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An Analysis of Corporate Restructuring in India

Avnit Kaur R. Chadha
Ad-hoc Professor, Department of Commerce / Accountancy,
Shah N.H. Commerce College, Valsad.
Veer Narmad South Gujarat University, Surat, Gujarat, India.
Email – chadhaavnit@gmail.com

Abstract: *In the context of the liberalization and globalization undertaken in the country in 1991, the corporate world received a new wave to mend their organizations. The Industrial Policy of 1991 emphasized on the concept of 'Continuity with Change' which gave the firms various relaxations like foreign investments, transfer of technology, etc. The Indian corporate sector started using the process of restructuring to meet its challenges and survive the competition. Restructuring gave the corporates new opportunities to make changes in its organization and eliminate its inefficiency and improve its performance. Corporate Restructuring plays 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. The present paper seeks to emphasize on various concepts and strategies related to Corporate Restructuring and also discusses the needs and effects of Corporate Restructuring in India.*

Key Words: *Restructuring, Corporate Restructuring, shareholders' value, strategies of corporate restructuring, effects of corporate restructuring.*

1. INTRODUCTION:

The corporate restructuring is often referred to as a scientific process. It can be compared to a medical surgery where the goal is the recovery of the patients. In the same way corporate restructuring aims to rehabilitate a distressed company. Restructuring as a term aims to change the organizational structure to make it fulfil its objectives. Restructuring helps the company change its business model due to any internal or external forces so that it can survive its competition and grow in the market. It helps the organization achieve its objectives more effectively and efficiently.

Corporate Restructuring is defined as the process which is related to changing the organization of a particular business. Corporate Restructuring can even lead to drastic changes like merging or demerging various departments in an organization. It is done with the motive to increase the efficiency and profitability of the business. In other words, it is a comprehensive process, which enables a company to consolidate its business operations and helps strengthen its position to achieve its corporate objectives and continue as competitive and successful entity. Corporate restructuring as a process helps in modifying the structure of the business organization. It is sought as a means when the company is facing any significant issues and finds itself in financial jeopardy. Corporate restructuring helps in eliminating the financial troubles of the company and helps to improve its performance. Corporate Restructuring enables the troubled company's management to hire any legal or financial expert who can advise the company in negotiations and transaction deals. The company may even go to the extent of appointing new managerial and top personnel specifically for making such controversial and difficult decisions to save the company and restructure it. Generally, the company opts for decisions such as debt financing, reduction of its operations and sale of its portions to interested investors.

2. MEANING OF CORPORATE RESTRUCTURING:

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 means the process of redesigning various aspects of a company. It relates to making alterations to the existing structure of the company to a certain extent. A number of factors contribute towards reorganization of a company. Some of the factors include making the company more competitive, survive the adverse economic climate, or to even move in entirely new direction. The existing structure of the company may have financial, legal, business or managerial limitations or any other restrictions which it must keep in mind before restructuring. Corporate Restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives. It may be constituted by a single objective or multiple objectives, but amongst them there must be a dominant objective which acts as the driving force for such restructuring.

The essence of Corporate Restructuring lies in enhancing the shareholder value. A company must continuously evaluate its business portfolio, capital mix and its ownership and assets management to find opportunities to increase the shareholders' value. The company must focus on asset utilization and profitable investment opportunities, and either to reorganize or divest less profitable or loss making businesses or products. For this purpose the company may consider two major aspects. One objective addresses the problem of conflict of interest between managers and shareholders. The second objective is to move assets to those owners who can utilize them more effectively. Corporate restructuring helps a company enable a change in its ownership, business mix, assets mix and make alliances with a view to enhance its shareholder value. Hence corporate restructuring may involve restructuring of its ownership, business and assets. A company can affect ownership restructuring through merger and acquisition, leveraged buyouts, buys back of shares, spin-offs, joint ventures and strategic alliances. Business restructuring involves the reorganization of business units or divisions. It includes diversification into new businesses, outsourcing, divestment brand acquisition etc. Asset restructuring involves the acquisition or sale of assets and their ownership structure.

3. REASONS FOR CORPORATE RESTRUCTURING:

Corporate restructuring is implemented under the following scenarios:

Change in the Strategy: The company may have certain divisions or subsidiaries that do not align with the core focus of the company. The management may want to improve the performance of the company by eliminating such divisions and improve its long term vision.

Lack of Profits: Sometimes there may be some divisions of the company which may not be profitable enough to cover the economic losses or cost of capital of the company. The poor performance of the division may result in the decline of the profitability of the company and lead to increasing costs to the company**.**

Reverse Synergy: According to reverse synergy, the individual parts or divisions of the company may be worth more than the combined unit. This becomes a reason for the company to divest its assets. The company may earn more value by divesting it off to a third party rather than owning it.

Cash Flow Requirement: When a company is facing some difficulty in obtaining finance, then it has the option to sell a division of the company. This acts as a quick approach to raise money and reduce the company's debt. Such sale of division helps in creating appropriate cash flow for the company for its present requirements.

4. TYPES OF CORPORATE RESTRUCTURING STRATEGIES:

Various types of corporate restructuring strategies include:

- Merger
- Demerger
- Reverse Mergers
- Disinvestment
- Takeovers
- Joint venture
- Strategic alliance
- Franchising
- Slump Sale
- Divestiture
- Reduction of Capital
- Buy-back of securities.

4.1. Merger: The terms merger, absorption, takeovers, and acquisition are often used interchangeably in common parlance. A merger refers to a combination of two or more businesses or entities into one business or entity. It refers to the absorption or fusion of one company by another. It is an arrangement whereby the assets of two or more companies come under the control of one company. Thus, either one of the existing company looses its identity and merges with the other. In India, the term 'amalgamation' is also referred as merger. Amalgamation of a company refers to the merger of one or more companies with another or of two or more companies to form a new company. All the assets and liabilities of the amalgamating companies then becomes the assets and liabilities of the amalgamated company. An absorption is a combination of two or more companies into an 'existing company'. In such a merger all the companies loose their identity except one.

4.2. Demerger: A demerger is a form of corporate restructuring in which a company segregates its operations into one or more components. Demerger as a term means a kind of partition or separation of undertakings under a common corporate umbrella. Demerger under the Companies Act refers to transfer of one or more of its undertaking to any resulting company. Demerger can take three forms:

- **Spin-off:** Here, the businesses are divided which then become independent businesses. Such company takes the assets, employees, technology, intellectual property or any existing product from the parent company itself. The shareholders of the parent company receive equivalent shares in the new company. The parent company and the spun off company both remain in existence.

- **Split-up:** A split-up is an arrangement whereby a company is divided into several parts. Here, the parent company ceases to exist and the stock is distributed to its shareholders
- **Split-off:** Here, a division or part of the parent company is sold off to another company as a part of corporate restructuring process.

4.3. Reverse Merger: Reverse Merger is an arrangement whereby a healthy company is merged with a financially weak company. Reverse merger helps lure a large number of companies as it allows the companies to grab the advantage of carry forward of losses and avail various tax benefits. It is generally done by a private company which purchases control of a public company and then carries out a merger with a private company. It gives an opportunity to the private company to receive most of the shares of the public company and get control over its Board.

4.4. Disinvestment: Disinvestment means selling or liquidating an asset or subsidiary of a company. It is commonly done by government companies to sell off or revive its unprofitable operations.

4.5. Takeover/Acquisition: Takeover is an arrangement where a company acquires a stake over the other company. This enables the company to acquire control over the management of the other company. Here, both the companies remain independent and function as separate legal entity, but there is a change in control over the companies. Takeover can be either Friendly Takeover or Hostile Takeover. When an acquisition is forced or controlled it is referred as Hostile Takeover.

4.6. Joint Venture (JV): Joint venture is an arrangement under which a new enterprise is formed. It requires the ownership, control and management of minimum two parties. All the parties share responsibilities according to a pre-arranged agreement. It helps the companies enhance their competitive strength by sharing their technology, trade mark, market access and even their risk capital. The parties subscribe to the shares of the joint-venture company in agreed proportion, in cash, and start a new business.

4.7. Strategic Alliance: Alliance as an agreement helps the companies come together to accomplish their common goals and strives to achieve the benefit of both of them. It is an arrangement between companies whereby they combine their capabilities, resources, core competencies, etc. to achieve their mutual goals.

4.8. Franchising: Franchising arrangement involves two parties, Franchiser and Franchisee. Here, the franchiser grants the franchisee the right to use its trade name to undertake its business. The franchisee company has the right to use the systems and process of the franchiser company to produce its specific goods and also market them.

4.9. Slump sale: Slump sale refers to the sale of the undertaking. Here, the sale is done for a lump sum consideration without assigning any value being to the individual assets and liabilities.

4.10. Divestiture: Divestiture refers to the sale of all or substantially all the assets of the company or any of its divisions. It can be done in cash or debt or other securities except equity shares or a combination of both. The divestiture arrangement helps in mobilizing resources for the core business activity of the company by realizing the value of non-core business assets.

4.11. Reduction of Capital: Reduction of Capital is an arrangement under which a company is allowed to reduce the liability in respect of its unpaid share capital. It also provides the provision to extinguish its paid up share capital and cancel its share capital to the extent which is in excess of its requirements.

4.12. Buy-back of Securities: Buy-back of securities is a method where the company can return the excess amount paid up on its shares back to its shareholders. When a company holds excess cash, which it will not require in next three to five years, it becomes prudent for the company to return the excess cash to its shareholders.

5. EFFECT OF CORPORATE RESTRUCTURING:

The various effects of Corporate Restructuring can be described as under:

Restructuring: Restructuring helps a struggling company to improve its position or help in expanding a successful business. A restructuring can include changing the way the company is managed, debt-servicing, implementing financing strategies, entering new market or modifying its products or services.

Organizational Shift: Some restructurings may result in organizational change. It might be due to a business entering a new market, making its divisions independent, bringing new partners, outsourcing administrative functions, sub-contracting, termination of employees, etc.

Change in Financing Strategies: Restructuring enables companies to make changes in its financial strategies to meet its capital needs. The company has many options like it can sell its stock, take new loans at higher interest rates but low monthly payments, make changes in its product lines, re-negotiate contracts with third parties, open new locations, introduce new products or eliminate products from its product line, etc.

New Product Mix: The company might need to restructure its business if new products or services are added in its product line which might need different skills. This might result in adding a new division in the company or opening a new production facility. For example, if a female dress designer decides to add men's suits in its product mix.

Different Distribution Strategy: The company might make changes in its distribution strategies by using different distribution channels. This might also lead to making changes in the operations of the company. This might include changes to its sales force, order-taking processes, product fulfilment, accounting services, customer service and information technology.

Re-Branding: When a business does restructuring by changing its product mix or distribution strategy, it also needs to make changes in its marketing message. Depending on changes made, the business might need to create a new brand message and brand-management strategy.

6. CONCLUSION:

Corporate restructuring strategy enables the company to continue to operate in some way. It helps the management of the company to try all possible measures to keep the entity going. Even in worst situations, Corporate Restructuring helps the company to face its financial troubles and revive back the company to earn profits. Now a days, companies take the assistance of professionals and experts for undertaking Corporate Restructuring. These professionals are external third parties who take into consideration all the aspects of the company and find ways to revive and restructure the company. They make recommendations to make the business run more efficiently. They strive to assess the present scenario of the company and restructure it for its better future. Thus it can rightly be said that the Corporate Restructuring mechanism acts as a very essential means to make the corporates viable and bring them out of financial crisis. It acts as a prior step towards protecting the company from liquidation and insolvency.

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