X Multinational Restructuring

Chapter Objectives

- To introduce international acquisitions by MNCs as a form of multinational restructuring;
- To explain how MNCs conduct valuations of foreign target firms;
- To explain why the valuations of a target firm may vary among MNCs; and
- To identify other methods of multinational restructuring.

Outline

1. Concept of Multinational restructuring
2. Forms of Multinational restructuring
3. Factors affecting target valuation
4. Valuation process
5. Disparity in foreign target valuations
6. Restructuring decisions as real options
7. Conclusion
8. Questions, assignments, applications

1. Concept of Multinational Restructuring

- Building a new subsidiary, acquiring a company, selling an existing subsidiary, downsizing operations, or shifting production among subsidiaries, are all forms of multinational restructuring.
- MNCs continually assess possible forms of multinational restructuring to capitalize on changing economic, political, and industrial conditions across countries.

2. Forms of Multinational Restructuring

- International acquisitions
- International partial acquisitions
- International acquisitions of privatized businesses
- International alliances
- International divestitures

2.1 International Acquisitions

- Through an international acquisition, a firm can immediately expand its international business since the target is already in place, and benefit from already-established customer relationships.
- However, establishing a new subsidiary usually costs less, and there will not be a need to integrate the parent management style with that of the acquired company.

2.1 International Acquisitions

- Like any other long-term project, capital budgeting analysis can be used to determine whether a firm should be acquired.
- Hence, the acquisition decision can be based on a comparison of the benefits and costs as measured by the *net present value (NPV)*.

2.1 International Acquisitions

- $$NPV = -\text{ initial outlay} + \sum_{t=1}^{n} \frac{\text{cash flow in period } t}{(1+k)^t} + \frac{\text{salvage value}}{(1+k)^n}$$

  k = the required rate of return on the project
  n = project lifetime in terms of periods

- If NPV > 0, the project can be accepted.
- If NPV < 0, the project can be rejected
- If NPV = 0, the project can be cosidered

2.1 International Acquisitions

- Note that the relevant exchange rate, taxes, and blocked-funds restriction, should be taken into account.
- The cost of overcoming the barriers that may be imposed by the government agencies that monitor mergers and acquisitions should be taken into consideration too.
- Examples of such barriers include laws against hostile takeovers, restricted foreign majority ownership, "red tape," and special requirements.

2.1 International Acquisitions

- While the Asian crisis had devastating effects, it created an opportunity for some MNCs to pursue new business in Asia.
- In Asia, property values had declined, the currencies were weakened, many firms were near bankruptcy, and the governments wanted to resolve the crisis.
- However, these MNCs must not ignore the lowered economic growth in Asia too.

2.1 International Acquisitions

- In Europe, the adoption of the euro as the local currency by several countries simplifies the analysis that an MNC has to perform when comparing various possible target firms in the participating countries.

2.2 International Partial Acquisitions

- An MNC may purchase a substantial portion of the existing stock of a foreign firm, so as to gain some control over the target's management and operations.
- The valuation of the firm depends on whether the MNC plans to acquire enough shares to control the firm (and hence influence its cash flows).

2.3 International Acquisitions of Privatized Businesses

- Many MNCs have acquired businesses from foreign governments.
- These businesses are usually difficult to value because the transition entails many uncertainties - cash flows, benchmark data, economic and political conditions, exchange rates, financing costs, etc.

2.4 International Alliances

- MNCs commonly engage in alliances, such as joint ventures and licensing agreements, with foreign firms.
- The initial outlay is typically smaller, but the cash flows to be received will typically be smaller too.

2.5 International Divestitures

- An MNC should periodically reassess its DFIs to determine whether to retain them or to sell (divest) them.
- The MNC can compare the present value of the cash flows from the project if it is continued, to the proceeds that would be received (after taxes) if it is divested.

3. Factors Affecting Target Valuation

- Target-Specific Factors
- Country-Specific Factors

3.1 Target-Specific Factors

➊ *Target's previous cash flows.* These may serve as an initial base from which future cash flows can be estimated.

➋ *Managerial talent of the target.* The acquiring firm may allow the acquired firm to be managed as it was before the acquisition, downsize the firm, or restructure its operations.

3.2 Country-Specific Factors

❶ *Target's local economic conditions*. Demand is likely to be higher when the economic conditions are strong.

❷ *Target's local political conditions*. Cash flow shocks are less likely when the political conditions are favorable.

❸ *Target's industry conditions*. Industries with high growth potential and non-excessive competition are preferred.

3.2 Country-Specific Factors

❹ *Target's currency conditions*. A currency that is expected to strengthen over time will usually be preferred.

❺ *Target's local stock market conditions*. When the local stock market prices are generally low, the target's acceptable bid price is also likely to be low.

❻ *Taxes applicable to the target*. What matters to the acquiring firm is the after-tax cash flows that it will ultimately receive in the form of remitted funds.

4. Valuation Process

- Prospective targets are first screened to identify those that deserve a closer assessment.
- Capital budgeting analysis is then applied to each of the targets that passed the initial screening process.
- Only those targets that are priced lower than their perceived net present values may be worth acquiring.

5. Disparity in Foreign Target Valuations

- **Estimated cash flows of the foreign target:**
- Different MNCs will manage the target's operations differently.
- Each MNC may have a different plan for fitting the target within the structure of the MNC.
- Acquirers based in certain countries may be subjected to less taxes on remitted earnings.

5. Disparity in Foreign Target Valuations

- **Exchange rate effects on remitted funds:**
- Different MNCs have different schedules for remitting funds from the target to the acquirer.
- **Required rate of return of the acquirer:**
- Different MNCs may have different plans for the target, such that the perceived risk of the target will be different.
- The local risk-free interest rate may differ for MNCs based in different countries

6. Restructuring Decisions As Real Options

- Restructuring decisions may involve *real options*, or implicit options on real assets.
- If a proposed project carries an option to pursue an additional venture, then the project has a *call option on real assets*.
- If a proposed project carries an option to divest part or all of itself, then the project has a *put option on real assets*.

6. Restructuring Decisions As Real Options

- The expected NPV of a project with real options may be estimated as the sum of the products of the probability of each scenario and the respective NPV for that scenario.

$$\mathbf{E(NPV)} = \sum_{i} p_i \times \mathrm{NPV}_i$$

p_i = probability of scenario i

NPV_i = NPV for scenario i

7. Conclusion

- There are different forms of MNC's restructuring such as international acquisition, partial acquisition, privatized business, alliance, divestitures
- The valuation of a firm's target is influenced by target specific factors and country specific factors
- The valuation process:
  - International Screening Process
  - Estimating the Target's Value
- Valuations of a foreign target may vary among potential acquirers because of differences in estimates of the target's cash flows, or exchange rate, the required rate of return

8. Questions, assignments, applications

- 6 questions of the self test
- questions and application, including advanced questions
- Assignment: Blades Inc Case