VUCA – II Unit (1)

CAPITAL EXPENDITURE DECISIONS UNDER RISK

Before making investment in any project (business), the investor estimates the cash inflows, cash outflows, and terminal cash flow. To estimate the future cash inflows, the investor will use capital budgeting (expenditure) techniques for taking decision. If the investor satisfies, then he will start the business otherwise he won't start. Estimation of cash flows depends on the project economic life, scrap value, initial cost, cash inflows, depreciation and tax. There are five capital budgeting techniques to estimate cash flows. These are as follows

1. Payback Period
2. Accounting Rate of Return (ARR)
3. Net Present Value (NPV)
4. Internal Rate of Return (IRR)
5. Profitability Index (PI)

Estimation of exact cash flows is not possible due to uncertainty in its estimation of cash flows.

Types of Decision Situations in Capital Expenditure – (2018)

The decision situations with reference to risk in capital budgeting decisions can be classified into three types.

a) Certainty
b) Uncertainty
c) Risk

Certainty: - It means no risk. The estimated returns are equal to the actual returns.

Ex: - Deposit in banks, invest in government securities. Hence it is risk free investment.

Uncertainty: - Due to lack of historical data, the possible outcomes will not estimate. The project is completely a new project the consequences (probabilities) will not possible to estimate. Due to lack of historical data, the probabilities are not known by decision maker.

Risk: - The possible outcome of the decision will estimate by the investor i.e. consequences of its investment, due to some historical data, he will estimate the probabilities.

Risk classified as systematic and unsystematic risk

- **Systematic risk**: - Due to external factors it is arises. The investor should bear this risk. He cannot escape from this. It is uncontrollable. It is not possible to reduce through diversification. Hence it is called undiversifiable.
- **Unsystematic risk**: - Due to internal factors it will arises. It will reduce through diversification. It is controllable and diversifiable.

SOURCES AND PERSPECTIVES OF RISK

Perspectives of systematic risk (example/sources)

1) **Market risk:** - Due to government policies, inflation, per capita income, gross domestic product of economy, lack of demand, purchasing power, it will arise.
2) **Interest rate**: - Due to RBI monetary policy it will arise.
3) **International**: - Due to exchange rate changes and political reasons.
4) **Stand alone risk**: - It refers the risk of the project when it is viewed in isolation. If the investor will invest in only one project this risk arise.(portfolio will not follow by investor)
5) **Firm risk**: - If investor invests in portfolio (more than in one or two projects) then risk arises. It is firm risk. Due to risk in one project will impact on total firm(portfolio)
   Eg: satyam, lanco, king fisher.

Perspectives of unsystematic risk (example/sources)

1) **Business risk**:-Due to internal factors, it arises. Dispute between management and workers, shortage of raw material, etc.
2) **Financial risk**: - The credit policy of the investor, debt collection period, bad debts, it will arise.
3) **Competitive risk**

TECHNIQUES FOR RISK ANALYSIS

Risk analysis is one of the most complex aspect of capital budgeting. Different techniques have been suggested and no single technique can be deemed as best in all situations. The following are the risk analysis techniques.

1. Sensitivity analysis
2. Scenario analysis
3. Simulation analysis
4. Break even analysis
5. Decision tree analysis
6. Project selection under risk

1. SENSITIVITY ANALYSIS: - The other name is 'what if' analysis.

The reliability of the NPV or IRR of the project will depend on the appropriate estimates of Net cash flows. The investor will consider three assumptions, while estimate the cash flows. The three assumptions are:

a. The pessimistic
b. The most likely(expected)
c. The optimistic (the best)

The NPV of the project is recalculated under these different assumptions. This method of recalculating NPV or IRR by changing each forecast (assumptions) is called Sensitivity Analysis.

It is a way of analysing change in the project's NPV/IRR for a given change in one of the variables (sales, selling price, variable cost, fixed cost, etc.). It indicates how sensitive a project's NPV is to change in particular variables. The more sensitive the NPV, the more critical is the variable. The following are the steps in the use of sensitivity analysis.

- Identification of all those variables, which have an influence on the project's NPV.
- Define the relationship between variables(revenue depends on cost)
- Analyse the impact of change in each of the variables on the projects NPV.

The decision maker computes the project's NPV under three assumptions: - Pessimistic, Expected, Optimistic, through 'what if' concept. For example: -

- What is the NPV, if volume increases or decreases?
- What is the NPV, if variable cost or fixed cost increases or decreases?
- What is the NPV/IRR, if selling price increases or decreases?

The following table explains this:

Forecasts under different assumptions

Variables	Pessimistic	Expected	Optimistic
Volume(in units)	7500	10000	12500
Unit selling price(Rs)	12.50	15.00	16.50
Unit variable cost(Rs)	8.00	7.00	6.00
Fixed cost	6000	5000	4000

If we change each variable (other holding constant)

Pros and cons of sensitivity analysis

ADVANTAGES:-

1) It helps the decision maker in understanding the total project by identifying change in the cash flow forecast through NPV in different assumptions.

2) It helps to disclose inappropriate forecast and thus guides the decision maker to concentrate on relevant variables.
3) The decision maker can consider actions, which may help in strengthening the weak spots in the project.

LIMITATIONS:-

1) **It provides ambiguous results**: The assumed possible outcome (pessimistic/ optimistic) is different to different departments (marketing, production) which will give inconsistency about outcomes.
2) **It fails to focus on the inter relationship between variables**. For **ex**: sales volume may be related to price and a price cut increases sales and reduce operating cost.
3) **The same sensitivity analysis may lead different decisions**. For **ex**: In pessimistic, the project may accept and optimistic conditions the project may reject.

2. SCENARIO ANALYSIS: -The sensitivity analysis explains that variables are independent of each other, in sensitivity one variable is varied at a time. In scenario analysis, several variables are varied simultaneously. In practice, its variables will be interrelated and they may change in combination.

One way to examine the risk of investment is to analyse the impact of alternative combinations of variables, called scenarios, on the projects NPV/IRR. Several variables are varied simultaneously. E.g.: we can consider three scenarios: pessimistic, optimistic and expected. In normal (expected) scenario, it may be possible to increase the base volume of 10000 units to 12500 units (25% increases), if the company reduces selling price from RS15.00 to 13.50 (10% reduce) and give more advertisement increase the variable cost by 5%.

Scenario summary

Variable combinations	Base values	Expected	Pessimistic	Optimistic
Sales volume (in units)	10000	12500	7500	12500
Selling price (unit Rs)	15.00	13.50	12.75	16.50
Variable cost(unit Rs)	6.75	7.10	7.43	6.75

Merit/ Evaluation: scenario analysis may be regarded as an improvement over sensitivity analysis because it considers variations in several variables together.

Limitations:

- In scenario analysis, if there are 10 inputs (variable) the analyst has to estimate 30 expected values (3*10) to do the scenario analysis.
- It is not possible to arise three situations simultaneously (recession, boom, stability).

3. SIMULATION ANALYSIS: - The Sensitivity and scenario analyses are quite useful to understand the uncertainty of the investment. Both explains that quantity increase, and sales decrease by 1 %, other things being equal, the NPV falls by 5%. Such information though useful, may not be adequate for decision making. The decision makers consider the interactions between variables and develop the probability of the change in variables.

The simulation analysis considers the interactions among variables and probabilities of change in variables. The simulation analysis is an extension of scenario analysis. The simulation analysis generates large number of scenarios according to the probability distributions of variables. It involves the following steps.

a. Identify the variables that influence cash inflows and outflows.
   E.g.: when a firm introduces a new product, the variables are investment, market size, price, variable cost, fixed cost etc.
b. There are interrelated variables.
   E.g.: Revenue depends on sales and price, sales volume on market size, operating expenses depends on variable cost, fixed cost and sales.
c. Identify the probability distribution for each variable. Some variables are more uncertain then others.
   E.g.: Difficult to predict market price or market growth.

Merits:

a) Compare with single valued estimate approach, simulation estimates probable accuracy as well as expected values.
b) Since the output is probability of NPV/IRR, the decision makers have substantial information about the reward-risk profile of the project.

Limitations:

a) Identifying all possible relationships and estimating probability is difficult, time consuming and expensive.
b) It generates probability of the project's NPV. But does not indicate whether or not the project should be accepted.
c) It considers that the risk of any project is different from other projects.

4. DECISION TREE ANALYSIS: - Decision Tree is a graphical representation in lying tree form. The present decision depends upon future events, and the alternatives of a whole sequence of decisions in future are affected by the present decision as well as future events. Thus, the consequences of each decision are influenced by the outcome of the chance event. At the time of taking decisions, the outcome of the chance event is not known, but a probability distribution can be assigned to it. A decision tree is a graphic representation of the inter-relationship between present decision and future events, future decisions and their consequences. The sequence of events is mapped out over time in a format similar to the branches of a tree.

Steps in Decision Tree Analysis

a) **Identifying the investment**: - It is the first step in which investment is to be invested. Investment may be a new project, new product, entering a new market, replacement of a machine etc.

b) **Identify Decision Alternatives**: - There are more alternatives to make investment. For ex: - If a company is planning to construct a plant to produce new product, it may construct a large plant, medium or small plant initially and expand it later or construct no plant. Each alternative will have different consequences.

c) **Draw a Decision Tree**: - The decision tree should be graphed indicating the decision points, chance events and other data. The relevant data such as projected cash flows, probability, the expected present value, etc. Should be located on the decision tree branches.

d) **Evaluate the Alternatives**: - Next step is to evaluate different alternatives.

e) **Selection of best Alternatives**: - The evaluator selects a profitable alternative, there by rejecting other alternatives.

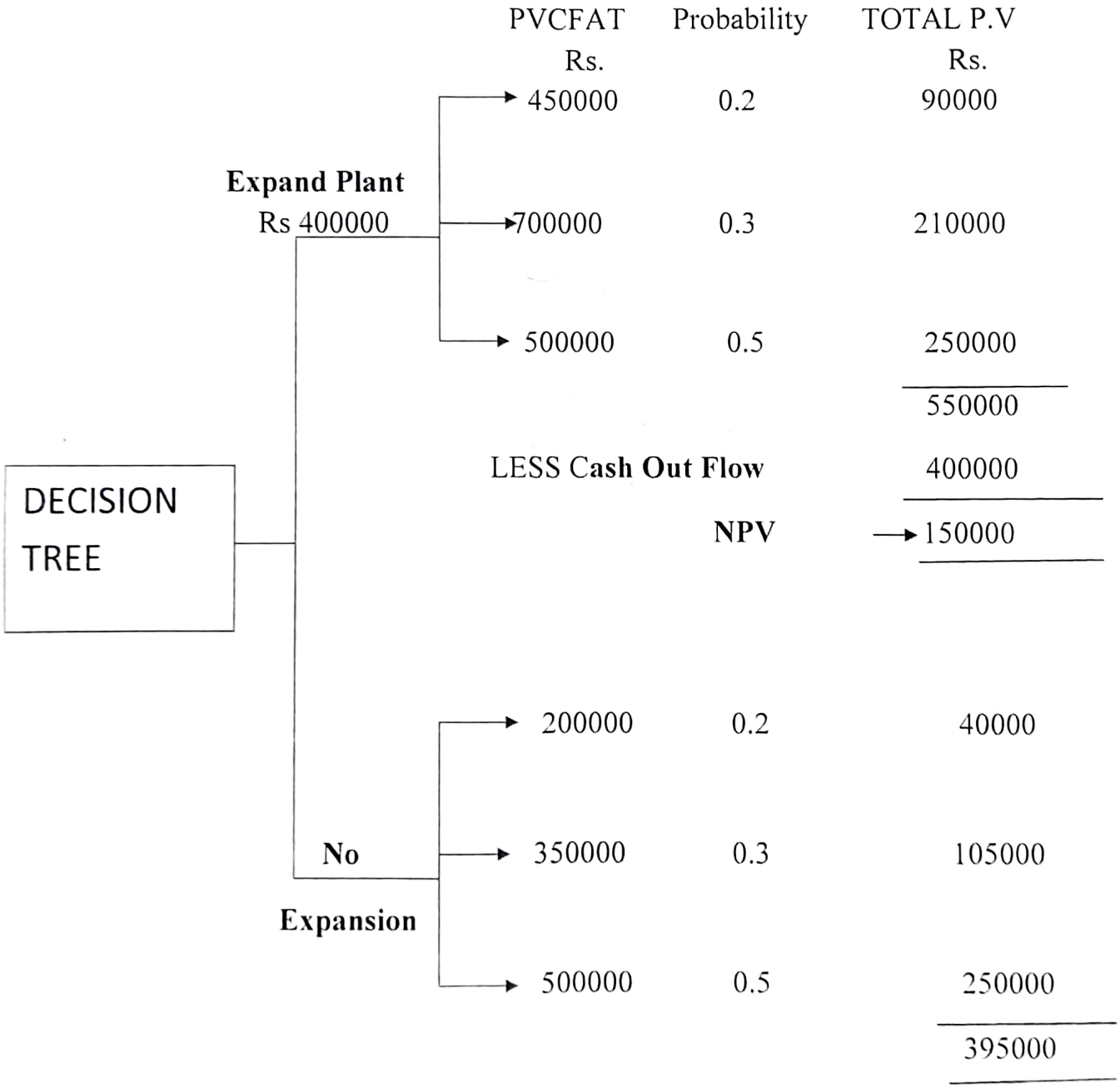
EVALUATION: Assumptions and alternatives in graphic form, much easier to understand than analytical form.

The decision tree is difficult as more alternatives and more variables that are dependent on one another. Ex: sales depend on market share which depends on promotion, expenses, etc.

CASE STUDY:

Venkat Intel Company estimates the present value of future expected cash flows after taxes relates to plant expansion proposal. The plant expansion costs RS 400,000. You are required to advice the financial feasibility with the use of decision tree approach.

CASH FLOWS AFTER TAX (RS)		
With Expansion	Without Expansion	Probability
450000	200000	0.2
700000	350000	0.3
500000	500000	0.5



DECISION: Proposed expansion is feasible, since the NPV is positive i.e. Rs.150000.

4

5. BREAK- EVEN ANALYSIS: - The financial manager should know how much should be produced and sold at a minimum to ensure that the project does not lose money. Such an exercise is called break even analysis and the minimum quantity at which loss is avoided is called the breakeven point.

$$BEP = \frac{\text{Fixed cost}}{\text{PV ratio}}$$

6. PROJECT SELECTION UNDER RISK: - Should the project be accepted or rejected? There are several ways to handle the risk. These are NPV, IRR, RADR and CEA.

a) **Risk Adjusted Discount Rate** (RADR): - RADR is the discount rate is used to convert future cash flows into present values. It is equal to the risk free return plus risk premium for investing on a project which is characterized by risk. Risk free rate is the rate of government securities, fixed deposits, etc.

RADR = Risk Free Return + Risk Premium
(DF 10%) (7%) + (3%)

Firms use different RADRs (risk premiums) for different capital budgeting decisions.

EX: High RADR for new projects (high risk), medium RADR for expansion projects and low RADR for replacement investment (low risk). It indicates that more riskiness of the project high discount rate and vice versa.

RADR can be used to find out NPV, IRR.

If NPV method is used: Accept: NPV > 0
Consider: NPV=0 Reject: NPV <0
If IRR method is used: Accept: IRR> RADR
Consider IRR=RADR Reject: IRR< RADR

RADR = Risk Free Rate + Risk Premium
(10%) (7%) + (3%)

YEARS	CFAT (RS)	DF (10%)	PV(RS)
1	20000	.909	18180
2	30000	.826	24780

MERITS:-

- It is simple to calculate and easy to understand.
- It gives psychological satisfaction to decision maker since it adds some premium for risk

LIMITATIONS:-

- It is difficult to estimate.
- It assumes that risk increases with time at constant rate, which is not valid.
- It does not make use of information from probability distribution expected future cash.

b) **Certainty Equivalent Approach** (CEA): - CEA overcomes, some of the limitations of RADR approach. If incorporates risk of project by adjusting the expected cash flows instead of adjusting the expected cash flows, instead of adjusting discount rates.

It represents the relationship between risks less (certain) cash flows and risky (uncertain) cash flow.

$$\text{Certainty Equivalent Coefficient} = \frac{\text{Risk less cash flow}}{\text{Risky cash flows}}$$

Certainty equivalent coefficient assumes a value between 0 and 1 and varies, increased. A high Certainty equivalent coefficient will be used if lower risk is forecasted and vice versa.

NPV, IRR techniques can be applied.

Accept: if NPV of certainty equivalent cash flows >0

Reject: if NPV of certainty equivalent cash flows< 0

If IRR techniques are used:

Accept: if IRR> RF; Reject: if IRR< RF; Consider if IRR= RF rate

MERITS

- Simple to calculate and easy to understand.
- It is superior to RADR, since it does not assume that risk increases with the time increase.

DEMERITS

- It is difficult to consider.
- It is inconvenient and difficult to specify service certainty equivalent coefficients.

5

FINANCIAL DERIVATIVES

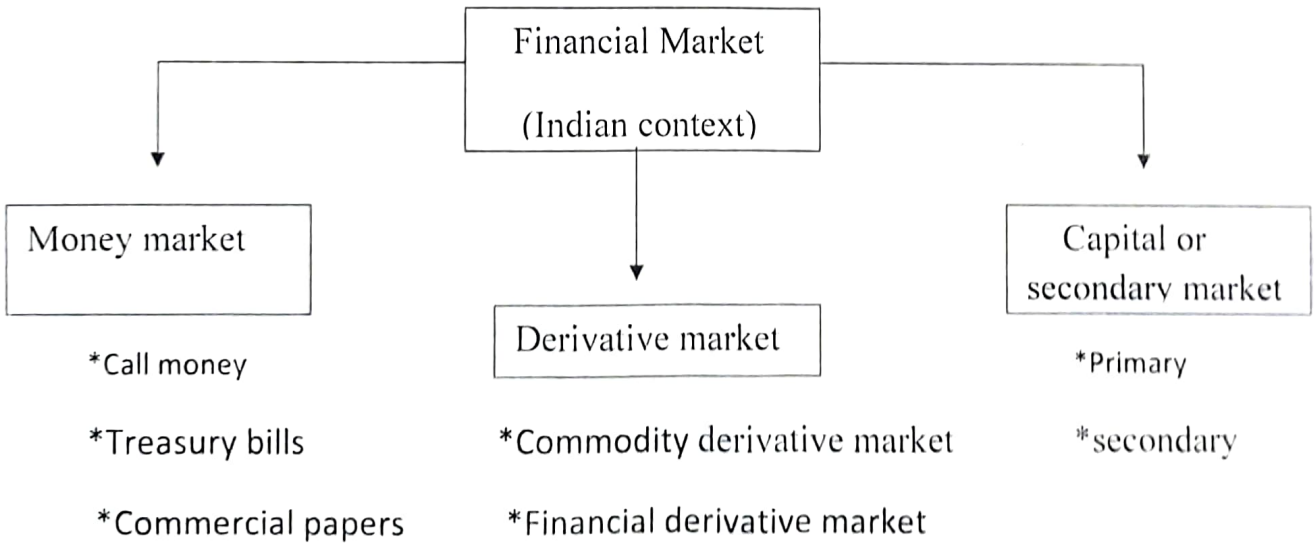
Capital expenditure (budgeting) techniques are used to estimate the return of the business before making investment. The risk analysis techniques will be used to find risk in the business. There are so many reasons to arise the risk such as price fluctuations, globalisation, technological and foreign exchange changes etc. To reduce the risk in business, the concept of derivatives has been introduced in the business. Derivative securities are the innovative risk management tools (products) to reduce the risk. By locking –in asset (securities) prices, derivative products minimise the impact of fluctuations on the profitability.

Derivative instruments are designed to provide protection to the traders in the commodity markets and financial markets against the uncertainty. The derivatives are financial contracts. The value of such contract will depend on the price of the original asset. The original asset may be commodities or financial asset. For **example**, sugar, wheat, cotton, coffee, etc are commodities while equity, debt, bonds, foreign exchange etc are financial assets. In the language of derivatives contract, the original assets are called underlying assets or simply underlying.

Derivatives are financial contracts between two parties to buy or sell an asset in future. A derivative is simply a financial instrument, which is derived from the value of other underlyings. A derivative does not constitute ownership; instead it is a promise to convey ownership.

Derivatives VS Shares

The shares and bonds (financial assets) which are claims on another person for future money. Derivatives are usually contracts or agreements between two parties.



Origin And Evolution of Derivatives:

To reduce the price fluctuations in the agricultural products, "The Chicago Board of trade (in London) was established in 1848". Future contracts were initially traded on agricultural commodities. Later, in 1864, it is extended to other products such as gold, silver, food, etc.

In India, 1875, Bombay Cotton Trade Association Ltd was setup for future contracts.

The Underlying Securities For Derivatives

- Commodities (coffee, soya bean, pepper, seeds, grain, potatoes, oil, cotton, jute)
- Metals(gold, silver)
- Short term debt securities (treasury bills), bonds.
- Currency exchange rates
- Common shares/ stock

Derivatives trading commenced in India in June 2000 after SEBI granted final approval (based on different committees recommendations) on BSE and NSE. Options trading on SENSEX and NIFTY commenced in June 2001.
31(prominent company shares) trading on BSE (till 2010)
233 securities traded on NSE (till 2010)
22 Commodity Exchanges recognised by the FMC (Forward Markets Commission) for commodity derivative trading such as...

a) National Commodity and Derivative Exchange Ltd (NCDEX) Mumbai.
b) Multi Commodity Exchange of India Ltd (MCX) Mumbai.
c) Indian Commodity Exchange Ltd .Gurgaon etc...

SEBI and RBI are regulatory authority to permit the following Stock Exchanges for equity, debt and forex related derivatives.

a) National Stock Exchange (233 securities)
b) Bombay Stock Exchange (31 securities)
c) United Stock Exchange
d) MCX-SX (Multi Commodity Exchange)

Factors Contributing to the Growth of Financial Derivatives

1) **Price Volatility**: - In the present highly uncertain business scenario, the importance of risk management is much greater than ever before. Change in the prices is called price volatility. Financial derivatives protect from possible adverse market movements and shifting risk during volatility periods and thereby reduce costs. Derivatives provide less costly solutions to the problem of risk in underlying assets.

2) **Globalisation of Markets**: - Globalisation has increased the size of the markets and enhanced competition. Consumers are benefited those who can not obtain better quality goods at a lower cost. In Indian context, the south East Asian crisis of 1997 had affected and depreciated currencies. Recession in 2010 arises in America had affected, and any war declaration, etc…

3) **Currency Exchange Rates**: - Changes in the currency exchange rates will also cause price volatility. China devaluing its currency (two times) created instability for Indian exports. This factor contributed to the growth of derivatives.

4) **Technological Advancements**: - New Technology emerges and dynamics of trade shifts. The use of modern computers and software makes possible such shifts. Customers select products through online. Due to this price volatility arises. Derivatives will help to manage arising from price volatility.

5) **Innovations in the Market**: - Innovation is transformation of thoughts to new ideas which leads to produce innovative products; which cause price volatility.

6) **Advances in Financial Theories**: - Initially forward contracts in its traditional firm. Option pricing models started by block Scholes in 1973 to determine call and put options.

FUNCTIONS OF DERIVATIVE MARKET

The derivative market performs a number of economic functions. Few important functions are outlined below.

1. Management of risk: - This is the most important function of derivatives. Financial derivatives provide a powerful tool for limited risk that individuals and organisations face in the ordinary conduct of their business. Different kinds of risks faced by participants are

a) Credit risk
b) Market risk
c) Liquid risk
d) Legal risk
e) Operational risk

Derivatives offer protection from possible adverse market movements and can be used to manage or offset exposures by hedging or shifting risks particularly during period of volatility thereby reducing costs.

2. Efficiency in Trading (Market Efficiency): - Derivatives bring efficiency in the market and make a full complete due to the following reasons:

a) Low transaction costs
b) Minimisation of risks
c) Clear reflection of the market perception. Derivatives help to discover both future and current prices of underlying assets.
d) Protection to investors from financial risks
e) Facilitating the trading activities under controlled/ regulated form.

3. Price Discovery: - In an organised derivative market price reflect the perception of market participants about the future. This leads the prices of underlying to the perceived future level. As a result, the prices of derivatives converge with the prices underlying at the expiration of derivative contract. Thus, derivatives help in discovery of future as well as current prices of underlying.

4. Price Stabilisation Function: - Derivatives provide a significant tool or mechanism through which all investors or participants can judge the movement of prices and protects themselves from financial risk. Indirectly derivatives stabilise the price movements through a participative controlled mechanism.

5. Catalyst for new Entrepreneurial Activity: - Derivatives offer new business and employment opportunities across the globe. At present, there are so many active people working in the stock markets as agents, traders, advisors and many more with distinctive responsibilities. The attractive gain through low investment instills a drive within educated people to earn more and start their own business.

Advantages of Derivatives

Derivatives are supposed to provide the following services:

1. **Risk Management**:- one of the most important services provided by the derivatives is to control, avoid, shift and manage efficiently different types of risks through various strategies like hedging, arbitraging, spreading, etc. Derivatives assist the holders to shift or modify suitably the risk characteristics of their portfolios. These are specifically useful in highly volatile financial market conditions like erratic trading, highly flexible interest rates, volatile exchange rate and monetary chaos.
2. **Barometers of the Future Trends**: - Derivatives serve as barometers of the future trends in prices which result in the discovery of new prices both on the spot and future markets. Further, they help in disseminating different information regarding the futures markets trading of various commodities and securities to the society which enable to discover or form suitable or correct or true equilibrium prices in the markets. As a result, they assist in appropriate and superior allocation of resources in the society.
3. **Income Generation**: - as we see that in derivatives trading no immediate full amount of the transaction is required since most of them are based on margin trading. As a result, large number of traders, speculators operate in such markets. So derivative trading reduce transaction costs in the markets for underlying assets.
4. **Large Pools of Funds**: - The derivatives assist the investors, traders and managers of large pool of funds to devise such strategies so that they may make proper asset allocation increase their yields and achieve other investment goals.
5. **Trading Efficiency**:- The derivatives encourage the competitive trading in the markets, different risk taking preference of the market operators like hedgers, traders, arbitrageurs, etc. resulting in increase in the country. They also attract young investors, professionals and other experts who will act as catalysts to the growth of financial markets.

CRITIQUES OF DERIVATIVES

1. Speculative and Gambling Motives

One of most important arguments against the derivatives is that they promote speculative activities in the market. It is witnessed from the financial markets throughout the world that the trading volume in derivatives have increased in multiples of the value of the underlying assets and hardly one or two percent derivatives are settled by the actual delivery of the underlying assets.

2. Increase in Risk

The derivatives are supposed to be efficient tool of risk management in the market. In fact this is also one-sided argument. It has been observed that the derivatives market—especially OTC markets, as particularly customized, privately managed and negotiated, and thus, they are highly risky.

3. Instability of the Financial System

It is argued that derivatives have increased risk not only for their users but also for the whole financial system. The fears of micro and macro financial crisis have caused to the unchecked growth of derivatives which have turned many market players into big losers. The malpractices, desperate behaviour and fraud by the users of derivatives have threatened the stability of the financial markets and the financial system.

4. Price Instability

Some experts argue in favour of the derivatives that their major contribution is towards price stability and price discovery in the market whereas some other has doubt about this. Rather they argue that derivatives have caused wild fluctuations in asset prices, and moreover, they have widened the range of such fluctuations in the prices. Further, the traders behave and function in professional manner and follow standard code of conduct. Unfortunately, all these are not so frequently practiced in the market, and hence, the derivatives sometimes cause to price instability rather than stability.

5. Displacement Effect

There is another doubt about the growth of the derivatives that they will reduce the volume of the business in the primary or new issue specifically for the new and small corporate units. It is apprehension that most of investors will divert to the derivatives markets, raising fresh capital by such units will be difficult, and hence, this will create displacement effect in the financial market.

TURNAROUND STRATEGY

RETRENCHMENT STRATEGIES

Retrenchment Strategy is followed when an organisation substantially reduces the scope of its activities. This is an attempt to find out the problem areas and diagnose the cause of the problems. After identification of the root causes of the problem, the next step will be to solve the problems. These steps result in different kinds of retrenchment strategies.

Retrenchment Strategy is a strategic plan for immediate measures to reduce (decline) cost, reduce market, reduce production, reduce product line or service and cut the salaries of executives.

(Problems)

CONSEQUENCES OF DECLINE: If any business unit is suffering from the following problems then Turnaround strategy is needed

- Diminishing profitability
- Reduce cash inflows and outflows
- Falling sales
- Decline market share
- Increasing debt
- Loss of credibility and goodwill

The following are the some of the major external and internal causes to reduce the above said problems.

EXTERNAL CAUSES: (For the above problems)

- New business models (competition)
- New dominant technologies (Reliance Jio, etc.)
- Adverse government policies (GST)
- Demand saturation
- Change in customers attitudes and preferences
- Emergence of substitute products.

INTERNAL CAUSES:

- Ineffective top management
- Inappropriate marketing strategies
- Wrong organisation design (organisation chart)
- Excess (Idle) fixed assets.
- Unproductive new product development

There are many industries around the world that are in a state of decline.

E.g. Fountain Pens Industry, Jute and Jute Products, Manual Type Writers, Calculators, Wooden toys etc.

TYPES OF RETRENCHMENT STRATEGIES:

- **Turnaround strategies**
- **Divestment (divestiture)**
- **Liquidation**
- Combinations.

A) TURNAROUND STRATEGIES: — 2,018

Turn around management refers to the management measures that reverse the negative trends in the performance of the company.

In other words, turn around management refers to management measures which turn a sick company back to healthy one.

The main objective of turnaround strategy is holding the business and cut the cost which stops from selling (divestment) or insolvency (liquidation)

Before a turnaround strategy can be implemented, the company has to be declared first as a sick company.

As per the Sick Industrial Companies Act (SICA) 1985 (special provisions / amendments Act 2003) any company incurring accumulated losses, more than 50% of its net worth during the proceeding five years will be declared as sick company.

BIFR (Board for Industrial and Financial Reconstruction) and IIBI (Industrial Investment Bank of India) will undertake the rehabilitation scheme for revival of sick units. RBI also coordinates activities between commercial banks and term- lending institutions. The government also provide tax benefits. The banks and financial institutions depute an executive consultant or turnaround specialist to do the job.

APPROACHES TO TURNAROUND STRATEGY

I. **Changes in the top Management**: - CEO will be replaced, with new person.

II. **Designing operating Turnarounds**: -

1) **Revenue strategy**: - Reduce the price of the product, cut advertisements and reduce the expenditure on R&D activities.
2) **Cost cutting strategy**: - Reduce the labour cost through golden shake hand, voluntary retirements.
3) **Asset reduction strategy**: - Idle assets should be sold and absolute machinery replaced.
4) **Combination strategy**: - Mergers, Acquisitions, Joint ventures, Strategic alliances

The success rate of turnaround strategies is very less. Some companies only succeeded through turnaround.

E.g. BHEL in 1980, Aravinda Mills, Scooters India Ltd and Bata (during 2005)

B) DIVESTMENT STRATEGIES: -

A divestment (divestiture or cut back) strategy involves the sale of a business, or major division, profit centre or SBU by the corporate company. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proven to be unsuccessful.

REASONS FOR DIVESTMENT:

1. To better utilise the resources available: Negative cash flows business unit create financial problem for the whole company. (E.g. Vijay Malya Group) Anil Ambani
2. To write off acquisitions: If acquisition is unprofitable.
3. Mismatch activities: Low demand and huge amount of problems
4. To stream line the product portfolio: traditional products will be eliminated
5. To manage financial crises.
6. Severe competition and inability to compete with the competitors.

E.g.

- Asian Paints divested its stake in Australia.
- The cosmetics company Lakme was divested and sold to Hindustan Levers.
- Hindustan Unilever Ltd divested its marine foods business to Mumbai based Temptation Foods Ltd.

C) LIQUIDATION STRATEGY: -

In case the firm has **not succeeded in the earlier strategies**, it resorts to liquidation strategy as the last resort. The liquidation strategy which involves close down an organisation and selling its assets. The liquidation strategy is the extreme step which leads to loss of employment to workers and close the business. The prospect of liquidation creates a bad impact on its company's (group) reputation.

CAUSES OF LIQUIDATION:

- When the future of the business is not bright
- The firm has accumulated losses.
- Better business offers
- Retaining value is less than sales value: It arises due to losing credibility

TURNAROUND STRATEGIES

I. Operating Turnarounds:
a) Change in the Top Mgt.
b) Revenue Strategy
c) Cost cutting strategy
d) Asset reduction strategy

II DIVESTMENT STRATEGY

III. COMBINATION STRATEGY

IV LIQUIDATION STRATEGY

14

LEGAL ASPECTS OF LIQUIDATION:

As per the Companies Act 1956 (2003) liquidation is termed as winding -up of a company as the process whereby its life is ended and the property sold for the benefit of creditors and owners. The Act provides a liquidator, who takes control of the company, collects its assets, pays its debts and finally, distributes any surplus among the members according to their proportion. At the end of winding- up, the company will have no assets or liabilities. Then the dissolution of the company takes place, and then the company's name removed from register of the companies.

The liquidation may be done in three ways:

- Compulsory winding-up under an order of the court
- Voluntary winding-up
- Voluntary winding-up under the supervision of the court.

D) COMBINATION STRATEGY:

- Mergers
- Acquisitions or Takeovers
- Joint Ventures
- Strategic Alliance.