Innovations in Corporate Restructuring: A Strategic Mantra for Creating Financial Sustanability

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Abstract

Corporate restructuring is a term which is generally used when a company needs to improve its competence and profitability. Through corporate restructuring one organization can improve it's economic outlook and can create new opportunities. It's a broad term which includes concepts from merger to divestures and other various types of battels for corporate control. The main essence of this restructuring lies in realizing the long term goal of wealth maximization. It's a process which is multidimensional. This restructuring can be used as a operational restructuring as well as a long term strategy of a business. It is the corporate management expression for the act of partially taking a part and reorganizing a company for the purpose of making it more resourceful and therefore more lucrative. The main purpose of this study is to highlights the changing trends in corporate restructuring in India. The paper furthers explains different formats of corporate restructuring and their consequences.

Introduction

Corporate restructuring is the way of redesigning the financial structure of any company. This redesigning can be done to increase the competitiveness of the organization or to make the company to survive in the present adverse market or to bring the entire organization to words a new direction. Restructuring a corporate entity is repeatedly a requirement when the company has grown-up to the point that the original structure can no longer proficiently manage the output and general interests of the company. An association may go for restructuring as a result of a financial crisis or a provisional or long term droop in the economy in general. At that time the organization may require financial restructuring as a means to keep the company floating during these hard times. This may be done by uniting departments, down-sizing staff, dipping production, moving production to low cost amenities and business outsourcing etc. In this kind of restructuring the center of attention is on survival rather than on growth. The acquisition of the corporation by new owners directs to redesigning of the company's divisions, repositioning the company's yield and services and even restructuring the executives. As per the study done by Harvard Business School corporate restructuring has allowed thousands of business around the

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world to react more quickly and effectively to new occasions and unanticipated pressures, there by re-establishing their competitive advantage. In India corporate have freshly withstood an increase of restructuring in different organizations. Last year, M&A actions were mostly restricted to IT and telecom sectors. They have now extended across the economy.

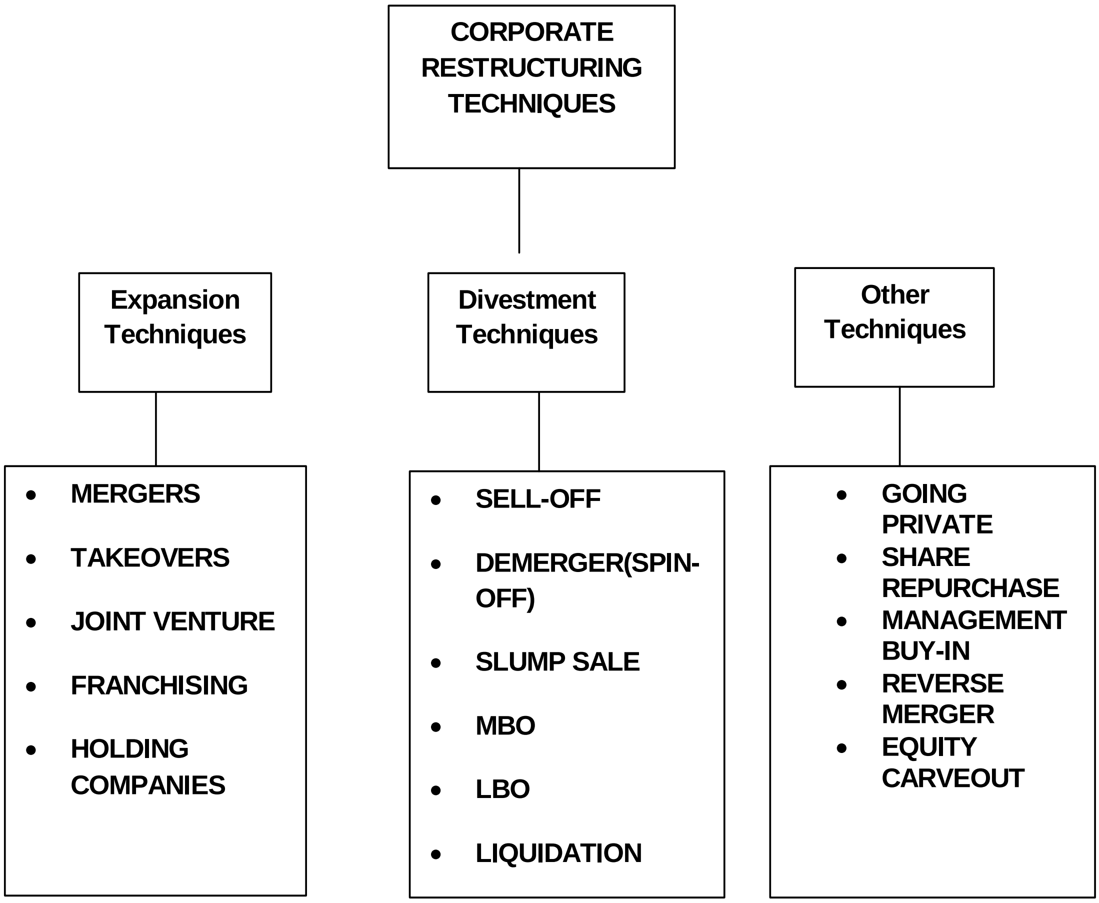
The reasons for this sharp drive to restructure in India are as:

1. Increased competition
2. Change in strict MRTP
3. New government policy and relicensing
4. All round resource optimization.
5. To create value for the organization.

After 1980 the demand for different merger, takeover, acquisition has been increased. In India the scenario of is boosting up like anything. As per the research of Pricewaterhouse coopers,in the first half of 2005 the value of M&A was \$6.9 billion as compared to \$2.9 billion in the first six monthy of 2004. All these way of corporate restructuring are now becoming one or other way of increasing the value of any company. This also helps in making creamy profits for any concern. In the early 1990s, when the economy was liberalized Indian business houses began to feel the warmth of competition. Conglomerates that had lost focus were forced to sell businesses that could not endure with competitive pressures. For example The Tatas, sold TOMCO to Hindustan Lever. Corporate restructuring, largely drove this 2nd wave of M&As.The 3rd wave started about some years ago in the key sectors like cement and telecommunications. Companies like Bharti Tele-Ventures and Hutch bought minor competitors to establish a national occurrence. As corporate world recently reported, this is the 4th wave of corporate deal-making in India. What makes the most new wave of M&As different from the 3 previous ones is the participation of global players. Foreign private equity is coming into Indian companies, like Newbridge's recent investment in Shriram Holdings.

Techniques of Corporate Restructuring

Business firm are engaged in lot of work which includes expansion, contraction and other restructuring assets and ownership structure. Corporate restructuring can be of many types. These are as following.



In this paper we are going to discuss some of the above techniques of corporate restructuring in brief. These are as follows:

Merger

Merger is a way of corporate restructuring. Here the simple equation is like 1+1=3.this is generally done for creating value for the company. This equation means that two companies together are more valuable then two separate two companies. When two firms willingly joins hands to go forward jointly that type of restructuring is known as 'Merger'. In case of merger both companies stocks are surrendered and new company stock is issued in its place. For instance the company Daimler-Benz and the company Chrysler ceased to exist when the two firms merged and a new company in the name of DaimlerChrysler was created. But in realty actual merger of equal generally doesn't happen. One company will buy another company and as per the deals agreement it allow the purchaser to proclaim it as an merger even if technically it demands to be acquisition. When both of the companies top officials joins hands with the motive that this coalition will go in favour of both the companies then that can also be called as merger. There are various types of merger. These are as:

(a) **Horizontal Merger: -** When two companies that are in same product line and have a direct competition with each other when they merger that kind of merger is called horizontal merger. This is some times called as horizontal integration. For example, The merger of Bank of Mathura with ICICI (Industrial Credit and Investment Corporation of India) Bank. This is generally done to achieve economies of scale.

(b) **Vertical Merger**: **-** When a supplier or customer merge with its company that is called so. For instance the most famous and popular example was the Carnegie Steel company. It controlled not only the mills where the steel was made but also the mines where the iron ore was extracted and coal mines that supplied the coal. This kind of merger promotes a company's financial growth and efficiency in the business.

(c) **Market-extension Merger: -** This is a merger between two companies who are selling same product but in different markets. A good example of such kind of merger is the accqusition of Eagle Bancshares Inc by the RBC Centura.

(d) **Product-extension Merger**: - This is a merger of two companies selling related products in the same market. The acquisition of Mobilink Telecom Inc. by Broadcom is an appropriate example of product extension merger.

(e) **Conglomerate Merger: -** Two companies merging whose area of business are totally different from each other. For example if a clothing company merges with a jewelry company then that is a kind of conglomerate merger.

Joint Venture

The joint ventures, in which two different firms invest some of their resources, is another such form that does not normally lead to the termination of either firm. Such projects typically engross only a small portion of the cooperating firms overall businesses and usually have restricted lives. Joint venture can be formed among a domestic company and foreign company with multinational company can permit the transfer of technology and reaching of global market. Entering into Joint venture is a part deliberate business policy to diversify and enter into new markets, acquire finance, technology patent and brand names. Forms of joint venture are like jointly controlled operations, jointly controlled assets, jointly controlled entities. The partners of joint ventures provide risk capital, technology, patent, trade mark, brand names and allow both the partners to reap benefit to agreed share.

Divestitures

Divestitures are measured as one of the significant techniques in corporate restructuring. Divestures does not deal with acquisition or mixture but it frequently examine the various newly acquired assets and divisions to determine whether the assets or divisions are fit into overall corporate strategy in value maximization and its future plans. If it does not serve the purpose, such assets or divisions are hived-off.

Strategic Alliances

Strategic alliance refers to an arrangement in which two or more corporate cooperates with each other in order to achieve the commercial objective. the main purpose of such alliance is cost reduction, technology sharing, risk sharing, product development. The concept of this alliance is more popular in infrastructure sectors and more particularly in areas of powers and gas. The basic motive is transfer of technology by implementing large objectives. Different forms of strategic alliance are like joint venture, franchising, supply agreement, purchase agreement, management contract etc.Mutual understanding and trust are basic fundas of strategic alliance. For smooth working of an alliance partners are required to have pre set priorities and expectations from each other.

Equity Crave Out

It's a modern technique of corporate restricting where parent company sell portion of its equity in a soly owned subsidiary to the general public or the investors. This enables the main company to generate cash flows or income which can be used for further investment e.g a deal to be finalized between Ventanta resources and Zain energy. More and more corporations are using equity carve-outs to increase shareholder value. A parent firm creates a subsidiary public through an initial public offering (IPO) of shares, resulting to a partial sell-off. A fresh publicly-listed company is shaped, but the parent keeps a controlling stake in the newly traded subsidiary.

A carve-out is a strategic path a mother company may take when one of its subsidiaries is rising faster and carrying higher valuations than other businesses owned by it.. Carve-out produces cash because shares in the subsidiary are sold to the public, but the issue also unlocks the value of the subsidiary unit and improves the parent's shareholder value.

The new authorized entity of a carve-out has a separate board, but in most carve-outs, the parent keeps some control. In these cases, some part of the parent firm's board of directors may be shared. Since the parent has a scheming stake, meaning both firms have common shareholders, the connection between the two will likely be strong. Some times companies go for a carve-out as because it is burden. Sometimes this goes wrong as a crave-out subsidiary is always loaded with debt. Crave-out can also create unexpected resistance among the parent and subsidiary. Troubles can arise as managers of the carved-out company must be answerable to their public shareholders as well as the owners of the parent company.

Sell Off

it is a sale of part of the organization with a third party in situations like shortage of cash, To concentrate more on core business, to increase profitability, to protect firms, take over activities by selling of the desirable division to the bidder. It occur when a mother company distributes all or most of its property of stock in a subsidiary to the parent's shareholders stand on the proportion to their holdings in the parent company, that is on a pro rata basis. After the sell-off the subsidiary company is no longer owned by the mother company and there are 2 separate publicly traded companies. Previously the shareholders only own the mother company's stock, whereas after the spin-off they own shares in both the mother and the subsidiary company. It is important to differentiate corporate spin-offs from 3 types of related transactions—equity carve-outs, split-offs, and split-ups.

Liquidation

liquidation of a company comes into picture when it faces problems like technological obsolesce ,financial loss, shortage of cash, lack of managerial skills .etc. the owner decide to stop further incurring of losses by going for the liquidation of the company. Generally it's a strategic motive.

Reverse Merger

Generally it's a normal practice in merger that a large company acquires a small one. but in case of reverse merger its smaller company acquires big one…like Mahindra tech acquired satyam computers. it may be motivated by tax benefit .The takeover by a smaller firm will also be more appropriate if it had a better record and more promising future. The reverse merger is often suggested as the best option to provide greater access to the capital markets, increase the company's visibility in the investment community, and offer the opportunity to utilize its stock to make acquisitions.

Acquisition

The term acquisitions are another uncertain term. Generally, it means attempts by one firm, called the acquiring firm to increase a majority interest in another firm called the target firm. The attempt to gain control may be a introduction to a subsequent merger to establish a parent subsidiary connection, to break up the target firm and set out of its assets or to take the target firm private by a small group of investors. There are a number of approaches that can be employed in corporate acquisitions like friendly takeovers, hostile takeovers etc. The specialist have engineered a number of strategies which frequently have strange nicknames such as shark repellents and poison pills terms which accurately express the real hostility involved.

Friendly takeover: - it's a kind of takeover in which the target firm's top management and board of directors are agreed for the takeover. In it a public offer of stock or cash is made by the acquiring company, and the board of the target firm will publicly agree to the buyout terms, which may yet be subject to shareholder or regulatory approval.

Example: - The takeover by the UK based Vodafone Air Touch and the German Mannesmann Gin February 2000.

Hostile takeover: - A hostile takeover is a type of corporate takeover which is carried out against the desires of the board of the target company. This is just the opposite of friendly takeover. The recent bid by Microsoft for yahoo may go to be one form of hostile takeover.

Demerger

Demerger is adapted as a business strategy to part business which doesn't contentedly merge with each other. Two businesses that are still together may have different needs to fulfill while they are still linked. It's a reorganization of a company or a group of companies in different companies or groups. it can be a step towards sale to another party. The demerger is also called as spin off or hiving off. After demerger the corporate body split into two or more corporate bodies having separate management and accountability. The main motive may be making each division as a profit centered organization to make each head of the division to account for profitability of their respective divisions.

Management Buyout

Management buy-out is the process of purchasing of the business by it's management when the existing owners wants that to soled out to third party. This can be so if the business is facing problems in it's functioning and growth. The existing management will come forward to purchase it from the owner and to run that in a perfect manner. This buy-out can be in part or this can be in total. in MBO the management will take away the powers from the owner. This MBO occurs when the owner faces problem in running the business and the life of the business is at stake. The management knows the strength and weakness of the business and hence can better bargain with this. The insider information available with the management will lead them to acquire a better stake. The purchase price is being financed by the management partly and the rest part is being arranged either through venture capital or through bank debt. Even when the case of family succession arises in business this MBO are also resorted. This helps in eliminating that part of the business which is facing problems and losses in running and also giving them to those persons who are really interested in running that part. The MBOs are used in restructuring the business and helps in eliminating the recessionary tendency in business.

Leveraged Buy-Out

This refers to a type of restructuring in which part of the acquiring money is being financed by debt. And this is generally done by a small group of investors. Generally the debt financing is up to 50% or more than that .the debt is secured by the assets of the acquired company and is usually amortized over a period of less than 10 years. In a typical LBO program the small group so to say the purchaser is being financed by buy-out specialist or investment bankers. The buy-out group may or may not include the present management of the target firm. Companies having serious operating problems that reflected in its financial statements are best leveraged buy-out candidate. The main objective of those who are invested in the company is to recover their investment.

Tracking Stock

A tracking stock is a individual type of stock issued by a publicly held corporation to track the value of one part of that company. The stock allows the diverse segments of the company to be valued differently by investors. For example a slow-growth company trading at a low price-earnings ratio (p/e ratio) ensues to have a fast mounting business unit. The company might issue a tracking stock so the market can value the new business disjointedly from the old one and at a considerably higher p/e rating. Why would a firm issue a tracking stock rather than spinning-off or carving-out its fast growth business for shareholders? The corporation keeps control over the subsidiary; the two businesses can carry on enjoying synergies and sharing marketing, managerial support functions, a headquarters and so on. The most significantly, if the tracking stock scales up in value, the parent corporation can use the tracking stock it owns to make acquisitions.

Still, shareholders require to keep in mind that tracking stocks are class B, means they don't grant shareholders the equal voting rights as those of the main stock. Every share of tracking stock may have merely a half or a quarter of a vote. In unusual cases, holders of tracking stock have no vote at all.

Implications of Corporate Restructuring

The corporate restructuring will result in to the followings:

- Market Players Get Reduced: due to this merger acquisition the companies who are generally weak or inefficient will either die or merged with other strong player.
- New Companies Will Emerge.: the companies after restructuring will become more competent enough to face the competitive world and will emerge as a new and strong company in the field of competition.
- Healthy Economic State of the Nation: the growth of the company will definitely lead and contribute to the growth of the nation.
- Social Discontent: large cases of lying off shutting down increasing number of sick units and increasing gap between the rich and the poor may prove to be a great national obstacle in the math of growth of national economy. also such phenomena will lead to political instability.

Conclusion

Today market- driven firms are selecting varied formats of restructuring commitments as part of their enduring transformation process to tackle the upcoming business threats and challenges and to enhance growth prospects. Corporate Restructuring is a realistic approach to save sick firms and driving poor performing companies to top performance. It blends proven restructuring programs with meticulous corporate analysis. The modern formats of corporate restructuring explain how to set and achieve asset, staffing, sales and profit goals. It involves resources allocation to keep a company alive during restructuring and how to use mergers and demergers offensively and defensively. Corporate Restructuring focuses on analysis, planning and implementation. All the restructuring theories in the world weigh less than a simple plan, well executed. Ratings agency Moody' s reports says SBI's competitive edge depends on its corporate restructuring strategies after assigning a 'Baa2' rating to the country's largest lender, implying moderate credit risk. During a time of global finanacial meltdown, one of the best ways to build goodwill and trust with stakeholders and customers can be to restructure or simplify the business. To do this effectively, businesses need thorough advice and guidance from business advisers who understand all the subtleties of corporate recovery. India's Corporate Recovery team has a successful track record of securing a future for companies in difficulty utilizing the benefits of corporate restructuring.

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