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IMPACT OF DE-MERGERS ON CREATION OF SHAREHOLDER VALUE: CASE STUDY OF SELECTED INDIAN COMPANIES

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Abstract
This article discusses two of the cases of demergers in Indian capital markets with a historical perspective, these seven cases are illustrative in nature to help analyze and understand the perspective of this study. These cases are both from within the period of this study as well as beyond the period of this study. The cases of demerger within the period of study have been analyzed in detail; however, because of aggregation of all demergers within the period isolated cases could not be discussed in earlier chapters. This paper tests effects of Indian demerger transactions. This study gives a better understanding of demergers as a transaction and practitioners would be able to guide their clients to take an informed decision surrounding the demerger announcement. For researchers, this study throws light on a new research paradigm and offers a robust methodology that can be used for various corporate restructuring transactions. This study would also help researchers to do a cross-sectional analysis of several corporate restructuring transactions.

Keywords: De-merger, share, capital market etc.

1. INTRODUCTION

As distinct from corporate growth, corporate restructuring requires a significant reduction in the resources that a corporation allocates to markets or process activities or geographical locations in which it is present. Such a reduction may be part of a process of reallocating corporate resources to new growth areas or improve focus, but, by definition, Corporate restructuring often involves reducing resource obligations to one or more markets, activities and/or areas, relative to previous commitments. Therefore, for a corporation, the starting point for restructuring is an existing organizational structure that employs a certain number of people, in particular, locations to serve particular markets by engaging in particular activities. Kar (2011), defines corporate restructuring as a broad umbrella term that includes a broad range of activities including, mergers and expansions, refocusing and otherwise restructuring asset and ownership structure. In a broad context, it has been defined as any form of corporate activity which involves a rearrangement or change in the asset structure of the organization with a view to attaining long term long term strategic objectives.

2. SHAREHOLDER VALUE CREATION

Value creation is a corporation’s raison d’être, that is an ultimate measure by which a corporation's performance is judged. There has been a lot of debate in the theoretical as sell as empirical literature about value creation. These debates are focused on what is the most appropriate type of value for the corporation to create.

3. DEMERGERS

In recent years, a host of divestitures, divisions, dividing-offs, and other such corporate restructuring works have occurred in the Indian market scenario. These restructurings are changing the company's capital structure. A few years ago, a conglomerate's diversification was trendy. Managers looked at diversification and, as a result, businesses have become large and grow their income with much diversification. Thus, these corporations have ended up being in several unrelated companies, which are no longer regarded as corporate strength by changing times. These corporations began to be insecure in managing a variety of unconnected companies, with competitiveness growing day by day and margins under pressure. Once all of these firms, from hairpins to aviation, have divided several unrelated companies and reorganize their strategies into core skills. Recently there has also been a great deal of corporate restructuring as a result of family settlements. Demergers are one way to dissolve these conglomerates for different reasons. In developing economies, the disintegration is generally known as spin-off.

The pro-rate distribution of majority (often 80 per cent or more) shares of the subsidiary to the parent shareholders can be described as a demerger, widely known as a spin-off in advanced economies worldwide. The subsidiary becomes a fully autonomous entity, initially having the same shareholder base as the parent company, due to a division. The former parent shareholders have two stocks after the transaction: the stock of the parent company and the shares of the demerged subsidiary. Consequently, a division leaves the decision to share the portfolio to the shareholders (whether the shareholder or not of the parent and the subsidiary company). In comparison to carvings, an exchange of cash does not have a dispersion. This disintegration is therefore not driven by the company's ability to produce cash instantly, while carvings (and sales) also become a funding source for businesses that have financial problems.

4. METHODOLOGY

To evaluate the announcement performance of demerger well-established event study methodology has been used in this research. Using financial market data, an event study measures the impact of a specific event on the firm value

Sample Selection: The research has selected a case study of two companies

5. RESULTS & DISCUSSION

5.1 Case 1: Demerger of IDFC Limited

IDFC Limited (BSE: 532659 | NSE: IDFC) was established as Infrastructure Development Finance Corporation Limited in 1997 with an objective to finance large infrastructure projects. The company has an established player into various financial business verticals such as stock broking, private equity, infrastructure and real estate finance as well as asset management and investment banking. The growth of IDFC has been driven by the substantial investment requirements of the infrastructure sector in India combined with the growth in the Indian economy over the last several years. IDFC's ability to tap global, as well as Indian financial resources, made IDFC an acknowledged expert in infrastructure finance.

In April 2014, IDFC got in-principle approval by RBI, to set up a new private bank under the section 22 of the Reserve Bank of India Act. Accordingly, IDFC on October 21, 2014, demerged its banking division namely IDFC Bank.

Objectives of Demerger:

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The board considered demerger as;

According to the new guidelines of RBI for private sector banks required that all new banks should be set up through a non-operative financial holding company. They were required to have a categorical structure in a way that all the functions that are required to be carried out by a bank should be separately carried out by the banking subsidiary company and all the other functions are to be carried out by the non-operative financial holding company.

- The board also believed that this demerger would allow both the companies to have stronger financial strength, flexibility and greater access to funds and resources. This would also help IDFC in diversifying the asset base and widening the liability base, larger leveraging and diversified financial sector opportunities provides a stable funding profile through retail funding.

- This demerger would also maximize the stakeholder value for IDFC and its stakeholders.

Scheme of Demerger:

As a consideration for the demerger of financing undertaking of IDFC Limited into IDFC bank, IDFC Limited issued one equity share of IDFC bank of Rs. 10 each for every one equity share on IDFC Ltd of Rs. 10 each. On completion of demerger, equity share capital of IDFC bank would have approximately 53% shares held by IDFC Financial holding company Limited and approximately 47% held by the shareholders of the IDFC Limited.

Announcement Date Returns:

Table 1: Announcement Date Returns of IDFC Limited (IDFC)

Date	Nifty	IDFC	Nifty Return	IDFC Return	Abnormal Return (Daily)	Abnormal Return (cumulative)
22-Oct-14	7995.90	145.70	0.86%	0.55%	-0.31%	-0.31%
23-Oct-14	8014.55	146.25	0.23%	0.38%	0.14%	-0.16%
27-Oct-14	7991.70	144.20	-0.29%	-1.40%	-1.12%	-1.28%
28-Oct-14	8027.60	146.00	0.45%	1.25%	0.80%	-0.48%
29-Oct-14	8090.45	145.10	0.78%	-0.62%	-1.40%	-1.88%
30-Oct-14	8169.20	148.25	0.97%	2.17%	1.20%	-0.68%
31-Oct-14	8322.20	156.30	1.87%	5.43%	3.56%	2.87%
03-Nov-14	8324.15	154.85	0.02%	-0.93%	-0.95%	1.92%
05-Nov-14	8338.30	153.45	0.17%	-0.90%	-1.07%	0.85%
07-Nov-14	8337.00	152.10	-0.02%	-0.88%	-0.86%	-0.01%
10-Nov-14	8344.25	150.95	0.09%	-0.76%	-0.84%	-0.86%

Listing Date Returns:

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Table 2: Listing Date Returns of IDFC Limited (IDFC) and IDFC Bank Limited (IDFC Bank)

		Company		Returns			Abnormal Returns		CAR	
Date	**Nifty**	**IDFC Ltd**	**IDFC Bank**	**Nifty**	**IDFC Ltd**	**IDFC Bank**	**IDFC Ltd**	**IDFC Bank**	**IDFC Ltd**	**IDFC Bank**
06-Nov-15	7954.30	55.45	70.40	-6.65%	-0.01%		6.64%	6.65%	6.64%	6.65%
09-Nov-15	7915.20	53.85	66.95	-0.49%	-2.89%	-4.90%	-2.39%	-4.41%	4.24%	2.24%
10-Nov-15	7783.35	52.65	64.55	-1.67%	-2.23%	-3.58%	-0.56%	-1.92%	3.68%	0.32%
11-Nov-15	7825.00	53.30	66.30	0.54%	1.23%	2.71%	0.70%	2.18%	4.38%	2.50%
13-Nov-15	7762.25	52.05	63.50	-0.80%	-2.35%	-4.22%	-1.54%	-3.42%	2.83%	-0.92%
16-Nov-15	7806.60	53.50	65.00	0.57%	2.79%	2.36%	2.21%	1.79%	5.05%	0.87%
31-Dec-15	7946.35	48.25	60.85	-0.10%	-12.98%	-13.57%	-12.88%	-13.47%	-7.84%	-12.60%

For IDFC, the banking license from Reserve Bank of India was a major trigger for growth. The company got permission to set up a bank under the new banking license norms of RBI. Accordingly, the demerger of banking subsidiary took place. On the day of announcement of this demerger, IDFC’s share gave an abnormal return of 1.20% and 3.56% on the following day as compared to benchmark NIFTY. However, as the time passes by the abnormal returns diminishes and is more or less in tandem with the market returns in -5 to +5 day event window.

In the case of listing date returns are concerned, IDFC Bank listed on stock exchanges on Nov. 6, 2015, and the daily abnormal returns following the listing date for IDFC bank were in excess of 6%. The same was evident in the stock price of the parent company IDFC, which also gave abnormal returns in excess of 6% on the listing of its demerged banking subsidiary.

The case of IDFC and IDFC bank demerger becomes a contrarian case in this series of demerger cases. The end year returns for the demerger IDFC and IDFC bank returns negative to -12.98% and -13.57% respectively, as compared to S&P CNX NIFTY returns of -0.10% for the corresponding period. The cumulative abnormal returns also signal destroying of shareholder value for the period under investigation.

5.2 Case 2: Demerger of Arvind Limited

Arvind Limited (BSE: 500101| NSE: ARVIND) was established in 1931 as Arvind Mills Limited, as a part of Mahatma Gandhi's policy of self-reliance or swadeshi movement to indigenously manufacture products like dhoties, sarees, mulls, dorias, crepes, shirtings, lingerie, coatings, printed lawns and voiles cambrics, twills and gabardine. The company in 1991 reached 100 million meters of denim per year mark, becoming the fourth largest producer of denim in the world. The company in 1994 Arvind forayed into telecom business and readymade garments business. It is the owner of the brands like Flying Machine, Newport, Ruf & Tuf and Excalibur, and has a license in India to manufacture and sell iconic international brands like Arrow, Lee, Wrangler, Izod, Cherokee, Mossimo, U.S. Polo Assn. and Nautica.

On July, 31 Arvind Limited announced the demerger of Arvind Infrastructure Ltd (AIL) from itself. AIL was formed in 2009 as subsidiary to use the land asset of the Arvind Limited. This was done with a view to focus on real estate business and take benefit of monetization of the huge land bank with the company.

Objectives of Demerger:

The rationale behind the demerger was to focus on the core competency of both the business units. As the operations of both the units is entirely different. The board of Arvind Limited was of the view that

- Focused management was required, as both the business needs a different set of skill and resources to meet the competitive and regulatory environment and to mitigate the risk.
- This demerger, therefore, would ensure the long-term sustainability of both the businesses, an increase in the profitability and strengthen market share of both the business.
- The demerger would also enhance its residual core business opportunity by streamlining the operations and cutting cost, ensure better and more efficient management control.
- It would also enable the investor to hold separately, the shares of the businesses, which suits to their investment strategy and risk taking ability.
- The transferee company (Arvind Limited) would have large net worth base and the greater borrowing capacity, which would provide a competitive edge.

Scheme of Demerger:

The shareholder of Arvind limited would get one equity share of Arvind Infrastructure of Rs. 10 each for every ten (10) share of Arvind Limited of Rs. 10 each.

Announcement Date Returns:

Table 3: Announcement Date Returns of Arvind Limited (ARVIND)

Date	Nifty	Arvind Ltd	Nifty Return	Arvind Ltd Return	Abnormal Return (Daily)	Abnormal Return (cumulative)
23-Jul-14	7795.75	236.10	0.36%	0.28%	-0.08%	-0.08%

24-Jul-14	7830.60	232.55	0.45%	-1.50%	-1.95%	-2.03%
25-Jul-14	7790.45	217.35	-0.51%	-6.54%	-6.02%	-8.05%
28-Jul-14	7748.70	210.90	-0.54%	-2.97%	-2.43%	-10.49%
30-Jul-14	7791.40	240.65	0.55%	14.11%	13.56%	3.07%
31-Jul-14	7721.30	230.65	-0.90%	-4.16%	-3.26%	-0.19%
01-Aug-14	7602.60	222.30	-1.54%	-3.62%	-2.08%	-2.27%
04-Aug-14	7683.65	232.85	1.07%	4.75%	3.68%	1.41%
05-Aug-14	7746.55	233.70	0.82%	0.37%	-0.45%	0.96%
06-Aug-14	7672.05	232.45	-0.96%	-0.53%	0.43%	1.38%
07-Aug-14	7649.25	239.80	-0.30%	3.16%	3.46%	4.84%

Listing Date Returns:

Table 4: Listing Date Returns of Arvind Limited (Arvind) and Arvind Infrastructure Limited (AIL)

		Company			**Returns**		**Abnormal Returns**			**CAR**
Date	**Nifty**	**Arvind**	**AIL**	**Nifty**	**Arvind**	**AIL**	**Arvind**	**AIL**	**Arvind**	**AIL**
26-Aug-15	7791.85	257.30	53.25	-1.12%	-2.61%		-1.49%	1.12%	-1.49%	1.12%
27-Aug-15	7948.95	264.90	50.60	2.02%	2.95%	-4.98%	0.94%	-6.99%	-0.56%	-5.87%
28-Aug-15	8001.95	271.35	48.10	0.67%	2.43%	-4.94%	1.77%	-5.61%	1.21%	-11.48%
31-Aug-15	7971.30	271.40	45.70	-0.38%	0.02%	-4.99%	0.40%	-4.61%	1.61%	-16.09%
01-Sep-15	7785.85	257.20	43.45	-2.33%	-5.23%	-4.92%	-2.91%	-2.60%	-1.29%	-18.69%
02-Sep-15	7717.00	258.30	41.30	-0.88%	0.43%	-4.95%	1.31%	-4.06%	0.02%	-22.75%
31-Dec-15	7946.35	358.20	85.95	1.98%	39.21%	61.41%	37.23%	59.43%	37.25%	36.68%

Arvind, a conventional textile manufacturer and a leader in denim manufacturing, demerged its subsidiary in real estate business. This is because the nature of two businesses were completely different and fund infusion from Arvind may not be feasible for several reasons like it is not a core business of Arvind, the real estate business has very different risk-return matrix and Arvind's existing shareholders may or may not be keen to take exposure in real estate. On the announcement of the demerger, in July 2014 the price of Arvind gave a slightly negative reaction, however, the stock did run up prior to this announcement considerably, giving an abnormal return of around 13.56% in days prior to the announcement. This indicates that probably this news of the announcement of demerger was predicted by the market. Also that the abnormal returns of Arvind on +5 days of the announcement were 4.84%.

On the listing days of Arvind Infra, the demerged company, the prices corrected sharply for 4 days post listing with every day, the lower circuit limit getting triggered for the stock. Accordingly, AIL gave an abnormal return of -22.75% post 5 days of its listing. On the other hand, the shares of Arvind did not register a significant outperformance.

Interestingly, at the end of the calendar year 2015, both Arvind, as well as AIL out-performed the benchmark index, wherein Arvind registering an abnormal return of 37.23% and AIL registering an abnormal return of 59.43% compared to benchmark S&P CNX NIFTY.

6. CONCLUSION

It is quite clear from above illustrative case studies on demerger and shareholder value creation in Indian context that demergers are not uncommon phenomena in Indian companies. Several companies across sectors and irrespective of size and scale of business have opted for demergers. Apparently, most demergers take place with a rationale of focusing on core business or develop a new business segment. It is also true that in order to manage size and complexity of different unrelated business verticals demerger becomes necessary. In some cases, the demergers are the way out to settle family feud and succession planning of the entrepreneur.

However, whatever the rationale be there for demerger above cases suggest that the announcement of demerger is looked positively by the markets, in most cases immediately preceding the announcement and in some cases once the scheme of demerger becomes clear. In the same manner listing of the demerged company also signals positive returns for both parent company as well as demerged entity. In most cases these company's returns exceed the benchmark returns.

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