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CORPORATE RESTRUCTURING AND GOLDEN PARACHUTE

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Abstract
Corporate restructuring refers to changes in ownership mix or business mix or assets mix. It is a comprehensive process by which a company can consolidate its business operations and strengths its position for achieving the desired objectives. It involves re-orientation, re-organization or realignment of assets and liabilities of the organization through conscious management action to improve future cash flow stream and to make more profitable and efficient. Golden parachute is a concept popularized in the context of corporate restructuring. The present study is a descriptive study. In this paper an attempt is made to provide an over-view on golden parachutes by differentiating it with other types of parachutes and by high lighting the advantages and disadvantages associated with it

Key Words: Corporate Restructuring – Golden Parachute – Silver Parachute—Tin Parachute – Platinum Parachute.

Introduction

Corporate restructuring refers to changes in ownership mix or business mix or assets mix. It is a comprehensive process by which a company can consolidate its business operations and strengths its position for achieving the desired objectives. It involves re-orientation, re-organization or realignment of assets and liabilities of the organization through conscious management action to improve future cash flow stream and to make more profitable and efficient. Important forms of corporate restructuring include merger or amalgamation, absorption, acquisition, takeover, tender offer, joint venture, divestiture, going private, equity buy back, anti takeover leveraged buyout, downsizing, outsourcing and so on. The most important reasons for corporate restructuring include synergic benefits, accelerated growth, increased market power, economies of scale, reduction in tax liability, growth, elimination of competition, building of the business empire, avoiding firms failure, spreading risk and so on. Golden parachute is a concept popularized in the context of corporate restructuring. In this paper an attempt is made to analyze the concept of golden parachute.

Methodology

The present study is a descriptive study. An attempt is made to review the existing literature on golden parachute. After extensive survey of the literature it is found that there was no specific study which dealt with over all view about golden parachutes. In this paper an attempt is made to provide an over-view on golden parachutes by differentiating it with other types of parachutes and by high lighting the advantages and disadvantages associated with it

Review of Literature

Morrison (1982) expressed the opinion that golden parachutes are nothing but provision of insurance against incompetence. Jenson and Ruback (1983) examined the ownership structure of the firms adopting golden parachutes. Lambert and Larcker (1985) found evidence for a positive relationship between the adoption of a golden parachute and security market reaction. Cochran, Wood and Jones (1985) found a strong negative association between EXCESS which is defined as the difference between firm's market value and the book value of the firm's assets normalized by sales and the adoption of golden parachutes. Prokesch (1986) described the controversies surrounding the golden parachute payments in several transactions of fortune 500 firms. Knoeber (1986) found that the greater the concentration of stock ownership the less likely the incidence of a golden parachute. Nussbaum and Drobrzynski (1987) expressed the view that stockholders activism has created immense pressure on management to abandon various measures including golden parachutes. Gibbons and Murphy (1988) expressed the view that golden parachutes may act to align the interest of management and shareholders and thus be economically efficient. CEOs with high degree of social influence opportunistically acquire golden parachutes irrespective of the golden parachutes economic value to the shareholders. Harbir Singh and Farid Harianto (1989) expressed the view that firms in which CEO has high tenure and stock ownership is relatively diffused, there is conducive environment to the adoption of golden parachutes.

Golden Parachute Definition and Origin

Golden parachute refers to substantial benefits given to a top executive or to a group of executives that provides income when the person is terminated due to corporate restructuring. These benefits include stock options, cash bonus, severance pay and the combination of these. In other words golden parachute is a compensation arrangement that provides special severance benefits to executives if the corporation changes ownership and covered executives are terminated. Executives generally expect parachute arrangement for self-protection. Mc Millon and Reisinger(1983) defined golden parachutes as any contractual agreement that will potentially provide CEO with a payment contingent upon a change in control of the company. Krueger

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(1985) defined Golden parachutes as contracts between the employer and executives that provide for additional compensation when there is change in control or ownership happen. The term golden parachute came into existence in the 1980s in America. The first formal guidelines for this type of severance agreement were established by the U.S. Congress as part of the Deficit Reduction Act of 1984. Golden parachute provisions are also covered in Sections 280G and 4999 of the Internal Revenue Code. The formal guidelines state that two circumstances must be present for a golden parachute clause to be activated: there must be a change in ownership or effective control of the corporation or a substantial portion of its assets; and the executive must be terminated without cause, forced to relocate, or faced with a significant reduction in responsibilities as a result of the change in ownership.

Golden Parachutes Differentiated From Silver, Tin and Platinum Parachutes

Golden parachutes are generally defined as those that exceed three times the recipient's average salary for the prior five years. According to Roger Siske, a partner at Sonnenschein Nath & Rosenthal in Chicago and chairman of its national employee benefits and executive compensation practice, the typical golden parachute provides the recipient with a minimum of three times his or her annual salary, three years' worth of bonus, and three years' continuation of principal benefits. Companies typically provide golden parachutes only to their top five executives. Silver parachutes are generally awarded to executives below the top level. These are less lucrative than golden parachutes. Siske says these plans typically pay out about 1.5 to 2.5 times the recipient's annual salary, bonus and benefits. Tin parachutes are less popular than golden and silver parachutes, which include severance plans that cover all of the employees of a company in the event it undergoes a change in control. The value of a tin parachute vary significantly from company to company, but typically provide a severance payment linked to the recipients' years of service and/or their age, often with a cap, such as 1.5 times annual compensation. In some cases, severance packages awarded to senior executives have been termed "platinum parachutes" both because of the enormous size of the payments and because they haven't always been tied to a change in control of the company.

Advantages of Golden Parachutes

Golden parachutes benefit the organizations in following ways

1. **Useful for attracting high level employees** Golden parachutes are useful for attracting and retaining higher level employees. Especially when the companies are under the risk of corporate restructuring, golden parachutes will be useful for attracting top level of executives by providing insurance against risk.
2. **Prevents anti corporate restructuring tactics** Top **e**xecutives can be tempted to delay or even sabotage the efforts of corporate restructuring because they are afraid of losing their own job. With a golden parachute clause guaranteeing their compensation in the event of corporate restructuring, anti merger, anti acquisition, anti takeover and anti divestiture tactics can be prevented.
3. **Conflict of interests between agents and owners can be minimized** Golden parachutes encourage agents (managers) to accept changes of control that will bring shareholder (owners) gains and will minimize the conflict of interest between agents and owners and the transaction costs resulting from managerial resistance
4. **Minimizes hostile take-over** When golden parachutes are in place, other companies find hostile takeovers less attractive because they need to pay for expensive termination packages.
5. **Encourage top executives to make risky decisions** Top executives may be reluctant to take risky decisions in the absence of golden parachutes. They may feel fear that making mistakes or going the wrong way on strategic decisions can result in losing their job, so they are reluctant to take risks and maintain status quo. Organizations need leaders who are willing to take risks. Golden parachutes can be a tool to help them for being effective and make bold decisions.
6. **Helpful for friendly departs** When employees are fired, they often want to retaliate against their employer. They may threaten to sue, disclose sensitive material, or take even more drastic action. Because of golden parachute agreements, employees depart from the organizations when they are fired.

Disadvantages of Golden Parachutes

Following are the disadvantages of golden parachutes

1. **Hinder motivation** Of late golden parachutes are hindering motivation of the higher level employees in developing the organization. Top level employees who are guaranteed with golden parachute severance packages and who do not have to worry about performance and evaluations will probably have poor work ethics. They will be reluctant to make risky decisions of taking organizations to higher levels.
2. **Drains company money** Golden parachutes require companies to pay substantial amounts of money, even when terminating the employees for good cause. This will drain the organizational funds.
3. **Lower level employees feel resentment** Only top level employees receive golden parachute agreements. These top level employees are already well compensated. Whereas lower level and middle level employees who make less money don’t necessarily get any help if they are terminated. In fact top executives who decide the fate of the company

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and make the company to be a target for acquirer by their poor performance are being well protected through golden parachute packages. Because of this lower level employees feel resentment.

4. **Golden parachutes encourages inefficiency** Golden parachutes agreements attracted lot of criticism that these agreements are giving insurance for poor performance and are encouraging inefficiency. Poor performing top executives are being protected through these arrangements in case of corporate restructuring.

Conclusion

To conclude, the concept of golden parachute became popular in the context of corporate restructuring. In spite of lot of criticisms against the practice, provisions, and the amount of golden parachutes, it provides a protection for top level employees in the event of corporate restructuring. Golden parachute costs are a very small percentage of a corporate restructuring costs and do not affect the outcome.

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