

DEMERGER, A PANACEA FOR CORPORATE PROBLEMS - A CASE STUDY ON CROMPTON GREAVES LIMITED

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Abstract

The research study focuses on the impact of demerger on the financial performance of Crompton Greaves Limited, now named as C G Power and Industrial Solutions Ltd. Various business environmental factors such as technological, political, social and competition which are internal and external to the corporate entities affect the business organization. These create threats as well as opportunities. In order to overcome various threats and to capitalize opportunities, the corporate entities resort to corporate restructuring. Demerger is one such form of corporate restructuring with the help of which, the company can separate its loss making division and can improve its overall performance. In this study, various statistical and financial tools such as, paired t- test, and financial ratios like, return on net worth/ equity, return on assets and asset turnover ratio are employed. The study concluded that, the demerger had no significant impact on return on net worth/ equity and return on assets but in case of asset turnover ratio, reverse was the situation.

Keywords: Demerger, Return on Net Worth/ Equity, Return on Assets and Assets Turnover Ratios

INTRODUCTION

The corporate entities do not function in isolation. It functions within the business environment. This environment consists of internal and external environment. The factors which are within the ambit of the organization constitute internal environment and those which are outside the purview of the organization is known as external environment. These factors constantly keep on changing. With the changes, it creates various opportunities and threats for the business corporates. In order to survive and ensure sustenance, the corporate entities are required to adopt appropriate business strategies to make itself compatible with the dynamic business environment. Thus the corporate organizations need to make various strategic decisions in tandem with the business conditions and objectives. Corporate restructuring is one such strategic move, that facilitates the company in designing its appropriate response to capitalize the opportunities and face the challenges and threats. Corporate restructuring can be employed in different forms like mergers and acquisition, takeovers, divestments, joint ventures, strategic alliances and demergers.

DEMERGER

Demerger is a procedure that is used by companies to separate its loss making division, with a view to concentrate on its core business competencies and thereby ameliorate its overall performance. When a company demerges its segment or division, it results into formation of a separate entity, which is also known as a resulting company, and the company from which such division is separated, is known as demerged company. Thus, the demerger gives birth to a resulting company that has got separated from the parent company.

When the company's overall performance is affected by any of its division or segment, it is advisable to separate such loss making division. This can be done with the help of demerger, which is one of the tools of the Corporate Restructuring process.

LITERATURE REVIEW

Dr. Vijay Kumar Khurana and Dr. Manju Gupta (2013), in their study tried to find the impact of demerger on total profitability, shareholder's wealth and net worth of a company. For the purpose of the said study, the authors used a combination of descriptive research and exploratory research. Further, they used various statistical tools and techniques like non probabilistic convenience sampling techniques, T- test and ratio analysis to analyse the data of three companies namely Larsen & Toubro Limited, Bajaj Auto Limited and Celebrity Fashions Limited. The authors concluded that, in case of L & T, the demerger had a significant impact on its total market capitalization, and there was an increase in its total profits and return on net worth. In case of Celebrity Fashion it was further concluded that, there was a significant increase in the total market capitalization, and no change was found in return on net worth percentage and total profits. Whereas in case of Bajaj Auto the authors concluded that, there was a significant decrease on return on net worth, total profits and total market capitalization.

Dr. Ranjit Singh, Dr. Amalesh Bhowal and Mr. Varun Bawari (2009), tried to analyse the impact of demerger on the shareholder's wealth, in respect of the companies that got demerged in the year 2006. The authors used the case study approach and the random sampling method, and selected case of five companies namely Television Eighteen India Limited, Zee Entertainment Enterprise Limited, Great Eastern Shipping Company Limited, Camlin India Limited and Indiabulls Financial Services Limited. The researchers collected the required data from the respective companies' websites and from that of Bombay Stock Exchange. It was concluded that, except in the case of Camlin Limited, all other companies showed an appreciation in the value of shareholder's wealth.

Pavak Vyas, Bharati. V. Pathak and Dipti Saraf (2015), used an event study methodology, to study the impact of demerger on the price of the share of 51 companies that were listed in India. For the said purpose, the researchers studied price of respective shares ten days prior and post the announcement of demerger. It was concluded by the researchers that the demerger announcement had a positive impact on the shareholder's value and thus it increased the shareholder's wealth.

SIGNIFICANCE OF STUDY

The corporate entities constantly are influenced by their internal as well as external environment. There are various factors in these environments which creates an impact on the overall performance of the entities. This is because the entity does not run in isolation. It is because of these factors and various competitive factors, that the corporate faces various challenges and competition through out its life. In order to overcome the competition, it sometimes becomes necessary for them to take different strategic decisions from time to time. Corporate restructuring is one such strategy through which it can overcome such situations. Further, demerger is one such corporate restructuring strategy, with the help of which the company can separate its loss making division and improve the overall performance of the company. Thus, study of impact of demerger will help in understanding as to how, it can help the companies overcome various challenges, and improve its performance.

Objective of the Study: - The study aims on the following three goals:

- To find the impact of demerger on Return on Net worth/ Equity
- To find the impact of demerger on Return on Assets
- To find the impact of demerger on Asset Turnover Ratio

HYPOTHESIS:-

H01: There is no significant impact of demerger on Return on Net worth/ Equity

H02: There is no significant impact of demerger on Return on Assets

H03: There is no significant impact of demerger on Asset Turnover Ratio

RESEARCH METHODOLOGY

The main objective of this research study is to examine the impact of demerger on Return on Net worth/ Equity, Return on Assets and Asset Turnover Ratio. The ground of the study is based on a case study approach of Crompton Greaves Ltd now named as CG Power and Industrial Solutions Ltd. For the said study, considering the year of demerger as the base year, the data for six years pre and post demerger has been collected from the money control website. For the purpose of this study, the Paired t test was run .

DISCUSSION

Return on Net Worth/ Equity

t-Test: Paired Two Sample for Means		
	<i>Post Demerger</i>	<i>Pre Demerger</i>
Mean	8.021666667	22.14833333
Variance	1686.220737	72.90013667
Observations	6	6
Pearson Correlation	-0.192700123	
Hypothesized Mean Difference	0	
Df	5	
t Stat	-0.795055106	
P(T<=t) one-tail	0.231317652	
t Critical one-tail	2.015048372	
P(T<=t) two-tail	0.462635304	
t Critical two-tail	2.570581835	

Using the Paired t- test, it is observed that since the P – value of Return on Net worth/ Equity (0.4626) is greater than 0.05, we accept the null hypothesis. Thus, it can be concluded that there is no significant impact of demerger on the Return on Net worth/ Equity.

Return on Assets

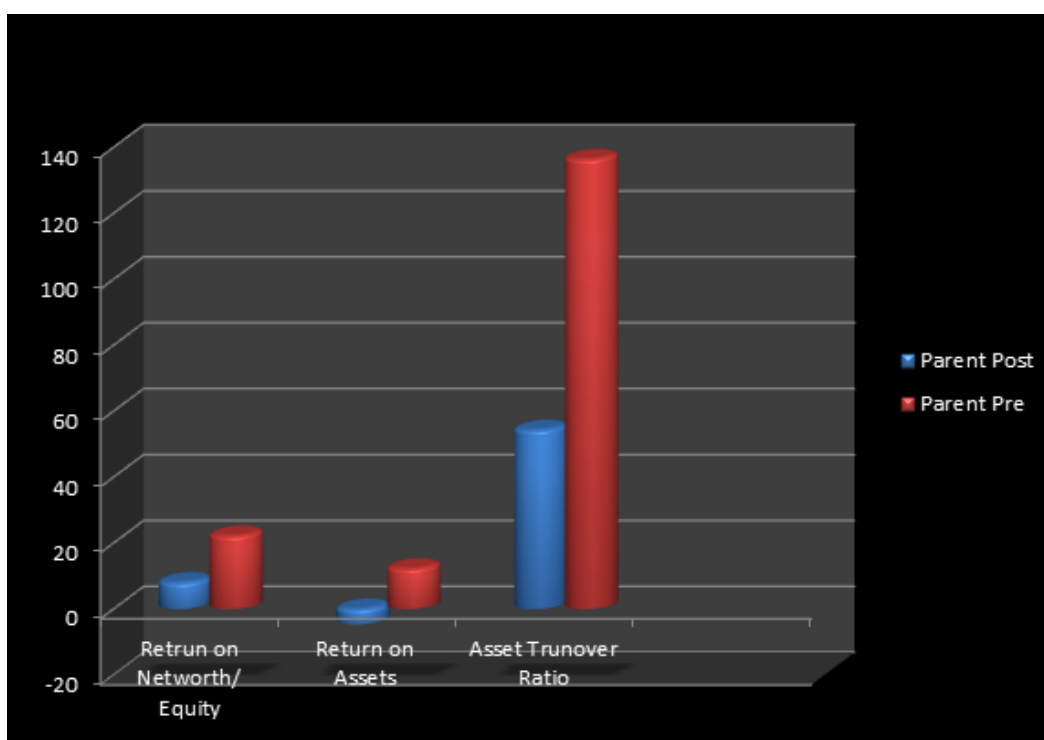
t-Test: Paired Two Sample for Means		
	<i>Post Demerger</i>	<i>Pre Demerger</i>
Mean	-4.62	12.21
Variance	557.85928	13.45608
Observations	6	6
Pearson Correlation	0.286117027	
Hypothesized Mean Difference	0	
Df	5	
t Stat	-1.804820739	
P(T<=t) one-tail	0.065471219	
t Critical one-tail	2.015048372	
P(T<=t) two-tail	0.130942438	
t Critical two-tail	2.570581835	

Using the Paired t- test, it is observed that, since the P value of Return on Assets (0.1309) is greater than 0.05, the null hypothesis is accepted, thus it can be concluded that there is no significant impact of demerger on the Return on Assets.

Asset Turnover Ratio

t-Test: Paired Two Sample for Means		
	<i>Post Demerger</i>	<i>Pre Demerger</i>
Mean	54.24666667	136.4283333
Variance	2516.829827	115.9148967
Observations	6	6
Pearson Correlation	-0.453311632	
Hypothesized Mean Difference	0	
Df	5	
t Stat	-3.602497725	
P(T<=t) one-tail	0.007751201	
t Critical one-tail	2.015048372	
P(T<=t) two-tail	0.015502402	
t Critical two-tail	2.570581835	

Applying the Paired t test, it is found that since the P value of Asset Turnover Ratio (0.0155) is less than 0.05, the null hypothesis is rejected. Thus, it can be concluded that there is a significant impact of demerger on the Asset Turnover Ratio.



CONCLUSIONS

The companies may resort to demerger as a tool of corporate restructuring with a view to improve their financial performance or to get rid of a weaker division. However, in the given study of Crompton Greaves Ltd which is now known as CG Power and Industrial Solutions LTD, it is inferred that the event of demerger did not have any significant impact on return on net worth/ equity and return on assets. In contrast a significant impact was observed in case of assets turnover ratio as a consequence of the said demerger. The present study is done with respect to only three parameters of Crompton Greaves Ltd i.e. return on net worth/ equity, return on assets and asset turnover ratio. Future researchers can study the impact of demerger on other parameters as well.

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