Case Studies on

Corporate Restructuring – Vol. I

Edited by

Rajendar Singh Rathore

Icfai Business School Case Development Centre

Icfai Books

71, Nagarjuna Hills, Punjagutta, Hyderabad – 500082

Icfai Books
71, Nagarjuna Hills,
Punjagutta, Hyderabad – 500082
Andhra Pradesh, INDIA
Phone: 91 - 40 - 23435387/91, Fax: 91 - 40 - 23435386
e-mail: icfaibooks@icfai.org, ibscdc@icfai.org
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Editorial Team: Priyanka Ramgopal and Subha Dharmapuri

Visualiser: Ch. Yugandhar Rao
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AN OVERVIEW

The increasing competition, rapid advances in technology, more demanding shareholders, more challenging workforces and rising complexity of the business conditions have increased the burden on managers to deliver superior performance and value for their shareholders. In this modern "winners take all" economy, companies have to take a timely responsive action to save their organisations. At this point of time, company executives may ask whether it is time to restructure the company. However, before considering any action, they must first answer the questions: "Will restructuring work?" and "When does restructuring improve economic performance?"

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

Crum and Goldberg define restructuring of a company as "a set of discrete decisive measures taken in order to increase the competitiveness of the enterprise and thereby to enhance its value."[1] It generally includes a diverse array of company actions, from selling business lines to acquiring new business lines, from downsizing workforces to the addition of new business units and from stock repurchase to debt elimination. Although most of the research studies report that restructuring improves performance of a company, the outcome varies with the type of initiative selected by the company and the effectiveness of their initiative. Well-managed organisations are more likely to realise the intended results, irrespective of the initiative chosen. Therefore, the company executives have to decide – "which restructuring works best?"

The general framework for corporate restructuring and reorganisation consists of the following[2]:

1) Reorganisation of assets
    a) Acquisitions
    b) Sell-offs or divestitures
2) Creating new ownership relationships
    a) Spin-offs
    b) Split-ups
    c) Equity carve-outs

[1] Hailemariam Stifanos, "Corporate Restructuring and Value Creation", *CORPORATE VALUE CREATION, GOVERNANCE AND PRIVATISATION*, 2001, http://dissertations.ub.rug.nl/FILES/faculties/management/2001/s.hailemariam/c4.pdf, page 51

[2] Weston J. Fred, et al., "Restructuring and Divestitures", *TAKEOVERS, RESTRUCTURING AND CORPORATE GOVERNANCE* (Second Edition), Prentice Hall, page 229

3) Reorganising financial claims
   a) Exchange offers
   b) Dual-class recapitalisations
   c) Leverage recapitalisations (bankruptcy)
   d) Financial reorganisation
   e) Liquidation
4) Other Strategies
   a) Joint ventures
   b) ESOPs and MLPs
   c) Going-private transactions (LBOs)
   d) Using international markets
   e) Share repurchase programs

When one company purchases another company and clearly establishes itself as the new owner, the purchase is called an acquisition. Divestiture, on the other hand, involves sale of a unit or a segment of company to a third party. The company's assets, product lines, subsidiaries or divisions are sold for cash or securities or a combination of these. In spin-offs, a company distributes all its shares in a subsidiary to their shareholders on a pro rata basis. As a result, a new public corporation is formed with the same ownership pattern as that of the parent organisation. There is no money exchange and revaluation of subsidiary's assets. The transaction is treated as a stock dividend and a tax-free exchange. On the other hand, in a split-up, two or more new companies are formed in place of the parent company. The parent company is liquidated after exchanging the stocks of two or more subsidiary companies for all the parent company's stock. They are usually a result of spin-offs.

In equity carve-outs, some of the shares of a subsidiary are offered for sale to the general public as a means to generate cash for the parent organisation without losing its control. In split-offs, the parent company issues its subsidiary's shares to the parent company's shareholders in return for a specified number of parent company's shares.

Capital structure and leverage decisions represent potentials for value enhancement, for acquiring other firms or to defend against being acquired by others. Leverage recapitalisation involves a relatively large issue of debt that is used for the payment of a relatively large cash dividend to non-management shareholders or for the repurchase of common shares, or a combination of both, thereby increasing the ownership share of the management. On the other hand, in a dual-class stock recapitalisation, firms establishes a second class of common stock that has limited voting rights but usually with a preferential claim to the firm's cash flows.

An exchange offer provides one or more classes of securities, the right or option to exchange part or their entire holding for a different class of securities of the firm. Financial reengineering is used by the firms to limit their financial exposure and also to facilitate merger transactions. If the firm is worth more "dead than alive", creditors will force the firm to liquidate. In liquidation, the firm can be sold in parts or as a whole for an amount that exceeds the pre-liquidation market values of the firms' securities. Voluntary liquidations are used when there is a threat of a "bust-up" takeover.

Joint ventures are used to acquire complementary technological or management resources at lower cost, or to benefit from economies of scale, critical mass and learning curve effect. They are often used to provide countervailing power among rivals in a product market and among rivals for a scarce resource.

Employee Stock Ownership Plan (ESOP) is a type of stock bonus plan that invests primarily in the securities of the sponsoring employer firm. They are designed to promote employee stock ownership and to facilitate raising of capital by employers. On the other hand, Master Limited Partnership (MLP) is a type of limited partnership whose shares are traded publicly. The limited partnership interests are divided into units that trade as shares of common stock. MLPs offer investors liquidity via an organised secondary market for trading of partnership interests. Both ESOPs and MLPs have tax advantage and both have been involved in takeover and takeover defence activities.

Going private refers to the transformation of a public corporation into a privately held firm. A Leverage Buyout (LBO) is a general form of restructuring wherein the managers, with the help of some outside agencies, replace the public stockholdings with closely held equity. Sometimes, the stocks and assets are purchased by a small group of investors especially buyout specialists or investment bankers or commercial bankers. Usually, the incumbent management is included in the buying group. The buyout process varies with few managers preferring the acquisition of the entire company, while few preferring the acquisition of a division or subsidiary. When the company's key executives are involved in the buyout process, it is termed management buyouts (MBOs).

Share repurchase program generally deals with the cash offers for outstanding shares of common stock thereby helping in changing the capital structure of the firm. It also helps in reducing the common stock so that the debt/equity ratio or leverage ratio is increased. There are four major types of share repurchase programs – Fixed Price Tender Offers (FPTs), Dutch Auctions (DAs), Transferable Put Rights (TPRs) and Open Market Repurchases (OMRs).

The selection of the restructuring initiative varies with the type of organisation, the management and the challenges faced by the organisation. However, generally, specialists distinguish three modes of restructuring – Portfolio Restructuring, Financial Restructuring and Organisational Restructuring.

Portfolio Restructuring: It involves changes in the asset mix of the organisation, i.e. addition or disposal of assets from the organisation's business. It includes acquisitions, asset sales, divestitures, liquidations, spin-offs or a combination thereof. It is cited that spin-offs generate higher performance gains than sell-offs and acquisitions and divestitures. Better strategic focus, strong control of multiple business units and superior economies of scope can be the intermediate effects of portfolio restructuring.

Financial Restructuring: It involves changes in the capital structure of an organisation which includes leveraged buyouts, leveraged recapitalisation and debt for equity swaps. The largest returns in financial restructuring come from leveraged and management buyouts. Increased emphasis on cash flows and changes in managerial incentives can be the intermediate effects of financial restructuring.

Organisational Restructuring: It involves changes in the organisational structure which include divisional redesign, reducing the hierarchical level, reduction in product diversification, compensation revision, improving governance and workforce reductions. However, it is more dependent upon the circumstances in which it is initiated and has the least impact on performance. An increase in operating efficiencies, greater employee satisfaction, reduced turnovers and better communications can be the intermediate effects of an organisational restructuring.

These intermediate effects, directly or indirectly, influence the financial performance of the organisation. However, this ultimate effect might be visible within a few years or might take a longer time period. To measure the impact of restructuring, the organisation can study the impact on market performance through the movement in the organisation's stock prices after the announcement of the restructuring or through the impact on accounting performance by analysing the changes in earnings (like return on equity and return on investment) before and after the restructuring.

Studies reveal that generally, there is a statistically significant improvement in the organisational performance after a restructuring event. However, it may not be the case always. It is cited that the average percentage change in performance is positive for financial and portfolio restructuring, while it is negligible or sometimes negative in case of organisational restructuring (Table I).

Table I

Average Impact of Restructuring on Company Performance

Type of Restructuring	Mean Percentage Performance Improvement	Median Percent Performance	Percent Positive Means	Number of Studies Size	Average Sample
Portfolio	5.6	2.9	86*	21	154
Financial	37.5	24.5	86*	27	35
Organisational	– 0.21	0.1	50	4	207

* Significantly different from 50 percent (base case) at p< 0.01

Source: Bowman H. Edward et al., "When Does Restructuring Improve Economic Performance?", *California Management Review*, Volume 41, Number 2, Winter 1999, page 36 (ECCH Reference No. CMR141)

The portfolio and financial restructuring display higher percentage of positive returns than organisational restructuring. In five out of six cases (i.e. 86%) of financial and portfolio restructuring, the impact on performance was positive, while for organisational restructuring, the impact was positive for 50% of the cases.

However, it is cited that excessive aggressive buying and selling of business units, as a part of portfolio restructuring is not effective. Portfolio restructuring has to be performed selectively with good results coming from spin-offs of peripheral business units followed by sell-offs to other business corporates. In a restructuring effort, there is also an increased possibility that the performance effect could be more of a wealth transfer than value creation. In many restructuring cases, it is found that the investors gain substantially while the employees, bondholders and communities suffer.

Despite various beliefs, studies reveal that restructuring does help companies achieve tangible gains. Although there are various options for a manager to choose from while considering restructuring of a firm, analysts consider financial restructuring as a healthy way to choose from because of its consistent prediction of future performance. The portfolio restructuring and organisational restructuring follows this.

This book consists of twenty-four case studies on some of the world's most remarkable restructuring cases in contemporary times, notably, British Petroleum, America Online, Daewoo, Delta Air Lines, Deutsche Bank, Nokia, Hindustan Level Limited, Philips, Toshiba and Chrysler. These case studies, covering a wide range of diverse industries viz., airlines, automobile, consumer electronics, banking and financial services etc., provide valuable insights into a wide spectrum of underlying reasons that push companies into trouble. One can also learn, by taking recourse to a radical thinking, as to how these companies could spur their performance and re-establish their competitive advantage.

The case studies, *Restructuring Initiatives at Alstom*, *America Online: The Restructuring Strategies*, *Avon Product Inc. – Redesigning its Supply Chain*, *Reinventing Chrysler – Dieter Zetsche's Strategy* and *Restructuring Efforts at Cadbury Schweppes*, illustrate the reasons for the declining performance of these companies and the restructuring efforts being undertaken by the management to revive the companies.

On the other hand, case studies like *Daewoo Corporation: Corporate Restructuring Success* and *BP: Organisational Restructuring and Evolution of a New Corporate Identity*, highlight the success stories of the corporates that had timely identified the need for restructuring and by means of various strategies, were able to successfully increase their competitiveness and maximise their market value.