

## Corporate Restructuring: Leading to Competitive Advantage

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### Abstract

Corporate restructuring entails any fundamental change in a company's business or financial structure, designed to increase the company's value to shareholders or creditor. Corporate restructuring is often divided into two parts: financial restructuring and operational restructuring. Financial restructuring relates to improvements in the capital structure of the firm. An example of financial restructuring would be to add debt to lower the corporation's overall cost of capital. For otherwise viable firms under stress it may mean debt rescheduling or equity-for-debt swaps based on the strength of the firm. This paper examines different types of successful corporate restructuring practiced and identifies the tools and techniques behind their successes.

*Key words: Corporate Restructuring, Debt Restructuring*

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### Introduction

In the aftermath of the financial crisis the term corporate restructuring has become synonymous with “debt restructuring”, at least for a large part of the undiscerning public. But the term “corporate restructuring” is also used when group entities are restructured to achieve commercial objectives with increased efficiency without losing market share or credibility. Corporate restructuring to manage debt (also called corporate debt restructuring) is used when a company is having trouble making payments on its debts. It is usually undertaken in response to an extreme financial crisis. In theory, after a restructuring exercise, payments should be manageable. Generally, a corporate debt restructuring will be accompanied by cutting operating expenses, altering the firm’s business portfolio by selling or acquiring assets and/or changing the firm equity ownership structure.

In certain instances, servicing debt is not always the main objective of corporate restructuring: the objective may be to improve operational and financial performance, explore strategic opportunities or improve public market valuations. In this sense “corporate restructuring” covers all forms of legally accepted measures by which one or more corporate entities can alter corporate form to affect current relationships with third

parties and even amongst shareholders of the corporate entity subject of restructuring. Broadly speaking corporate restructuring can take the form of:

- Corporate expansion (merger, acquisition, joint venture);
- Corporate contraction (spin-off, divestiture, carve-out (including equity carve-out), asset abandonment, liquidations, deregistration of corporate entities; and
- Ownership and control (purchase of own shares and conversion to a private company (whether by a leveraged buy-out (LBO) or by other means)).

Economic realities have forced managers to reassess the need to retain extensive group structures and, if required, to replace with ones designed to efficiently serve core business objectives. In our experience another challenge in recent times to existing corporate structures has come from the business side, especially when they (existing corporate structures) impede a natural shift in business strategy called for by the need to explore new businesses opportunities.

Whatever the reasons, a corporate restructuring exercise is desirable if it achieves identified corporate needs, the bottom line always being improved efficiency and profitability of the company. Motives behind corporate restructuring matters in which the firm has been involved recently are diverse; some are as follows:

- To close down entities that are not adding any value to the business;
- Reduce operating cost by downsizing corporate group, but add activities on licenses of the reduced group entities to conduct business unaffected;
- Outsource non-core activities such as HR management, accounting and other back office functions to third parties or affiliates and reorganize the group entities;
- Reduce intermediary costs by incorporating entities or adding relevant activities to existing corporate licenses to conduct distribution through self-owned retail outlets or subsidiaries;
- Reorganize group entities in the region to fall under subsidiary in UAE to avail tax free status and benefit on repatriation of dividends to foreign parent company under avoidance of double taxation treaty between UAE and the country where the foreign parent company is domiciled; and
- Consolidate group companies set up in the region under holding structure set up in an off shore jurisdiction to achieve uniformity in corporate policy, better administration and manage exit strategy.

## **Research Methodology**

The research is carried out through a case study to obtain insights as to why restructuring in organizations is necessary and what relationship exists between restructuring and competitive advantage. This is done by examining a successful company Larsen and Toubro Ltd which practiced restructuring processes successfully and inferences are drawn if restructuring could lead to shareholders' market value as well as competitive advantage.

## **Background**

L&T was established by two Danish engineers H. Holck Larsen and S.K.Toubro in 1942. Within a span of fifty years L&T became one of the most respected companies in India (9). The sales turnover of the company during last seven years rose from Rs. 53.88 billion in the year 1996/1997 to Rs. 115.25 billion in the year 2003/2004 (10). The company is a leading manufacturer and engineer in turnkey projects having diversified activities in electrical and electronics; construction projects; cement manufacturing; medical equipment; shipping; earthmoving equipment; heavy engineering and information technology. From the year 2000, the company was planning to restructure some of its business divisions through demerger and consolidation in order to concentrate more on infrastructure and turnkey businesses.

## **Reasons for L&T's Demerger**

L&T was trying to protect itself from a takeover bid by Grasim Industries Ltd. (GIL) a flagship company of Aditya Birla Group, from the year 2001. GIL was trying to take over control in L&T management by purchasing shares of L&T from the open market. The company first acquired 15 percent stake in L&T and also made an open offer to L&T shareholders to increase its stake. However, it could not get very good response from the existing L& T shareholders.

In this situation, if L&T's demerger plan of cement division had gone through, GIL's stake in the cement business would have gone down to 3.75 percent. At this moment, GIL had already spent over Rs 10 billion in acquiring its L&T stake and was not ready to allow the latter's plan to demerge the cement business. GIL accused L&T that through demerger plan, L&T was trying to retain control of the cement division within itself, without focusing the interest of shareholders. According to GIL, under the L&T demerger plan, L&T shareholders would have only 24 percent stake in the new cement company where individual shareholders would hold very little control in this new entity.

## **Demerger: The Three Steps**

Finally, at the extraordinary general body meeting held on 3rd February 2004, shareholders approved the demerger of L&T's cement division. The name of the

demerged entity was made public as UltraTech CemCo Ltd. (UCL). This extraordinary general body meeting witnessed a lot of heat amongst the shareholders. On two main resolutions, two polls were conducted on the scheme of arrangement, involving the reduction of share capital of residual engineering from Rs. 2.48 billion and demerger of L&T cement division.

The face value of L&T share was also reduced from Rs.10 to Rs 2, awaiting poll results. L&T wanted 51 percent of the shareholder's approval who were present in the meeting and voting of 75 percent of value to go through for demerger. GIL was interested in acquiring the cement division of L&T and was confident that all the above objectives would be comfortably achieved. The proposed open offer of cement division closed after the listing with the new company. With the demerger of the cement business, L&T needed to restructure the equity capital.

In a three step demerger plan, it was decided that in the first phase L&T would spin off the cement business into a new company, UltraTech CemCo Ltd. (UCL), where L&T would hold 20 percent and the balance of 80 percent would be held by existing shareholders of L&T.

In the second phase, GIL would buy 8.5 percent of UCL from L&T @ Rs. 342.60 per share and make an open offer to other shareholders of another 30 percent at the same price. It would take GIL's stake to 51 percent in UCL, if this offer was fully subscribed, and on the sale of its stake in UCL, L&T would realize Rs. 3.62 billion.

In the third phase, L&T Employee Welfare Foundation would acquire the GILs 15.3 percent stake in the residual engineering company. Hence, after the demerger, GIL gave an open offer to UCL shareholders and purchased the shares to cover a 51 percent hold in UCL. Table--2 below, shows in short the sequence of the demerger process in L&T Ltd. Immediately after the acquisition, GIL finally changed the name from UltraTech CemCo Ltd. to UltraTech Cement Ltd.

### **Outcome of L&T Demerger**

There were two important issues in this demerger. The first important issue was that to protect the interests of both existing and former employees, L&T Employees Welfare Foundation was given a stake in the company. The second issue was how shareholders at large also could benefit from this demerger. During early 2003, L&T's ten-rupee face value share prior to demerger was hovering around Rs. 350/400 per share. After the demerger, for every 100 shares of L&T, shareholders got 50 shares of L&T of Rs. 2 face value each and 40 shares of UCL with face value of Rs. 10 each. Around April 2004, the entire demerger process was complete. Although initially there were some corrections in the market, later share prices of both L&T and UCL started rising. Within three years shareholders of erstwhile L&T increased their wealth with a growth more than SENSEX or Nifty. In March 2006, the face value of Rs. 2 a share of L&T was quoted between Rs.

2375 to Rs.2616 (11) per share, while of UCL was quoted between Rs. 562.5 to Rs 689 12 per share on the Bombay Stock Exchange. This means shareholders' value went up by more than 100 percent within two years, which was unprecedented in the history of demergers of any company.

### **Conclusion**

From the above cases of restructuring, the point may arise that, prior to restructuring, none of these companies were managed properly. They were huge in size; the company management could not select the right strategic options to push their businesses ahead of other priorities. Or, even, the core competency levels had reached to its saturation points when these business units were no longer viable and therefore restructuring was the only option to avoid losses or stagnation. The above arguments may be well suited to L&T Ltd. where these companies had enough strength in power, infrastructure, medical equipment and Turnkey projects. L&T had its weaknesses in the cement business. All these forced the above companies to go for all-round restructuring. L&T took a wise decision and demerged its cement business.

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