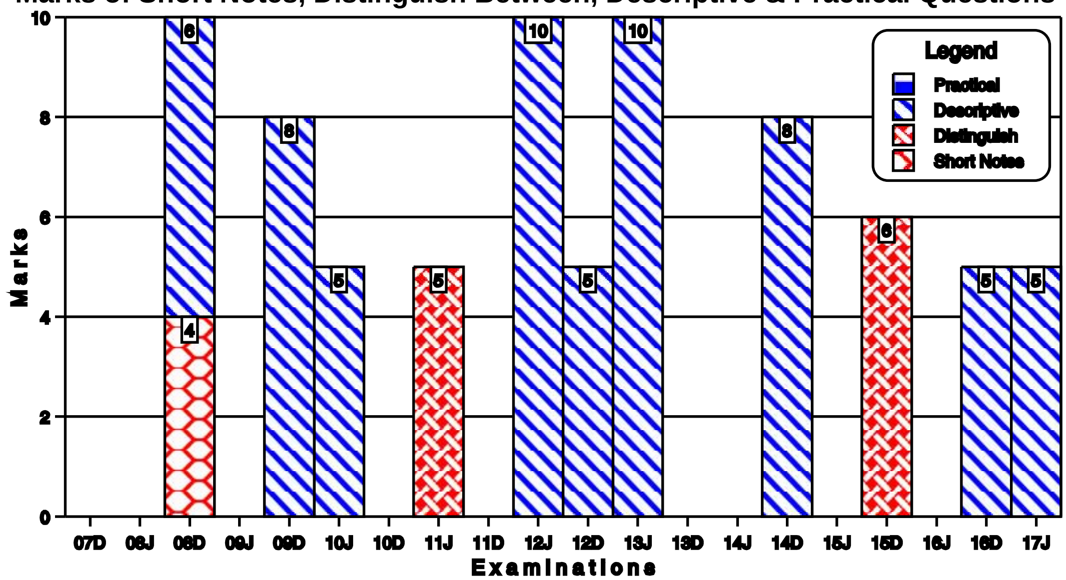
1 CORPORATE RESTRUCTURING - INTRODUCTION AND CONCEPTS

THIS CHAPTER INCLUDES

- Meaning of Corporate Restructuring
- Need & Scope of Corporate Restructuring
- Various Modes of Restructuring
- Historical Background
- Emerging Trends
- Planning formulation execution of various restructuring strategies
- Role of professionals in restructuring process

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



Questions of Dec. 2008 are from CS Final Gr. II Old Course and from June 2009 onwards are from CS Professional Programme New Course.

CHAPTER AT A GLANCE

Topic	Important Highlight
1. Corporate Restructuring	Restructuring is a mean whereby the organisational structure is changed so that the organisation accomplishes its objectives. 'Corporate Restructuring' is a term of wider importance and covers in its ambit restructuring or reorganizing or financial restructuring of any organisation done in order to operate more effectively and efficiently.
2. Need of Corporate Restructuring	The various needs for undertaking a Corporate Restructuring exercise are as follows: (i) to focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure. (ii) consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets. (iii) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company. (iv) acquiring constant supply of raw materials and access to scientific research and technological developments. (v) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed. (vi) improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

3.	**Types of Corporate Restructuring Strategies**	Various types of corporate restructuring strategies include: 1. Merger 2. Demerger 3. Reverse Mergers 4. Disinvestment 5. Takeovers 6. Joint venture 7. Strategic alliance 8. Slump Sale 9. Franchising 10. Strategic alliance etc.
4.	**Merger**	It is the absorption or fusion of one company by another. It is an arrangement whereby the assets of two or more companies come under the control of one company. Thus, one of the two existing company looses its identity & gets merged with another.
5.	**Demerger**	As per the Rules made under Chapter XV of the Companies Act, 'demerger' in relation to companies means transfer, pursuant to scheme of arrangement by a 'demerged company' of its one or more undertakings to any 'resulting company' in such a manner as provided in Section 2(19AA) of the Income Tax Act, 1961, subject to the shares been allotted by the 'resulting company' to the shareholders of the 'demerged company' against the transfer of assets and liabilities.
6.	**Reverse Merger**	Reverse Merger is said to have taken place when a healthy company merges with a financially weak company. Reverse merger lures a large number of companies since they allow the companies to grab the advantage of carry forward of losses & thus avail tax benefits.

7. Disinvest-ment	Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".
8. Takeover/ Acquisition	Takeover means an acquirer takes over the control of the target company. It is also known as acquisition. Takeover can be Friendly Takeover or Hostile Takeover.
9. Joint Venture (JV)	Joint venture is a venture in which an enterprise is formed with participation in the ownership, control and management of minimum of two parties. In joint venture, a business enterprise is formed for profit in which parties of joint venture share responsibilities in an agreed manner, by providing risk capital, technology, trade mark & access to market, etc.
10. Strategic Alliance	Alliance means an agreement between two or more organisation to cooperate with each other to accomplish their common goals and to strive for the benefits of both of them. It is an understanding between firms whereby resources capabilities & core competencies are combined to pursue mutual interests.
11. Franchising	Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce and market goods or services according to certain specifications.
12. Slump sale	Slump sale means the transfer of one or more undertaking as a result of the sale for a lumpsum consideration without value being assigned to the individual assets and liabilities in such sales.

13. Role of professionals in corporate restructuring process	a. Role of professionals in corporate restructuring is increasing day by day. b. Corporate restructuring involves decision on various technical and legal aspects such as valuation of organizations involved in restructuring process, swap ratio of shares if any, legal and procedural aspects with regulators such as Registrar of Companies, Tribunal etc., optimum tax benefits after merger, human and cultural integration, stamp duty cost involved etc. c. All these requires team of professionals including business experts, Company Secretaries, Chartered Accountants, HR professionals, etc., who have a role to play in various stages of restructuring process.

SHORT NOTES

2008 - Dec [8] (b) Write short note on the following :

(i) Slump sale **(4 marks)**

Answer :

- Slump sale refers to any transaction whereby the whole or substantially the whole of the undertaking is sold at lump-sum consideration without assigning values to individual assets.
- In such a case value of individual assets or liabilities is not determined, just the aggregate figure is known.
- Slump sale is an effective method for implementation of strategies.
- Under slump sale, a Business Transfer Agreement is to be drafted which chalks out the transfer of business to the buying company. In slump sale the seller normally fixes a lump sum price called ‘slump price’.

DISTINGUISH BETWEEN

2011 - June [2] (a) What is the difference between 'compromise' and 'arrangement'? **(5 marks)**

Answer:

Compromise and Arrangement

The word arrangement means reorganization of share capital of the company by consolidation of shares of different classes or division into different classes of shares or both.

On the other hand compromise presupposes the existence of a dispute which it seeks to settle.

The word arrangement has a wider meaning when compared to compromise.

Arrangement may include reorganization of the share capital, takeover of shares of one company by another.

2015 - Dec [3] (b) Distinguish between 'demerger' and 'slump sale'. **(6 marks)**

Answer:

Demerger: As per the Rules made under Chapter XV of the Companies Act, 'demerger' in relation to companies means transfer, pursuant to scheme of arrangement by a 'demerged company' of its one or more undertakings to any 'resulting company' in such a manner as provided in Section 2(19AA) of the Income Tax Act, 1961, subject to the shares been allotted by the 'resulting company' to the shareholders of the 'demerged company' against the transfer of assets and liabilities. Section 232 deals with mergers and amalgamation including demergers. AS-14 is not applicable in demerger.

Slump Sale: Slump sale means the transfer of one or more undertaking as a result of the sale for a *lump sum* consideration without value being assigned to the individual assets and liabilities in such sales.

Both demerger and slump sale results in hiving of a division or undertaking, but there are various differences which are as follows:

1. In case of slump sale, values are not assigned to individual assets and liabilities and the sale, of undertaking is for a *lump sum* consideration. Whereas in demerger, valuation of individual assets and liabilities are mandatory.
2. In case of demerger, the resulting company has to continue the business of transferred undertaking of demerged company, while it is not so in the case of slump sale.
3. Demerger unlike slump sale results into reorganization of capital.
4. In case of demerger, the shareholders of demerged company has to be issued shares of resulting company and in case of slump sale, the issue of shares does not take place.
5. In slump sale through amalgamation and merger AS -14 will be applicable.

DESCRIPTIVE QUESTIONS

2008 - Dec [6] (a) What do you mean by 'corporate restructuring'? What are the different kinds of restructuring? **(6 marks)**

Answer :

Corporate Restructuring

⇒ The term 'restructuring' means to rebuild or rearrange.

⇒ Restructuring is a means whereby the organisational structure is changed so that the organisation accomplishes its objectives.

⇒ 'Corporate Restructuring' is a term of wider importance and covers in its ambit restructuring or reorganizing or financial restructuring of any organisation done in order to operate more effectively and efficiently.

Different kinds of restructuring are as follows :

⇒ **Financial Restructuring :** It takes into account restructuring using the capital base and deals with the acquisitions & takeovers, mergers and amalgamation & like strategies.

⇒ **Organisational Restructuring :** It deals with reforming procedures and changing the organisational structure so as to adopt the organisation to cater to the changing environment.

⇒ **Market Restructuring :** The purview of market restructuring is with regards to restructuring of the product market segments.

⇒ **Technological Restructuring :** As the very name suggest, technological restructuring is the one to gain technological expertise by entering into alliance with other organisations.

2009 - Dec [2] (a) “Section 230 is a boon to the corporate restructuring”. Critically examine the statement and discuss the relevant provisions relating to corporate restructuring. **(8 marks)**

Answer :

- Corporate restructuring is a term of wider importance and cover in its ambit restructuring or reorganising or financial restructuring of any organisation.
- **Section 230 of the Companies Act** is surely a boon for corporate restructuring.
- **Section 230** is a complete code in itself and constitutes a single window clearance system.
- The said section gives enormous powers to the Tribunal to sanction the scheme of arrangement or compromise.
- In the case of ‘Oceanic Steam Navigation Co’. it was held that **Section 230** contemplates a compromise between a company and its creditors or any class of them, or its members or class of them and also provides a mechanism whereby such a compromise or arrangement may be binding on other persons too.

  Following persons can make application under Section 230 to the Tribunal for the purpose of calling meeting of creditors/members as the case may be with the company for compromise and arrangement.

  1. The Company
  2. Creditor/Member
  3. Liquidator in case of the company being wound up.

2010 - June [2] (b) Define 'corporate restructuring'. What are the various kinds of restructuring? **(5 marks)**

Answer :

Please refer 2008 - Dec [6] (a) on page no. 25

2012 - June [1] {C} (b) What is meant by 'strategic alliance' and what are its features?

(c) "A conglomerate merger is neither a type of horizontal merger nor a vertical merger." Discuss. **(5 marks each)**

Answer :

(b) Strategic alliance is a relationship between two or more parties to pursue a set of agreed upon goals or to meet a critical business need while continuing to remain independent organisation.

Some of the features of strategic alliance are as follows:-

(i) It aims for a synergy where each partner hopes that the benefits from the alliance will be greater than those from individual efforts.

(ii) Alliance often involves technology transfer, economic specialisation, shared expenses, reduction in cost, etc.

(iii) It is gaining importance in infrastructure sectors.

(iv) Strategic alliance aims to pool the resources and facilitate innovative ideas and techniques while implementing large projects.

(v) It could help company to develop a more effective process, expand into a new market or develop an advantage over a competitor, among other possibilities.

Answer:

(c)
- Conglomerate merger is a merger between firms that are involved in totally unrelated business activities.
- The companies, which are merged are neither competitors nor complimentaries.
- The business of these companies are neither horizontally nor vertically related to each other.
- Merging companies operate in unrelated markets.
- Conglomerate mergers are merger of different kinds of businesses under one flagship company.
- Thus conglomerate merger is neither a type of horizontal merger nor a vertical merger.

2012 - Dec [1] {C} (c) As per the provisions of the Companies Act, 2013 and the Income-tax Act, 1961 there is no difference between de-merger and slump sale; though it results in separation of a division or unit of an existing company to a potential buyer. But in common parlance, it means rightward and leftward, *i.e.*, totally different approach from one to another. The first requires no payment but second requires down payment. But the ultimate objective is to hive off some business which is not compatible with the core business competency of the main company.

Discuss the eventuality in conjunction with the provisions of the Income-tax Act, 1961. **(5 marks)**

Answer:

Demerger:

Section 2(19AA) prescribes certain conditions to be fulfilled , for demerger, which are as below :

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become share-holders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Slump Sale:

Slump sale means the transfer of one or more undertaking as a result of the sale for a *lump sum* consideration without value being assigned to the individual assets and liabilities in such sales.

Both demerger and slump sale results in hiving of a division or undertaking, but there are various differences which are as follows:

1. In case of slump sale, values are not assigned to individual assets and liabilities and the sale, of undertaking is for a *lump sum* consideration. Whereas in demerger, valuation of individual assets and liabilities are mandatory.
2. In case of demerger, the resulting company has to continue the business of transferred undertaking of demerged company, while it is not so in the case of slump sale.
3. Demerger unlike slump sale results into reorganization of capital.
4. In case of demerger, the shareholders of demerged company has to be issued shares of resulting company and in case of slump sale, the issue of shares does not take place.

2013 - June [1] {C} (a) "Corporate restructuring aims to achieve certain predetermined objectives at corporate level." Comment and explain how corporate restructuring would help bringing an edge over competitors.

(b) "In the modern business world, the strategic alliance and joint venture both have the same objective and end result, i.e., pooling of resources, technologies and expertise, etc. to increase the market share, to enter into a new business and so on." Comment on this statement highlighting the basic differences between the two. **(5 marks each)**

Answer :

(a) ● 'Corporate Restructuring' is a term of wider importance and covers, in its ambit, the restructuring or reorganizing or financial restructuring of any organisation done in order to operate more effectively & efficiently.

- **Objective of corporate restructuring:**
  - Re - direction of the company and activities.
  - Risk reduction.
  - Deploying surplus cash from one business to another business.
  - Development of core-competencies.
- Corporate restructuring helps in bringing an edge over competitor. It aims at exploiting the strategic assets accumulated by a business i.e. natural monopolies, goodwill, etc.
- In order to drive a competitive force, corporate restructuring strategies such as merger & acquisitions exercise could be taken up that would bring an edge over competitors.

Answer:

(b) Strategic Alliance:

- Alliance means an agreement between two or more organisation to cooperate with each other to accomplish their common goals and to strive for the benefits of both of them.
- It is an understanding between firms whereby resources capabilities & core competencies are combined to pursue mutual interests.

Joint Venture:

- Joint venture is a venture in which an enterprise is formed with participation in the ownership, control and management of minimum of two parties.
- In joint venture, a business enterprise is formed for profit in which parties of joint venture share responsibilities in an agreed manner, by providing risk capital, technology, trade mark & access to market, etc.

2014 - Dec [2A] (Or) (iii) Explain the concept of 'vertical merger' and differentiate between 'forward integration' and 'backward integration'.

(5 marks)

Answer:

Vertical Merger:

- Vertical Merger is one of the types of 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.
- Vertical merger provides a way for total integration to those firms which are striving for owning of all phases of the production schedule together with the marketing network.

Forward Integration:

Forward integration may result if a company decides to take over the retailer or Customer Company.

Backward Integration:

If a company takes over its supplier/producers of raw material, then it may result in backward integration of its activities.

2014 - Dec [3] (d) Good Earth Pvt. Ltd. wants to become a public listed company without opting for initial public offer (IPO). What is the best strategy available for the company? Distinguish the same from 'strategic alliance'.

(3 marks)

Answer:

Reverse merger is the opportunity for the unlisted companies to become public listed company, without opting for Initial Public offer (IPO). In this process the private company acquires the majority shares of public company, with its own name.

Strategic Alliance: Any agreement between two or more parties to collaborate with each other, in order to achieve certain objectives while continuing to remain independent organizations is called strategic alliance.

2016 - Dec [1] (a) "Corporate restructuring aims at different things at different times for different companies but the single common objective in every restructuring exercise is to eliminate the disadvantages and combine the advantages." Comment on the statement highlighting various needs for undertaking corporate restructuring. **(5 marks)**

Answer:

The various needs for undertaking a Corporate Restructuring exercise are as follows:

(i) To focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.
(ii) Consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.
(iii) Revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.
(iv) Acquiring constant supply of raw materials and access to scientific research and technological developments.
(v) Capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.
(vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

2017 - June [1] (c) Discuss "Strategic Alliance" and "Joint Venture" as corporate restructuring strategies. **(5 marks)**

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Define 'corporate restructuring'. What are the various kinds of restructuring? 08 - Dec [6] (a), 10 - June [2] (b)	2 Times

Table Showing Marks of Compulsory Questions										
Year	**12 D**	**13 J**	**13 D**	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**
Descriptive	5	10								
Total	5	10								