

Driving Force

by Daniel Connell, Manager TMF Group

Daniel Connell analyses best practice when restructuring a company, and places the company secretary at the heart of the process.

As a result of the global financial crisis the past 18 months have probably been some of the most interesting and most challenging months that the company secretarial sector has seen. Never before have clients been so selective in the types of projects that they undertake, due to the budget restraints that have been imposed on almost all company secretaries and their departments. Throughout the course of 2010, companies have been looking at implementing selective 'value-add' projects, a prime example being a reorganisation project.

The need for a reorganisation can be derived from a number of areas, but our experience has shown that there is normally one of two key drivers as to why a company chooses to undertake a reorganisation. The first driver is that mergers and acquisitions (M&A) activity has caused a group's legal entity structure to become misaligned with its business structure, often with multiple jurisdictions involved. Post-merger this can potentially cause serious problems. For example, a large amount of corporate memory will often leave a company as people leave the newly-merged organisation. The company will therefore be keen to streamline the post-merger structure to ensure that its legal structure is more closely aligned to the business. This ensures that non-compliance does not become an issue and control over corporate data is maintained. The second common driver behind a reorganisation is tax planning. Many entities within a group structure will be in place to ensure that the group is as tax-efficient as possible. However, with ever-changing tax regimes across jurisdictions, it can often be necessary to revisit tax structures to ensure that they remain efficient and that any tax planning is being properly implemented at a local level. This ensures, for example, that the correct level of local substance is maintained.

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From a strategic point of view the value proposition for a reorganisation project is really quite simple and is based around sound corporate governance and basic economics. However, the implementation of such a process is somewhat more complex and littered with potential pitfalls for the company secretary to negotiate.

The value proposition

As a basic figure, it has been estimated that the cost of maintaining a corporate entity in its most simple form is £40,000 p.a. This covers the cost of maintaining corporate secretarial compliance in a jurisdiction, preparing and maintaining tax filings and compliance, the preparation of Statutory accounts and management time. This figure would not include anything other than the most basic of audit costs and would apply to a company that was either dormant, a pure holding company or only experienced a minimal level of trading activity. In other words every entity that can be removed from a corporate structure will create an ongoing saving of at least £40,000 p.a.

Economically that makes a reorganisation project quite a straightforward ‘sell’ for company secretaries within their organisation as it is effectively a project that pays for itself in a short period of time. Where reorganisation is driven by the need for more effective tax planning, the potential tax savings can be significant depending on the individual group and its existing tax structure.

From a corporate governance best practice perspective, a lean group structure is always the most desirable. A lean structure carries less risk and is much easier to manage from a compliance perspective. It reduces, for example, the chances of an individual company being dissolved for non-compliance because it has simply become ‘lost’ in an unwieldy group structure. This can happen very easily in larger groups, especially in overseas jurisdictions, and can present a significant reputational risk, as well as potential financial and tax costs. Of course maintaining visibility of both corporate data and the capital structure in a leaner group set up is also far easier and often gives the non-executive directors and other stakeholders, such as banks, additional comfort when signing-off group accounts.

The pitfalls

A lack of advance planning and poor communication are two of the biggest potential pitfalls that a reorganisation project faces. The reason for this is that multiple departments, such as: finance, legal, tax and company secretarial, need to provide input into the reorganisation process and in most cases commit budget to the project. Therefore, well before a company starts the physical reorganisation process, it is crucial to the project’s success that the key stakeholders meet on a regular basis to agree budgets and key performance indicators (KPI) for the project. This means ensuring that all the departments that are involved nominate members who will make-up a cross-department steering group. Without taking this action any reorganisation is doomed to fail, as it risks an entity being dissolved without any one of the aforementioned departments being consulted. A straightforward example of this would be an offshore vehicle, which on paper looks to be non-trading with large losses against it. It is quite possible that finance, legal and company secretarial would all quite happily have the entity dissolved. However, the tax department may well be using this entity to offset profits elsewhere in the group and dissolving the entity could therefore crystallise a large tax levy. This might seem like an obvious example, but without effective cross-departmental communication it is staggering what decisions can be made. Tax is just one example; there are so many other issues that need to be considered before moving or removing an entity from a group structure. Other considerations might include:

- Does the entity have any employees?
- Does the entity hold any IP or is it party to contracts on behalf of the group?
- Are there any inter-company loans?
- Does the company have any bank accounts?
- Are the current directors registered locally?
- Are the company’s filings up-to-date?
- Is the company trading?
- Does the company hold any assets?

The above list is far from exhaustive, but it demonstrates that a company will require a variety of people to answer these queries, which is why the presence of a cross-departmental steering group that meets regularly is so important.

Whilst establishing a steering group is essential, many reorganisations stall if no one is on hand to drive this process. The amount of information that needs to be gathered and signed-off by multiple people as part of any reorganisation is vast and by definition takes some time. Therefore, without the presence of a person or a team that will really drive the steering group's decision-making process, the risk of the project stagnating is high. Many organisations choose to use an external provider to chair the steering group and install KPIs to ensure speedy decision-making. Where an external provider is not used, the company secretary is often the person who will drive this process. The company secretary's position as 'guardian of the group structure' and the unique set of skills this role requires often means that he or she will be an effective person to drive the steering group's decision-making process.

Effective decision-making is therefore paramount to any reorganisation. However, this does not actually deal with the execution of the reorganisation. It is often at the execution stage that the company secretarial team really comes alive and truly drives the process. Once a decision has been made about the desired outcome of the reorganisation at steering group level, it is normally left to the company secretarial team to implement the plan. Implementing such a plan in a post-merger situation, which affects multiple jurisdictions, can be a daunting task. Dissolution methods and timelines can vary greatly from country to country. Therefore the ability to rely on trusted in-house local resource or a reputable professional services firm is essential. In a post-merger situation, a company will normally look to merge the assets of the local entities so that the remaining shell entity can be easily dissolved. The outcome is that rather than have two parallel entities in a jurisdiction, only one remains. In this situation a very detailed check-list will be necessary to ensure that a proper audit trail is maintained. This will ensure that all assets, such as employees etc., are properly transferred and approved by local boards and shareholders. Without this audit trail there is a high risk of dissolving an entity before all the necessary steps have been taken, such as the transfer of assets. This could potentially lead to a large amount of value leaving the business unintentionally. For this reason it is crucial that a member of the team is given specific responsibility for coordinating implementation of the reorganisation. Where local service providers are being used it may be a good idea to have a member of the firm engaged to coordinate services as well, especially where the in-house company secretarial team has limited resources available for projects of this nature.

It is clear that the reorganisation of a company offers the opportunity to add value. It is also a highly complex project to execute, both in terms of planning and implementation. It is for these reasons that they are amongst the most rewarding and interesting projects to be part of as a company secretary. It also seems clear that, as companies continue to emerge from the financial crisis, reorganisations may well remain near the top of agenda.

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