Whose Company Is It Anyway?

The life of a company is as precious as that of a human. The Insolvency and Bankruptcy Code, 2016 has added a new lifeline to rescue a company when it experiences a serious threat to its life.

A 'company' is a legal person having its own identity independent of its stakeholders. It has such rights and duties, powers and obligations, and relationship with stakeholders, as defined in its charter. The stakeholders have defined interests or rights in a company, and its property and management. The shareholders own shares of the company. However, no one, not even the shareholders, individually or collectively, own a company or any of its properties.

A company, having no mind of its own, acts through its immediate stakeholders. Each stakeholder, however, has a unique objective function, with a unique set of rights, interests, and level of engagement with the company. Consequently, the interests of one stakeholder may conflict with those of another and / or of the company. The stakeholders may work at cross purposes, and even against the interest of the company. Some of them leave the company at the earliest sign of its distress. Departure of a major shareholder often orphans the company.

A company has indefinite life by law. There is, however, a continuous threat to its life from the 'market'. Every other company is its predator - a company swallows another company for its own growth. A company takes too much of risk for its survival, which may become its nemesis. It loses business to others on account of competition. Creative destruction often destroys more companies than it creates!

The law provides a process to end a company's life under certain circumstances. The death of a company has become as easy as its birth, thanks to improved 'ease of doing business'. It is not surprising that the average life of S&P 500 companies has reportedly reduced from 90 years to 18 years over the last century. A company having perpetual succession now lives shorter than a human! The question arises: Whose company is it?

There are layers of trustees to protect the life of a company. A Board of Directors appoints and supervises the executive management and replaces it in case of its failure, in accordance with the contractual arrangements. The shareholders elect directors to the Board, monitor their performance and replace them if they fail to perform, in accordance with the provisions of the Companies Act, 2013. A promising set of shareholders may even replace the existing set through the market for corporate control. The creditors step in to rescue the company, when it fails to service debt, from its management and shareholders, in accordance with the provisions of the Insolvency and Bankruptcy Code, 2016 (Code).

A company must maintain a delicate balance to remain afloat. Among others, two balances are critical for its continued existence. First is the balance between limited liability and unlimited liability. The shareholders enjoy limited liability only because the society at large has underwritten unlimited liability. The society bears the brunt of unlimited liability such as those arising from Bhopal gas tragedy, Satyam fiasco, etc. A company cannot survive in the long run if it benefits one at the cost of another. A variety of institutions such as disclosures, independent directors, regulation of related party transactions, protection of minority interest, limits on authority of trustees, key managerial personnel, auditors, taxes and subsidies, corporate social responsibility, etc., minimise conflict of interests of the stakeholders, subordinate the interests of immediate stakeholders to those of the company and establish precedence of interests of the society over those of the company.

The second is the balance between the present and future. A company is expected to serve the posterity forever with higher and higher prosperity. If it lives too much in the present, it may jeopardise its future and vice versa. It must survive competition and innovation to live longer. It must bear the full cost of business today. The strategies of resilience and adaptation such as research and development, risk management, sustainable business model, visionary leadership, preparedness for unknown unknowns, etc., minimise threat to the life of a company.

When a company fails to balance the present vis-à-vis future, it experiences financial distress to start with, which, if not addressed in time, may convert into economic distress, making the process irreversible. The Code empowers creditors, through an insolvency proceeding, to rescue a company before it is too late. The insolvency proceeding requires only a credible and capable person to take charge of the company, and a viable and feasible resolution plan to rescue it, to put the company on a sustainable path.

A resolution plan may entail a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of organisation, business model, ownership, or balance sheet; strategy of turn-around, buy-out, merger, amalgamation, acquisition, or takeover; and so on. It must, however, increase the value of the company, which is valued 100 today, to 110 the next year, 120 the year after and so on. It must also ensure that the value that exists today and that accrues tomorrow are shared by the stakeholders equitably.

The State provides a complete framework, including layers of trustees, incentives and motivations for them, norms for various balances, and mechanism for compliance with them, to keep a company in the pink of health. It, however, assigns the role of saviour to creditors, when a company experiences a serious threat to its life. They are duty bound to correctly detect distress of a company well in time, takeover its reins through an insolvency proceeding where they do not have a more efficient remedy, run it as a going concern, preserve its underlying value, visualise possible options for value enhancement, retrieve the value lost on account of irregular transactions, curtail the rights of stakeholders to the extent necessary, create a market for competing, feasible and viable resolution plans from capable and credible people, and approve the best of them that maximises the value of the company and balances the interests of all stakeholders. They must rescue a company irrespective of whose company it is.

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