



Demergers: Corporate Financial Performance in India

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ABSTRACT

A demerger is a legal process that enables a major firm or conglomerate to separate its brands or departments into autonomous entities. In addition to being an unusual and complex strategy, demergers impact the combined company's financial health and the amount of profit available to stakeholders. This study investigates the impact of demergers on corporate financial performance in India, specifically focusing on Return on Net Worth (RONW), Return on Investment (ROI) and Earnings per Share (EPS). Analyzing data from selected companies that underwent demergers during the financial year 2018-19, the research employs a paired t-test to assess changes in financial metrics before and after the demerger. The analysis shows that in some cases, demergers can lead to a positive impact on ROI, EPS and RONW. The results reveal that while individual companies experienced fluctuations in ROI, EPS and RONW, none of the changes were statistically significant. The findings suggest that demergers do not consistently result in measurable improvements in financial performance, indicating that other external factors may play a more significant role in influencing these metrics. Further research into the underlying elements determining post-demerger performance can be built upon this work and corporate restructuring effects can be better understood.

1. INTRODUCTION

Demergers in the corporate world, although they date back to the 1920s, became popular across the United States in the 1950s as a prevalent method of restructuring an organization. A demerger simply allows a parent company to restructure its business by untangling divisions and redistributing equity. Perhaps the most well-known type is the pro rata distribution, in which shares in the subsidiary are distributed among shareholders as they currently stand. This guarantees that neither ownership nor control is diluted or relinquished, whereas demerged company's management, control and day-to-day operations are fully isolated from the main company (Tsamenyi et al., 2017).

A demerger differs from other forms of divestiture mechanisms inasmuch as it does not

often include direct cash transaction. This renders it unique, as the process is not motivated by a pressing need to raise cash flow or eliminate debt charges. Linguistically, there are different terms used across geographic locations: in British English, the activity is commonly referred to as a "demerger," while in American English, the same term "spin-off" is largely more common (Hodson, 2014). The current paper investigates why demergers are most common way for corporate restructuring in industries and, with that, what advantages and issues are involved.

For conceptual convenience, the terms like demergers, divestitures, and split-offs will be employed interchangeably even though technically distinct. In general, demergers can happen voluntarily or involuntarily. Voluntary demergers are mostly strategic management decisions intended to simplify operations, while

involuntary divestitures usually stem from government actions, specifically antitrust decrees. In such instances, firms are forced to dispose of business units to avoid monopolistic domination (Kumar et al., 2019). The holding company involved in the demerger is the Demerged Company, whereas the new firm or firms created are termed the Resulting companies.

In recent years, organizations have increasingly recognized that demergers provide opportunities to strengthen their primary areas of expertise and highlight the intrinsic value of individual business units (Merkestein & Lindeque, 2020). By enabling independent operation, demergers often foster greater managerial focus, improved resource allocation, and enhanced market visibility for both the entity. Empirical evidence indicates that these structural shifts often result in enhanced creation of value for the parent and the split-off entities, and consequently, for shareholders and organizational performance (Zerdin, 2017).

2. OBJECTIVES OF THE STUDY

- To analyse if spin-offs significantly affect companies' ROI.
- To determine if spin-offs significantly impact RONW for the companies.
- To analyse how the spin-off affected the companies' EPS.

3. REVIEW OF LITERATURE

Corporate restructuring has increasingly emerged as a crucial strategy for corporations which are attempting to stay competitive in volatile economic landscapes. Of the several types of restructuring, demergers have drawn significant attention from researchers and practitioners alike because of their ability to help organizations hone their strategic vision, release shareholder value, and respond to market forces. There are many studies that have analyzed the effects of demergers, both financially and operationally, and also emphasized their wider economic and managerial implication.

Mahapatra and Samal (2023) point out that mergers and demergers are parts of overall corporate reorganization, which help firms, shift their focus towards core areas. By demerging non-core divisions into standalone units, organizations tend to increase efficiency and strategic focus. Their study focuses on demerger of (a.) Crompton Greaves Consumer Electricals Limited (CGCEL) and (b.) Crompton Greaves Limited (CGL).

After the restructuring, CGL was renamed Crompton Greaves Power and Industrial Solutions Limited (CGPISL). The research has a detailed financial analysis both pre and post demerger periods of CGPISL and CGCEL. Drawing on annual reports as secondary data, the authors used the DuPont model in measuring financial performance and the student's t-test to test if statistically significant difference existed within main financial indicators prior to and subsequent to demerger. Further, the research calculated economic value added (EVA) to establish long-term sustainability. The results reveal insights into whether or not stakeholders really gain anything from such reorganization of organizations and offer a comparative analysis of organizational performance during the two periods.

Building on the theoretical frameworks of demergers, **Panday (2021)** asserts that demergers enable big conglomerates to divide their different brands or departments into distinct legal firms. This process, albeit complicated, has considerable financial implications and stakeholder wealth. Panday observes that demerger is a structural separation and also a strategic business move involving the precise steering of accounting, taxation, and legal structures. Compliance here is typically widespread, tending to complicate the process more than with other forms of restructuring. Panday's study develops knowledge of the concept of demerger and put into perspective its increasing relevance in corporate life. To show these principles in action, the research examines the Hero Honda demerger, employing a ten-year's data and ratios to compare results. The research supports the proposition that demergers are potent weapons for firms to reassess the company's value, reposition

strategies, and make decisions that go with changing market demands.

The applicability of demergers was further highlighted through the Covid-19 economic crisis, as noted by **Baba et al. (2021)**. The pandemic put unprecedented pressure on companies worldwide, with the result that revenue reductions, liquidity deficiencies, and systemic financial stress occurred. Against this backdrop, demergers became a tool by which companies attempted to reorganize and stabilize activities. Baba et al. carried out a large-scale study on 268 projects based on demergers starting April 2012 to 2021 with aim on impacts on their financial and operational performance. With profitability ratios analysis both at pre and post demerger, the research concluded that although there was no statistically significant change in pre and post financial performance, organizations still gained strategically. Demergers enabled companies to reframe business plans, enhance efficiency, and preserve continuity in the face of unfavorable conditions. The evidence indicates that, although short-term financial benefits may not be huge, demergers do confer medium to long-term resilience and flexibility—attributes highly essential during the pandemic.

Besides resilience in finance, the response of the capital market to demergers has also been examined by researchers. **Metha et al. (2019)** investigated the behavior of stock prices following demerger declarations in context of India. Their research explored eleven demerger events, spanning a dataset of 240 days of trading—120 days prior and 120 days subsequent to the announcing, plus the event day itself. The aim was to examine whether return patterns changed as a result of the demerger declaration. It was found that stock price momentum did, in fact, change after the declaration, which suggests that investors view demergers as significant signals of strategic change. This evidence shows the information effect of demergers, where the restructuring is perceived by markets as a value creation opportunity and thus results in variations in trading activity. This work is complementary to more targeted studies on operational and

financial measures by indicating that demergers impact investor sentiment and stock market dynamics as well.

Another aspect of research is offered by **Singhal (2018)**, who places demergers in the overall context of corporate strategy. In the view of Singhal, demergers are becoming more prominent in today's globalized and competitive economies, sometimes even doing away with conventional M\&A as favored strategic means. The study examines the financial effectiveness of demerged companies in India based on profitability, leverage, and liquidity indicators. Using a paired sample t-test, the research contrasted company performance for four years before and subsequent to demerger. Surprisingly, no material improvement in post-demerger financial performance emerged. Earnings per share, dividend per share, net profit margin, Return on equity and interest coverage failed to reflect significant positive change. These results imply that although demergers are generally advocated as vehicles for value unlocking, the financial consequences do not remain same as what managers anticipate or investors expect.

Collectively, these studies offer a rich perspective on demergers. **Mahapatra and Samal (2023)** underscore their contribution to core competency strengthening and stakeholder assessment, **Panday (2021)** stresses the regulatory and legal intricacies and strategic advantages as well, **Baba et al. (2021)** depict their usefulness in times of crisis as a mechanism of resilience, **Metha et al. (2019)** uncover the effect on stock market responses, and **Singhal (2018)** raises doubts about their real financial return the Indian scenario. Overall, the literature indicates that demergers are not a surefire way for financial betterment but are being more highly regarded as strategic re-focusing tools, risk management techniques, and organizational sharpening.

4. RESEARCH METHODOLOGY

4.1 Research Design

This research adopts a quantitative computations based on secondary data to

calculate the financial impact of demergers on corporate performance in India. The study focuses on companies that underwent demergers in the financial year 2018-19, with the aim of analyzing their returns both before and after demerger in terms of Return on Net Worth (RONW), Earnings per Share (EPS), Return on Investment (ROI).

4.2 Data Collection

Financial data was sourced from the official website of the companies under study, NSE, Money Control as well as Capitaline Database, a comprehensive repository of financial information on Indian companies. The selected sample includes 4 companies that completed demergers in year 2018-19.

4.3 Time Frame

The financial performance of the company's was analyzed over two periods for ensuring uniformity:

- **Before demerger:** Financial years 2014-15 to 2017-18
- **After demerger:** Financial years 2019-20 to 2022-23

4.4 Sample Selection

A total of 4 companies that underwent demergers in 2018-19 were selected for the study, as these were the only companies with complete financial data available for both pre- and post-demerger periods.

4.5 Data Analysis

The study has used the Sample Paired t-test to compute, statistically significant difference in the financial metrics (ROI, EPS and RONW) before and after the demerger. The paired t-test shows comparison of the same companies' performance over the two time periods, ensuring that the observed changes are result of the demerger.

- a. **Return on Investment (ROI)** – A measure of profitability that shows how much return is earned relative to the amount invested.
- b. **Return on Net Worth (RONW)** – Measures the impact on shareholders' equity and the efficiency of capital utilization.

- c. **Earnings per Share (EPS)** – It represents the profit available to each equity share of the company.

4.6 Tools and Software

The statistical analysis was performed using SPSS statistical software, ensuring accurate calculation of the paired t-test results and overall data interpretation. A p-value < 0.05 was considered statistically significant.

- **Before the demerger:** Financial years 2014-15 to 2017-18
- **After the corporate demerger:** Financial years 2019-20 to 2022-23

In order to check the reliability of the questionnaire Cronbach alpha test is applied on sample size of 32 collected during pilot study. If the value of alpha is above .70 the reliability of the questionnaire is acceptable suggested by Babbie (1992)¹⁶. Therefore, modifications are done in the questionnaire to bring it to the acceptable level. After modification the value of all factors reached to the acceptable level.

5. ANALYSIS AND RESULT

The hypotheses of this study are described below:

H₀- No demergers have a statistically significant impact on return on net worth, return on investment or earnings per share.

H₁- Problems with return on net worth (RONW), return on investment (ROI), or earnings per share (EPS) have statistical importance.

5.1 Adani Enterprises Limited (AEL)

Adani Enterprise Limited (AEL) demerged its renewable power undertaking into Adani Green Enterprise Limited (AGEL) in year 2018.

Table.1 (a) presents a comparison of the Return on Investment (ROI) for Adani Enterprises Limited pre-post demerger. The mean ROI decreased slightly from 1.83 (before) to 1.68 (after). The variance of ROI also increased post-demerger, from 0.256 to 0.469, indicating greater fluctuations in performance. P-value of 0.733, the paired t-test shows no statistically significant difference in ROI before and after the demerger. Hence, it can be concluded that there is no

statistically significant difference between the two variables.

Table 1(b) for Return on Net Worth (RONW), the mean before demerger was 6.78, which decreased to 5.86 after demerger. The variance in RONW increased post-demerger, from 1.46 to 3.23, showing more variability in performance. However, the p-value of 0.433 suggests no significant change in RONW due to demerger.

Table.1(c) shows that Earnings per Share (EPS) increased from a mean of 10.69 before the demerger to 11.89 after it, suggesting a potential positive impact on profitability per share. Paired t-test resulted in a p-value of 0.783, implying no statistically significant difference in EPS before and after demerger.

5.2 CESC Limited

The CESC Ltd. demerged non-power businesses of Retail & Tech Ventures into two different listed entities which were renamed as Spencer's Retail and the other one as CESC Ventures in year 2018.

Table.2(a) shows a comparison of the Return on Investment (ROI) for CESC Ltd before and after demerger. The mean ROI decreased slightly from 3.28 (before) to 3.03 (after). There exist no statistically significant difference in ROI, as shown by the p-value of 0.250.

Table 2(b) shows Return on Net Worth (RONW), the mean increased from 7.94 (before) to 8.46 after demerger. The variance decreased significantly from 2.85 to 0.214, suggesting more consistency in RONW after demerger. Despite this improvement, the p-value of 0.594 shows no statistically significant change in RONW.

In Table 2(c) Earnings per Share (EPS) saw a notable decrease, with the mean dropping from 62.09 (before) to 35.77 after demerger. A p-value of 0.226 indicates that the decline in earnings per share is not supported by statistical evidence.

5.3 Birlasoft Limited

KPIT Technologies Ltd's engineering business was demerged and KPIT Engineering Limited was formed as a new entity. Under this

Table 1a: ROI

	Before	After
Mean	1.8275	1.675
Variance	0.256092	0.469167
Observations	4	4
P(T<=t) two-tail	0.732501	-
t Critical two-tail	2.446912	-

Table 1b: RONW

	Before	After
Mean	6.7775	5.855
Variance	1.463292	3.229167
Observations	4	4
P(T<=t) two-tail	0.433259	-
t Critical two-tail	2.570582	-

Table 1c: EPS

	Before	After
Mean	10.6925	11.895
Variance	22.96483	45.25417
Observations	4	4
P(T<=t) two-tail	0.782606	-
t Critical two-tail	2.570582	-

Table 2a: ROI

	Before	After
Mean	3.2775	3.0325
Variance	0.086492	0.061292
Observations	4	4
P(T<=t) two-tail	0.249577	-
t Critical two-tail	2.446912	-

Table 2b: RONW

	Before	After
Mean	7.935	8.455
Variance	2.8503	0.214033
Observations	4	4
P(T<=t) two-tail	0.594261	-
t Critical two-tail	3.182446	-

Table 2c: EPS

	Before	After
Mean	62.09	35.7725
Variance	25.9128	1175.371
Observations	4	4
P(T<=t) two-tail	0.226159	-
t Critical two-tail	3.182446	-

restructuring 2 companies were formed Birlasoft Limited and KPIT Technologies in Nov. 2018.

The table 3(a) compares the Return on Investment (ROI) for Birlasoft Ltd before and after demerger. The mean ROI increased from 10.27 (before) to 11.52 (after), suggesting an improvement in overall profitability post-demerger. A p-value of 0.482, however, rules out any statistical significance for the ROI increase.

For Return on Net Worth (RONW), the mean remained almost unchanged, with a slight increase from 15.02 (before) to 15.14 (after). The variance decreased from 12.94 to 9.27, indicating slightly more consistency in RONW after demerger. Despite these minimal changes, the p-value of 0.963 shows no significant impact on RONW after demerger.

Table 3(c) shows Earnings per Share (EPS) showed a decline from a mean of 9.82 (before) to 7.48 after demerger, suggesting a reduction in profitability per share. However, this drop in earnings per share is not statistically significant, according to the p-value of 0.132.

5.4 Neelkanth Limited

Neelkanth Ltd. demerged warehousing and real estate divisions in 2015. After demerger Asian Warehousing Pvt. Ltd. was formed & Neelkanth Ltd. continued the business of agro-commodities.

The table 4(a) presents a comparison of the Return on Investment (ROI) for Neelkanth Ltd pre-post demerger. The mean ROI significantly increased from -0.08 (before) to 6.76 (after), indicating a positive shift in profitability post-demerger. Despite this notable increase, a p-value of 0.229 rules out any statistical significance for the ROI change.

For Return on Net Worth (RONW), the mean also improved significantly, rising from -0.075 (before) to 7.11 after demerger. The variance increased from 1.24 to 91.73, indicating higher fluctuations in RONW post-demerger. However, the rise in RONW does not appear to be statistically significant, as indicated by the p-value of 0.233 ($p > 0.05$).

Table 4(c) shows Earnings per Share (EPS) showed an improvement, with the mean

Table 3a: ROI

	Before	After
Mean	10.265	11.515
Variance	3.6163	7.228967
Observations	4	4
P(T<=t) two-tail	0.482005	-
t Critical two-tail	2.570582	-

Table 3b: RONW

	Before	After
Mean	15.02	15.135
Variance	12.9354	9.2721
Observations	4	4
P(T<=t) two-tail	0.962658	-
t Critical two-tail	2.446912	-

Table 3c: EPS

	Before	After
Mean	9.8225	7.475
Variance	0.873358	5.3015
Observations	4	4
P(T<=t) two-tail	0.131843	-
t Critical two-tail	2.776445	-

Table 4a: ROI

	Before	After
Mean	-0.08	6.76
Variance	1.202067	81.05913
Observations	4	4
P(T<=t) two-tail	0.2286	-
t Critical two-tail	3.182446	-

Table 4b: RONW

	Before	After
Mean	-0.075	7.11
Variance	1.237767	91.72687
Observations	4	4
P(T<=t) two-tail	0.232905	-
t Critical two-tail	3.182446	-

Table 4c: EPS

	Before	After
Mean	-0.01	1.0125
Variance	0.015067	1.852758
Observations	4	4
P(T<=t) two-tail	0.231468	-
t Critical two-tail	3.182446	-

increasing from -0.01 (before) to 1.01 after demerger, reflecting better profitability per share. The variance increased from 0.015 to 1.85, indicating more variability in EPS after demerger. However, Statistical analysis reveals that the change in EPS is not significant ($p > 0.05$) with a p-value of 0.231.

6. FINDINGS

The aim this research was to compute how demergers affected the bottom lines of Indian companies using three important financial measures: ROI, RONW, and EPS. To determine if there were statistically significant changes in these indicators after demerger, a paired t-test was used. We can conclude from the data that-

6.1 Adani Enterprises Limited

- o **ROI:** The mean ROI decreased slightly after demerger, but the change was not statistically significant (p-value: 0.733).
- o **RONW:** RONW also saw a decrease post-demerger, though not significant (p-value: 0.433).
- o **EPS:** The EPS showed a slight increase post-demerger, but the change was not statistically significant (p-value: 0.783).

6.2 CESC Limited

- o **ROI:** A small decrease in ROI was observed post-demerger, but it was not statistically significant (p-value: 0.250).
- o **RONW:** A minor improvement in RONW was recorded, but it was not statistically significant (p-value: 0.594).
- o **EPS:** EPS significantly declined after demerger, but the change was still not statistically significant (p-value: 0.226).

6.3 Birlasoft Limited

- o **ROI:** A slight improvement in ROI was seen post-demerger, but it was not statistically significant (p-value: 0.482).
- o **RONW:** There was almost no change in RONW after demerger, and results were not statistically significant (p-value: 0.963).
- o **EPS:** EPS declined post-demerger, but the change was not statistically significant (p-value: 0.132).

6.4 Neelkanth Limited

- o **ROI:** A significant improvement in ROI was recorded, from negative to positive, but the change was not statistically significant (p-value: 0.229).
- o **RONW:** Similar to ROI, RONW improved from negative to positive post-demerger, though the change was not statistically significant (p-value: 0.233).
- o **EPS:** EPS also improved from negative to positive, yet the change was not statistically significant (p-value: 0.231).

7. CONCLUSION

These findings shows that while some companies experienced improvements in ROI, RONW, and EPS post-demerger, none of the changes were statistically significant. Thus, the financial performance had no significant impact on these companies due to demerger.

7.1 Return on Investment (ROI)

While some companies experienced an increase or decrease in ROI post-demerger, such as Neelkanth Ltd, which showed a notable improvement, the changes in ROI across all companies were not statistically significant. This suggests that while demergers might influence the financial structure of companies, they do not consistently impact profitability (ROI).

7.2 Return on Net Worth (RONW)

RONW also showed mixed results. Some companies saw slight improvements or declines, such as Birlasoft Ltd with almost no change in RONW and Neelkanth Ltd, which improved substantially. However, none of the changes were statistically significant. This indicates that demergers had no consistent effect on the companies' ability to generate returns from shareholder equity.

7.3 Earnings per Share (EPS)

Although there were observable changes in EPS, such as a decrease in CESC Ltd and increase in Neelkanth Ltd, these changes were also not statistically significant. This implies that demergers did not lead to a significant change in profitability per share for shareholders.

Overall, while demergers resulted in some fluctuations in financial metrics across the companies, these changes were not statistically significant, indicating that demergers may not necessarily lead to measurable improvements or declines in financial performance in terms of ROI, RONW, and EPS. This shows that market circumstances and internal reorganization, among other things, might be more important in deciding how firms' finances turn out after a merger.

The present research provides valuable insights into the limited financial impact of demergers on performance of corporates, suggesting that demergers alone may not significantly alter key financial metrics like ROI, RONW, and EPS. In some cases, demergers can cause positive impact on financial metrics such as ROI, RONW, and EPS so that companies can focus on core competencies and streamline operations. This implies that further research

could explore additional reasons, like market conditions, corporate governance, or strategic decisions, which may interact with demergers to influence financial outcomes. The study also highlights the requirement for larger, more diversified samples to better understand the broader effects of demergers or corporate restructuring in different industries and market environments.

8. LIMITATIONS

This study is limited by the small sample size, as only four companies that underwent demergers in 2018-19 were analyzed, which may not provide a comprehensive representation of the whole corporate sector. Additionally, external reasons like market conditions and internal company decisions that could influence financial performance were not considered, potentially impacting the findings.

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