Corporate restructuring as a solution for business failures

DISHA AGARWAL

KIIT UNIVERSITY, SCHOOL OF LAW

Abstract

In the dynamic and competitive landscape of the business world, organizations often face challenges that may lead to failures or inefficiencies. Business failures can result from various factors such as economic downturns, technological disruptions, management issues, or external market pressures. This paper explores corporate restructuring as a strategic solution to address and overcome business failures.

The objective is to analyze the concept of corporate restructuring, its different forms, and how it can be effectively employed to revitalize struggling businesses. The paper discusses the various reasons behind business failures and emphasizes the need for proactive measures to adapt and respond to changing environments. Corporate restructuring involves significant changes to an organization's structure, operations, and financial aspects, aiming to enhance efficiency, reduce costs, and improve overall performance.

The methodology involves a comprehensive review of existing literature on corporate restructuring, business failures, and successful turnaround strategies. Case studies of organizations that have successfully implemented restructuring measures will be examined to extract key insights and lessons learned. Additionally, interviews with industry experts and professionals with experience in corporate restructuring will provide practical perspectives on the challenges and opportunities associated with this strategic approach.

The paper concludes by highlighting the critical role of leadership, communication, and stakeholder management in the success of corporate restructuring efforts. It emphasizes the importance of aligning restructuring initiatives with the organization's long-term strategic goals and fostering a culture of adaptability and innovation. By understanding and implementing effective corporate restructuring strategies, businesses can not only survive challenging times but also emerge stronger, more agile, and better positioned for sustainable success in the ever-evolving business environment.

Keywords: *corporate restructuring, stakeholder management, financial restructuring*

Introduction

It is widely believed that the way a business grows could be classified either as organic or inorganic growth. Organic growth occurs through routine and special internal business strategies, tactics, and decisions that enhance sales figures, revenue numbers, customer base, and profit margins. Such decisions do not impact the corporate structure of the business entity.

Sometimes businesses attempt to grow at an accelerated pace through inorganic growth by identifying synergies and opportunities in other enterprises and acquiring such targets. Such growth may cause a change in the corporate entity.

However, sometimes a business simply cannot generate enough revenue and for a variety of other reasons, might be hurtling towards failure and probable demise. Even in such situations, a business can be saved from total closure through corporate restructuring strategies that salvage the value that exists in a failing business and give it a new lease of life albeit in an altered corporate structure.

What is corporate restructuring?

Corporate restructuring is the process involved in changing the organization of a business. This involves significantly changing an entity's business model, financial structure, or management team, to address challenges and increase stakeholder value. The corporate restructuring may involve employee retrenchment at any scale, or bankruptcy, or both. Restructuring processes are usually designed to reduce the impact on employees, and statutory laws are also designed to protect the interests of the employees first.

Scope of corporate restructuring

The scope of corporate restructuring includes cost reduction, enhancing the economies of scale, improving efficiency, and generating greater profits. Sometimes, to grow or even survive, a business may need to restructure itself and focus on competitive advantage. Corporate restructuring may mean different processes and strategies at different times for different companies and the common goal in every case of restructuring is to eliminate the disadvantages and consolidate the advantages. Therefore, corporate restructuring is employed both as a correction strategy and as a growth strategy.

Forms of corporate restructuring

Comparison of various commentaries on a conceptual study of corporate restructuring could be confusing because what one author may refer to as a 'type' of corporate restructuring, the other may refer to as a 'strategy' of corporate restructuring, and none of them may be incorrect, therefore it is paramount to keep this in mind while studying works of different authors on this subject.

Financial restructuring

"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." -Warren Buffet.

Restructuring of the financial aspects of a business may be undertaken when the going is not good and there is a fall in the revenues, possibly because of adverse economic conditions and other externalities or sometimes even internalities. Management may choose to change its equity patterns, debt servicing schedule, and cross-holding pattern, to sustain the market, survive, reduce costs, and return to profitability. Some other initiatives under financial restructuring include, but are not limited to:

- Reduction of tax liability,
- Divestment of unproductive assets,
- Outsourcing,
- Relocation of operations (to reduce costs),
- Renegotiation of contracts,
- Debt Refinancing.

Organisational restructuring

"When we own portions of outstanding businesses with outstanding managements, our favorite holding period is forever." -Warren Buffet.

Businesses may function efficiently, turn more profitable, and run better due to well-planned and executed organizational restructuring. It means changing the organizational structure, for example reducing the levels of hierarchy, redesigning job positions, removing excess or under-performing employees, and changing reporting structure. Some other initiatives under organizational restructuring include, but are not limited to:

- Regrouping of business,
- Decentralization,
- Portfolio Restructuring,
- Corporate Strategy.

Reasons for Corporate Restructuring

Corporate restructuring is implemented in the following situations:

1. Change in the Strategy: The management of the distressed entity attempts to improve its performance by eliminating certain divisions and subsidiaries which do not align with the core strategy of the company. The division or subsidiaries may not fit strategically with the company's long-term vision. Thus, the corporate entity decides to focus on its core strategy and dispose of such assets to the potential buyers.

2. Lack of Profits: The undertaking may not be enough profit-making to cover the cost of capital of the company and may cause economic losses. The poor performance of the undertaking may be the result of a wrong decision taken by the management to start the division or the decline in the profitability of the undertaking due to the change in customer needs or increasing costs.
3. Reverse Synergy: This concept is in contrast to the principles of synergy, where the value of a merged unit is more than the value of individual units collectively. According to reverse synergy, the value of an individual unit may be more than the merged unit. This is one of the common reasons for divesting the assets of the company. The concerned entity may decide that divesting a division to a third party can fetch more value rather than owning it.
4. Cash Flow Requirement: Disposing of an unproductive undertaking can provide a considerable cash inflow to the company. If the concerned corporate entity is facing some complexity in obtaining finance, disposing of an asset is an approach in order to raise money and to reduce debt.

Characteristics of Corporate Restructuring

- To improve the Balance Sheet of the company (by disposing of the unprofitable division from its core business)
- Staff reduction (by closing down or selling off the unprofitable portion)
- Changes in corporate management
- Disposing of the underutilised assets, such as brands/patent rights.
- Outsourcing its operations such as technical support and payroll management to a more efficient 3rd party.
- Shifting of operations such as moving of manufacturing operations to lower-cost locations.
- Reorganising functions such as marketing, sales, and distribution.
- Renegotiating labour contracts to reduce overhead.
- Rescheduling or refinancing of debt to minimise the interest payments.
- Conducting a public relations campaign at large to reposition the company with its consumers.

Corporate restructuring strategies

1. Mergers: A merger is a strategy wherein two or more businesses are merged either by way of amalgamation or absorption. Mergers may be: – (i) horizontal, (ii) vertical, (iii) co-generic, and (iv) conglomerate.
2. Demerger: In a Demerger, certain business operations of an entity are segregated into one or more entities. A demerger strategy is undertaken to unlock the value of a particular business and enable it to operate smoothly with more focus.
3. Reserve Merger: According to the explanation provided by the Institute of Company Secretaries of India, a reverse merger is a strategy where a private company acquires the majority shares of a public company, under its name and in the process becomes a public listed company itself without causing an initial public offering.
4. Disinvestment: Disinvestment is a strategy where an entity, a conglomerate, or a government sells or liquidates an asset or a business unit.
5. Takeovers: Takeover is also known as acquisition. In a takeover/acquisition, the acquirer attempts to gain control of the target company to achieve market supremacy. It may be a friendly or a hostile takeover.
6. Joint Venture: A joint venture is a corporate strategy wherein two or more companies form an entity to undertake a financial activity together. The companies agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. Joint ventures are set up for fixed periods and they may be either project-based or functional-based.
7. Strategic Alliance: A strategic alliance is an agreement between two or more parties to collaborate, to achieve certain objectives while continuing to remain independent organizations.
8. Slump Sale: It is the transfer of one or more businesses or undertakings as a ‘going concern’ and for a lump-sum sale value without specific values being assigned to the individual assets and liabilities.

Applicable Law for Corporate Restructuring Services

The following laws would govern business restructuring services:

1. Companies Act 2013 or Companies Act 1956- Section 233 (of the CA 2013) deals with the process in which companies can opt for a fast-track merger.
2. Insolvency and Bankruptcy Code, 2016- When speaking about debt restructuring and financial restructuring, the IBC code deals with the aspects of resolution and liquidation.

3. SEBI (Securities Exchange Board of India) Laws -When a company wants to go for a reverse merger or list its securities within a stock exchange in India.

Corporate restructuring: the process

Below is a general overview of the process mostly adopted in routine corporate restructuring cases and this is not applicable to restructuring that is mandatorily caused under the force of the law.

- Identifying potential targets: This stage of the process involves the identification and preliminary review of external targets, in case of acquisition strategy. However, this process may also be internally looking wherein the management tries to identify internal business units, group companies, or subsidiaries for integration or spin-off via demerger, reverse merger, or other possible restructuring strategies.
- Due Diligence: Once a target has been engaged, the important stage of deep investigation of the target is undertaken. All relevant facts and information are gathered, research and analysis are carried out and a due diligence report is prepared for management decision support. Such investigation helps determine the real value of the subject and reveals whether the target is really what it looks like. Due diligence is most helpful for the management of the acquirer if it is a 360-degree process covering financial, legal, human resource, and business aspects of the target.
- Business Valuation: Business valuation or assessment includes the examination and evaluation of both the present and future market value of the target company. This stage of the process is different from due diligence because due diligence involves investigation and reporting while this stage involves evaluation, projection, and estimations.
- Planning: The stage of planning is not necessarily after business valuation nor is it chronologically glued to the present position. Planning is an ongoing process, but the finalization of this process needs to happen now because the next stage in the process will involve the implementation of the plan. Planning the structuring of the deal, the steps of compliance and the deadlines for each such step, the process of integration, the plan to deal with the employees, retrenchment packages if applicable and accompanying regulatory compliances, fresh employment contracts, novation of contracts, assignments of contracts, planning for registration and et all must be done now and kept ready.
- Executing the deal: Time to put all that planning into practice, put in the hard work, and improvise in the face of uncertainty, all while also implementing innovative marketing and outreach campaigns to allay apprehensions of customers, suppliers, and external stakeholders of the target.
- Integration: This stage comprises the preparation and execution of the final contracts, and post-restructuring processes come into play from this stage for completing the integration or spin-offs and set the stage for successful day to day functioning in the new avatar.

Corporate restructuring : the panacea?

When businesses are facing losses, economic downturns, reducing customer base, severe competition, corporate restructuring is often pressed into service as a rescue tool. The Covid-19 pandemic induced worldwide slowdown in yet another scenario when corporate restructuring will play a major role in reviving and rescuing various businesses all over the world. Research has shown that delisting risk increases when companies undertake repetitive restructurings, large-scale retrenchments, massive asset downsizing, high levels of debt and failure to cut costs and focus on core competency.

In India, even the companies that file for bankruptcy, now have additional avenues of corporate restructuring through the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (IBC), except for financial services companies such as banks, non-banking financial companies (NBFCs), and investment funds. The object of the IBC is to attempt to give another chance to failed and sinking companies. Before the inception of this code, there was no clear direction and a large number of statutes (i.e., The Indian Partnership Act, 1932, The Central Excise Act, 1944, The Customs Act, 1962, The Income-tax Act, 1961, The Recovery of Debts Due to Banks and Financial Institutions Act, 1993, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, The Finance Act, 1994, The Sick Industrial Companies (Special Provisions) Repeal Act, 2003, The Limited Liability Partnership Act, 2008, The Payment and Settlement Systems Act, 2007, and The Companies Act, 2013) were involved in the insolvency proceedings along with archaic laws such as Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, and bankrupt businesses had limited chances of revival.

Corporate restructuring under CIRP can be initiated by the creditors of the concerned business or by the business entity itself. Under this process, licensed insolvency professionals work with the creditors and the

corporate debtor to come up with a plausible restructuring plan that gets implemented after due approval by the National Company Law Tribunal (NCLT).

Under the present system. in cases of restructuring and resolution of distressed/defaulting companies, four process routes are available in India:

- For a defaulting company, resolution through CIRP, failing which, liquidation under the IBC;
- Enforcement or recovery against a defaulting company and its assets or guarantees by way of statutory mechanisms under the applicable laws;
- For distressed companies (i.e., companies that have defaulted on their debt obligations for 30 – 60 days), restructuring by RBI-regulated institutions under the relevant circulars issued by the RBI; and
- Voluntary restructuring of assets and liabilities under a scheme of arrangement under the Companies Act 2013.

The concepts of IBC, CIRP, and pillars of IBC along with each of the aforementioned routes are large subjects and the contents thereof are beyond the scope of this article.

Case studies

Satyam Computer Services (2009)

Reason for restructuring

Business failure due to fraud;

- Satyam was among the most admired information technology companies until the year 2008-09 when it became a victim of frauds allegedly perpetrated by its founder(s). Satyam was an award-winning IT company and one of the faces of the Indian IT industry.
- It had a sound business model and portfolio of large international clients, therefore when calamity struck, the government had to immediately resort to firefighting to save the face of the Indian IT industry on the world stage. A high-level committee of the biggest names in various industries was set up to come up with a restructuring plan for the then-ailing Satyam.
- After the finalization of the restructuring plan, a formal public auction process was announced, and Tech Mahindra obtained a 46% stake in Satyam and eventually the entity completely merged with Tech Mahindra and came to be known as Mahindra-Satyam. The companies got merged legally on 25 June 2013 and the entity Satyam became history since then.

Yes Bank (2020)

Reason for restructuring

Business failure due to crises induced by alleged fraud;

- When crises struck, the financial position of Yes Bank Ltd deteriorated rapidly, more particularly concerning its liquidity, capital, and some critical parameters The alleged fraud of bank officials and a complete absence of any credible plan by the board and stakeholders for infusion of capital had compelled the Reserve Bank of India (RBI) to intervene and act in the public interest.
- The losses for Yes Bank stood at ₹185.64 billion for the third fiscal quarter ending December 2019 and Gross Non-Performing Assets had risen to 18.87 percent in the said quarter as against 2.10 percent for the previous year and it was clear that the bank would not survive without a capital infusion and clean-up of its bad debts.
- The reconstruction scheme of Yes Bank as announced by the RBI, proposed changes to the authorized capital, and the number of equity shares. Yes Bank itself was placed under a withdrawals moratorium with account holders being permitted to withdraw no more than 50,000/- from their account during the entire moratorium period.
- As per the approved reconstruction plan for Yes Bank, the State Bank India (SBI) would invest up to 49 per cent equity in Yes Bank.
- Axis Bank, Bandhan Bank, Federal Bank, Housing Development Finance Corp (HDFC), ICICI Bank, IDFC First, and Kotak Mahindra Bank, joined the investor consortium to invest in Yes Bank.
- As per the approved reconstruction plan, SBI, which invested 49 per cent equity at the time of restructuring, was not permitted to reduce its stake in Yes bank to below 26 per cent for three years,

while other investors and shareholders are required to lock in 75 per cent of their investment in Yes Bank for a mandatory period of three years.

- A new, temporary board, constituted by the RBI, was required to remain in force for one year or till such time that an alternate board is constituted by Yes Bank.
- The employees of Yes Bank allegedly continued their services on the same employment terms and salary as was applicable for the previous year.
- All offices and branches of Yes Bank continued to function in the then-existing manner and locations. No prohibition was placed on opening new offices and branches or closing the then-existing ones.
- The new management of restructured Yes Bank continues to recover bad loans and work with asset reconstruction companies and investors to clean the book. Gross non-performing assets for the quarter ending September 2021 fell to 14.97% compared to 15.6% in the previous quarter ending June 2021.
- The restructured Yes Bank is trying to increase the share of retail and MSME lending in its loan portfolio and reduce focus from corporate lending where it burnt its fingers due to defaults.

Conclusion

Corporate restructuring is a broad term that encompasses various strategies used for rescuing failing businesses or unlocking growth potential, and value in others. Corporate restructuring led by CIRP-IBC-NCLT has marked a watershed moment in the field of this subject in India and put India on the world stage, yet several issues need to be ironed out before it is too late. There have been recent accusations of certain elements gaming the CIRP-IBC-NCLT system and defeating the very purpose of IBC and CIRP; the government was quick to realize the shortcomings and is taking appropriate steps to resolve the problem. A committee of experts has been set up by the government, to explore the idea of adopting the UNCITRAL Model Law on cross-border insolvency and the matter is being pursued actively by the government with one of the probable outcomes being cross-border enforcement of awards passed in India under the IBC. Therefore, one can expect quality advances in corporate restructuring both under company laws as well as insolvency laws. The government is keenly aware of the need to limit the time taken to complete the restructuring, and resolution process of distressed companies, problems faced by the insolvency professional in the course of their work, and delays involved in obtaining approvals from the NCLT therefore the RBI and the government seek to empower the Insolvency and Bankruptcy Board of India (IBBI) and insolvency professionals, in that direction.