

A Study on Human Resource Development and Shareholders perspective of Demerger as a Corporate Restructuring Tool in Modern India

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ABSTRACT: To meet up the competition in today's modern era, Indian companies are opting for various corporate restructuring tools. Mergers and acquisitions are used by companies from years together but cases of demergers have been increasing in the recent years. Demerger is an act of splitting up an undertaking of a company into a separate resulting company. The various reasons for demerger are increasing valuation of the company, focusing on core competencies, removal of negative synergy, attracting investors or family settlement. With the increasing use of demerger as corporate restructuring tool in modern India, it is important to understand the concept of demerger. The process of demerger affects its stakeholders. Hence the researcher has made an attempt to study the concept of demerger in detail. The objective of the study is also to explain the shareholders and employees perspectives to demerger. Shareholders are highly affected by the tool of demerger and hence demerger can be implemented only after resolution being passed by majority of the shareholders present at the meeting convened for the same and sanction of high court is also to be obtained. The study is based on secondary data obtained from reliable sources. The study concludes that demerger is an effective corporate restructuring tool. The study also states how shareholders wealth is affected by demerger and emphasizes on role of human resource management during the process of demerger.

KEYWORDS: Demerger, Human Resource, Shareholders , Corporate Restructuring,

I. INTRODUCTION

Corporate restructuring means any change in the business capacity or portfolio which is done or a change in the capital structure of a company or any change in the ownership or control over the management of company. In today's dynamic competitive world, companies are continuously searching various options by which shareholders value can be enhanced. All these attempts channelized as strategies are referred to as restructuring strategies. Important forms of corporate restructuring are Merger, Consolidation, Acquisition, Divestiture, Carve outs, Joint venture, Reduction of capital, Buy back of securities, Delisting of securities and Demerger.

Demerger is a form of corporate restructuring in which structural readjustments are made in a way that a company splits into two or more entities keeping the economic position of the members same. Demerger is an act of splitting off a part of an existing company to become a new company, which operates completely separate from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. The entity that emerges has its own board of directors and, if listed on a stock exchange, have separate listings. It does not result in a purchase or sale transaction but is just a division of an existing entity, the demerged company.

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II. OBJECTIVES OF THE STUDY

1. To understand the concept of demerger as a tool of corporate restructuring
2. To study the shareholders perspective of demerger.
3. To study the human resource perspective of demerger.

Significance of the Study:

Since more and more companies are opting for demerger as a corporate restructuring tool in modern India, it is important to understand the concept of demerger from various perspectives. The most important stakeholders in the company are the owners hence this study makes an attempt to understand the shareholders perspective to demerger and how shareholders wealth is affected by demerger. Another important element is human resource in any company so it is important to study how the employees of a company adopting demerger as restructuring tool are affected. The study also enlightens about the role of human resource management in dealing with employees during the entire process of demerger. The study will help the companies planning to adopt demerger to implement the process of demerger in a better way. The study will also help investors and common public to understand the concept of demerger in a systematic way. This study shall provide all round view about demerger.

Conceptual Framework:

a) Demerger: - Although the term Demerger has not been defined in the Companies Act, 1956, however, it has been defined in Sub-section (19AA) of Section 2 of the Income-tax Act, 1961. According to the said Sub-section, demerger in relation to companies, means transfer, pursuant to a scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that:

- i. All the property of the undertaking being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company.
- ii. All the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of resulting company of virtue of the demerger.
- iii. The property and the liabilities of the undertaking, being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- iv. The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;
- v. The shareholders holding not less than three fourths in value of the share in the demerged company (other than shares already held therein immediately before the demerger or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger.
- vi. The transfer of the undertaking is on a going concern basis;
- vii. The demerger is in accordance with the conditions, if any, notified under Sub section (5) of Section 72A of the Income Tax Act 1961 by the Central Government in this behalf

b) Demerged Company: According to Section (19AA) of Income Tax Act, 1961 demerged company means the company whose undertaking is transferred, pursuant to a demerger to a resulting company.

c) Resulting Company: According to Section 2(47A) of Income Tax Act, 1961 resulting company means one or more company, (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger, and the resulting company in consideration of such transfer of undertaking issues shares to the shareholders of the demerged company and include any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

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III. REVIEW OF LITERATURE

1. Allen and McConnell, (1998), studied the managerial behavior with respect to controlling of assets and to demerge subsidiaries. It is argued that demergers generally are supported by manager, if firm is struggling for capital. It was concluded that firms that execute demergers are not operated well and high leverage before demerging. It is also observed that the average excess stock returns are substantially better when demerger is executed for capital to invest than for paying off debts.
2. Capron (2001) identified that demergers are often part of the restructuring of merging firms. Demergers are more than just a merger in reverse. Demergers are been done to re-align firms with their core business focus and manage their level of diversification. Demerger has become the corrective solution to failed restructuring caused to incorrect mergers.
3. Chris and -Merkoulova, (2004), compared US demerger and European demergers and observed a significant abnormal return in short run and subsequent spin-offs. The cumulative average abnormal return was approximately 3.5% for spin-offs by companies that increase their industrial focus and less than 1% for non-focus increasing companies. In the long-run returns in excess of matching firms were mostly insignificant for parents, subsidiaries and pro-forma combined firms. Finally suggested that, unlike US spin-offs, European spin-offs were not associated with long-run superior performance.
4. Bhagbole, (2013) had touched the aspect of Marketing, studied the impact of demerger on the Hero group particularly the Hero brand. Specifically, focus was on Brand Image Study whether there is any change in the decision-making process for consumers while buying a Hero bike in the future The study reveals that there were concerns regarding sustained growth in the long-term. This is because Hero group will face increased competition from new entrants and there were concerns regarding the technological capability of Hero without Honda.
5. Chandratrein (2010) presents the detailed information of laws and procedures in India related to corporate restructuring amalgamations, arrangements, compromises, corporate mergers and demergers, reduction of capital, buy-back of shares, variation of investors' rights, with cases, materials, forms and precedents.

IV. DEMERGER AS A TOOL FOR CORPORATE RESTRUCTURING

The rationale behind a company opting for demerger as corporate restructuring tool is either improving valuation of the company or attracting investors. It is seen in most of the cases that demerger is opted for gaining specialization that is to focus on core competencies and reducing diversity in the business of the company. Some of the demergers were undertaken as a part of family settlement also. Thus, demerger also occur due to reasons almost the same as mergers i.e. the desire to perform better and strengthen efficiency, business interest and to curb losses, wastage and competition. Undertakings demerge to set down businesses and fix responsibility, liability and management so as to ensure improved results from each of the demerged unit. Following is the SWOT analysis of demerger as a corporate restructuring tool in modern India.

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SWOT analysis:

Strengths	Weakness
<ol style="list-style-type: none"> 1. Unlock the full potential of the business by creating different companies. 2. Increase the valuation of wealth of shareholders. 3. Attract the investors. 	<ol style="list-style-type: none"> 1. Anxiety amongst employees in course of creating departments. 2. Delay in finalization of deals. 3. Sometime sudden change in management and organization vision creates a gap leaving certain capacity idle and promoting inefficiency in utilization of resources.
Opportunities	Threats
<ol style="list-style-type: none"> 1. Restructuring is an attempt to relax some or all of the short run constraints which is concerned with changing structure in pursuit of long run strategy. 2. Can focus on core business. 3. Scope for independent collaboration and expansion. 	<ol style="list-style-type: none"> 1. Difficult to tap credit / funds. 2. Losing the synergy. 3. Misconception in the minds of investors about the stability of resulting company.

V. SHAREHOLDERS PERSPECTIVE TO DEMERGER

Shareholders being the owners of the company are most affected by any type of corporate restructuring. Hence researcher has made an attempt to analyse how shareholders are affected by the decision of demerger. De-merger is essentially a scheme of arrangement under Section 391 to 394 of the Companies Act, 1956 requiring approval by majority of shareholders presented in meeting convened for the purpose and sanction of High Court.

There are lot of psychological aspects involved in impact of demerger on shareholders like they are anxious and uncertain about company's growth, management and performance post demerger. But the most important aspect is the impact on shareholders wealth. Though the exchange ratio given in demerger is 1:1 i.e. for every one share held in demerged company the shareholder will be given one share of each of the resulting companies; the shareholders wealth may not remain same as the stock prices of demerged company post demerger would be affected and also the stock prices of resulting company would be affected by the risk and return expectation of the shareholders. Shareholders wealth is the number of shares hold by a shareholder multiply by market price of one share. Mathematically, Shareholders' wealth = No. of shares x Market price per share.

Market price of a share also acts as a barometer of the company's performance. Amongst the other reasons for demerger, the most important rationale behind adopting such restructuring strategy is to maximize shareholders wealth. The stock position in market is affected by the way shareholders perceive the demerger of company. It is seen in most of the cases that shareholders get anxious about the future prospects of demerged and resulting companies which leads to selling of shares of the company. Hence it may be seen that there can be temporary downfall in the share prices post announcement of the demerger. Therefore it is very important for the managers of the company to communicate properly reason behind the demerger and the prospective growth of the resulting companies post demerger. This would help in sustaining shareholders faith in the company. Studies have also proved that on a long run these temporary effects on share market are automatically corrected seeing the progress of resulting companies. The companies perform better post demerger because of specialized focus and removal of negative synergy. In addition to shareholders wealth

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based on market price, it is also important to note the other factors that determine shareholders satisfaction in relation to corporate restructuring activity. They are price earnings ratio, earnings per share ratio and other financial ratios of the company post demerger. Hence it can be said that lot of volatility is seen on stock market at the release of news of demerger but what is important is the long run impact on performance of the companies.

VI. HUMAN RESOURCE PERSPECTIVE TO DEMERGER

The process of demerger is a complicated process involving lot of formalities and hence generally takes months to complete the entire process. It involves not only the disintegration of assets and liabilities relating to undertaking being demerged but it is also accompanied with disintegration of human capital, information technology and business processes. The entire process of demerger can be said to be in three phase's namely initial phase, transition phase and closing phase. The initial phase involves secrecy of news, transition phase involves fear of unforeseen uncertainties and the closing phase involves time pressure and tension amongst employees to wrap up the process. It is not that only legal or secretarial team is under pressure of legal formalities relating to demerger but even the other departments are affected. Especially the employees related to undertakings being transferred. While it is relatively easy to think that a split in the business will just create new organizations / close down a business unit / provide individual focus on a business area, with all other factors remaining pretty much the same, reality is quite the opposite. Besides, there is never a certainty of how the business might function after a demerger until after the demerger has actually happened. These factors lead to considerable stress and anxiety within the employees regarding job cuts, new working dynamics, management changes, taking on a business identity, molding into a new work culture. Often, this anxiety manifests into resentment towards the restructuring activity and inadvertently leads to a demoralized workforce, which is a certain recipe for corporate disaster.

Like most other corporate activities, demergers go through defined pre demerger, demerger, and post demerger stages where a lot of different activities are carried out to ensure that the demerger is a success. During all of these stages, the management typically tends to focus on financial and legal metrics without giving much thought to the most important assets they have in hand – their employees. Employees within an organization have different concerns and reactions towards a demerger situation in all the above stages of the demerger process and can influence the outcomes of the demerger in many adverse ways if not dealt with sensitivity. Without clear communication to the employees about the objectives of the demerger and the effect it will have on the employees, a sense of anxiety and resentment is created which dampens the morale and saps the performance. It might also lead to a lot of employees looking to find other avenues of employment thereby creating a bad presence in the market or rumors about internal instability which might dent investor and market confidence. Feeling of disengagement, low employee morale and survivor syndrome are commonly found amongst employees of demerged companies.

Changing the perception of employees and getting them on board to adopt new processes, cultures, and operations requires careful communication and factoring in of a lot of sensitivities. For organizations, to give thought to involve their employees in planning the demerger, to engage them during the demerger, and to keep transparent communication along with clear role definition, after the demerger is the single most important parameter to ensure that a demerger activity successfully takes place.

Human Resource Role:

The role of Human Resource in demerger is little bit the same in merger & acquisition. But as the demerger is always loss of best talent it is very delicate. Human Resource always plays a important role by helping people capital on :

- Working up with culture change ;
- Preparing different policies, packages, procedures;
- Development and Designing of organizational hierarchy and structure;
- Availing assurance on work and job security and sustainability;
- Enactment, Registration and Compliance of labor laws and local ethics.

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Human Resource related best practices to be followed during and after demerger:

- Organizing employee engagement activities and work.
- Leaders identification from the parent organization /company who would lead the demerged company for effective implementation and communication of the same to employees.
- Identifying the key talent and skills which are required and available for demerged company.
- Restructuring or designing the hierarchy of company.
- Managing the change of culture and society.
- Explaining the policies and procedures of new establishment.
- Educating managers and counseling of employee.

VII. CONCLUSION

Demerger as a tool for corporate restructuring has been used as an aid for increasing shareholders wealth. Shareholders are the most important stakeholders in case of a company. They are the ones most affected by any corporate restructuring strategy. Hence, investors should differentiate between genuine attempts at value creation and de-mergers undertaken to create hype around the stocks. Investors should be cautious about strategies adopted by few companies to manipulate prices. Investors should focus on the quality of management and corporate governance record of the company. Human resource of the companies is also affected by the process of demerger and hence it is very important for human resource department to involve employees at every stage of demerger and to initiate incentives to keep employees motivated during the entire process.

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