



Improving the efficiency and effectiveness of the company-The corporate restructuring way

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Abstract

Corporate restructuring has been dominant global business theme from the mid-seventies. It has been fuelled by a variety of forces like global competition, technological breakthroughs, managerial innovations, regulatory changes, transformation of formerly centrally planned socialistic and communistic economies, and expansion of international trade. It has led to dramatic improvement in corporate performance. Observers of corporate restructuring believe that the gains are attributable to synergetic benefits, sharper forces, better corporate governance, improvement in managerial incentives and motivation, greater disciplining power of debt, and elimination of cross subsidies. Corporate restructuring is a process by which a firm does an analysis of itself at a point of time and alters what it owes and owns, refocuses itself to specific tasks of performance improvements. Corporate restructuring would radically alter a firm's capital structure, asset mix and organization so as to enhance the firm's value.

Keywords: Corporate restructuring, demerger, equity carve-out, franchising, joint ventures

Introduction

The corporate restructuring of a company involves an activity to make the organization more balanced, profitable and enable the company to achieve its objectives in a more simplified manner than previously. The restructure may include the organizational restructuring like merger, amalgamation, takeover, divestment, expansion, joint venture etc. or financial reorganization like buyback of shares, issue of sweat equity shares, redemption of shares, issue of convertible debentures/preference shares, consolidation of shares, split-up of share value, issue of bonus shares, issue of deep discount bonds etc. The basic objective of corporate restructuring is reorganizing the existing operations keeping in view the continuance of business and to improve the firm's profitability. The reorganization plan should be fair, equitable and feasible. The scheme of restructuring should not give any undue advantage to any stakeholders at the cost of others. The basic difference is that corporate restructuring is resorted to keep the business is running and reorganization is done to achieve a balanced operational result. The operational restructuring aims at improving and constantly increasing the operational and economic viability of the underlying business model. It includes mergers, hive offs of divisions or product lines, closing- down unprofitable facilities etc. The corporate restructuring is designed to accomplish specific goals and strategies such as:

- Profitability and ROI improvement,
- Higher economies of scale,
- Optimum break-even point,
- Reducing financial and operational risks,
- Continuous improvement in shareholder value etc.

Coverage Areas of Corporate Restructuring

The following are the broad areas of restructuring

Financial: This involves decisions relating to acquisitions, mergers, joint ventures and strategic alliances. This also deals with restructuring the capital base and raise finance for new projects.

Technological: This involves investment in research and development and also alliances with overseas companies to exploit technological strengths.

Marketing: This involves decisions regarding the product market segments where the company plans to operate based on its core competencies.

Manpower: This involves establishing internal structures and processes for improving the capability of the people in the organization to respond to changes.

A good restructuring exercise consists of a mixture of all these. These alterations have a significant impact on the firm's balance sheet by redeploying assets or by exploiting unused financial capacity. The underlying object of corporate restructuring is efficient and competitive business operation by increasing the market share, branch power and synergies. Corporate restructuring is a process by which a company can consolidate its business operations and strengthen its position for achieving the desired objectives staying synergetic, slim, competitive and successful.

Rationale for Corporate Restructuring

There are a good number of reasons why companies are going for restructuring

- The globalization of business has compelled companies to open new export houses to meet global competition. Global market concept has necessitated many companies to restructure, because lowest cost producers only can survive in the competitive global markets,
- Changed fiscal and government policies like deregulation/decontrol has led many companies to go for newer markets and customer segments.
- Revolution in information technology has made it necessary for companies to adopt new changes for improving corporate performance.
- Many companies have divisionalised into smaller businesses, Wrong divisionalization strategy has led to revamp themselves. Product divisions which do not fit

into the company's main line of business are being divested. Fierce competition is forcing the companies to re-launch themselves.

- Improved productivity and cost reduction has necessitated downsizing of the work force- both at works and at managerial level.
- Convertibility of rupee has attracted medium-sized companies to operate in the global markets.
- Competitive business necessitated to have sharp focus on core business activities, to gain synergy benefits, to minimize the operating costs, to maximize efficiency in operation and to tap the managerial skills to best advantage of the firm.
- Economies of scale can be achieved by consolidating the capacities and by expansion of activities.
- By diversification of business activities, the minimization of business risks is possible and it will enable the firm to achieve at least the minimum target rate of return.
- By restructuring the enterprise, a sick company can be successfully revived and rehabilitated, and can be brought back to profitable lines.
- With the integration of sick unit into the successful unit, the adjustment of unabsorbed depreciation and write-off of accumulated loss is possible, there by the successful unit can have strategic tax planning.
- Corporate restructuring includes financial reorganization, by bring the company to achieve a desired balance of debt and equity, and thereby reduce the overall cost of capital and financial risks.
- The restructuring process will facilitate to have horizontal and vertical integration, thereby the competition is eliminated and the company can have access to regular raw materials and reaching new markets and accessibility to scientific research and technological developments.
- The application of information technology and responsibility accounting concepts will facilitate to divide the total enterprise into strategic business units, a better way of achieving the corporate goals.

Implications of Corporate Restructuring

The corporate restructuring will result in the below mentioned implications:

1. **Reduced number of players in a market segment:** Due to the phenomena like mergers and acquisitions there will be only companies with competitive edge left in a particular field. The weak, inefficient, unviable companies will either die or merged with other stronger players.
2. **Emerging of new look companies:** The companies coming out of the process of restructuring and renewal exercises will be better equipped to face the transitional companies or enter into alliances with the same.
3. **Healthy economic state of the nation:** The new acquired better health of the companies will directly contribute to the growth of the national economy.
4. **Social discontent:** Large cases of laying off, shutting down, increasing number of sick units and increasing gap between the rich and the poor may prove to be a great national obstacle in the path of growth of national

economy. Also, such phenomena will lead to political instability.

Corporate Restructuring Process

Every organization has its own character, culture, value system etc. Therefore, there cannot be a specific strategy for all the organizations or majority of organizations. The prevailing political system, social conditions etc. have their own powerful influence on any organization. Each organization has to find its own remedy suited to its specific requirement. The restructuring process can be divided in two broader parts as detailed below

Hardware Restructuring

This involves redefining, dismantling, or modification of the existing structure of the organization. The major areas of the hardware restructuring are as follows

Identification of core competency: This involves a detailed analysis of the inherent strengths of the company in area vis-a-vis the competitors, as the competitors will not take long time to enter into the area of another weak competitor.

Flattening of organizational layer: To have the desired responsiveness of the company towards company policies or strategies, the organizational layers should be as less as possible.

Downsizing: Over the years many organizations have accumulated fat in terms of overstaffing. A lean organization is the need of the hour to stay competitive in the market.

Creation of self-directed teams: These teams should be such that they will not wait for the direction from the higher-ups. They will have a kind of autonomy in functioning.

Benchmarking: This is a continuous process of measuring the products, services and business practices of a company against the toughest competitors or those companies recognized as the industry leaders. It is the search for industry best practices that lead to superior performance.

Software Restructuring

This involves cultural and process changes required to create the more collaborative environment needed for the renewal and growth of the company. Software restructuring includes

Communication: By creating transparency in the organization and convincing each employee about the need for the restructuring exercise the same can be carried out in an effective way otherwise it will run into all kinds of problems. Good strategies are useless if they cannot be implemented and strategies cannot be implemented if people are not enthused about it.

Organizational support: The vertical and horizontal relationships through coaching, guiding rather than control. Competition and contention is a must for renewal,

Trust: It is very vital particularly in the context of risk taking activities. On the organizational setup, it provides confidence necessary for someone to let go of the security

of business as usual and take a leap in the belief that he will get a supportive hand in the organization.

Stretch: Tightly defined business boundaries constrained the generation of new ideas. Thus, stretch is the liberating and energizing element of managerial context that raises individual aspiration levels and encourages people to lift their expectations of themselves and others.

Empowering people: The top-down decision-making practice has to give way to ideas from the bottom and decentralized decision-making. Replace the very concept of orders from the top with ideas from the bottom.

Industry foresight: This is different from vision of the company. Vision is generally very narrowly held by one two people and the rest of the organization has to carry it. Foresight comes from or a lot of hard work to understand what is changing such as a technology, demographics, regulations etc.

Training: To weed-out the outdated ideas from the minds of people, a continuous training program have to be adhered to. The different sized groups have got their own kind of threats and opportunities, organizational efficiency/inefficiency, constraints/limitations, advantages disadvantages etc. Therefore, each group to have their own variety of restructuring strategies.

Techniques of Corporate Restructuring

The techniques generally adopted in corporate restructuring and reorganization are shown in figure 1 and being elaborated briefly here under

Mergers

The terms 'merger', 'amalgamation and 'acquisition 'are often used interchangeably to denote the situation where two or more companies, keeping in view their long-term business interest, combine into one economic entity to share risks and financial rewards. However, in strict sense, merger is used for the fusion of two companies to achieve expansion and diversification. Amalgamation is an arrangement for bringing the assets of two companies under the control of one company, which may or may not be one of the original two companies. Amalgamation signifies the transfer of all or some part of the assets and liabilities of one or more existing business entities to another existing or new company.

Takeovers

Takeover is a business strategy whereby a person acquires control over the other company either directly by acquiring assets or indirectly by controlling management. Takeover is a part of business strategy for acquiring control over another business to consolidate and acquire large share of the market. The legal eyes of raiders are on the lookout for cash cows and high growth rate companies with low equity stake of promoters.

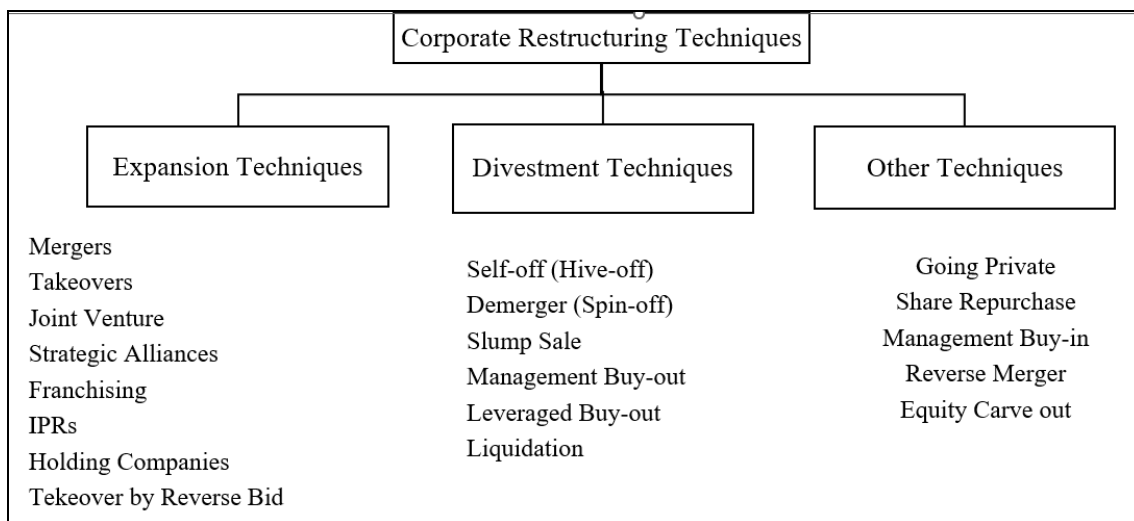


Fig 1: Corporate Restructuring Techniques

Joint Ventures

All joint ventures are typically characterized by two or more ventures being bound by a contractual arrangement which establishes joint control. Activities, which have no contractual arrangements to establish joint control, are not joint ventures. The contractual arrangements establish joint control over the joint ventures. Such an arrangement ensures that no single venture is in a position to unilaterally control the activity. Joint venture may give protective or participating rights to the parties to the venture. Protective rights merely allow covertures to protect its interests in the venture in situation where its interests are likely to be adversely affected.

Joint venture is a form of business combination in which two unaffiliated business firms contribute financial and/or physical assets, as well as personnel, to a new company formed to engage in some economic activity, such as the

production or marketing of a product. Joint venture can be formed between a domestic company and foreign enterprise in order to flow the skills and knowledge both the ways. A joint venture by a domestic company with multinational company can allow the transfer of technology and reaching of global market. The partners in joint venture will provide risk capital, technology, patent, trade mark, brand names and allow both the partners to reap benefit to agreed share. Joint ventures with multinational companies contribute to the expansion of production capacity, transfer of technology and capital and above all penetrating into global market. Entering into a Joint venture is a part a part of strategic business policy to diversify and enter into new markets, acquire finance, technology, patent and brand names.

Forms of Joint Venture - Joint ventures takes many forms and structures. But, it can be broadly categorized into three:

- a. **Jointly Controlled Operations:** The operation of some joint ventures involves the use of the assets and other resources of the ventures rather than the establishment of a corporation, partnership or other entity or a financial structure that is separate from the ventures' themselves.
- b. **Jointly Controlled Assets:** Some joint ventures involve the joint control, and often the joint ownership, by the ventures' of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.
- c. **Jointly Controlled Entities:** A jointly controlled entity is a joint venture, which involves the establishment of a corporation, partnership or other entity in which each venture has an interest.

Divestitures

Divestitures are considered as one of the important techniques in corporate restructuring. Divestitures does not deal with acquisition or combination but it frequently examine the various recently acquired assets and divisions to determine whether the assets or divisions are fit into overall corporate strategy in value maximization and its future plans. If it does not serve the purpose, such assets or divisions are hived-off.

Slump Sale

When a company sells or disposes the whole or substantially the whole of the undertaking for a predetermined lump sum amount as sale consideration is called 'slump sale'. The acquirer may be interested in purchase of an undertaking or part of it as a going concern and the acquirer is not interested in taking the whole company as part of the transaction. While fixing the selling price, the value of assets are not individually counted and the liabilities are not separately considered while fixing the slump price. A business transfer agreement will be entered into between the acquirer and seller and the hive-off deal passes the title for both movable and immovable properties and the related liabilities as a 'going concern'.

Strategic Alliances

An 'alliance' is defined as associations to further the common interests of the members. Strategic alliance is an arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives. The motives behind strategic alliances are to reduce cost, technology sharing, product development, market access, availability of capital, risk sharing etc. The concept of 'alliance' is gaining importance in infrastructure sectors, more particularly in the areas of power, oil and gas. The basic objective is to facilitate transfer of technology while implementing large objectives. The resultant benefits are shared in proportion to the contribution made by each party in achieving the targets. In strategic alliance, two or more firms that unite to pursue a set of agreed upon goals, remain independent subsequent to the formation of an alliance. The strategic alliances are generally in the forms like joint venture, franchising, supply agreement, purchase agreement, distribution agreement, marketing agreement, management contract, technical service agreement, licensing of technology/patent/trademark/design etc. The strategic

alliance agreement contains the terms like capital contribution, infrastructure, decision making, sharing of risk and return etc. A strategic alliance integrates the synergetic talents of alliance partners. Mutual understanding and trust are the basic tenets of strategic alliances. For smooth functioning of an alliance, partners are required to have preset priorities and expectations from each other.

Equity Carve out

It is a situation where a parent company sells portion of its equity in a wholly owned subsidiary to the general public or to a strategic investor. Equity carves out enable the parent to generate cash inflow which can be used for further investments. In a spin-off, the shares received from the acquirer of undertaking are distributed among the existing shareholders of the parent company. But in equity carve out the shares of the parent company are sold out to outside investors.

Franchising

Franchising provides an immediate access to business operations and technology in profitable fields of operations. It is an important means of doing business in several countries and represents an effective combination of the advantages of large business with the motivation and adaptation capabilities of small or medium scale enterprises. It also enables linkages of large and small businesses within a framework of vertical division of labour. The concept of franchising is quite comprehensive and covers an extensive range of marketing and distribution arrangements for goods and services. Franchises are becoming a key mechanism for technological, marketing and service linkages between enterprises within a country as well as globally.

Intellectual Property Rights

The worth of a company lies more in its intangible assets (patents, trademarks, brands, copyrights etc.) than tangible assets (land, building, plant & machinery). The intellectual property rights give real value to a company. Patents, trademarks and strong brands lead to higher sales, economies of scale and profits. Some business gains, however, instead of investing efforts, time and money in research and development for new patents, trademarks and brands, prefer to buy these from companies or go to the extent of acquiring the companies themselves.

Holding Companies

A holding company enjoys controlling interest in the subsidiary by acquiring substantial voting power in the form of acquisition of equity shares carrying voting rights. When the holding company acquires 100% voting power in subsidiary, it is called 'wholly owned subsidiary'. Acquisition of controlling interest in subsidiary by holding company is form of combination and can also be used as a technique of restructuring. The holding company is also called as 'parent' enterprise. A parent can exercise control over subsidiary in the following manner:

- a. More than 50% of voting power of subsidiary is held by parent either directly or along with other subsidiaries, or
- b. The composition of the board of directors or the governing body of subsidiary is controlled by parent with a view to obtain economic benefits from its activities.

A group enterprise consists of parent and all its subsidiaries. Consolidated financial statements are prepared and presented treating the group as a single enterprise.

Sell-off

In a strategic planning process, a company can take decision to concentrate on core business activities by selling off the non-core business divisions. A sell-off is a sale of part of the organization to a third party in the following circumstances:

- a. To come out of shortage of cash and severe liquidity problems.
- b. To concentrate on core business activities.
- c. To protect the firm from takeover activities by selling-off the desirable division to the bidder.
- d. To improve the profitability of the firm by selling-off loss-making divisions.
- e. To increase the efficiency of men, machines and money.
- f. To facilitate the promising activities with enough funds by sell-off non-performing assets
- g. To reduce the business risk by selling-off the high risk activities.

Going Private

In a restructure program, the management of the widely held company may decide to go private by purchase of stocks from the outside public and delisting the shares in the stock exchanges where the shares are traded. By going private, a company can avoid the predators from bidding the company. It can avoid the listing fees of the stock exchanges and when the company is in financial difficulties this will avoid the fall in share prices. It facilitates to avoid the declaration of periodical results for general public. By keeping-off from the public, trade secrecy can be maintained.

Liquidation

A business may go into decline when losses are made over several years. The losses are set-off against past profits retained in the business (reserves), but clearly the situation cannot continue for very long. In such case liquidation of company may be imminent. In case of technological obsolescence, lack of market for the company's products, financial losses, cash shortages, lack of managerial skills, the owners may decide to liquidate the business to stop further aggravation of losses. With a strategic motive also, a business unit may be liquidated.

Takeover by Reverse Bid

Normally, a large company takeover a small company. But when a small company acquires a big company, in a takeover mode, such situation is called 'takeover by reverse bid'. This would be possible when the substantial shares are in the control of small company or its directors. It would also be possible when the small company is a cash rich company and big company is a sick company. The takeover by reverse bid enables the acquirer to exploit the economies of scale. BIFR had also encouraged this mode of takeover for rehabilitation and revival of sick industrial companies.

Reverse Merger

In corporate merger, relative size in terms of either capital employed or turnover of the companies in deal determines which will be acquired by whom. In normal practice, it is

the larger company which acquire a smaller one. But in case of reverse merger it is a smaller company acquires the larger company. The reverse merger may be motivated by tax benefits available whenever at least one of the companies in deal has accumulated loss or unabsorbed expenses/allowance that can be carried forward and set-off against future profit of the amalgamated company. The takeover by the smaller firm would also be more appropriate if it had the better record and more promising future. In some cases the smaller company is listed but the larger company is not and, therefore, in order to keep the listing, without having to pay costs in obtaining a new one, the smaller listed company makes the acquisition.

The restructuring through reverse merger process is carried on following three steps:

- a. Capital reduction of the losing company to write-off the share capital not represented by assets.
- b. Consolidation of shares after capital reduction to make face value of shares of the acquirer at par with that of the target.
- c. Change of name after merger to publicize the name of the target.

Demerger

Demerger is adopted as a business strategy to separate business which doesn't comfortably merge with each other. Two businesses may have different strategies, operational or regulatory needs which are difficult to fulfil while they are still linked. They may even be competing with each other for business. A demerger is a form of reorganization where business activities owned by one company or group are separated out into several companies or groups. Each business will usually have the same ultimate ownership as before. A demerger may also be a step towards sale to third party. Demerger is not just opposite to the term 'merger'. The real meaning of demerger means, for strategic reasons, a conglomerate is spitted into two or more independent separate bodies and assets are transferred to such bodies. For example, XYZ Ltd. carries on the business of cement, chemicals and textiles. If textiles unit is not doing well or is doing exceptionally well. In either case it may be found desirable to split-off textiles business into a separate company to have sharp focus. The demerger refers to a situation, where an undertaking is separated and transferred to a separate company and decided to run into as an independent unit from the earlier enterprise. The demerger is also called as 'spin-off' or 'hiving off'. By demerging the business activities, a corporate body splits into two or more corporate bodies with separation of management and accountability. The main reason may be for making each division as a profit centered organization to make each head of the division to account for profitability of their respective divisions.

Management Buy-In (MBI)

The management team who have got special skills will search out and purchase business, to their interested area, which has considerable potential but that has not been run to its full advantage due to lack of managerial and technical skills, fails to establish the market for the company's products. After the identification of suitable unit for purchase, the management team will make arrangements with the venture capitalist for finance. The management team will generally have lesser funds for investment and,

therefore, debt component will be more in their purchase of the business unit. The MBI is just reverse to MBO. In MBI, the management of other concern, not the management of the same company, acquires the majority shareholding and thus the existing management of the concern has to leave the concern.

Management Buy-out (MBO)

MBO is the purchase of a business by its management when the existing owners are trying to sell business to third parties due to its slow growth or lack of managerial skills in running the business. The existing managers will come forward to purchase and run the business by taking it over from the owners. In a MBO, the managers purchase all or part of the business from its owners. The management team will take substantial controlling interest from the existing owners who are having control over the affairs of the company. The management team may consist of one or more directors and employees, either with or without inviting for external associates. It is a method of setting up of business by the management team itself. The cases of MBO occurs when the existing owners unable to run the company successfully and when the very existence of the company is at stake. It is a divestment technique to sell the business which does not fit in with the new strategic plan of the group. The management will know the strengths and weaknesses of the business they are proposing to purchase from the owners and can make a better bargain. The insider information available with the managers will lead them to acquire substantial stake. The purchase price is met by a small amount of their own funds and the rest of funds are arranged through venture capital and bank debt. MBOs are also resorted when the succession of family business arises. Sometimes the conglomerate intend to concentrate on core activities and by disposing the non-core divisions to the managers who are interested in running them and allowing those units to continue as strategic partner in business. The MBOs are used in restructuring the business and to tide over the recessionary tendency in business.

Leveraged Buy-out (LBO)

An LBO is defined as 'the acquisition of an operating company with the funds derived primarily from debt financing, by a small group of investors. In LBO, debt financing typically represents 50% or more of purchase price. The consideration for LBO is a mix of debt and equity components with high gearing. The debt is secured by the assets of the acquired firm and is usually amortised over a period of less than ten years.

In a typical LBO program, the acquiring group consists of a small number of persons or organizations sponsored by buy-out specialists or investment bankers. This group, with the help of certain financial instruments like high-yield, high-risk debt instruments (junk bonds), deferred payment instruments, private placement instruments, bridge financing, loans from venture capitalists, merchant bankers etc., acquire all or nearly all the outstanding shares of the target firm and takes the target firm private. The buy-out group may or may not include current management of the target firm. If the group so does, the buy-out may be regarded as MBO. Except this functional difference, an MBO is also regarded as an LBO in the sense that for an MBO operation, the buying group puts up only a small part of the purchase price and borrows the amounts through private sources.

Companies with serious operating problems that are reflected in current and projected losses are a classic leveraged buy-out candidate. Therefore, troubled companies or turnarounds are not often LBO prospects. Usually, the operating performance and/or financial condition of the company has deteriorated to the extent that the lenders and investors are calling the 'shots Controlling shareholders and management are at the mercy of these financing sources because they are dependent on them for future funding. The main objective of those who have invested in the company is to salvage their investments. Usually, the candidates for implementation of an LBO strategy are the possible target firms threatened by takeover proposals from outside.

Summing-up

Finally, we may conclude that corporate restructuring is the process of reorganizing a company's management, finances, and operations to improve the efficiency and effectiveness of the company. Changes in this area can help a company increase productivity, improve the quality of products and services, and reduce costs. Corporate restructuring is an action taken by the corporate entity to modify its capital structure or its operations significantly. Generally, corporate restructuring happens when a corporate entity is experiencing significant problems and is in financial jeopardy.

The process of corporate restructuring is considered very important to eliminate all the financial crisis and enhance the company's performance. The management of the concerned corporate entity facing the financial crunches hires a financial and legal expert for advisory and assistance in the negotiation and the transaction deals.

Usually, the concerned entity may look at debt financing, operations reduction, any portion of the company to interested investors. In addition to this, the need for corporate restructuring arises due to the change in the ownership structure of a company. Such change in the ownership structure of the company might be due to the takeover, merger, adverse economic conditions, adverse changes in business such as buyouts, bankruptcy, lack of integration between the divisions, over-employed personnel, etc.

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