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# Corporate Restructuring: A Panacea to Corporate Governance Flaws

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***Abstract***

*India has seen multiple corporate scandals and financial crises involving several large corporations, some of which have been saved from sinking. However, scepticism in pinpointing the primary cause of such an incident is not new. Following extensive research, it has been determined that the occurrence of such an unfavourable event in any corporate house triggered the intersection of corporate governance and corporate restructuring; thus, understanding the two aspects will improve effective risk management, as the two aspects appear to be supplementary and complementary to one another, particularly in reviving a collapsing corporate house. Traditionally, the two have been seen distinctively, particularly in terms of their relevance, applicability, and drawing interrelationships between them were never a concern. The paper will offer an idea of how corporate restructuring might be utilized to correct corporate governance issues in a company. In addition to elucidating the various broad spheres of corporate restructuring and their implications, the researcher will emphasize the importance of effective corporate governance, failure of which is attributed to be one of the major factors for a financial crisis or the ultimate collapse of a corporate house, despite its size, and it is at this point that corporate restructuring is used as a tool to rehabilitate the same. The researcher will rely on case studies while explaining how corporate restructuring is aptly used to overcome the flaws in corporate governance.*

**Keywords:** Corporate Governance, Corporate Restructuring, Financial Crisis, Corporate Internal Reconstruction and Corporate External Reconstruction.

## INTRODUCTION

A business can take many different shapes depending on the entrepreneur's preference. A sole proprietorship, a partnership, or a Hindu undivided family business are all viable options. However, in conducting a large-scale company, this type of organization inevitably suffers from limited resources and boundless liabilities. This is why the corporate form of business organisation seemingly is an ideal alternative to overcome these limitations for any business enterprise to grow. The corporate acquires its identity and functions separately from its members or owners of the firm, as it is well known for its separate legal entity after incorporation. It also allows normally unaffiliated or unrelated individuals to form a mutual ownership group by owning equity shares, with no restriction on the number of members particularly in the case of a public company. As a result, the corporate form of organization is often regarded as one of the most effective vehicles for attaining business objectives.

The world has undergone a substantial transition from entrepreneurial ideas to the corporatization of commercial organizations in recent decades, resulting in a shift toward corporate governance. As a result, there are a variety of investors in every type of company, ranging from financial institutions to government agencies to retail

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investors who make significant investments. This creates a problem of corporate accountability, which raises questions about the rights and responsibilities associated with membership and ownership of corporate organizations. The exercise of such authority by the controlling owners in an exceptionally righteous manner is what corporate governance is all about, and failure to do so resulted in the corporate house crumbling. As much as the corporate form of organisation is best suited to accomplishing a commercial objective, business fraud has been seen in the modern corporate world, and it has taken its toll. Top executives of large corporations engage in financial larceny, with the sums involved frequently in the billions of dollars, with the ultimate victims of corporate fraud being consumers, creditors, investors, and workers. When fraud is discovered, the company that perpetrated it is always declared bankrupt, and the corporate structure is restructuring to help it recover, the intersection of corporate governance and corporate restructuring was initiated as a result of this.

**GRASP THE CONCEPT**

Corporate Governance was not well-known in India till the early twenty-first century. The corporation takes a long time to acquire traction in corporate governance. The first Corporate Governance principles were published in 1998, but this notion was initially utilized in the 1990s [1]. Following that, several committees were formed to make recommendations on corporate governance, including the Kumar Mangalam Birla report (2000), the Narayana Murthy Committee (2002), and the Naresh Chandra Committee. But the major change in the concept of Corporate Governance came with the issuance of voluntary guidelines by the Ministry of Corporate Affairs in 2009 which has to be complied with by the listed companies. Since the Enron corporate fraud in early 2000, the notion of corporate governance has risen from obscurity to become an unavoidable aspect of the business world. Corporate Governance received a new and robust foundation with the passage of the Companies Act of 2013, which included substantial requirements.

Corporate governance entails balancing the interests of a company's many stakeholders, including shareholders, management, workers, customers, suppliers, bondholders, financiers, the government, and the general public. According to James D Wolfensohn, (*then President of World Bank from June 1, 1995, to May 31, 2005*) "*Corporate Governance is about promoting corporate fairness, transparency and accountability*" [2]. It is an extensive concept comprises transparency, accountability, fairness and responsibility, sometimes these are referred to as the pillar of corporate governance. For better understanding, "Transparency" concerning in the operation of the business; timely and accurate disclosure of all relevant information, including financial status, performance, ownership, and corporate governance, Management's "accountability" to the Board and the Board's "accountability" to the shareholders, "Fairness" towards all the stakeholders; including minorities shareholders, rendering equitably; provide effective redressal to any aggrieve stakeholders and Responsibility towards the society. The term "governance" means control, and it refers to the governance or control of a corporate organization [3]. As a result, corporate governance is a critical pillar in ensuring that best management practices are followed in accordance with a set of principles, rules, and regulations.

Corporate restructuring embraces a broad range of transactions, including selling part and partial of the business line or making large acquisitions, altering capital structure via infusion of large amounts of debt, and changing the internal structure of the firm [4]. Reconstruction is a restructuring process for a business that includes legal, operational, and financial aspects [5]. Therefore, Corporate restructuring is a process of restructuring the structure of a company either internally or externally. Occasionally operational synergies may also be the motive behind this process to expand or enhance the overall performance of the companies [6].

**Internal Reconstruction**

It is a type of corporate restructuring that focuses on reorganizing the firm's financial condition within, rather than dissolving the firm. The legal existence of the firm is preserved throughout internal rebuilding, and no new business is founded. The situation that prompted internal restructuring *inter alia* includes, Firstly, Financial statements misrepresent the financial ground reality, for example, assets are overvalued and fictional assets appear on the balance sheet and secondly, the company is deliberately overcapitalized with a complex capital structure. Internal reconstruction entails a complete revaluation and reporting of the company's financial assets and liabilities. It is attempting to strike an agreement with its creditors in order to reduce its payables. It also aspires to change the capital structure's heaviness. This can take numerous forms, including; Alteration of share capital, Alteration of share capital are governed by sections 61 to 64 of the Companies Act of 2013. It might take the form of a new share issuance, a stock conversion of fully paid shares, the cancellation of unissued capital, the consolidation of existing shares, or the sub division of existing shares. Dividend rates, Variation of shareholder rights, According to Section 48 of the Companies Act of 2013, when a company's share capital is split into several classes of shares, the rights linked to any class of shares may be modified with the written approval of the class's members. Holders of at least three-fourth of the outstanding shares of that class, or by other by means of a special resolution passed at a separate meeting of the holders of the issued and Reduction of Share Capital. As per Section 66 of the Companies Act 2013, subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular.

**External Reconstruction**

When a company face an acute financial crisis for a certain period for any reason usually due to flaws in corporate governance, the alternative in hand is to opt to either sell its business or to allow it to be acquired or merged by losing its identity in order to revive from such difficulties. This process is attributed to external restructuring. In general parlance, External reconstruction is a type of corporate restructuring in which the previous firm is liquidated and then taken over by a new firm, the former company that is liquidated is known as a 'transferor company,' while the new firm is known as a 'transferee company.' The new business is founded to take over the previous firm's assets and obligations. Shareholders of the transferor company become the shareholders of the transferee company. In other terms, external reconstruction refers to the selling of an existing firm's business to a new firm created. One firm is liquidated and a new one is founded in external rebuilding. The value of the liquidated corporation is estimated to be in the millions of dollars [7]. Therefore external reconstruction *inter alia* can take in the form of Merger/amalgamation, acquisition/takeover and demerger. This concept of Corporate restructuring undoubtedly depicts the viability of resorting to as a rescue mechanism in eliminating all sorts of financial crises.

**The Interface of Corporate Governance and Corporate Restructuring: A Case Study**

The board of management are the brain and key player in the governance of the company and it is their utmost duty to ensure effective enforcement of corporate governance. Poor and mismanagement, ethical leadership, lack of integrity, corruption, fraud, and violation of a set of corporate governance principles and rules are the main contributors to bankruptcy and financial failures. The epitome of poor corporate governance that prompted an overhaul of the Indian legal regime on corporate governance was the Indian Enron case the Satyam fiasco scam. On the 7th of January, 2009, B. Ramalinga Raju, the founder and then-chairman of Satyam Computer Services, admitted to orchestrating an accounting fraud on Satyam's books that the Indian government now estimates may have cost investors as much as Rs. 14,000 crores (approximately US$3 billion based on current exchange rates). Raju is accused of defrauding Satyam by fabricating nearly $1 billion in cash on the company's balance sheet. Raju, Satyam's managing director and chief financial officer, as well as two PricewaterhouseCoopers auditors, were arrested as a result of Raju's confession. Raju and the others were charged with criminal breach of trust and criminal conspiracy by the state of Andhra Pradesh [8]. The Satyam debacle served as an example of “poor” corporate governance standards. It has not demonstrated a positive relationship with its shareholders and workers. Satyam's Corporate Governance issue occurred as a result of the company's failure to meet its obligations to numerous stakeholders special interests. When we talk about special interests, we should consider the following: separating the duties of the board and management; separating the duties of the CEO and chairman; nomination to the board; directors and executive remuneration; and protecting the rights of shareholders and their executives, the said interest poorly managed in the instant case was finally unfolded in 2008 when Mr Ramalinga Raju, the company's CEO, announced a $1.6 billion bid for two Maytas companies, Maytas Infrastructure Ltd and Maytas Properties Ltd, claiming he wanted to make the money available to help financial experts, While the ground reality shows Raju's family has both aided and hindered the two groups. However, the market and financial experts both gave him the thumbs down, forcing him to withdraw within 12 hours. That ultimately triggered a probe and led to his confession.

During that period of dismay, Tech Mahindra company acquisition (which is one form of external restructuring) was a source of its survivability [9]. Tech Mahindra is an information technology (IT) firm under the Mahindra Group, an Indian multi-industry conglomerate with various operations such as automobiles, farm equipment, and financial services. The acquisition of Satyam was seen by Anand Mahindra, Chairman and Managing Director of the Mahindra Group, as a strategic opportunity to take the company to the next level of growth. Further, the acquisition would allow the Group to diversify across sectors, clients, and locations, advertise a wide range of services to Satyam's large customer base and make use of shared support infrastructure to save operational costs. On one hand, the motive of the acquisition was to set clear principles which are rectifying the flaws in corporate governance issues; by creating a trusting environment where ethical behaviour is valued; managing reputation risks by meeting customers and demonstrating the Mahindra Group's commitment, and restoring customer faith through newfound business models of delivery and engagements [10].

The 2010 kingfisher restructuring is another watershed that demonstrates the interface of corporate governance and corporate restructuring. Kingfisher Airlines was an Indian airline group founded in 2003 by Vijay Mallya and controlled by the Bengaluru-based United Breweries Group, with headquarters in Mumbai's Qube Andheri (East) and a registered office in Bangalore's UB City. On the 9th of May, 2005, with four Airbus A320-200 aircraft, Kingfisher Airlines began commercial operations. Kingfisher Airlines developed itself as a high-service-oriented airline in a short period, earning multiple accolades for its services as well as numerous honours for being India's greatest airline. Kingfisher embarked on a massive capital expenditure program in an attempt to dominate the airline industry, accordingly for a swift attempt to access an international route, in 2007, Kingfisher Airlines acquired a 26% stake in Air Deccan which was a low-cost Airline that later increased its stakeholding up to 50% and subsequently both organisations merged which later turn out to be his greatest blunder move [11]. From 2008 to 2010 the company accumulated sixty-seven Airbus aircraft, financing the purchase largely through dry leases, it also heavily used bank loans to finance capital expenditure and working capital. As collateral to these loans, it had pledged all its movable assets, trademarks, goodwill of the company, and receivables and hypothecated Kingfisher house, the company headquarters [12]. Grant Thorton undertook a valuation of the Kingfisher brand and the company pledged its brand as collateral with its lenders for ₹ 41 billion. The loan raised amounted to three times the company’s market value. Yet kingfisher had been reporting losses ever since it commenced operations. Due to dishonouring contracts with vendors and lessors, Kingfisher had numerous court cases. Since 2008 the company had been unable to pay aircraft lease rentals on time and had grounded several aircraft as it was unable to meet the expenses, in addition, it had trouble in paying its fuel bills as a result several cases were filed against Kingfisher by several fuel supplier companies for non-payments of dues. The company incurred substantial losses, and its net worth was eroded in 2009, [13] and it had accumulated losses amounting to ₹ 42 billion between April 2005 and March 2010. In November 2010, to prevent an implosion, the company’s board of directors approved a debt recast package with lending banks, following a one-time relaxation in restructuring guidelines sanctioned by the Reserve Bank of India [14]. Following the restructuring, the airline undertook several steps to cut costs and face the challenges ahead. These steps included changes to the business model, reduction in interest and lease rentals by converting some loans into foreign currency loans etc. the restructuring quickly resulted in performance improvements. However, despite all effort to rescue the sinking ship, at the time of Mallya's disclosure to the Bombay Stock Exchange, two analysts at Veritas, a Canadian investment research firm, rightly pointed out that both Kingfisher Airlines and its parent United Breweries (UB) holding were on the verge of bankruptcy. This led many to question the company accounting practices [15]. And we now have witnessed one of the shocking downfalls of five-star accredited airlines.

The main reason for its demise was indisputably due to flaws in corporate governance; there was a lack of delegation and accountability to its stakeholders, which is one of the pillars of corporate governance. When Mallya's son got into an online argument with an actress about his staff's unpleasant behaviour, it demonstrated his lack of maturity and bad management abilities. On the other hand, Vijay Mallya, chairman of Kingfisher Airlines, has always maintained an 'Ekla Chalo Re' mentality in the airline industry, also he was totally cold and unethical towards his stakeholders such as his employees [16]. Corporate Affairs Minister Veerappa Moily blamed the carrier's woes on poor governance and a lack of competent or professional management. She states that *"Why the health of a company failed, because of bad governance. You must have professional management. You can't' have individual decision-makers [17]."*

**CONCLUSION**

After thorough research, the aforementioned cases are deemed aptly to highlight the interface of corporate restructuring and corporate governance, if corporate restructuring is truly a remedy for corporate governance defects. It has been determined that financial crises and company bankruptcy are directly or indirectly the results of poor corporate governance, and it is widely believed that corporate restructuring, either internally or externally, is the best way to recover from such a dire situation. However, it is understood that the Corporate Restructuring technique may not always succeed when the severity of corporate governance failure is irreversible and bad governance endures; an example of such a scenario is Kingfishers Airline, where the 2010 restructuring resulted in immediate performance improvements, and in 2011, it had earnings before interest, taxes, depreciation and amortization (EBITDA) margin of 20% whereas the other same line of business such as Jet Airways had a margin of 17%. Its earnings before interest, tax, depreciation, amortization and rentals (EBITDAR) were -0.8%, whereas competitors such as Jet and Spice Jet had margins of -9.2% and -11.7% respectively [18]. However, despite all the effort to rescue and improve in performance, the Airline could not survive as inadequate corporate governance remained to exist and reluctance to deflect from it. On the other hand, the viability of corporate restructuring is undeniably evident from Satyam's external corporate restructuring via acquisition by Tech Mahindra, which is based on various underlying factors such as confidence in the stability of the company assets, employee potential, and business growth prospects [19]. Unlike the case of Kingfishers Airline, where a lack of delegation persists despite the airline's impending demise, Satyam's restructuring was a success, in other words, resorting to corporate restructuring as a panacea for corporate governance flaws was a success in Satyam's case, due to its determination to overcome the flaws and reinforcing corporate governance, nonetheless losing its identity in the long run, but its stakeholders, such as employees, maintain their job holdings.

In a nutshell, it is concluded that effective corporate governance implementation is a key to booming business and that in the event of dire failure, Corporate Restructuring is an effective technique to revive or save a company from collapsing, provided that there is a strong motive and determination to eliminate existing corporate governance flaws. Furthermore, the practice should be that the Corporate Governance framework must be reinforced first, followed by implementation in both law and spirit. In this way even if corporate governance procedures are unable to prohibit unethical behaviour by senior management, they can at least serve as a way of discovering such behaviour before it is too late.

 

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