CHAPTER: 1

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1.1 Introduction:

Change is inevitable. In fact it has become a necessity for any corporate house or business organization to keep on changing their business performance or activities as per the call of dynamic economic environment. There are various external factors those force these business houses to keep themselves updated. Such as increased competition, emergence of new markets, emergence of new competing products, new class of consumers, demographic changes, business cycles, emergence of new and efficient technology.

Some of the organizations acts proactive to these challenges and adopt the environment but those who fail to do so, later on forced to adopt changes. The organizations acting wisely are market leaders and later are losers. Survival has become a challenge in today’s global economy.

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

With liberalization and opening up of the Indian economy since the middle of 1991, Indian corporate sector felt the need to reposition itself quickly in order to effectively respond to emerging completion and also exploit the opportunities that were expected to unfold in the coming years. Repositioning has become a necessity for the Indian corporate sector as there were lot many inadequacies like lack of customer focus, diversified portfolio, unprofitable product lines, outdated technologies, uneconomic capacities, poor productivity, inefficiency on front of asset utilization, slow business processes, high gearing, huge overheads etc.

Corporate restructuring became a key solution to overcome all extensive problems lying in Indian corporate sector. In addition, an extensive reform taken in the year 1991 - Liberalization, Privatization and Globalization (LPG) in Indian economy led Indian corporate to be gain more competitive edge opening up with great global
opportunities. It has signaled the need for an extensive restructuring of an Indian corporate sector.

The major policy changes introduced since July, 1991 include:

a) Abolition of industrial licensing
b) Lifting of restrictions on the size of firms
c) Drastic reduction in the areas reserved for the public sector
d) Disinvestment of Government equity in public sector undertakings
e) Liberalization of foreign investment regulations
f) Liberalization of import tariffs
g) Removal of all quantitative restrictions on imports
h) Abolition of the office of the controller of Capital issues
i) Reducing the central excise and customs duties
j) Reducing income tax rates both for corporate and individual assessee

Due to these policy changes corporate restructuring wave started in India from 1994.

1.2 Concept of Corporate Restructuring:

Restructuring means change. The Oxford Dictionary (2007) defines restructuring as ‘giving a new structure, to rebuild/ rearrange’. It means any inbuilt valid changes done in the structure of the corporate entity. It can be related to its capital formation (capital structure), ownership pattern, or business capacity. Corporate restructuring is the process of redesigning one or more aspects of a company.

Sander defines as “Restructuring is an attempt to change the structure of an institution in order to relax some or all of the short run constraints. It is concerned with changing structures in pursuit of a long run strategy.

Corporate restructuring results into major changes like size of business, ownership of business, control or management of the business It is the process of redesigning one or more features of a business firm. Corporate restructuring is a crucial strategy implemented to remain relevant in the business world.
Crum and Goldberg (1998)\(^1\) define restructuring as a set of discrete decisive measures taken in order to increase the competitiveness of the enterprise and thereby to enhance its value or performance.

Gibbs (2007)\(^2\) defined restructuring as a change in the operational structure, investment structure, financing structure and governance structure of a company. Sterman (2002)\(^3\) referred it as diverse activities such as divestiture of underperforming business, spin-offs, acquisitions, stock repurchases and debt swaps, which are all a onetime transaction, but also structural changes introduced in day to day management of the business.

Chandra (2007)\(^4\) defines corporate restructuring to a broad array of activities that expand or contract a firm’s operations or substantially modify its financial structure or bring about a significant change in its organizational structure or internal financing.

Weston et al. (2005)\(^5\) corporate restructuring refers to liquidating projects in some areas and redirecting assets to other existing or new areas.

Bowman and Singh (1999)\(^6\) classified restructuring activities into three categories namely portfolio restructuring, financial restructuring and organizational restructuring.

- Portfolio restructuring: it entails significant changes in the asset mix of a firm or the lines of business which a firm operates, including liquidation, divestiture, asset sales and spin-offs.

• Financial restructuring: it includes changes in the capital structure of a firm, including leverage buyouts, leveraged recapitalization and debt equity swaps. A common way for financial restructuring is increasing equity through issuing of new shares.

• Organizational restructuring: it involves significant changes in the organizational structure of the firm, including redrawing of divisional boundaries, flattening of hierarchic levels, spreading of the span of control, reducing product diversification revising compensation, reforming corporate governance and downsizing employment.

So, Corporate Restructuring can be defined as any change in the business capacity or portfolio that is carried out by an inorganic route or a change in the capital structure of a company that is not a part of its ordinary course of business or any change in the ownership of or control over the management of the company or a combination thereof.

1.3 Why Corporate Restructuring?

There are various forms of corporate restructuring and apart there are various reasons for corporate restructuring. These reasons can be pronounced as motives behind corporate restructuring. Motives here means the objectives for which the corporate thought of corporate restructuring. The motives are classified as:

1.3.1 Motives for expansion: There are two ways for the company to grow. One is internal growth and other is external growth. Internal growth is also known as organic growth. Firms tries to grow internally means they make the changes to the company’s product, companies policies or any other internal decisions. When it thought of external, it’s beginning for restructuring. Apart technology plays an important role as a driver in expansion strategy. Generally a firm with improved and superior technology wants to engineer its technological superiority by acquiring firms of inferior technology. Further product advantage and product differentiation gets more relevance in expansion internationally when a firm finds acceptance for its product abroad. Different regulations, tax burden and other restrictions imposed by the government also induce companies to increase size. Exchange rate is specifically identified with expansion leading to international mergers. Comparative strength or
weakness of the domestic versus foreign currency makes a difference in price paid for acquisition, production costs and the value repatriated profit to the parent. Political stability that is the frequency with which government changes, the order of transferring power and the change in the policy and outlook due to change in the administration becomes a decisive factor in expansion. One of the important drivers for expansion is the diversification both geographically and by product line. It may come in the form of vertical integration, both forward and backward, which also helps in reducing risk.

1.3.2 Motives behind corporate control: Corporate control plays significant role when it comes to success of any strategic decision. Successful performance depends on control in an organization. To reinforce effective control capital structure of the firm is changed. Adopting buyback mechanism debt equity ratio or leverage ratio is attempted to improve. In order to increase shareholders return and wealth, the firm may undertake the strategy of distributing surplus cash maintaining shareholders value in a situation of poor state of market.

1.3.3 Motives behind contraction: The accountability created by restructuring through demerger often improves performance, and investors also benefit from the greater visibility of the demerged entities to analysts and the public. Demerger is intended to promote independence as the separated company can operate freely at its own discretion. Some demerger effort is undoubtedly an attempt to correct previous invest decisions materialized through mergers and acquisitions. Sometime divestiture involves selling to a value increasing buyer, which is planned at the time of prior mergers and acquisitions activity. Demerger represents harvesting value by unlocking the hidden value. By making financial and managerial resources available and concentrating on the core competency the firm is able to enhance shareholders value as well as value of the firm.

1.3.4 Motives behind change in ownership: The most important reason for changes in ownership structure is to manage leverage of the firm. It also helps in fairness to minority shareholders. If a firm wants to come out from the regulations of Securities and Exchange Board of respective country it may prefer that a small group of investors will buy the entire equity interest.
1.4 Reasons for Restructuring:

There are various reasons why corporate prefer restructuring? To list out following are the various reasons for restructuring.

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

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

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

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

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

1.4.6 Divestment: (Rajinder S.Aurora) Many companies have either divisionalized their operations into smaller businesses, or have sold off units or divisions that do not have a strategic fit with the business. Divestment is often done to get out of activities that do not add value to the business, or sometimes destroy value. It is also a way of releasing capital resources that have been blocked in activities where the company does not enjoy core competency or competitive advantage.

1.4.7 Improving bottom line: (Rajinder S.Aurora) the basic business activities shall always be maximizing profits. It is the only way to keep all the stakeholders happy. To achieve it, companies have to narrow down the gap between the attainable and the attained. Restructuring becomes necessary to realize the full potential of the company.
1.4.8 Core competencies: (Rajinder S.Aurora)Core competency is a specific factor that a business perceives to be central to its functioning. It provides recurring consumer benefits, is not easy for competitors to imitate and can be leveraged widely across many products and markets. A core competency can be technical a reliable process, a close relationship with customers and suppliers, product development and/or culture, such as employee dedication. The concept is integral to the strategic vision of the company as it provides the fundamental basis for the provision of added value.

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

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

1.4.11 Evolving appropriate capital structure: (Rajinder S.Aurora)Companies that are either over capitalized or undercapitalized opt for restructuring. The process helps the company to evolve a balanced capital mix. It not only minimizes the cost of capital, but also increases earnings. When companies expand their operations, the capital base grows and the capital mix changes. This also affects the cost of capital. The capital requirements change during different stages of the organizational life cycle and the capital mix often becomes inappropriate and unbalance. Therefore companies adopt restructuring to evolve an appropriate financial structure and achieve reduction in the cost of capital.

1.4.12 Consistent growth and profitability: (Rajinder S.Aurora)the expectations of customers have changed over the years. Today, they demand quality at a reasonable price. They do not mind spending, but always look out for products that
offer value for money. This aspiration of the customers is not unwarranted, as customer is the king. To meet customer expectations, companies have to adopt improved production techniques and effective cost control measures. If a company is not ready for this change, it should restructure its operations so that these objectives can be achieved.

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

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

1.4.15 Resolving conflicts: Companies often experience conflict between the management and the shareholders’ perception of the prevailing state of affairs. The management often perceives that all is well with the company, whereas shareholders thing otherwise. To resolve this conflict, companies often initiate restructuring. (Rajinder S.Aurora)

1.4.16 Transferring corporate assets: Companies often have assets that they are unable to use efficiently. They choose restructuring to transfer their assets to a more efficient user. The efficient user may be its own division/segment or another company. This transfer benefits the company by making the operations cost effective and by increasing the company’s returns. (Rajinder S.Aurora)
1.4.17 Bifurcating business: There is a common belief that the sum of returns of two businesses is often greater than that of a single entity. This happens as bifurcation results in increased efficiency due to a focused approach. Companies often opt for restructuring with the aim to bifurcate the company into two or more entities so that it can achieve the objectives of increased returns. (Rajinder S. Aurora)

1.5 Types of Corporate Restructuring:

Restructuring is a strategic process that provides companies with the much needed launching pad to improve their performance and profitability. However, the objectives to improve performance do not always ensure success. While results have been mixed, companies have often found new directions and drive to perform. Restructuring can be carried out in any one the following lines.

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

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

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

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

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

1.6 Forms of Corporate Restructuring:

Corporate restructuring involves changes in ownership structure or business mix or asset mix with a view to enhancing the shareholders wealth. Mergers and Acquisitions are often viewed as corporate restructuring decisions as they affect the ownership pattern.

1.6.1 Merger: Merger is defined as a combination of two or more companies. Here two or more companies’ combines into one company or one company purchases another company for cash and integrates the purchased company with itself. In former one survives and other loses their existence. The term merger refers to fusion between two or more enterprises, which results in the emergence of a single enterprise. Such a fusion involves the transfer of assets and liabilities of the merging companies to the merged company. The shareholders of the merging company become the shareholders in the merged company.

1.6.2 Consolidation: Consolidation involves creation of an altogether new company owning assets, liabilities of two or more companies, both of which ceases
to exist. For e.g. A Limited and B Limited will cease to exist and C Limited will carry on the businesses of both A Limited and B Limited.

1.6.3 Acquisition: Acquisition results when one company purchase the controlling interest in the share capital of another existing company. In acquisition both the companies may continue to exist. It is also known as takeover. It is the buying of one company by another company. An acquisition may be friendly or hostile. In case of friendly acquisition, the companies engaged in the deal co-operate each other for negotiation. And when acquisition becomes hostile it is known as takeover because there can be unwillingness of target company to be bought by another company.

1.6.4 Joint Venture: Joint ventures are new enterprises formed by coming together of two or more participants, typically formed for special purposes for a limited duration. It is a combination of subsets of assets contributed by two or more business entities. Each of the partners in the venture continues functioning as a separate firm, and the joint venture represents a new business project. It can also be called a contract among participants who not only agree to work together and expect to gain from the venture, but also agree to make a contribution.

Levins defines a joint venture as a new firm formed to achieve specific objectives of a partnership like temporary arrangement between two or more firms. JV is advantageous as a risk reducing mechanism in new market penetration and in pooling of resource for large projects. They however, present unique problems in equity ownership, operational control, and distribution of profits. Research indicates that two out of five JV arrangements last less four years, and are dissolved in acrimony. (R.Vadapalli)\(^8\) For example: GM -Toyota JV. General Motors hoped to learn from the new experience of management techniques of the Japanese in building high quality, low cost compact and subcompact cars. Toyota was seeking to learn the management traditions that had made GM the numero uno in the production of auto in

\(^8\)R.Vadapalli, Mergers and Acquisitions, 2010.
the world. Moreover, they wanted to learn operating an auto company in the US, dealing with contractors, suppliers and workers.

1.6.5 **Sell off:** Sell off means selling a part of or the whole of the firm through a sale, liquidation or spin off. For example: Coromandel Fertilizers sold its cement division to India Cements.

1.6.6 **Spin off:** In a spin off also a new legal entity is created, but shares are issued to the existing stockholders on a pro rata basis. This means that the stockholder base in the new company is the same as that of the old company. Though the stockholders are the same the spun off firm has its own management team and its activities are carried out as a separate company. This form of restructuring creates a new publicly traded company that is separate from the former parent company.

1.6.7 **Split up:** A split up is defined as the separation of a company into two or more parts. This term is applied to a restructuring where the firm is not merely divesting a piece of the firm but is strategically breaking up the entire corporate body. Here the firm is broken up into a number of spin offs after which the parent company does not exist any longer, and only the newly formed companies exist. The shareholders in the companies may not be the same as the shareholders trade their shares in the parent company with shares in one or more of the units that are spun off.

1.6.8 **Divestiture:** Divestiture means sale of assets, but not in a piecemeal manner. Here in this type of restructuring, a company sells all or substantially all the assets of any one or more of its undertakings or divisions or of the company as a whole. A transaction through which a firm sells a portion of its assets, a product line a subsidiary or a division to another company for cash or securities is called divestiture. Divestiture is a form of contraction. Mergers, asset purchase and takeovers lead to expansion and are based on the principle of synergy which says 2+2 = 5. Divestiture on the other had is based on the principle of reverse synergy which says 5-3=3. Divestiture are simple exit routes and do not result in the creation of a new entity. The primary reasons for adoption of divestiture are as follows:

- Certain assets do not contribute to the firms profit; rather they put extra pressure on its resources.
- Divesting the excess assets can help a firm focus on its remaining assets, thereby increasing the overall efficiency of the enterprise.

1.6.9 Equity carves out: Equity carves out involves the sale of equity interest in a subsidiary. It is different from a divestiture in that the sale may necessarily result in the subsidiary company being in control of the parent company. The new equity gives the investors shares of ownership in the portion of the selling company that is being divested. In case of equity carve out; a new legal entity will be created having a stockholder base that may be quite different from that of the parent company. The divested company will have a different management team and will be considered as a separate firm. This mode of restructuring creates a new publicly traded company with partial or complete autonomy from the parent firm. Equity carves outs became a popular financing technique in the late 1980s. When a parent company conducts an equity carve out it may sell a 100% interest in the subsidiary, or it may choose to remain in the subsidiary’s line of business by selling only a partial interest and keeping the remaining percentage of ownership.

1.6.10 Leveraged Buyouts (LBO): The term ‘leveraged’ signifies the most significant and major use of debt or loan capital for financing the acquisition. The term ‘buy outs’ signifies the gain of control of a majority of the equity of the target company. Leveraged buyouts means the most significant and major use of debt or loan capital for financing the acquisition.

According to Miller, the leveraged buyout is “a financing technique of purchasing a private company with the help of borrowed or debt capital.”

(Bhaggban Das)\(^9\) In 2000, Tata Tea acquired the world’s second largest tea brand Tetley at a price of £271 million, out of which £235 million raised in the form of borrowed capital. For such acquisition, Tata Tea has created a special purpose vehicle- Tata Tea(Great Britain) which is the 100% subsidiary of Tata Tea, in order to acquire the assets of the target company Tetley. Here, Tata Tea Ltd. Created the SPV

with an aim to ensure that the balance sheet of Tata Tea does not affected by the additional funding costs, while the company can enjoy the benefits of such acquisition.

**1.6.11 Management Buy Out (MBO):** In a management buyout, the managers and or directors purchase all or part of the business from its owners. The management team will take substantial controlling interest from the existing owners who are having control over the affairs of the company. The management team may consist of one or more directors, one or more employees either with or without external associates. It is a method of setting up of business by the management team itself. The cases of management buyout occur when the existing owners unable to run the company successfully and when the very existence of the company is at stake. It is a divestment technique to sell the business which does not fit in with the new strategic plan of the group. The management will know the strengths and weaknesses of the business they are proposing to purchase from the owners and can make a better bargain. The insider information available with the managers will lead them to acquire substantial stake.

**1.6.12 Employee Stock Ownership Plans (ESOP):** An Employee Stock Ownership Plan allows companies to share ownership with employees without requiring the employees to invest their own money. With an ESOP, shares of company stock are contributed to an ESOP fund on behalf of the employees. Although other employment based plans, such as stock bonus and profit sharing plans may contain company’s stock, an ESOP is required to invest primarily in company stock. It offers extraordinary benefits to companies and their shareholders and employees. ESOPs provide a market for the shares of closely held businesses; motivate greater employee’s productivity; and provide tax advantages in the financing of acquisitions, capital improvements, charitable giving and stock purchases from retiring owners.
Bibliography:


