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THE IMPACT OF DEMERGERS ON SHAREHOLDER WEALTH: A STUDY ON INDIAN DEMERGER

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Abstract
The demerger is widely used corporate restructuring strategies, play a significant role in shaping the landscape of businesses, especially in dynamic markets like India. Demerger, a subset of corporate restructuring, has gained attention as a strategy for unlocking shareholder value and optimizing business operations. This research paper aims to analyze the role of demerger as a strategy for corporate restructuring and its impact on shareholder wealth creation, focusing on selected Indian companies. Through a comprehensive review of literature, case studies, and financial analysis, this paper seeks to provide insights into the motivations behind demergers, their execution, and their outcomes in terms of shareholder wealth creation. By examining the demerger process and its implications in the Indian context, this paper aims to contribute to the understanding of corporate restructuring strategies and their effects on shareholder value.

Keywords: Demerger, Corporate Restructuring, Shareholder Wealth Creation, Indian Companies, Financial Analysis.

Introduction

Corporate restructuring is a strategic management process that aims to make significant changes to a company's organizational structure, operations, or ownership. One of the key strategies within corporate restructuring is demerger, which involves the separation of a company into distinct entities, each with its own operations, assets, and liabilities. Demergers have become increasingly common in the business world, driven by various factors such as the desire to focus on core businesses, improve operational efficiency, and unlock shareholder value.

In India, companies in a wide range of industries have used demergers to change the way their businesses work and make shareholders richer. To restructure companies, this study paper looks at demerger and how it affects the wealth creation of shareholders, focusing on a few Indian companies. This paper will look at the reasons for demergers, how they are put into action, and the financial effects to give useful information about how well demergers work to create value. Corporate reform includes several different plans that are meant to make a company more productive and competitive. Some of these tactics are mergers and acquisitions, sales, spin-offs, and de-mergers. Demerger means that a company is split into two or more separate entities, each with its own activities and management structure.

Literature review

Sudarsanam, 2003. The implementation of a demerger frequently involves various important stages, such as strategic planning, extensive research, compliance with regulations and laws, and integration after the demerger. Companies must thoroughly assess the justification for the demerger and formulate a precise strategy for carrying out the division of assets, liabilities, and operations. Research indicates that achieving successful demergers requires careful planning and implementation, along with effective interaction with stakeholders.

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Singh et al. (2016) studied Indian demergers using Bombay Stock Exchange data. Their findings suggest demergers generally boost shareholder wealth by eliminating inefficiencies and unlocking value. However, they warn investors to be cautious of manipulative demergers and to focus on management quality and corporate governance before investing.

Singhal (2019) studies financial performance after demergers in India. She finds mixed results, with only 44% of demerged firms showing improved financial ratios. This suggests demergers do not guarantee better performance.

Mitchell & Mulherin, 1996, has conducted research on the corporate restructuring trough demerger. According the researcher, one of the primary objectives of corporate restructuring, including demergers, is to create value for shareholders. Research has shown that demergers can lead to significant increases in shareholder wealth, as they enable companies to unlock hidden value, reduce conglomerate discount, and improve capital efficiency.

Sundaresan & Wang, 2007., the extent to which demergers result in shareholder wealth creation depends on various factors, including the strategic fit of the demerged entities, the effectiveness of post-demerger integration, and market conditions .

Loughran & Vij, 1997. empirical studies have found mixed evidence regarding the long-term impact of demergers on shareholder value, highlighting the importance of conducting thorough analysis and evaluation

Key concept of demerger:
The demerger is a smart move that is being used to restructure the business activities of the company so that it can focus on its core business again. Companies always try to improve their business actions because they need to stay ahead of their rivals and compete. A demerger lets a company reorganize parts that aren't working as well as they'd like. Here are the main ideas behind the demerger.

Increasing focus: Through the division of a secondary business division, the parent company can allocate its resources towards its core capabilities and potentially enhance operational effectiveness.

Unlocking value: Occasionally, a company's multiple divisions may be underestimated when considered as a collective entity. Demerging enables investors to assess the worth of each unit more precisely.

Strategic reasons: Demerger can raise funds by divesting a business unit or discouraging a hostile takeover by reducing the company's appeal as a potential target.

Stock price impact: the stock price of the company reduced, as the assets belonged to the parent’s company transferred to the resultant firm, resulting the lowering firms book value.

Tax benefits: Demerger allow a firm’s tax neutrality as it do not involve any cash transaction.

Objective: Numerous studies have been conducted to examine the effects of demerger on financial performance. Previous research has analyzed various aspects of demerger. However, this study specifically focuses on the following objectives:

1. To investigate the potential impact of demerger on enterprises' return on investment.
2. To evaluate the possible influence of demerger on the Return on Net Worth of companies.
3. To assess the effect of demerger on firms' Earnings per Share (EPS)

Methodology

The methodology used for this study relies on secondary data. The sample consists of 5 firms that underwent demerger in 2015-16. These firms will be analysed to determine if there is any influence of the demerger on ROI (Return on Investment), RONW (Return on Net Worth), and EPS (Earnings per Share). The data is sourced from the official website of the relevant company, NSE, as well as from Money Control. The essential ratios are averaged and analyzed using an independent sample T-test through the Zamovi platform.

Hypothesis

H0- There is no statistical significance of demerges on ROI or RONW or EPS.
Ha- There is statistical significance of demerges on ROI or RONW or EPS.

Table 1.1 showing the descriptive statistics of the ROI, RONW and EPS of the selected companies

	Group	N	Mean	Median	SD	SE
AV. ROI	POST	4	11.28	11.99	2.65	1.32
	PRE	4	6.35	6.29	1.39	0.695
AV. RONW	POST	4	5.65	5.12	2.22	1.11
	PRE	4	11.51	11.54	2.31	1.154
AV.EPS	POST	4	15.19	14.96	2.10	1.05
	PRE	4	16.96	16.41	3.70	1.850

Source: author compilation based on the data analysis

The above table 1 shows the descriptive statistics of the ROI, RNOW, and EPS of the businesses that went out of business.1. The results show that the ROI post-mean (11.28), median (11.99), and standard deviation (2.65) are higher than the ROI pre-mean (6.35), median (6.29), and standard deviation (1.39). The post-RONW mean (5.65), median (5.12), and standard deviation (2.22) are all lower than the pre-RONW mean (11.51), median (11.54), and SD (2.31). The post EPS mean (15.19), median (14.96) and SD (2.10) are all a little lower than the pre EPS mean (16.96), median (16.41), and SD (3.70).

Table 1.2 showing the Homogeneity of Variances Test (Levene's)

	F	df	df2	p
AV. ROI	0.719	1	6	0.429
AV. RONW	0.196	1	6	0.674
AV.EPS	2.447	1	6	0.169

Source: author compilation based on data analysis

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A Levene's test for homogeneity of variance was performed to assess whether there were any violations of the assumption of equal variance. The analysis revealed a p-value greater than 0.05, indicating that there is no evidence of unequal variance between the two groups: pre and post ROI, RNOW and EPS of the demerged companies.

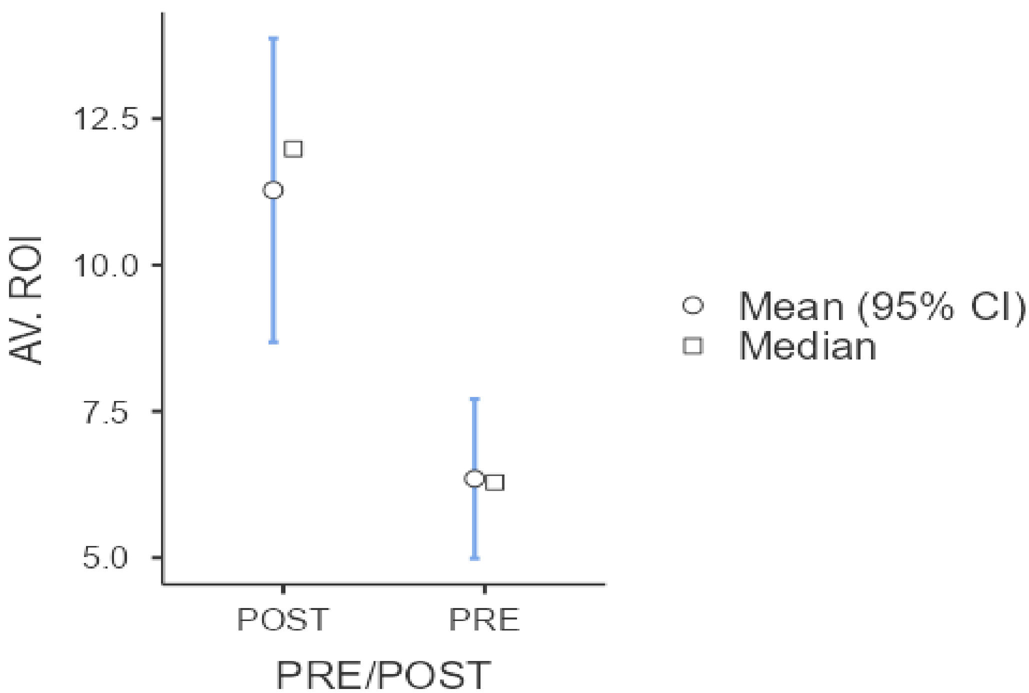
Table 1.3 presenting the result of independent sample t-Test

		Statistic	df	p	Mean difference	SE difference
AV. ROI	Student's t	3.297	6.00	0.016	4.93	1.49
AV. RONW	Student's t	-3.656	6.00	0.011	-5.86	1.60
AV.EPS	Student's t	-0.829	6.00	0.439	-1.76	2.13

Source: author compilation based on data analysis

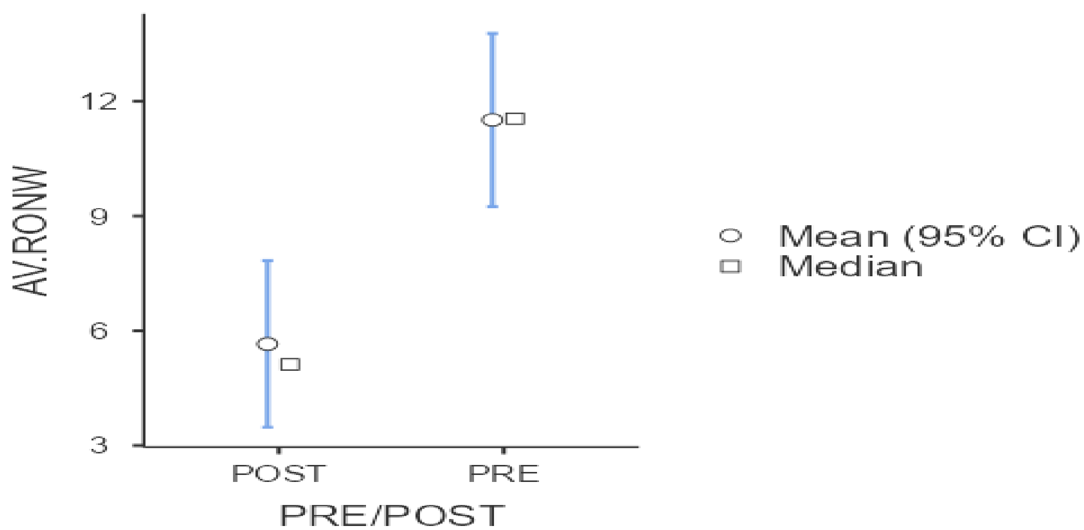
Table 1.3 displays the outcomes of an independent sample t-test study. The study demonstrates that the Average Return on Investment (ROI) and Return on Net Worth (RONW) are statistically significant at a 95% level of significance. The P value for the two variables is less than 0.05. However, the EPS does not have statistical significance as it has a higher P value of 0.439.

Figure 1.1 AV. ROI of demerged companies



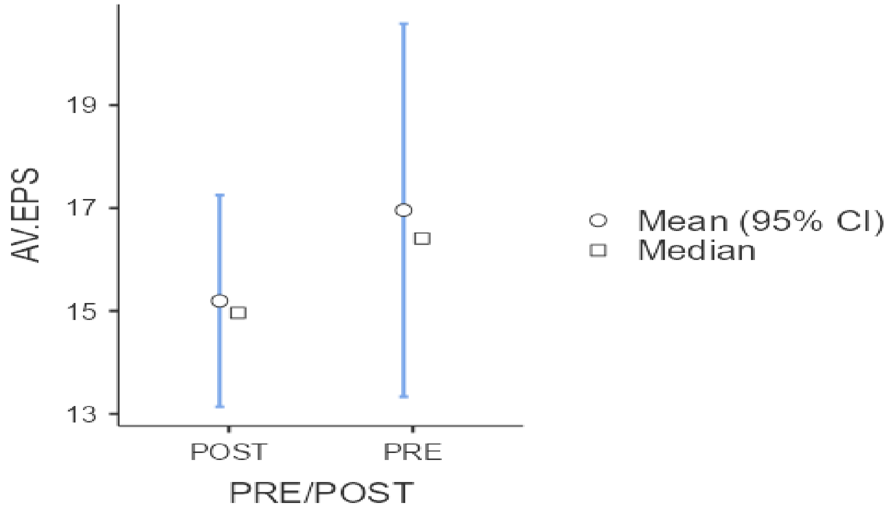
Source: author compilation based on data analysis

Figure 1.2 AV. RONW of demerged companies



Source: author compilation based on data analysis

Figure 1.3 AV. EPS of demerged companies



Source: author compilation based on data analysis

The graph above illustrates the demerged company's ROI, indicating that the average post-mean is consolidated between the range of 7.5 to 12.5. In contrast, the pre-average mean falls between 5 and 7.5. The RNOW post range is from 3 to 9, and the pre range is from 9 to 12. The EPS pre-mean range is from 13 to 19, and the range is from 13 to 17.

Conclusion

Demerger is a business restructuring strategy commonly used to enhance the profitability of organizations and raise shareholder value. To obtain the results, we calculate the average of the EPS, RONW, and ROI for the four years prior and the four years following. During the investigation, we saw a favorable increase in Return on Net Worth (RONW) and Return on Investment (ROI) following

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the demerger. Therefore, it can be inferred that demergers have shown to be a highly effective approach for increasing shareholders' wealth and concentrating on key skills. Demerger enables organizations to concentrate on their core strengths and enhance profitability in their business.

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Appendix

Table 1.1 showing the pre and post financial ratio of demerged companies

Sn	Name of companies	Ratio's	2019-20	2018-19	2017-18	2016-17	2014-15	2013-14	2012-13	2011-12
1	Mastek ltd	ROI	11.97	16.98	10.75	5.32	2.75	8.83	6.2	1.16
		RONW	13.44	14.16	12.73	6.9	2.97	9.25	6.44	0.09
		EPS	45.21	42.61	29.74	13.96	7.94	21.08	13.06	0.19
2	Adani Enterprise LTD	ROI	10.57	10.74	8.84	9.22	2.21	2.72	2.06	2.38
		RONW	6.71	4.86	5.01	6.98	7.57	9.34	7.51	9.43
		EPS	10.35	6.52	6.89	8.98	17.7	20.19	14.67	16.72
3	Balkrishna Industries limited	ROI	21.88	23.63	25..46	26.0	12.35	12.41	10.88	11.8
		RONW	19.16	16.26	18.01	20.23	20.76	25.04	24.22	24.21
		EPS	49.64	40.02	38.36	37.56	48..89	49.19	36.12	27.48
4	CG Power and Industrial Solution Ltd	ROI	-17.79	2.13	-1.46	7.41	0.34	4.33	-0.65	8.48
		RONW	0	-23.4	-24.96	-11.96	0.51	6.75	-1..02	10.34
		EPS	-34.5	-8.03	-11.47	-7.83	3.34	3.86	-0.56	5.82
5	Arvind Ltd	ROI	11.17	14.4	12.96	15.28	8.01	8.75	7.52	15.25
		RONW	3.53	8.22	8.18	8.82	13.89	15.3.3	12.57	24.95
		EPS	3.7	8.75	11.97	12.18	13.21	13.71	9.63	16.9

Source: money control