2.1 Concept of Corporate Restructuring

The process of reorganizing one or more aspects of the business of a company or financial structure for increasing its efficiency and profitability is known as corporate restructuring. According to Prasanna Chandra “Corporate restructuring refers to a broad array of activities that expand or contract a firm’s operations or substantially modify its financial structure or bring about a significant change in its organizational structure and internal functioning.” Thus, the term corporate restructuring is an umbrella term that encompasses four distinct groups of activities viz. Expansion, Contraction, Financial restructuring and Organizational Restructuring. It is a strategic tool used by the corporate houses to boost value to the organization as well as to the investors. The need for reorganizing a company may be felt due to a number of different factors such as to make the company more competitive, to overcome a currently adverse economic climate, or for moving towards an entirely new direction. The process of corporate restructuring essentially involves significant reorganization of assets and liabilities of the organization so as to conduct the business operations in an efficient, effective and competitive manner with the underlying objective of improving the quality and quantity of the future cash flow streams and thereby increasing the organization’s market share, brand power, and synergies. In a nutshell, corporate restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its financial position for achieving its short-term and long-term corporate objectives. Corporate restructuring, significant for survival of a company in competitive environment, has gained considerable importance all over the world because of fierce competition, globalization and rapid technological enhancements. With the opening up
of the Indian economy and the structural reforms initiated in the early 1990s, Indian industries were also compelled to adopt restructuring to sustain.

2.2 Reasons of Corporate Restructuring

The essence of corporate restructuring lies in achieving the long run goal of wealth maximization. The following reasons may be attributed to the phenomenon of corporate 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 segment.

❖ Revolution in information technology has made it necessary for companies to adopt new changes for improving corporate performances.

❖ Many companies have divisionalized into smaller businesses. Wrong divisionalization strategies have 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 relaunch 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 skill to the 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 risk is possible and it enables the firm to achieve at least the minimum targeted 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 and thereby the successful unit can have strategic tax planning.

Corporate restructuring includes financial reorganization which brings the company to achieve a desired balance of debt and equity, thereby reducing the overall cost of capital and financial risks.

The restructuring process facilitates 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 facilitate to divide the total enterprise into strategic business units, a better way of achieving corporate goals.

2.3 Different Forms of Corporate Restructuring

In the present business world mergers, amalgamations, takeovers have become day to day activity. Many mergers and amalgamations are also been taking place all over the world. We all are well acquainted to these words. When two or more companies are added together to form a new entity for better synergy, we term it as merger or amalgamation. But there are many types of corporate restructuring which people combine under the umbrella of words mergers and amalgamation like merger, consolidation, acquisition, divestiture, demerger, carve out, joint venture, reduction of
capital, buy back of securities, delisting of securities etc. The particular restructuring strategy to be adopted by a company depends on its individual and circumstantial situations and on the perception of the management. Different forms of corporate restructuring are presented below with the help of a tree-diagram:

Exhibit: 2.1
Different Forms of Corporate Restructuring

As already stated, the term corporate restructuring encompasses four distinct groups of activities viz. expansion, contraction, financial restructuring and organizational restructuring. Let us now discuss in detail regarding each of these broad categories of corporate restructuring and its different forms.

[A] Expansion

Organizations planning for expansion resort to amalgamations, acquisitions, mergers, asset purchases, joint ventures, and takeovers. They are different forms of corporate restructuring that bring together the resources of two businesses under a single umbrella. They are considered synergistic in nature because they lead to benefits of economies of scale, utilization of tax shelters, creation of a vast pool of assets, and the setting up of a more efficient management.
Expansion is regarded as the most common and convenient form of restructuring as it involves only increasing the existing capacity of the business and does not involve any additional technical expertise. The expansion of business capacity brings in additional funds through debt and/or equity, acquisition of modern machinery and value-addition to the product segments and ultimately increases the firm's profitability. Different forms of expansion include:

[A-1] Merger

As a matter of fact, Indian industrialists today feel that the best route to achieve a significant size for their company comparable with global standards is merger. This is because in the present era of liberalization, privatization and globalization, the old theory "small is beautiful" has been replaced by the new theory "big is bountiful." The terms mergers, amalgamations and acquisitions are often used interchangeably. However, technically they differ from each other as is explained in Chapter 3.

[A-2] Takeover

Takeover is another type of corporate restructuring which involves acquisition of a certain block of equity share capital of a company which enables the acquirer to obtain and exercise the control over the affairs of the company. Theoretically, the acquirer must obtain more than 50% of the paid up equity share capital of the acquired company to enjoy complete control. However, in practice, effective control can be exercised even with a smaller holding, usually between 20% and 40%, because the remaining shareholders being scattered and ill-organized, are not likely to challenge the control of the acquirer. A takeover can take the form of any one of the following types:

❖ Friendly Takeover

After contemplating the motives and financial viability of the acquisition, once the bidder has decided to take over the target, its management starts negotiations with the management and/or shareholders of the target. If the financial compensation package offered by the would-be acquirer company in terms of purchase consideration, share exchange ratio, method of payment etc., is acceptable to the management of the
target company, it makes certain recommendations and endorses the merger proposal to its shareholders for approval. If the target shareholders provide their consent / approval to the merger, the merger between the firms is said to have taken place in a friendly atmosphere and is appropriately referred to as friendly takeover. Since this type of takeover involves negotiations between the bidder and the target, it is also known as negotiated takeover. IBM's acquisition of Daksh was a friendly takeover.

❖ Hostile Takeover

On the other hand, if the takeover proposal of the would-be acquiring company is not acceptable to the management of the target company, it will obviously try to defy the proposed takeover. It may refuse to negotiate as well. In such a situation, the would-be acquirer can directly approach the shareholders of the target firm by providing tender offers. Tender offers are formal offers to purchase shares of the target firm at a specified price higher than the prevailing market price with a view to induce the shareholders of the target firm to sell their shares. If the management of the would-be acquirer succeeds in its attempt to purchase sufficient number of shares from the shareholders of the target firm so as to gain control over the target firm, such a takeover is considered unfriendly in nature and is referred to as a hostile takeover. The most dominant purpose which has forced most of the companies to resort to this kind of takeover is increase in market share. Abrupt jumps in share prices and sudden rise in trading volumes are the warning signs of a hostile takeover. The takeover of Raasi Cements by India Cements was the first major hostile takeover in India. It was one of the fiercest takeover battles ever fought between two companies in the history of M&As.

Apart from tender offers, the acquirer company can use any of the following strategies aimed at taking over the target company.

Street Sweep: In street sweep, the acquirer purchases a large number of shares in a company before making an open offer. In this case the target firm is left with no other alternative but to give consent to the merger proposal.

Bear Hug: In this case, the acquirer tries to put pressure on the management of the target company by threatening to make an open offer. The board of the target
company surrenders straightaway and agrees to a settlement with the acquirer for change of control.

**Brand Power:** This strategy involves the process of entering into an alliance with powerful brands to sweep away the partner's brands and eventually buy out the destabilized company.

**Anti-Takeover Defensive Strategies**

A wide range of anti-takeover defensive strategies are employed by the target companies to defend themselves against the attack mounted by the acquiring companies in their bids for open market takeover particularly in the United States which has a long and colourful history of takeover. These defensive strategies, categorized into pre-offer defensive strategies and post-offer defensive strategies, are briefly described below.

**Pre-Offer Defensive Strategies**

**Staggered Board:** The board of directors comprises of three equal groups. One group is elected every year.

**Super Majority Clause:** For approval of a merger proposal by the target company a very high percentage of votes, usually 80 percent or so, is required.

**Poison Pill:** This strategy involves issue of low priced preferential shares to existing shareholders to increase the capital base which will make the hostile takeover somewhat expensive.

**Poison Put:** In this case, the existing shareholders of the target company are granted the right to buy bonds which are convertible into the stock of the acquiring company in the event of a merger on very favourable terms.

**Dual Class Recapitalization:** A new class of equity shareholders is created which enjoys superior voting rights.

**Golden Parachute:** The incumbent management is entitled to receive fabulous compensation in the event of takeover.
Post-Offer Defensive Strategies

**Greenmail**: The target company agrees to buy the shares acquired by the bidder at a premium in exchange for the bidder's promise to abstain from hostile takeover.

**Pac-Man Defence**: In this strategy the target company makes a counter bid for the bidder's company. This would force the bidder to defend itself and consequently call off his raid.

**Litigation**: This is a strategy where a target company files a suit against the bidder for violating anti-trust or securities laws.

**Asset Restructuring**: If the bidder is tempted by certain valuable assets of the target company, the target company can sell its most precious assets called the 'crown jewels', and / or buys assets which the bidder does not want or that may pose anti-trust problems for it.

**Liability Restructuring**: The target company buys back its own shares at substantial premium or issues shares to a friendly third party.

Most American firms employ at least one anti-takeover defence. The two popular defences are the staggered board and the poison pill.

**Anti-takeover Defences in India**

Companies in India have fewer anti-takeover defences available to them, compared to their American counterparts. In order to ward off a takeover attempt, companies in India presently invoke one or more of the following defences:

**Making Preferential Allotment**: A company may allot equity shares or convertible securities on a preferential basis to the promoter group so that its equity stake is enhanced.

**Effect Creeping Enhancement**: As per SEBI guidelines, the promoter group can raise its equity holding by creeping enhancements, subject to limits, without invoking the provisions to make an open market offer.
**Amalgamate Group Companies:** Two or more companies promoted by the same group may be amalgamated to form a larger company. Other things being equal, a larger company is less vulnerable to a takeover in comparison to a smaller company.

**Sell the Crown Jewels:** If the raider is tempted by certain valuable assets of the target company, the target company may sell those assets to make itself unattractive.

**Search for a White Knight:** In order to fend off the strategy of the bidder, the target company makes an appeal to a friendly company to buy the whole, or part, of the company. The understanding is that the friendly buyer promises not to extricate the management of the target company.

❖ **Bail-Out Takeover**

A bail-out takeover is a takeover of a financially sick company by a financially rich company as per the provisions of Sick Industrial Companies (Special Provisions) Act, 1985 to bail out the former from losses.

Evidently, hostile takeovers, as far as possible, should be avoided as they are more difficult to accomplish. In other words, friendly takeovers are better forms of corporate restructuring.

**[A-3] Purchase of a Division / Plant**

With the increase in corporate restructuring activities, purchase and sale of divisions or plants are becoming very common. Purchase of cement plant of TISCO by LAFARGE, purchase of nylon tyre cord division of CEAT by SRF Ltd., acquisition of food division of GLAXO India Ltd. by HEINZ India Ltd. are some noteworthy examples of this form of corporate restructuring. It is to be noted that, the counterpart of purchase is divestiture. If firm A purchases a plant or a factory or a business division of firm B, from the point of view of firm B it represents a divestiture. Purchase (or divestiture) of a division / plant are expected to gain importance in the years to come as firms want to restructure themselves with greater freedom in the more liberalized economic environment.
Business Alliances

Business alliances such as joint ventures, strategic alliances, equity partnerships, licensing, franchising alliances, and network alliances have gained importance significantly. In many situations, well-designed business alliances are becoming the workable alternatives to mergers and acquisitions. Business alliances are motivated by a number of factors like desire to share risk, gaining access to new markets, reducing costs, receiving favourable regulatory treatment, or acquiring (or exiting) a business. Business Alliances have become very common in diverse fields like high-technology, media and entertainment, automobiles, pharmaceuticals, oil exploration, and financial services. For example, General Motors and Toyota entered into an unprecedented joint venture agreement in the 1980s, IBM announced business alliances worth US $ 30 billion with companies like Cisco and Dell computers in 1999, Merck has over 100 R&D alliances with a variety of entities, Oracle has over 15,000 alliances with its business partners etc.

Common Forms of Business Alliances

Business alliances come in a variety of forms. The more commonly used forms are: joint ventures, strategic alliances, equity partnerships, licensing, franchising alliances, and network alliances.

Joint Ventures: A joint venture is set up as an independent legal entity in which two or more separate organizations participate for a specific period with a specific objective or for a continuing business relationship such as the Sony Ericsson joint venture. Joint ventures are useful for a company to enter into new segment of market. The joint venture agreement spells out how ownership, operational responsibilities, and financial risks and rewards will be shared by the cooperating members. Needless to mention, each member preserves its own corporate identity and autonomy. This is in contrast to a strategic alliance, which involves no equity stake by the participants, and is a much less rigid arrangement.

Strategic Alliances: A strategic alliance is a cooperative relationship like joint venture. However, it does not, unlike a joint venture, result in the creation of a separate
legal entity. A strategic alliance may involve an agreement to transfer technology, provide R&D service, or grant marketing rights.

**Equity Partnership:** Besides having the attributes of a strategic alliance, an equity partnership also involves one party taking a minority equity stake in the other party.

**Licensing:** Licensing means giving permission. There are two types of licensing which are very popular. The first type of licensing involves licensing of a specific technology, product, or process; the second type involves licensing of a trademark or copyright.

**Franchising Alliance:** In this form of business alliance, a firm gives rights to a number of licensees operating in different geographical locations to sell goods and services.

**Network Alliances:** A network alliance is a web of inter-connecting alliances among different companies which often goes beyond national and industrial boundaries. Under such arrangements, two companies may work together in one market but compete in another. These alliances are often seen in multimedia, computer, airlines, and telecommunication industries.

[A-5] **Diversification**

This involves entering into a line of business or product different from the existing line of activity which can be conveniently and economically combined with the existing activities of the business. This is a very common form of restructuring and it goes with the objective of widening the risk base. However, diversification into areas which are totally unrelated may bring more problems to the business than possible benefits.

[B] **Contraction / Divestiture**

Unlike the merger in which all assets are sold, in a contraction / divestiture only some of the assets are sold which may be in the form of a plant, division, product line,
subsidiary etc. Although divestiture, from the perspective of selling firm, causes contraction, it enables the selling firm to have a more lean and focused operation and does not bring about decrease in its profits. Instead, it is believed by the selling firm that its value will be augmented by parting / divesting some of its loss producing or less return generating assets / divisions / operating units. Cash proceeds from selling such unproductive / non-performing assets can be utilized in expanding / rejuvenating other leftover assets / operating units and in this way the firm can enhance the profits of the demerged / divesting firm.

Methods of Contraction / Divestiture

[B-1] Hive-Offs:

It refers to sale of a loss making division or a product line by a multi-product company. This serves a dual purpose. The buyer is benefitted because of low acquisition cost of a completely established product line which he can conveniently combine with his existing business and thus increase his profit and market share. On the other, the seller is benefitted since it enables him to get rid of an ailing operation from its business structure and concentrate more on profitable segments and consolidate its business activities. The recent example of such restructuring is hiving off its share in Excel Industries by Tata Chemicals.

[B-2] Demerger: Spin-Offs and Split-Ups

Spin-Off refers to the process where a division or a product line of a company is separately reorganized into a different entity. The entity so formed may either be in the form of a subsidiary company or altogether a separate company. A spin-off requires creation of a new, separate, corporate firm; the shares of the newly created legal entity are distributed on a pro rata basis to existing shareholders of the parent company; such a distribution enables the existing shareholders to maintain the same proportion of ownership in the newly created firm as they had in the original firm. As a sequel, the newly created entity becomes an independent company, taking its own decisions and developing its own policies and strategies, which need not necessarily be the same as those of the parent company. In brief, the firm acts as a separate business entity.
However, spin-off, like outright sale, does not bring any cash to the parent company. For example, Air India formed Air India Engineering Services Limited by spinning off its engineering department.

A variation of spin-off is the split-up. In broad terms, split-up involves the breaking up of the entire firm in a series of spin-offs (in terms of newly created separate legal entities) so that the parent firm no longer exists and only the new offspring survive. For instance, a corporate firm has 4 divisions, namely, A, B, C and D; a decision to split-up implies that four new corporate firms (with autonomous and separate legal status) are to be formed to take over, say, one division each and the original corporate firm is to be wound up. Since demerged units are relatively smaller in size, they are logistically more conveniently managed. Therefore, it is expected that spin-offs and split-ups are likely to enhance efficiency and may prove instrumental in achieving better performance. The demerger of the Reliance group is by far the biggest corporate restructure story in the private sector.

[B-3] Equity Carve Out

In equity carve out a parent firm makes a subsidiary public through an initial public offering (IPO) of shares, amounting to a partial sell-off. A new publicly-listed company is created, but the parent keeps a controlling stake in the newly traded subsidiary. A carve-out is a strategic avenue a parent firm may take when one of its subsidiaries is growing faster and carrying higher valuations than other businesses owned by the parent. A carve-out generates cash because shares in the subsidiary are sold to the public, but the issue also unlocks the value of the subsidiary unit and enhances the parent's shareholder value. The new legal entity of a carve-out has a separate board, but in most carve-outs, the parent retains some control. In these cases, some portion of the parent firm's board of directors may be shared. Since the parent has a controlling stake, meaning both firms have common shareholders, the connection between the two will likely be strong. That said, sometimes companies carve-out a subsidiary not because it's doing well, but because it is a burden. Such an intention won't lead to a successful result, especially if a carved-out subsidiary is too loaded with debt or had trouble even when it was a part of the parent and is lacking an established
track record for growing revenues and profits. Carve-outs can also create unexpected friction between the parent and subsidiary. Problems can arise as managers of the carved-out company must be accountable to their public shareholders as well as the owners of the parent company. This can create divided loyalties.

[C] Financial Restructuring

In case of corporate restructuring through mergers / acquisitions / takeover and amalgamation, the potential acquiring firm has to deal with the management and/or shareholders of the other firm(s). Financial restructuring, on the other hand, is carried out internally in the firm with the consent of its various stakeholders. Viewed in this context, this form of corporate restructuring is relatively easier to put to ground.

Financial restructuring is a suitable mode of restructuring for corporate firms that have incurred sizable losses for/over a number of years. As a sequel, the share capital of such firms, in many cases, gets substantially eroded / lost; in fact, in some cases, accumulated losses over the years may be more than share capital, causing negative net worth. Given such a dismal state of financial affairs, a vast majority of such firms are likely to have a dubious potential for liquidation. Can some of these firms be revived? Financial restructuring is one such a measure for the revival of only those corporate firms that hold promise/prospects for better financial performance in the years to come. To achieve the desired objective, such firms warrant/merit a restart with a fresh balance sheet, which does not contain past accumulated losses and fictitious assets and shows share capital at its real/true worth.

Restructuring Scheme: Financial restructuring is achieved by formulating an appropriate restructuring scheme involving a number of legal formalities (including consent of the court and consent of the affected stakeholders, say, creditors, lenders and shareholders). It is normal for equity shareholders to make the maximum sacrifice, followed by preference share and debenture-holders/lenders and creditors, respectively. The sacrifice is in terms of waiver of a part of the sum payable to various liability holders. The sacrifice may also be in terms of acceptance of new securities with a lower coupon rate, with a view to reduce the future financial burden on the firm. The
arrangement may also take the form of conversion of debt into equity; sometimes, creditors, apart from reducing their claim, may also agree to convert their dues into securities to avert pressure of payment. As a result of all these measures, the firm may have better liquidity to work with. Thus, financial restructuring implies a significant change in the financial/capital structure of corporate firms, leading to a change in the payment of fixed financial charges and change in the pattern of ownership and control.

In brief, financial restructuring (also referred to as internal reconstruction) aims at reducing the debt/payment burden of the corporate firm. The aggregate sum resulting (a) from the reduction/waiver in the claims from various liability holders and (b) profit accruing from the appreciation of assets such as land and buildings is then utilized to write off accumulated losses and fictitious assets (such as preliminary expenses and cost of issue of shares and debentures) and create provision for bad and doubtful debts on debtors and downward revaluation of certain assets, say, plant and machinery, if they are overstated. In practice, the financial restructuring scheme is drawn in such a way so that all the above requirements of write-off are duly met.

However, it is to be noted that, each and every scheme of financial restructuring is unique in nature and company specific. A financial reconstruction can take place only when the stakeholders are ready to forego their claims in the company as required and believe that their sacrifice will put back the restructured company (reflecting true value of assets, capital and other significant financial parameters) on the profit track in near future. This form of corporate restructuring thus helps in the survival of a financially sick firm which would have liquidated otherwise.

[D] Ownership Restructuring

[D-1] Going Private

A public enterprise going private is a form of ownership restructuring. It is commonly known as privatization. In many developing countries, public sector was established to take care of industries of strategic importance like steel, petroleum, and defense. Over the passage of time, inefficiencies like bureaucracy and red tapism crept
into the system leading to continuous financial losses. Therefore, the government in these countries started transferring ownership of their businesses into private hands.

[D-2] Buyouts

Buyouts constitute yet another form of corporate restructuring. In the corporate world, Management buyouts (MBO) are the more usual modes of acquisition. The MBO involves the sale of the existing firm to the management. The management may be from the same firm or may be from outside (entrepreneurs) or may assume a hybrid form (i.e., the management may consist of that of the existing firm as well as from the outside). In general, when the potential acquiring management team does not have adequate financial resources of its own to pay the acquisition price, it seeks financial support from other sources, say investors, institutions, venture funds, banks and so on. When finance is arranged by outside investors, it is normal for them to secure representation on the board of the corporate firm. In cases when debt forms a substantial part of the total financing from outsiders, the buyout transaction is appropriately referred to as a leveraged buyout (LBO). Since LBOs cause substantial financial risk, it is desired that firms should have a relatively low degree of operating or business risk. LBOs will not be a suitable form of corporate restructuring if the acquired firm already has a high degree of business risk. Further, to ensure the success of LBO it is imperative that the acquiring management should carry out the exercise to determine the maximum level of debt it should go for, based on its cash generating capacity to service the debt in future. This exercise enables the firm to determine the maximum degree of financial leverage it can employ in a buyout.