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Corporate Restructuring for Shareholder Value

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CORPORATE RESTRUCTURING FOR SHAREHOLDER VALUE

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ABSTRACT

This paper takes an overview of two prime concerns of corporate managements in the recent times, viz., shareholder value management and corporate restructuring. The paper begins with a brief discussion on the emergence of shareholder value management as the main *raison d'etre* of corporate managements in the market economies, a concern that is yet to agitate Indian board rooms and investors. The paper then goes on to discuss the phenomenon of corporate restructuring that is sweeping the industrial world and examines some of the principal methods of corporate restructuring and their underlying motives. It concludes with a brief discussion on the rising trend of restructuring activities undertaken by the Indian corporate sector. The paper seeks to confine itself to the broader issues such as the motives and methods of corporate restructuring rather than legal or tax minutiae around which are structured specific transactions.

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This paper undertakes a *tour d'horizon* of two of the most important concerns of corporate managements in our times, shareholder value management and corporate restructuring. To a great extent these two are interlinked: one is the cause and the other is the result; restructuring is often the corporate response to the compelling need to deliver shareholder value.

The paper begins with a brief discussion on the emergence of shareholder value management as the main *raison d'etre* of corporate managements in the market economies, a concern that is yet to agitate Indian board rooms and investors. The paper then goes on to discuss the phenomenon of corporate restructuring that is sweeping the industrial world and examines some of the principal methods of corporate restructuring and their underlying motives. It concludes with a brief discussion on the rising trend of restructuring activities undertaken by the Indian corporate sector. The paper seeks to confine itself to the broader issues such as the motives and methods of corporate restructuring rather than legal or tax minutiae around which are structured specific transactions.

2 Shareholder Value Management and Corporate Restructuring

Defining the term shareholder value management (SVM) means stating the obvious: "increasing shareholder value over time", through giving consistent returns on shareholders' investments through dividends and increases in the market price of the shares of the company concerned. To paraphrase Rappaport [1], the shareholder value approach estimates the economic value of a corporate [action] by discounting forecasted cash flows by the cost of capital. These cash flows in turn serve as the foundation for shareholder returns from dividends and share price appreciation.

Corporate restructuring (CR) is a broad term to denote significant reorientation or realignment of the investment (assets) and/or financing (liabilities) structure of a company through conscious management action with a view to drastically alter the quality and quantum of its future cash flow streams. This broad definition includes such corporate actions as mergers, acquisitions, divestitures, de mergers (spin offs) and debt equity changes [7], even though increasingly the term restructuring has been (unfortunately) used as an euphemism for corporate shrinkage through divestiture and closure, and perhaps, even more commonly to man power reduction. However the term *corporate restructuring* is used in this paper in its widest sense to cover all possible types of corporate redesign.

The continuing corporate restructuring wave that began in the 80s has been mainly triggered off by a renewed commitment to deliver shareholder value either by a prospective acquirer or the incumbent management itself as a viable defence against an unwelcome bid. To that extent both SVM and CR are inseparable as the end and the important means to that end.

3 Shareholder Value Management as a key corporate goal

It is recognised that corporate managements are required to follow a stakeholder approach balancing the long term interests of various stakeholders such as shareholders, employees, lenders and creditors, suppliers and customers and the community. It is, however, becoming increasingly evident that it would be necessary to recognise shareholders as *primus inter pares*, if not dominant, amongst the stakeholders This is not only because of the need to have a practical criteria to resolve conflicts and assign priorities amongst diverse stakeholders' interests, but also because long term pursuit of shareholder interests automatically subsumes most, if not all, other stakeholders' interests as well in a *viable and sustainable* manner.

As briefly explained above, SVM involves maximising cash flows over time in a manner that would help service the diverse categories of investors through appropriate returns commensurate with the risk they undertake. SVM emphasises that cash flows are the most important sources of value and any corporate action involving cash outlay could be justified only if it generates positive cash flows over time leading to positive net present value on discounting the periodic cash flows at an appropriate cost of capital. Profits or earnings are necessary but not sufficient conditions for creating shareholder value in the sense that

profits are often the sustainable source of positive cash flows but would not be worth if profit generation calls for *greater* incremental investments in fixed or working capital.

Shareholder value represents the residual (equity) portion of the firm or company value (Vc) as shown below.

(1) Company value *(Vc)* = Value of debt *(Vd)* + Value of equity *(Ve)*

(2) $Ve = Vc - Vd$.

A commonly used, comprehensive model is the free cash flow to the firm (FCFF) model summed up below.

(3) *Vc* = Sum of discounted annual free cash flows (Fcf), with yearly cash flows discounted at a cost of capital *(Kc)*

(4) *Kc* = Cost of equity *(Ke)* + Cost of debt *(Kd)*, both *Ke* and *Kd* duly adjusted for the respective weightage in the total capital structure.

Since companies have perpetual existence, *Vc* (the firm valuation), should capture the expected free cash flows (Fcf) through the future and Fcf typically represents the net cash flows after providing for incremental investments in fixed and working capital. And often the significant source of positive cash flows is profits, after accounting all expenses and taxes. Since increasing stream of cash flows is a function of volumes, output prices and cost and efficiency in input consumption, the entire gamut of growth and operating strategies pursued by a company management are captured in the valuation model. By the same token, since increase in present value can also be influenced, besides increases in cash flows, by lowering the cost of capital, the importance of financing mix through an optimal debt-equity mix is also captured by the FCFF valuation model. Similarly the dimension of risk is also incorporated both through adjustments in the cash flows and in the cost of capital.

There is considerable empirical evidence that stock market valuation of a company invariably trends towards its free cash flow valuation [3] and thus the key to shareholder value management is maximising the cash flow generation over time and/or lowering its cost of capital. This underscores that company managements should undertake investments only

if they are capable of generating positive present value generating cash flows during their life time. A corollary to this rule is that company managements should be open and required to distribute an increasing portion of its cash flow generation by way of dividend to its shareholders rather than reinvesting in negative present value generating investment projects. The latter, it goes without saying, would be shareholder value destroying rather than shareholder value enhancing.

The essence of shareholder value management (SVM) as captured by the aforesaid discussion is of considerable import to corporate restructuring decisions which are invariably guided by the voluntary recognition, or often by external compulsion, to deliver shareholder value.

4 Investor Revolt and Restructuring Response

For a variety of reasons, corporate managements of the market economies began deviating from the their prime goal of maximising shareholder wealth/delivering shareholder value and acting in their own interest. One principal reason could be what is referred to as the agency problem, ie., supervisory failure by a widely dispersed shareholding community on company boards to act strictly as agents of and in the interest of shareholders. As a result company managements began undertaking large scale investments in search of size and growth, as these were important determinants of management remuneration and prestige.

- Heavy investments in slow growth business in search of market share.
- Large investments in diversification projects ostensibly reduce risks and broaden their growth platform-the conglomerate diversification phenomenon.
- Mega acquisitions involving high premiums over the (targets') market prices, often for the explicit purposes of diversification.
- Investments in non-productive assets and corporate white elephants.

Close on the heels of this era began occurring major changes in the global economy. Of particular significance is the large scale internationalisation of business and industry, emergence of intense competition on a global scale and globalisation of capital markets.

Rapid technological changes and relatively slower economic growth in the developed economies compounded the problems of companies in a variety of industry sectors. Company managements were taken off guard by intense competition from low cost, high quality products from emerging companies in the newly industrialising world intending to operate on a global scale. Traditional, highly diversified companies or conglomerates of the developed countries found themselves unequal to the task, having spread themselves too thin across a wide front.

This was the time institutional investors who had overtaken households in corporate stock ownership became restive and began demanding greater attention to shareholder value from lackadaisical company managements. Institutional investors argued against indiscriminate, expensive non-synergistic diversification by company managements on the ground that they (investors) themselves can very often undertake "homegrown" diversification more effectively and efficiently than the forced diversification through conglomerates.

As companies began experiencing decline in valuation in line with decline in performance on account of lack of focus, intense competition, slow response to fast-paced changes in technology and the market place, aggressive "corporate raiders" like Carl Ichan, T. Boone Pickens, Hanson, James Goldsmith and leveraged buy-out (LBO) boutiques KKR (Kohlberg Kravis and Roberts & Co) emerged on the scene to re-capture value. Hostile takeovers, asset stripping, leveraged buy-outs etc. emerged to clean up the corporate act and institutional investors dissatisfied with company managements that strayed in delivering shareholder value voted with their wallets to welcome the takeover specialists riding on the plank of redeeming shareholder value. Very soon company managements found themselves required to undertake corporate restructuring on their own rather than forced into by successful hostile bidders. For example, it is widely recognised that the radical restructuring through demerger of the Imperial Chemical Industries Plc. (ICI) of UK was to a great extent prompted by the acquisition of 2.8% stake thereof by the Hanson group, one of the most successful acquirers of undervalued companies. Recently Kirk Kerkorian, an aggressive investor, drew media attention by picking up stakes in the US auto giant, Chrysler and demanding return of its huge pile of cash (about US $ 10 billion) to shareholders on the ground that the company management might misinvest the cash. And companies across different industries are undertaking efficiency-driven consolidation through focused, synergistic acquisitions and deliberate, profitable divestitures and are showing new willingness to return value to shareholders through stepping up dividend and share buyback or repurchase programme.

5 Methods of Corporate Restructuring

As Rock and Rock [4] point out, "corporate restructuring can encompass a broad range of transactions but generally alludes to substantial changes in a firm's business portfolio and/or financial structure. Restructuring radically alters a firm's structure, asset-mix and/or organisation so as to enhance the firm's value. These alterations have a significant impact on the firm's balance sheet by redeploying assets (through acquisitions, divestiture and/or work force reduction) or by exploiting unused financial capacity.....". In the words of Bowman and Singh [5], "restructuring can be conceptualised as change along one or more of three dimensions: assets, capital structure or management."

While asset and capital restructuring can be termed as external, organisational restructuring may be referred to as internal; this is based on the significance and impact of the restructuring process on a company's internal or external stakeholders.

The different methods of restructuring and their implications are now discussed.

5.1 External Restructuring

5.1.1 Asset-based (portfolio) restructuring

- Acquisition of business (divisions)/companies
- Merger (amalgamation in India)
- Asset swaps
- Divestiture of business/companies
- Demerger or spin-off

5.1.2 Financial or capital restructuring

- Leveraged buy-outs
- Leveraged recapitalisation
- Share buyback
- Debt to equity conversion and other realignments of claims

5.2 *Internal Restructuring*

5.2.1 Portfolio restructuring

* Cost reduction through closure of units, redundancy programmes etc.

5.2.3 Organisational restructuring

* Management or organisational restructuring involving decentralisation, delayering, product-market based divisionalisation, matrix structure etc.

With in these broad groups and categories therein, there could be wide variations and adaptations largely arising from the need to structure a transaction in a given situation.

It should be noted, as Bowman and Singh point out [6], organisational restructuring often accompanies changes in the other two dimensions (portfolio and financial). However for a variety of reasons, the discussion in this paper is confined to external restructuring transactions only. Nonetheless the importance of organisational restructuring often in conjunction with external restructuring or even on its own in reshaping companies needs to be hardly emphasised.

6 Asset-based Restructuring

6.1 *Mergers and Acquisitions (M&A)*

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Acquisition of companies/business units or merger with other companies has been one of the most common ways of carrying out restructuring. While acquisition of companies can be "friendly" or "hostile", merger invariably involves friendly pooling of interest undertaken by managements of companies of roughly comparable sizes. However in the Indian context the term merger is used to denote consolidation of separate legal entities, not necessarily of similar sizes, into one through a statutory process of amalgamation. Since the motives of merger or acquisition are the same and both involve transfer of ownership and control of assets and the right to manage corporate cash flows and the difference between the two

is very often only a matter of technical detail, the term mergers and acquisitions (M&A) is often used interchangeably.

6.1.1 M&A Motives and shareholder value

There are several reasons why companies or groups pursue mergers and acquisitions aggressively, all of them not necessarily shareholder value-enhancing. Some of the important motives for M&A are given below.

* Organisational renewal and/or strategic repositioning.

  Eg., Acquisitions (and divestitures) of TI Group plc, the emergence of the tobacco giant Philip Morris Companies Inc. as one of the largest food companies in the world through acquisition of General Foods and Krafts, Inc., and back home the proposed Brooke Bond Lipton India Limited-Hindustan Lever Limited merger.

* Speedy growth and expansion without adding to industry capacity and at the same time "killing" a competitor.

  Eg., merger of The Tata Oil Mills Company Ltd. (TOMCO) with Hindustan Lever Ltd., Acquisition by the Translektra Domestic Products Ltd. (makers of "Good knight" mosquito repellent mats) of its competing brands Banish and Jet, Carborundum Universal's acquisition of Cutfast Abrasives etc.

* Quick, low risk entry into new markets.

  Eg. Whirpool Corporations's entry into India through Kelvinator India Ltd and H.J. Heinz through acquisition of Glaxo India Ltd.'s Foods Division.

* Strategic control over backward/forward linkages in the value chain.

  Eg., Acquisition of pharmaceutical distributors by US Drug companies, Paramount-Viacom-Blockbuster merger in the US.

* Unrelated diversification.

  Eg., Acquisition of Sterling Drugs by Eastman Kodak

* Pursuit of efficiency gains in mature or highly competitive product-markets.

  Eg., Formation of ABB through merger of Asea AB of Sweden and BBC Brown Boveri of Switzerland ; Glaxo Holdings plc's acquisition of Welcome plc; formation of Novartis through merger of Sandoz and Ciba Geigy.

* Financing gains/financial powers.

  Eg., Acquisitions of Hanson plc.

* Avoiding bankruptcy.

  Eg., Amalgamation of Godrej Soaps Ltd with ailing Gujarat-Godrej Innovative Chemicals Ltd.

Shareholder value consequences of M&A strategies and transactions will have to be carefully evaluated as empirical evidence points to high level of failures for the acquirers and hence loss for their shareholders. Since most acquisitions involve payment of huge premium to the target company's shareholders over the pre-bid market price of its shares, the acquirer must be in a position to extract considerable post-acquisitions efficiency or synergistic gains to justify the premium in present value terms which alone would enhance shareholder value. In unrelated diversifications, by very definition, synergistic gains would be hard to come by and in view of no premium "home-grown" diversification opportunities by investors themselves, unrelated diversification by acquisition *per se* carries little or no shareholder value enhancing potential.

On the other hand, even a hostile acquisition involving high premium could add to shareholder value if there is significant relatedness ie., opportunity to extract substantial synergistic and efficiency gains: the 1995 acquisition by Glaxo Holdings plc. of Welcome plc. points to this.

Similarly, agreed or friendly merger has strong potential for generating shareholder value in view of *ab initio* better organisational climate for generating synergistic and efficiency gains and absence of very high premium in such deals.

Not surprisingly purely financially motivated M&A (such as tax-driven mergers) could often have only very little positive shareholder wealth effect, as the expected financial gains could be overwhelmed by adverse business-related cash flow consequences. (Eg., the acquisition of Karnataka Scooters Ltd. by Brooke Bond India Ltd through the merger route).

6.2 Divestitures and Asset Swaps

Divestiture refers to disposal (in favour of third party) of business units, subsidiary companies or significant holdings in associates, often for cash. Asset swap, on other hand, entails simultaneous divesting and acquisition of each others' business by two companies, settling the difference in valuation, if any, in cash.

6.2.1 Divestiture Motives and Shareholder Value

Companies undertake divestitures for the following reasons.

- To exit from non-core businesses following strategic review and as part of strategic repositioning. Divestiture could be followed by pursuing growth in the core business through new investment or synergistic acquisitions, often using the divestiture proceeds.

  Eg. Divestiture of several businesses including its old "cash cow" by TI plc. and its series of acquisitions in its newly defined core business areas.

  To cut down or stop losses or cash haemorrhage.

  Eg., Tata's exiting from TOMCO; Damania Airway's divestiture.

- To generate cash, to get out of tight liquidity or for restructuring financial structure.

  Eg. planned divestitures of Shaw Wallace; divestiture of diesel/agro engines business by the erstwhile Enfield India Limited.

- Inability to meet the growing financial requirements of a business that may be basically sound.

- For financial gains.

  Eg., Divestitures of Hanson plc, group for which acquisitions of undervalued companies and their piecemeal divestitures at a gain were core business!

- To salvage an underperforming associate company.

  By divesting a reasonably stable business of a well performing multi-business company in favour of a underperforming associate company, the group management seeks to support the latter.

Where two companies have businesses that have diametrically opposite chosen profiles (what is core for one is non-core for the other and vice versa), asset swap could be profitably resorted to.

Potentially every business/company could be a candidate for divestiture if the upfront after tax cash flow from divestiture/present value thereof is more than the present value of free cash flows generated by the business or the company from continuing operations. A strategic buyer may be in a position and willing to offer much higher value for a business, in view of his unique potential to extract synergistic or efficiency gains, not open to another, conglomerate buyer.

Needless to state, planned, early divestiture would be crucial for maximising gains and to avoid forced divestiture as desperate step, under conditions of extreme financial emergency.

6.3 Demergers or Spin-offs

Demerger has emerged as a major restructuring route for delivering value to shareholders in recent times. Demerger involves spinning off (profitable or robust) parts of a diversified company into a new company and undertaking free distribution of the shares of the new (spun-off) company to the shareholders of the original company. One of the most celebrated demergers is the 1993 spin-off of the Imperial Chemical Industries plc. (ICI), whose bio-science (pharmaceuticals, agrochemicals etc.) operations were spun off into Zenecca and leaving the chemicals business with the ICI. Several other conglomerates like ITT, Hanson are also restructured through spin-off.

Unlike in a divestiture, the "parent" company or group does not receive any proceeds from a demerger as the demerged company's shares are directly distributed to the "parent" company's shareholders. There are several reasons why company managements choose to demerge or split up diversified or conglomerate companies to deliver shareholder value.

6.3.1 Demerger Motives

- Closing the value-gap

  Several conglomerates are perceived to suffer from undervaluation in the sense that the market valuation of the company as a whole is less than the *sum* of the expected valuation of the individual businesses, had they been stand-alone companies. The undervaluation from what has come to be known as "conglomerate discount" arises from a variety of reasons: perceived lack of management focus on core competencies, absence of synergies, cross subsidisation, inability or disinterestedness of security analysts to "follow" these companies etc. In such circumstances letting the individual businesses stand in the capital market on their own strength through demerger could help bridge the value-gap. This is particularly so if at least some of the parts of the conglomerates are reckoned to be "stars" that may have been obscured and subsumed by large but less attractive business parts. The demerger of the two well known UK companies, ICI plc and the earlier one of Courtaulds, sought to address this problem.

* Facilitate sharper management focus.

  Since in conglomerates there is the danger of diffused managerial efforts from possible lack of focus on any individual business, potential "winners" often get neglected and demerger seeks to address this problem.

* Avoid cross subsidisation and permit resource allocation by market.

  In conglomerates the top management carries out resource allocation amongst the various businesses not necessarily in a rational manner, often leading to cross-subsidisation of weak businesses by healthy ones. Following demerger, the spun-off companies are required to submit themselves to the resource allocation discipline of the capital market.

* Permit "homegrown" direct portfolio diversification by investors.

  Demerger recognises the fact in the absence of operational synergies, conglomerates do not add any unique value (from their diverse businesses), which shareholders cannot do on their own. Following demerger, investors are free to plan their own portfolio decisions independently, rather than being forced through the diversified company.

7 Capital and Financial Restructuring

Needless to state that the distinction between asset-based and purely financial-side restructuring is often blurred as acquisitions or divestiture has strong financial or capital structure consequences. Nonetheless the distinction is made on the basis of the dominant motives behind a given restructuring transaction.

7.1 Leveraged buy-outs (LBOs)

LBOs, widely in vogue in the eighties in the US, involve an acquirer acquiring usually mature and often diversified company with stable cash flows with extremely high level of debt including a good dose of junk (high-yielding, speculative grade) bonds. Debt to equity ratios

could be as high as 25 or 30 to 1. The acquired company is usually taken private and debt is quickly brought down through strong cash flows from divestitures and significant operational efficiencies in the acquired unit. The bought out firm is taken public in 3 to 5 years when the LBO investors book their profits.

The motive for LBOs is mainly short-term financial gains for a group of private investors. In as much as the LBOs often involve payment of large premium, the public shareholders of the bought-out firms also stand to gain. Part of the gains also come by way of tax shield on interest on the large borrowings.

One of the principal benefits of the LBO phenomenon is that company managements, particularly of stable, mature companies, that tended to be complacent and laid back, are shaken up and kept on their toes to deliver enhanced shareholder value.

7.2 Leveraged Recapitalisation (Leveraged recap)

This form of restructuring is carried out when a company (again usually with stable, large free cash flows) decides to deliver shareholder value up-front by giving a large, one time, special dividend to its shareholders. The dividend is financed by very high level of borrowings which are brought down over the next several years. Leveraged recap is thus nothing but the company paying advance dividend to its shareholders against future cash flows rather than the usual pay-as-you-earn quarterly or annual dividends. Leveraged recap also adds to shareholder value through creating large interest tax shield from the high leverage undertaken, not available in the normal course of operations.

Leveraged recap is often resorted to by companies when confronted with a unwelcome takeover threat, though there has been cases of companies undertaking leveraged recap, even when not faced with a takeover, to subject themselves to the efficiency-enhancing pressures and discipline imposed by high leverage.

Despite criticisms about the purely financial considerations of LBOs and Leveraged recaps, there is also recognition of the positive, disciplining roles they play.

7.3 Buyback (Repurchase) of Shares

Companies with large annual free cash flows are increasingly under pressure from investors to return the cash back to them either through dividends (regular or special) or through regular or special programme of buying back their own shares in the market. Buy-back of shares is perhaps more tax efficient from the point of view of the shareholders (lower capital gains tax rate Vs. normal tax rate on current income) and is aimed at boosting the per share market price by reducing the number of outstanding shares.

Highly leveraged transactions and share buyback are designed to ensure that company managements do not get trapped in the "free cash flow syndrome"; ie. ending up investing the large free cash flows in *shareholder value destroying projects* rather than distributing back to the shareholders.

7.4 Debt to Equity Conversions etc.

Such financial restructuring transactions are usually undertaken to save financially distressed firm from bankruptcy or liquidation. They include debt-holders agreeing to accept equity or preference shares in lieu of their claims, waiver of part of their claims, reduction of existing shareholders stakes etc. The main objective is to give breathing time to the distressed firm and help it generate cash flows over time; without the existing bond and equity holders' willingness to defer/give up part of their claims, the firm could often end in bankruptcy leading to much greater loss to all the security holders.

8 Restructuring Involving Ownership Changes

As may be noted, many of the restructuring measures discussed above such as acquisition, merger etc.involve ownership changes for one or all of the business units involved; of particular import are LBOs and other transactions that often result in the bought-out company being taken private.

A well known form of restructuring particularly common in Europe is management or employee buy-out (MBO/EBO) in which a large company divests parts or specific units to their existing employees often led by the units' operating management. Since the operating management and the employees have the business specific knowledge and expertise, often

they are in a position to run the business effectively, even though the business unit concerned may have ceased to be of strategic importance to its parent company.

Another form of restructuring involving ownership changes is strategic alliance or joint ventures where another company is often brought in as a significant partner with equity stakes in an existing company. Strategic alliance often could be a prelude to or even a euphemism for a merger or acquisition. The shareholder value implications of some of these transactions are less obvious; these depends on what the strategic alliance partners bring to the table either as upfront cash or as unique strengths or resources that translate into positive future cash flows.

9 Internal Vs. External Restructuring

The discussion hereinabove deals with external restructuring of a company that necessarily calls for involvement with outside companies or other existing or new stakeholders. Considerable shareholder value enhancing restructuring is undertaken by companies internally: downsizing, closing down unviable capacities, consolidating facilities, lopping of large chunks of costs through employee redundancy programmes etc. While often internal restructuring can be undertaken independently, invariably they form part of an external restructuring move like a merger as mentioned earlier.

Similarly there has been considerable efforts in organisational restructuring with the objective of enhancing organisational responsiveness to the fast-paced environment and speed up intra-company decision making processes. These are often through delayering, significant decentralisation of decision making powers, divisionalisation along narrow product-market levels etc.

10 Shareholder Value Management and Corporate Restructuring in India

There has been, not unexpectedly, sharp increase in the number and types of restructuring transactions by Indian companies in the post-liberalisation period, prompted by a variety of motives. However it would appear focused restructuring with a firm eye on shareholder

value is yet to pick up in a big way. While there are regulatory and institutional impediments to implement some of the restructuring modes one so often comes across in the US and UK (eg. regulatory restriction on share buyback, absence of bank finance for acquisitions etc.) in India, explicit attention to shareholder value management is yet to move over to the top of Indian corporate agenda.

The several peculiarities in India' industrial and corporate ownership structures and financial system - products of the regulatory and historical relics - may have been responsible for this. The highly restrictive industrial licensing system meant company managements, until a few years back, were forced to pursue growth not on the basis of sound business logic but in areas where licenses could be "managed". The institutional financial arrangements warranted the promoters to ante up 20%-25% of a new project's cost by way of promoters' contribution which necessarily favoured intercorporate investments by existing companies of the same promoter. Most of the intercorporate investments in highly unrelated areas often did not add any value to investing company or its minority shareholders, except that they helped the promoter groups (families) to grow. The financial institutions, all in public sector, were playing confused and ambivalent roles as development bankers, bond holders, equity investors and quasi- managers (through board nominations) and they never were demanding even when servicing of their debts were less than prompt. Until recently stock market regulations were weak and investing public were "courted" only at the time when companies wanted to tap the market with fresh issues. With the promoters and the public financial institutions together holding, often 50%-60% of the voting stock and the rest with fragmented individual shareholders, there was little pressure on company managements to act in the best interest of *all* the shareholders rather than on their own. For a variety of reasons several unhealthy practices emerged, eg., formation of a plethora group companies, some of them closely held by the promoters; close business dealings with each other involving high actual and potential conflict of interest; near absence of truly independent outside directors etc. Mutual funds that have emerged as major institutional investors in the last few years are yet to get even voting rights, the main disciplining tool. Until the legislative changes proposed as part the Depositary Bill passed by the Parliament in August, 1996 company managements could refuse registration of share transfer at will, under the obnoxious provisions of section 22 A (3)(c) of the Securities Contracts Regulations Act (SCRA) that straightaway repulsed any attempt at a hostile bid, a very powerful check on errant company managements and those not caring to deliver shareholder value.

There are, however, strong indications that company managements will have to give greater attention to shareholder value management in the coming days. The entry of foreign institutional investors both through international capital issue (eg. Global Depositary Receipts) and portfolio investment routes and increasing pressure on the domestic financial institutions and mutual funds to demand performance from company managements and the sharp increase in the focused research and analysis of Indian companies by a new breed of equity analysts - all point to increased pressure on companies to deliver shareholder value.

As mentioned there has been a sharp increase in the restructuring activities in Indian corporate sector in last three years or so, as Indian companies respond to the post liberalisation environment. One is also witnessing a rush by the several Indian business houses to enter the several new areas being opened up; many of them highly capital intensive with entirely different risk dimensions and return profiles.

The types of restructuring one is witnessing in India could be grouped as follows:

10.1 Acquisitions

There has been a spate of acquisitions - of both business units (divisions) and companies; while acquisition of business divisions has direct potential to add to shareholder value, acquisition of companies (often involving 30%-40% equity stakes) are of doubtful value particularly if they involve entry into unrelated areas (Eg. Mcleod Russel's acquisition of 51% of Union Carbide India Ltd for Rs. 290 crore and Torrent group's attempt to acquire Ahmedabad Electricity Company Ltd).

A large number of acquirers has been multinational units either seeking to enter or consolidate their presence in India. (Eg. H.J. Heinz' acquisition of Glaxo India's food business, Colgate- Palmolive India Ltd's acquisition of oral hygeine business Hindustan Ciba-Geigy Ltd. , Daewoo's buying into DCM Toyota Ltd. etc.)

10.2 Mergers/Amalgamations

The steep increase in the number of mergers (amalgamations) may have been prompted by a variety of stated and unstated motives. One oft-cited rationale for amalgamation has been consolidation of relatively smaller companies into large company with a critical mass (eg. Polyolefene Ltd. merger with National Organic Chemicals Ltd., the merger of the Mafatlal

Textile companies, merger of Escorts Tractor Ltd. with Escorts Ltd. etc). There are indications that in a number of cases amalgamation may have been motivated to consolidate and increase the promoter holdings to guard against possible takeover threats. Several mergers involving multi-national company (MNC) subsidiaries operating in India seem to be for achieving synergistic/effciency gains through consolidation and these are often logical sequence to the merger/acquisition of their parents abroad. The spate of mergers in the Unilever group of companies operating in India, the expected merger of Burroughs Welcome India Ltd. and Glaxo India Ltd., and between Sandoz India Ltd and Hindustan Ciba-Geigy Ltd. are illustrative of this trend.

Amalgamation has been resorted to even in the past for tax reasons; the reverse merger in which a profit making company merges with a (tax) loss company continue unabatedly to optimise tax management within a group.

10.3 Divestitures

There has certainly been a new willingness to undertake divestiture as companies re-evaluate their strategic options. Several multi-national company (MNC) subsidiaries operating in India like Glaxo, Hindustan Ciba-Geigy have made large divestitures. Similarly Ceat Ltd. has divested its nylon tyre cord division in favour to SRF Ltd. for about Rs. 320 crore as both the companies redefined their core businesses.

The are several cases of divestitures prompted by severe liquidity pressures and financial considerations. Several Indian companies have attempted to expand far too rapidly in highly capital intensive areas in the first flush of liberalisation without fully evaluating the changing business risks and competitive position on account of, say, lowering of entry and tariff barriers. With finances not entirely in place and fast-changing fortunes in their old and new businesses, several of them have been caught unawares in a liquidity bind, and poor conditions in the capital market have only compounded their woes. If tight liquidity and bearish capital market conditions are to continue -there are strong indications to this effect - one would witness a spate of divestitures in the coming months.

One is also witnessing the phenomenon of disposal of valuable real estate and other properties and use of the proceeds for internal restructuring such as man power reduction through voluntary retirement schemes. Hindustan Ciba-Geigy, Boots, Philips India etc. have shown the lead in this respect.

In a unique case, Hindustan Lever Limited and its 60% subsidiary, Stepan Chemicals Limited (now Hind Lever Chemicals Limited) have swapped businesses between themselves mainly to avoid the problem of "potential conflict of interest" involved in both the companies dealing in similar product markets.

10.4 Demergers

There have been a few cases of demergers like that of the DCM Ltd. (in 1989) undertaken purely for settling promoter family disputes. More recently there have been demergers of Hoechst India Ltd., Sandoz (India) Ltd., and KCP Ltd., for facilitating sharper focus on the individual businesses comprised in their diversified portfolio.

10.5 Restructuring of sick units

Sick or financially weak units are being restructured with the intervention of the Board of Industrial and Financial Reconstruction (BIFR), under the Sick Industrial Companies (Special Provisions) Act - SICA - through merger under section 72A of the Income Tax Act and/or financial restructuring involving reduction of claims by debt holders, mainly financial institutions and banks. An increasing trend is voluntary restructuring by company managements through reverse merger with a group company, divestitures and negotiating for a one time settlement with the lenders involving substantial reduction in their claims.

10.6 Strategic Alliances/Joint Ventures

A few Indian business groups have restructured some of their existing companies by converting them or specific business units into joint venture companies: eg. Lakme-Hindustan Lever, DCM Toyota-Daewoo (now known as DCM-Daewoo), Bilt-Owen, Kotak Mahindra Finance Ltd's conversion of several of its businesses into joint venture subsidiaries etc. Many of these joint ventures could be either prelude to or euphemism for eventual divestiture by the Indian partner. In several cases, the joint-venture mode may have been necessitated by the inability to meet the growing financial needs of the business or technological compulsions.

10.7 Intra-group Arrangements

Restructuring arrangements between group companies for a variety of reasons - ranging from purely liquidity reasons to nursing a sick unit of the group - are quite common. The leasing of Birla Tyres by its owner Kesoram Industries Ltd. with other Birla group companies, transfer by Mahindra and Mahindra Ltd. of its Metal Pressings Unit at Kanhe to Mahindra Ugine Steel Company Ltd. etc. are examples of such transactions.

10.8 Capital Reduction

Some companies, particularly in the public sector, suffer from over-capitalization and many have found it necessary to reduce their huge equity base to sustainable level to make them attractive for the capital market. Tamil Nadu Newsprints Ltd., has already undertaken reduction before entering the market and other public sector units like the Steel Authority of India Ltd., and National Aluminium Company Ltd. have also been reported to be keen to do so.

Shareholder value consequences of a large number of such restructuring moves by the Indian corporate sector appear to be debatable - at best neutral, at worst negative; and in several recent transactions [7], one is left to conclude that the main restructuring motives appear to be beefing up promoter holdings or group liquidity rather than maximising wealth for *all* the shareholders.

11 Restructuring in India: The Shape of Things to Come

There is growing evidence that Indian companies will be forced by the changing investor profile and consequently changing investor expectations to accord highest priority and explicit attention to delivering shareholder value. Consequently Indian company managements will be forced to address several issues urgently: large and complex intercorporate investments many of which have doubtful, if not negative shareholder value implications; mutual fund like portfolio investments, highly diversified product-market portfolio ranging from financial services and real estate to manufacturing, power and telecom, large and material intra-group transactions involving actual and potential conflicts of interest. The continuing environment of tight liquidity, real threat of hostile takeovers (from the repeal of Section 22 (A)(3)(c) of SCRA), more activist role from the public financial institutions in corporate governance matters - all these point to companies

undertaking large scale restructuring, but for shareholder value purposes. The inevitable, though somewhat slow, privatisation of the public sector would be yet another trigger for large scale corporate restructuring. Certain regulatory and tax changes would be necessary to make them truly shareholder value-oriented, eg., unambiguous tax position regarding demergers, need for tax concessions to encourage liquidation/shareholder distribution of intercompany investments etc. The days of undertaking corporate restructuring for delivering shareholder value to *all* the shareholders, not just the promoters, are not too far.

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3. For a short illustrative commentary see: E. Mark Gressle (ed) *Corporate Restructuring: the theme of the 1980s*, Chapter 3, in Bryan de Caires (ed), 1990, Corporate Restructuring, London Euromoney Publications Plc.

4. Rock, Milton L., and Rober H., 1990, Introduction, in *Corporate Restructuring: A Guide to Creating the Premium-Valued Company*, New York, McGraw-Hill Publishing Company, pp 1.

5. Bowman Edward H., and Harbir Singh, 1990, *Overview of Corporate Restructuring Trends and Consequences*, in Rock and Rock (ed), Corporate Restructuring: A Guide to Creating the Premium-Valued Company, *opp. cit*, pp 8-21.

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7. See The Money Manager (of Business Standard), 1996, *Routes to Consolidation*, August 29, pp 1 & 3.