Chapter – 3
Research Methodology
3.1 RATIONALE OF THE STUDY:

The literature review undertaken on the subject – Financial Restructuring and its Impact on Corporate Performance in India – reveals that there is a need to study the said subject in Indian context. It was also revealed that the impact of the financial restructuring on parameters such as sales, gross profit, net worth, current ratio, fixed assets and payments to government towards taxes have been unexplored. This study has explored these aspects in the context of Indian Corporates.

There is a drastic change in the Indian economy which has also changed the banking system, their policies and procedures, corporate finance as well as legal system in the country since last about 50 years. Right from era when the industrialization started, the focus has shifted from predominantly agriculture to the development of industry. Since then, manufacturing sector has emerged as one of the main thrust sector in the country. Considering the need and also the requirement of the industry, it was felt that nationalization was required for certain sectors like Banking and Insurance as well as for sick/weak units during late sixties and seventies. Service sector has emerged as one of the most powerful sector. IT and IT enabled services and the financial service sector has played a lead role in the nineties and the beginning of the twenty-first century. Realizing the importance of infrastructure for the growth of the economy, the government has given a thrust to infrastructure sector and Infrastructure growth has become a buzzword.

A shift in the role of the Government has been witnessed in the last two decades. The role of the government is more of supervisory in nature and to fulfill this role it has set-up various regulatory agencies to supervise the functioning of various entities/sectors in the economy. To regulate listed companies, Stock Exchange Board of India (SEBI), to regulate telecom companies, Telecom Regulatory Authority of India (TRAI), to regulate electricity companies, Electricity Regulatory Authority (ERA), etc. have been set up.
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Similarly, the Government has also changed its policies and legal framework as per the requirement. As a result of industrialization, weak and inefficient units have also emerged as by-products. The Government was concerned about the rampant increase in the sickness in the manufacturing sector and sizable amount of Banks/ FIs money blocked in such units, widespread unemployment, etc. For the purpose of revival and rehabilitation of various sick units, the government initially started with nationalization of sick/weak industries. Not getting desired result, the government decided to take over the management of the sick industry for a temporary period and make it viable and then again giving back the management to the original owners. Nationalization or taking over management by Government and making unit viable through the help of professionals and again giving it back to owners proved very costly and burdensome. Understanding this fact, a separate quasi judicial authority - Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies (Special Provision) Act, 1985 was formed.

The BIFR proceedings also undertook a long time to dispose off the cases registered with it resulting in large amount of sizable assets locked with sick firms and large amount of dues with various banks /FIs which were classified as non-performing assets. The government came out with Debt recovery Act, 1993 to unlock the Bank/ FIs Money. Due to the non-obstinate provisions under SICA Act, the measures adopted through DRT Act had not fructified desired result. Still, unscrupulous promoters were taking advantage of provisions of SICA Act and avoiding/ delaying recovery of the Bank’s dues. Understanding the peculiar problems, the Government has come out with Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002, which has given wide power to the banks for taking over the assets of the defaulting unit. More so, non-effectiveness of BIFR has prompted the government to come out with a solution for speedy rehabilitation. With the help of the Companies Amendment Act, 2002, the government has decided to form a separate authority to look after rehabilitation/ restructuring/revival or winding up of the sick units by repealing the SICA Act and forming a separate National Company Law
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Tribunal. The said Companies amendment Act 2002 could not see the light of the day till 2010 because of the challenge of the validity of forming NCLT by the government in the various High Courts and recently the Supreme Court of India gave a judgment in favour of the Government. Meanwhile the Companies Bill, 2008 was also introduced and a systematic separate authority to be formed to look into weak/sick industry by repealing SICA Act. In spite of all these measures, though in terms of percentage, sickness is considered to be controlled/ reduced but in terms of absolute numbers, there is a continuous increase in the number of sick companies and locking up of the Banks/FIs money.

In a nutshell, the corporate sickness has increased and how the restructuring exercise in India is helpful in turning around the company is a matter of research. An extensive literature review has also been undertaken in this context, not much research providing specific direction about the relationship between financial restructuring and its impact on the corporate performance has been undertaken. Moreover, country specific researches are very few – in the context of India there is a gap. Hence, there was a motivation to take such a study in the Indian context with a special focus on the financial restructuring in the last decade.

The literature review highlights the gaps in the research relating to corporate performance upon restructuring in Indian context. This study aims to fill up the same gap and investigate the change in the performance of the corporate i.e. top line (sales), bottom line (profit), gross fixed assets, current ratio and taxes paid.
3.2 RESEARCH OBJECTIVES:

3.2:1 Major objective

➢ The main objective of the study is to understand the impact of the financial restructuring on the financial performance of the company. Thus, it is intended to analyze the corporate financial restructuring and its resultant impact on various parameters such as sales, gross profit, net profit and taxes paid.

3.2:2 Sub Objectives

i. To identify the types of firms in terms of size which are more prone to sickness.

ii. To identify the causes and problems of sickness.

iii. To study the various schemes / mechanisms/laws to deal with sickness in India.

iv. To study legal and regulatory frame work on corporate insolvency and restructuring in both developed and developing countries.
3.3 SCOPE OF THE STUDY:

Financial restructuring is offered to all sectors and industries i.e. manufacturing sector, service sector, infrastructure sector, trading activities and it also includes micro, small, medium and large industries including proprietary concern, partnership firms, cooperative societies, private and public limited companies and public sector undertakings. It is not feasible to have data of micro and small industries because of non-availability of adequate published information. Moreover, most of them are in the unorganized sector, which makes it difficult to get financial and audited data of such firms. Infrastructure sector has been identified as a thrust area only during last decade and most of the firms under this category are either new firms or do not have adequate tenure wherein restructuring was required or has yielded result. On the other hand, service sector and trading activities do not have adequate asset base and in most of the cases, the banks/ financial institutions as well as promoters would like to take recourse of liquidation/ insolvency/winding up process instead of restructuring.

In light of this, the study is mainly focused on the manufacturing sector and units covered under organized sector where the published material/data are available. The study covers only large and medium firms who have emerged from either BIFR proceedings or CDR process.

The period covered for analysis is mainly from 2000-01 to 2008-09 i.e. those firms whose cases of restructuring were disposed off between 2000-01 to 2008-2009 by BIFR/CDR Cell. In other words those firms have emerged from sickness between 2000-01 to 2008-09 have been covered.
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3.3:1 **Research Hypothesis**

H1. There is a significant difference in the Gross Sales of a company after financial restructuring.

H2. There is a significant difference in the profitability of a company after financial restructuring.

H3. There is a significant difference in the gross fixed assets of the company after financial restructuring.

H4. There is a significant difference in the current ratio of the company after financial restructuring.

H5. There is a significant difference in payment of taxes to the exchequer of the Government after financial restructuring.
3.4 RESEARCH DESIGN

All the research approaches can be classified into one of the three categories of research: Exploratory, Descriptive and Casual. These categories defer significantly in terms of research purpose, research questions, proposition of hypothesis that are formed and the data collection methods that are used.

This study is a descriptive research design using both qualitative and quantitative tools.

3.4:1 Data Collection

The data for fulfilling the objectives of the study has been collected through secondary and primary sources as outlined below:

(a) Primary data collection:

An exhaustive questionnaire for collecting the primary data was prepared keeping into consideration the objectives of the research study. A structured questionnaire with both close ended and open ended questions was framed. An open ended question was included in the questionnaire to get suggestions from the respondents to improve/strengthen the system.

Sampling plan and size

The sampling plan was adopted by the researcher to collect responses from the participants in the restructuring process.

i) Domain Officers/Managers of Banks and Retired Domain Managers/Officers of the bank

ii) Promoters of industries undergone/undergoing through restructuring process.

iii) Professionals having adequate exposure/knowledge on financial restructuring aspects
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These participants were chosen as they have adequate exposure/knowledge in the financial restructuring process. The sample mainly consists of domain managers dealing with the restructuring of finance in the banks and financial institutions and professionals like CA, CS, MBA who happen to be a part of restructuring process. Promoters who have undertaken financial restructuring process have been selected but they are few in number as they were not willing to give the desired response. In the beginning, the researcher had also approached the domain managers/officers of the BIFR at New Delhi, domain managers at CDR cell at IDBI but desired response could not be elicited.

For this research, the convenience method under non-probability sampling method is used so as to eliminate high cost and reduce the time for the research to be conducted. A first draft of the questionnaire was prepared and pre tested with the domain managers of banks dealing with the restructuring cases and small errors were eliminated from the questionnaire, post which, the questionnaire was administered to 50 respondents.

The number of respondents to whom the questionnaire was administrated is as under:

<table>
<thead>
<tr>
<th>Participants</th>
<th>Size (Nos)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Bankers, Ex- bankers</td>
<td>35</td>
</tr>
<tr>
<td>b) Promoters</td>
<td>4</td>
</tr>
<tr>
<td>c) Professionals</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>50</strong></td>
</tr>
</tbody>
</table>
(b) **Secondary data collection:**

The secondary data for understanding the effect of the restructuring on the corporate performance has been collected and reviewed from the CMIE, Prowess database. The companies selected were those which emerged from sickness after undergoing the BIFR/Corporate debt restructuring (CDR) process. These companies were identified from the BIFR website. These companies were basically divided into two groups based on data availability from the database. One group of companies whose two years post-restructuring data is available and another group whose four years post-restructuring data is available. A total of 146 companies was selected out of which 59 companies belong to the first group and 87 companies belong to the second group. Of the 146 companies, 124 companies are BIFR registered/declared sick/revived and 22 companies are restructured through the CDR scheme. Of the 146 companies, 110 are large scale firms and 36 are medium scale firms. The definition of large scale and medium scale is given in the ‘Definition’ section of this chapter.

**Statistical tools used**

For analyzing the primary data responses, percentage and ranking method has been used. Moreover, Likert’s five point scale has been used to analyze the perceptions of respondents.

Financial parameters/ ratios such as Gross Sales, Gross Profit, Net Profit, Gross Fixed Assets, Current Ratio, Total Income to the Assets ratio, and Total Income to Compensation to Employees have been calculated. To know whether there is an improvement in financial performance of the firm after the restructuring, paired t-test is used to test the hypothesis developed in the study.
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For comparison of performance, the year in which the firm was registered/declared sick is classified as base year and the years prior to the base year together with the base year are clubbed as pre-restructuring period and the years after restructuring (either two/four years) are clubbed as post restructuring period.

Assumptions:

The following assumptions were made:

1. The respondents are well aware about the problems of the sick industries as well as financial restructuring mechanism/laws available in the country.

2. The respondents will answer the question with honesty and without intentional bias.

3. The respondents will understand the questions asked and the scales used.

4. The respondents will not use prior opinions, grudges or feelings about the companies facing financial liquidity when answering the questions.

3.4: 2 Research Framework:

The study is structured as follows:

The study has been broadly divided into eight chapters. Chapter 1 gives a brief background of the study in the form of introduction. The concept of financial restructuring, the measures adopted by banks and financial institutions for restructuring and explanations of various terms used for restructuring have been discussed.
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Chapter -2 covers the literature survey on financial restructuring and its impact on corporate performance in the Indian and International context.

Chapter-3 describes the profile of the study and research methodology adopted.

Chapter-4 lists and analyses the legal framework available for financial restructuring, and the laws of the country dealing with insolvency as well as informal mechanism of restructuring adopted by banks/FIs/RBI. It also attempts to give brief idea about the Insolvency Laws and financial restructuring process prevalent in other countries of the world.

Chapter-5 presents primary data analysis of responses received from bankers, ex-bankers, promoters, and professionals who have sufficient exposure in the field.

Chapter-6 covers the secondary data analysis of firms emerging from sickness for the period prior to sickness and post restructuring.

Chapter-7 presents an empirical evidence of impact on corporate performance of financial restructuring in India. To facilitate empirical study, the study collects broad indicators of corporate performance before 2 or 3 years of sickness and 2 or 4 years after the financial restructuring.

The last Chapter - Chapter-8 gives an overview of the above chapters and finally the recommendations. This study has also some limitations which are stated in this section. These limitations can serve as basis for future research.
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Definition of the terms used in the Thesis:

“Acquisition” - Purchase of controlling interest in a firm, generally through tender offer for the target shares.

“Assets” - are things that one owns which have value in financial terms.

“Asset reconstruction (under SARFAESI Act)”
As per Section 2(b) of SARFAESI Act 2002 “asset reconstruction” means acquisition by any securitization company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance.

“Attachment” – means the property has been taken in judicial custody and cannot be sold or dealt with by the owner. Attachment usually arises by operation of law or by order of a judicial authority.

“Bankruptcy” - is a condition in which a firm (or individual) is unable to meet its (his) obligations and, hence, its (his assets are surrendered to a court for administration.

“Company” - means a company formed and registered under this Act or an existing company as defined in clause (ii). (Sec.3 (1)(i) of Companies Act, 1956).

“Current Assets” – are short terms assets, constantly changing in value, such as stocks, debtors and bank balances.

“Current Liabilities” - are short term liabilities, due to be paid less than one year, such as bank overdrafts, money owed to suppliers and employees.

“Debt” - includes a judgment-debt. (sec.2(a) of Provincial Insolvency Act, 1920).
“Default” - is generally referred to failure to satisfy an obligation when due.

“Financial assets (under SARFAESI Act)”

As per Section 2(l) of SARFAESI Act 2002 “financial asset” means debt or receivables and includes:

(i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or

(ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or

(iii) a mortgage, charge, hypothecation or pledge of movable property; or

(iv) any right or interest in the security, whether full or part underlying such debt or receivables; or

(v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or

(vi) any financial assistance;

“Large Enterprise (Manufacturing firms)” where the investments in plant and machinery is more than ten crore Rupees.

“Liquidate” - means winding up the affairs of the company by ascertaining liabilities and apportioning assets. (Concise Oxford English Dictionary).

“Micro Enterprise (Manufacturing firms)” – where the investments in plant and machinery does not exceed twenty five lakh Rupees.
“Medium Enterprise (Manufacturing firms)” where the investments in plant and machinery is more than five crore Rupees but does not exceed ten crore Rupees.

“Net worth (under SICA Act)”

Net worth under SICA Act means the sum of the total of the paid up capital and free reserves. Free Reserves under SICA Act,1985 means all reserves credited out of the profits and security premium but does not include reserves credited out of revaluation of assets, write back of depreciation provision and amalgamation.

“Potential sick unit (as defined under SICA Act)”

As per Section 23 of the SICA Act, Potential sick company means a company, accumulated loss of which as at the end of any financial year have resulted in erosion of 50% or more of it peak net worth during the immediately preceding 4 years.

“Secured Creditor” – means a person holding a mortgage, charge or lien on the property of the debtor or any part thereof as a security for a debt due to him from the debtor. (Sec.2)(e) of Provisional Insolvency Act, 1920).

“Securitization” : is a process by which cash flows or claims of a third party or entity either existing or future, are identified, consolidated, separated from the originating entity and then transformed into “securities” to be offered to the investors.

“Sick Industry (as defined under SICA Act)”

As per Section 3(1)(o) of the SICA Act, “Sick industrial company is defined as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth”.

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“Sick Industry (as defined under the Companies Amendment Act, 2002)”

As per Section 2 (46AA) of the Companies Amendment Act, 2002, “Sick industrial company means an industrial company which has.

(i) the accumulated losses in any financial year equal to fifty per cent or more of its average net worth during four years immediately preceding such financial year, or

(ii) failed to repay its debt within any three consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such company.”

“Small Enterprise (Manufacturing firms)” where the investments in plant and machinery is more than twenty five lakh Rupees but does not exceed five crore Rupees.

“Structured finance”

Structured finance is referred to such financing instrument where financier does not look at the entity as a risk but tries to align the financing to specific cash accruals of the borrower.