DIVESTITURE AS A STRATEGY FOR SMALL AND MEDIUM ENTERPRISES SURVIVAL

BY

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ABSTRACT

This study examined divestiture as a strategy for small and medium enterprises survival. The methodology used is a review of relevant and extant literature, reports on Apple, Shell Petroleum Nigeria,Union Bank NIG. PLC ,General Motor and after which a conclusion was made. Small and medium enterprises failures in Nigeria have caused concerned to scholars due to its failure rate and its attendant consequences on the economy of Nigeria. It was revealed that firm can choose the divestiture option that addressed its failing performance to revamp the firm to healthy performance.

Keywords: Divestiture, SMEs, Restructuring, Reposition, Performance, Strategy.

Introduction

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN),(2015)posits that eighty percent of small and medium enterprises(SMEs) in Nigeria close shop in less than 5years of operation. Few that managed to survive are involved in over trading and sometimes taking the firm out of its core competence thereby hindered the performance of the firm which invariably resorts to low capacity utilization. There is need for such diversified firms to divest due to their misfit with the firm strategy or with the firms operation, as well as the managers monitoring and control actions. A failed diversification strategy can cause diseconomies and halt performance which often leads to asset reductions. Most often, it can also lead to firm exit of business which plunge the workers into unemployment with attendant consequences of social vices like robbery, arson, banditry, kidnapping and nation low capacity utilization which causes poverty. Thus the firm may pursue both performance enhancements and strategic reorientation with business divesture.

The motivation for this research work is to investigate how small and medium enterprises in Nigeria can deplore divestment as a survival strategy in the face of failing performance of firms. Such strategy will ensure continuous existence of the firm and instilled confidence on the workers to contribute to the achievement of the organization goal. It can also help to increase not only the revenue based of the country but also its gross domestic product and capacity utilization. It is against this background, the study attempts to find out the various divestiture strategy option available to failing SMEs performance and how the firm performance influence the choice of different kind of divestiture strategy. In view of the above, the research question is does divestiture improve on the firm performance? To achieve the above, this paper will examine the various extant and relevant literatures on divestiture. The findings from the research will help business manager reinvigorate their business into core competence and shed their excesses. Accordingly, the work is structured into introduction; which highlights the motivation for the research work, theoretical and conceptual frame work, findings and conclusion.

Literature Review

Kempler and Khuen (2004) posited that the two most important theories to prove the value potential of corporate restructuring are the management efficiency hypothesis and information hypothesis.

The management efficiency hypothesis posits that the management of large corporations is generally unable to address the unique peculiarities of each segment in diversified corporations. Its performance is therefore inferior to smaller specialized firms. Consequently management should restructure the corporation by building corporate resources in its core competence.

The information hypothesis posits that the information that investors get about the separate business of conglomerates is low. Consequently financial market participants often penalize them with a conglomerate discount in the valuation. After a restructuring, more information about the individual business unit is processed, which lower the conglomerate discount and increased shareholders value. Burgelman (1996), Kaiser and Stouraitis (2001) opined that divestiture means that a firm disposes a significant part of its asset that is in diversified firms, whole business units or divisions. It is a shedding of property and that property may consist of many numbers of things from business, products, facilities and employees. It also entails a termination of managerial and ownership's control(Thomas, 1983). A divestiture of a business unit that involves strategic reorientation is denoted as a strategic business unit, without changing a parent firms, prior strategies is considered as a status quos preserving exit(Decker and Mellewigt, 2007). Divestiture can be a vehicle for the elimination of a misconceived strategy that challenged a firm acceptability in the market. Byerly et al., (2003) differentiated between refocusing and repositioning as potential strategic implications of divestiture. Refocusing means that a firm aims to eliminate peripheral activities especially business that are unrelated to a firm core are abandoned. By repositioning, a firm aims at striking a new strategy path such a step involves a new business emphasis that is core changes. Repositioning entails a firm, entire abandonment of prior strategy and structures and their replacement by completely new ones. Underperformance of a firm often signals the necessity to change corporate strategy, particularly when some businesses do not meet expectation but burden a firm with high debt. Steenhuis and Bruijn (2009) added better investment opportunities and problems associated with managing subsidiary as reasons why firm divest. Berry (2010) posit that lower cost of production, new market opportunities, poor performance, lack of synergy, need for funds and poor management are reasons for firm divestment.

Business could be discarded due to lack of fit with its peer businesses. Negative synergy among activities, which is the absence of internal complementary means that the marginal return of an activities does not increase with the augmenting level of another activities in the same corporation(Stigelitz & Heine, 2007). A lack of intra-organizational complementarities can trigger divestiture. Corporate restructuring entails a range of activities including portfolio restructuring, financial restructuring and organizational restructuring. Portfolio or asset restructuring involves the redeployment of corporate assets through divestitures of business lines that are considered peripheral to the core business strategy. Portfolio restructuring includes strategies such as sell offs, spine-offs, split-offs, split ups, subsidiary initial public offering(IOPs) and liquidating. Kemper and Khuen (2004) posits that divestiture or sell offs describe the sale of an affiliate company or business units to a strategic buyer. In these cases the buyer normally purchases the whole business unit in order to exert full control.

Sell-offs consists of a sale of any part of a firm property to outside party. The property may be an asset or product, a business unit, a division or subsidiary or a sale of stock or investment interest(Cumming &Malle, 1999).

Spin-offs: Spin-offs describe the change in ownership of the affiliate company from the present corporation directly to its shareholders. Each owner receive a stake in the affiliate, which depends on the equity participation in the holding corporation, after the transaction, the shareholders own two different corporations and the subsidiary is legally independent from holding corporation.

Split-offs: In a split off, the parent firm issues new stock in a subsidiary in exchange for the shareholders stock in the parent company. The parent firm essentially repurchases its outstanding share in exchange for transferring ownership in a division to the parent shareholders. Although the owners of the split-offs subsidiary are the same as in the parent company, the split-off entity has no ties to the parent firm.

Split ups: Split- ups describe the breaking of a firm into two or more independent companies. While the holding corporation is liquidated, its former shareholders receive a participation in the new companies.

Subsidiary IPO'S: Subsidiary IPOs describe the partial sale of an affiliated company via sales of shares in the stock market in which the holding corporation may lose its control over the affiliate.

Equity Curve out: The parent firm establishes an independent entity and sells equity in subsidiary to the public in the form of an initial public offering.
Strategic Alliance: This has to do with co-operation of companies along vital areas like marketing, technical known how.

Liquidation: Assets of the unit are sold and the proceedings are distributed among its shareholders.

Financial Restructuring

Leveraged Buyout: Leveraged buyout is the acquisition of another company using a significant amount of borrowed money (or loans) to meet the cost of acquisition. Often the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. Purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capita (Gao ,2010). The most common leveraged buyout arrangement among small businesses is for management to buy up all the outstanding shares of the company's stock using company's assets as collateral for a loan to fund the purchases. The loan is later repaid through company's future cash flow or the sale of company assets.

Management Buyout: Gao (2010) posits that a special case of a leveraged acquisition is a management buyout (MBO) which occur when a company's manager buy or acquire a large part of the company. The goals of MBO may be to strengthen the manager's interest in the success of the company.

Mezzanine Financing: Laura (2009) posits that mezzanine finance is finance usually provided by specialist financial institutions, that is neither pure equity nor pure debt. It can take many different forms and can be secured or unsecured; it usually earns a higher rate of return than pure debt but less than equity, it is often used in management buyout. Golej (2016) posits that Mezzanine is the capital that fills the gap between equity and the mortgage. It is a debt tool that is more expensive than mortgage financing, but lower yielding and cheaper than equity.

Organization Restructuring: in organization restructuring, the focus of change is on management and internal corporate governance structure. Downsizing remains a partial divestiture strategy, in which some not all of human capital is eliminated. The parent company has no ties to the formal employee. Downsizing can enable companies to reduce costs, improve competitiveness and reinvigorate an organization.

Divestiture Determinant

External Determinants: are those that arise from the firm's external environment. These include compulsory, technological, economic and socio-cultural forces

Compulsory: Compulsory divestiture is forced divestitures. The firm does not originate the decision, instead the government

Technological: A company may choose to divest to accommodate for product, technological or plant obsolescence. The company's technological operation may not be competitive, as a result of technological advancements and constraints in operations.

Economic: Economic determinants, for divestiture include tax implications, analyst and stake holder influence, market fluctuations and investee restructuring.

Socio- cultural: this reflects the overall climate in which firms operates.

Internal Determinants
Internal determinant are those that arise from within the firm. These include financial, strategic fitness and avoidance

Financial: this has to do with subsidiary poor performance, or the firm might be losing money, desire to cut costs, desire to reduce debt and desire to finance other acquisition.
Strategic fitness: Strategic fitness determinant arise out of an incompatibility between the company and the divested unit. Operations that no longer correspond with the new strategy are divested. Fitness determinants may be structural,cultural or managerial.

Avoidance: Firms also engage in divestiture to avoid risk, uncertainty, takeovers or significant investmentof resources.

Apple
Apple had lost over $1 billion on an expansive line of products that included Flops like the Newton message pad, a handheld device similar to a palm pilot. Even worse the company was 90 days from being insolvent. Apple's recovery began with a $150 million investment from Microsoft. The company trimmed Apple's product offering so that it could focus on selling a small number of transformative devices, laid off 3,000 employees and discontinued about 70% of Apple products, including the Newton message pad. The company also became more innovative in its design.

The company newfound focus paid off the following year with the release of the imac; with a sleek, translucent design and an easy internet setup, the consumer friendly desktop computer sold nearly 800,000 units first 5 months. The products success made 1998 Apple's first profitable year since 1995. Imac success was followed up with ipad in 2001 and iphone in 2007. Today Apple is $300 billion company and a household name synonymous with attractive product design.

Shell Petroleum Nigeria
May 18, 2021,Shell Petroleum Nigeria reported that is selling its Nigerian business- the company shallow water and onshore asset interest because it no longer view its activities in the Niger Delta as core to its ongoing strategy, which is driven by the environmental, social and governance (ESG) pressure from its investors.

Also, several of the oil mining leases (OMLs) have upcoming development costs, which shell does not intent to fund. Shell could no longer afford to be exposed to the risk of theft and sabotage.
Shell, operatorof Nigeria's onshore oil and gas joint venture SPDC, has struggled for years with spills in the Niger Delta as a result of vandalism, as well as operational issues, leading to costly repair operations and high profile lawsuits.

Union Bank NIG. PLC

January 28, 2020, Union Bank of Nigeria PLC announced that it has entered a share sale and purchase agreement to divest of its 100% equity stake in Union Bank UK PLC. The sale is aligned with Union Bank's strategy to geographically streamline its business operations to focus on growth opportunities in Nigeria.

General Motor co (GM)

General Motors Company commonly known as GM, is American Global Automotive corporation headquartered in the U.S.A, that design, manufactures, markets and distributes vehicles and vehicle parts and sells financial services. General Motors produces vehicle in 37 countries under thirteen brands. GM has been present in Russian market since 1992. In March 2015, GM announced plans to change their business model in Russia and have ceased manufacturing, eliminated Opel brand distribution and reduced Chevrolet brand distribution in the year ended December 31, 2015. This decision impacts 300 dealers and distributors and 1,130 employees. Costs related to the change the change in our business model in Russia of $337 million in (General Motor Europe) GME and $91 million in GM international operation.

GMO in Russia industry sales to retail and fleet customers decreased 36.1% to 1.6 million vehicle compared to the corresponding period 2014. Since 2016, the company has decided to focus the premium segment of the Russian automotive market and offers the luxurious brand Cadillac and legendary American models such as the Chevrolet Corvette, Camaro and Tahoe.

Findings

Small and medium enterprises faced with failing performance can adopt any of the divestiture strategy that is peculiar to its failings to rebound the business into health. If its failing performance is as a result of overtrading, the firm can embark on portfolio restructuring, if it is organization incompetence or overtrading that limit managerial ability, the firms can set up board of directors/expertise to oversee the management of the firm while the manager divest self from day to day management, downsize in case of overstaff enhances the firm performance. If the failing performance is as result of financial restructuring, the firm can embark on the various financing options like leveraged buyout, management buyout and mezzanine financing. The various divestiture options have the ability to ensure the continuity of the firm and enhanced performance.

Apple had lost over $1 billion on an expansive line of products and the company was 90 days from being insolvent. The company strategic option was to divest its product offering into core competence, laid off 3,000 employees and discontinued about 70% of Apple products. Such strategic divestiture decision paid off the following year with the release of the imac; the consumer friendly desktop computer that sold nearly 800,000 units in its first 5 months, this was followed up with the introduction of ipad in 2001 and iphone in 2007. Today Apple is $300 billion company and a household name synonymous with attractive product design.

Shell Petroleum Nigeria considered divestment in the shallow water and onshore asset interest because it could not cope with high rate of vandalism, operational issues leading to costly repair operations and high profile lawsuit. Union Bank considered divestment to geographically streamline its business operations to focus on growth opportunities in Africa.

General Motors divest its investment in Russian market in 2015. Eliminated Opel brand distribution and reduced Chevrolet brand. This decision impacts 300 dealers and distributors and 1,130 employees. Such strategic decision saves the company $337 million in General Motor Europe and$ 91 million in General Motor international operation (GMO). Sales decreased in Russia from 36.1% to 1.6 million vehicles compared to the corresponding period in 2014. The restructuring, focus General Motor in Russia on the production of luxurious brand – Cadillac and legendary American models such as the Chevrolet Corvette, Camero and Tahoe.

Implication

Apple had lost $1 billion on an expansive products line and the company strategic option was to divest. The implication is that when organization products offering are bringing less returns to meet the demand of the stakeholders, is an indication that the organization is over- trading, the only strategic option to check the slide, is divestment. When organization divest into its core competence, it's likely to improve on its product delivery and rebound the company success. Apple focus on its core competence helps in quality design of imac, ipad and iphone. The implication is that firm can do much better if they focus on their core competence as it helps to enhance creativity of the staff of the organization. A divided attentions yield little or no result. Until organization shed excess weight, is likely to remain in limbo. Divestiture remains the only strategic option at this critical stage. Apple strategic option was not limited to the product offering but also staff restructuring and total repositioning of the firm on its strategic objectives.

Shell purported sales of its Nigerian business because it no longer views its activities in the Niger Delta as core to its ongoing strategy has implication on its increase investment requirement. When it becomes increasingly difficult /expensive to run subsidiary's operations due to challenges that are peculiar to the industry, the parent company may decide to divest from the particular business line. When a company's line of business continue to incur indirect loses that erode the positive contributions of the subsidiary, divestiture remain an option to cut down cost. Once the purpose of diversification is defeated, refocusing becomes strategic option.

Union Bank sales and purchase agreement to divest of its 100% equity stake in Union Bank UK PLC may be as a result of Non-profitability of existing business operations. The implication is that when a parent firm's subsidiary market share is eroded by more aggressive competitors in a competitive environment and when it becomes increasingly difficult to sustain the subsidiary then divestiture becomes an option to focus on core business.

General Motor decision to divest its operations in Russia may be due to Non-profitability of the operation and erosion of the subsidiary market share by more aggressive competitors or the subsidiary operating at the maturity end of its product life cycle. GeneralMotor decision to divest in Opel brand distribution and reduced Chevrolet brand saves the organization $337 million costs in General Motor Europe and $91 million in General Motor international operation. Refocusing on core competence is a painful strategic decision aim to eliminate products offering that burden the organization with a lot of debt and operational deficiency due to stiff competition and managerial inept. Divestment could be the need to rebrand as the original product may not meet the present needs of the consumer. General Motor refocusing on specific brands paid off as the legendary American models such as Chevrolet Corvette, Camaro, Tahoe and Cadillac remain competitive in the world automobile market and revamped the profitable level of General Motor.

Conclusion

When a firm has expanded to the extent that it experienced failing performance that is, decline improved value to the firm, it can restructure its operation through divestiture options to enable it refocus on the core competence of the firm in other to enhance its performance and possibly improved on its value. Apple divestment is an evidence of firm eliminating its excess products offering line that are not adding value to the organization and focus on core competence that maximized the wealth of the stakeholders. Apple focus on core competence enhanced its design of quality products like imac, ipad and iphone that rebound the company into success. Sometime, organization peripheral services could make firm loss focus on their core competence. When returns from such offerings increase the loss to the organization, it's time to divest and reposition the organization. Such repositioning helps the firm to strategically meet the needs of target market.

General Motor embarked on reduction in size as a strategic option to curb organization decline and failure. The refocusing on specific brands of comparative advantage helps to reduce cost and boost profitability through increased innovation and creativity. When organizations concentrate on its core specific, it eliminates waste and redirect financial resources to area of competitive advantage. Divestiture therefore is not a sign of failure but a time to re-strategies into core competence for improved productivity that quarantine capacity utilization. Firms should be encouraged to divest as a strategic option for the interest of the stakeholders, when it becomes increasingly expensive to run other products line that add little value to the organization. This work spells out the various method of divestiture and a firm can choose any of them that maximize it value creation. This work was limited to review of extant and relevant literature, report on Apple, Shell Petroleum Nigeria, Union Bank PLC and General Motors; there is need for empirical test of divestiture on failing SMEs. The researcher suggests for further study the divestiture of failing family owned business conglomerate as a succession planning.

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