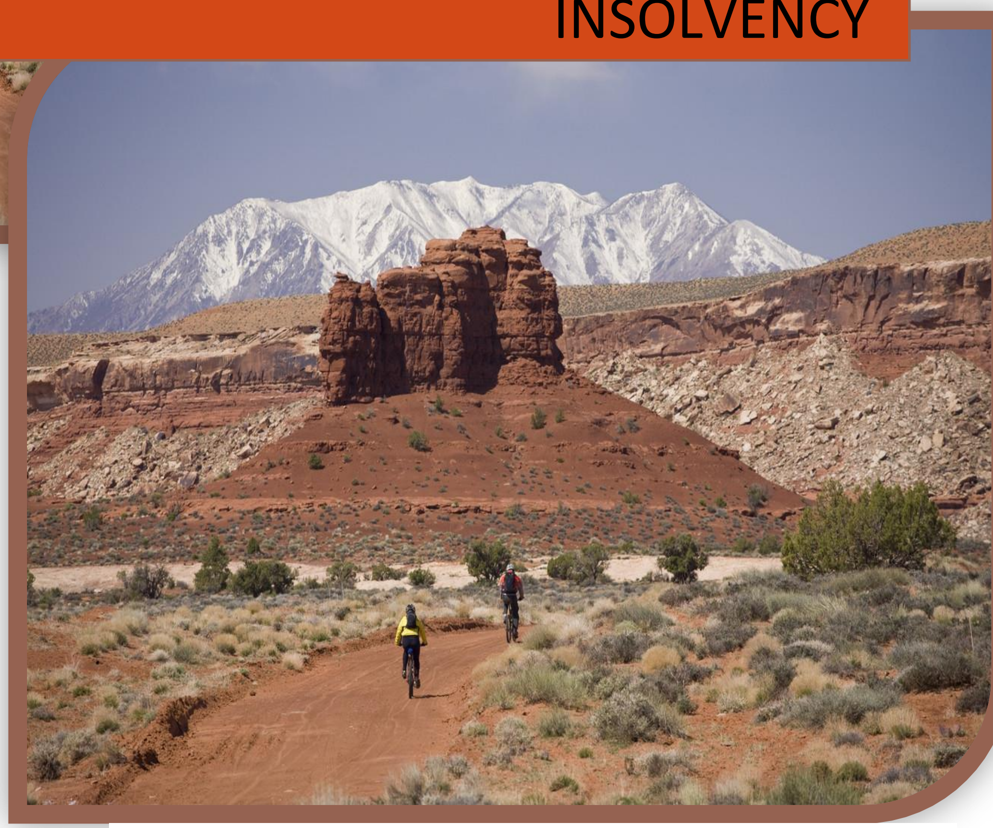
CORPORATE RESTRUCTURING, VALUATIONS AND INSOLVENCY



CA Akhil Mittal
Dishaan Commerce Academy
www. dcacademy.co.in

Summary

PART A : Corporate Restructuring (50 Marks)

PART B : Valuation (30 Marks)

PART C : Insolvency (20 Marks)

PART A

Corporate Restructuring

(50 Marks)

Chapter-1
Corporate Restructuring – Introduction & Concepts

(A) Introduction:
There are two types of growth of business organization i.e. **organic and inorganic.** Both are different from each other in terms of the motive with which they are achieved:

Organic growth→
It is achieved through internal strategies, which may relate to business or financial restructuring that result in **enhanced customer base, higher sales, and increased revenue.**

In-Organic growth→
Provides entity with an avenue for accelerated growth enabling it to skip few steps. Restructuring through mergers, amalgamation etc. constitute one of the most important way for securing inorganic growth.

(B) Meaning Of Corporate Restructuring:
Corporate Restructuring is defined as the process-
- Involved in changing the organization of a business.
- Involves dramatic changes to business by cutting/merging department.
- Implying rearranging the business for increased efficiency and profitability.

(C) Need and Scope of Corporate Restructuring:
Corporate Restructuring is concerned with the arrangement of business activities of the company as a whole to achieve certain predetermined objectives. This objective includes:

- Orderly redirection of firm's activities.
- Risk Reduction
- Development of Core competencies.
- Exploiting inter-dependence among present or perspective business.
- Deploying surplus cash from one business to finance profitable growth in another.

The various needs for undertaking a Corporate Restructuring exercise are as follows:
- To focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.
- Consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.
- Revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.
- Acquiring constant supply of raw materials and access to scientific research and technological developments.
- Capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.
- Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

(D) Planning, formulation and execution of various restructuring strategies:

Corporate restructuring strategies:
depends on the nature of business, type of diversification required and results in profit maximization through pooling of resources in effective manner, utilization of idle resources, effective management of competition etc.,.

Planning the type of restructuring:
Requires detailed business study, expected business demand, available resources, utilized/idle portion of resources, competitor analysis, environmental impact etc., The bottom line is that the right restructuring strategy provides optimum synergy for the organizations involved in the restructuring process.

Important aspects to be considered while planning or implementing corporate restructuring strategies.

Code to Remember: H.C.L. का V.A.T.

- Human and Cultural synergies
- Competition aspects etc.
- Legal and procedural Issues.
- Valuation & Funding
- Accounting aspects
- Taxation and Stamp duty aspects

Various types of corporate restructuring strategies include:

1. Merger

Horizontal Merger: { Merger in Same industry }
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. Horizontal mergers are designed to achieve economies of scale and result in reduce the number of competitors in the 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**.**

Backward Merger: When a company takes over other company's suppliers/producers of raw material.
Forward Merger: If a company decides to take over the retailer or Customer Company.

Co generic Merger: : { Different but related products}
- Where two companies are in the same correlated 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
- There are no important common factors between the companies in production, marketing, research and development and technology.
- E.g., a watch manufacturer acquiring a cement manufacturer.

2. Demerger: A company segregated into manageable part

It is a form of corporate restructuring in which the entity's business operations are segregated into one or more components. A demerger is often done to help each of the segments operate more smoothly, as they can focus on a more specific task after demerger.

3. Reverse Mergers: Private company acquiring a public Company

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.

This type of merger is dome by the private company so that it can bypass the lengthy and complex process of going public.

4. Disinvestment: Organization selling assets/subsidiary

Disinvestment means the action of an organization or government selling or liquidating an asset or subsidiary. It is also known as "divestiture".

5. Takeovers: Control over the target company

Takeover means an acquirer takes over the control of the target company. It is also known as acquisition. Normally this type of acquisition is undertaken to achieve market supremacy. It may be:

Friendly takeover → One company takes over the management of the target company with the permission of the board.

Hostile takeover→ One company takes over the management of the target company without its knowledge and against the wish of their management.

6. Joint venture: Combination of 1+ companies to business together

A joint venture is an entity formed by two or more companies to undertake financial activity together. The parties agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. It may be Project based joint venture or Functional based joint venture.

Project based Joint venture→ The joint venture entered into by the companies in order to **achieve a specific task** is known as project based JV.

Functional based Joint venture→ The joint venture entered into by the companies in order to achieve **mutual benefit** is known as functional based JV.

7. 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.

8. Slump Sale:

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

If a company sells or disposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale.

9. 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.

The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty and gains.

(E) Salient Features of Companies Act, 2013 relating to Corporate Restructuring (Section 230- 240)

■ National Company Law Tribunal to assume jurisdiction of High Court.	
Section 230(2)	**Application for compromise or arrangement + Affidavit** An Application for compromise or arrangement to be accompanied by an affidavit, disclosing- 1. All **material facts** relating to the company. 2. **Reduction of capital** if any included in the compromise or arrangement; 3. Any **scheme of** corporate debt **restructuring consented** to by **not less than 75% of the secured creditors** in value + Creditor's responsibility statement + Report of the auditor as to the funds requirement after CDR + Conformity to liquidity test etc.
Proviso to Section 230(3)	Notice relating to compromise or arrangement and other documents to be placed on the website of the company.
Section 230(5)	**Notice of meeting for approval of the scheme of compromise/ arrangement** Notice of meeting for approval of the scheme of compromise or arrangement be sent to various regulators including: ■ Central Government. ■ Reserve Bank of India. ■ Respective Stock Exchange. ■ SEBI etc.

Proviso to Section 230(4)	**Persons entitled to object the scheme of compromise or arrangement:** ■ Persons holding not less than 10% of the shareholdings; or ■ Persons having outstanding debt amounting to not less than 5% of the total outstanding debt As per the latest audited financial statement.
Proviso to Section 230(7)	**No sanction for Compromise or arrangement if accounting treatment is NO AS compliant**.
Section 234	Cross border Merger permitted. The 1956 act permits merger of foreign company with Indian company and not vice versa.
Section 233 (10)	**Abolishing the practice of companies holding their own shares** Through a trust (Treasury Stock) in case of merger of holding and subsidiary companies. Ultimately the shares are to be cancelled.
Section 233	**Fast track mergers introduced.**

(F) Winding Up: Section 2(94A)

Defines the term winding up to means winding up under the Companies Act, 2013 or liquidation under the Insolvency and Bankruptcy Code, 2016.

Following are the modes by which company can be wound up:

By	*National Company Law Tribunal (Tribunal)*	*Under*	***Part I*** ***Chapter XX*** *of the Companies Act, 2013*
By	Voluntary Liquidation	under	**Part II** **Chapter V** of the Insolvency and Bankruptcy Code, 2016

(a) Following are instances where company can be wound up by Tribunal:

- If the company, **by special resolution,** resolved that company be wound up by the Tribunal. (स्वयं के द्वारा)
- If the company has acted against the interests of the sovereignty and integrity of India.
- If on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner.
- If the company has made a default in filing with the Registrar its financial statement or annual returns **for immediately** preceding **5 consecutive financial years.**
- if the Tribunal is of the opinion that it is just and equitable that the company should be wound up

(b) An application for the winding up of a company has to be made by way of petition to the Tribunal by any of the following persons:

1. The company;
2. Any contributory or contributories;
3. All or any of the persons specified in clauses (a) and (b);
4. The Registrar;
5. Any person authorized by the Central Government in that behalf; or
6. In a case falling under clause (b) of section 271, by the Central Government or a State Government.

Voluntary Winding up

The provisions relating to Voluntary Winding Up of Companies under the Companies Act, 2013 are omitted vide MCA Notification No. F.O. 3453(E) dated 15th November, 2016 and notified Section 255 of the Insolvency and Bankruptcy Code, 2016 which refers to the eleventh Schedule of the Insolvency and Bankruptcy Code, 2016.