

# [Marriot restructuring this is a case study on the restructuring](https://assignbuster.com/marriot-restructuring-this-is-a-case-study-on-the-restructuring/)

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On the part of the shareholders of the former company, one share of stock In each of the new companies was to be given to them for each share of stock hey previously held. This announcement caused immediate and opposite price movements forMarriottCorporation’s stocks and bonds.

Stockholders were elated with the decision, while bondholders were angered, particularly investors who bought bonds Just that April. Nonetheless, Marriott management tried to assure bondholders that Interest and principal payments would be delivered on time.

Main Problem How should management, its stock and bondholders treat the situation? Analyses AT Marriott Corporation’s proposed restructuring involves splitting the parent company onto two separate entities based on two of its main activities – Marriott International would manage, while Host Marriott would own. Since most of Marriott Corporation’s current debts were associated with its asset-purchasing activities, many of the former company’s debt was now found in Host Amorist’s accounts, leaving Marriott International virtually debt-free in comparison.

The restructuring was technically a spin-off which meant that stockholders of the parent company would receive a share of stock in each of the new companies for each stock they previously held, thereby paving stockholders with ownership in two firms instead of one while no cash was actually transferred.

Furthermore, the Marriott family and all stockholders would still own the same percentage in the new companies as what they owned in the parent company.

Unlike other forms of corporate restructuring, Marriott Corporation’s own version of a spin-off allowed it to transfer most of its debts into one company, while leaving another free for unhampered expansion. Marriott achieved much of its growth by building hotels and then selling them to limited partnerships as tax shelters. Marriott made its profits from management fees and the sales of the hotels. However, when Congress eliminated these tax deductions, Marriott ended up with over 1 50 properties, built largely with borrowed funds, that it could not sell.

The $250 million annual mortgage interest expense threw Marriott into a severe cash crunch.

Then, in 1992, Marriott divided his company in two, spinning off its profitable management business from its debt-laden real-estate holdings. The new firm, Marriott International, was now free to accelerate its expansion. The creativity of the restructuring decision lies in the fact that Marriott Corporation was able to free itself from the limitations of being a company heavily laden with debt.

Since the restructuring meant that only one company would now be held liable for most of the debt, it allowed the shareholders of Marriott Corporation to minimize their losses in the event that it defaults. Rather than watching the entire parent company suffer, it would be for the well being of the shareholders that a portion of Marriott Corporation, in the form of Marriott International, prospers. Furthermore, the companies would also receive the benefits of a conventional spin-off.

Probably the most common reason for creating spin-offs is that they improve efficiency. Since the parent company is split into two separate companies with each having differing activities from one another, it allows for the management of each to concentrate on their main activity and deal with the problems solely associated with it. If each business must stand on its own feet, there is no risk that the funds will be siphon off from one in order to support unprofitable investments in the other.

Moreover, if the two parts of the business are independent, it is easy to see the value of each and to reward managers accordingly. The restructuring decision benefited the shareholders more than Amorist’s bondholders.

With stocks in two companies rather than one, Amorist’s shareholders are able to diversify their portfolio without additional investment outlay. Whether or not Host Marriott defaults on its debt or not, shareholders are still secured with an alternative investment in Marriott International. The rise in the price of Marriott

Corporation’s stocks after the announcement simply reflected how other investors also saw the restructuring decision as an opportunity to take advantage off. The bondholders, on the other hand, are less fortunate. With most of the debt being linked with Host Marriott, the returns of these bondholders are now attached to a heavily indebted firm with massive leverage in comparison with its parent company.

The debt, now greater in proportion in the smaller, spin-off firm, is riskier than previous, and has attained a lower security rating to show for it (from a EBB –

Adequate capacity to pay for Marriott Corporation, to a single B – Greater vulnerability to default, but currently has capacity to pay for Host Marriott). When Amorist’s bondholders paid for the safer EBB bonds, they expected EBB level risk and not single B bonds, which are associated with a higher risk. With the bond prices plummeting after the announcement, bondholders, especially those who Just bought Marriott bonds months before, could have bought the same bonds at a lower price if they had Just waited for a few months for the announcement.

More so, bondholders ere never informed of such corporate restructuring plans before they bought bonds from Marriott when it is arguable that the corporation must have already been planning months before for such a major move. The central issue, whether or not it was purposeful or simply an effect of the restructuring, is that bondholders wealth was expropriated in favor of stockholders, and thus it is natural that the bondholders and stockholders act the way did.

Recommendation Despite the event risk posed by Amorist’s restructuring decisions, we think that it is n bondholders’ best interest to simply hold on to their bonds.

Although Host Marriott would indeed have a greater difficulty in servicing all debts, especially since it now holds less assets and controls less revenue as before, it can still rely on the $MOM credit line provided to them by Marriott International. The credit line, although expiring at a date sooner than the maturities of many of the bond issues outstanding, can help in paying of the annual interest expenses until the management of Host Marriott can adjust to its current situation. Simply selling off one’s bonds could bring bout undesirable losses on speculations not yet clearly ascertained.

Furthermore, the price of the bonds three months after the announcement has been experiencing a steady increase to its previous amounts.

Although we are quite doubtful that the market values of these bonds would return to its original rates, trends show that the drastic plunge experienced during the week after the announcement could be simply a shock set by market panic. When worse comes to worst, and Host Marriott does indeed default on its bond payments, then bondholders, having priority claim over

Host Marmot’s various Nora assets , Is still assured AT getting Dacca I K TTS Investment. Probably the worst off are those bondholders who have bought Amorist’s bonds in the interest of quickly selling it off again for a capital gain. For these individuals, they could simply cut their losses at the point when the bond prices stabilize or simply hold on to the bonds and claim the interest returns from it. Marriott management should put the fears of bondholders to rest by making sure that they do indeed manage to pay off the interest payments, and later on, the maturity amounts.

Marriott International, in particular, should play an active part in helping Host Marriott service its debts and liabilities.

Although the main purpose of a spin-off is to warrant different divisions in a solitary firm independent management control over itself, Host Marriott is still for the most part the responsibility of Marriott International, the debt-free older brother. Whatever happens to Host Marriott nonetheless affects the very same shareholders of Marriott International. In that sense, it is also a loss on the part of the owners of Marriott International if Host Marriott goes under.

More so, it can also be reasonably ascertained that if Host Marriott falls, Marriott Internationals managing business would also be affected by the loss of Host Amorist’s hard assets (hotels, motels, etc. ).

The credit line provided by Marriott International could be a powerful tool in helping Host Marriott get back on its feet. Since Marriott International is now rated single A under Standard and Poor’s, it can easily borrow money at a cheaper rate. In turn, if it is legally possible, Marriott International can extend a greater credit line with a later expiration date to

Host Marriott, who himself will have a more difficult time in borrowing at a low interest rate. This “ passing” of loan credibility can act as a giant loophole which could surge both Marriott back into prosperity. In wrapping up, stockholders have control (through the managers) of decisions that affect the profitability and risk of the firm and it is in their own best interests that they also reassure existing bondholders of their creditworthiness despite the lowered security rating.

In the end, when all sides of the company are satisfied, it is the stockholders themselves who will feel the most benefit.