MERGER AND CORPORATE RESTRUCTURING

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Module – I

Financial Policy and Corporate Strategy

Learning Objectives:

- Strategic financial decision making framework
- Strategy at different hierarchy levels
- Financial planning
- Interface of Financial Policy and Strategic Management
- Balancing financial goals vis-à-vis sustainable growth

1. Strategic Financial Decision Making Frame Work:

Capital investment is the springboard for wealth creation. In a world of economic uncertainty, the investors want to maximize their wealth by selecting optimum investment and financial opportunities what will give them maximum expected returns at minimum risk. Since management is ultimately responsible to the investors, the objective of corporate financial management should implement investment and financing decisions which should satisfy the shareholders by placing them all in an equal, optimum financial position. The satisfaction of the interests of the shareholders should be perceived as a means to an end, namely maximization of shareholders' wealth. Since capital is the limiting factor, the problem that the management will face is the strategic allocation of limited funds between alternative uses in such a manner, that the companies have the ability to sustain or increase investor returns through a continual search for investment opportunities that generate funds for their business and are more favorable for the investors. Therefore, all businesses need to have the following three fundamental essential elements:

- A clear and realistic **strategy**,
- The **financial** resources, controls and systems to see it through and
- The right **management** team and processes to make it happen

We may summarize this by saying that:

Strategy + Finance + Management = Fundamentals of Business

Strategy may be defined as the long-term direction and scope of an organization to achieve competitive advantage through the configuration of resources within a changing environment for the fulfillment of stakeholder's aspirations and expectations. In an idealized world, management is ultimately responsible to the investors. Investors maximize their wealth by selecting optimum investment and financing opportunities, using financial models that maximize expected returns in absolute terms at minimum risk. What concerns the investors is not simply maximum profit but also the likelihood of it arising: a risk-return trade-off form a portfolio of investments, with which they feel comfortable and which may be unique for each individual.

We call this overall approach strategic financial management and define it as being the application to strategic decisions of financial techniques in order to help achieve the decision-maker's objectives. Although linked with accounting, the focus of strategic financial management is different. Strategic financial management combines the backward-looking, report-focused discipline of (financial) accounting with the more dynamic, forward-looking subject of financial management. It is basically about the identification of the possible strategies capable of maximizing an organization's market value. It involves the allocation of scarce capital resources among competing opportunities. It also encompasses the implementation and monitoring of the chosen strategy so as to achieve agreed objectives.

1.1 Functions of Strategic Financial Management: Strategic Financial Management is the portfolio constituent of the corporate strategic plan that embraces the optimum investment and financing decisions required to attain the overall specified objectives. In this connection, it is necessary to distinguish between strategic, tactical and operational financial planning. While strategy is a long-term course of action, tactics are intermediate plan, while operations are short-term functions. Senior management decides strategy, middle level decides tactics and operational are looked after line management.

Irrespective of the time horizon, the investment and financial decisions functions involve the following functions:

- Continual search for best investment opportunities;
- Selection of the best profitable opportunities;
- Determination of optimal mix of funds for the opportunities;
- Establishment of systems for internal controls; and
- Analysis of results for future decision-making

Since capital is the limiting factor, the strategic problem for financial management is how limited funds are allocated between alternative uses. This dilemma of corporate management is resolved by the pioneering work of Jenson and Meckling (1976), which is popularly known as 'agency theory' which you have already studied in Financial Management. According to this theory, strategic financial management is the function of four major components based on the mathematical concept of expected NPV (net present value) maximization, - Financing decisions; Investment decisions; Dividend decisions; and Liquidity decisions.

The Key decisions falling within the scope of financial strategy include the following:

1. **Financing decisions:** These decisions deal with the mode of financing or mix of equity capital and debt capital.
2. **Investment decisions:** These decisions involve the profitable utilization of firm's funds especially in long-term projects (capital projects). Since the future benefits associated with such projects are not known with certainty, investment decisions necessarily involve risk. The Projects are therefore evaluated in relation to their expected return and risk.
3. **Dividend decisions:** These decisions determine the division of earnings between payments to shareholders and reinvestment in the company.
4. **Portfolio decision:** These decisions involve evaluation of investments based on their contribution to the aggregate performance of the entire corporation rather than on the isolated characteristics of the investments themselves. You have already, learned about the Financing and Investment decisions in Financial Management.

2. Strategy at Different Hierarchy Levels

Strategies at different levels are the outcomes of different planning needs. There three levels of Strategy – Corporate Level; Business unit level; and Functional or development and coordination of that portfolio of businesses.

2.1 Corporate Level Strategy: Corporate level strategy fundamentally is concerned with selection of businesses in which a company should compete and also with the development and coordination of that portfolio of businesses.

Corporate level strategy should be able to answer three basic questions:	
Suitability	Whether the strategy would work for the accomplishment of common objective of the company
Feasibility	Determines the kind and number of resources required to formulate and implement the strategy
Acceptability	It is concerned with the stakeholders' satisfaction and can be financial and non-financial

2.2 Business Unit Level Strategy: Strategic business unit (SBU) may be any profit centre that can be planned independently from the other business units of a corporation. At the business unit level, the strategic issues are about practical coordination of operating units and developing and sustaining a competitive advantage for the products and services that are produced.

2.3 Functional Level Strategy: The functional level is the level of the operating divisions and departments. The strategic issues at this level are related to functional business processes and value chain. Functional level strategies in R & D, operations, manufacturing, marketing, finance, and human resources involve the development and coordination of resources through which business unit level strategies can be executed effectively and efficiently. Functional units of an organization are involved in higher level strategies by providing input to the business unit level and corporate level strategy, such as providing information on customer feedback or on resources and capabilities on which the higher level strategies can be based. Once the higher level strategy is developed, the functional units translate them into discrete action plans that each department or division must accomplish for the strategy to succeed.

Among the different functional activities viz. production, marketing, finance, human resources and research and development, finance assumes highest importance during the top down and bottom up interaction of planning. Corporate strategy deals with deployment of resources and financial strategy is mainly concerned with mobilization and effective utilization of money, the most critical resource that a business firm likes to have under its command. Truly speaking, other resources can be easily mobilized if the firm has adequate monetary base. To go into the details of this interface between financial strategy and corporate strategy and financial planning and corporate planning let us examine the basic issues addressed under financial planning.

3. Financial Planning

Financial planning is the backbone of the business planning and corporate planning. It helps in defining the feasible area of operation for all types of activities and thereby defines the overall planning framework. Financial planning is a systematic approach whereby the financial planner helps the decision maker to maximize his existing financial resources by utilizing financial tools to achieve his financial goals.

There are 3 major components of financial planning:

- Financial Resources (FR)
- Financial Tools (FT)
- Financial Goals (FG)

Financial Planning: FR + FT = FG

For an individual, financial planning is the process of meeting one's life goals through proper management of the finances. These goals may include buying a house, saving for children's education or planning for retirement. It is a process that consists of specific steps that helps in taking a big-picture look at where you financially are. Using these steps you can work out where you are now, what you may need in the future and what you must do to reach your goals.

Outcomes of the financial planning are the financial objectives, financial decision-making and financial measures for the evaluation of the corporate performance. Financial objectives are to be decided at the very outset so that rest of the decisions can be taken accordingly. The objectives need to be consistent with the corporate mission and corporate objectives. Financial decision making helps in analyzing the financial problems that are being faced by the corporate and accordingly deciding the course of action to be taken by it. The financial measures like ratio analysis, analysis of cash flow statement are used to evaluate the performance of the company. The selection of these measures again depends upon the corporate objectives.

4. Interface of Financial Policy and Strategic Management

The interface of strategic management and financial policy will be clearly understood if we appreciate the fact that the starting point of an organization is money and the end point of that organization is also money. No organization can run an existing business and promote a new expansion project without a suitable internally mobilized financial base or both i.e. internally and externally mobilized financial base.

Sources of finance and capital structure are the most important dimensions of a strategic plan. The need for fund mobilization to support the expansion activity of firm is very vital for any organization. The generation of funds may arise out of ownership capital and or borrowed capital. A company may issue equity shares and/or preference shares for mobilizing ownership capital and debentures to raise borrowed capital. Public deposits, for a fixed time period, have also become a major source of short and medium term finance. Organisations may offer higher rates of interest than banking institutions to attract investors and raise fund. The overdraft, cash credits, bill discounting, bank loan and trade credit are the other sources of short-term finance.

Along with the mobilization of funds, policy makers should decide on the capital structure to indicate the desired mix of equity capital and debt capital. There are some norms of debt equity ratio, which need to be followed for minimizing the risks of excessive loans. For instance, for the public sector organization, the norm is 1:1 ratio and for private sector firms, the norm is 2:1 ratio. However this ratio in its ideal form varies from industry to industry. It also depends on the planning mode of the organization. For capital intensive industries, the proportion of debt to equity is much higher. Similar is the case of high cost projects in priority sectors and for projects in under developed regions.

Another important dimension of strategic management and financial policy interface is the investment and fund allocation decisions. A planner has to frame policies for regulating investments in fixed assets and for restraining of current assets. Investment proposals mooted by different business units may be divided into three groups. One type of proposal will be for addition of a new product by the firm. Another type of proposal will be to increase the level of operation of an existing product through either an increase in capacity in the existing plant or setting up another plant for meeting additional capacity requirement. The last is for cost reduction and efficient utilization of resources through a new approach and or closer monitoring of the different critical activities. Now, given these three types of proposals a planner should evaluate each one of them by making within group comparison in the light of capital budgeting exercise. In fact project evaluation and project selection are the two most important jobs under fund allocation. Planner's task is to make the best possible allocation under resource constraints.

Dividend policy is yet another area for making financial policy decisions affecting the strategic performance of the company. A close interface is needed to frame the policy to be beneficial for all. Dividend policy decision deals with the extent of earnings to be distributed as dividend and the extent of earnings, which cannot be profitably utilized by the company. Stability of the dividend payment is desirable consideration that can have a positive impact on share prices. The alternative policy of paying a constant percentage of the net earnings may be preferable form the point of view of both flexibility of the firm and ability of the firm. It also gives a message of lesser risk for the investors. Yet some other companies follow a different alternative. They pay a minimum dividend per share and additional dividend when earnings are higher than the normal earnings. In actual practice, investment opportunities and financial needs of the firm and the shareholders preference for dividend against capital gains resulting out of share are to be taken into consideration for arriving at the right dividend policy. Alternatives like cash dividend and stock dividend are also to be examined while working out an ideal dividend policy that supports and promotes the corporate strategy of the company.

Thus, the financial policy of a company cannot be worked out in isolation of other functional policies. It has wider appeal and closer link with the overall organizational performance and direction of growth. These policies are being related to external awareness about the firm, especially the awareness of the investors about the firm, in respect of its internal performance. There is always a process of evaluation active in the minds of the current and future stake holders of the company. As a result preference and patronage for the company depends significantly on the financial policy framework. Hence, attention of the corporate planners must be drawn while framing the financial policies not at a later stage but during the stage of corporate planning itself. The nature of interdependence is the crucial factor to be studied and modeled by sing an in depth analytical approach. This is a very difficult task compared to usual cause and effect study because corporate strategy is the cause and financial policy is the effect and sometimes financial policy is the cause and corporate strategy is the effect.

5. Balancing Financial Goals Vis-à-Vis Sustainable Growth

The concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases and to set sales growth goals that are consistent with the operating and financial policies of the firm. Often, a conflict can arise if growth objectives are not consistent with the value of the organization's sustainable growth. Question concerning right distribution of resources may take a difficult shape if we take into consideration the rightness not for the current stakeholders but for the future stakeholders also. To take an illustration, let us refer to fuel industry where resources are limited in quantity and a judicial use of resources is needed to cater to the need of the future customers along with the need of the present customers. One may have noticed the save fuel campaign, a demarking campaign that deviates from the usual approach of sales growth strategy and preaches for conservation of fuel for their use across generation. This is an example of stable growth strategy adopted by the oil industry as a whole under resource constraints and the long run objective of survival over years. Incremental growth strategy, profit strategy and pause strategy are other variant of stable growth strategy.

Sustainable growth is important to enterprise long-term development. Too fast or too slow growth will go against enterprise growth and development, so financial should play important role in enterprise development, adopt suitable financial policy initiative to make sure enterprise growth speed close to sustainable growth ratio and have sustainable healthy development.

What makes an organization financially sustainable?
To be financially sustainable, an organization must; • have more than one source of income; • have more than one way of generating income; • do strategic, action and financial planning regularly; • have adequate financial systems; • have a good public image; • be clear about its values (value clarity); and • have financial autonomy

Source: CIVICUS "Developing a Financing Strategy".

The sustainable growth rate (SGR), concept by Robert C. Higgins, of a firm is the maximum rate of the growth in sales that can be achieved, given the firm's profitability, asset utilization, and desired dividend payout and debt (financial leverage) ratios. The sustainable growth rate is a measure of how much a firm can grow without borrowing more money. After the firm has passed this rate, it must borrow funds from another source to facilitate growth. Variables typically include the net profit margin on new and existing revenues; the asset turnover ratio, which is the ratio of sales revenues to total assets; the assets to beginning of period equity ratio; and the retention rate, which is defined as the fraction of earnings retained in the business.

SGR = ROE x (1 – Dividend Payout ratio)

Sustainable growth models assume that the business wants to: 1) maintain a target capital structure without issuing new equity; 2) maintain a target dividend payment ratio; and 3) increase sales as rapidly as market conditions allow. Since the asset to beginning of period equity ratio is constant and the firm's only source of new equity is retained earnings, sales and assets cannot grow any faster than the retained earnings plus the additional debt that the retained earnings can support. The sustainable growth rate is consistent with the observed evidence that most corporations are reluctant to issue new equity. If, however, the firm is willing to issue additional equity, there is a principle no financial constraint on its growth rate. Indeed, the sustainable growth rate formula is directly predicted on return on equity.

Economists and business researchers contend that achieving sustainable growth is not possible without paying heed to twin cornerstones: growth strategy and growth capability. Companies that pay inadequate attention to one aspect or the other are doomed to failure in their efforts to establish practices of sustainable growth (though short-term gains may be realized). After all, if a company has an excellent growth strategy in place, but has not put the necessary infrastructure in place to execute that strategy, long-term growth is impossible. The reverse is true as well.

The very weak idea of sustainability requires that the overall stock of capital assets should remain constant. The weak version of sustainability refers to preservation of critical resources to ensure support for all, over a long time horizon. The strong concept of sustainability is concerned with the preservation of resources under the primacy of ecosystem functioning. These are in line with the definition provided by the economists in the context of sustainable development at macro level.

What makes an organization sustainable?

- In order to be sustainable, an organization must;
- have a clear strategic direction;
- be able to scan its environment or context to identify opportunities for its work;
- be able to attract, manage and retain competent staff;
- have an adequate administrative and financial infrastructure;
- be able to demonstrate its effectiveness and impact in order to leverage further

resources; and

- get community support for, and involvement in its work.

Source: CIVICUS "Developing a Financing Strategy".

The sustainable growth model is particularly helpful in situations in which a borrower requests additional financing. The need for additional loans creates a potentially risky situation of too much debt and too little equity. Either additional equity must be raised or the borrower will have to reduce the rate of expansion to a level that can be sustained without an increase in financial leverage.

Mature firms often have actual growth rates that are less than the sustainable growth rate. In these cases, management's principal objective is finding productive uses for the cash flows that exist in excess of their needs. Options available to business owners and executives in such cases includes returning the money to shareholders through increased dividends or common stock repurchases, reducing the firm's debt load, or increasing possession of lower earning liquid assets. These actions serve to decrease the sustainable growth rate. Alternatively, these firms can attempt to enhance their growth rates through the acquisition of rapidly growing companies.

Growth can come from two sources: increased volume and inflation. The inflationary increase in assets must be financed as though it were real growth. Inflation increases the amount of external financing required and increases the debt-to-equity ratio when this ratio is measured on a historical cost basis. Thus, if creditors require that a firm's historical cost debt-to-equity ratio stay constant, inflation lowers the firm's sustainable growth rate.

Mitsubishi Corporation (MC): New Strategic Direction (charting a new path toward sustainable growth)
Mitsubishi Corporation has abolished its traditional "Midterm management plan" concept of committing to fixed financial targets three years in the future, in favour of a long-term, circa 2020 growth vision. The "New Strategic Direction" consists of basic concepts on management policy together with business and market strategies. It seeks to recognize the Company's value and upside potential as a "*sogo shosha"* capable of "*providing stable earnings throughout business cycles by managing a portfolio diversified by business model, industry, market and geography".* MC remains dedicated to sustainable growth but as even more committed to helping solve problems in Japan and around the world. Its chief goal is to contribute to sustainable societal growth on a global scale. The summary of this New Strategic Direction is: • Future-pull approach eyeing 2020 with a vision to double the business by building a diversified but focused portfolio. • Clear portfolio strategy: Select winning businesses through proactive reshaping of

portfolio.
- Growth business and deliver returns while maintaining financial discipline.

Summary

1. Strategic Financial Decision Making Framework

All businesses need to have the following three fundamental essential elements:

- A clear and realistic **strategy**
- The **financial** resources, controls and systems to see it through and
- The right **management** team and processes to make it happen.

1.1 Functions of Strategic Financial Management: Strategic Financial Management is the portfolio constituent of the corporate strategic plan that embraces the optimum investment and financing decisions required to attain the overall specified objectives.

Irrespective of the time horizon, the investment and financial decisions functions involve the following functions:

- Continual search for best investment opportunities
- Selection of the best profitable opportunities
- Determination of optimal mix of funds for the opportunities
- Establishment of systems for internal controls
- Analysis of results for future decision-making.

According to agency theory, strategic financial management is the function of four major components based on the mathematical concept of expected NPV (net present value) maximization, which are:

1. Financing decisions – These decisions deal with the mode of financing or mix of equity capital and debt capital. If it is possible to alter the total value of the company by alteration in the capital structure of the company, then an optimal financial mix would exist – where the market value of the company is maximized.
2. Investment decisions – These involve the profitable utilization of firm's funds especially in long-term projects (capital projects). Because the future benefits associated with such projects are not known with certainty, investment decisions necessarily involve risk.
3. Dividend decisions – These decisions determine the division of earnings between payments to shareholders and reinvestment in the company.

4. Portfolio decisions – These decisions involve evaluation of investments based on their contribution to the aggregate performance of the entire corporation rather than on the isolated characteristics of the investments themselves.

2. Strategy at different hierarchy levels

Strategies at different levels are the outcome of different planning needs. The three Levels of an enterprise strategy are:

2.1 Corporate Level Strategy: Corporate level strategy is concerned with three basic questions – suitability, feasibility and acceptability of the strategy.

2.2 Business Unit Level Strategy: At the business unit level, the strategic issues are about both practical coordination of operating units and about developing and sustaining a competitive advantage for the products and services that are produced.

2.3 Functional Level Strategy: Functional level strategies in R&D, operations, manufacturing, marketing, finance and human resources involve the development and coordination of resources through which business unit level strategies can be executed effectively and efficiently.

Among the different functional activities viz. production, marketing, finance, human resources and research and development, finance assumes highest importance during the top down and bottom up interaction of planning.

3. Financial Planning

Financial planning is a systematic approach whereby the financial planner helps the customer to maximize his existing financial resources by utilizing financial tools to achieve his financial goals.

Financial planning is simple mathematics. There are 3 major components:

- Financial Resources (FR)
- Financial Tools (FT)
- Financial Goals (FG)

4. Interface of financial policy and strategic management

The interface will be clearly understood if we appreciate the fact that the starting point and end point of an organization is money. Sources of finance and capital structure are the most important dimensions of a strategic plan. A company may issue equity shares and/or preference shares for mobilizing ownership capital.

Along with the mobilization of funds, policy makers should decide on the capital structure to indicate the desired mix of equity capital and debt capital. There are some norms for debt equity ratio. This ratio is in its ideal form varies from industry to industry.

Another important dimension on strategic management and financial policy interface is the investment and fund allocation decisions. A planner has to frame policies for regulating investments in fixed assets and for restraining of current assets. Investment proposals mooted by different business units may be divided into three groups. One type of proposal will be for addition of a new product by the firm. Another type of proposal will be to increase in capacity in the existing plant or setting up of another plant for meeting additional capacity requirement. The last is for cost reduction and efficient utilization of resources through a new approach and or closer monitoring of the different critical activities. Now, given these three types of proposals a capital budgeting exercise, in fact project evaluation and project selection are the two most important jobs under fund allocation. Planner's task is to make the best possible allocation under resource constraints.

Dividend policy is yet another area for making financial policy decisions affecting the strategic performance of the company. A close interface is needed to frame the policy to be beneficial for all. Dividend policy decision deals with the extent of earnings to be distributed as dividend and the extent of earnings to be retained for future expansion scheme of the firm.

It may be noted that financial policy of a company cannot be worked out in isolation of other functional policies. It has a wider appeal and closer link with the overall organizational performance and direction of growth.

5. Balancing Financial Goals vis-à-vis Sustainable Growth

The concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases and to set sales growth goals that are consistent with the operating and financial policies of the firm. Often, a conflict can arise if growth objectives are not consistent with the value of the organisation's sustainable growth. Question concerning right distribution of resources may take a difficult shape if we take into consideration the rightness not for the current stakeholders but for the future stakeholders also.

The sustainable growth rate (SGR) of a firm is the maximum rate of growth in sales that can be achieved, given the firm's profitability, asset utilization, and desired dividend payout and debt (financial leverage) ratios.

The sustainable growth model is particularly helpful in situations in which a borrower requests additional financing. The need for additional loans creates a potentially risky situation of too much debt and too little equity. Either additional equity must be raised or the borrower will have to reduce the rate of expansion to a level that can be sustained without an increase in financial leverage.

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MODULE – II

'Mergers And Acquisitions - M&A'

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Mergers and acquisitions (M&A) is a general term that refers to the consolidation of companies or assets. While there are several types of transactions classified under the notion of M&A, a merger means a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.
The term M&A also refers to the department at financial institutions that deals with mergers and acquisitions.

BREAKING DOWN 'Mergers and Acquisitions - M&A'

M&A can include a number of different transactions, such as mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions. In all cases, two companies are involved, where an acquiring company makes an offer to buy the other company in its entirety or purchase some of its assets.

Merger

In a merger, the boards of directors for two companies approve the combination and seek shareholders' approval. After the merger, the acquired company ceases to exist and becomes part of the acquiring company. A merger in 2007 was a deal between Digital Computers and Compaq, where Compaq absorbed Digital Computers.

Acquisition

In an acquisition, the acquiring company obtains the majority stake in the acquired firms, which does not change its name or legal structure. An example of this transaction is Manulife Financial Corporation's 2004 acquisition of John Hancock Financial Services, where both companies preserved their names and forms of organization.

Consolidation

A consolidation creates a new company. Stockholders of both companies must approve the consolidation, and subsequent to the approval, they receive common equity shares in the new firm. For example, in 1998 Citicorp and Traveler's Insurance Group announced a consolidation, which resulted in Citigroup.

Tender Offer

In a tender offer, one company offers to purchase the outstanding stock of the other firm at a specific price. The acquiring company communicates the offer directly to the other company's shareholders, bypassing the management and board of directors. While the acquiring company may continue to exist, if there are certain dissenting shareholders, most tender offers result in mergers. An example is when Johnson & Johnson made a tender offer in 2008 and acquired Omrix Biopharmaceuticals for $438 million.

Acquisition of Assets

In a purchase of assets, one company acquires the assets of another company. The company whose assets are being acquired must obtain approval from its shareholders. Typically, the selling company is liquidated upon the final transfer of assets to the acquiring firm. The purchase of assets is typical during bankruptcy proceedings, where other companies bid for various assets of the bankrupt company, which later ceases to exist.

Management Acquisition

In a management acquisition, the management of a company purchases a controlling stake in a company, making it private. Such an M&A transaction is typically financed disproportionately with debt, and the majority of shareholders must approve it. In 2013, Dell Corporation announced that it was acquired by its chief executive manager, Michael Dell. This was a management acquisition.

Motives Behind Merger

(i) **Economies of Scale**: This generally refers to a method in which the average cost per unit is decreased through increased production

(ii) **Increased revenue /Increased Market Share**: This motive assumes that the company will be absorbing the major competitor and thus increase its to set prices.

(iii) **Cross selling:** For example, a bank buying a stock broker could then sell its banking products to the stock brokers customers, while the broker can sign up the bank' customers for brokerage account.

(iv) **Corporate Synergy:** Better use of complimentary resources. It may take the form of revenue enhancement and cost savings.

(v) **Taxes**: A profitable can buy a loss maker to use the target's tax right off i.e. wherein a sick company is bought by giants.

(vi)**Geographical or other diversification**: This is designed to smooth the earning results of a company, which over the long term smoothens the stock price of the company giving conservative investors more confidence in investing in the company. However, this does not always deliver value to shareholders.

NATURE AND TYPES OF M&A

Mergers vs. Acquisitions

A merger takes place when two companies combine together as equals to form an entirely new company. Mergers are rare, since most often companies are acquired by other companies, and it is more of absorption of operation of the target company. The term merger is more often used to show deference to employees and former owners when another company is taken over. Mergers and acquisition are a means to a long-term business strategy. New alliances, mergers or takeovers are usually based on company vision and mission statements, and they have to truly reflect company corporate strategy in terms of what it wants to achieve with the strategic move in the industry. The process of acquisition or a merger calls for a disciplined approach by the decision makers at the company. Three important considerations should be taken into account:

•Company must be willing to take risk, and make investment early-on to benefit fully from the merger, competitors and the industry takes heed and start to merger or acquirer themselves.

•In order to reduce and diversify risk, multiple bets must be made, since some of the initiatives will fail, while some will prove fruitful.

•The management of the acquiring firm must learn to be resilient, patient and able to emulate change owing to ever-changing business dynamics in the industry.

Horizontal Mergers

Horizontal mergers happen when a company merges or takes over another company that offers the same or similar product lines and services to the final consumers, which means that it is in the same industry and at the same stage of production. Companies, in this case, are usually direct competitors. For example, if a company producing cell phones merges with another company in the industry that produces cell phones, this would be termed as horizontal merger. The benefit of this kind of merger is that it eliminates competition, which helps the company to increase its market share, revenues and profits. Moreover, it also offers economies of scale due to increase in size as average cost decline due to higher production volume. These kinds of merger also encourage cost efficiency, since redundant and wasteful activities are removed from the operations i.e. various administrative departments or departments such as advertising, purchasing and marketing.

Vertical Mergers

A vertical merger is done with an aim to combine two companies that are in the same value chain of producing the same good and service, but the only difference is the stage of production at which they are operating. For example, if a clothing store takes over a textile factory, this would be termed as vertical merger, since the industry is same, i.e. clothing, but the stage of production is different: one firm is works in territory sector, while the other works in secondary sector. These kinds of merger are usually undertaken to secure supply of essential goods, and avoid disruption in supply, since in the case of our example, the clothing store would be rest assured that clothes will be provided by the textile factory. It is also done to restrict supply to competitors, hence a greater market share, revenues and profits. Vertical mergers also offer cost saving and a higher margin of profit, since manufacturer's share is eliminated.

Concentric Mergers

Concentric mergers take place between firms that serve the same customers in a particular industry, but they don't offer the same products and services. Their products may be complements, product which go together, but technically not the same products. For example, if a company that produces DVDs mergers with a company that produces DVD players, this would be termed as concentric merger, since DVD players and DVDs are complements products, which are usually purchased together. These are usually undertaken to facilitate consumers, since it would be easier to sell these products together. Also, this would help the company diversify, hence higher profits. Selling one of the products will also encourage the sale of the other, hence more revenues for the company if it manages to increase the sale of one of its product. This would enable business to offer one-stop shopping, and therefore, convenience for consumers. The two companies in this case are associated in some way or the other.

Usually they have the production process, business markets or the basic technology in common. It also includes extension of certain product lines. These kinds of mergers offer opportunities for businesses to venture into other areas of the industry reduce risk and provide access to resources and markets unavailable previously.

Conglomerate Merger

When two companies that operates in completely different industry, regardless of the stage of production, a merger between both companies is known as conglomerate merger. This is usually done to diversify into other industries, which helps reduce risks.

REASONS BEHIND EACH TYPE OF M&A

There are various reasons as to why a company might to decide to merge or acquire another company, although there has to be a strategic reasoning or logic behind the merger. All the successful mergers and acquisitions have a specific, well thought-out logic behind the strategic move. Mergers and acquisitions usually create value for the company in different ways, some of which are listed below:

Improve the company's performance

This involves improving the performance of the target company, as well as the company itself. It is one of the most important reasons of value-creating strategies of M&A. If another company is taken over, its performance can be radically improves, due to economies of scale. Also, the two companies combined would have a greater impact in the market as they are more likely to capture a greater market share, hence higher revenue and profits. Operating-profit margins can be significantly improved under the new management if wastage and redundancies are removed from the operations.

Remove Excess capacity

In many cases, as industries grow, there comes a point of maturity, which leads to excess capacity in the industry. As more and more companies enter the industries, the supply continues to increase, which brings the prices considerably down. Higher production from existing companies and entry of new companies in the industry disrupts the balance as supply increases more than demand, which lead to a fall in price. In order to correct this, companies merge with or acquire other companies in the industry, hence getting rid of excess capacity in the industry. Factories and plants can be shutdown, since it is no longer profitable to sell at that low a prices. Usually least productive plants or factories are retired in order to bring the balance back to the industry. Reducing excess capacity has a lot of benefits as it extends less tangible forms of capacity in the industry. It makes companies rethink their strategy, and nudges them to work towards improving quality rather than quantity.

Accelerate growth

Mergers and acquisitions are often undertaken to increase the market share. If competitor company is taken over, its share of sales is also absorbed. As the result, the acquirer gets higher sales, revenues and consequently higher profits. Some industries have a mix of very loyal customers, which means that it is very difficult to attract customers from competition by other means, as the industry is highly competitive and consumers are disinclined to make the switch. In such circumstances, merger or acquisition are highly beneficial, since they provide an opportunity to drastically increase market share. It also allows economies of scale, as per unit cost decrease due to higher volume. Smaller players in the market are sometimes taken over to penetrate the market further, where big companies fail to make an impact. Controlling smaller firms in the industry can greatly accelerate sales of those smaller companies' products and services, since a big name is now attached to them. The acquirer also brings in its expertise and experience to bring efficiency to the operations of the target company. The combined company also benefit from exposure to various segments of the industry, which were previously unknown to the acquirer. The new combined company could help introduce new products tailored for the unchartered markets, hence finding new consumers for the same products and services.

Acquire skills and technology

Companies often acquire or merge with other companies in hopes to acquire skills and/or technology of the target company. Some companies control certain technologies exclusively, and it is too costly to develop these technologies from scratch. This means that it is easier to take over a company with the desired technology. A merger / an acquisition provides an opportunity for both companies to combine their technological progress and generate greater value from the sharing of knowledge and technology. These kinds of merger usually lead to innovation and entirely new products and services, hence are beneficial not only to the companies themselves, but to the industry as well. Same goes for skills, which are in certain cases exclusive, and can only be sought out, if the said company is taken over.

Roll-up strategies

Some firms are too small in the market and are highly fragmented, which means they experience higher costs, and it is not feasible for them to keep up operations because there are no economies of scale due to a very small volume. An acquisition is such case is more common and can be hugely beneficial to the target company, as it could keep on operating only with an element of economies of scale. It would also help an acquirer, since it would be able to penetrate smaller fractions of the market, as smaller companies have access to these markets. Hence this kind of merger creates value for both companies, and promises greater efficiency in the operational activities. Advertising campaigns can be coordinated together in order to increase revenues and save on costs.

Encourage competitive behavior

Many companies decide to take over other companies in an attempt to improve the overall competitive behavior in the industry. This is done by eliminating price competition, which leads to improvement in rate of internet return of the industry. If the competition is kept at bay, and new entrants are not allowed, firms don't have to compromise on quality as price is no longer a competing factor. Smaller businesses can only gain share through offering at lower prices, but price competition reduces overall profits for the industry. In order to restore the balance, and invest all effort an energy on quantity, mergers and takeovers are initiated to improve the overall competitive environment in the industry.

LEGAL TERMINOLOGY

Mergers and acquisitions are highly complex, and they most often require authorization from central government organization like competition commissions. There are various legal terminologies used when companies decide to merge as listed below:

Sale of Majority of Assets

In a merger / acquisition of one by another company, one company buys out the majority of assets of the other company. The control is transferred to the acquirer after approval of majority of shareholders of the target company. The acquirer usually only takeover liabilities that are attached to the purchased assets, which means that other liabilities are retained by the target company and paid off by them through their own means. Acquirer may, at times, decides to take up liabilities too. Shareholders have the same rights after the merger, since they are entitles to a divided, which is usually higher after the merger.

Stock for Assets

In this type of transaction, one entity buys outs the other one for a certain number of shares. The target company dissolves, passing all its assets to the acquirer. The control is established after approval from acquirer Company's management. For the target company, vote of approval from majority shareholders is required for the dissolution. All the liabilities attached to the assets of Target Company are passed on to the acquirer company, while all other liabilities are retained by the target company unless acquirer volunteers to take them on as well. Shareholders after the merger are likely to receive a higher dividend.

Stock for Stock

Stock for stock transaction involves two companies, where one entity buys shares in another company from its shareholders. The target's company's assets are passed on to the acquirer, while the target company is run as a subsidiary of the acquirer. A new stock has to be created for this kind of merger, which means that the majority of the acquirer company's shareholders are required to approval the merger. The shareholders of the target company are able to individually decide whether they want to participate or not. The merger entails limited liabilities for the acquirer in terms of target's company liabilities. If shareholders decide not to sell their shares, they might be frozen out.

Merger/Consolidation

This kind of transaction requires the presence of two companies. One company purchased the other, or alternatively both dissolves and become a new company. In this case, both companies require approval from majority of shareholders. The company or the acquirer takes up all rights and all liabilities, some of which are unknown to both corporations. Shareholders retain the right to receive dividends, in addition to retaining dissenter's appraisal rights. This is the most common sort of merger, which basically means that one company is absorbed into the other one. Assets are taken over, while liabilities are cleared at the time of the merger or takeover the acquirer.

Dissolution

Dissolution involves only one corporation, since the company is being dissolved. If the company wants to dissolve voluntarily, it needs the majority vote by shareholders in addition to filing with the state. At times, courts order involuntary dissolution in certain cases such as a deadlock situation. The control is usually held by majority vote by shareholders. In the case of dissolution, all liabilities must be cleared, although any future liability is absolved. Dissolution usually means that the company does not exist anymore, which means its operations are wrapped up during the process dissolution.

Freeze-Out In this case, the majority shareholders attempt to buyout the shares of the minority of shareholder. Only one company is involved, and control is defined by the majority through board approval. The liabilities in this case remain with the company as there is no other party involved. This is mostly done to reaffirm control by the majority shareholders over the operations of the company, since they face no obstacles once the deal goes through.

Tender Offer

This merger is similar to stock for stock, the only difference being the shareholders are offered money in exchange for their shares, after which the target company is dissolved, merged or run as a subsidiary. Management approval is needed since the acquirer usually borrows to finance the merger. While individual shareholders of Target Company may sell at their will, although a controlling percentage of target company's shared is required for this mergers. After the purchase of shares, the acquirer has limited liability in terms of target's company financial obligations. After the merger, shareholders can expect a higher dividend, while shareholders of target have no right, since they are no hold shares.

Triangular Merger

As the name suggest, this merger involves three companies. The first step involves the acquirer company forming a subsidiary, whose only assets are shares of the parent company. The newly formed subsidiary then does a stock for assets or stock for stock as explained above with the target company. Consequently, the target company mergers or completely dissolves.

Process of Merger & Acquisition.

Check your own liquidity and financial health

Before you enter any transaction, determine if you have the financial wherewithal by performing a thorough financial health check. "Since the recession, most organizations have shifted their focus away from profit and loss statements and towards liquidity. That means asking if you have enough liquidity to carry off a transaction successfully. Once you determine if you have the liquidity to make and sustain an investment, then ask if your capital structure can bear the added strain. "If not, assess a range of debt and equity capital funding strategies that will give you the balance sheet you need to be successful in the M&A game,".

Make sure your people can see clearly

Before closing a deal, you'll also want to ensure you have a team in place with the experience to assess a transaction, complete an investment, forecast its performance and tolerate sensitivities around the results. "The ability to envision and solve the challenges (financial and organizational) you will face in integrating the transaction and creating a smoothly functioning new company will be absolutely key," he says. "If not, consider bringing in temporary, specialized executive leadership to help you through. In all, you must be dead sure that the projected benefits, synergies and savings from the transaction can be realized in fact.

Define your goals and success factors

In putting together your M&A strategy, you should analyze both your competitive position as well as your future objectives. “That means understanding what you’re doing with your business, where you want to go and what you value most. “That means making sure you understand what it is you are trying to gain through this transaction.” To do that, start by answering the following questions.

• Is your goal to increase market share?
• Do you want to enter markets contiguous to the ones you already play in?
• Do you want to acquire new products, processes and intellectual capital?
• Do you want to increase your economies of scale so that you can be the low-cost company in your market?
• Perhaps you are trying to eliminate a competitor, expand a product line or achieve a vertical integration.

“Regardless of your goals,, “you should focus on them relentlessly throughout the process and align your decisions with them. The acquisition should be a way to bridge the gap between your company’s current state and the future state you desire for it. These factors become the items to test for in screening prospective targets and then performing due diligence."

Consider M&A candidates

Now that you know what you want out of a merger or acquisition, it’s time to begin the search for the right fit. But what factors should come into your screening process? “One is integration feasibility, meaning: What are the organizational and operational challenges of integrating them? For example, which of the key people would you want to keep, and would they stay? Another integral step in evaluating targets is developing revenue and cost models for the combined organization. Define key success factors to realize value along with “threshold” assumptions and a business forecast to understand what you must achieve for the acquisition to be successful.

It also suggested that as you search for candidates, do your best to avoid becoming too fixed on a particular company. That means keeping your eyes open to potential roadblocks as much as the benefits of a target or, “you may face a surprise and fail to recognize the value you are seeking.

Plan and execute due diligence

When it comes time to evaluate a potential deal, you’ll need to do more than just some simple math or even an “audit lite.” “When done properly, due diligence should test the strategic fit of the acquisition,” “Start by considering your goals for this acquisition and the drivers of the valuation. Knowing what you need to preserve will dictate what you need to test for in due diligence. Your overriding goal is to verify that the value you expect is actually there. It encompasses financial, operational, legal, technology and people due diligence. That you shouldn’t neglect conducting due diligence on the target’s customers, specifically understanding what cements those relationships and how to sustain them once the acquisition goes through.

Create a transition team

“Major transitions require strong leadership; it sets the tone for savings and efficiencies,. “That’s why it is critical to create a transition steering committee and a functional team. These groups, which must include line managers who are close to the action, should engage leaders from both sides of the acquisition and they should set their expectations high and work from a well-defined work plan, revisiting it as conditions on the ground change.

Carefully plan and perform the integration

When it’s finally time to merge the operations, processes and cultures of the two companies, you should, “focus on revalidating all of the plans you have developed since the deal was first considered,” Remember, this is an iterative process: Evaluate what drives value, what is working and what is not. And throughout, remember speed is critical at this stage; delay drives failure and may cost you key people. This is the time to sweat the small stuff, like being sure that acquired employees know how to enter expense reports and check their benefits.”

Other tips for ensuring a smooth transition include establishing milestones and creating incentives plans tied to their completion. “Drive the integration deep into the organization, holding managers responsible for successful execution of each,. “Remember, value is not made when you sign the deal; it is made during integration. More deals fail due to poor integration than any other factor, so begin planning as soon as the target is identified.

Develop your plans according to function and accountability and concentrate on those issues raised during due diligence that threaten your ability to realize value."

Extra tip: Keep in mind the four C's In doing your best to ensure that your M&A transaction fulfills all the goals and objectives you have hoped, the "Four Cs" is use full to keep you on target:

- **Compensate**: If you want existing management to stay, make their targets achievable and compensate appropriately.
- **Communicate**: People on both sides of the transaction should be completely aware of what's going on to help quell rumors and paranoia. People will respond to uncertainty by assuming the worst.
- **Care**: How you react to challenges can make all of the difference. Even small inconveniences can generate ill feelings. Respond quickly and completely.
- **Cull**: If you must say goodbye to any members of management, make your decisions quickly, but carefully.

Legal Procedures to be followed in merger & acquisition.

Laws Regulating Merger

Following are the laws that regulate the merger of the company:-

(I) The Companies Act , 1956

Section 390 to 395 of Companies Act, 1956 deal with arrangements, amalgamations, mergers and the procedure to be followed for getting the arrangement, compromise or the scheme of amalgamation approved. Though, section 391 deals with the issue of compromise or arrangement which is different from the issue of amalgamation as deal with under section 394, as section 394 too refers to the procedure under section 391 etc., all the section are to be seen together while understanding the procedure of getting the scheme of amalgamation approved. Again, it is true that while the procedure to be followed in case of amalgamation of two companies is wider than the scheme of compromise or arrangement though there exist substantial overlapping.

The procedure to be followed while getting the scheme of amalgamation and the important points, are as follows:-

(1) Any company, creditors of the company, class of them, members or the class of members can file an application under section 391 seeking sanction of any scheme of compromise or arrangement. However, by its very nature it can be understood that the scheme of amalgamation is normally presented by the company. While filing an application either under section 391 or section 394, the applicant is supposed to disclose all material particulars in accordance with the provisions of the Act.

(2) Upon satisfying that the scheme is prima facie workable and fair, the Tribunal order for the meeting of the members, class of members, creditors or the class of creditors. Rather, passing an order calling for meeting, if the requirements of holding meetings with class of shareholders or the members, are specifically dealt with in the order calling meeting, then, there won't be any subsequent litigation. The scope of conduct of meeting with such class of members or the shareholders is wider in case of amalgamation than where a scheme of compromise or arrangement is sought for under section 391

(3) The scheme must get approved by the majority of the stake holders viz., the members, class of members, creditors or such class of creditors. The scope of conduct of meeting with the members, class of members, creditors or such class of creditors will be restrictive somewhat in an application seeking compromise or arrangement.

(4) There should be due notice disclosing all material particulars and annexing the copy of the scheme as the case may be while calling the meeting.

(5) In a case where amalgamation of two companies is sought for, before approving the scheme of amalgamation, a report is to be received form the registrar of companies that the approval of scheme will not prejudice the interests of the shareholders.

(6) The Central Government is also required to file its report in an application seeking approval of compromise, arrangement or the amalgamation as the case may be under section 394A.

(7) After complying with all the requirements, if the scheme is approved, then, the certified copy of the order is to be filed with the concerned authorities.

(II) The Competition Act ,2002

Following provisions of the Competition Act, 2002 deals with mergers of the company:-

(1) Section 5 of the Competition Act, 2002 deals with "Combinations" which defines combination by reference to assets and turnover

(a) Exclusively in India and

(b) In India and outside India.

For example, an Indian company with turnover of Rs. 3000 crores cannot acquire another Indian company without prior notification and approval of the Competition Commission. On the other hand, a foreign company with turnover outside India of more than USD 1.5 billion (or in excess of Rs. 4500 crores) may acquire a company in India with sales just short of Rs. 1500 crores without any notification to (or approval of) the Competition Commission being required.

(2) Section 6 of the Competition Act, 2002 states that, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

All types of intra-group combinations, mergers, demergers, reorganizations and other similar transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated in sub-regulation 5(2) of the Regulations. These transactions do not have any competitive impact on the market for assessment under the Competition Act, Section 6.

(III) Foreign Exchange Management Act,1999 The foreign exchange laws relating to issuance and allotment of shares to foreign entities are contained in The Foreign Exchange Management (Transfer or Issue of Security by a person residing out of India) Regulation, 2000 issued by RBI vide GSR no. 406(E) dated 3rd May, 2000. These regulations provide general guidelines on issuance of shares or securities by an Indian entity to a person residing outside India or recording in its books any transfer of security from or to such person. RBI has issued detailed guidelines on foreign investment in India vide "Foreign Direct Investment Scheme" contained in Schedule 1 of said regulation.

(IV) SEBI Takeover Code 1994

SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15% up to 55%, provided the acquirer does not acquire more than 5% of shares or voting rights of the target company in any financial year. [Regulation 11(1) of the SEBI Takeover Regulations] However, acquisition of shares or voting rights beyond 26% would apparently attract the notification procedure under the Act. It should be clarified that notification to CCI will not be required for consolidation of shares or voting rights permitted under the SEBI Takeover Regulations. Similarly the acquirer who has already acquired control of a company (say a listed company), after adhering to all requirements of SEBI Takeover Regulations and also the Act, should be exempted from the Act for further acquisition of shares or voting rights in the same company.

(V) The Indian Income Tax Act (ITA), 1961

Merger has not been defined under the ITA but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger has been given a special treatment in the Income-tax Act since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. As per Finance Minister this has been done to accelerate internal liberalization. Certain provisions applicable to mergers/demergers are as under: Definition of Amalgamation/Merger — Section 2(1B).

Amalgamation means merger of either one or more companies with another company or merger of two or more companies to form one company in such a manner that:

(1) All the properties and liabilities of the transferor company/companies become the properties and liabilities of Transferee Company.

(2) Shareholders holding not less than 75% of the value of shares in the transferor company (other than shares which are held by, or by a nominee for, the transferee company or its subsidiaries) become shareholders of the transferee company.

The following provisions would be applicable to merger only if the conditions laid down in section 2(1B) relating to merger are fulfilled:

(1) Taxability in the hands of Transferee Company — Section 47(vi) & section 47

(a) The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on merger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vii)]

(b) In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company. [Section 49(2).

(VI) Mandatory permission by the courts

Any scheme for mergers has to be sanctioned by the courts of the country. The company act provides that the high court of the respective states where the transferor and the transferee companies have their respective registered offices have the necessary jurisdiction to direct the winding up or regulate the merger of the companies registered in or outside India.

The high courts can also supervise any arrangements or modifications in the arrangements after having sanctioned the scheme of mergers as per the section 392 of the Company Act. Thereafter the courts would issue the necessary sanctions for the scheme of mergers after dealing with the application for the merger if they are convinced that the impending merger is “fair and reasonable”.

The courts also have a certain limit to their powers to exercise their jurisdiction which have essentially evolved from their own rulings. For example, the courts will not allow the merger to come through the intervention of the courts, if the same can be effected through some other provisions of the Companies Act; further, the courts cannot allow for the merger to proceed if there was something that the parties themselves could not agree to; also, if the merger, if allowed, would be in contravention of certain conditions laid down by the law, such a merger also cannot be permitted. The courts have no special jurisdiction with regard to the issuance of writs to entertain an appeal over a matter that is otherwise “final, conclusive and binding” as per the section 391 of the Company act.

(VII) Stamp duty

Stamp act varies from state to State. As per Bombay Stamp Act, conveyance includes an order in respect of amalgamation; by which property is transferred to or vested in any other person. As per this Act, rate of stamp duty is 10 per cent.

Intellectual Property Due Diligence In Mergers And Acquisitions

The increased profile, frequency, and value of intellectual property related transactions have elevated the need for all legal and financial professionals and Intellectual Property (IP) owner to have thorough understanding of the assessment and the valuation of these assets, and their role in commercial transaction. A detailed assessment of intellectual property asset is becoming an increasingly integrated part of commercial transaction. Due diligence is the process of investigating a party’s ownership, right to use, and right to stop others from using the IP rights involved in sale or merger ---the nature of transaction and the rights being acquired will determine the extent and focus of the due diligence review. Due Diligence in IP for valuation would help in building strategy.

Where in:-

(a) If Intellectual Property asset is underplayed the plans for maximization would be discussed.

(b) If the Trademark has been maximized to the point that it has lost its cachet in the market place, reclaiming may be considered.

(c) If mark is undergoing generalization and is becoming generic, reclaiming the mark from slipping to generic status would need to be considered.

(d) Certain events can devalue an Intellectual Property Asset, in the same way a fire can suddenly destroy a piece of real property. These sudden events in respect of IP could be adverse publicity or personal injury arising from a product. An essential part of the due diligence and valuation process accounts for the impact of product and company-related events on assets – management can use risk information revealed in the due diligence.

(e) Due diligence could highlight contingent risk which do not always arise from Intellectual Property law itself but may be significantly affected by product liability and contract law and other non Intellectual Property realms. Therefore Intellectual Property due diligence and valuation can be correlated with the overall legal due diligence to provide an accurate conclusion regarding the asset present and future value.

Legal Procedure For Bringing About Merger of Companies

(1) Examination of object clauses:

The MOA of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the shareholders, board of directors, and company law board are required.

(2) Intimation to stock exchanges:

The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders should be mailed to the concerned stock exchanges.

(3) Approval of the draft merger proposal by the respective boards:

The draft merger proposal should be approved by the respective BOD's. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.

(4) Application to high courts:

Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of shareholders and creditors for passing the merger proposal.

(5) Dispatch of notice to shareholders and creditors:

In order to convene the meetings of shareholders and creditors, a notice and an explanatory statement of the meeting, as approved by the high court, should be dispatched by each company to its shareholders and creditors so that they get 21 days advance intimation. The notice of the meetings should also be published in two newspapers.

(6) Holding of meetings of shareholders and creditors:

A meeting of shareholders should be held by each company for passing the scheme of mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. Same applies to creditors also.

(7) Petition to High Court for confirmation and passing of HC orders:

Once the mergers scheme is passed by the shareholders and creditors, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.

(8) Filing the order with the registrar:

Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.

(9) Transfer of assets and liabilities:

After the final orders have been passed by both the HC's, all the assets and liabilities of the merged company will have to be transferred to the merging company.

(10) Issue of shares and debentures:

The merging company, after fulfilling the provisions of the law, should issue shares and debentures of the merging company. The new shares and debentures so issued will then be listed on the stock exchange.

Waiting Period in Merger

International experience shows that 80-85% of mergers and acquisitions do not raise competitive concerns and are generally approved between 30-60 days. The rest tend to take longer time and, therefore, laws permit sufficient time for looking into complex cases. The International Competition Network, an association of global competition authorities, had recommended that the straight forward cases should be dealt with within six weeks and complex cases within six months.

The Indian competition law prescribes a maximum of 210 days for determination of combination, which includes mergers, amalgamations, acquisitions etc. This however should not be read as the minimum period of compulsory wait for parties who will notify the Competition Commission.

In fact, the law clearly states that the compulsory wait period is either 210 days from the filing of the notice or the order of the Commission, whichever is earlier. In the event the Commission approves a proposed combination on the 30th day, it can take effect on the 31st day. The internal time limits within the overall gap of 210 days are proposed to be built in the regulations that the Commission will be drafting, so that the over whelming proportion of mergers would receive approval within a much shorter period.

The time lines prescribed under the Act and the Regulations do not take cognizance of the compliances to be observed under other statutory provisions like the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('SEBI Takeover Regulations'). SEBI Takeover Regulations require the acquirer to complete all procedures relating to the public offer including payment of consideration to the shareholders who have accepted the offer, within 90 days from the date of public announcement. Similarly, mergers and amalgamations get completed generally in 3-4 months' time. Failure to make payments to the shareholders in the public offer within the time stipulated in the SEBI Takeover Regulations entails payment of interest by the acquirer at a rate as may be specified by SEBI. [Regulation 22(12) of the SEBI Takeover Regulations] It would therefore be essential that the maximum turnaround time for CCI should be reduced from 210 days to 90 days.

Conclusion

With the FDI policies becoming more liberalized, Mergers, Acquisitions and alliance talks are heating up in India and are growing with an ever increasing cadence. They are no more limited to one particular type of business. The list of past and anticipated mergers covers every size and variety of business -- mergers are on the increase over the whole marketplace, providing platforms for the small companies being acquired by bigger ones. The basic reason behind mergers and acquisitions is that organizations merge and form a single entity to achieve economies of scale, widen their reach, acquire strategic skills, and gain competitive advantage. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits, which in façade depends on the kind of companies being merged. Indian markets have witnessed burgeoning trend in mergers which may be due to business consolidation by large industrial houses, consolidation of business by multinationals operating in India, increasing competition against imports and acquisition activities. Therefore, it is ripe time for business houses and corporates to watch the Indian market, and grab the opportunity.

Impact of Mergers and Acquisitions

Mergers and acquisitions bring a number of changes within the organization. The size of the organizations change, its stocks, shares and assets also change, even the ownership may also change due to the mergers and acquisitions. The mergers and acquisitions play a major role on the activities of the organizations. However, the impact of mergers and acquisitions varies from entity to entity; it depends upon the group of people who are being discussed here. The impact of mergers and acquisitions also depend on the structure of the deal.

Possible Impact of Mergers and Acquisitions

Have a look at the impact of Mergers and Acquisitions on different segments of business impacts on Employees Mergers and acquisitions may have great economic impact on the employees of the organization. In fact, mergers and acquisitions could be pretty difficult for the employees as there could always be the possibility of layoffs after any merger or acquisition. If the merged company is pretty sufficient in terms of business capabilities, it doesn't need the same amount of employees that it previously had to do the same amount of business. As a result, layoffs are quite inevitable. Besides, those who are working would also see some changes in the corporate culture. Due to the changes in the operating environment and business procedures, employees may also suffer from emotional and physical problems.

Impact on Management

The percentage of job loss may be higher in the management level than the general employees. The reason behind this is the corporate culture clash. Due to change in corporate culture of the organization, many managerial level professionals, on behalf of their superiors, need to implement the corporate policies that they might not agree with. It involves high level of stress.

Impact on Shareholders

Impact of mergers and acquisitions also include some economic impact on the shareholders. If it is a purchase, the shareholders of the acquired company get highly benefited from the acquisition as the acquiring company pays a hefty amount for the acquisition. On the other hand, the shareholders of the acquiring company suffer some losses after the acquisition due to the acquisition premium and augmented debt load.

Impact on Competition

Mergers and acquisitions have different impact as far as market competitions are concerned. Different industry has different level of competitions after the mergers and acquisitions. For example, the competition in the financial services industry is relatively constant. On the other hand, change of powers can also be observed among the market players.

Here are a few important factors and reasons why merger and acquisition deals fail.

Limited or no involvement from the owners: Appointing M&A advisors at high costs for various services is almost mandatory for any mid to large size deal. But leaving everything to them just because they get a high fee is a clear sign leading to failure. Advisors usually have a limited role, till the deal is done. Following that, the new entity is the onus of the owner. Owners should be involved right from the start and rather drive and structure the deal on their own, letting advisors take the assistance role. Among others, the inherent benefit will be tremendous knowledge-gaining experience for the owner, which will be a lifelong benefit.

Theoretical valuation vs. the practical proposition of future benefits: The numbers and assets that look good on paper may not be the real winning factors once the deal is through. The failed case of Bank of America's acquisition of Countrywide is a typical example.

Lack of clarity and execution of the integration process: A major challenge for any M&A deal is the post-merger integration. A careful appraisal can help to identified key employees, crucial projects and products, sensitive processes and matters, impacting bottlenecks, etc. Using these identified critical areas, efficient processes for clear integration should be designed, aided by consulting, automation or even outsourcing options being fully explored.

Cultural integration issue.. This factor is also quite evident in global M&A deals, and a proper strategy should be devised either to go for hard-decision forceful integration setting aside cultural differences, or allowing the regional/local businesses run their respective units, with clear targets and strategy on profit making.

Required capacity potential vs. current bandwidth: The deals with purpose of expansion require an assessment of current firm's capacity to integrate and build upon the larger business. Are your existing firm's resources already fully or over utilized, leaving no bandwidth for the future to make the deal a success? Have you allocated dedicated resources (including yourself) to fill in the necessary gaps, as per the need? Have you accounted for time, effort and money needed for unknown challenges which may be identified in the future?

Actual cost of a difficult integration & high cost of recovery: Keeping bandwidth and resources ready with correct strategies which can surpass the potential costs and challenges of integration could have helped. Investments today in a difficult integration spread over the next few years may be difficult to recover in the long run.

Negotiations errors: Cases of overpaying for an acquisition (with high advisory fee) are also rampant in executing M&A deals, leading to financial losses and hence failures.

External factors and changes to the business environment: The Bank of America/Countrywide failure was also due to the overall financial sector collapsing, with mortgage companies being the worst hit. External factors may not be fully controllable, and the best approach in such situations is to look forward and cut further losses, which may include completely shutting down the business or taking similar hard decisions.

Assessment of alternatives: Instead of buying to expand with an aim to surpass competitors, is it worth considering being a sale target and exit with better returns to start something new? It helps to consider extreme options which may prove more profitable, instead of holding onto the traditional thoughts.

The backup plan: With more than 50% of M&A deals failing, it's always better to keep a backup plan to disengage in a timely manner (with/without a loss), to avoid further losses. The above mentioned examples although are cited as failed, but they do seem to have executed the de-merger in a timely manner.

Takeover

In business, a takeover is the purchase of one company (the target) by another (the acquirer, or bidder). In the UK, the term refers to the acquisition of a public company whose shares are listed on a stock exchange, in contrast to the acquisition of a private company.

Friendly takeovers

A "friendly takeover" is an acquisition which is approved by the management. Before a bidder makes an offer for another company, it usually first informs the company's board of directors. In an ideal world, if the board feels that accepting the offer serves the shareholders better than rejecting it, it recommends the offer be accepted by the shareholders.

In a private company, because the shareholders and the board are usually the same people or closely connected with one another, private acquisitions are usually friendly. If the shareholders agree to sell the company, then the board is usually of the same mind or sufficiently under the orders of the equity shareholders to cooperate with the bidder.

Hostile takeover.

A "hostile takeover" allows a bidder to take over a target company whose management is unwilling to agree to a merger or takeover. A takeover is considered "hostile" if the target company's board rejects the offer, and if the bidder continues to pursue it, or the bidder makes the offer directly after having announced its firm intention to make an offer.

A hostile takeover can be conducted in several ways. A tender offer can be made where the acquiring company makes a public offer at a fixed price above the current market price. . An acquiring company can also engage in a proxy fight, whereby it tries to persuade enough shareholders, usually a simple majority, to replace the management with a new one which will approve the takeover. Another method involves quietly purchasing enough stock on the open market, known as a "creeping tender offer", to affect a change in management. In all of these ways, management resists the acquisition, but it is carried out anyway.

The main consequence of a bid being considered hostile is practical rather than legal. If the board of the target cooperates, the bidder can conduct extensive due diligence into the affairs of the target company, providing the bidder with a comprehensive analysis of the target company's finances. In contrast, a hostile bidder will only have more limited, publicly available information about the target company available, rendering the bidder vulnerable to hidden risks regarding the target company's finances. An additional problem is that takeovers often require loans provided by banks in order to service the offer, but banks are often less willing to back a hostile bidder because of the relative lack of target information which is available to them.

A well-known example of an extremely hostile takeover was Oracle's hostile bid to acquire PeopleSoft.

Reverse takeovers

A "reverse takeover" is a type of takeover where a private company acquires a public company. This is usually done at the instigation of the larger, private company, the purpose being for the private company to effectively float itself while avoiding some of the expense and time involved in a conventional IPO.

An individual or organization, sometimes known as a corporate raider, can purchase a large fraction of the company's stock and, in doing so, get enough votes to replace the board of directors and the CEO. With a new agreeable management team, the stock is a much more attractive investment[why?], which would likely result in a price rise and a profit for the corporate raider and the other shareholders.

Backflip takeovers

A "backflip takeover" is any sort of takeover in which the acquiring company turns itself into a subsidiary of the purchased company. This type of takeover can occur when a larger but less well-known company purchases a struggling company with a very well-known brand.

Examples include:

The Texas Air Corporation takeover of Continental Airlines but taking the Continental name as it was better known.

NationsBank's takeover of the Bank of America, but adopting Bank of America's name.

Financing a takeover

Funding Often a company acquiring another pays a specified amount for it. This money can be raised in a number of ways. Although the company may have sufficient funds available in its account, remitting payment entirely from the acquiring company's cash on hand is unusual. More often, it will be borrowed from a bank, or raised by an issue of bonds. Acquisitions financed through debt are known as leveraged buyouts, and the debt will often be moved down onto the balance sheet of the acquired company. The acquired company then has to pay back the debt. This is a technique often used by private equity companies. The debt ratio of financing can go as high as 80% in some cases. In such a case, the acquiring company would only need to raise 20% of the purchase price.

Loan note alternatives.

Cash offers for public companies often include a "loan note alternative" that allows shareholders to take a part or all of their consideration in loan notes rather than cash. This is done primarily to make the offer more attractive in terms of taxation. A conversion of shares into cash is counted as a disposal that triggers a payment of capital gains tax, whereas if the shares are converted into other securities, such as loan notes, the tax is rolled over.

All share deals

A takeover, particularly a reverse takeover, may be financed by an all share deal. The bidder does not pay money, but instead issues new shares in itself to the shareholders of the company being acquired. In a reverse takeover the shareholders of the company being acquired end up with a majority of the shares in, and so control of, the company making the bid. The company has managerial rights.

All-cash deals

If a takeover of a company consists of simply an offer of an amount of money per share, (as opposed to all or part of the payment being in shares or loan notes) then this is an all-cash deal. This does not define how the purchasing company sources the cash- that can be from existing cash resources; loans; or a separate issue of shares.

Pros and cons of takeover.

While pros and cons of a takeover differ from case to case, there are a few reoccurring ones worth mentioning.

Pros:

1. Increase in sales/revenues (e.g. Procter & Gamble takeover of Gillette)
2. Venture into new businesses and markets
3. Profitability of Target Company
4. Increase market share
5. Decreased competition (from the perspective of the acquiring company)
6. Reduction of overcapacity in the industry
7. Enlarge brand portfolio (e.g. L'Oréal's takeover of Body Shop)
8. Increase in economies of scale
9. Increased efficiency as a result of corporate synergies/redundancies (jobs with overlapping responsibilities can be eliminated, decreasing operating costs)
10. Expand strategic distribution network

Cons:

1. Goodwill, often paid in excess for the acquisition
2. Culture clashes within the two companies causes employees to be less-efficient or despondent
3. Reduced competition and choice for consumers in oligopoly markets (Bad for consumers, although this is good for the companies involved in the takeover)
4. Likelihood of job cuts
5. Cultural integration/conflict with new management
6. Hidden liabilities of target entity
7. The monetary cost to the company
8. Lack of motivation for employees in the company being bought.
9. Domination of a subsidiary by the parent company, often causing the corporate veil to be pierced

Takeovers also tend to substitute debt for equity. In a sense, any government tax policy of allowing for deduction of interest expenses but not of dividends has essentially provided a substantial subsidy to takeovers. It can punish more-conservative or prudent management that do not allow their companies to leverage themselves into a high-risk position. High leverage will lead to high profits if circumstances go well, but can lead to catastrophic failure if circumstances do not go favorably. This can create substantial negative externalities for governments, employees, suppliers and other stakeholders.

Anti-takeover tactics

In order to resist such takeover, the target company's management and board of directors may adopt several anti-takeover tactics in one of the following forms:

1. A company might allot its equity shares or convertible securities on a preferential basis, thereby giving rights to the holder to convert its shares any time into the equity stake of the company, thereby, diluting the ownership in the firm and making the takeover unfavorable for the acquiring firm.
2. The target company may be amalgamated with the other company promoted by the same group to form a larger company. By doing so, the acquisition becomes expensive, and thus, the acquirer finds difficult to acquire the bigger firm relative to the smaller firm.
3. If the company finds, that it possesses certain valuable assets or other belongings which are the cause for such an acquisition, may sell those and become less lucrative for the acquiring firm. This strategy is called as "selling crown jewels."
4. A company may seek help from its friends or find a white knight who might rescue the target firm from the clutches of the acquirer.

Apart from these anti-takeover defenses, there are several other defensive tactics adopted by the firms worldwide. These are as follows:

1.Poison Pill
2.Golden Parachute
3.Greenmail
4.Pacman Defense
5.Staggered Board
6.White Knight
7. Equity carve out

However, when both the companies consider the takeover as a positive step taken towards the success of both the businesses individually, is said to have opted for a friendly takeover often called as an acquisition.

Poison Pill

Definition: The Poison Pill is the anti-takeover tactic adopted by the firm to discourage a hostile takeover, by making the stock unfavorable for the corporate raider, who has given the hostile bid.

Poison Pill Strategies

1. **Flip in**: This strategy enables the existing shareholders of the target company to buy additional shares at a high discount rate. This poison pill is effective when the acquiring firm holds more than 20% share of the target firm's stock and occurs before the merger has been finalized.
2. **Flip Over**: This strategy offers the existing shareholders of the target company to buy additional shares of a new company (so formed after the merger) at substantial discount rates.
3. **Preferred stock plans:** There is a preferred stock registered with the securities and exchange commission against which the common shareholders get dividends. There is a special clause that preferred stock can be converted into the common stock after the takeover. Therefore, such poison pill increases the cost of merger and dilutes the ownership of the acquiring company.
4. **Poison Puts**: These are the special bonds given to the investors who can realize cash against these anytime before their maturity. If the target firm is engaged in the takeover attempts, then the acquiring company would have an immense pressure to arrange the fund to pay off the put owners.
5. **Back-end Plans:** This strategy enables the existing shareholders of the target company to convert their debts into cash at the price pre-determined by the management of the company. By doing so, the takeover is made

6. much more expensive and unfavorable for the acquiring firm.

Thus, the target firm can choose either of the poison pill strategies to make the hostile takeover highly expensive or unfavorable**.**

Golden Parachute

Definition: The Golden Parachute is an agreement between the company and the top executive(s), that he will be paid lucrative benefits in the event when a company is taken over by the other firm, and his employment gets terminated, as a consequence of merger or acquisition.

In other words, golden parachute is a clause in the employment contract, generally of top key executives, that employee will receive certain significant benefits as an inducement for early employment termination from the company due to a takeover. Benefits given to the employees include stock options, severance pay, cash bonuses or other benefits.

The golden parachute is a disputed concept. Supporters believe that this clause helps in hiring or retaining the top level executives, due to the lucrative benefits attached to it. These benefits enable an individual to remain objective in the firm, in case a firm is involved in a merger or takeover activities.

Also, the golden parachute contracts can be used as an anti-takeover measure taken by the company to discourage the takeover or a merger by any other firm, due to the huge cost associated with these contracts.

But however, opponents believe that it is the legal duty of every employee (including top executives) to act in the best interest of the company and, therefore, should not be given additional benefits to remain objective and perform activities that are advantageous for the company. Also, the top executives are already paid handsome salaries and should not be given any extra benefits in case of their early termination from the company.

Greenmail

Definition: The Greenmail is the anti-takeover tactic undertaken when the target firm buys back its own shares at an inflated price from the unfriendly firm which possesses a large stock of the target company and is threatening a hostile takeover.

In other words, the money given by the target firm to another company, called as a corporate raider to buy back its own shares in order to prevent the takeover bid is called as a greenmail.

The target company is forced to pay a substantial premium to get the control over its own shares. This strategy is also called as “bon voyage bonus” or a “goodbye kiss”.

Greenmail is like blackmail, wherein the corporate raider demands a ransom amount to release the control over the target company’s stock. Actually, the corporate raider has no intention of buying the target company; it just wants to make a profit from the costly buy backs.

On the acceptance of greenmail payment, the corporate raider stops chasing the takeover and do not buy any shares of the target company for a specified time period. Although the target company gets control over its own shares, it may end up with the considerable amount of additional debt, which might have been taken to finance the greenmail.

Pac-Man Defense

Definition: The Pac-Man Defense is a defensive mechanism used against the hostile takeover, wherein the target firm turns around the table and acquires the firm that has made the hostile bid or has initiated the takeover.

In other words, a defensive strategy in which the firm facing the threat of hostile takeover “turns the tables” by acquiring its would-be buyer. This defense strategy has got its name from the popular video game Pac-Man, in which the Pac-Man initial objective is to escape the ghosts chasing him and once he consumes the power pill, he is able to turn around and eat the ghosts that are trying to eat him in a maze.

If any firm makes an aggressive or hostile bid on any other publicly traded company, which is not acceptable to the target firm, then it may use all the possible methods to take over the acquiring company. Such as, the target company may purchase the acquiring company’s stock by using its war chest.

What is War Chest? The war chest is the buffer of cash maintained by the company and is kept aside to be used against the uncertain adverse events.

A war chest is usually invested in the liquid assets such as Treasury bills, bank deposits, etc. that are readily available on demand. Thus, it is generally used in the acquisition and takeover of another company or businesses and hence, the Pac-Man defense strategy also makes use of these funds to resist the hostile takeover.

Staggered Board

Definition: The Staggered Board is the board comprising of three equal classes of the board of directors who are elected on an annual basis. In other words, the staggered board is the governance practice in which certain members, generally one-third of the total board of directors are elected each year, rather than all at once.

The major advantage of a staggered board over the traditionally elected board is that it helps in preventing the hostile takeover. When any hostile bidder attempts to acquire any company with the staggered board has to wait for at least one year, until the next annual meeting of shareholders takes place, before he can enjoy control over the target firm.

The other obstacle for the bidder is that he can win only two or three seats on the staggered board and has to wait for the time till the election for those seats occurs. Even though the hostile bidder wins one seat on the board; the other board members may defend their company from the takeover by implementing any poison pill strategy to terminate the intention of a bidder in the midway.

Thus, the staggered board is an anti-takeover tactic that a company uses in order to protect itself from the undesirable bidders. But however, this arrangement of the board of directors might reduce the shareholder returns significantly. As most of the times, the bidder's offer premium to the shareholders for their shares and thus, the latter earn more money in return for their shares after a hostile bid than what they would have been earning before the takeover. Hence, the takeover is sometimes good to have an increased returns.

Equity Carve out - **Definition:** The Equity Carve out is the corporate strategy wherein the company sells a portion or a division in a wholly owned subsidiary through the IPOs and retain the full control over the management. Under this arrangement, limited shares are offered to the public, while the majority stake is retained by the parent company.

Usually, more than 50% shares are held by the parent company with the intent to exercise control over the management of the subsidiary, so formed. The parent company may distribute its shares either among the existing shareholders of the new company or list them on the stock exchange so that it could be purchased by the potential investors.

Another form of equity carve out is spin-off, but, however, both are different from each other. In the case of a spin-off, the shares of the spun-off company are distributed among the existing shareholders of the parent company, while in the case of equity carve out the shares are distributed to new potential investors.

Another difference between these two is, the equity carve out brings cash into the parent company whereas in spin-off no such cash is infused into the base company.

The companies adopt the equity carve out strategy to enhance the business value by disposing of the less profitable business undertakings and realizing cash that can be used in improving the core business activities.

Going Private

Listed firms go private through a leveraged buyout (LBO)—for example, a management buyout or an institutional buyout).

Reasons for going private are the value of the tax shield, increased incentives for management through equity ownership, to reduce cash flows, to avoid the direct and indirect costs of maintaining a listing, or as an anti-takeover device.

At announcement of the LBO of a listed firm, the premium (the offer price relative to the pre-buyout share price) amounts to about 40% and abnormal returns to about 25%.

Good candidates for LBOs have stable cash flows, low and predictable capital investment needs, a liquid balance sheet with collateralizable assets, an established market position, and are in a recession-proof industry.

Introduction

When a listed company is acquired and subsequently delisted, the transaction is referred to as a public-to-private or going-private transaction. As most such transactions are financed by substantial borrowing, which is used to repurchase most of the outstanding equity, they are called leveraged buyouts (LBOs). An overview of the different types of LBO is given in Table 1. Four categories are generally recognized: management buyouts (MBOs), management buying (MBIs), buying management buyouts (BIMBOs), and institutional buyouts (IBOs)

LBO

Leveraged buyout. Acquisition in which a nonstrategic bidder acquires a listed or non-listed company utilizing funds containing a proportion of debt that is substantially above the industry average. If the acquired company is listed, it is subsequently delisted (in a going-private or public-to-private transaction)

MBO

Management buyout. An LBO in which the target firm's management bids for control of the firm, often supported by a third-party private equity investor

MBI

Management buy-in. An LBO in which an outside management team (often backed by a third-party private equity investor) acquires a company and replaces the incumbent management team

BIMBO

Buy-in management buyout. An LBO in which the bidding team comprises members of the incumbent management team and externally hired managers, often alongside a third-party private equity investor.

IBI

Institutional buy-in. An LBO in which an institutional investor or private equity house acquires a company. Incumbent management can be retained and may be rewarded with equity participation

Reverse LBO

A transaction in which a firm that was previously taken private reobtains public status through a secondary initial public offering (SIPO)

Why Do Listed Firms Go Private?

Reduction of Stockholder-Related Agency Costs

The central dilemma of principal-agent models is how to get the manager (the agent) to act in the best interests of the stockholders (the principals) when the agent has interests that diverge from those of the principals and an informational advantage.

•The incentive realignment hypothesis states that the gains in stockholder wealth that arise from going private are a result of providing more rewards for managers (through an increased ownership stake) that induce them to act in line with the interests of investors. Furthermore, in the case of an institutional buyout, the concentration of ownership leads to improved monitoring of management.

•The free cash flow hypothesis suggests that the expected stock returns follow from debt-induced mechanisms that force managers to pay out free cash flows. Free cash flow is the cash flow in excess of that required to fund all projects that have positive net present value (NPV) when discounted at the appropriate cost of capital. The high leverage does not allow managers to grow the firm beyond its optimal size (so-called "empire building") and at the expense of value creation.

Tax Benefits

The substantial increase in cash flow creates a major tax shield, which increases the pre-transaction (or pre-recapitalization) value. After the buyout, firms pay almost no tax for a period of at least five years. Consequently, the (new) stockholders gain, but the government loses out.

Reduction of Transaction Costs

The cost of maintaining a stock exchange listing is very high. Although the direct costs (fees paid to the stock exchange) are relatively small, the indirect costs of being listed are substantial (for example the cost of complying with corporate governance/transparency regulations, which requires larger accounting/legal departments, the cost of investor relations managers, and the cost of management time in general, etc.). For a medium-sized listed company these indirect costs are estimated at US$750,000–1,500,000 annually. The going-private transaction eliminates many of the transaction costs. in particular

Defense against Takeover

Afraid of losing their jobs if a hostile suitor takes control, the management may decide to take the company private. Thus, an MBO is the ultimate defensive measure against a hostile stockholder or tender offer.

Undervaluation

As a firm is a portfolio of projects, there may be asymmetric information between the management and outsiders concerning the maximum value that can be realized with the assets in place. If management believes that the share price is undervalued in relation to the firm's true potential, they may privatize the firm through an MBO. Alternatively, if an external party believes that it is able to generate more value with the assets of the firm, the firm may be taken over by means of an IBO or MBI.

'Spinoff'

A spinoff is the creation of an independent company through the sale or distribution of new shares of an existing business or division of a parent company. A spinoff is a type of divestiture. Businesses wishing to streamline their operations often sell less productive or unrelated subsidiary businesses as spinoffs. For example, a company might spin off one of its mature business units that is experiencing little or no growth so it can focus on a product or service with higher growth prospects. The spun-off companies are expected to be worth more as independent entities than as parts of a larger business.

BREAKING DOWN 'Spinoff'

Spinoffs are a common occurrence; there are typically about 50 per year in the United States. You may be familiar with Expedia's spinoff of TripAdvisor in 2011, United Online's spinoff of FTD companies in 2013 or Sears Holding Corporation's spinoff of Sears Canada in 2012, to name just a few examples.

A corporation creates a spinoff by distributing 100% of its ownership interest in that business unit as a stock dividend to existing shareholders. It can also offer its existing shareholders a discount to exchange their shares in the parent for shares of the spinoff. For example, an investor could exchange $100 of the parent's stock for $110 of the spinoff's stock. Spinoffs tend to increase returns for shareholders because the newly independent companies can better focus on their specific products or services. Both the parent and the spinoff tend to perform better as a result of the spinoff transaction, with the spinoff being the greater performer.

The downside of spinoffs is that their share prices can be more volatile and can tend to underperform in weak markets and outperform in strong markets. They can also experience high selling activity; shareholders of the parent may not want the shares of the spinoff they received because it may not fit their investment criteria. Share price may dip in the short term because of this selling activity, even if the spinoff's long-term prospects are positive.

Divestiture

A divestiture is the partial or full disposal of a business unit through sale, exchange, closure or bankruptcy. A divestiture most commonly results from a management decision to cease operating a business unit because it is not part of a core competency. However, it may also occur if a business unit is deemed to be redundant after a merger or acquisition, if the disposal of a unit increases the resale value of the firm, or if a court requires the sale of a business unit to improve market competition.

BREAKING DOWN 'Divestiture'

A divestiture, in its simplest form, is the disposition or sale of an asset by a company. Divestitures are essentially a way for a company to manage its portfolio of assets. As companies grow, they may find that they are trying to focus on too many lines of business, and they must close some operational units to focus on more profitable lines. Many conglomerates face this problem.

Companies may also sell off business lines if they are under financial duress. For example, an automobile manufacturer that sees a significant and prolonged drop in competitiveness may sell off its financing division to pay for the development of a new line of vehicles. Business units that are divested may be spun off into their own companies rather than closed in bankruptcy or a similar outcome.

Examples of Divestitures

Divestitures can come about in many different forms. However, the most common is the sale of a business unit to improve financial performance. For example, Thomas Reuters Corporation, a multinational mass media and information company based in Canada, sold its intellectual property and sciences (IP&S) division on July 14, 2016. Thomas Reuters initiated the divestiture because it wanted to reduce the amount of leverage on its balance sheet.

The division was purchased by Onex and Baring Private Equity for $3.55 billion in cash. The IP&S division booked sales of $1.01 billion in 2015, and 80% of those sales are recurring, making it an attractive investment for the private equity firm. The divestiture represented one-fourth of Thomas Reuters' business in terms of divisions, but it is not expected to alter the company's overall valuation.

Divestitures can also come about due to necessity. One of the most famous cases of court-ordered divestiture involves the breakup of the Bell System in 1982. The U.S. government determined that Bell controlled too large a portion of the nation's telephone service and brought anti-trust charges in 1974. The divestiture created several new telephone companies, including AT&T and the so-called Baby Bells, as well as new equipment manufacturers.

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Refinancing

Mr. Ramakrishna Mishra, Associate Prof. – Finance

Things change. Sometimes that means a loan needs to change, and refinancing is the way to do that. To refinance a loan is to replace it with a new loan, usually a loan with better features. That doesn't mean the debt goes away – it just gets moved to a different loan.

Definition

Paying off an existing loan with the proceeds from a new loan, usually of the same size, and using the same property as collateral. In order to decide whether this is worthwhile, the savings in interest must be weighed against the fees associated with refinancing. The difficult part of this calculation is predicting how much the up-front money would be worth when the savings are received. Other reasons to refinance include reducing the term of a longer mortgage, or switching between a fixed-rate and an adjustable-rate mortgage.

If there are prepayment fees attached to the existing mortgage, refinancing becomes less favorable because of the increased cost to the borrower at the time of the refinancing.

Refinancing is the process of swapping out loans, moving debt to a different loan or lender.

The process is briefly described below:

With an existing loan

1. Apply for a new loan

2. The new loan pays off the existing loan

3. You're now left with the new loan

Why do People and Businesses Refinance?

Refinancing is a time-consuming process, and it can be expensive. So why go through the process? There are several potential benefits of refinancing.

Save money: a common reason for refinancing is to save money on interest costs. This generally requires that you refinance into a loan with a lower interest rate than your existing interest rate. Especially with long-term loans and large dollar amounts, lowering the interest rate can result in significant savings.

Improve cash flow: refinancing can lead to lower payments (such as your required monthly mortgage payment). This makes cash flow management easier and leaves more money in the budget for other monthly expenses. When you refinance, it's often the case that you extend the amount of time that you'll repay a loan – this means lower monthly payments.

A lower interest rate (with all other things staying the same) can also lead to lower monthly payments. However, simply extending the life of a loan can actually mean you'll pay more for the loan over the long term.

Shorten your loan term: you can also refinance into a shorter term loan. For example, you might have a 30-year home loan, but that loan can be refinanced into a 15-year home loan. This might make sense if you intend to make larger payments to get rid of the debt more quickly. Of course, you can also just make extra payments without refinancing (and that might make more sense because you'd avoid additional closing costs).

Consolidate debts: if you have multiple loans, it might make sense to consolidate those loans into one single loan – especially if you can get a lower interest rate. It'll be easier to keep track of payments and loans.

Change your loan type: even if you don't get a lower interest rate or monthly payment, it can make sense to refinance for other reasons. For example, if you have a variable rate loan, you might prefer to get a different loan with a fixed rate. This would make sense if rates are low but you expect them to rise.

Pay off a loan that's due: some loans have to be repaid on a specific date, and you might not have the funds available to completely pay off the loan.

In those cases, it might make sense to refinance the loan – pay it off with a new loan – and take more time to pay off the new loan. For example, some business loans are due after a few years, but they can be refinanced into longer-term debt after the business has established itself and shown a history of making on-time payments.

Disadvantages of Refinancing a Loan

Refinancing is not always a good idea. Even if you get a lower interest rate or monthly payment, it could be a mistake to get rid of your existing loans. Evaluate the pros and the cons before you move forward.

Transaction costs: refinancing can be expensive. Especially with loans like home loans, you'll pay closing costs which can add up to thousands of dollars. You want to make sure you'll more than break even before you pay those costs. Even simpler loans from online lenders can include processing and origination fees.

Additional interest costs: when you stretch out a loan over a longer period of time, you pay more interest. You might enjoy lower monthly payments, but that benefit can be erased by the higher lifetime cost of borrowing. Run some numbers to see how much it really costs you to refinance. Get familiar with loan amortization and see how your interest costs change with different loans.

Lost benefits: some loans have important features that will go away if you refinance. For example, federal student loans are more flexible than private student loans if you fall on hard times. Plus, federal loans might be forgiven if your career involves public service. Likewise, a fixed-rate loan might be ideal if interest rates skyrocket – even if you temporarily get a lower rate with a variable rate loan.

What Doesn't Change

Debt: when you refinance, some things change and some things don't. You still have debt – the exact same amount as before (unless you increase the debt due to closing costs or taking cash out).

Collateral: if you used collateral for the loan, that collateral will probably still be at stake (and required) for the new loan. For example, refinancing your home loan means you could still lose the home in foreclosure if you don't make payments. Likewise, your car can be repossessed with most auto loans. Unless you refinance into a personal unsecured loan, the collateral is at risk.

Payments: in most cases, you monthly payment will change when you refinance. You've got a brand new loan, and the payments are calculated with that loan balance, term, and interest rate. To avoid getting caught by surprise, learn how to model a loan yourself (it's easy with online spreadsheets).

Refinancing Institution in India.

Institutions Eligible for Refinance:

State Co-operative Agriculture & Rural Development Banks (SCARDBs)

Regional Rural Bank.

State Co-operative Banks (SCBs)

Commercial Banks (CBs)

State Agricultural Development Finance Companies (ADFCs)

Primary Urban Co-operative Banks

Purposes:

Farm Sector: Investment in agriculture and allied activities such as minor irrigation, farm mechanisation, land development, soil conservation, dairy, sheep rearing, poultry, piggery, plantation/horticulture, forestry, fishery storage and market yards, bio-gas and other alternate sources of energy sericulture, apiculture, animals and animal driven carts, agro-processing, agro-service centres, etc.

Non-Farm Sector: Investment activities of artisans, small-scale industries, tiny sector village and cottage industries, handicrafts, handlooms, powerlooms, etc

Loan Period : Upto a maximum of 15 years

Refinance Windows .

Automatic Refinance Facility (ARF - FS & NFS): Release of refinance without prior sanction for refinance limit upto Rs.20,lakh.

Project based lending.

Criteria for Refinance

Technical Feasibility of the project

Financial viability and bankability

Organizational arrangements for credit supervision

Ultimate Beneficiaries

Although refinance is provided to SCARDBs/SCBs/CBs/RRBs/ADFCs/PUCBs, the ultimate beneficiaries of investment finance may be individuals, proprietary/partnership concerns, companies, state-owned corporations or cooperative societies.

Insolvency and Corporate Reorganization.

PROCESSES AND PROCEDURES

What reorganisation and bankruptcy processes are available for financially troubled debtors. existing legal regime, the main procedures of reorganisation and rehabilitation for companies in financial difficulties include schemes for compromise, arrangements and reconstruction under the Companies Act 1956, or revival and rehabilitation under the Sick Industrial Companies (Special Provisions) Act 1985 (SICA).

There are also guidelines issued by the Reserve Bank of India (RBI) for restructuring of corporates facing distress. The corporate debt Share restructuring (CDR) mechanism was introduced in 2001, a voluntary, non-statutory system that allows a financially distressed company with two or more lenders and debts of more than Rs100 million ($1.6 million) to restructure its debts with the supermajority consent of its lenders.

Is there a stay on creditor enforcement action available?

SICA envisages stay of coercive recovery proceedings including suits, without the express approval of BIFR or the Appellate Authority in terms of section 22(1) of SICA. The protection is automatically available to a sick company from the date of registration of its reference with the BIFR and continues till the continuation of implementation of the sanctioned scheme.

Sarfaesi (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Act 2002), RDDB (Recovery of Debts Due to Banks and Financial Institutions Act 1993) and the SFC Act (State Financial Corporations Act 1951) empower the secured creditors to enforce their security interest in each process. However, in case of proceedings pending under SICA, coercive recovery proceedings – except through the mechanism of Sarfeasi – are not permitted without the express approval off the BIFR or AAIFR (Appellate Authority for Industrial and Financial Reconstruction) as per section 22(1) of SICA.

In cases where winding-up proceedings have been initiated, the pending suits, if any, are stayed under the terms of section 446 of the 1956 Act (section 279 of 2013 Act) and the only option available to the unsecured creditors is to file their claim before the liquidator.

What are the key features of a reorganization plan and how is it approved?

Under SICA, the BIFR may appoint any one of the secured lenders or some independent bank or FI as the operating agency (OA) to formulate a scheme for the revival of the company.

The reorganization or rehabilitation plan under SICA may provide for: the financial reconstruction of the sick industrial company; or the proper management of the sick industrial company by change in or takeover of its management, its amalgamation with any other company, sale or lease of a part or whole of any of its industrial undertaking, the rationalization of managerial personnel and workmen in accordance with law and such other preventive, and remedial measures as may be appropriate.

The said measures may also include: reduction in the interest or rights of the shareholders of the company; Reduction of the debts of the company to a sustainable level and reschedulement of the same to synchronize with the cash flow of the company; relief and concession from statutory creditors; reduction and payment of dues of unsecured creditors; lease of the industrial undertaking of the sick company to any person including a cooperative society formed by the employees of such undertaking; and, sale of the industrial undertaking of the sick industrial company, free from all encumbrances and all liabilities of the company or free from specified encumbrances and liabilities to any person, including a cooperative society formed by the employees of such undertaking.

The scheme prepared by the OA is examined by BIFR and, thereafter, a draft rehabilitation scheme (DRS) is formulated and published by BIFR to seek suggestions and objections from all concerned. The DRS is also required to be circulated to the central government, state government any schedule or other bank, a public FI or state level institution, or any other institution or authority from which any financial assistance has been institution or authority from which any financial assistance has been sought under the DRS, for their consent. In case the DRS has the consent of three quarters or more of the secured creditors, in value terms, then upon sanction by the BIFR, the restructuring of debts in terms of the DRS becomes binding on all concerned. For the purpose of the consent of the said parties, a time period of 60 days is allowed which may further be extended by BIFR by another 60 days. BIFR may, after considering the objections and suggestions of the various parties, sanction the scheme for the revival of the company. The implementation of the sanctioned scheme is monitored by BIFR and a monitoring agency is appointed by BIFR for this. The sanctioned scheme may be modified by the BIFR, and the scheme sanctioned by the BIFR is binding on all the concerned parties.

There is no requirement under the provisions of SICA to seek any specific consent from any of the unsecured creditors. Chapter XIX of the 2013 Act provides for consent by 75% of the secured creditors and 25% of the unsecured creditors for sanctioning the scheme.

Under the Companies Act 1956, in a compromise or arrangement between a company and its creditors or between a company and its members, the Company Court will order a meeting of the creditors (separate class for secured and unsecured) or members to be conducted in such manner as the court directs. If the scheme of compromise or arrangement is approved by creditors representing three quarters in value of the creditors of each class and members of each class, and if the court deems fit, it will sanction the same which will be binding on all the creditors or members, and also on the company (or the liquidator and contributories of the company).

Can a creditor or a class of creditor be crammed down?

In case of a scheme of arrangement (section 391394 of the Companies Act 1956), minority creditors who have less than 25% exposure in the dues of the company can be crammed down and directed to fall in line with the majority of creditors.

In a restructuring scheme sanctioned by the BIFR under SICA, the minority secured lenders (banks and FIs) can be crammed down to accept the terms of restructuring agreed to by the secured lenders representing three quarters or more of them in value terms. Although there is no specific provision dealing with the unsecured creditors for a scheme under SICA but in the interest of the revival of a sick company, the BIFR may reduce the interests of unsecured creditors. However, as per a recent judgment of the Delhi High Court (Continental Carbon India v Modi Rubber 2012) such unsecured creditors may not consent for such reduction in interest and may opt to stand outside of the scheme and seek recovery of their entire dues after the expiry of the scheme period.

Is there a process for facilitating the sale of a distressed debtor's assets or business?

Credit bidding or stalking horse bids are not allowed. For secured assets, where the lenders have a security interest, they can enforce the sale of the secured assets under the provisions of the Sarfaesi Act 2002, without the intervention of the court. If the company is being wound up, the secured creditors can choose to stand out of the proceedings and the amount realised through the sale of the secured assets will be appropriated in accordance with the provisions of the Companies Act. Under the SICA provisions, the sale of assets can only happen in a transparent manner through an asset sale committee constituted under the aegis of the BIFR, through an asset sale committee constituted under the aegis of the BIFR, as is envisaged in a scheme to be sanctioned by the BIFR.

What are the duties of directors of a company in financial difficulty?

SICA requires that, if a company becomes a potentially sick industrial company, its board of directors should declare this (with reasons) to the shareholders by convening a meeting, and to the BIFR by filing a report.

SICA further requires that if a company becomes a sick industrial company, it should file a mandatory reference with BIFR within 60 days of the date of finalization of the accounts for the relevant period, seeking adoption of necessary remedial measures for its revival. In case of noncompliance, the directors of the company are liable for strict penal action.

In a voluntary winding up of the company, the directors of the company are required to make a declaration verified by an affidavit to the effect that they have made full inquiry into the affairs of the company and to the insolvency of the company.

The directors are further required to give a notice of the appointment of the liquidator of the company at its general meeting to the registrar of companies. The directors of the company will cease to exercise all powers of the board, and the managing directors and other fulltime directors will cease to exercise their powers for winding up the company.

In a creditors' voluntary winding up, the directors must convene the meeting of the creditors of the company, where they must present a statement of the position of the company's affairs together with a list of the estimated amount of each creditor's claim.

In the winding up by court the directors have a duty to defend the company in the windingup petition filed by the creditor. The directors will also file a statement on the state of affairs of the company, upon appointment of an official liquidator.

Directors must act honestly, without any negligence and in good faith in the bona fide best interest of the company, or they may be made liable for breach of trust and be required to compensate the company for losses or damages.

As per section 542 of the Companies Act 1956, if in the course of the winding up of a company, it appears that the business of the company has been carried on with intent to defraud creditors of the company or any other persons, the court may direct that the person responsible will be personally liable without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct.

What priority claims are there and is protection available for post- petition credit?

In winding up, the claims of various stakeholders will be settled in order of priority as provided in sections 529A, 530 of the 1956 Act (sections 326 and 327 of the 2013 Act).

The dues of the secured creditors and workers' dues have a priority, on pari passu basis, followed by crown debts and other dues (even if creditors have enforced their security interest under the applicable statutes such as Sarafesi, RDDB, and the State Financial Act).

As per some state enactments, some of the statutory dues (such as VAT) have overriding first charge over the assets of a company, the workers' liabilities and the crown debts, and need to be appropriately dealt with liabilities and the crown debts, and need to be appropriately dealt with prior to the appropriation of any amounts by the secured creditors.

In proceedings pending under SICA, the statute does not provide any priority per se; however, the consent of secured creditors, statutory authorities, for example, who are section 19(1) parties, are specifically sought.

Is there a different regime for banks and other financial institutions?

The Banking Regulation Act 1949 applies to the reorganisation of banks. The RBI has discretionary powers to approve the voluntary amalgamation of two banking companies under the provisions of section 44A of the Banking Regulation Act 1949. Large cooperative banks with paidup share capital and reserves of Rs100,000 ($1,570) were brought under the purview of the Banking Regulation Act 1949 with effect from March 1 1966 and within the ambit of the RBI's supervision.

Section 44A of the Banking Regulation Act 1949 requires that the draft scheme of amalgamation be approved by the shareholders of each banking company through a resolution passed by a majority in number representing two-thirds in value of the shareholders, present in person or by proxy at a meeting called for the purpose. Before convening this meeting, the draft scheme of amalgamation needs to be approved individually by the boards of directors of the two banking companies. Section 44A of the Banking Regulation Act 1949 also requires that after the scheme of amalgamation is approved by the shareholders, it should be submitted to the RBI for sanction.

Tracking stock or Targeted stock

Tracking stock or targeted stock are specialized equity offerings issued by a company that is based on the operations of a wholly owned subsidiary of a diversified firm. Therefore, the tracking stock will be traded at a price related to the operations of the specific division of the company being "tracked". Tracking stock typically has limited or no voting rights.[1] Often, the reason for doing so is to separate a high-growth division from a larger parent company. The parent company and its shareholders remain in control of the subsidiary's or unit's operations.

Tracking Stock Shares issued by a company which pay a dividend determined by the performance of a specific portion of the whole company. It is generally a class or series of common stock of the issuing corporation. Tracking stock does not represent or require any change in business structure. Holders of tracking stock are considered to hold equity in the parent company and not the specific entity represented by the tracking stock. Payment is subject to the risk of the operations of the issuer as a whole. Tracking stock is often set up by companies that have several diverse divisions, both so that investors can take a share in a division of their interest, and so that the performance of these divisions can be tracked in terms of shareholder interest. A company will sometimes issue a tracking stock when it has a very successful division that it feels is underappreciated by the market and not fully reflected in the company's stock price.

Salient Features of Tracking/Targeted Stock

1. **Voting Rights** *Holders of tracking stock typically have voting rights, which may be fixed at the time* of issuance or floating (e.g., fixed but subject to periodic adjustments based on relative market values).

2. **Dividend Rights** The dividend rights of tracking stock are based on the earnings of the tracked business. The dividend policy (i.e., when and how much of the tracked business' earnings are to be distributed) is subject to the discretion of the Board of Directors of the issuer.

3. **Liquidation Rights** Holders of tracking stock do not have a special right to the tracked assets and share in all of the issuer's assets. Liquidation rights are often based on the relative values of the tracked and total assets at the time of issuance, but are sometimes fixed in proportion to relative market capitalization immediately prior to liquidation.

4. **Conversion Rights** The issuer can generally elect to convert the tracking stock, often at a premium, into another class of stock subject to certain restrictions. In some transactions, the tracking stock automatically converts to another class of stock if the issuer sells the tracked assets. In other instances, conversion may be one of several options.

Alternatives to Tracking/Targeted Stock

1. **Spinoff** The "tracked" assets of the parent are dropped into a new subsidiary, which is then spun off to shareholders of the issuer.

2. **IPO Carve Out** The "tracked" assets are dropped into a subsidiary and the subsidiary engages in an initial public offering for up to 20% of its stock. The parent and the new subsidiary remain consolidated for tax purposes.

3. **Convertible Debt** Issuer issues debt, which is convertible into stock of the subsidiary.

DOWNSIZING & LAYOFF

A "layoff" is an action by an employer to terminate employees for lack of work. The term connotes that the termination is temporary—but it may well become permanent. A "downsizing" simply means releasing employees because the operation no longer needs them; reorganization or restructuring of the institution has eliminated jobs. The euphemistic "right-sizing" is sometimes substituted—to flatter management, one assumes. An "RIF," which stands for "reduction in force," is an old and rather straightforward term, its most likely source being governmental and military changes in employment: both actually take place from time to time. The newest addition to this lugubrious terminology (at least from the employees' point of view) is "outsourcing" or "off-shoring," meaning that the work is being transferred to another organization either domestically or overseas.

The layoff is a necessary corollary to seasonal or intermittent employment common in some industries, for example in construction, where building activity typically slows or stops in the winter months and resumes in spring. Industries that manufacture goods sold for winter use often have high levels of production (including lots of overtime) in the summer. The inverse of that takes place when spring and summer goods are made in winter. Industries highly linked with the tourist season typically have layoffs. People employed in these types of activities adapt to the layoffs by having alternative forms of employment in the "off-season." Layoffs also take place in times of economic down-turn because overall demand declines. Producers will cut back from three shifts to two or one or release some employees even when only operating one shift. But economy-driven layoffs are not permanent, and workers are "called back" when things pick up again. Based on statistics collected by the U.S. Department of Labor (DOL), extended mass layoffs have affected on average 1.3 million employees in the period 1996 through 2003—at higher rates during the recessionary period that began in 2000, at lower levels in the booming 1990s.

The laid-off worker has no guarantee of being called back to work; similarly, the employer may not be able to hire back labor if contracts don't renew or the business does not pick up. In the last decade or so the layoff itself has become a euphemism for force reduction. It is a telling sign of the times that DOL began collecting data on layoffs in April 1995 for the first time and has since published such data monthly. Even more revealing is the fact that DOL later added categories such as layoffs due to "overseas relocation" and "import competition"—the last category indicating jobs lost because work in-house has been replaced by imports. All this suggests that the term "layoff" shades imperceptively into the "downsizing" category.

Downsizing typically has multiple causes of which one may well be increased productivity. According to the DOL productivity in manufacturing (output per hour) increased on average 4.4 percent a year from 1995 to 2005 and 2.3 percent a year in business as a whole. If demand for goods and services is steady, this means that each year fewer workers are needed to supply the economy. The second factor behind downsizing is declining revenue due either to a poor economy or increased foreign competition. Finally, if labor is available at lower costs overseas and the work can be transferred, business will relocate jobs to reduce costs.

The stream of business news over at least the 1990s and the mid-2000s seems to suggest that these factors are very much present, indeed that corporate well-being and layoffs are inversely proportional—as a sampling of headlines shows: Compaq Stock Rises 8% on Sales and Job Forecast (The New York Times, October 9, 1992; the article cites the elimination of 1,000 jobs); Stock Rises on News of Possible, Bigger Layoffs (Annex News Watch, September 29, 2004, regarding EDS); and Ford Slashes Jobs, Stocks Rise (CBS News, January 24, 2006). Many more stories carry the same message in the body—if not in the headline. To be sure, stocks rise on any news that a company—especially a troubled company—is cutting costs. Notable in the present context is that so many companies shed jobs as a way of cutting costs.

SMALL BUSINESS IS NOT EXEMPTED

Small business is also subject to seasonal patterns and therefore lays off employees as needed, calling them back at a later time. More painfully, however, the small business must also respond to economic and market pressures and therefore must occasionally reduce its employment because the revenues are just not there. Every owner, therefore, should have plans and policies for reducing employment permanently. Such managerial techniques involve 1) conformity with law, 2) appropriate communications, and 3) employee assistance, sometimes called "outplacement" in human resources jargon.

In common parlance the first issue is based on fairness but fairness is enforced by employment and civil rights statues. When downsizing the workforce, the owner must base his or her actions on the requirements of the business and lean over backwards to avoid even the suggestion of bias against protected minorities: women, the disabled, racial minorities, workers over the age of forty, and veterans. In most cases job terminations will be based on functions that can no longer be supported; if these have to be reduced rather than eliminated, a neutral criterion like job tenure may be used, with the most junior employees terminated first. Such a rule would also apply if an across-the-board reduction, based on a percentage of all employees, is adopted. The rules being applied should be made public so that their fairness is visible to all involved, whether they stay or leave.

Communications are important both to maintain the morale of employees retained and to hold the good will of those discharged. They may be back again. The practice of announcing a downsizing late on Friday or the day before Christmas reflects very adversely on the owner's courage and tact, of course. Employees may have to leave, but they appreciate a clear statement of the reason why they're being terminated and like to have as much notice as possible. Some owners feel that they may lose the effective labor of those laid off by announcing early; but in almost all such situations, employees have long anticipated problems; therefore early notice may actually improve productivity during this period by removing uncertainty. If the selection rules are obviously fair and impartial, all employees will react favorably toward the company. And this will be doubly true if the announcement includes information about help the employer intends to provide to those leaving.

Providing outplacement help involves extra work on the owner's part but invariably has a favorable effect. Such help may involve getting assistance from one or more employment agencies, providing information on how to file for unemployment benefits, counseling by the owner or a third party, helping to prepare good resumes, providing leads and contacts, and preparing letters of recommendation.

Many owners, quite naturally, feel the need to downsize as a sign of personal failure—and this despite a good track record of long and successful employment of lots of people. Experience, however, teaches that business does have its downs as well as ups—and also teaches that the owner will benefit from minimizing his or her own frustrations. A good way to do that is trying to help those affected.

ALTERNATIVES TO DOWNSIZING A few companies have had, and continue to have, "no-layoff" policies or, more realistically, a "no-layoff" philosophy. Julia King, writing in Computerworld, described two such companies, Lincoln Electric Co. and FedEx Corp. "The employment practices go by different names," King wrote, "but the spirit and business strategies behind them are the same. By shunning downsizing as a matter of corporate values, both companies are looking to create a fiercely loyal and productive workforce, which in turn generates high customer satisfaction ratings and bottom-line results. And so far, it's a strategy that seems to work well, in both good economic times and bad."

Elizabeth Smith Barnes, writing in Workforce Management described the no-layoff policy of Hypertherm, Inc. Barnes provided a telling quote from the company's founder, Dick Couch, revealing the mindset behind such policies. "I was at a conference on entrepreneurship at Dartmouth," Barnes quotes Couch saying. "The guy next to me was a young, very bright venture capitalist who believed that the purpose of business is to maximize shareholder equity. I say that the purpose of business is to satisfy the customer and to focus on the development and well-being of your associates, from which good things will happen—including the 'accidental' benefit to shareholders. It seems some corporate folks are never going to understand the value of no layoffs because their fundamental philosophy about what we're in business for is very different."

No-layoff policies are not realistic for many small businesses, but the practices of leaders suggest ways and means both of avoiding layoffs and dealing with cost problems creatively. Techniques mentioned include very careful hiring, cross-training of employees so that many are able to shift from job to job, intense employee involvement in the business through suggesting programs and innovations, and, in the extreme case, pay reductions or reduced work hours so that all employees stay—and share the hardship in common.

'Employee Buyout - EBO'

A restructuring strategy in which employees buy a majority stake in their own firms. This form of buyout is often done by firms looking for an alternative to a leveraged buyout. Companies being sold can be either healthy companies or ones that are in significant financial distress.

For small firms, an employee buyout will often focus on the sale of the company's entire assets, while for larger firms, the buyout may be on a subsidiary or division of the company. The official way an employee buyout occurs is through an employee stock ownership plan (ESOP). The buyout is complete when the ESOP owns 51% or more of the company's common shares.

History

In the mid-19th century, as the United States transitioned to an industrial economy, national corporations like Procter & Gamble, Railway Express Agency, Sears & Roebuck, and others recognized that someone could work for the companies for 20 plus years, reach an old age and then have no income after they could no longer work. The leaders of those 19th century companies decided to set aside stock in the company that would be given to employees when they retired.

In the early 20th century, when the United States sanctioned an income tax on all citizens, one of the biggest debates was about how to treat stock set aside for an employee by his employer under the new US income tax laws.

ESOPs were developed as a way to encourage capital expansion and economic equality. Many of the early proponents of ESOPs believed that capitalism's viability depended upon continued growth and that there was no better way for economies to grow than by distributing the benefits of that growth to the workforce.

In 1956, Louis Kelso invented the first ESOP, which allowed the employees of Peninsula Newspapers to buy out the company founders.[19] Chairman of the Senate Finance Committee, Senator Russell Long, a Democrat from Louisiana, helped develop tax policy for ESOPs within the Employee Retirement Income Security Act of 1974 (ERISA), calling it one of his most important accomplishments in his career.[20] ESOPs also attracted interest of Republican leaders including Barry Goldwater, Richard Nixon, and Gerald Ford, and Ronald Reagan.

In 2001, the United States Congress enacted Internal Revenue Code section 409(p), which effectively requires for ESOP benefits to be shared equitably by investors and workers. This ensures that the ESOP includes everyone from the receptionist to the CFO.

Forms Like other tax-qualified deferred compensation plans, ESOPs must not discriminate in their operations in favor of highly compensated employees, officers, or owners. In an ESOP, a company sets up an employee benefit trust that is funded by contributing cash to buy company stock or contributing company shares directly. Alternately, the company can choose to have the trust borrow money to buy stock (also known as a leveraged ESOP, with the company making contributions to the plan to enable it to repay the loan. Generally, almost every full-time employee with a year or more of service who worked at least 20 hours a week is in an ESOP.

The United States ESOP model is tied to the unique US system encouraging private retirement savings plans and tax policies that reflect that goal. That makes it difficult to compare to other tax codes from other nations.

A 2013 study found that in 2010, 2,643 S ESOPs directly employed 470,000 workers and supported an additional 940,000 jobs, paid $29 billion in labor income to their own employees, with $48 billion in additional income for supported jobs, and tax revenue initiated by S ESOPs amounted to $11 billion for state and local governments and $16 billion for the federal government. Also, the study found that total output was equivalent to 1.7 percent of 2010 U.S. GDP. $93 billion (or 0.6 percent of GDP) came directly from S ESOPs, while output in supported industries totaled $153 billion (or 1.1 percent of GDP).

Advantages and disadvantages to employees.

In a US ESOP, just as in every other form of qualified pension plan, employees do not pay taxes on the contributions until they receive a distribution from the plan when they leave the company. They can roll the amount over into an IRA, as can participants in any qualified plan. There is no requirement for a private sector employer to provide retirement savings plans for employees.

Some studies conclude that employee ownership appears to increase production and profitability and improve employees' dedication and sense of ownership ESOP advocates maintain that the key variable in securing these claimed benefits is to combine an ESOP with a high degree of worker involvement in work-level decisions (employee teams, for instance). Employee stock ownership can increase the employees' financial risk if the company does badly

ESOPS, by definition, concentrate workers' retirement savings in the stock of a single company. Such concentration is contrary to the central principle of modern investment theory, which is that investors should diversify their investments across many companies, industries, geographic locations, etc Moreover, ESOPs concentrate workers' retirement savings in the stock of the same company on which they depend for their wages and current benefits, such as health insurance, worsening the non-diversification problem. High-profile examples illustrate the problem. Employees at companies such as Enron and WorldCom lost much of their retirement savings by overinvesting in company stock in their 401(k) plans, but the specific companies were not employee-owned. Enron, Polaroid and United Airlines, all of which had ESOPs when they went bankrupt, were C corporations.

Opponents to ESOP have criticized these pro-ESOP claims and say many of the studies are conducted or sponsored by ESOP advocacy organizations and criticizing the methodologies used.[35][36] Critics argue that pro-ESOP studies did not establish that ESOPs results in higher productivity and wages. ESOP advocates agree that an ESOP alone cannot produce such effects; instead, the ESOP must be combined with worker empowerment through participatory management and other techniques. Critics point out that no study has separated the effects of those techniques from the effects of an ESOP; that is, no study shows that innovative management cannot produce the same (claimed) effects without an ESOP.

In some circumstances, ESOP plans were designed that disproportionately benefit employees who enrolled earlier by accruing more shares to early employees. Newer employees, even at stable and mature ESOP companies can have limited opportunity to participate in the program, as a large portion of the shares may have already been allocated to longstanding employees.

ESOP advocates often maintain that employee ownership in 401(k) plans, as opposed to ESOPs, is problematic. About 17% of total 401(k) assets are invested in company stock, more in those companies that offer it as an option (although many do not). ESOP advocates concede that it may be an excessive concentration in a plan specifically meant to be for retirement security. In contrast, they maintain that it may not be a serious problem for an ESOP or other options, which they say are meant as wealth building tools, preferably to exist alongside other plans. Nonetheless, ESOPs are regulated as retirement plans, and they are presented to employees as retirement plans, just like 401(k) plans.

Conflicts of interest

Because ESOPs are the only retirement plans allowed by law to borrow money, they can be attractive to company owners and managers as instruments of corporate finance and succession. An ESOP formed using a loan, called a "leveraged ESOP," can provide a tax-advantaged means for the company to raise capital. According to a pro-ESOP organization, at least 75% of ESOPs are, or were at some time, leveraged. According to citing ESOP Association statistics as cited in. In addition, ESOPs can be attractive instruments of corporate succession, allowing a retiring shareholder to diversify the company of stock while deferring capital gains taxes indefinitely.

Company insiders face additional conflicts of interest in connection with an ESOP's purchase of company stock, which most often features company insiders as sellers and in connection with decisions about how to vote the shares of stock held by the ESOP but not yet allocated to participants' accounts. In a leveraged ESOP, such unallocated shares often far outnumber allocated shares for many years after the leveraged transaction.

Other forms of employee ownership

Stock options and similar plans (stock appreciation rights, phantom stock, and restricted stock, primarily) are common in most industrial and some developing countries. Only in the U.S., however, is there a widespread practice of sharing this kind of ownership broadly with employees, mostly (but not entirely) in the technology sector (Whole Foods and Starbucks also do this, for instance). The tax rules for employee ownership vary widely from country to country. Only a few, most notably the U.S.,Ireland, and the UK, have significant tax laws to encourage broad-based employee ownership.] In India, employee stock option plans are called "ESOPs.

The most celebrated (and studied) case of a multinational corporation based wholly on worker-ownership principles is the Mondragon Cooperative Corporation.] Unlike in the United States, however, Spanish law requires that members of the Mondragon Corporation are registered as self-employed. This differentiates co-operative ownership (in which self-employed owner-members each have one voting share, or shares are controlled by a co-operative legal entity) from employee ownership (where ownership is typically held as a block of shares on behalf of employees using an Employee Benefit Trust, or company rules embed mechanisms for distributing shares to employees and ensuring they remain majority shareholders).

Different forms of employee ownership, and the principles that underlie them, are strongly associated with the emergence of an international social enterprise movement. Key agents of employee ownership, such as Co-operatives UK and the Employee Ownership Association (EOA), play an active role in promoting employee ownership as a de facto standard for the development of social enterprises.

Other varieties of employee ownership include:

Direct purchase plans Direct purchase plans simply allow employees to buy shares in the company with their own, usually after-tax, money. In the U.S. and several foreign countries, there are special tax-qualified plans, however, that allow employees to buy stock either at a discount or with matching shares from the company. For instance, in the U.S., employees can put aside after-tax pay over some period of time (typically 6–12 months) then use the accumulated funds to buy shares at up to a 15% discount at either the price at the time of purchase or the time when they started putting aside the money, whichever is lower. In the U.K. employee purchases can be matched directly by the company.

Stock options Stock options give employees the right to buy a number of shares at a price fixed at grant for a defined number of years into the future. Options, and all the plans listed below, can be given to any employee under whatever rules the company creates, with limited exceptions in various countries.

Restricted stock Restricted stock and its close relative restricted stock units give employees the right to acquire or receive shares, by gift or purchase, once certain restrictions, such as working a certain number of years or meeting a performance target, are met.

Phantom stock Phantom stock pays a future cash bonus equal to the value of a certain number of shares.

Stock appreciation rights Stock appreciation rights provide the right to the increase in the value of a designated number of shares, usually paid in cash but occasionally settled in shares (this is called a “stock–settled” SAR).

Cooperatives Worker cooperatives are very different from the above mechanisms. They require members to join. Each worker-member buys a membership interest at a fixed price, or buys a share. Only workers can be members, but cooperatives can hire non-worker owners. Each member gets one vote.

Sale of assets The compensated distribution of valuable property that can be tangible or intangible. In a typical business or private transaction involving a sale of assets, the seller gains ownership of some form of cash or its equivalent, while the buyer obtains ownership of the asset.

Financial Reconstruction

When a company is suffering loss for several past years and suffering from financial difficulties, it may go for reconstruction. In other words, when a company's balance sheet shows huge accumulated losses, heavy fictitious and intangible assets or is in financial difficulties or is to over capitalized, and then the process of reconstruction is restored.

Reconstruction may be internal and external.

External reconstruction When a company is suffering losses for the past several years and facing financial crisis, the company can sell its business to another newly formed company. Actually, the new company is formed to take over the assets and liabilities of the old company. This process is called external reconstruction. In other words, external reconstruction refers to the sale of the business of existing company to another company formed for the purposed. In external reconstruction, one company is liquidated and another new company is formed. The liquidated company is called "Vendor Company" and the new company is called "Purchasing Company". Shareholders of vendor company become the shareholders of purchasing company.

Internal Reconstruction Internal reconstruction refers to the internal re-organization of the financial structure of a company. It is also termed as re-organization which permits the existing company to be continued. Generally, share capital is reduced to write off the past accumulated losses of the company. The accounting procedure of internal reconstruction is distinct from that of amalgamation, absorption and external reconstruction

Corporate restructuring becomes a buzzword during economic downturns. A company going through tough financial scenario needs to understand the process of corporate restructuring thoroughly. Although restructuring is a generic word for any changes in the company, this word is generally associated with financial troubles.

Module - III

Corporate Restructuring

Definition Corporate restructuring is a corporate action taken to significantly modify the structure or the operations of the company. This usually happens when a company is facing significant problems and is in financial jeopardy. Often, the restructuring is referred to the ways to reduce the size of the company and make it small. Corporate restructuring is essential to eliminate all the financial troubles and improve the performance of the company.

The troubled company's management hire legal and financial experts to assist and advise in the negotiations and the transaction deals. The company can go as far as appointing a new CEO specifically for making the controversial and difficult decisions to save or restructure the company. Generally, the company may look at debt financing, operations reduction and sale of the company's portions to interested investors.

Reasons for Corporate Restructuring:

Corporate restructuring is implemented under the following scenarios:

Change in the Strategy: The management of the troubled company attempts to improve the company's performance by eliminating certain subsidiaries or divisions which do not align with the core focus of the company. The division may not seem to fit strategically with the long-term vision of the company. Thus, the company decides to focus on its core strategy and sell such assets to the buyers that can use them more effectively.

Lack of Profits: The division may not be profitable enough to cover the firm's cost of capital and cause economic losses to the firm. The poor performance of the division may be the result of the management making a wrong decision to start the division or the decline in the profitability of the division due to the increasing costs or changing customer needs.

Reverse Synergy: This concept is in contrast to the M&A principles of synergy, where a combined unit is worth more than the individual parts together. According to reverse synergy, the individual parts may be worth more than the combined unit. This is a common reasoning for divesting the assets. The company may decide that more value can be unlocked from a division by divesting it off to a third party rather than owning it.

Cash Flow Requirement: A sale of the division can help in creating a considerable cash inflow for the company. If the company is facing some difficulty in obtaining finance, selling an asset is a quick approach to raising money and reduce debt.

Restructuring Techniques/Stages Troubled company restructurings are complex endeavors. To be successful, a company must fix both the challenges that caused the problem in the first place, and create revisions to the debt that accumulated from past transactions. Most companies are ill-equipped to address even one of these two problems without assistance from financial advisors experienced in such matters.

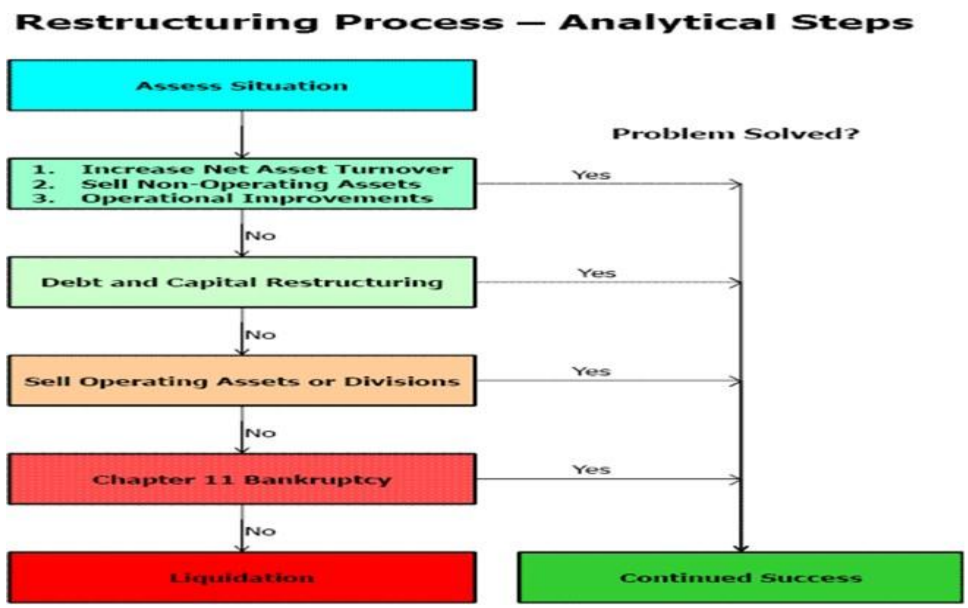
The graph that appears below describes the stages of performing a troubled company workout.

The graphic is perhaps misleading in one important way. Although the graphic describes a sequential process, success is more likely if the various adjacent steps are addressed simultaneously instead of sequentially. The troubled company usually needs options, and more options are better than few. Time is rarely the troubled company's friend, so the ability to create additional options more quickly improves the chances for success.

As already noted, each of these steps needs to be done quickly, almost always more quickly than the existing management finds comfortable. In the typical situation where accurate information is in short supply, decisions are often made with incomplete information. This is where experience is invaluable, and how an expensive consultant is able to add value.

For every one of these steps, cash is king. No company with a relatively large hoard of cash ever filed bankruptcy. For a company in a liquidity crisis, all ideas should be evaluated based upon the idea's impact on the cash account when compared to the cash impact of other options. A transaction that does not generate cash in the near term should not occur in a workout situation, regardless of either (i) the long-term benefit that is expected, or (ii) the impact on accrual-based earnings.

Management often believes that they can grow their way out of the problems that are already upon them. Hope runs eternal, and the next great idea is often thought to be the company's savior. The problem is that most new products and ideas require up-front investment for development, plus additional working capital for inventory and receivables. The new product may indeed be great, but growth from the new product will almost never generate sufficient cash by itself, particularly in the short-term. For this reason, cash will almost always need to be generated from other painful steps in the following chart.



Assess Situation Assessment of the company's situation is a necessary first step before any long-term action is taken. The goal is to have an accurate picture of the most important factors that drive the business's success or failure, regardless of how dismal the assessment is.

If the troubled company has good accounting records, this step can be done in just days. More realistically, most troubled companies have lousy records. Nevertheless, the assessment period should not take more than three weeks, simply because most troubled companies have little time before dire consequences occur.

During the assessment period, most efforts that are not generating additional cash will be delayed until after the initial assessment is complete. Most checks will be delayed. Exceptions include:

1. Payroll

2. A secured lender that clearly is in an over collateralized position

3. COD requirements for orders that are clearly profitable to customers that are clearly credit-worthy

4. Critical support functions that are on the verge of being cutoff for non-payment. Examples of critical support functions are utilities, phone, internet connection, key licensing agreements, and leases without which operations cannot continue. Most companies are surprised at how few items are really "must haves".

At this initial step, and through each step, a detailed cash flow forecast is needed. Most companies are not used to this rigor, but the forecast is required to understand what further action is needed.

Operational Improvements

The company must have a clear understanding of what caused the existing problem(s). Beware of any explanation that asserts the problem(s) will disappear if there were just a little more money available to borrow. Additional financing (discussed below) may be part of the solution, but one must also have a clear understanding of the current operational and cash flow deterioration, and how these underlying challenges will change.

Reduction of headcount (payroll) is usually part of every restructuring. This is normally left to the outside consultant because existing management is unable or unwilling to make the necessary decisions. The starting point for these difficult decisions is an organization chart that shows (i) responsibilities of each person/group, and (ii) compensation. Sales personnel should usually be moved to a fully contingent (commission) compensation program, at least in the short-term.

An area where additional personnel cuts are not likely is the accounting staff, usually because this group has often already been decimated. We see many troubled companies, in the name of earlier cost-cutting, that have already eliminated the majority of the accounting function. The accountants are perceived as being "overhead", and are sometimes viewed as naysayers about the CEO's growth plans. Perhaps the existing accounting personnel are not well qualified and should be replaced, but sufficient resources need to be given to the accounting area. The accountants are required to provide information that will (i) allow the troubled company to monitor its affairs, (ii) provide credible answers to secured lenders, vendors, investors and others whose cooperation the company must have, and (iii) assist in developing and implementing plans that will preserve cash, sell assets, and perform other tasks required by the restricting plan.

It is preferable to make personnel reductions all at once. Meet with those who remain to explain what has just happened, the plan for solving the problem, and the role of the remaining people in the company's future success.

Cost cutting gets prominent attention in most restructurings, but this need not be the emphasis. Instead, the emphasis should be improving operational effectiveness by solving the challenges that prevent profitability and liquidity. If solving these challenges involves cost-cutting, so be it, but this is not always the case.

Increase Net Asset Turnover; Sell Non-Operating Assets

Vendors who are owed money need to be explicitly classified based on their importance to future operations. This needs to be done to ensure that the limited cash resources are used to pay those creditors who enable the business to continue, and not simply those creditors with the most aggressive collections department.

Since your negotiating position with important sole-source vendors is poor, attempt to identify a secondary source of supply that will extend credit on terms more favorable than what the existing vendor is offering. Absent having a replacement vendor, suppliers who are

(i) critical to future operations and (ii) owed amounts that are already seriously past due should be contacted. Explain that changes are underway with the assistance of restructuring experts. Provide payment commitments that are realistic. Do not make promises that you cannot keep. One of the big problems in many restructurings is the lack of cooperation from important vendors because management lacks credibility with payment promises. Once a payment commitment is made to a key vendor, the commitment must be met as a means of rebuilding trust and obtaining ongoing cooperation.

At the risk of being obvious, past due amounts from the company's customers must be more aggressively collected. An otherwise great customer that is not paying its bills is not really a great customer.

Most businesses have assets that are not being used in, or are not critical to, current operations. Examples of such assets are (i) equipment that might be useful in the future but is not being actively used now, (ii) valuable assets that are infrequently used, and whose underlying purpose can be outsourced, and (iii) inventory with low turnover. Any such assets that can be converted to meaningful cash should be sold.

Sell Operating Assets or Divisions Sometimes, prior growth or acquisition efforts generated too much debt. This requires an assessment of the cash returns that are earned by each business segment, compared to the value of that segment. Those businesses, product lines, or divisions that have no near-term realistic means of earning more than their cost of capital must be sold.

This requires valuation expertise. Preferably, the restructuring consultant you have employed has this capability as part of its available resources.

Debt and Capital Restructuring In recent years, companies facing liquidity problems were sometimes able to borrow or refinance in a capital market that was flush with liquidity, and looking to earn additional yield. As has been widely reported, this is no longer the case.

Be careful with any lending consultant or lender who promises new money sources, but who also requires a substantial up-front, non-recoverable fee for their pre-funding efforts. Learn up-front the terms of these proposed new lenders. There is no magic (despite claims of "contacts"), and no lender generosity in the current market. The promised new loan (if it exists at all) will likely come with substantial new requirements and risks that you should understand before investing your hope and time.

No existing lender is going to engage in any restructuring transaction unless the borrower is improving on the lender's current situation. Believing otherwise is simply naïve. Be realistic in terms of what you will be willing and able to offer a new or existing lender in a refinancing. For example:

1. If the lender does not already have a collateralized position, a security interest will have to be given.

2. Can existing or new investors contribute additional equity as part of a lender workout?

3. If the owner's personal guarantee has not already been given, such a guarantee will now likely be a requirement.

4. If the loan agreement does not already have significant operating restrictions and events of default, these will be added as part of any new deal.

5. If dealing with a nontraditional lender, expect to offer convertible equity positions that will usually give operational control to the new financing source unless strict benchmarks are met.

If you have nothing new to give in terms of the above, you will be left to offer your new business plan and related forecast. The plan will need to identify (i) what is being asked of the secured lender, and (ii) how whatever is being asked of the secured lender will improve the secured lender's current situation. If existing management lacks sufficient credibility with the lender, a workout consultant may assist the borrower in asking for more time, a release of cash collateral, or other provisions that will provide necessary operating cash and/or freedom.

A debt-for-equity exchange is a difficult transaction that is most often accomplished only when the threat of bankruptcy is relatively close. Debt-for-equity swaps are done in a context where each claimant group is aware of their priority and recovery in a bankruptcy. Lenders will accept the swap only if it improves what they perceive will occur in a bankruptcy. In any substantial troubled debt swap, existing stockholders will be severely diluted or wiped out entirely. Similarly, the former debt holders (now stock holders) will generally gain corporate governance control.

Methods:

There are various ways in which a company can reduce its size. The following are the methods by which a company separates a division from its operations:

Divestitures: Under divestitures, a company sells, liquidates or spins off a subsidiary or a division. Generally, a direct sale of the divisions of the company to an outside buyer is the norm in divestitures. The selling company gets compensated in cash and the control of the division is transferred to the new buyer.

Equity Carve-outs: Under equity carve-outs, a new and independent company is created by diluting the equity interest in the division and selling it to outside shareholders. The new subsidiary's shares are issued in a general public offering and the new subsidiary becomes a different legal entity with its operations and management separated from the original company.

Spin-offs: Under spin-offs, the company creates an independent company distinct from the original company as done in equity carve-outs. The major difference is that there is no public offering of the shares, instead, the shares are distributed among the company's existing shareholders proportionately. This translates into the same shareholder base as the original company, with the operations and management totally separate. Since the stocks of the new subsidiary are distributed to its own shareholders, the company is not compensated by cash in this transaction.

Split-offs: Under split-offs, the shareholders receive new stocks of the subsidiary of the company in trade for their existing stocks in the company. The reasoning here is that the shareholders are letting go of their ownership in the company to receive the stocks of the new subsidiary.

Liquidation: Under liquidation, a company is broken apart and the assets or the divisions are sold piece by piece. Generally, liquidations are linked to bankruptcies.

Conclusion:

Corporate restructuring allows the company to continue to operate in some way. The management of the company tries all the possible measures to keep the entity going on. Even when the worst happens and the company is forced to pieces because of the financial troubles, the hope remains that the divested pieces can function good enough for a buyer to acquire the diminished company and take it back to profitability.