

IMPACT OF LEVERAGE BUYOUT (LBO) AND MANAGEMENT BUY OUT (MBO) ON COMPANIES

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Abstract

Based on previous research, researchers analyzed the impact of LBO and MBO on company performance. The research method used is qualitative research with descriptive analysis techniques through a literature review. This research focuses on collecting empirical data and information related to the impact of LBO and MBO. The results showed that LBO can significantly affect company performance by increasing profitability, sales growth, and operational efficiency. External factors such as economic conditions and industry competition, as well as internal factors such as management quality, changes in ownership structure, and incentive systems, influence the long-term success of LBOs. However, risks such as reduced profitability and operational efficiency also need attention. On the other hand, MBO positively impacts a company's operational performance, including increasing profits, profit margins, and efficiency. MBO often occurs when economic policy uncertainty increases and can result in favorable purchase prices and significant operational improvements. However, MBO is not consistent in increasing the performance of companies that fail through MBO, and tax factors also affect the value and performance of companies in the context of MBO. Overall, MBO has the potential to increase company performance, value, and productivity, but structural changes need attention. MBO is not consistent in increasing the performance of companies that fail through MBO, and tax factors also affect the value and performance of companies in the context of MBO. Overall, MBO has the potential to increase company performance, value, and productivity, but structural changes need attention. MBO is not consistent in increasing the performance of companies that fail through MBO, and tax factors also affect the value and performance of companies in the context of MBO. Overall, MBO has the potential to increase company performance, value, and productivity, but structural changes need attention.

Keywords: *Management Buyout (MBO), Leveraged Buyout (LBO)*.

1. INTRODUCTION

Leverage buyouts (LBO) and management buyout (MBO) are transactional strategies that involve the acquisition of a company through the use of debt and significant management participation. In LBO, external investors buy the company using large borrowed funds, whereas in MBO, the existing management of the company buys the company they work for. In both cases, the main goal is to improve company performance, create added value, and achieve significant profits. Fierce competition in the business world has encouraged many companies that are growing and developing to take the right steps to maintain their position. In an effort to survive and compete globally, these companies have formulated strategies that are adaptive and easily adapted to keep up with the changes that are taking place. One of the most important strategies implemented by companies today is through corporate control transactions. Corporate control transactions are an action taken by a company to take over or control another company through various transactions, such as mergers, acquisitions, leverage buyouts (LBO), or management buyouts (MBO). By

conducting corporate control transactions, companies can expand the strength and scope of their business, acquire valuable resources, optimize operational efficiency, and achieve better growth.

Purchases using debt, which is better known as leverage buyout (LBO), is a technique that is widely used by various business entities, both internal management and external companies. This technique can be used by individuals, partnerships, and other companies to buy stock in a target company using debt. According to Saraswati, (2022) that LBOs can assist companies in restructuring, increase profitability, and drive faster growth. However, the bankruptcy risk attached to LBO needs to be watched out for. In addition, the benefits of LBO tend to favor dealmakers, private equity investors, and managers of private equity firms, while the positive impact on the target firm may not always be apparent. Then research Bacon et al., (2004) studied management buyouts and human resource management saying that the effect of MBO on human resource management resulted in increased employment, adoption of new reward systems, and expansion of employee engagement. These developments support the resource-based view that purchasing develops internal assets over agency theory's predictions that managers will adopt a cost reduction approach.

However, some researchers examine the LBO phenomenon, such as research from Chemmanur et al (1994) that generally only companies that have achieved good performance will conduct a public offering (go public) after conducting a Leverage Buyout (LBO). In addition, generally only high quality corporate borrowers issue public debt after an LBO. This shows the importance of in-depth analysis of the implementation of the LBO mechanism and its impact on companies. Based on previous phenomena and research, researchers will analyze the impact of LBO and MBO on companies in order to obtain broader results.

2. LITERATURE REVIEW

2.1 Leveraged Buyouts (LBO) Concept

The term LBO (Leveraged Buyouts) refers to the purchase of all or most of the shares of a company, with funds borrowed from a third party. These third party funds usually come from institutional investors. Such as pension funds, insurance funds and others. Third party funds are usually coordinated by an investment banking firm that is specifically engaged in the LBO sector. One of the characteristics of LBO is an effort to increase earning target company. Even from a macroeconomic point of view, LBO is considered unable to advance the economy, because in principle LBO is considered not to add new production/production, but is merely a "tweak" in the financial sector. (Munir Fuady, 2004). According to Brigham et al, (2014), leverage buyout (LBO) or purchase using debt is one of the methods used to reduce excess cash flow. In an LBO, most purchases of company stock are funded through debt. The rationale behind using LBO is the projected savings expected from reducing unproductive spending. This motivation encourages a number of purchases using debt.

After LBO, high debt payments will force managers to save cash by eliminating unnecessary expenses. However, increasing debt and reducing free cash flow also has its own risks and disadvantages, namely increasing bankruptcy risk. In LBO, high levels of debt can put pressure on the company if it is unable to meet its debt repayment obligations as they mature. This suggests that while LBOs can be beneficial in reducing excess cash flows, they also exacerbate financial risks that need to be managed carefully.

2.2 Purpose of LBO

The main objective of an LBO is to create value for the acquired company and the investors involved. Here are some ways how LBO can create value:

1. Operational Efficiency

After acquiring a company, LBO investors generally have full control over the company's operations. They can implement efficiency improvements, reduce unnecessary costs, and increase productivity to optimize company performance

2. Financial Restructuring

In LBO, the target company's financial structure can be changed to improve financial performance. For example, by reducing interest expenses or replacing debt with equity capital, companies can improve cash flow and reduce financial risk.

3. Working Capital Management

LBO investors often focus on managing the working capital of the acquired company. By optimizing the cash conversion cycle, inventory management, and management of receivables and payables, they can increase company liquidity and reduce financial risk

4. Tax Efficiency

In some cases, LBOs can optimize a company's tax structure by taking advantage of existing tax policies. This can reduce the tax burden and increase the net profit that can be used to create value. However, it is important to note that LBO also has risks that need to be considered, such as increasing debt levels and the risk of bankruptcy if the company is unable to meet debt service obligations. Therefore, LBO must be carried out carefully and involve a comprehensive analysis of the company's performance, growth potential, and ability to generate sufficient cash flow to pay debt obligations. (Brigham et al, 2014).

2.3 Leverage Buyout Transaction Structure (LBO)

According to Brigham et al, (2014) The structure of LBO transactions may vary depending on the needs and characteristics of each transaction. It is important for parties involved in an LBO, including investors, banks and target companies, to understand and carefully manage the financial structure to ensure the viability and success of the transaction. The following types of transactions from LBO are:

1. Equity and Loan Capital

In LBO transactions, equity capital and loans are used to finance company acquisitions. Equity capital is a capital contribution from investors or groups of investors who buy shares of the target company. Meanwhile, loans are obtained from banks or other financial institutions and are used as a large part of transaction financing.

2. Senior and Subordinate Financing

Financing in an LBO can consist of layers of senior and subordinate debt. Senior financing has a higher priority of payment and tends to have lower interest rates. Subordinate financing has a lower priority of payment and generally carries a higher interest rate. With this financing structure, senior debt holders have greater security in repaying their loans compared to subordinate debt holders

3. Debt Covenants (Clauses).

In LBO transactions, debt agreements usually include covenants or clauses that regulate the obligations and limitations of the borrower. These covenants may include restrictions regarding financial ratios, dividend payments, capital expenditures, and so on. The aim is to protect the interests of debt holders and ensure that the target company fulfills its debt service obligations and maintains financial health

4. Mezzanine Financing

In some cases, LBO transactions may involve mezzanine financing. Mezzanine financing is a form of financing that sits between equity capital and a loan. It can be a debenture convertible into equity or have characteristics similar to subordinate debt. Mezzanine financing is used to fill the gap between equity capital and senior loans, and usually carries a higher risk with a higher return.

2.4 The Management Buyout (MBO) Concept

Management buyouts (MBO) is an agreement that allows a company's management team to acquire the business they work for, from the owner, with financial support. Typically, most of the financing for acquiring a business is provided by banks and private equity groups. Banks provide loans and overdraft financing, which are relatively inexpensive finance, while private equity groups provide equity finance and will want a larger return to compensate them for the additional risk they

take on. Sometimes the vendor, selling the business, will provide some of the finances (Stuart RC McCullough, n.d.)

2.5 MBO Implementation Steps

According to (Stuart RC McCullough, n.d.) The following are the steps in implementing MBO:

1. The management team interested in MBO undertook an evaluation of the potential and possible benefits associated with acquiring the company.
2. The management team identifies sources of funding for the purchase of company shares, such as private equity capital, bank funding or mezzanine financing
3. Negotiations are carried out with the owner or holding company regarding prices, transaction structure, and other terms
4. Agreements of sale and MBO contracts are drawn up and signed by the parties involved
5. implementation of MBO, where ownership and control of the company is transferred to a management team that buys shares

2.6 The difference between LBO and MBO

Often the terms LBO and MBO are interchanged in practice, because LBO deals often involve the managers of the companies concerned. MBO often takes the LBO pattern. However, actually MBO can take the LBO pattern, but it can also not. If you take the LBO pattern, the funding is taken from a third party and paid for by the target company.

There are also many advantages possessed by the MBO deal, which are not necessarily owned by the LBO deal, because the MBO deal contains the following:

- a) The disciplinary impact of greater debt
- b) Separation between the purposes of “owner” and “manager”
- c) Good operational impact of acquisition objectives that contain elements of clarity and togetherness
- d) Incentives in the form of ownership strengthen existing motives
- e) Good social relations and teamwork in equal interests
- f) Can increase managerial responsibility and freedom which has a positive impact and energy resulting in decisions by looking at the whole rather than only seeing it partially.
- g) Efforts and skills that are completely transparent in achieving success or failure
- h) Clear feedback and reward system
- i) Have a stronger commitment in achieving common goals

Source : (Munir Fuady, 2004)

2.7 Hypothesis Development

From the description above it can be concluded that the hypothesis in this study is as follows:

- H1: LBO has a positive effect on the company
- H2: MBO has a positive effect on the company

3. RESEARCH METHOD

The research method used is qualitative research with descriptive analysis techniques, using library research. This research focuses on collecting empirical data and information related to the impact of LBO and MBO on companies.

4. RESULTS AND DISCUSSION

4.1 Results

This study aims to conduct a literature review to understand the impact of leveraged buyouts and management buyouts on companies.

In this study, 10 literatures were found which discussed the impact of LBO and MBO on companies. All of these journals are national journals that are searched through the Google Scholar portal using keywords such as "the impact of leveraged buyouts on companies", "the impact of management buyouts on companies". Then, critical appraisal analysis is used to analyze the core journals, books, and results of studies to identify the similarities and differences between the journals.

The critical appraisal analysis table for 10 journals can be seen below:

No	Journal Author (year) and Title	Core Title	Study Results	Similarities and Differences with researchers
1	(Kaplan, 1991) "Purchasing with endurance and leverage"	Discusses how successful and enduring LBOs are in the long term	The findings focus on post-LBO company performance, factors influencing LBO success and long-term sustainability.	Equation: discusses LBO and success factors Difference: does not address MBO
2	(Ma, 2019) "The Impact of Leverage Buyout on Target Companies"	Discusses the investment value of LBO target companies by comparing their stock performance.	The findings focus on that LBO buyers prefer asset-light industries over capital-intensive industries. The share performance of the target companies after IPO reveals that most of the targets underperformed the market during their first year, while their 3-year performance was more positive.	Equation: discusses LBO buyers and company stock performance Difference: does not discuss about MBO
3	(Saraswati Kuntum Widuri, 2022) "Analysis of the impact of Leverage buyout and reverse level buyout on the company"	Discusses the purchase of LBO in private companies.	The findings focus on that LBO may benefit the deal makers and private equity investors and managers of these private equity firms, but LBO may not have a positive effect on the firm itself.	Equation: discusses the purchase of LBO Difference: discussing R-LBO, which means initial public offering (IPO) of companies that have previously been bought by private equity investors
4	(Nikoskelainen & Wright, 2007) "The impact of corporate governance mechanisms on increase in value in a leveraged buyout"	Discusses the increase in value that occurs in purchases that involve leverage in the company	The findings focus on increasing the value and return characteristics in Leveraged Buyout (LBO) related to corporate governance mechanisms resulting from leveraged buyouts, especially in the form of managerial equity shares. Then the positive return characteristics and probability of return are mainly related to the size of the target buyout and acquisitions that occur during the ownership period. the difference in return characteristics between insider-driven buying and outsider-driven buying	Equation: discusses LBO in companies Difference: does not discuss about MBO
5	(Easterwood, 1998) "Divestment and financial difficulties in leveraged buyout"	Discusses the wealth effect for LBO sellers around divestitures announcements	The findings focus on the wealth impact for Leveraged Buyout (LBO) sellers with respect to divestment announcements using bond returns. The abnormal return on average with respect to	Equation: discussing LBO but for sellers and financial difficulties. Difference: does not discuss MBO in this study

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		using bond returns	the sale of assets indicates a dependence on whether the company is experiencing financial difficulties or not	
6	(Steven KAPLAN, 1988) "The effect of management buyout on performance and operating value"	Discusses the effect of Management Buyout on operational performance and company value	Results The findings focus on management buyout with the results showing that MBO has a positive impact on the company's operational performance. After MBO occurs, companies tend to experience increased profits, profit margins, and operational efficiency	Equation: discusses MBO The difference: performance and operational value
7	(Hammer et al., 2023) "Management buyout in times of economic policy uncertainty"	Discusses management buyout on economic instability	The findings focus on that purchasing management (MBO) is significant more likely to occur if economic policy uncertainty (EPU) increases. MBOs achieve more profitable purchase prices and greater post-purchase operating improvements than institutional purchases during high EPU times	Equation: discusses MBO Difference: not discussing the company but rather the national economy
8	(OFEK, 1994) "Efficiency Gains in Failed Buyout Management"	Discusses the management buyout that failed to improve operations	the findings focused on testing 120 failed MBOs to test whether operational improvements following successful MBOs were the result of organizational changes or private information. Companies with failed MBOs experienced no improvement in operating performance after the purchase attempt	Equation: discusses MBO in the company Difference: not discussing LBO
9	(Oliver Hart & Bengt Holmstrom, 1991) "Management buyout: Tax Evidence as a Source of Value"	Discusses the impact of taxes on company value and performance	The results of the study focus on the performance of MBO that tax factors can be a source of value in MBO. Favorable tax arrangements can increase the value of companies experiencing MBO. This study provides further understanding of the factors that influence the success and value of MBO	Equation: discusses the impact of MBO Difference: discuss from a tax point of view
10	"Buyout Management and Enterprise-Grade Productivity: Evidence from the UK Manufacturing Companies Panel"	Discusses the impact of MBO on company productivity using panel data from companies in the UK	The results of the study focus on the impact of MBO, which results from successful MBO research that contributes positively to company productivity in the long run	Equation: discusses the impact of MBO Difference: not discussing LBO

Source: Literature journal analysis

The ten literature journals above show varied results regarding "factors of success and failure in mergers and acquisitions". The selection of the ten journals was adjusted to the objectives of the researcher which discussed "the impact of leveraged buyouts and management buyouts on companies:

4.2 Discussion

a) Analysis from the LBO Aspect

Kaplan, (1991) test how successful and long-lasting LBOs are in the long term. He collects data from a number of LBOs that occurred between 1970 and 1983, and analyzes the performance of companies that experienced LBOs during the long post-LBO period. Some important findings from this research are:

1. Post-LBO company performance

Kaplan found that in general, companies that experience LBO tend to experience an increase in performance in the few years after the LBO occurs. This is especially the case in terms of profitability, sales growth and operational efficiency. However, this increase in performance is not always sustainable in the long term.

2. Factors influencing the success of LBO

factors that influence the success of LBO. Some of the factors that have contributed positively to the success of LBO include management quality, increased leverage, changes in ownership structure, and changes in the incentive system. On the other hand, companies with underlying fundamental problems, such as poor operational performance or structural weaknesses, are more likely to face difficulties after an LBO.

3. Long term Sustainability

that the long-term success of LBOs is strongly influenced by macroeconomic conditions and the industry in which the company operates. Changes in business cycles, regulatory policies, and industry competition can have a significant impact on the long-term sustainability of LBOs.

Then another study by Mama, (2019) provide conflicting evidence that the average target firm exhibits a weakening in profitability after the LBO occurs. This could be due to various factors, such as higher interest expense due to increased leverage associated with LBOs. target companies tend to experience lower operational efficiency after LBO. The possibility of operational restructuring or management changes that affect business efficiency could be a contributing factor. Target companies in LBO tend to face higher solvency risk. This can occur due to an increase in debt used to finance LBO transactions, which increases the company's debt burden. LBO buyer operations can improve the target company's cash flow conditions. This could be due to financial restructuring, operational efficiency improvements, or management improvements made by LBO buyers. Then another study by Saraswati, (2022) provides evidence that LBO can help target company restructuring, improve profitability, growth, and capital expenditure. However, an LBO also has risks, including business risk and interest rate risk, which can increase the probability of bankruptcy

Further research from Nikoskelainen & Wright, (2007) give evidence that larger purchases tend to perform better and provide higher returns for investors. This indicates that size factor plays an important role in determining success and returns in the context of LBO. Research conducted by Easterwood, (1998) provides evidence that overall divestment is not associated with a significant wealth effect for the full sample of firms. However, companies experiencing financial distress show negative and significant abnormal returns related to divestment, while returns in non-event months are not significant. So this study presents the finding that the wealth effect of a divestment in the context of a leveraged buyout can differ depending on the financial condition of the company and the existing debt structure. From SALL research results show that Leveraged Buyout (LBO) can have a significant impact on company performance. After LBO, companies tend to experience improved performance in terms of profitability, sales growth, and operational efficiency. However, the long-term success of LBOs is influenced by external factors such as economic conditions and industry competition. Internal factors such as management quality, ownership structure changes, and incentive systems also influence the success of LBOs. However, there are risks such as reduced profitability and operational efficiency after LBO. Therefore, it is important for companies to consider these factors and manage LBO with the right strategy.

b) Analysis from the MBO Aspect

In research conducted by Steven Kaplan, (1988) proves that MBO has a positive impact on the company's operational performance. After MBO occurs, companies tend to experience increased profits, profit margins, and operational efficiency. In addition, MBO is also associated with an increase in firm value. The researchers found that companies that experienced MBO had higher stock prices and better valuations compared to companies before MBO occurred. This shows that MBO can provide significant benefits to companies in terms of operational performance and value. This research provides important insights for interested stakeholders in MBO, as it demonstrates the positive potential of the strategy in increasing company performance and value.

Then another study by Hammer et al., (2023) provide evidence that management buyouts (MBO) tend to occur more frequently when economic policy uncertainty (EPU) increases. This indicates that the EPU provides an opportunity for insiders to exploit private information and take advantage of appropriate market conditions. In addition, research results show that MBOs achieve more profitable purchase prices and experience greater operational improvement after purchase compared to institutional purchases, especially when EPUs are high. This finding supports the notion that MBO can provide greater benefits in conditions of economic policy uncertainty. In another study by OFEK, (1994) provides evidence that this study found no evidence of an increase in performance in companies that were not successful through MBO (Management Buyout). the results of this study do not support the hypothesis that efficiency in successful MBO can occur without structural change, or that purchases are motivated by private information held by managers when they make offers for firms. In addition, this study found evidence that there are costs to managers who attempt unsuccessful MBO bids. The management turnover rate after cancellation of the MBO bidding is much higher than the annual turnover rate in a random sample.

Next in research Oliver & Bengt, (1991) provides evidence that the impact of taxes on the value and performance of companies in the context of Management Buyouts (MBO). Researchers find evidence that the tax factor can be a source of value in MBO. Favorable tax arrangements can increase the value of companies experiencing MBO. This study provides further understanding of the factors that influence the success and value of MBO. This research also runs the same by (Ames, 2002) that the impact of MBO on company productivity using panel data from companies in the UK. This study found that successful MBO contributes positively to firm productivity in the long term. Companies that experience MBO experience significant increases in productivity within a few years after the transaction. These findings indicate that corporate restructuring that occurs in MBO can provide a positive boost to company productivity and performance. Some important findings regarding Management Buyout (MBO). MBO has a positive impact on the company's operational performance, including increasing profits, profit margins, and efficiency. MBOs also occur more frequently when economic policy uncertainty increases. In addition, MBO tends to achieve favorable purchase prices and experience significant operational improvements. However, research also shows that MBO does not consistently improve the performance of companies that fail through MBO. Tax factors can also affect the value and performance of companies in the context of MBO. Overall, MBO has the potential to increase company performance, value and productivity, but it needs to pay attention to factors such as structural changes and tax aspects.

5. CONCLUSION

Based on the literature study that has been conducted on 10 journals, the conclusions that can be obtained are as follows:

1. From the results of the analysis it can be concluded that Leveraged Buyout (LBO) has a significant impact on company performance. Post-LBO, there has been an increase in performance in terms of profitability, sales growth, and operational efficiency. However, the long-term success of LBOs is influenced by external factors such as economic conditions and industry competition. Internal factors such as management quality, ownership structure changes, and incentive systems also play an important role. Risks such

as decreased profitability and operational efficiency also need attention. Therefore, managing LBO with the right strategy is the key to achieving successful results

2. The results of the analysis can be concluded that MBO (Management Buyout) has a positive impact on the company's operational performance, including increasing profits, profit margins, and efficiency. MBOs often occur when economic policy uncertainty increases, and can achieve favorable purchase prices and significant operational improvements. However, MBO does not necessarily improve the performance of companies that fail through MBO, and tax factors also affect the value and performance of companies under MBO. Overall, MBO has the potential to increase company performance, value, and productivity, but it needs to pay attention to structural changes and tax aspects in its implementation.

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