4–7 times cash flow/EBITDA for small to mid-sized companies. For example, a company that makes $2 million a year EBTIDA would be worth $12 million at a 6 multiple. Once this is known, one can ask the owner the price they expect from the deal. Any price within a 4–7 range is thus acceptable.
- Identifying and evaluating financing options such as debt, equity from buyout funds, subordinated debt, insurance companies, corporate development companies, hedge funds and other lenders.

1.15 WHY ARE LBOs NO LONGER POPULAR?

Leveraged buyouts are today a subject of severe scrutiny. This is quite unlike a few years ago when they were the darling of the financial markets. The general

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feeling is that LBOs have been ingenious and questionable, with no great results achieved, which is forcing the financial world to do a re-think. Some experts are also of the view that all LBOs should not be treated the same way. There are obvious differences in the credit risks involved. The criticism broadly originates from the number and size of the current day LBOs. While a $2 billion LBO would raise eyebrows five years ago, a deal of $30 billion is today readily accepted. Obviously one cannot ignore the risk involved in such a deal. For example, the RJR/Nabisco deal of $24.9 billion (Asher 2009).

Critics have been crying foul because LBOs pile huge amounts of new debt on corporate balance sheets, drive down bond ratings, and consequently the market value of bonds held in the company's portfolio. Since LBOs are funded through debt, any rise in interest would drive the company to financial crisis, creating a deep recessionary impact on the economy. With fall in company revenue, servicing the huge debts becomes near impossible and bankruptcy appears to be the only way out as shown in Table 1.1. It may also spell doom for banks, insurance companies, investment houses, and pension funds that have started staying away from LBOs.

The pro-LBO group, however, feels that the risk is not as high as is being made out, as LBOs are seen across sectors, thus diversifying the risk. Given the financial tools one can run sensitized cash flow analyses to establish different interest rate scenarios, and estimate the tolerance of a borrower for higher interest rates.

1.16 MANAGEMENT BUYOUTS

Management buyout (MBO) is a process where managers and/or executives of a company purchase the controlling interest in a company from existing shareholders. The management usually buys the target business from the parent company. Of course, it is very important to establish whether the parent company is willing to sell the company. To facilitate a management buyout, a new company is incorporated to buy the business or shares of the target company.

A management buyout requires personal financial commitment of the managers in addition to a loan or equity. Funds are also arranged through the Venture Capitalists since the process is complicated and requires significant financial resources.

The success of a management buyout depends on establishing a coherent business plan that will help in obtaining the funding required for the MBO. It is necessary to convince the parent company that the managers are the best buyers for the business as they understand the business. Even the investors need to feel assured that the business shall continue successfully and provide them with a satisfactory return on investment.

Management buyouts have become popular for the following reasons:

- They provide a chance to management to run the business.
- The management team of the new company will be highly motivated, a group that has deep knowledge of the business, and is eager to make profits.

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- Since the management of the new company has expert knowledge of the business of the new company, the process of commercial due diligence would be comparatively easier and less time-consuming.

Management buyouts are also capable of creating problems for the company:

- An MBO involves serious financial commitment and acceptance of risk by the management.
- The management team comprises employees who have become owners of the business. As employees, they are not affected much by the success or failure of the venture, but as owners, they feel the heat directly.
- While commercial due diligence may take less time, all other elements of the due diligence process would require time and expenditure.
- The new company is highly leveraged, i.e., has a high proportion of debt relative to equity. The heavy interest burden makes the company less competitive in terms of price.

1.17 IMPLICATIONS OF CORPORATE RESTRUCTURING

With the business world becoming very competitive and dynamic, organizations have to go through restructuring to survive and thrive. While companies initiate the process of restructuring, it is important to note that the success or failure of the measures initiated depend on the type and degree of restructuring. While strategic and operational changes address the fundamentals of the company, financial restructuring addresses the financial issues. A company looking for a major shift in business focus should pursue extensive restructuring.

However, the crux of the matter is that although restructuring is carried out for creating customer value, it affects every stakeholder and every aspect of the business.

Let us analyse the implications of restructuring on different groups.

1.17.1 Investors

Investors represent individuals, institutions, and companies that have a financial stake in the company. Investors are concerned about the immediate future and long-term returns that the company is capable of generating. Restructuring has serious financial implications, and this creates insecurity and uncertainty in the minds of the investors. It is therefore imperative for the management to share the corporate vision so that investors feel confident and remain invested in the company.

1.17.2 Customers

Restructuring often results in change of focus of the business, leading to reallocation of resources, introduction of new products or withdrawal of the existing products, changes in the after-sales policy of the company, etc. Such proposed changes can result in erosion of customer base and confidence and

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have severe adverse effects on future business prospects. To dispel the fears of the existing and prospective customers, the company should communicate its future plans. Post restructuring, the management should focus on the needs and expectations of the customer by providing quality products and reducing the lead time.

1.17.3 Management

Corporate restructuring results in changes in business processes, introduction of changes that suit change in processes, changes in systems, and in ensuring effective communication with all the stakeholders. The changed environment has the following implications on the management:

- Release of financial resources blocked in unproductive assets and low return assets and businesses.
- Diversion of core competencies to core areas reducing the risk of failure.
- Provision of an opportunity to the management to prove its ability to 'manage the change'.

1.17.4 Employees

Employees represent the most affected stakeholders in the process of restructuring, for it impacts them psychologically, culturally, and financially. Since they share common values, culture, assumptions and fears, restructuring poses several challenges to them. Employees have a 'patterned mindset'; hence it becomes difficult for them to adapt to the new set of challenges posed by the changed environment. This creates fear in their minds, leading to psychological turmoil. The biggest challenge they face is the need to unlearn old skills and acquire new skills.

If the employees are left to live with this fear, one can expect disastrous consequences. The management has to therefore involve the employees in the process. This is the only assured way of changing their mindset with ease and communicating to them that the organization is willing to empower them.

1.17.5 Others

Restructuring can also impact other stakeholders in the following manner:

- Reduction in competition as weak and inefficient players exit the market.
- Possibilities of seizing new opportunities to create new businesses.
- Contribution to the growth of the national economy.
- Need for the government to provide resources and subsidies to companies, which imposes a burden on the national exchequer.
- Subsidies leading to social discontent, with great potential for political instability.

Thus, one finds that restructuring provides the company with the much-required competitive edge. However, implications need to be understood and properly handled so that the benefits are not lost.

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The modern business environment reflects a radical shift in the manner the business is being conducted. The changes are capable of generating both positive and negative impact on the business. In the light of this fact, managers need to critically appreciate the causes and consequences of corporate restructuring. While restructuring can prove beneficial, companies should avoid unnecessarily experimenting with new ideas and tools in the name of restructuring.

SUMMARY

Corporate restructuring deals with elements that can change the effectiveness and performance of an entity. The basic objective is to introduce path-breaking changes in the structural and performance parameters of the company so that the entity returns to the list of profit-making entities. While corporate restructuring need not necessarily yield positive results, it certainly provides the company with an opportunity to revitalize its activities and progress on the recovery path.

KEY DEFINITIONS

Acquisitions Acquisitions represent purchase of new entities to utilize the existing strength and capabilities or to exploit the untapped or under-utilized markets. They are also carried out to grow in size and prevent possibilities of future takeover attempts.

Buyback of shares/tender offers A tender offer is a public offer made by a potential acquirer to purchase some or all of the shareholder's shares in a company. The offer price is higher than the current market value of the shares. It is assumed that the premium would induce the shareholders to sell their holdings.

Capacity expansions This strategy involves expansion in the production capacity, resulting in higher trading volumes and hefty margins. This strategy works when the market is starved for goods.

Cash disgorgement Cash Disgorgement is the principle where accumulated cash resources of a business are spent or reinvested effectively.

Core business processes Core business process is about deciding what the company is good at and focusing on the strengths for attaining the goals.

Corporate restructuring Restructuring is the act of partially dismantling or otherwise reorganizing a company for the purpose of making it more efficient and therefore more profitable. It involves the reorganization of a company to attain greater efficiency and to adapt to new markets. It also implies liquidating projects in some areas and redirecting assets to other existing or new areas.

Customer delight The concept of customer delight states that only those companies that can understand and fulfil the needs and expectations of the customer shall survive.

Customer focus Customer focus is about understanding the needs of the customers and offering better and improved customer service.

Diversification Diversification is a strategy where a company enters different product or market segments to increase market penetration. The main objective of diversification is to exploit the new avenues available and add to the group profits.

Dual class stock recapitalization Under this head, the entity creates a second class of common stock that carries limited voting rights and usually preferential claim to the entity's cash flows. This is done by distributing limited voting shares on pro-rata basis to the existing shareholders. Such stocks usually carry higher rate of dividends.

Equity carve-outs Equity carve-out is the process where an IPO of a portion of the common stock of a wholly owned subsidiary is offered to raise resources. Equity carve-outs are also known as 'split-off IPOs'. This process initiates trading in a

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new and distinct set of equity claims on the assets of the subsidiary.

ESOPs Employee stock option plans are contracts between a company and its employees that give employees the right to buy a specific number of the company's shares at a fixed price within a specified period of time.

Exchange offers An exchange offer provides one or more classes of security the right or option to exchange part or all of their holdings for a different class of securities of the entity.

Financial distress Financial distress is a condition in which the liquidation value of the firm's assets is less than the total face value of the creditor's claims.

Financial restructuring Financial restructuring involves change in the capital structure and capital mix of the company to minimize its cost of capital. It is about infusion of financial resources to facilitate mergers, acquisitions, joint venture, strategic alliances, LBOs and stock buyback.

Forced sales The capital structure of a company includes both equity and debt. When debt exceeds equity, the entity becomes high leveraged and often finds the debt load intolerable. To manage the situation, the company often decides to sell unrelated and underperforming assets and businesses. This is called forced sales.

Hardware restructuring When the structure of the organization is redefined, dismantled, or modified, the restructuring is termed as hardware restructuring.

Hiving off Hiving off is a process wherein an existing company sells a particular division to reduce unproductive expenditure and slim the organization. It also helps an entity to reap the benefits of core competencies, competitive advantage, and emergence of high capacity.

Joint ventures A joint venture is generally understood as technical and financial collaboration either in the form of greenfield projects, takeovers, or alliances with existing companies.

Leveraged buyouts When a company acquires another company using a significant amount of borrowed funds like bonds or loans to pay the cost of acquisition, the transaction is termed a leveraged buyout (LBO).

Leveraged recapitalization Leverage decisions represent potential for value enhancement or defence against takeovers. Leverage recapitalization often results in operating improvements. The large overhang of debt stimulates the management to improve operations to generate sufficient cash flows to pay the debt.

Liquidation Liquidation is initiation of bankruptcy proceedings. Here all the assets are discarded and the liabilities repaid, after which the entity ceases to exist.

Management buyouts Management buyout (MBO) is the process where managers and/or executives of a company purchase controlling interest in a company from existing shareholders. The management usually buys the target business from the parent company.

Mergers Mergers involve the coming together of two or more companies and pooling of resources for the purpose of achieving certain common objectives.

Non-sponsored leveraged buyouts This strategy is adopted in case of financially healthy businesses, where the financing techniques are similar, but the management gains operating control with around 85% to 100% ownership depending on the situation. These types of buyouts are called non-sponsored leveraged buyouts.

Organizational restructuring Organizational restructuring is a restructuring strategy designed to increase the efficiency and effectiveness of personnel through significant changes in the organizational structure.

Portfolio management Portfolio management involves determining how each business division fits into the overall business strategy of the company, evolving strategies to position the company in the competitive environment, ascertaining the impact of the strategic decisions on the contribution of the company and the potential of the redefined strategy on achieving synergy in goals and objectives.

Portfolio restructuring Portfolio restructuring involves divesting or acquiring a line of business perceived peripheral to the long-term business strategy of the company.

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Sell-offs or divestitures Sell-offs or divestitures are attempts to come out of a product segment or sector to adjust the operations to the changing economic and political environments. They involve voluntary decisions implemented to attain the objective of shareholder wealth maximization.

Software restructuring Software restructuring involves cultural and process changes to establish a collaborative environment that facilitates growth and restructuring.

Spin-offs In a spin-off, a company creates a subsidiary whose shares are distributed on a pro-rata basis to the shareholders of the parent company. This strategy is adopted when the company feels that it would generate positive returns.

Splits Splits involve breaking up the business into independent entities to exploit opportunities of growth, raise capital, achieve efficiency, and derive taxation benefits. Splits also provide benefits of synergy, competence, and revival.

Split-ups Split-ups represent a restructuring process where companies split themselves into two or more parts.

Sponsored leveraged buyouts Under sponsored LBOs, the private equity firms offer to buy a controlling stake in a company using leverage obtained from banks based on the financials of the company.

Strategic alliances and collaborations Strategic alliances represent a long-term agreement between two or more entities to co-operate with each other in specific areas of interest. Such areas of common interest include access to new technology and product range, access to market, etc.

Targeted stock Under targeted stock, an entity's operations are split into two or more common equity claims, but the businesses remain wholly owned segments of a single parent. Here the targeted stock is regarded as common stock of the consolidated company and not of a subsidiary.

CONCEPT REVIEW QUESTIONS

1.1. Explain the concept of corporate restructuring. Discuss in brief the conceptual framework of corporate restructuring.
1.2. State the reasons that force a company to opt for restructuring. What are the barriers encountered while restructuring the business?
1.3. Why do companies restructure?
1.4. Explain the different types of corporate restructuring
1.5. Explain the strategic options that companies pursue while restructuring the business.
1.6. What is buyback of shares? Where do the resources for buyback come from? State the mandatory conditions that companies have to fulfil before going for a buyback.
1.7. What are leveraged buyouts (LBOs)? Explain the different types of LBOs.
1.8. What are the reasons for the declining popularity of LBOs?
1.9. Discuss the implications of corporate restructuring.
1.10. Write notes on the following:
(a) McKinsey 7S model
(b) Evolving added value structure
(c) Cost leadership options for restructuring
(d) Product excellence options for restructuring
(e) SWOT options for restructuring
(f) Asset reorganization options of restructuring
(g) New ownership relationship options of restructuring
(h) Reorganizing financial claims
(i) Financial reorganization
(j) Cash disgorgement
(k) ESOPs
(l) Forced sales
(m) Organizational imperatives
(n) Buyback of shares
(o) Norms for buyback of shares in India
(p) Management buyouts

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PROJECT ASSIGNMENT

Analyse the corporate restructuring process initiated at Daewoo India. In addition, examine why the restructuring efforts did not yield the desired results.

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CASE STUDY

India Yamaha Motor

Abstract

India Yamaha Motor (Yamaha) entered the Indian market in 1980s with its 100 cc motorbikes. While other players kept growing, Yamaha has been struggling to stay afloat, and has incurred huge accumulated losses. The company planned a major restructuring exercise to turnaround. This case tries to look at issues that ailed the company and the measures the company initiated for a turnaround.

Pedagogical Objectives

- To understand and identify the reasons that forced Yamaha to opt for restructuring of its Indian operations
- To identify the measures initiated by the company to turnaround its operations in India

Introduction

The Indian two-wheeler industry has been bristling with brands, colours, and engine sizes. New models keep hitting the roads practically every month. The market has kept pace with the economic development and has been growing at a healthy rate of 18% to 28% annually. Initially scooters and mopeds enjoyed great popularity in the Indian two-wheeler market. The 1980s saw a change in this trend with the launch of 100 cc motorcycles. This was when the Indian companies started entering into JVs and technical collaborations and entities such as IndSuzuki, Hero Honda, Kawasaki Bajaj, and Escorts-Yamaha were born. Suddenly the trend shifted and motorcycles started replacing scooters. The shift in customer preferences was promoted by attractive finance options offered by banks and financial institutions. Other factors that fuelled the shift in preferences were goodies and freebies available, promotion through brand ambassadors the target buyers identified with, such as Dharmendra, Sunny Deol, Akshay Kumar, Jackie Shroff, Sachin Tendulkar, John Abraham, etc. who successfully helped the companies to connect with the youth. Companies even changed their strategy and started projecting motorcycles as a symbol of freedom, exuberance, and convenience (Kapoor 2003).

Changing Face of Yamaha

The Indian motorcycle market saw severe competition with all the players eying the ever expanding market. Yamaha has had a presence in the Indian motorcycle market since 1985 ever since it entered into technical collaboration with Escorts Motors. The partnership was built on the principle of cooperative relationship for manufacturing and selling the Yamaha brand of motorcycles in a market where demand for motorcycles had been on an upward spiral.

Initially Escorts held a 74% share in the partnership. However, with time the composition of the partnership kept changing with the investment ratio gradually going in favour of Yamaha Motor Company (YMC) by 2000. The major reason behind the change in ownership was the fact that Escorts-Yamaha's market share had been sliding while other players were consolidating their position. Yamaha Motor Company even assumed managerial control of the company and the company was renamed Yamaha

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Motors Escorts Limited (YMEL). Yamaha operated in India through two entities that managed manufacturing and marketing operations and these entities had a total capital of ₹1.6 billion. When the slide continued further, Yamaha decided to restructure its Indian operations by merging the two entities. The first thing that was done was to rename the company as Yamaha Motors India Limited (YMI). The company decided to restructure its sales operations, undertook numerous measures to build a separate brand name by launching new products, overhauled the marketing strategy and realigned the HR policies to those prevailing in the industry.

Need for Restructuring

Though Yamaha did have an early success in India with its power-packed RX-100 model in the late 1980s, the company was unable to keep pace with the vehicles launched by Bajaj, TVS, and Hero Honda, which grabbed the market share. From being an almost cult product, the RX-100 lost its die-hard patrons when it failed to catch up with the two-stroke to four-stroke transition forced by the government in the early 1990s. Yamaha tried many times to launch new products and rebuild its reputation, but it always failed (Ramanathan 2010).

While Yamaha started its Indian operations long ago, it has been incurring losses since 2001 forcing the company to explore the option of acquiring managerial control in the JV. All the efforts initiated by the management to prevent losses failed to generate results and the company continued to bleed. The market share of the company, which had been sliding year after year, touched an all time low of 4% in the 7.5 million Indian two-wheeler market (www.mint.com).

During this phase of sliding market share, the company borrowed huge amounts to stay afloat. Declining sales revenue and continuous losses made it difficult to repay the loans. The deteriorating financial health of the company forced the management to plan restructuring of its Indian operations.

When the restructuring plan was announced in 2007, the company had accumulated losses of ₹3.36 billion. However, the head of the Indian operations Yukimine Tsuji, who was subsequently appointed CEO, expressed confidence that the revenue generated after restructuring would help the company repay the huge debt and the company would turn profitable in 2009–10. Contrary to the projections of the company, Morgan Stanley analysts projected that Yamaha India would be unable to achieve its target of lapping up 10 per cent market share of total motorcycle sales by 2010. Analysts projected that Yamaha India would sell 400,000 units by 2010, but will end up with an operating loss of ₹2.90 billion.

Restructuring Plan

As a first step towards restructuring the Indian entity, YMC decided to dissolve the old units and merge them into a new entity Yamaha Motors India (YMI) from April 2008. To carry out its plans, the company offered Mitsui Corporation a stake in YMI. Mitsui Corporation agreed to pick up a 30% stake (www.mint.com).

The restructuring required pumping in financial resources as the financial health of the entity was far from satisfactory. It was decided that ₹4 billion would be infused into

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the capital of the company, raising it from the current ₹1.6 billion to ₹5.6 billion. Of the additional capital, ₹2.32 billion was to be contributed by the parent company and ₹1.68 billion by Mitsui Investment, a subsidiary of Mitsui Corporation.

The additional financial resources were proposed to be used for launching new products in the domestic market using contemporary technology. The company believed that the use of contemporary technology along with a new marketing campaign would help it arrest the continuous slide in the market share of the company's motorcycles.

The Indian operations had an accumulated loss of ₹10 billion. As a part of the restructuring strategy, the parent company agreed to absorb the losses of YMI to ensure that the new company started its operations without any burden of the past in its balance sheet. The belief was that with no ghosts of the past in its balance sheet, the company would be able to restructure its operations and its bottom line would turn black by 2009–10. The confidence originated from the fact that while the company was restructuring its operations, the focus and direction would remain intact.

Another important element of the restructuring plan was a two-fold strategy that focussed on changes in the production facilities of the company. The plan of action proposed was to replace the 40-year-old facility at Surajpur in Uttar Pradesh, with a brand new facility and a simultaneous upgradation of the factory at Faridabad that produced engines and carried out machining and casting of components. The existing facility, it was proposed, would be used for paint jobs and manufacturing of engines and other components while the new facility was proposed to be used for bike assembly.

The company proposed to manufacture 50% of the components in-house and procure the balance through vendors (www.mint.com). This strategy was driven by the belief that it would help the company create quality benchmark for the vendors, although the company had no plans to rationalize its vendor base. On the marketing front, the company proposed to increase the number of dealers from the current level of 350 to 500 by the end of 2009, said Koji Arai, Director and Chief Sales Officer (www.mint.com).

The company committed ₹8 million for the restructuring process from 2008–10. Of this, 30% was to be utilized for developing new products and the balance was earmarked for restructuring other elements of the business.

The parent company has been providing adequate support to its subsidiaries across the globe by focusing on developing more fuel-efficient for motor cycles to improve competitiveness of its products. The company planned to spend 202 billion yen on research and development up to 2010 to help achieve in emerging and ASEAN countries and to accelerate development of environment-friendly engines (www.mint.com).

The company also decided to introduce 'India-only models'. The models were to be locally built and exported to Europe with some modifications.

Ishikawa, the CEO and anathema for most Japanese managers, went on record to say that he wants to turn around Yamaha's waning fortunes in India by transforming it into a niche, high-value player that eschews the low-margin, big-volume commuter segment, presently dominated by Hero Honda, Bajaj Auto, and TVS Motors (Ramanathan 2010).

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Post-restructuring Outcomes

It was expected that the restructuring programme would speed up product development, improve quality, and cost reduction. The company was keen on reorienting the sales channel to infuse consumer-oriented policies (Kapoor 2003).

Ishikawa admitted that a big problem would be employees' attitude, which would be very difficult to change. 'The challenge is the Escorts heritage we carry,' he says, referring to the JV Yamaha had formed with Escorts in the 1980s. Though it was successful for nearly a decade, the ties soured due to differences in the style of management. It came to an end in 2000, when Escorts divested its 24% stake in the JV, letting Yamaha walk forward alone. However, the Escorts heritage remains, says Ishikawa. Work culture is 'not aggressive, not transparent. There is a need to change the mindset to make it like Yamaha's. That is why Yamaha is more active (with the Indian operations)'.

However, Ishikawa and his bosses in Japan know they cannot hide behind legacy problems. Workforce problems or challenges due to changing market dynamics have been faced by Hero Honda and other competitors as well. In the early 1980s, TVS Motors had to fight a bitter battle with its workforce only to emerge as a fine example of turnaround. The mid-to-late 1990s were tough for Bajaj Auto, which saw its domineering scooter market vanishing into thin air. However, the company bounced back under the leadership of Rajiv Bajaj with a whole new range of motorcycles, even creating new segments with Bajaj Pulsar. Of late, this has hit Hero Honda's leadership too, but the company is fighting back with new products and aggressive pricing (Kapoor 2003).

The company therefore started focussing on broad cultural change by bringing in the Japanese work ethos of single-minded devotion and discipline. To get rid of 'dead wood', the company decided to spend about ₹500 million towards a voluntary retirement scheme, which reduced the workforce from 2,400 to 2,000.

While the company was ready to sort out its internal problems, it realized that positioning its products with a new generation of consumers will be expensive and difficult. It is here that Yamaha's biggest strength would help, that is, being the world's no. 2 motorcycle company with a wide product range and technological competency. This was expected to give Yamaha India a strategic depth and range of products to fall back on, which domestic competitors such as Bajaj Auto lacked, although at present Yamaha meant very little to Indian consumers. However, the company was convinced that these bikes planned would place Yamaha in a niche market. (Exhibit 1.1)

Ishikawa's decision to go after niche markets was driven by the argument that it would not require Yamaha to compete neck-to-neck with Hero Honda and Bajaj Auto. Yamaha undertook extensive market research and concluded that there was great potential for sports bikes and release high performance 150 cc bikes. Research showed that this segment accounted for a little over 10 per cent of the market, but was gradually eating into the commuter segment. Yamaha planned to come out with these bikes as they would put the company in the niche market and also help it counter and outshine rival products such as Bajaj Pulsar and TVS Apache.

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Yamaha realized that there was a strong need to win back the lost trust of the customers for which understanding the local flavour of the market was the key. The company started exploring the possibility of replicating its out-of-the-box strategy that it pursued successfully in Thailand, where it began hosting rock concerts, built Yamaha bike clubs and started sponsoring day and night events to engage youth—its key customers—riders that Hero Honda and Bajaj Auto cannot replicate. The company also started contemplating selling accessories and apparel. However, the key part of the plan was to identify new segments quickly, which would allow Yamaha to identify and address new customer segments with specific products, and think beyond replacement sales for existing customers.

One major problem the company had faced was an unimpressive and non-performing dealer network. Part of the reason was that some key dealers were Escorts dealers who had been hanging around from the days they sold tractors and farm equipment. Many of them did not feel the need to update their selling skills and approach. The company also realized that there was a strong need to improve the dealer network and focusing on key markets in B-class cities would help. Yamaha tried doing this but failed. The company launched 'Yamaha One' programme with the objective of boosting dealer effectiveness by creating one or two swanky outlets in Delhi, but overall the plan went nowhere. This failure was perceived as a big letdown for it would delay the turnaround of the company.

Post-restructuring, YMI planned to manufacture 400,000 bikes annually at the Surajpur plant. The company introduced new models such as FZ-15 and R15, which helped the company attain a 16% growth in sales during April-November 2008. During this period, the industry clocked a growth of a meagre 2.5%. While the results look impressive, Yamaha continues to incur losses and a turnaround seems miles away.

Conclusion

In spite of six tough, loss-ridden years, Yamaha refuses to exit India. It continues to concentrate on the niche market in the 200 to 250 cc category and hitting the market with high-end performance bikes. The company still feels it can turn things around and can realign its India strategy just like it did in Thailand where it tried to sell the lifestyle, and not just the product. The company plans to ramp up the capacity from 300,000 units to one million units by 2010. Yamaha also plans to bring in *R1* and *R6* by the end of the year, although its plans to launch a scooter have been shelved for now.

Discussion Question

Analyse the case and discuss the pros and cons of the restructuring strategy of Yamaha Motor India. Suggest measures that you feel the company could have taken to speed up the process of restructuring.

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Exhibit 1.1 The Competitive Scenario

Company	Units sold April–Mar 2005–06	Units sold April–Mar 2006–07	Change (%)	Market share 2005–06 (%)	Market share 2006–07 (%)
Hero Honda	2,893,070	3,157,429	9.14	49.79	48.18
Bajaj	1,747,806	2,078,860	18.94	30.08	31.72
TVS	752,576	844,174	12.17	12.95	12.88
Yamaha	205,480	210,315	2.35	3.54	3.21
Honda	98,072	163,977	67.22	1.69	2.50
Others	113,555	98,889	–12.92	1.95	1.51
TOTAL	5,810,559	6,565,664	12.79	100	100

Source: Report by IMaCS for IBEF, 2008

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