Thinner and flatter corporate structure is the way to go

BY VICTOR SAW

It was July 2012 and General Electric Co (GE) had just announced it would simplify its corporate structure. The energy business was to be reorganised into three standalone units, namely GE Energy Management, GE Oil & Gas and GE Power & Water.

In the words of Jeffrey Immelt, the chairman and CEO, "Big companies are always fighting organisational complexity ... Removing layers is one way to reduce costs and increase our speed, focus and agility in the marketplace so we can serve customers better."

Immelt recognised that simplifying GE's business would allow things to work better and drive down costs. In this context, let us examine corporate simplification as a complementary process to efficiency in today's business environment.

Challenges with complex corporate structures

About 1.04 million companies are registered in Malaysia today. The table shows that the top 20 listed companies have a combined total of 2,075 subsidiaries.

Complex corporate structures certainly cost a huge amount of money to maintain and administer. Millions of ringgit are spent annually just on regulatory and governance compliance.

When companies expand aggressively, the number of entities within the group tends to increase as well. In the long run, operational inefficiencies, tax complications and misalignment in business models become roadblocks to future growth.

Corporate simplification is about refocusing: zooming in on business needs, and preventing organisational goals and core competencies from going off at a tangent. This helps businesses use their valuable resources efficiently to support their growth strategies. A leaner corporate structure also drives efficient corporate governance. Management will have better control and this improves oversight in managing corporate risk.

Simplification is not necessarily simple

We believe in an integrated approach with three key thrusts, to achieve effective, thinner and flatter corporate structures:

1. Identify business needs, organisational goals and strategies to rationalise business models.
2. Review core activities, reporting structures and operating processes to simplify operating and management models.
3. Simplify corporate structures through a strike-off, divestment or members' voluntary liquidation (MVL).

The first two thrusts deal with strategic planning. Here, management will think of how best to increase overall efficiency in the business, keeping in mind tax optimisation. And they will strive to produce a workable set of solutions for implementation.

Take, for example, a dormant subsidiary holding valuable intangibles in the form of licences or patent rights. Are these intangibles still relevant to the overall strategies of the group? Retaining the subsidiary allows the company to exploit the inherent commercial values attached. Alternatively, the company can transfer the intangibles to another subsidiary, if possible, prior to streamlining the structure. Both the pros and cons must be weighed prudently before making the decision.

What if a company has a dormant subsidiary in a foreign country? The company must then consider whether it intends to do business in that country in the future. It is procedurally simpler and more cost effective to retain the entity than setting up a new one. But if there's no intention to do business there, perhaps getting rid of the subsidiary is the way forward to avoid unnecessary expenditure such as annual compliance costs.

The third thrust is all about translating those solutions into firm actions. According to a quote often attributed to Yogi Berra, the famous American baseball player, "In theory, there is no difference between theory and practice; in practice, there is".

Getting this stage right will mean that management is on the right track for a successful corporate simplification.

You'll often have questions at this stage: How do I reduce the number of entities in my group? Is it very costly in terms of money and time?

Striking off is the cheapest option but it is subject to approval from the Registrar of Companies. Even if it is approved, it is advisable to make sure that all liabilities, in particular taxes, have been paid before an application to strike off is made. As directors, I am sure you would not like to be hauled up by the tax authority years later for unpaid taxes.

Divestment would be most costly as considerable time and effort as well as legal cost would have to be incurred. In most instances, how would you find buyers for dormant companies? Setting up a new company is a far simpler and more straightforward option.

MVL sits in between the other two options. The pre-requisite for the MVL is that the company has to be solvent prior to liquidation. Also, 75% of its shareholders have to approve its proposed liquidation. The liquidator, independent of the directors and shareholders, takes control of the company and proceeds to liquidate the company, and eventually distributes surplus funds to the shareholders.

This allows the directors and management to then concentrate their effort on executing other strategies. The whole liquidation process generally takes six months to two years to complete, depending on the complexity of each entity and upon clearance from the tax authority.

Be relevant or be doomed

Today's corporate leaders need to be bold and have the will to make changes for the betterment of their businesses. If corporate simplification is needed to stay relevant and prosper in today's business environment, then that is the call to make. To do this, corporate leaders will have to periodically review their business structures and assess if change is needed.

Ultimately, companies should ask themselves: Is this the best that we can get? Have we been staying on top of the opportunities out there?

In case you're wondering, GE's market value rose by US$30 billion to US$243.7 billion as at May 2013 (Forbes Global 2000 Leading Companies, 2013). Not too bad for simplifying something complex. E

ANNUAL REPORTS OF THE RESPECTIVE COMPANIES FOR THE YEAR 2012

Number of subsidiaries — top 20 companies listed on Bursa Malaysia (by market capitalisation)

LOCAL SUBSIDIARIES		FOREIGN SUBSIDIARIES		TOTAL SUBSIDIARIES	RANGE OF SUBSIDIARIES HELD
Total active	Total inactive*	Total active	Total inactive*		
785	284	743	263	2,075	4 to 443

* Subsidiaries that are currently dormant, in members' voluntary liquidation, pending striking off and pre-operating

Victor Saw is an executive director in PwC's Business Recovery team. This is the fifth of six fortnightly articles by PwC Malaysia's Advisory practice. This series looks at how businesses can manage change amid uncertainties by strengthening fundamentals and planning ahead. The final article talks about how big data presents new and exciting ways of preventing fraud.