Facing more competitive markets, more demanding shareholders, and more challenging workforces, company executives may ask whether it is time to reorganize the company. In considering such action, a first question is likely to be: “Does restructuring work?” But company leaders should push immediately beyond that concern, for the answer is both yes and no—hardly a concrete guide for executive action. After more than a decade of extensive restructuring of large companies, company executives should now be able to address the more complex but pragmatically more important question: “When does restructuring improve economic performance?”

Corporate restructuring has, of course, become a staple of management life during the past decade. Numerous firms have reorganized their divisions, streamlined their operations, and spun-off their divisions. As in most strategic decisions, the common driver has been the assumption that such actions spur company performance. For supportive experience, company executives often turn to publicized accounts of restructurings elsewhere that have worked well. They then take their own actions in the name of enhancing productivity, reducing costs, or enlarging shareholder wealth.’

The broad array of restructuring initiatives has fostered an extensive academic research literature on the impact of restructuring. Although many studies have reported that restructuring improves performance, some report no or even negative effects. The diversity in outcomes is to be expected because the rubric...
of restructuring includes a diverse array of company actions, from selling old lines of business to acquiring new lines, from eliminating debt to repurchasing stock, from introducing business units to downsizing work forces. The diversity of outcomes is also to be expected because companies vary in the effectiveness of their initiatives. Well-managed enterprises, whatever the chosen course, are more likely than others to realize the intended results. As a result, the question of whether restructuring works shifts to a question of which restructuring works best. Drawing on the extensive research literature now available, this article addresses the latter question. In gathering the available research, we have chosen to define restructuring broadly. While most studies have concentrated on a relatively specific form of restructuring—be it divisional spin-offs, leveraged buyouts, or employment downsizings—we have intentionally cast a wide net.

Source of Research Studies

Our data base is a set of research articles on company restructuring and performance that appear in the largest single electronic source, ABI/Inform. This source summarizes more than 800 business publications, including academic journals and business magazines. We have selected academic research studies that meet three criteria. The articles must:

- include a sufficient number of companies to permit statistical analysis,
- incorporate longitudinal measures of company performance, and
- have been published since 1986, thereby focusing our analysis on relatively contemporary company restructuring.

These considerations led to the identification of 25 articles reporting 52 distinct studies. The typical study based its analysis on nearly 100 companies, and the 52 studies together report data from approximately 5,000 firms. We have thus focused on a select set of studies published during the past decade that systematically examine the impact of restructuring on performance. Since the database includes diverse samples of companies as well as a variety of formats of restructuring, measures of performance, and methods of analysis, we use relatively simple measures to summarize and compare the studies’ results. The published articles of the studies included in this analysis appear in the Appendix.

Three Modes of Restructuring, Two Measures of Performance

The impact of restructuring is likely to vary across its major forms, and we draw on a three-fold distinction developed by Bowman and Singh:3

- portfolio restructuring—significant changes in the mix of assets owned by a firm or the lines of business in which a firm operates, including liquidations, divestitures, asset sales and spin-offs;
- financial restructuring—significant changes in the capital structure of a firm, including leveraged buyouts, leveraged recapitalizations, and debt for equity swaps; and
- organizational restructuring—significant changes in the organizational structure of the firm, including divisional redesign and employment downsizing.

The consequences of restructuring can be conceptualized in terms of a sequence of intermediate effects, which may have positive or negative outcomes. In the case of portfolio restructuring, these intermediate effects could be increased strategic focus, greater economies of scope, and more cogent control of multiple business units. In the case of financial restructuring, these intermediate effects could be an emphasis on cash flows and changes in managerial incentives. In the case of organizational restructuring, these effects could be greater employee satisfaction, reduced turnover, increased efficiencies, and better communication.

Ultimately, these intermediate effects may have some impact on financial performance or economic wealth of the corporation. This ultimate effect may be perceptible in a few years or over a longer time period. It is for this reason that some of the articles used an operating effect over a shorter period, while others used a stock market effect during a brief window of public information disclosure.

The mechanism of “when does restructuring work” is therefore composed of many intermediate effects, but the total or derivative economic effect is captured by the operating profit changes and/or stock market changes.

Accordingly, we distinguish between two measures of company performance in the wake of a restructuring:

- market performance—abnormal movements in the firm’s stock price in the days after a restructuring announcement; abnormal returns reflect changes in a company’s share price, adjusted for market trends, that can be attributed to the restructuring event; and
- accounting performance—changes in financial measures of the company’s performance, including return on equity and return on investment; these changes are typically calculated over a several-year window surrounding the restructuring event, allowing comparison of post- restructuring accounting performance with the pre-restructuring record.

Some studies, such as that of Clark and Ofek,4 examine both accounting and market-based performance measures. However, most opt for one approach or the other.
### TABLE I. Average Impact of Restructuring on Company Performance

<table>
<thead>
<tr>
<th>Type of Restructuring</th>
<th>Mean Percentage Performance Improvement</th>
<th>Median Performance</th>
<th>Percent Positive Means</th>
<th>Number of Studies</th>
<th>Average Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio</td>
<td>5.6</td>
<td>2.9</td>
<td>86*</td>
<td>21</td>
<td>154</td>
</tr>
<tr>
<td>Financial</td>
<td>37.3</td>
<td>24.5</td>
<td>86*</td>
<td>27</td>
<td>35</td>
</tr>
<tr>
<td>Organizational</td>
<td>-0.21</td>
<td>0.1</td>
<td>50</td>
<td>4</td>
<td>207</td>
</tr>
</tbody>
</table>

* Significantly different from 50 percent (base case) at p<0.01

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**Financial Restructuring Makes More of a Difference**

The studies generally report a statistically significant improvement in performance following a restructuring event, but not always. As seen in Table 1, the average percentage change in performance is positive for portfolio and financial restructuring, but is small and sometimes negative for organizational restructuring.

Financial restructuring has the strongest positive returns, in large part due to the high returns reported in studies of leveraged buyouts and management buyouts (which compose a significant proportion of the sample on financial restructuring). Debt for equity swaps and other forms of financial restructuring are associated with considerably more modest returns and show negative values in some cases. Portfolio restructuring displays the next highest returns. Organizational restructuring exhibits the least impact.

The third column of the table shows the proportions of the studies that report positive means. It indicates that financial and portfolio restructuring studies display higher proportions of positive returns than organizational restructuring. In five out of six cases—86 percent—of financial and portfolio restructuring, the impact on performance is positive. In only half of the cases of organizational restructuring, however, is the impact positive.

As can be seen in the table, organizational restructuring does not have a significant impact on performance. The mean and the median impact on performance is very small in percentage terms. As noted in the table, this result was based on four studies that focused exclusively on organizational restructuring and its economic performance implications. However, it is important to note that these studies examined an average of 207 instances of organizational restructuring. In this sense, the reported result of very small effects of organizational restructuring is based on a large sample of observations. As an extension not reported separately in the table, we broadened the set of organizational restructuring studies to include portfolio restructuring studies that had some aspect of organizational restructuring as well. This increased the number of studies with some organizational restructuring to ten, and it also raised the corresponding number of actual cases of restructuring reported in these studies. The mean and median effects on economic performance rose to 2.7% and 0.7% respectively. The percentage of studies with positive means rose to 81%, significantly higher than the baseline of 50%. Comparing the results for organizational restructuring alone with those when organizational restructuring is combined with portfolio restructuring, we see a higher likelihood of positive effects of the latter on performance. Organizational restructuring is evidently more likely to be effective when managers accompany such changes with shifts in the business portfolio of the firm.

In the following sections, we discuss the three areas of restructuring in more detail and offer illustrations of each.

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**Portfolio Restructuring**

A company may restructure its business portfolio for several reasons. To sharpen focus, it can dispose of a unit that is peripheral to the core business. To raise capital or rid itself of a languishing operation, it can sell off a division. Portfolio restructuring can also entail aggressive combinations of acquisitions and divestitures. A dozen studies published over the past decade have explored the impact of such restructurings on American companies.

**When Portfolio Restructuring Works**

Spin-offs yield the greatest performance reward, with 5 percent gains on average by the parent company (based on 181 companies); sell-offs generate gains of 2 percent (based on some 2,000 firms); more general portfolio changes—acquisitions and divestments with relocusing—generate no improvements on average (based on 169 companies). Taken together, the impact of portfolio restructuring on performance is 3 percent.

A close reading of these studies reveals that firms engaging in sell-offs are, compared with other companies, performing more poorly before the sell-offs. Companies that decide to liquidate themselves by selling off all of their pieces, not just selected parts, achieve returns that are three or four times larger than average. Announcing the price of a sell-off also makes a difference: when the price is not disclosed, the average returns are close to zero or non-significant.

Several studies note that when both company earnings and abnormal stock returns are tracked, earnings improvements are five or six times greater than the stock gains. A large difference is observed between sell-offs accompanied by payouts to shareholders or bondholders and sell-offs in which the proceeds are reinvested in the remaining business: the performance impact for such payouts is twice the average for all sell-offs, while the impact for reinvestment is close to zero. In sum, when sell-offs are not accompanied by additional focus, price announcements, or distribution of revenue to stockholders, they have little impact on post-restructuring performance.
Portfolio Restructuring Research Study

“Asset Sales and Increase in Focus” by Kose John and Eli Ofek is illustrative of the studies of portfolio restructuring. Their database is 321 divestitures of operating units of at least $100 million in the years 1985 and 1986.

The reasons offered for the sales included an increase in focus, a buyer who would manage the division better, or a need for cash. An increase in profits per year over the next three years of the remaining company (adjusted for industry) averaged 8 or 9 percent. The average market reaction in the three days after the announcement, adjusted for general market movement, stood at 1.5 percent.

The authors completed several regressions to distinguish the impact of several characteristics. An increase in corporate focus across all divisions (measured with the Herfindahl index) was positively correlated with an increase in both subsequent earnings and stock price. A buyer similar in SIC codes to the division it acquired resulted in higher stock price for the divesting company. A division sold that was dissimilar to the seller and similar to the buyer yielded the greatest gain—a 5 percent boost in the sellers’ stock price.

In sum, the average effect of asset sales were significantly positive, an increase in seller focus made it larger, and a similar buyer made it even larger. For the sample of more than 200 public firms, the earnings performance effects were positively correlated with the stock market effects—but they were not equal. In principle, if the earnings differences (approximately 8 or 9 percent on average) were to continue indefinitely, the corporation should see its value enhanced by that amount. The stock price effects are lower, at about 1.5%.

Several explanations can be offered for this difference. Most likely, the market expects the performance differences of future earnings to die out—and fairly soon after the three-year advantage calculation. Another possibility is that the market had already “anticipated” such a sale and previously boosted the price. A third possibility is that the market does not really believe the accounting for the present differences in reported earnings. With large write-offs, sometimes taken with the sale of the division that do not go through the earnings statements, near future earnings can be suspect. It is possible, however, that as the increased earnings are reported quarter-by-quarter, the market may adjust upward for this effect, and in other studies there is some supportive evidence. Drawing on these considerations, it is likely that the real wealth effect is somewhere between the two measures offered, 1.5 to 9 percent.

Portfolio Restructuring Case Study

One of the most visible business portfolio restructurings in recent years has been the 1995 breakup of AT&T into three components: Lucent, a stand-alone equipment producer, which includes Bell Laboratories; NCR, a computer manufacturing and service firm, similar to the original NCR that AT&T had earlier acquired; and the new AT&T, the long-distance telephone company.

AT&T’s chief executive, Robert Allen, and many stock analysts argued that the sell-off would create more shareholder value because of negative synergies that had emerged between the businesses. AT&T’s equipment division, for instance, had found it difficult to sell its products to other telecommunications firms that were competing with AT&T for telephone customers.

In the wake of AT&T’s announced breakup, its stock price rose during the next several days from $57 per share to $65—a 14 percent increase. Earnings in 1996 earnings were about 20 percent higher than those in 1994 earnings. More recently, however, a sharp drop in the price-earnings ratio of the new AT&T (the telephone business)—from 20 before the breakup to its current level of 10—has had an adverse impact on the total value of the three companies taken together. Shareholders received one-third of a share of Lucent, one-sixteenth of a share of NCR, and one share of the new AT&T. While the stock price of Lucent has doubled, NCR’s price has changed little and the new AT&T’s has declined. The value of the three stocks combined in the summer of 1997 is at about the same level as that of the sell-off. However, in the Fall of 1997, with a new CEO appointed, the increase in the total value of the combined stock matches the increase at the time of the breakup.

The tri-vestiture allowed Lucent to sell its products more effectively to telephone companies that did not see it as experiencing the potential conflicts of interest that it had when it was integrated within AT&T. The tri-vestiture also removed bureaucratic constraints on NCR, since there were few synergies between NCR and the rest of AT&T. The breakup for the new AT&T came at a time of intensifying competition in the telephone industry and its performance prospects remain uncertain. Lucent gained the most after the breakup, as it was now seen by its customers, the telephone companies, as a company independent of AT&T. Overall, the portfolio restructuring of AT&T allowed each resultant company to focus on its distinctive capabilities and on the opportunities presented in the competitive environment.

Portfolio Restructuring Summary

Where a choice can be made between spin-offs and sell-offs, the average performance differs by a factor of two. The market responds more favorably to a transaction in which existing shareholders receive the new business than one in which the current business receives the new cash. When spin-off divisions and their parents are later merged into other companies—about a third will be—their performance during the three years that follow is better than for those not subsequently merged: 17 versus 4 percent.

It appears that results are best if firms initiate spin-offs rather than sell-offs—and count on subsequent mergers. The research also indicates that returns are highest when the proceeds of such sales are used to reduce debt or give special dividends to shareholders. The evidence implies as well that it does not pay to be an aggressive buyer and seller of businesses: total returns from such transactions are slightly below those realized from no transactions.
Financial Restructuring

Of the studies that focus on financial restructuring, a number examined the impact of leveraged buyouts (LBOs) and, especially, management buyouts (MBOs). Buyouts are defined as transactions in which managers, with the aid of outside investors, replace public stockholding with closely held equity and high levels of debt. In recent years, a favored vehicle for changing a firm’s capital structure is to increase its leverage, and it is not surprising that the performance impact of LBOs and MBOs is a frequent subject of study.

Three sets of arguments have been advanced to explain the use of leveraged buyouts to take the company private. The first argument, primarily advanced by Jensen, contends that managers of public firms have an incentive to waste free cash flow of the firm, defined as cash available to the firm after funding all projects whose net present value is positive. Rather than return the excess cash to shareholders, managers are inclined to invest it in projects that do not generate new wealth for shareholders. This is less likely to occur, however, when a firm’s stock is acquired by a team of investors and managers using a high level of debt. Managers in the leveraged company usually have high equity stakes in the firm, disciplining their decisions, and the high debt level in any case tends to absorb much of the free cash flow, in effect mopping up much of the excess cash that might otherwise be wasted.

A second line of argument explaining the rise of leveraged buyouts, proposed by Lowenstein, reasons that managers have much more information about the true value of the firm’s assets than external investors and stock analysts. If the firm is undervalued in the marketplace, inside managers are the first to appreciate the fact and are thus best positioned to take advantage of it. Even if they make no operational or strategic changes after the purchase, the buyout managers will gain because they acquire a large fraction of the company’s undervalued equity. The third argument for the energy behind LBOs suggests that they are little more than a transfer of wealth. The buyout does not lead to net increase in value. Rather, it redistributes wealth from the bondholders to the stockholders.

When Financial Restructuring Works

Buyout studies often focus on reverse LBOs in which companies make subsequent public offerings and are thus required by the U.S. Securities and Exchange Commission to disclose information about their financial operations. Others have examined LBOs that include some public debt or stock after the buyout since they too must disclose their financial performance. For post-buyout performance, researchers utilized a variety of measures, including the ratio of operating income to sales, operating or net cash flow to sales, operating cash flow to assets or operating cash flow to employees, and various indicators of the management of working capital.

The research evidence generally points to the dynamics identified by the first line of argument: leveraged buyouts are often followed by an increase in free cash flow, greater focus on core business, reduced slack in resources, and enhanced operational efficiency.

The research by Kaplan, for instance, finds that LBO-firms tend to focus more on increasing net cash flow, and they do this in part by reducing capital expenditures and refocusing operations. The work by Seth and Easterbrook reports that firms after a buyout tend to reduce their scope of operations and increase their operating income. Bull confirms that companies improve their operating performance. Smart and Waldofgel find increases in operating income in post-buyout corporations. Smith reports that improvements in income occur not because of layoffs or reduced long-term capital expenditures, but rather from the increased efficiency of operations.

These studies also indicate that:
- Long-term operating performance improves after the LBO not only compared with a company’s pre-buyout levels, but also compared with other firms in the industry.
- Shareholder wealth increases after management buyouts. Hite and Vetsuytens, for instance, find that shareholders on average gain 0.55 percent in share price from divisional MBOs during the two days after the buyout announcement. The evidence suggests that divisional MBOs yield shareholder gains similar to those following divisional divestitures. Kaplan reports that both pre-buyout shareholders and post-buyout investors gain.
- Divisional LBOs display larger gains than full LBOs. Research by Muscarella and Vetsuytens indicate why: divisional buyouts make greater gains in operating efficiency than do leveraged buyouts of the entire company.

Finally, the evidence indicates that buyouts are followed by no significant reductions in employment, once post-buyout divestitures are taken into account. Kaplan tests the claim made by Shleifer and Summers that buyouts and takeovers transfer wealth from employees to investors, but he finds no support for the claim that layoffs are responsible for increases in operating income. Smith and Muscarella and Vetsuytens report similar findings.

Research suggests that post-MBOs may have a shorter time horizon than the pre-MBO firms. The increased demand of making large and frequent interest payments can force managers to postpone investments that are important for long-term performance. Also, calculations underlying the firm’s increased debt structure may have been too optimistic for the level of investment required to maintain the productive assets of the firm. The under-investment in long-term capital expenditures may as well stem from lower levels of slack resources for cushioning unexpected downturns.
Several kinds of evidence suggest that buyouts can increase the risk to the firm. First, several prominent LBOs such as Macy’s and Revere slid into bankruptcy as a result of high debt repayment schedules coupled with industry downturns. Second, the rate of financial distress among post-LBO firms that do survive is found to be relatively high. Denis and Denis report that nearly a third of the firms that underwent leveraged recapitalizations between 1985 and 1988 subsequently encountered financial privation. Third, LBOs tend to underinvest in long-term assets where risk is greater. Long and Ravenscraft report post-buyout decreases in expenditures on research and development, and Kaplan finds evidence of reduced capital expenditures.

Although some of the studies could not fully separate company-specific problems from industry-wide downturns, the evidence suggests that companies do increase their risks when they radically alter their capital structures through leveraged buyouts. Still, this does not imply reduced performance, and, to the contrary, other research finds improved results. Zahra, for example, reports enhanced performance among LBO companies in the years after their purchase.

Financial Restructuring Research Study

Steven Kaplan’s study, “The Effects of Management Buyouts on Operating Performance and Value,” is illustrative of research on financial restructuring. The primary question he explores is whether firms made significant improvements in their operating performance after the leveraged buyout, and whether these operating income improvements are sufficient to create economic value beyond the premium paid in the transaction. The findings indicate clearly that economic value is created in these transactions.

Kaplan examines 76 buyouts of free-standing public corporations in 1980-1986, all the transactions on which data are available for that period. Presenting detailed contrasts of post-buyout operations with pre-buyout conditions for a usable sample of 48 buyouts, he finds that operating income rose significantly after buyout, more than sufficient to recover the buyout premium paid to pre-existing shareholders of the firm. Improvements in operating income typically arose from increased cash flows generated from the companies’ operations. While there was some reduction in total number of employees within the firms in the sample, this reduction was not significantly less than that in corresponding firms in the industry that did not restructure financially through buyouts.

The introduction of strong managerial performance incentives in the form of large equity positions after the buyout encouraged executives to focus more intensively on producing shareholder value. The firms cut much of their debt burden resulting from the buyout within the first few years, reducing their risk of bankruptcy.

One tradeoff in an otherwise positive performance picture is that capital expenditures by the post-LBO companies are lower than their levels when they were publicly held. Overall, however, Kaplan reports strong evidence of improved cash flows and operating income in the LBO firms. The observed changes indicate that this form of financial restructuring has favorable impacts on both operating income and shareholder value.

Financial Restructuring Case Study

The turnaround of Harley-Davidson through a management buyout is an example of a firm that substantially improved its performance after financial restructuring. Harley-Davidson, a storied name in the motorcycle world, had lost market share in the United States to a variety of Japanese manufacturers. Honda, the most notable of these rivals, had initially attacked the U.S. market in the lighter weight motorcycle sector, where Harley-Davidson was not a participant. These initial inroads into the motorcycle market were ignored by Harley-Davidson; it had felt secure in the heavyweight motorcycle category. Harley-Davidson was owned at the time by AMF incorporated, a diversified firm which had bought Harley-Davidson in 1969 to capitalize on the growth of motorcycles. When Honda and other Japanese manufacturers began to challenge Harley-Davidson, AMF set up a joint venture with Aermacchi, an Italian manufacturer of lighter motorcycles. The products resulting from this collaboration did not match the Japanese products for quality or cost.

After Honda attacked the heavyweight market segment with its “Goldwing” line, Harley-Davidson began losing market share in the heavyweight segment. When the Harley-Davidson division requested research money and capital investment to catch up with the Japanese, its parents provided none. In 1981, AMF’s senior management decided to sell the Harley-Davidson division, and inside Harley-Davidson management eventually acquired it for $81.5 million. Management acquired ten percent of the equity and financed the rest with debt.

With its heavy debt burden, management had no choice but to further trim costs and improve operating efficiency. It also became clear, however, that Harley-Davidson would need to improve quality to stay viable. The now private firm began to benchmark all its production and inventory processes against the Japanese. The initial comparison was striking—Honda had a 5 percent failure rate in final quality inspection while 50 percent of Harley-Davidson’s products failed the same tests. The management team also concluded that Harley-Davidson’s prior strategy as a division of AMF was flawed: it had pursued market positioning strategies with insufficient attention to product quality. As a result, the firm had not responded to the quality challenges presented by its global competitors.

When installed as the principal equity investors, senior managers quickly began improving the fundamental operational profile of the firm. From 1981 to 1983, the company mounted a productivity improvement strategy with high employee involvement and just-in-time inventory management. With tighter cost controls accompanying the improved manufacturing quality initiative, Harley-Davidson regained market share from the Japanese competitors and restored its brand luster.
By 1989, Harley-Davidson’s market share had reached 59 percent of the U.S. market, well above its 1980, pre-buyout share of 30 percent. In the same period, Honda’s market share declined from 34 to 15 percent. Harley-Davidson had a successful initial public offering in 1989, with management retaining significant equity positions in the company. In 1990, it instituted an employee stock option plan, allowing employees to share in equity appreciation. The firm has since emerged as the industry leader in the U.S. and overseas.

Overall, the financial restructuring encouraged management to focus on the essentials of a strategy to build a better organization. Under the earlier ownership of a diversified conglomerate in which top management was distant from operations, the Harley-Davidson division had struggled with lackluster performance and quality problems. The leveraged buyout allowed management to make significant personal gains from the firm’s success. Annual return on equity over the seven years after buyout has averaged 35 percent.

Financial Restructuring Summary

In sum, the evidence indicates that financial restructuring generates economic value. Closer examination of the results suggests, however, that many of the changes after restructuring tend to be operational in nature: many of the benefits in the post-buyout firm result from greater focus on operations, reduction in the firm’s product scope, and elimination of wasteful spending.

Organizational Restructuring

Companies redesign their operations for a variety of reasons. The textbook prescription is to align company structure with strategy, an action that can be necessitated either by a change in strategy or by a structure that has drifted away from an earlier fit with strategy. Recent organizational restructuring has included the redrawing of divisional boundaries, flattening of hierarchical levels, spreading of spans of control, reducing product diversification, revising compensation, streamlining process, and reforming governance. The downsizing of employee ranks is often a by-product of such restructuring efforts, though in some instances it has been defined as an end in itself.

Some of the more extensive changes—such as the transformation from a functional to strategic business-unit form—are expected to take months if not years to achieve. Short-term market reactions to restructuring announcements can nonetheless serve as a useful clue to whether organizational restructuring is likely to have long-term impacts.

When Organizational Restructuring Works

We found only a small number of published studies explicitly linking organizational restructuring to performance. A larger number of studies examining organizational restructuring was identified in the organizationally oriented journals, such as Administrative Science Quarterly, but unfortunately these studies did not relate changes in economic performance with restructuring. The results of the few that did so are mixed: some report positive impacts of organizational changes on financial performance, others report negative effects. In either case, however, the effects are modest in magnitude.

Two studies examined the impact of corporate layoff announcements on shareholder value. A study by Worrel, Davidson, and Sharma found a small negative reaction of shareholder returns—down by 1 percent during a ten-day interval and 3 percent over ninety days—in response to 194 layoff announcements in 1979-1987. They also report that market reactions are more pronounced for financially distressed firms than for the non-distressed. Their interpretation: layoff announcements by troubled firms without any accompanying strategic announcements signal the presence of un-addressed problems that may hamper future earnings. The authors find that when companies announce layoffs as part of more general strategic changes, company shares rise on average by 4 percent; when they announce layoffs alone, share prices fall by 6 percent. Unless accompanied by a broader strategic redirection of the firm, layoffs tend to be badly received by shareholders.

A later study by Iqbal and Shekhar examined the impact of downsizings on both stock returns and annual returns on equity, using a sample of 187 layoffs from 1986 to 1989. They found that shareholders reacted negatively to layoffs by dropping stock price on the day of announcement by 0.3 percent. They also compared the stock reactions to layoff announcements by financially weak and financially healthy companies: price responses are significantly different, with positive stock reactions for financially weak firms and negative reactions for financially healthy firms. Although their overall averages are similar to those of Worrel and associates, Iqbal and Shekhar’s results on financially troubled firms are different. They attributed the negative returns associated with layoffs by financially healthy firms to disruptions expected within the firms following layoff. Iqbal and Shekhar also examined the impact of layoffs on return on equity and found evidence of a decline in earnings after layoffs.

Other studies, however, furnish more affirmative evidence on the value of organizational restructuring. Brickley and Van Drunen examined the impact of restructuring announcements on both shareholder wealth and earnings performance. They focused on the restructurings of company divisions—the formation of new units and the division, merger, or closing of old units—and on the realignment of management responsibilities. Stock prices generally increase in the immediate aftermath of the announced restructurings, though generally by less than 1 percent. On the other hand, company earnings decline, at least in the short run, apparently in part because of the increased expenses associated with implementation of the restructuring.
Organizational Restructuring Research Study

“Internal Corporate Restructuring” by James A. Brickley and Leonard D. Van Doren is illustrative of the studies of organizational restructuring. The database is 222 announcements of changes in the structure of 179 companies from 1980 through 1984. Changes in a company’s unit structure or management responsibilities are included, but mergers and spin-offs are not.

One example of an organizational restructuring announcement comes from a diversified holding company, as reported in the Wall Street Journal: “Tenneco Inc. said it formed a natural-gas trading subsidiary that will post monthly offering prices for natural gas....Tennaspe Exchange will effectively act as a natural-gas trader, purchasing fuel in Texas and Louisiana and selling it in the expanding national ‘spot,’ or short-term, natural-gas market.” Another example comes from a manufacturer, again as reported in the Wall Street Journal: “Firestone Tire and Rubber Co. said it established a top-level corporate planning and administrative job to free the president to oversee line operations.”

Companies offered a range of justifications for their organizational restructuring. Among the leading rationales are preparations for expansion into new markets or product lines, actions to improve decision making or operational efficiencies, and steps to reduce operating costs. Often, however, firms offered no reasons for their changes.

To assess the impact on stockholder wealth, the authors examined the restructuring company’s stock price in the days before and after announcement. They expected to see greater effects when the Wall Street Journal published longer articles than shorter accounts, on the premise that more information would have greater impact on investors (the articles are divided into long and short groups by their median length, four column inches).

Regression analysis reveals that the stock market responds positively on average to organizational restructuring announcements. The impact is statistically significant, but the magnitude is modest—on average less than one percent. The analysis also reveals substantial variation around that mean, depending on the type of organizational change and the rationale for it. The closing of a unit produces no positive gains, but other major changes do. When the announcements offer no explanation for the restructuring, the market does not move. When the firm reports that its actions are to take advantage of investment opportunities or to achieve greater operational efficiencies, however, its stock price does rise. The impact of a company’s announcement on its share price is greater when the Wall Street Journal provides lengthier coverage.

The authors expand their framework to consider whether it makes a difference if a company has been a target or potential target for an unwanted takeover. As anticipated, companies that had been under the shadow of a hostile acquisition during the year prior to their organizational restructuring see greater improvement in their shareholder wealth in the wake of the announcement.

Organizational restructuring generally have favorable impact on stockholder wealth, yet the authors also find that impact on the company’s accounting measures is not favorable. Earnings performance is not improved in the years immediately after the restructuring. This result may be due to the higher expenses that can accompany the process of organizational restructuring, with savings or other gains not realized for several years. If so, this may suggest that companies face a short-term inverse relationship between their accounting and market measures of performance. Investors anticipate long-term improvements in earnings from organizational restructuring, but the resulting changes may necessitate short-term expenses to achieve them.

Organizational Restructuring Case Study

The Xerox Corporation felt the pressure for restructuring in the early 1980s, well before many American firms. Its dominance of the copier market had seemed unassailable—until Japanese makers such as Canon mastered production of copiers that were often cheaper and better. Xerox first focused on improving the reliability of its products, launching its “leadership through quality” program in 1984, an initiative that helped it win the Malcolm Baldrige National Quality Award. It then turned to redefining its strategy—repositioning itself in a 1990 initiative called “Xerox 2000”—from a maker of machines to a manager of documents.

Xerox next concentrated on revamping its organizational design. Observing that “a more complex and volatile business environment requires capacity to cope with change,” chief executive Paul Allaire launched a campaign in 1992 to redefine the firm’s “architecture.” The goal, he said, was “to make this $17 billion company more entrepreneurial, more innovative, and more responsive to the marketplace.”

The organizational restructuring of Xerox entailed moving from a classic functional system to a set of relatively autonomous business units. Until then, most key decisions had been made at headquarters, where the top of the functional operations met. The restructuring into nine strategic business units, each focused on a distinct type of customer, moved those decisions deeper in the firm and closer to the customer. Business units came to operate almost as mini-firms under the company umbrella, each responsible for its own profits and loses, and each headed by a president who now enjoyed the latitude of an entrepreneur and the incentives of an owner.

Xerox placed more executive compensation at risk and more emphasis on strategic thinking. To ensure that managerial decisions were aligned not only with the promotion of business unit performance, but also the company as a whole, Xerox introduced a novel formula for its contingent compensation. A manager’s bonus and long-term incentives now depend on a product of individual, business unit, and company performance. If a manager falls short in any one of the three areas at the end of the year, his or her variable compensation—year-end bonuses and long-term stock options—is zeroed out.
The market reaction to Xerox Corporation's announcement of a 10 percent cut in its workforce in October 1993 is illustrative of how stock price can rise when a firm's restructuring holds promise for investors. Since Xerox had been improving its quality, decentralizing its divisions, and streamlining its work for several years, shareholders perceived the 10 percent reduction as the latest installment in a prolonged remaking of the company, not panic masquerading as a plan. In announcing the cutbacks, CEO Paul Allaire reminded shareholders that the downsizing was part of a long-standing agenda “to make the company more productive, more customer oriented, and bring products to market more quickly.” Given the company’s recent history, the message carried credibility. On learning of the layoff announcement, a First Boston analyst spoke for many: “We are just starting to see these types of restructurings. These guys are ahead of the curve.” Despite a charge of $700 million to complete the restructuring, on the day of the announcement, investors drove Xerox stock up by 7 percent.

Organizational Restructuring Summary

Some forms of organizational restructuring do not bring sought-after improvements in performance. It appears that layoffs unaccompanied by other organizational changes tend to have a negative impact on performance. Downsizing announcements combined with organizational restructurings are likely to have a positive, though small, effect on performance. Changing the divisional structure of the firm has a positive though modest impact on performance.

Conclusion and Implications

Corporate restructuring has been the subject of extensive research in the past decade. Of the three forms of restructuring examined here, financial restructuring improves economic performance the most. Perhaps this is because such restructuring is most explicitly focused on economic performance. The evidence, however, indicates that not all forms of financial restructuring work equally well: the largest returns come from leveraged and management buyouts. Leveraged recapitalizations—when firms take on considerable debt but remain publicly held—achieve more modest returns.

Portfolio restructurings also work well, with spin-offs bringing the highest returns, followed by sell-offs. In five out of six studies, the results are positive, indicating that portfolio changes generally yield financial benefits.

Organizational restructuring is more contingent upon the circumstances in which it is initiated and has the smallest impact on performance. The mean performance results display high variation, with half of the result positive and half negative, indicating that organizational redesigns and reductions in employment bring mixed consequences. While management teams may cite shareholders as the drivers of their downsizing decisions, investors are not favorably disposed to such actions.

Overall, many forms of restructuring have positive but modest effects on performance, measured in terms of both accounting results and shareholder returns. This finding is striking because the value of restructuring has been the subject of so much controversy in recent years.

Several points of caution, however, should be kept in mind. First, research on portfolio restructuring indicates that overly aggressive buying and selling of business units is not effective. Selectivity in portfolio restructuring is one management implication, with greatest results coming from spin-offs of businesses that are peripheral to the firm, followed by sell-offs of businesses to other corporate buyers. Second, there are risks in the process of restructuring. This point is best illustrated by the research on financial restructuring: it shows that although leveraged management buyouts have been associated with positive economic returns, they also bring increased risk of default due to the unremitting obligation of large interest payments.

In interpreting these findings, four additional considerations should be kept in mind: negative externalities, Schumpeterian expectations, counterfactual analysis, and reinvention and growth.

Negative externalities point to the possibility that the performance effects of restructuring may be more of a matter of wealth transfer than value creation. Cases can be found where employees, communities, bondholders, and even customers have all suffered while investors have gained handsomely. These effects are external to the financial performance measures used by corporations, investors, and the studies examined here. Accounts in the business and popular press remind us that workers and managers caught-up in company downsizing and plant closings often experience large personal losses, and these costs are not incorporated into the measures reported in the articles we have synthesized.

Schumpeterian expectations remind us of the “gale of creative destruction” that is constantly reshaping capitalism’s institutions and organizational forms. Behind the gale are such forces as new technologies, shifting consumer tastes, and intensifying global competition. Whatever the sources, the consequences include extensive remakes of many corporations and a Darwinian winnowing out of those that are not able to restructure themselves fast and far enough. Much of the restructuring that is the subject of the studies examined here reflect those forces for change that are well beyond management control.

The third point of counterfactual analysis asks: What would have occurred if the firms had not restructured? Performance effects in the studies reviewed in this article are measured by comparing a company’s future with its past. A challenge is to develop methods for instead comparing alternative futures, a firm’s performance after restructuring against its performance if it had not restructured. In defending their restructuring, executives often argue that in appraising their actions, one should focus not on the 30,000 jobs shed from an original base of 100,000, but rather on the 70,000 saved.
The fourth point of reinvention and growth is the frequently advanced admonition that corporations must not only restructure to overcome past limitations, but also reinvent themselves for renewed growth. It is new products, new markets, new investments, new jobs, and new profits that are arguably the ultimate measure of long-term performance.

Despite the limitations on how we have framed the performance question here, available studies indicate that—although the results are not dazzling—companies do achieve tangible gains from restructuring. It is also evident that restructuring is a heterogeneous phenomenon, with some forms of change having greater financial impact than others. As managers consider their options for restructuring, the data reported here imply that the financial route may be the most consistently predictive of future performance, followed by portfolio restructuring, with organizational restructuring the least sure.

**APPENDIX**

**Studies of Restructuring**


When Does Restructuring Improve Economic Performance?


Notes


2. Ibid., in terms categories of restructuring.


16. Ibid.


22. Smith, op. cit.

23. Smart and Waldofgel, op. cit.; Smith, op. cit.; Kaplan, op. cit.; Bull, op. cit.


29. In an article on hostile takeovers, Andrei Shleifer and Lawrence Summers argue that often a firm’s value is created in a hostile takeover by changing implicit contracts made with employees by the pre-existing management. The argument is that the new management can, after acquisition, break such implicit contracts and replace them with other, less expensive contracts (in terms of wages or commitments of compensation). Such an argument has also been made in the context of leveraged buyouts, that after such buyouts, management teams will reduce the number of lower level employees, citing the more constrained financial circumstances of the firm due to its debt load. See Andrei Shleifer and Lawrence Summers, “Breach of Trust in Hostile Takeovers,” in A. Auerbach, ed., Corporate Takeovers: Causes and Consequences (Chicago, IL: University of Chicago Press, 1988), pp. 33-56.

30. Smith, op. cit.

31. Muscarella and Vetsuytens, op. cit.


34. Kaplan, op. cit.

35. Zahra, op. cit.


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41. Ibid.