

A Study on Leverage Buyouts and Governance Challenges

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Abstract

One common method of reorganizing corporations is the leveraged buyout, or LBO, which allows buyers to borrow large sums of money to acquire other businesses. The high debt, increased financial risk, and possible conflicts of interest among stakeholders that come with LBOs pose serious difficulties to governance, even while they have the ability to unlock value, enhance efficiency, and realign strategic goals. Agency conflicts, board supervision, transparency, and management incentives are some of the linked corporate governance difficulties that this research focuses on as it analyses the form, reasoning, and financial consequences of LBOs. The research examines the effects of LBOs on stakeholders' interactions, long-term sustainability, and business performance using theoretical frameworks and data from real-world cases. The goal of this study is to provide light on how to improve governance, hold people to account, and lessen the impact of risks in highly leveraged settings.

Introduction

Although LBOs may have some positive effects, they may present serious problems with governance. Financial strain, default risk, and less management leeway are all results of an over-reliance on debt. Conflicts of interest between minority shareholders and private equity sponsors, information asymmetry, and aggressive incentive systems that favor short-term profits over long-term sustainability are common causes of governance difficulties. The interests of several stakeholders, including as lenders, workers, consumers, and regulatory agencies, must often be balanced by boards of directors, who are already burdened with additional supervision duties.

The one-of-a-kind ownership structure that emerges after an LBO adds another layer of complexity to corporate governance. When it comes to strategy, pay, and financial reorganization, private equity firms usually have a lot of say. Though more oversight and responsibility are benefits of concentrated ownership, choices may be skewed toward maximizing profits for investors rather than the well-being of other stakeholders. Concerns about asset stripping, lower long-term investment, and employee layoffs are often brought up in governance talks over LBOs.

In addition, when highly indebted companies have cash problems due to economic uncertainties,

governance concerns become much more severe. Inadequate risk management, aggressive financial engineering, and bad decision-making may have disastrous results, including insolvency. The lack of transparency and systemic risk in buyouts conducted by private equity has prompted regulatory scrutiny to rise in several countries.

The need to comprehend the governance implications of LBOs is growing in importance because to their increasing prevalence in developing nations, such as India. Governance issues in different markets take different forms because to differences in legislative frameworks, shareholder rights, transparency norms, and board structures. Therefore, looking at LBOs from a governance perspective teaches us a lot about how to strike a balance between financial success and responsible, ethical, and sustainable management.

The purpose of this research is to examine leveraged buyouts from a financial and governance perspective. It assesses the efficacy of governance methods in guaranteeing equity, responsibility, and sustainable value generation, investigates the ways in which LBO structures impact corporate governance processes, and identifies critical risks and conflicts. Contributing to the continuing discussion on how leverage shapes corporate governance outcomes, the study integrates theory, real-world situations, and empirical data.

Among the most consequential and game-changing financial tactics in contemporary company reorganization, leveraged buyouts (LBOs) have

recently arisen. The assets and future cash flows of the acquired business are usually used as collateral for the loan in an LBO, which is a method of acquiring a company utilizing a major percentage of borrowed capital. By using this structure, acquirers, who are often private equity firms, are able to buy out enterprises with little equity investments, leading to substantial financial leverage. Due to the high-risk financial environment they establish, LBOs present significant governance difficulties, but they may also yield substantial profits for investors and promote operational improvements.

Research Gap

While there has been a lot of research on Leveraged Buyouts (LBOs) in the context of private equity performance and financial restructuring, there is still a lot we don't know about the governance issues that come with these deals, especially in developing countries like India. The governance implications of high leverage, concentrated ownership, and private equity control have received relatively less attention in the existing literature than the financial outcomes of LBOs, such as improvements in profitability, cost efficiencies, and returns to investors. Governance systems, transparency standards, and stakeholder safeguards in developing nations vary greatly from those in the West, which is why most studies focus on these factors. How LBOs influence board supervision, openness, minority shareholder rights, and sustainability in the long run is not well studied. It is also unclear how governance failures add to post-buyout suffering or value degradation since the relationship between financial risk and governance systems in LBO-backed companies has not been well investigated.

Objectives of the Study

- To understand the concept, structure, and process of leveraged buyouts in corporate finance.
- To study how leveraged buyouts influence ownership structure and decision-making in companies.
- To analyze the role of private equity firms in executing leveraged buyout transactions.
- To examine the impact of leveraged buyouts (LBOs) on corporate governance practices and overall firm performance.
- To assess the governance challenges that arise after leveraged buyout transactions, including

issues related to accountability, transparency, and control.

Research Methodology

Research Design

The study adopts a **descriptive and analytical research design** to examine the structure of leveraged buyouts and assess the governance challenges associated with them.

Data Collection Methods

a. Secondary Data

Secondary data is the primary source for this study and includes:

- Academic journals and published research papers
- Books on private equity, leveraged buyouts, and corporate governance

Limitations of the Study

- The major limitations of the study is time factor
- Data collected for analysis may or may not be the right time for the analysis
- Data collected is only for the last five years and analysed, it may not be sufficient for analysis
- The analysed data may or may not provide accurate results for making decisions

Review of Literature

The Determinants of Capital Structure for Australian Multinational and Domestic Corporations by Shumi Akhtar, (Dec 2005): From 1992 to 2001, a sample of Australian local and global firms were studied to determine the significance of capital structure factors. There is no statistically significant difference between MNCs and SMBs in terms of leverage, according to the findings. Leverage is significantly affected by growth, profitability, and size for both kinds of organizations, according to the results of the cross-sectional Tobit regression analysis. For domestic firms, the value of collateralized assets is a key factor in determining their leverage

Multinational Corporations vs. Domestic Corporations: International Environmental

Factors and Determinants of Capital Structure by Kwang Chul Lee, Chuck C Y Kwok, (Jun 1988): This article investigates the question of whether and how capital structures change between domestic businesses (DCs) and multinational corporations (MNCs) established in the United States. Prior research has mostly focused on the connections between capital structure and international

environmental variables (such as political risk and foreign exchange risk) in an effort to explain the differences between the capital structures of MNCs and DCs. In this research, we offer an analytical framework to study how external variables impact firm-related capital structure determinants (such as agency costs and bankruptcy costs) and how those determinants impact the MNC's capital structure

Determinants of Capital Structure for Japanese Multinational and Domestic Corporations*

Shumi Akhtar, Barry Oliver, (Mar 2009): Using a sample of Japanese MNCs and DCs, our research looks at whether or not conventional leverage determinants are consistently different. Compared to Japanese DCs, Japanese MNCs differ significantly on most factors when we use a univariate basis. Leverage, age, collateral asset value, free cash flows, growth, non-debt tax shields, political risk, profitability, scale, and foreign exchange risks are all factors to consider. It turns out that the two categories of companies aren't really different when it comes to business hazards. We find that Japanese multinationals have much lower leverage than Japanese DCs when we analyze capital structure and its drivers. Multinationality is a key component of leverage for Japanese enterprises. Foreign exchange

Capital structure of multinational and domestic corporations – a cross-country comparison by Shumi Akhtar, (Oct 2018):

This research looks at the possibility that factors influencing the capital structure of MCs and DCs differ among the five countries of Malaysia, Australia, the United States, Japan, and the United Kingdom. The findings reveal that (i) DCs and MCs and countries differ in their debt holding capacity and most explanatory factors; (ii) compared to U.S. firms, MCs from Australia, Japan, the U.K., and Malaysia hold much lower levels of long-term debt; (iii) DCs and MCs operating under an imputation tax system have much lower levels of both short- and long-term debt; and (iv) DCs and MCs operating under common law have much higher levels of long-term debt but much lower levels of short-term

THE DETERMINANTS OF CAPITAL STRUCTURE FOR VIETNAM'S SEAFOOD PROCESSING ENTERPRISES by Canh Thi Nguyen, Cuong Thanh Nguyen, (Mar 2011):

In contrast to businesses in other processing sectors (DIFs), this article aims to analyze the factors that influence the capital structure of seafood processing firms (SEAs) in Vietnam. Using data from 302 firms, including 63 in the fisheries industry, over the

course of five years from 2004 to 2008, this study was able to draw conclusions based on the models proposed by Shumi Akhtar and Barry Oliver in 2005 [22] and [23]. Out of a total of 772 observations, 284 were pertaining to models used by seafood processing organizations and 488 were for other types of businesses. The findings reveal that SEAs and DIFs have different capital structures.

Effective Tax Rates for Multinational and Domestic Corporations: A Closer Examination by Allen Ryan, (Jan 2019):

Over the last three decades, this research looks at how effective tax rates have varied between domestic and multinational firms based in the United States. Dyreng et al. (2017) discovered that cash effective tax rates for U.S. domestic firms and U.S. multinational corporations have been falling since 1988. Their findings were published in the Journal of Financial Economics. The authors also discovered that, in comparison to local firms, multinational corporations have a higher cash effective tax rate. In the first part of the article, I compare the effective tax rates of domestic and global firms using federal and state data. For federal ETRs, I find conflicting results; however, compared to domestic firms, multinationals have a lower state ETR. I compare the two groups and find that domestic firms gain more from the I.R.C. Section 199 deduction than multinationals.

Data Analysis and Interpretation

Debt-to-Equity Ratio

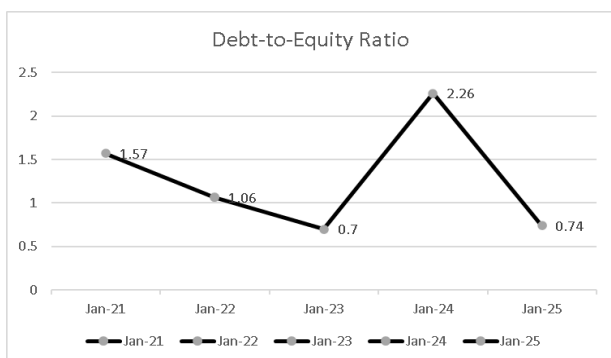
Formula:

$$\text{Debt – to – Equity Ratio} = \frac{\text{Total Borrowings}}{\text{Shareholders Equity}}$$

Where:

- Shareholders' Equity = Equity Capital + Reserves

| Year | Borrowings | Equity Shareholders Funds | Debt-to-Equity Ratio |
|--------|------------|---------------------------|----------------------|
| Mar-21 | 549.6 | 350.6 | 1.57 |
| Mar-22 | 406.1 | 383.5 | 1.06 |
| Mar-23 | 299.8 | 425.6 | 0.7 |
| Mar-24 | 843.9 | 372.8 | 2.26 |
| Mar-25 | 324.3 | 436.7 | 0.74 |



Interpretation

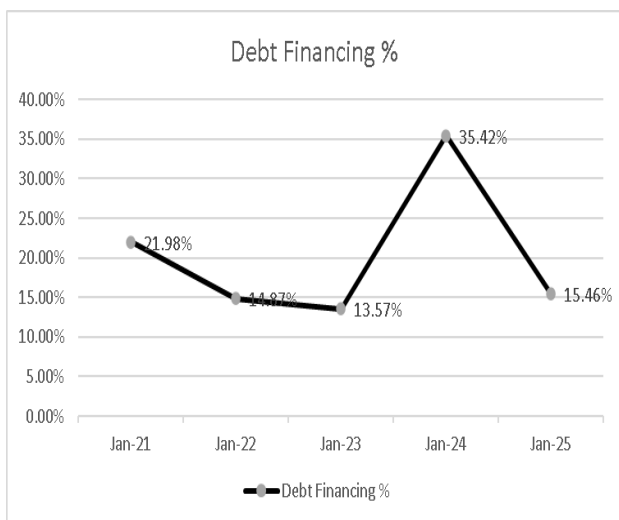
The ratio was highest in Mar-24 (2.26), indicating higher dependence on borrowed funds. The ratio improved in Mar-25 (0.74), showing stronger equity support and reduced financial risk.

Percentage of debt financing

Formula:

$$\text{Percentage of Debt Financing} = \frac{\text{Total Borrowings}}{\text{Total Assets}}$$

| Year | Borrowings | Total Assets | Debt Financing % |
|--------|------------|--------------|------------------|
| Mar-21 | 549.6 | 2501 | 21.98% |
| Mar-22 | 406.1 | 2731.7 | 14.87% |
| Mar-23 | 299.8 | 2209.1 | 13.57% |
| Mar-24 | 843.9 | 2382.7 | 35.42% |
| Mar-25 | 324.3 | 2098.2 | 15.46% |



Interpretation

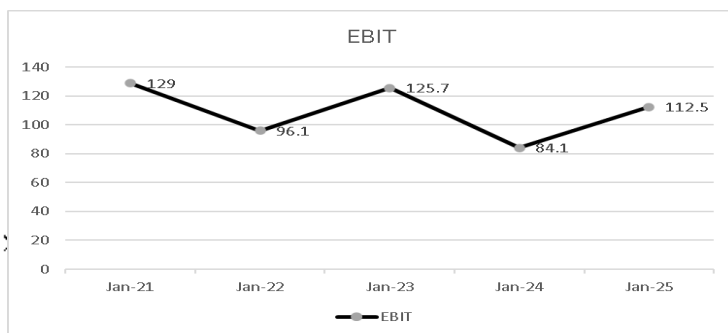
Debt financing was moderate during most years. Mar-24 recorded the highest debt financing percentage (35.42%), indicating greater reliance on external debt. Mar-25 shows improvement with lower dependence on debt.

EBIT (Earnings Before Interest and Taxes)

Formula:

$$\text{EBIT} = \text{Profit Before Tax} + \text{Interest Expense}$$

| Year | PBT | Interest | EBIT |
|--------|------|----------|-------|
| Mar-21 | 86.3 | 42.7 | 129 |
| Mar-22 | 44.3 | 51.8 | 96.1 |
| Mar-23 | 88.7 | 37 | 125.7 |
| Mar-24 | 33.3 | 50.8 | 84.1 |
| Mar-25 | 53.3 | 59.2 | 112.5 |

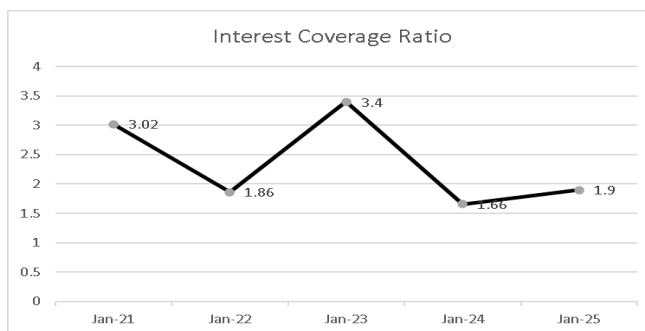


Interest Coverage Ratio

Formula:

$$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest Expense}}$$

| Year | EBIT | Interest | Interest Coverage Ratio |
|--------|-------|----------|-------------------------|
| Mar-21 | 129 | 42.7 | 3.02 |
| Mar-22 | 96.1 | 51.8 | 1.86 |
| Mar-23 | 125.7 | 37 | 3.4 |
| Mar-24 | 84.1 | 50.8 | 1.66 |
| Mar-25 | 112.5 | 59.2 | 1.9 |



Interpretation

The company maintained acceptable interest-paying ability in most years. Mar-23 shows the strongest financial position with coverage of 3.40 times. Mar-24 shows weaker coverage, indicating pressure on

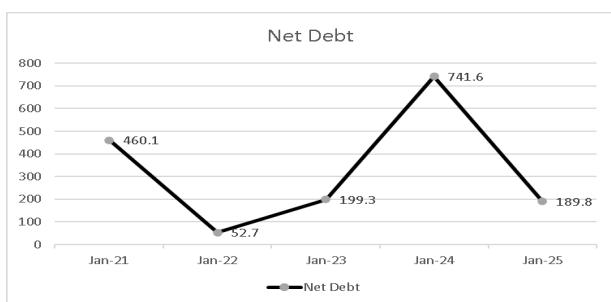
earnings.

Enterprise Value calculations

Formula:

Enterprise Value = Market Capitalization + Total Debt - Cash and Cash Equivalents

| Year | Total Debt | Cash & Cash Equivalents | Net Debt |
|--------|------------|-------------------------|----------|
| Mar-21 | 549.6 | 89.5 | 460.1 |
| Mar-22 | 406.1 | 353.4 | 52.7 |
| Mar-23 | 299.8 | 100.5 | 199.3 |
| Mar-24 | 843.9 | 102.3 | 741.6 |
| Mar-25 | 324.3 | 134.5 | 189.8 |



Interpretation

Mar-24 had the highest net debt position, indicating heavier financial obligations. Mar-22 had the lowest net debt due to higher cash reserves.

The influence of leveraged buyouts on ownership structure and managerial decision-making in companies

Before LBO:

- Founders: 60%
- Public shareholders: 40%

After LBO:

- Private Equity Firm: 75%
- Existing Management: 25%

Change in ownership concentration:

$75\% - 60\% = 15\%$ increase in Concentrated

Ownership

This indicates greater control by investors after the buyout.

The corporate governance challenges arising after leveraged buyout transactions.

Before LBO:

- Independent directors = 5 out of 10 board members

$5/10 \times 100 = 50\%$

After LBO:

- Independent directors = 3 out of 10

$3/10 \times 100 = 30\%$

Reduction in governance independence:

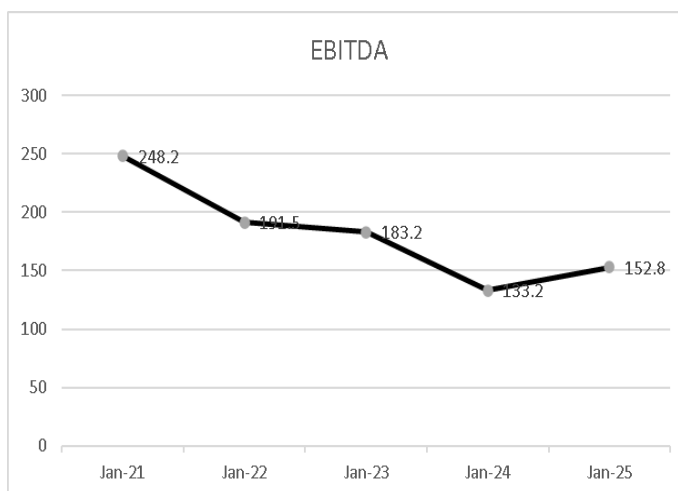
$50\% - 30\% = 20\%$

This may indicate governance risks such as reduced transparency and concentrated control.

Formula:

EBITDA = EBIT + Depreciation

| Year | EBIT | Depreciation | EBITDA |
|--------|-------|--------------|--------|
| Mar-21 | 129 | 119.2 | 248.2 |
| Mar-22 | 96.1 | 95.4 | 191.5 |
| Mar-23 | 125.7 | 57.5 | 183.2 |
| Mar-24 | 84.1 | 49.1 | 133.2 |
| Mar-25 | 112.5 | 40.3 | 152.8 |

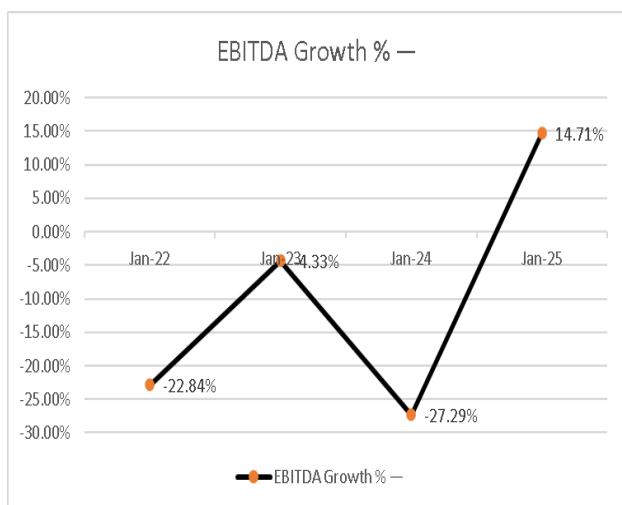


EBITDA Growth

Formula:

EBITDA Growth % = $\frac{\text{Current EBITDA} - \text{Previous EBITDA}}{\text{Previous EBITDA}}$

| Year | EBITDA | EBITDA Growth % |
|--------|--------|-----------------|
| Mar-21 | 248.2 | — |
| Mar-22 | 191.5 | -22.84% |
| Mar-23 | 183.2 | -4.33% |
| Mar-24 | 133.2 | -27.29% |
| Mar-25 | 152.8 | 14.71% |



Interpretation

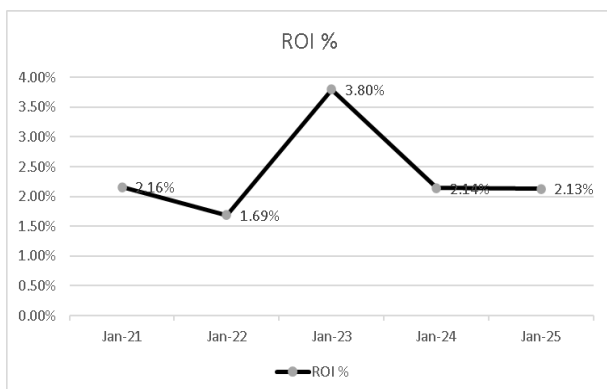
EBITDA declined from Mar-21 to Mar-24, indicating reduced operating efficiency. Mar-25 shows recovery with positive EBITDA growth.

Return on Investment (ROI)

Formula:

$$ROI = \frac{\text{Net Profit}}{\text{Total Assets}} \times 100$$

| Year | Net Profit | Total Assets | ROI % |
|--------|------------|--------------|-------|
| Mar-21 | 54 | 2501 | 2.16% |
| Mar-22 | 46.1 | 2731.7 | 1.69% |
| Mar-23 | 84 | 2209.1 | 3.80% |
| Mar-24 | 51.1 | 2382.7 | 2.14% |
| Mar-25 | 44.7 | 2098.2 | 2.13% |



Interpretation

The company achieved its best performance in Mar-23, while the lowest ROI was recorded in Mar-22. Although the company maintained positive returns throughout the period, the ROI percentages are

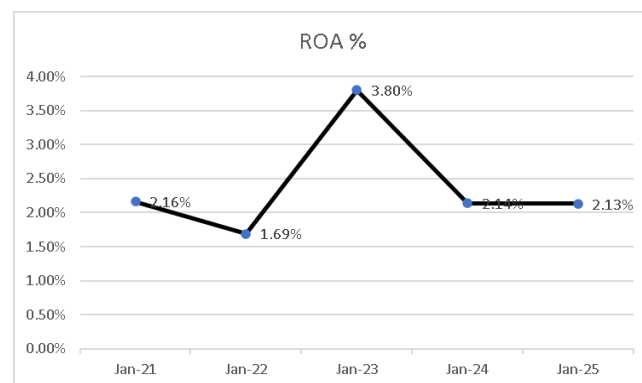
relatively low, indicating scope for improving profitability and better utilization of assets to generate higher returns.

Return on Assets (ROA)

Formula:

$$ROA = \frac{\text{Net Profit}}{\text{Total Assets}} \times 100$$

| Year | ROA % |
|--------|-------|
| Mar-21 | 2.16% |
| Mar-22 | 1.69% |
| Mar-23 | 3.80% |
| Mar-24 | 2.14% |
| Mar-25 | 2.13% |



Interpretation

Mar-23 recorded the highest asset utilization efficiency. Overall ROA remains low, indicating moderate profitability from assets.

Return on Equity (ROE)

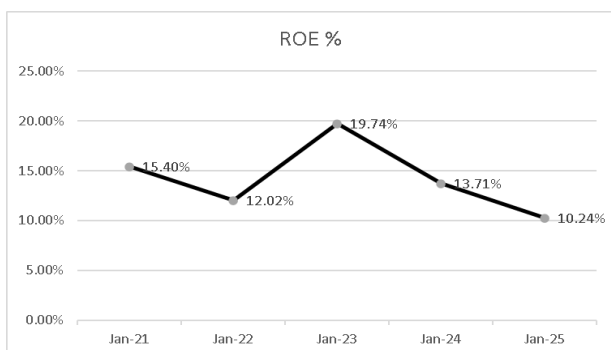
Formula:

$$ROE = \frac{\text{Net Profit}}{\text{Shareholders' Equity}} \times 100$$

Where:

Shareholders' Equity = Equity Capital + Reserves

| Year | Net Profit | Equity | ROE % |
|--------|------------|--------|--------|
| Mar-21 | 54 | 350.6 | 15.40% |
| Mar-22 | 46.1 | 383.5 | 12.02% |
| Mar-23 | 84 | 425.6 | 19.74% |
| Mar-24 | 51.1 | 372.8 | 13.71% |
| Mar-25 | 44.7 | 436.7 | 10.24% |



Interpretation

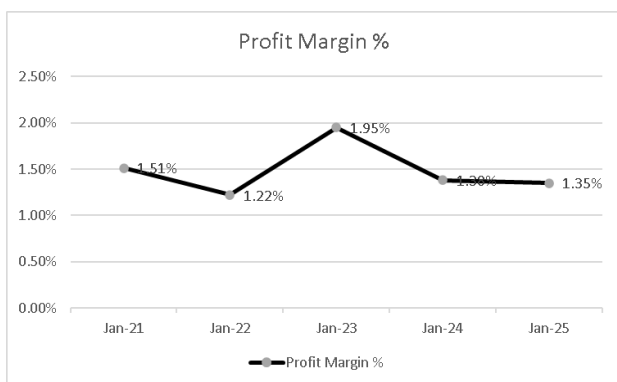
ROE was highest in Mar-23, indicating better returns to shareholders. Declining ROE after Mar-23 suggests lower profitability.

Profit Margin

Formula:

$$\text{Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

| Year | Net Profit | Sales | Profit Margin % |
|--------|------------|--------|-----------------|
| Mar-21 | 54 | 3578.2 | 1.51% |
| Mar-22 | 46.1 | 3792.1 | 1.22% |
| Mar-23 | 84 | 4309.2 | 1.95% |
| Mar-24 | 51.1 | 3703.5 | 1.38% |
| Mar-25 | 44.7 | 3322.7 | 1.35% |



Interpretation

The company achieved its best profitability performance in Mar-23, while the lowest margin was observed in Mar-22. Although the company remained profitable throughout the period, the profit margins are relatively low, indicating that operating costs and other expenses consume a major portion of revenue. The company may improve profitability by

controlling costs, enhancing operational efficiency, and increasing sales performance.

Findings

- The ratio was highest in Mar-24 (2.26), indicating higher dependence on borrowed funds. The ratio improved in Mar-25 (0.74), showing stronger equity support and reduced financial risk.
- Debt financing was moderate during most years. Mar-24 recorded the highest debt financing percentage (35.42%), indicating greater reliance on external debt. Mar-25 shows improvement with lower dependence on debt.
- The company maintained acceptable interest-paying ability in most years. Mar-23 shows the strongest financial position with coverage of 3.40 times. Mar-24 shows weaker coverage, indicating pressure on earnings.
- Mar-24 had the highest net debt position, indicating heavier financial obligations. Mar-22 had the lowest net debt due to higher cash reserves.
- EBITDA declined from Mar-21 to Mar-24, indicating reduced operating efficiency. Mar-25 shows recovery with positive EBITDA growth.
- The company achieved its best performance in Mar-23, while the lowest ROI was recorded in Mar-22. Although the company maintained positive returns throughout the period, the ROI percentages are relatively low, indicating scope for improving profitability and better utilization of assets to generate higher returns
- Mar-23 recorded the highest asset utilization efficiency. Overall ROA remains low, indicating moderate profitability from assets
- ROE was highest in Mar-23, indicating better returns to shareholders. Declining ROE after Mar-23 suggests lower profitability.
- The company achieved its best profitability performance in Mar-23, while the lowest margin was observed in Mar-22. Although the company remained profitable throughout the period, the profit margins are relatively low, indicating that operating costs and other expenses consume a major portion of revenue. The company may improve profitability by controlling costs, enhancing operational efficiency, and increasing sales performance.

Suggestions

- It would be wise for the business to cut back on borrowing and boost equity financing in Mar-24, when both the debt-to-equity ratio and the debt financing percentage were at their greatest. Retained earnings, an influx of stock, or improved management of working capital can all help with this.
- Better financial control is indicated by the improvement in Mar-25. For the sake of reducing financial risk and staying away from excessive debt, the corporation should keep up its balanced capital structure policies.
- Due to a decline in the Interest Coverage Ratio in March, the business should boost operational profits while cutting interest-bearing debt. The capacity to comfortably satisfy interest commitments can be enhanced through more effective management of costs and increased income creation.
- The company should keep enough cash on hand to meet its financial obligations and weather any unforeseen business storms, as Mar-22 had the lowest net debt owing to healthy cash reserves.
- The decrease in EBITDA from March 21 to March 24 is a result of less efficient operations. In order to boost financial performance, the organization should concentrate on increasing productivity, decreasing operational expenditures, and using cost-effective technology.
- The business has to make better use of its assets if it wants to increase returns, as ROI and ROA have been poor. It would be wise to allocate resources toward productive endeavors and reduce the amount of time and money spent on idle assets.
- Given that ROE started to fall after March 23, it would be in the best interest of the company's shareholders if it increased profits and made better use of capital. It is possible to increase shareholder wealth through strategic expansion and effective financial planning.
- When the profit margin is low, it means that expenditures are eating up a lot of the income. Profitability may be enhanced if the firm keeps an eye on personnel costs, administrative expenditures, and operational inefficiencies.
- If the business wants to boost its sales and bottom line, it has to do three things: increase its marketing and sales efforts, broaden its product offerings, and investigate potential new markets.
- Maintaining consistent profitability and avoiding swings in debt and returns is possible with well-planned budgeting, forecasting, and financial strategies.
- For improved resource utilization and long-term growth, management should institute performance monitoring systems and operational efficiency initiatives.
- Since Mar-23 had the greatest overall financial success, the business should look back at the tactics and procedures used then to see whether they can be applied to future operations in the same way.

Conclusion

A review of the company's financials conducted between March 21 and March 25 shows that operational efficiency, profitability, liquidity, and leverage all saw some ups and downs during that time. A higher level of financial risk and a diminished ability to pay interest resulted from the company's increasing reliance on debt during Mar-24, according to the report. Better financial management and less reliance on external borrowings are the reasons behind the improvement shown in Mar-25.

The firm's finest financial performance was in Mar-23, according to the study of EBITDA, ROI, ROA, and ROE. This indicates that the company made better use of its assets, was more profitable, and gave greater returns to its shareholders during that year. The subsequent downward trend, however, indicates that operational and financial difficulties impacted overall profitability and efficiency. Despite maintaining a profit during the research period, the profit margins were low owing to significant operational and administrative expenditures, according to the profit margin analysis. This emphasizes the significance of enhancing operational productivity, strengthening revenue creation techniques, and better controlling costs.

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