



SB-4106

M. B. A. (Sem. IV) (Full Time) Examination
March / April – 2011
Corporate Restructuring

Time : 3 Hours]

[Total Marks : 100

Instructions :

(1)

નીચે દર્શાવેલ નિશાનીવાળી વિગતો ઉત્તરવહી પર અવશ્ય લખવી. Fillup strictly the details of signs on your answer book.	Seat No. :
Name of the Examination :	<input type="text"/>
<input type="text" value="M. B. A. (Sem. 4) (Full Time)"/>	<input type="text"/>
Name of the Subject :	<input type="text"/>
<input type="text" value="Corporate Restructuring"/>	<input type="text"/>
Subject Code No. : <input type="text" value="4"/> <input type="text" value="1"/> <input type="text" value="0"/> <input type="text" value="6"/>	<input type="text"/>
Section No. (1, 2,.....) : <input type="text" value="Nil"/>	<input type="text"/>
	Student's Signature

- (2) Figures on the **right** indicate maximum marks of the question.
- (3) Question Nos. **7** is **compulsory**.
- (4) Elucidate your answers with examples wherever necessary.
- (5) Answer any 4 from question nos. 1 to 6.

- 1 Competition is at the core of any corporate restructuring activity. Do you agree ? Explain in light of the five competitive forces of Michael Porter. **16**
- 2 Explain the concepts of Organizational Learning and Organizational Capital in detail. Explain the transfer of OL and OC through Mergers or acquisitions. Give appropriate examples. **16**
- 3 What is the rationale behind sell offs and divestitures ? Give examples of any two sell offs (spin off, split up, equity curve out or disinvestment) in India. **16**
- 4 What are share repurchases ? How does share repurchase lead to change in the capital structure of the firm ? Explain the share repurchase model and show how value is created for the shareholders. **16**
- 5 A company is facing the problem of choosing between two mutually exclusive projects. Project A requires a cash outlay of Rs. 1,00,000 and cash running expenses of Rs. 35,000 per **16**

year. On the other hand, Project B will cost Rs. 1,50,000 and require cash running expenses of Rs. 20,000 per year. Both the machines have an eight year life. Project A has a Rs. 4000 salvage value and Project B has a Rs. 14,000 salvage value. The company's tax rate is 50% and has a 10% required rate of return. Assume depreciation on straight line basis and no tax on salvage values of assets. Which project should be accepted ?

- 6 The following is the information related to two companies 16
having the same level of risk but different capital structures :

	<i>U Ltd.</i>	<i>L Ltd.</i>
Equity	90,000	50,000
Debt	-	50,000
Total Value	90,000	1,00,000
Earnings	20,000	20,000
Interest.....	-	5,000
Net Profit.....	20,000	15,000
Ke	22.2%	30%
Kd	-	10%
Ko	22.2%	20%

Are the two firms in equilibrium ? Show how the values of both the firms will be brought into equilibrium by the actions of the investors.

- 7 Based on the case given below, answer the following 36
questions :

Case study the AOL and time warner merger

THE AOL AND TIME WARNER MERGER

A merger between AOL and Time Warner was announced on January 10, 2000. A new company named AOL Timer Warner Incorporated was the planned outcome of the merger. AOL shareholders would receive 1 new share for each AOL share, and TWX shareholders would receive 1.5 new shares for each TWX share.

The merger captured the imagination of the public. AOL agreed to pay stock worth about \$165 billion for Time Warner, a 70% premium. At the announcement, it was estimated that the market value of the combined companies would be \$350 billion. As important as the large value of the deal was the combination of "new economy" and "old economy" companies AOL's stock price had boomed in the 1990s as a hot Internet stock. Investors saw its potential for significant

future earnings growth based on its implementation of technology. Meanwhile, Time Warner was a leader of old-line media, owning publishing, television, cable, movie, and other entertainment properties. Although AOL only brought 18% of the revenues and 30% of the operating cash flows to the table, AOL shareholders would own 55% of the combined firm.

New technologies were crucial in transforming the industries of AOL and Time Warner. The internet industry underwent rapid transformation in the 1990s. In the early part of the decade, it was seen as a kind of virtual library. The Internet would be the means to exchange tremendous amounts of academic information easily. The introduction of Netscape Navigator in 1994 made the Internet more accessible to the masses. During the late 1990s, e-commerce became a central function of the Internet, with shopping online becoming “the next big thing”. Many analysts believe the AOL Time Warner merger is the sign that multimedia entertainment will be the next major step for the Internet and a precursor to combining more old and new economy industries.

For all the promise of the Internet as a source of multimedia entertainment many challenges have to be overcome. Although some believe that Internet sources eventually will replace print media, many find it cumbersome to read from a computer screen for long periods of time. Television on demand (where consumers pay to watch programming of their own choosing) has long been a dream for media companies, but so far it never has been implemented effectively. The movie and music industries have experienced challenges from the Internet in the form of piracy. In particular, some consumers are finding it easier to download their favourite songs from the Internet than to purchase CDs. However, virtually all these multimedia activities are eased by fastest Internet connections, sparking the conversion to broadband.

The reasons for the AOL Time Warner merger reflect the challenges that both companies face in the changing business environment. AOL was a content distributor. As an Internet service provider (ISP), monthly fees are the source of 70% of its revenues. AOL faces competition from Microsoft and from free and low-cost Internet access providers. In order to continue its profit growth, AOL could no longer rely on subscription revenue. Instead, AOL had to pursue increased advertising and e-commerce. It needed unique content and services to distinguish itself from its competitors.

Furthermore, AOL was constricted in a world shifting toward high-speed Internet connections. AOL currently relies on dialup modems using regular telephone lines. The speed restrictions are a bottleneck for multimedia content delivery. Because AOL doesn't own any high-speed lines, it would have been forced to hash out deals with companies that do (e.g., AT&T). Once it became clear the broadband cable Internet access could become the future of the ISP industry, AOL became the most vocal supporter of government intervention to force cable firms to open their cables to outside ISPs. This would allow firms like AOL to offer its services to the cable customers of other firms without having to own the "pipes" that carry the information to the home. Uncertainty concerning the future of open access was a motivation for AOL to acquire its own cable system.

TWX was a content producer and a broadband content distributor. Its revenues were growing at 10% to 15% per year. Any opportunity for higher growth would require developing a successful Internet business. So far, it had no clear Internet strategy and had been frustrated by its inability to exploit its cable and media assets more effectively in the Internet. Its interactive TV, Full Service Network, failed. Its Pathfinder Web site was a fiasco. Its broadband distribution business over cable lines through its partial ownership of the Internet provider Road Runner had not grown as rapidly as was hoped. Thus, the merger answered AOL's concerns about how it would implement its broadband strategy without owning content or having access to high-speed lines. It allows TWX to leverage its entertainment assets more effectively online with the benefit of AOL Internet resources and expertise.

The merger will link AOL's broad customer relationships to TWX's content and service distribution. The premier Internet distribution company in the world will be paired with the leading owner of copyrights in the world. AOL brings its worldwide Internet services, AOL and CompuServe, with a combined 22.2 million subscribers base or 54% of the total ISP business; also portal sites such as Netscape Netcenter and AOL.com; Web browsers like Netscape Navigator and Communicator; and several leading Internet brands such as ICQ and A.I.M. instant messaging. Digital City, AOL MovieFone, and MapQuest.com.

TWX brings the second largest U.S. cable television system with 13 million subscribers in Time Warner Cable and 350,000 subscribers in its partially owned broadband Internet provider, Road Runner, print media businesses that include Time Incorporated with 33 magazines such as *Entertainment Weekly*, *Fortune*, *Life*, *People*, *Sports Illustrated*, and *Time*, with an estimated 120 to 130 million readers and a 21% share of the 1998 consumer magazine advertising dollars; the eighth-largest book publishing business, which includes Book-of-the-Month Club, Time Life, Little Brown, and Warner Books; television broadcasting with 10 cable channels including CNN with a global reach of more than 1 billion. HBO with 30 million subscribers. TNT and TBS with 75 million homes, and the WB network; movie and television production such as Warner Bros. and New Line Cinema with 8% of the domestic film market; and music and Warner Music Group, which accounted for 16% of all records sold. The new company embraces nearly all types of media including cable, magazine, movies, music, and online offering new opportunities for cross promotion and expanded e-commerce.

It was estimated that the combination would save \$1.0 billion in 2001. Potential cost savings would arise from administrative savings and from substantially lower advertising and promotion costs. The new management team states that layoffs are unlikely and the intention is to expand the company. In the future, broadband strategies could represent substantial savings; for example, it could dramatically cut manufacturing and shipping costs associated with audio and video delivery.

Perhaps due to skepticism about the estimates of synergies or the overall strategic vision of the merger, the market had a negative initial reaction to the announcement of the merger. Although TWX stock took off, due to the large premium, AOL stock suffered, as illustrated by Figure B1.1. On February 19, 2000, AOL stock reached its low point of 54 and began to recover. By late March, AOL was trading at more than 80% of its pre-merger levels. Some people attributed the loss of value to the fact that investors did not yet “get” the merger. In some mergers, the complexity of the deal makes it hard to immediately recognize future

revenue sources, cost savings, and other synergies that may arise. The AOL Time Warner deal was further complicated by the fact that AOL was covered by Internet financial analysts, and Time Warner was covered by media financial analysts. No analysts were fully conversant with both businesses.

This provides a summary of the economic and business aspects of the transaction. Strong views have been expressed on other issues. One concern is media independence. Another is editorial integrity. These issues were raised directly by Jim Lehrer in his January 12, 2000, interview with Steve Case, head of AOL, and Gerald Levin, head of TWX. Levin assured Jim Lehrer that Henry Luce had left a legacy that Time was to be operated not only in the interest of shareholders, but also in the interest of the public. Case emphasized that AOL would support the public service objective. He argued that individual segments of the combined firm in the future would be even more independent of other segments to demonstrate their integrity.

Some critics fear that a small number of firms increasingly control viewer choices. Others argue the opposite. In earlier decades, viewers were limited to the offerings of four major networks; today every viewer has a multiplicity of choices. At least dozens of choices are "possible through cable television, although the majority of cable channels are owned by the few large media firms that control the networks. Thus, critics argue that although the number of choices has increased, fewer viewpoints are represented in deciding what those choices will be. The AOL Time Warner merger is an indicator that the Internet may fall under the same media influences that control television and other media outlets. Indeed, the merger gave rise to speculation about other firms that could follow the same "new" and "old" media combination strategy. Prominently mentioned were Yahoo! and Disney as potential partners.

The convergence between TV, the PC, and the Internet will continue to evolve. No one knows for sure what the nature of the ultimate development will be. Many firms and interest groups will shape the future of the media industry. Other media firms are going to have to decide if they will follow Time Warner and seek a strong Internet partner, or if they will continue independently. Cable providers like AT and T and the new AOL Time Warner will have to resolve the debate with Internet service providers to determine who will bring broadband Internet access into people's homes. Entertainment firms will have to coordinate with technology firms if they are to achieve interactive television. Such dynamic interactions will be shaped by mergers, joint ventures, strategic alliances, and other forms of interfirm relationships.

- (a) Do the SWOT analysis of AOL and Time Warner.
- (b) Do you see any major problems which may arise due to the differences in the organizational cultures of the two companies ?
- (c) Discuss the issue of the integration of the diverse compensation structures between Time Warner and AOL.
- (d) Has the merger yielded the synergies forecasted for 2001-2002 ?

FIGURE B1.1 AOL and TWX Initial Stock Price Reactions

