

## CORPORATE RESTRUCTURING - A FINANCIAL STRATEGY

Vikas Srivastava<sup>1</sup>

Ms. Ghausia Mushtaq<sup>2</sup>

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### ABSTRACT

*This paper serves the very purpose of defining the corporate restructuring as a financial strategy adopted towards the financial development and enhancement of an organization suffering from a major set back at any level of operation.*

*Technological advancement and environmental or political – legal changes and policies enable the companies to move in the direction routed by the changing environment of the new era. There is a lot of competition in almost all respect as there is not only the survival of the fittest but also the wittiest. In phase of rapid industrialization, only those organization will survive which will create and able to deliver the maximum value as satisfaction to their customers.*

*The corporate restructuring, as the financial strategy, will make an effect on the overall cost of capital or will have an effort to bring it to the lowest so that the changes with respect to various operational and functional activities of the organization will be taken care of by the organizational changes.*

*Corporate restructuring is one of the most complex and fundamental phenomena that management experiences. Each company has two opposing objectives from which it has to choose: to diversify or to refocus on its core business. Financial restructuring involves the redeployment of corporate assets through divestures of business lines that are considered peripherals of the core business strategy. Significant changes in corporate capital structure are termed as financial restructuring.*

### 1.0 INTRODUCTION

With rapid advances in information technology and acute resources constraints across the globe, the business world has become more complex and fluid in recent times. To survive and compete the present day organizations should do away with their existing culture,

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<sup>1</sup> Mr. Vikas Srivastava – Assistant Professor, Gyan Institute of Management, Lucknow.

<sup>2</sup> Ms. Ghausia Mushtaq – Assistant Professor, Gyan Institute of Management, Lucknow.

policies, structure and start with a clean sheet. They have to put more emphasis on the business process as a whole and do everything to keep the smile on the customer's face. Corporate restructuring implies activities related to expansion or contraction of operations or changes in its assets or financial or ownership structure:

Restructuring starts with its very purpose .It began with the redefining or researching of the purpose of doing business.

Once the purpose is adequately redefined, scope for restructuring surfaces. Sometimes it also happens that realization of the scope for restructuring may bring you back to the purpose and you start rethinking about the purpose.

Business restructuring therefore may be approximately defined as a conscious effort to restructure policies, programs, products, processes and people, to serve the redefined purpose on a sustainable basis, because most of the restructuring exercises are carried out with an impulsive reaction to the market variables or internal problems, without a serious attempt of looking at long term results.

Externally the organization must reach for new products, new service and new market opportunities. Working with suppliers, distributors and customers to redefine markets and industries. Internally structures and management styles must be capable of creating and delivering these products and services. Strategic awareness, information management and change are very important if the organization wants to get a head of its competitors.

Corporate restructuring, thus involves destroying old paradigms, old technology, old ways of doing things and starting all over afresh.

## **II.0 TECHNIQUES OF RESTRUCTURING**

<i>Expansion Techniques</i>	<i>Divestment Techniques</i>	<i>Other Techniques</i>
• Merger	• Sell Off	• Going Private
• Takeover	• De-Mergers	• Share Repurchasing
• Joint Ventures	• Slump Sale	• Management Buy In

• Strategic Alliance	• Management Buy Out	• Reverse Merger
• Franchising	• Leverage Buy Out	• Equity Crave Out
• IPRS	• Liquidation	
• Holding Companies		

The restructuring process can be divided into two broader parts as detailed below:

### **II.1 HARDWARE RESTRUCTURING**

It involves redefining, dismantling, or modification of the existing structure of the organization

Identification of core competency

Flattening of organization layer

Downsizing

Creation of self directed teams

Benchmarking

### **II. 2 SOFTWARE RESTRUCTURING**

Communication

Organizational Support

Trust

Stretch – liberating and energizing element of managerial context

Empowering people

Industry Foresight

Training

### **III.0 REASONS FOR RESTRUCTURING**

1. Globalization of business caused restructuring because in this era only the lowest cost producers can survive.
2. Change in fiscal and government policies like deregulation/decontrol has led many companies to go for newer markets
3. Information technology motivates many companies to adopt new technology for technological advancement of the company.

4. Irrational divisionalisation of an organization into smaller units has been a cause for corporate restructuring.
5. Quality enhancement and cost reduction has necessitated downsizing of work force both at work and managerial levels.
6. Economic value of currency and foreign exchange rate implications
7. Focus on core business and to develop synergies has established restructured corporate.
8. To minimize the risk through diversification is also one of the reasons for corporate restructuring.
9. To write off loss and integration of sick unit into successful organization companies also go for restructuring.
10. The restructuring process will facilitates to have horizontal and vertical integration, thereby the competition is eliminated and the company can have access to regular raw material.

#### **IV.0 FINANCIAL REORGANIZATION**

The term financial reorganization refers to the restructuring of company by affecting change in capital structure for achieving balanced operative results.

The financial reorganization is resorted to bring balance in debts and equity funds, short term and long term financing, to achieve reduction in finance charges, to reduce lost of capital, to increase EPS, to improve market value of shares, to reduce the control of financiers on the management of company etc

#### **IV.1 STEPS IN FINANCIAL REORGANIZATION**

##### **IV.1.1 VALUATION OF BUSINESS**

Any business can be valued by taking into consideration the value of the assets of the organization and the earning power and the future growth of the organization .This growth or earning power is difficult to estimate accurately. .But to implement the plans of financial reorganization one may value the assets higher who have high liquidation value and can value lower to those assets who have lower liquidation value. Here liquidation dose not mean financial reorganization.

#### **IV.1.2 FORMULATING OF NEW CAPITAL STRUCTURE**

In any of the capital structure whenever the proportion of equity is more to debt then there will be lower EPS. In time of prosperity and when the debts are more than equity then it will be very difficult to maintain an optimal capital due to high cost of debt. Therefore in order to maintain a proper balance in the capital structure financial reorganization is introduced. In financial organization the debt ratio can be reduced by reduction of fixed charge burden, by the introduction of new equity and preference share capital. When equity is more, the cost of servicing to equity will also be more which can be reduced by relying on debt whenever further funds are raised for expansion and diversification proposals. The company has to strengthen its financial position.

#### **IV.1.3 EXCHANGE OF OLD SECURITIES FOR NEW SECURITIES**

In a scheme of financial reorganization old securities are valued at its worth and are exchanged for new securities with new obligations and rights. In order to mobilize funds, sometime old securities are also exchanged for new ones to meet the reorganized structure. The setting up of the new combination of equity, preference and debt in the financial organization, is an appropriate technique.

#### **IV.2 FINANCIAL RECONSTRUCTION AND REORGANIZATION**

The financial reconstruction would be taken up when the firm is continuously making losses and the assets shown in the balance sheet is not representing its true worth because of accumulated losses.

In this scheme, the capital amounts and the asset values are reduced to write off past losses as well as rearrange the capital structure of the business on a sound financial basis. As a part of financial reconstruction, sometimes a new company is specially formed to purchase the existing business, it is called as external reconstruction. When book value of capital and asset are reduced to write off past losses, it is referred to as internal reconstruction.

But in case of financial reconstruction, the reconstruction schemes can be implemented to bring in more reality to improve the overall financial strength of the company by adjusting its gearing.

#### IV.2.1 REORGANIZATION ILLUSTRATION

The existing capital structure of a XYZ Co. Ltd. company undergoing reorganization may be as follows (in millions)

Debentures	9
Subordinate Debenture	3
Preferred Stock	6
Common Stock Equity (at book value)	10
Total	28

If the total amount of valuation of the reorganized company is to be 20 million, the trustee might establish the following capital structure in step 2:

Debentures	3
Income Bonds	6
Preferred Stock	3
Common Stock	8
Total	20

Having established the “appropriate” capital structure for the reorganized company, the trustee then must allocate the new securities. In this regard the trustees may propose that the debenture holders exchange their 9 million debenture for 3 million debenture and 6 million in income bonds that the subordinate debenture holders exchange there 3 million in securities for preferred stock and that preferred stock holders exchange their securities for 6 million of common stock in the reorganized company. The common stock holders then are entitled to 2 million in stock in the reorganized company.

Thus each claim is settled in full before a junior claim is settled. The example represents a relatively mild reorganization. In harsh reorganization, debt instruments may be exchanged entirely for common stock in the reorganized company and the old stock may

be eliminated completely. Had the total valuation in the above example been 12 million in common stock, only the straight and subordinate debenture holders would receive a settlement in this case. The preferred and common stock holders of the old company would receive nothing.

## **V Case Study**

### **V.1 REHABILITATING DAIEI - A JAPANESE RETAILER IN TROUBLE**

On April 10, 1957, Isao Nakauchi started a discount drugstore in Osaka, Japan. Nakauchi was a Japanese soldier who had survived heavy fire while serving in the Philippines during World War II.

The first store was highly successful and this prompted Nakauchi to open more such stores in the Osaka area. Nakauchi later named the retail chain 'Daiei'. The company's motto was to provide "good products, cheaper and cheaper." By the late 1960s, Daiei had established itself as a leader in the retailing industry in Japan. It stayed focused on its philosophy of "for the customers", offering them products at low prices.

In 1964, Daiei expanded its operations in Tokyo and opened its first suburban store near Osaka in 1968. The company gradually expanded into other parts of Japan by acquiring established companies and starting new stores.

### **V.2 THE CRISIS**

By early 2000, Daiei had emerged as the largest retailer in Japan; it had grown so rapidly because of its aggressive expansion policies mainly supported by borrowings from banks. However, with deflation in the Japanese economy, Daiei's debts snowballed. The company went bankrupt in the fiscal 2001-02, reporting a net loss of 332.51 billion yen and a negative equity of 297.4 billion yen. The total current liabilities for the company that year had grown to 2.22 trillion yen with 90% of it either in the form of short term borrowings or long term debt due within a couple of years.

### **V.3 HEADING FOR REHABILITATION**

After several months of efforts, the Industrial Revitalization Corporation of Japan (IRCJ), finally, in March 2005, selected a consortium led by trading house Marubeni Corporation

(Marubeni) to rehabilitate The Daiei Incorporation (Daiei), Japan's troubled supermarket chain operator. Marubeni had teamed up with the investment firm Advantage Partners Inc. Daiei had once been one of Japan's largest retailers, but in course of its expansion drives during the 1980s and early 1990s, it had amassed huge debts. Despite its efforts, the company was unable to decrease its debt burden significantly.

Many Japanese and foreign investors exhibited an interest, but IRCJ finally zeroed down to three groups for final consideration. The three groups of investors were the ones led by Japanese supermarket chain operator Aeon Corporation, trading house Marubeni, and investment fund Kiacon Corporation. After reviewing the rehabilitation plans submitted by these three contenders, IRCJ chose Marubeni because it had closer ties with Daiei, having developed products jointly with it in the past.

IRCJ decided to invest 50 billion yen in Daiei's shares to acquire a 33.4 percent equity stake along with a third of voting rights. It aimed to change Daiei from a supermarket chain selling a wide range of merchandise to the one centered on food products.

#### **V.4 THE RESTRUCTURING EFFORTS**

On January 18, 2002, Daiei announced its three-year management restructuring plan with the intention of pushing down its consolidated interest bearing debts to under one trillion yen by the end of February 2005. Its three major creditor banks promised to provide financial support of 420 billion yen through a debt for equity deal.

The deal included swapping of some of Daiei's debts for shares and writing off some loans. Besides this, Daiei intended to retire 50% of issued shares and reduce the number of its subsidiaries from about 150 to less than 100. The company also planned to lay off 6,000 of its full-time permanent employees out of a total of 32,000.

#### **V.5 THE AFTERMATH**

IRCJ had earned a reputation for imposing strict turnaround plans on debtor firms, and the path for Daiei was also expected to be quite demanding. The agency was planning to shut down its unprofitable stores. IRCJ further planned to allow Daiei to open about 100 food supermarkets over the next five years under its rehabilitation program.

The agency's plans were based on the performance of Daiei's food supermarket operations, which were relatively better than its other businesses. IRCJ was also

considering general merchandise store operations and credit card business as among Daiei's core businesses in the future.

## V.5 CONCLUSION

A corporate structure is not immutable. Companies frequently reorganize by adding new businesses or disposing off the existing ones. They may alter their capital structure and they may change their ownership and control.

Restructuring can be in any of the following ways, leverage restructuring that is takeovers or buyouts of company or division that is financed mostly with debt. Companies shed and acquire assets. Assets may be divested by spin-offs, carve outs or asset sales. These divestitures are generally good news to investors; it appears that the divisions are moving to better homes, where they can be well managed and more profitable.

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