

Chapter 1: Introduction and Concept of Corporate Restructuring

Meaning:

Restructuring as per Oxford dictionary means "to give a new structure to, rebuild or rearrange". As per Collins English dictionary, meaning of corporate restructuring is a change in the business strategy of an organization resulting in diversification, closing parts of the business, etc, to increase its long-term profitability. Corporate restructuring is defined as the process involved in changing the organization of a business. Corporate restructuring can involve making dramatic changes to a business by cutting out or merging departments. It implies rearranging the business for increased efficiency and profitability. In other words, it is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving corporate objectives-synergies and continuing as competitive and successful entity.

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Restructuring may involve major layoffs or bankruptcy, though restructuring is usually designed to minimize the impact on employees, if possible. Restructuring may involve the company's sale or a merger with another company. Companies use restructuring as a business strategy to ensure their long-term viability.

Corporate restructuring is an inorganic growth strategy. For e.g. ABC Limited has surplus funds but it is not able to consider any viable projects. Whereas XYZ Limited has identified viable projects but has no money to fund the cost of the project. The merger of ABC LTD and XYZ Limited is a mutually beneficial option and would result in positive synergies of both the Companies.

Corporate Restructuring is a strategic decision. It is an action taken by a corporate to significantly modify the financial and operational aspects of the company, usually when the business is facing financial stress. Also, Corporate Restructuring can also be considered as the process of changing the business operations and business portfolio in order to assess more profitable business options. In corporate restructuring, there are either operational or functional structure changes or changes in the business model of the company.

The Corporate Restructuring takes place in two forms



1. **Financial Restructuring:** Financial restructuring deals with all changes the businesses makes to its debts and equity, including mergers, acquisitions, joint ventures and other deals. Generally, these occur when a company joins or is bought by another company. Ownerships of the company, or at least some interest in the company, is transferred to another organization or group of investors. Actual business practices may remain unchanged.
2. **Organisational Restructuring:** The Organisational restructuring means changing the structure of an organisation, such as reducing hierarchical levels, downsizing the employees, redesigning the job positions and changing the reporting relationship. This is done to cut the cost and pay off outstanding debts to continue with business operations in some manner.

Need for Corporate Restructuring

Corporate Restructuring is concerned about placing business activities of corporates as the whole in order to accomplish certain prearranged objectives. The objectives encompass the following:

- Orderly redirection of the firm's activities;
- Positioning extra cash flow from 1 business to finance profitable growth in another;
- Misusing inter-dependence amongst current or potential businesses within the corporate portfolio; — risk reduction; and
- Development of core competencies.

The needs for undertaking Corporate Restructuring are as follows:

- (i) To focus on basic strengths, operational synergy & other effective allocation of managerial capabilities and infrastructure too.
- (ii) Consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.
- (iii) Revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.

(iv) Acquiring the constant supply of raw materials and access to scientific research and technological developments.

(v) Capital restructuring by a suitable combination of loan and equity funds to decrease the cost of servicing and improve return on capital employed.

(vi) Improve corporate performance to bring it on par with competitors by adopting the radical changes brought out by information technology.

Planning, formulation and execution of various restructuring strategies

Corporate restructuring strategies depends on the nature of business, type of diversification required and results in profit maximization through pooling of resources in effective manner, utilization of idle resources, effective management of competition etc.,. Planning the type of restructuring requires detailed business study, expected business demand, available resources, utilized/idle portion of resources, competitor analysis, environmental impact etc.,. The bottom line is that the right restructuring strategy provides optimum synergy for the organizations involved in the restructuring process. It involves examination of various aspects before and after the restructuring process.

CORPORATE RESTRUCTURING - HISTORICAL BACKGROUND

In earlier years, India was a highly regulated economy. Though Government participation was overwhelming, the economy was controlled in a centralized way by Government participation and intervention. In other words, economy was closed as economic forces such as demand and supply were not allowed to have a full-fledged liberty to rule the market. There was no scope of realignments and everything was controlled. In such a scenario, the scope and mode of Corporate Restructuring were very limited due to restrictive government policies and rigid regulatory framework. These restrictions remained in vogue, practically, for over two decades. These, however, proved incompatible with the economic system in keeping pace with the global economic developments if the objective of faster economic growth were to be achieved. The Government had to review its entire policy framework and under the economic liberalization measures removed the above restrictions by omitting the relevant sections and provisions.

The real opening up of the economy started with the Industrial Policy, 1991 whereby 'continuity with change' was emphasized and main thrust was on relaxations in industrial licensing, foreign investments, transfer of foreign technology etc. With the economic liberalization, globalization and opening up of economies, the Indian corporate sector started restructuring to meet the opportunities and challenges of competition. The economic and liberalization reforms, have transformed the business scenario all over the world.

The most significant development has been the integration of national economy with 'market-oriented globalized economy'. The multilateral trade agenda and the World Trade Organization (WTO) have been facilitating easy and free flow of technology, capital and expertise across the globe. A restructuring wave is sweeping the corporate sector the world over, taking within its fold both big and small entities, comprising old economy businesses, conglomerates and new economy companies and even the infrastructure and service sector. From banking to oil exploration and telecommunication to power generation, petrochemicals to aviation, companies are coming together as never before. Not only this new industries like e-commerce and biotechnology have been exploding and old industries are being transformed. With the increasing competition and the economy, heading towards globalisation, the corporate restructuring activities are expected to occur at a much larger scale than at any time in the past. Corporate Restructuring play a major role in enabling enterprises to achieve economies of scale, global competitiveness, right size, and a host of other benefits including reduction of cost of operations and administration.

Forms of Corporate Restructuring

1. **Merger:** Merger is the combination of two or more companies which can be merged together either by way of amalgamation or absorption. The combining of two or more companies, is generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock. Mergers may be

(i) **Horizontal Merger:** It is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor and hence expands as the firm's operations in the same industry. Horizontal mergers are designed to achieve economies of scale and result in reduce the number of competitors in the industry.

(ii) **Vertical Merger:** It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in

backward integration of its activities. On the other hand, Forward integration may result if a company decides to take over the retailer or Customer Company. Vertical merger provides a way for total integration to those firms which are striving for owning of all phases of the production schedule together with the marketing network

(iii) **Co generic Merger:** It is the type of merger, where two companies are in the same or related industries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger. The potential benefit from these mergers is high because these transactions offer opportunities to diversify around a common case of strategic resources.

(iv) **Conglomerate Merger:** These mergers involve firms engaged in unrelated type of activities i.e. the business of two companies are not related to each other horizontally nor vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. Conglomerate mergers are merger of different kinds of businesses under one flagship company.

The purpose of merger remains utilization of financial resources enlarged debt capacity and also synergy of managerial functions. It does not have direct impact on acquisition of monopoly power and is thus favoured throughout the world as a means of diversification.

2. **Demerger:** It is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. A demerger is often done to help each of the segments operate more smoothly, as they can focus on a more specific task after demerger.

3. **Reverse Merger:** Reverse merger is the opportunity for the unlisted companies to become public listed company, without opting for Initial Public offer (IPO). In this process the private company acquires the majority shares of public company, with its own name.

4. **Disinvestment:** Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".

5. **Takeover/Acquisition:** Takeover means an acquirer takes over the control of the target company. It is also known as acquisition. Normally this type of acquisition is undertaken to achieve market supremacy. It may be friendly or hostile takeover.

Friendly takeover: In this type, one company takes over the management of the target company with the permission of the board.

Hostile takeover: In this type, one company takes over the management of the target company without its knowledge and against the wish of their management.

6. **Joint Venture (JV)**: A joint venture is an entity formed by two or more companies to undertake financial activity together. The parties agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. It may be Project based joint venture or Functional based joint venture.

Project based Joint venture: The joint venture entered into by the companies in order to achieve a specific task is known as project based JV.

Functional based Joint venture: The joint venture entered into by the companies in order to achieve mutual benefit is known as functional based JV.

7. **Strategic Alliance**: Any agreement between two or more parties to collaborate with each other, in order to achieve certain objectives while continuing to remain independent organizations is called strategic alliance.

8. **Franchising**: Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce and market goods or services according to certain specifications. The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty and gains.

9. **Slump sale**: Slump sale means the transfer of one or more undertaking as a result of the sale of lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale