

**IMPACT OF LEVERAGED BUYOUT ON SHAREHOLDERS' VALUE ADDED:
EVIDENCE FROM SELECT INDIAN COMPANIES**

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Abstract

This study examines the impact of the leveraged buyout on shareholders' value-added of the firms. For this purpose, we have chosen the firms which have undergone leveraged buyout in India during the period from 2000-01 to 2014-15. We have adopted a control sample methodology where we have selected a control company against each sample company on the basis of market capitalization. Under this methodology, first of all, we have computed the average Shareholders' Value Added (SVA) of the selected sample firms and their matching control firms separately before and after the LBO period in order to find out the improvement in shareholders' value after a leveraged buyout. We have applied paired sample t-test on the mean difference to determine the statistically significant result. It is found from the study that there is an improvement in shareholders' value after leveraged buyout since the post-LBO average SVA of the sample companies has shown far better performance in terms of shareholders' value than its matching control company.

Keywords: Leveraged buyout, Control sample methodology, Shareholders Value Added.

Introduction

The term leveraged buyout (LBO) may be defined as the purchase of a significant and controlling equity stake in mature companies which normally possess strong cash flows, using significant debt financing raised by borrowing against the assets and/or cash flows of the acquired company (Rodden& Lewellen,1995). Leveraged buyout (LBO)occurs when someone purchases a company almost entirely through debt. There is a large number of

research studies in the field of the leveraged buyout but in India, there is a little number of research studies. Researchers like Kaplan (1989), Berg&Gottschalg (2005), Bergström, Grubb&Jonsson (2007), Chapman& Klein (2009), Achleitner&Figge (2014), Kielenniva (2014), Bassoulet (2015) have shown that LBO results in improvement of shareholders' value whereas some scholars like Morck, Shleifer &Vishny (1988), Harbula(2011), Fremlink&Volosovych (2012), Hagsund&Selsmark (2020) have opined that leveraged buyout leads to the destruction of value to the firms. In this backdrop, the study examines the impact of the leveraged buyout on the shareholders' value added in the context of India.

Objectives

The objectives of the study are

- 1) To compute the shareholders' value-added of the select firms
- 2) To examine the impact of the leveraged buyout on the shareholders' value-added of select Indian companies.

Hypothesis

The testable hypothesis of the study is as follows: LBO leads to improvement in shareholders' value-added.

Database and methodology

The financial data used for the study are collected from secondary sources mainly from annual reports of the select companies. The corporate tax rates applicable for different financial years have been collected from the official website of the Income Tax Authority of India. Besides, we have used the 'Capitaline2000 database package. This database package has also been consulted for collecting the share price data of the sample companies and daily nifty data over the study period.

In the case of market value added only the unrealized gain has been considered, but in case of SVA both realized and unrealized gains have to be considered. SVA may be measured in two common approaches namely, (1)Economic Value Approach and (2) Market Value Approach. Under the economic value approach, SVA is calculated by deducting gains on debt capital and preference share capital from economic value added. Therefore, SVA can be computed by means of capitalization of EVA which represents the addition of real value rather than true value-added. Under the market value approach SVA

is the sum of MVA and other realized gain like dividend received, benefit from right issue, bonus issue, etc. Hence, SVA may be calculated as: $SVA = MVA + \text{Total Equity Dividend}$. It is also necessary to make adjustment for change in the number of outstanding shares and proportionate dividends for the change. Considering the change SVA is calculated by using the formula:

$$SVA = MVA + T.D \pm \frac{\text{Number of days adjusted with the number of share remaining invested}}{365} * DP$$

increase /decrease in number of shares adjusted.

Where T.D is the Total Equity Dividend and DPS is Dividend per Share.

After computing the SVA, we have applied the control sample methodology (where a comparison has been made between the sample company and its matching control company). We have calculated the mean value of SVA between the pre-LBO and post-LBO periods. We have also applied paired t-test in order to determine the results that are statistically significant between the two periods [pre-LBO period and post-LBO period].

Analysis and Discussion

It is noticed from Table 1 that the mean SVA of Hindalco Industries Ltd has decreased in the post-LBO period (6814.93) as compared to that of the pre-LBO period (7891.62). It indicates that there is the destruction of shareholders' value of the company after LBO. National Aluminium, the Control Company, has exhibited improvement in shareholders' value after the LBO period as its mean SVA has increased remarkably in the post-LBO period (14879.04) as compared to that of the pre-LBO period (4530.57).

From Table 1 it is seen that there is a remarkable improvement in shareholders' value of UB Group in the post-LBO period (1706.40) as compared to that of the pre-LBO period (599.97). The control company, Radico Khaitan has disclosed shareholders' value destruction after the LBO period as its mean value of SVA has decreased remarkably in the post-LBO period (142.48) in contrast to that of the pre-LBO period (491.87). Therefore, the sample company (UB Group) has depicted better performance than that of the Control Company from the shareholder's value creation perspective.

It is observed from Table 1 that there is a notable increase in shareholders' value of Tata Steel after LBO as the mean SVA of the company has enhanced remarkably in the

post-LBO period (35128.33) as compared to that of the pre-LBO period (9327.45). The control Company, JSW Steel has also depicted similar results to that of Tata Steel in the post-LBO period. It indicates that both the companies have been able to create shareholders' value after the occurrence of LBO.

It is noticed from Table 1 that the average SVA of United Spirits has increased remarkably in the post-LBO period (8704.67) as compared to that of the pre-LBO period (1576.66). The control company, Radico Khaitan has shown results quite contrary to that of United Spirits Ltd. The result indicates that there is the destruction of shareholders' value after the LBO period. Therefore, comparing the results between the two companies it may be argued that United Spirits is a shareholders' value creator while Radico Khaitan is a shareholders' value destroyer after LBO has taken place.

From Table 1 it is observed that Post-LBO mean SVA (20517.01) of Tata Motors has increased as compared to that of the pre-LBO mean SVA (7080.72). The result indicates that there is a notable improvement in shareholders' value of the company after LBO. The mean SVA of Maruti Suzuki, the Control Company, has decreased in the post-LBO period (6572.55) as compared to that of the pre-LBO period (6630.42). It indicates that there is shareholders' value destruction of the firm in the post-LBO period. Therefore, it can be said that Tata Motors has experienced far better performance in respect of value creation for shareholders than that of Maruti Suzuki.

It is evident from Table 1 that mean SVA of Dr. Reddy's laboratory has increased notably in the post-LBO period (544.93) as compared to that of the pre-LBO period (-837.47). The result indicates an improvement in shareholders' value of the company after LBO. Control company, Sun Pharma, also indicates a similar improvement in shareholders' value after LBO as its mean value of SVA has increased remarkably in the post-LBO period (5012.85) as compared to that of the pre-LBO period (2940.49). Therefore, both the companies Dr. Reddy's Lab and Sun Pharma are value creators to shareholders' after leveraged buyout period.

From Table 1 it is observed that United Phosporus (sample company) has exhibited a decrease in average SVA in the post-LBO period (-11.96) as compared to that of the pre-LBO period (778.68). The result indicates that the company has destroyed value after LBO has occurred. Pidilite Industries has shown improvement in shareholders' value after the

LBO period as its average SVA has increased remarkably in the post LBO period (718.45) in comparison to that of the pre-LBO period (191.02).

It is disclosed in Table 1 that there is a remarkable improvement in the average SVA of Aban Offshore after LBO as the post-LBO mean SVA (5778.92) of the company is greater than that of pre-LBO mean SVA (450.11). Besides, similar results are found in the case of Reliance Industries. Therefore, Reliance Industries and Aban Offshore are both shareholders' value creators after the LBO period.

From Table 1 it is noticed that mean SVA of Tata Coffee has decreased in the post-LBO period (62.89) in comparison to that of the pre-LBO period (199.58) which indicates that the company has destroyed its value after LBO. Tata Global Beverage has also disclosed that it has destroyed value to shareholders after LBO since its mean SVA in the post-LBO period is less than that of the pre-LBO period.

The summary results of mean SVA of sample companies and its matching control companies are presented in Table 2. It is seen that 6 (66.67%) sample companies out of 9 sample companies have disclosed increase in mean SVA after the LBO has taken place. It is further observed that only 5 (55.56%) control companies have exhibited an increase in mean SVA in the post-LBO period. Therefore, it can be said that post-LBO SVA of the sample companies is far better than that of control companies.

Paired sample t tests are conducted on mean SVA of both sample and control companies in order to check whether the above calculated results are statistically significant or not in between the two periods [i.e., pre-LBO and post-LBO]. If significant result is found in case of sample companies and insignificant result is obtained for control companies then it can be concluded that LBO has a significant positive impact on shareholders' value creation of the sample companies. The Paired t-test results are exhibited in Table 3. It is found that the t-value (-1.963**) on mean SVA of the sample companies is significant at the 5% level. Hence, the null hypothesis (H₀) is rejected and the alternative hypothesis is accepted (H₁). It indicates that there is a statistically significant improvement in shareholders' value of the sample companies after LBO. On the other hand, the t-value (-1.213) of the control companies is insignificant on the same variable. The result indicates that there is no statistically significant improvement in shareholders' value of the control companies after the LBO has occurred.

Major findings and Conclusion

From the above discussion, it is found that the average SVA of sample companies like UB Group, Tata Steel, United Spirits, Tata Motors, Dr. Reddys' Laboratory, and Aban Offshore has increased in the post-LBO period as compared to that of the pre-LBO period whereas average SVA of control companies like National Aluminium, JSW Steel, Sun Pharma, Pidilite Industries, Reliance Industries has increased in the post-LBO period as compared to that of the pre-LBO period. The results indicate that there is an improvement in shareholders' value after a leveraged buyout. Only sample companies like Hindalco Industries, United Phosphorus, and Tata Coffee have depicted an increase in average SVA in the post-LBO period in contrast to that of the pre-LBO period. It indicates that there is the destructions are shareholders' value as a result of leveraged buyout since its matching control companies like National Aluminium, Pidilite Industries have depicted a quite contrary result. It is also observed from the study that 67 percent of the sample LBO companies have shown an increase in average SVA after LBO whereas it is only 56 percent of the control companies after LBO. Moreover, the result of paired t-test on the average SVA of the sample companies is significant but it is insignificant for the control companies. Therefore, it can be concluded that LBO results in an improvement in the SVA of the sample companies.

Table1: Shareholders Value Added (Rs. In crore) of Sample Companies and Control Companies

NameofCompany	(t-3)	(t-2)	(t-1)	t	(t+1)	(t+2)	(t+3)	Mean	
								Pre-LBO	Post-LBO
Hidalco IndustriesLtd	9928.63	4637.38	9108.84	-5947.99	5888.04	-11447.68	26004.43	7891.62	6814.93
National Aluminium	7300.03	-1037.33	7329.02	-4184.80	15361.85	16515.45	12759.83	4530.57	14879.04
UB Group	236.5	516.12	1047.3	2454.28	1245.36	1582.8	2291.04	599.97	1706.40
Radico Khaitan	180.29	403.56	891.77	-333.23	-125.78	-481.61	1034.83	491.87	142.48
Tata Steel	10308.7	9166.13	8507.51	-2211.87	27924.29	35811.09	41649.62	9327.45	35128.33
JSW Steel	443.58	3554.44	-298.72	2781.42	10625.4	-10899	20697.4	1233.10	6807.94
United Spirit Ltd	105.77	928.12	3696.08	2590.25	7537.41	8647.41	9929.18	1576.66	8704.67

Radico Khaitan	180.29	403.56	891.77	-333.23	-125.78	-481.61	1034.83	491.87	142.48
Tata Motors Ltd	14558.62	924.06	5759.48	13492.16	6180.65	17842.23	37528.14	7080.72	20517.01
Maruti Suzuki	9670.68	-2707.43	12928	-2467.23	2397.39	-931.49	18251.75	6630.42	6572.55
Dr. Reddys Lab	-1292.77	537.59	-1757.24	5295.94	1187.97	2055.58	-1608.75	-837.47	544.93
SunPharma	484.06	5058.07	3279.35	8654.52	5821.49	7750.99	1466.08	2940.49	5012.85
United PhosporusLtd	29.76	1299.64	1006.65	2473.9	1047.24	-163.68	-919.45	778.68	-11.96
Pidilite Industries	104.49	193.84	274.74	1534.47	227.16	654.79	1273.41	191.02	718.45
Aban Offshore	46.17	282.62	1021.54	2634.44	3276.72	4200.83	9859.22	450.11	5778.92
Reliance Industries	10163.51	39214.99	5814.1	38431.62	82431.55	154508.6	92711.2	18397.53	109883.78
Tata Coffee	105.24	160.91	332.58	200.39	110.82	88.99	-11.14	199.58	62.89
Tata Global Beverage	547.76	1318.48	1656.03	2599.41	-359.26	3817.55	-448.63	1174.09	1003.22

Source: Authors' own calculation

Table2: Summary Result of Change in Mean SVA

Change in SVA	Sample Companies		Control Companies	
	Number of companies	Percent of companies in terms of change in Mean SVA	Number of companies	Percent of companies in terms of change in Mean SVA
Increase in SVA	6	66.67	5	55.56
Decrease in SVA	3	33.33	4	44.44
Total	9	100.00	9	100.00

Source: Authors' own calculation

Table3: Results of Paired Sample t Test on Mean SVA

Time Window	Variables	Mean	t
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Pre-LBO to post-LBO	Mean SVA(pre-LBO) of Sample Companies	3007.48	-1.963**
	Mean SVA(post-LBO) of Sample Companies	8805.12	
Pre-LBO to post-LBO	Mean SVA(pre-LBO) of Control Companies	4009	-1.213
	Mean SVA(post-LBO) of Control Companies	16129.2	

Notes:***implies significant at 1% level, **implies significant at 5% level, *implies significant at 10% level; Authors' calculation is based on SPSS.

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