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CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION AND WINDING UP

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CH 01 – TYPES OF CORPORATE RESTRUCTURING

CORPORATE RESTRUCTURING - INTRODUCTION

Corporate Restructuring is an expression that refers to the restructuring process undertaken by a business enterprise. It is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives. In a nutshell, Corporate Restructuring means reorganizing a company or its business or its financial structure in such a way so as to make it corporate and work more efficiently.

Literally, it means **"To give a new structure to, rebuild or rearrange".**

There are primarily two ways of growth of business organization –

1. Organic Growth
2. Inorganic Growth

A company is said to be growing organically when the growth is through the internal sources without change in the corporate entity. Organic growth can be through capital restructuring or business restructuring.

Inorganic growth is the rate of growth of business by increasing output and business reach by acquiring new businesses by way of mergers, acquisitions and take-overs and other corporate restructuring strategies that may create a change in the corporate entity.

CORPORATE RESTRUCTURING – Need and Scope

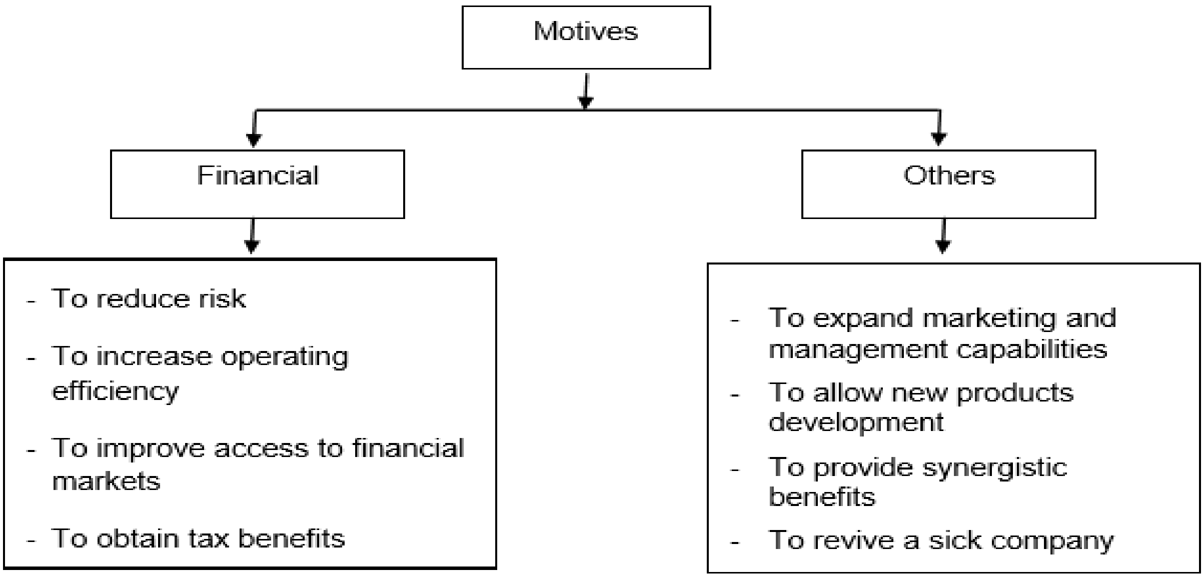
When a company wants to grow or survive in a competitive environment, it needs to restructure itself and focus on its competitive advantage. The survival and growth of companies in this environment depends on their ability to pool all their resources and put them to optimum use, a larger company, resulting from merger of smaller ones, can achieve economies of scale.

If the size of a company is bigger, it enjoys a higher corporate status. The status allows it to leverage the same to its own advantage by being able to raise larger funds at lower costs. Reducing the cost of capital translates into profits. Availability of funds allows the enterprise to grow in all levels and thereby become more and more competitive.

The various needs for undertaking a Corporate Restructuring exercise and its scope are as follows:-

A. *To enhance shareholders value*
B. *Orderly redirection of the firms activities*
C. *Deploying surplus cash from one business to finance profitable growth in another*
D. *Exploiting inter-dependence among present or prospective businesses*
E. *Risk reduction*
F. *Development of core-competencies*
G. *To obtain tax advantages by merging a loss-making company with a profit-making company*
H. *To have access to better technology*
I. *To become globally competitive*
J. *To increase the market share*

CORPORATE RESTRUCTURING – MOTIVES



KINDS OF RESTRUCTURING

The Restructuring exercise can be classified into different types based on the motive with which it is done. Generally, the different methods of corporate restructuring can be divided into these types-

Financial Restructuring	• which deals with the restructuring of capital base and raising finance for new projects. This involves decisions relating to acquisitions, mergers, joint ventures and strategic alliances
Technological Restructuring	• alliances which involves, inter alia, alliances with other companies to exploit technological expertise
Market Restructuring	• which involves decisions with , respect to the product market segments, where the company plans to operate based on its core competencies
Organisational Restructuring	which involves decisions with respect to the product market segments, where the company plans to operate based on its core competencies

TOOLS /MODES OF CORPORATE RESTRUCTURING

The Corporate Restructuring exercise can be undertaken with the help of a number of tools. Some of the most commonly used tools are discussed hereunder.

Merger

A merger can be defined as the fusion or absorption of one company by another. It is understood as an arrangement, whereby the assets of two (or more) companies get transferred to, or come under the control of one company (which may or may not be one of the original two companies).

A merger means absorption of one company by another company, wherein at least one of the two existing companies loses its legal identity after transferring all its assets, liabilities and other properties to the other company.

Mergers may be of the following types-

Horizontal Merger: *It is a merger of two or more companies that compete in the same industry. It is a merger with a direct competitor and hence expands as the firm's operations in the same industry.*

Vertical Merger: *It is a merger which takes place upon the combination of two companies which are operating in the same industry but at different stages of production or distribution system. If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities. On the other hand, Forward integration may result if a company decides to take over the retailer or Customer Company.*

Co generic Merger: *It is the type of merger, where two companies are in the same or related industries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger.*

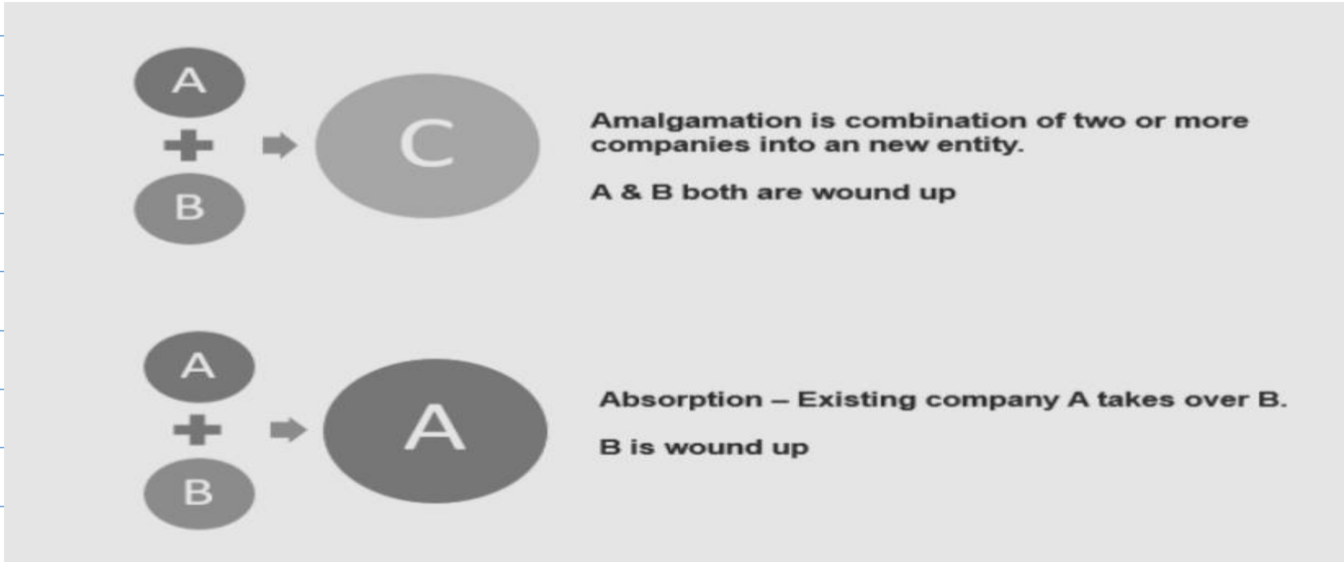
Conglomerate Merger: *These mergers involve firms engaged in unrelated type of activities i.e. the business of two companies are not related to each other horizontally nor vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology.*

Following are the benefits of Mergers –

- *Becoming bigger*
- *Preempted competition*
- *Domination*
- *Tax benefits*
- *Economies of scale*
- *Acquiring new technology*
- *Improved market reach and industry visibility*
- *Improved standing in the investment community*

Amalgamation

Amalgamation is an 'arrangement' or 'reconstruction'. Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another and as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or the amalgamated company.



Example – Idea - Vodafone, Flipkart – eBay, Bank of Baroda – Vijaya Bank – Dena Bank.

Takeover / Acquisition

The term takeover is not defined in the Companies Act, 1956. Broadly speaking, takeover refers to acquisition of company by another company. Takeover is an acquisition of shares carrying voting rights in a company with a view to gain control over the management of the company, it takes place when an individual or a group of individuals or a company acquires control over the assets of a' company either by acquiring majority of its shares or by obtaining control of the management of the business and affairs of the company.

Example – Ola – TaxiforSure, Flipkart – Myntra.

Demerger

Demerger is an arrangement in which a single business is broken into components, either to operate on their own, to be sold or to be dissolved. It is the process whereby some part / undertaking of one company is transferred to another company which operates completely separate from the original company. The shareholders of the original company are usually given an equivalent stake of ownership in the new company.

Types of Demerger

Divestiture - Divestiture means selling or disposal of assets of the company or any of its business undertakings/divisions, usually for cash (or for a combination of cash and debt).

Spin-offs - The shares of the new entity are distributed to the shareholders of the parent company on a pro-rata basis. The parent company also retains ownership in the spun-off entity.

Splits / Divisions - Splits involve dividing the company into two or more parts with an aim to maximize profitability by removing stagnant units from the mainstream business. Splits can be of two types, Split-ups and Split-offs.

> ***Split-ups:*** It is a process of reorganizing a corporate structure whereby all the capital stock and assets are exchanged for those of two or more newly established companies resulting in the liquidation of the parent corporation.
>
> ***Split-offs:*** It is a process of reorganizing a corporate structure whereby the capital stock of a division or subsidiary of corporation or of a newly affiliated company is transferred to the stakeholders of the parent corporation in exchange for part of the stock of the latter.

Equity Carve-Outs - Equity carve-outs are referred to a percentage of shares of the subsidiary company being issued to the public. Equity carve outs result in publicly trading the shares of the subsidiary entity.

Example – L&t – Ultratech Cement.

Disinvestment

Disinvestment refers to the transfer of the assets/shares/control from the government to the private sector. The concept of Public Sector Undertakings Disinvestment takes different forms ie from minimum government investment (privatization) to partnership with private sector, where the government is the majority shareholders.

Joint Venture

It is a strategic business policy whereby a business enterprise for profit is formed in which two or more parties share responsibilities in an agreed manner, by providing risk capital, technology, patent, trademark, brand names and access to markets.

Types Of Joint Ventures

Equity-based joint ventures is a type of joint venture in which two or more parties set-up a separate legal company to act as the vehicle for carrying out the project.

Non-equity joint ventures also known as cooperative agreements, seek technical service arrangements, franchise, brand use agreements, management contracts, rental agreements, or one-time contracts, e.g., for construction projects, non-equity arrangements in which some companies are in need of technical services or technological expertise than capital.

Example – Tata Starbucks

Strategic Alliance

Strategic Alliance means any arrangement or agreement under which two more companies cooperate in order to achieve certain commercial objectives. Strategic alliances are often motivated by consideration such as reduction in cost technology sharing, product development, market access to capital.

Example – Nike, Puma.

Slump Sale

Section 2 (42C) of the Income Tax Act, 1961, recognizes 'Slump-sale' as a transfer of an 'undertaking' i.e. a part or a unit or a division of a company, which constitutes a business activity when taken as a whole. It is a transfer of one or more undertakings as a result of sale for a lump sum consideration, without values being assigned to the individual assets and liabilities in such sale. Sale includes transfer of an asset from one person to another for some consideration, where consideration can be in kind or cash.

Management Buyout

A management buyout (MBO) is a transaction where a company's management team purchases the assets and operations of the business they manage.

Reverse Merger

A reverse merger is a merger in which –

a) a private company becomes a public company by acquiring it
b) a weaker or smaller company acquires a bigger company
c) a parent company merges into its subsidiary
d) a loss-making company acquires a profit-making company

Reasons for reverse merger –

- ✓ To carry forward tax losses of the smaller firm
- ✓ Economies of scale of production
- ✓ Marketing network
- ✓ To protect the trademark rights, licence agreements, assets of small/loss making company

LEGAL FRAMEWORK OF CORPORATE RESTRUCTURING

Corporate Restructuring in India is governed by the following Acts, Rules, etc.:

- ✓ Chapter XV of The Companies Act, 2013 (the Act)
- ✓ Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016
- ✓ Income Tax Act, 1961
- ✓ Accounting Standards
- ✓ Foreign Exchange Management Act,1999
- ✓ Competition Act, 2002
- ✓ Intellectual Property Rights
- ✓ Indian Stamp Act, 1899
- ✓ State Stamp Acts
- ✓ Insolvency and Bankruptcy Code, 2016

CHAPTER XV- COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS

Section 230 - *Power to Compromise or Make Arrangements with Creditors and Members*

Section 231- *Power of Tribunal to Enforce Compromise or Arrangement*

Section 232 - *Merger and Amalgamation of Companies*

Section 233 - *Merger or Amalgamation of Certain Companies*

Section 234 - *Merger or Amalgamation of Company with Foreign Company*

Section 235 - *Power to Acquire Shares of Shareholders Dissenting from Scheme or Contract Approved by Majority*

Section 236 - *Purchase of Minority Shareholding*

Section 237- *Power of Central Government to Provide for Amalgamation of Companies in Public Interest*

Section 238 - *Registration of Offer of Schemes Involving Transfer of Shares*

Section 239 - *Preservation of Books and Papers of Amalgamated Companies*

Section 240 - *Liability of Officers in Respect of Offences Committed Prior to Merger, Amalgamation, etc.*

CS Vaibhav Chitlangia is one of the very few people to have completed the Company Secretary Course at the age of 21 with All India Ranks at all the three levels. He got the All India Rank 15 in Foundation Programme (June 2016), All India Rank 22 in Executive Programme (June 2017) and All India Rank 04 in the Professional Programme (June 2018).

Vaibhav's interests include Mergers and Amalgamations, Competition Laws and Insolvency and Bankruptcy Code, amongst others. He also has prior experience in teaching subjects like Corporate Restructuring and Resolution of Corporate Disputes to the students of CS Professional Programme. He believes that

"the only impediment in the path of success is a person's own mind; if that is controlled, every feat is achievable"

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