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## DEMERGERS: AN ANALYSIS

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### INTRODUCTION

With the ever-growing advancements and competition in the market, a company always needs to be on its toes. The companies have to downsize their operations in this era of globalization, since it no longer fits into the company plans.<sup>1</sup> Companies use corporate restructuring as a strategy to keep up with the continually changing environment. Corporate restructuring means rearranging the business of a company for increasing its efficiency and profitability.<sup>2</sup> One such form of corporate restructuring is Demergers.

### DEMERGER: DEFINITION

#### AS PER THE STATUTES

Section 232 of Chapter XV of the Companies Act, 2013 along with the Companies (Compromise, Arrangements, and Amalgamations) Rules, 2013 governs mergers and amalgamations, including demergers. Although the term 'demerger' is not explicitly defined anywhere in The Companies Act, 2013, it has been defined under Section 2(19AA) of the Income Tax Act, 1961.<sup>3</sup> It can be understood in terms of transfer pursuant to a scheme of arrangement given under sections 391 to 394 of the Companies Act, 1956 by the virtue of demerger:

- i. All the property of the undertaking would be transferred by the demerged company, becomes the property of the resultant company.
- ii. All the liabilities of the undertaking would be transferred to the resultant company.

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<sup>1</sup> Kumar, N. (2014) *Global Journal for Research Analysis*, 3(9).

<sup>2</sup> *Corporate restructuring: Types and importance, Taxmann Blog*. Available at: <https://www.taxmann.com/post/blog/corporate-restructuring-types-and-importance/> (Accessed: February 10, 2023).

<sup>3</sup> See Income Tax Act, 1961 S. 2(19AA)

- iii. The resultant company would issue shares to its shareholder on proportionate basis.
- iv. Shareholders having not less than 3/4th in value of the shares in demerged company, becomes the shareholder of the demerged company, by the way of demerged.<sup>4</sup>

## DEFINITION

We can understand demerger as the process of dividing a company's operations into one or more components. These components can function as a standalone unit, be sold, or be liquidated. In simple words it means undoing a merger or merely a divorce of the units.<sup>5</sup> The dividing firm is known as the assignor, while the entities that already exist or are formed through the demerger process are known as the beneficiaries.<sup>6</sup>

## PROCESS FOR DEMERGING

1. The Scheme of Arrangement is prepared.
2. An application is filed in Court for direction to hold meeting and Court's approval.
3. A notice is issued at least 21 days before arranging the meeting.
4. The meeting is held.
5. Petition with the Court to sanction the Scheme of demerger. Then demerger happens.<sup>7</sup>

## TYPES OF DEMERGERS

There are various types of demergers. Such as:

1. Spin-off: In this the parent company distributes a proportion of the shares to form a subsidiary company to its existing shareholders by way of dividends. After the spin-off, the two are separate entities with their own management. It helps the subsidiary

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<sup>4</sup> See Companies Act, 1956 S. 391 to 394

<sup>5</sup> Adam Kudryl (2022) *How to split a company – the demerger process*, Available at: <https://harperjames.co.uk/article/splitting-a-company-an-overview-of-demergers/> (Accessed: February 21, 2023).

<sup>6</sup> Baba, C.M. et al. (2021) "The demerger impact upon sustainable development of economic entities: Evidence from Romania," *Sustainability*, 13(15).

<sup>7</sup> *supra*

become independent while allowing it to retain certain assets of the parent company and provides benefit to the shareholders as now they own shares of two separate companies.

2. Split-off: This is similar to a spin-off but comes with a small twist; the shareholders have to choose between continuing to hold shares in the parent company and exchange some or all shares they hold in the parent company for shares in the subsidiary company. This is also done to boost shareholder value.
3. Split-up: In this a single company splits into two or more autonomous, separately managed companies. This is done in an effort to maximize efficiency and profitability, or because of government mandates to contest monopolistic practices.
4. Carve out: The parent company downsizes its stake in one of its subsidiaries by a small percentage by selling some or all shares of its subsidiary to the public through an initial public offering. This creates a new set of shareholders and equity for the company and also helps reduce its workload of maintaining compliance for a subsidiary due to its large shareholding.
5. Divestment: It is carried out by the government by reducing its holdings in a Public Sector Undertaking (PSU) through release of a tender to sell its stakes. This is done when the government wants to exit a certain business sector or wants to raise funds to lower down its fiscal deficit.
6. Divestiture: this is similar to divestment but, it can be carried out for any public or private limited company. The process is carried out solely to raise money.<sup>8</sup>

## ADVANTAGES AND DISADVANTAGES

Demergers bring with itself a lot of benefits like it leads to improved focus on core company operations, increase capital hence, creates stock market value as there is an increase in supply of funds. Further it can help cut off losses by separating the loss-making unit and help discourage hostile takeovers. For these reasons, it is an attractive restructuring strategy which

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<sup>8</sup> *Demerger of Companies under companies act 2013 (2022) MUDS*. Available at: <https://muds.co.in/demerger-companies-act-2013/> (Accessed: February 11, 2023).

is why companies endeavour into it. Additionally, there are benefits for the shareholders when a company demerges such as- it helps boost shareholder value, increases transparency of operations, offers capital tax relief and long-term value creation which is what shareholders generally look for.<sup>9</sup>

On the contrary, there are numerous disadvantages of a demerger such as losing economies of scale, it is a costly process, clash of interest between the top-level management, stock value drop and dissatisfaction among employees.<sup>10</sup>

## CASE LAW AND CURRENT EXAMPLE

In Vodafone Essar Gujarat Ltd. v. Department of Income-tax 2012 SCC OnLine Guj 4843

Court held that mere asset re-structuring is not same as reconstruction and therefore it is not a scheme coming under section 391 [now section 230]. Further as no consideration moved from one party to the other for transfer of assets, it is also not a valid contract the Court held it as a device to avoid paying huge tax liabilities.<sup>11</sup>

In current news, metals and mining group Vedanta Limited is planning to demerge the aluminium, iron and steel, and oil and gas businesses into standalone, listed entities. This will unlock value for all stakeholders, enable strategic partnerships and attract deeper and broader investor bases.<sup>12</sup>

## CONCLUSION

Every corporate action always has two sides- the good and the bad. While a demerger as a process has many disadvantages, I believe that its benefits outweigh the negatives. Demergers help promote sustainability and is a very effective corporate restructuring strategy. It helps management uncover value as well as streamline operations. However, to minimize the

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<sup>9</sup> Borad, S.B. (2022) *Demerger – meaning, types, examples, and process*, eFinanceManagement. Available at: <https://efinancemanagement.com/mergers-and-acquisitions/demerger> (Accessed: February 11, 2023).

<sup>10</sup> *Benefits of demergers, reasons & advantages* ansarada. Available at: <https://www.ansarada.com/mergers-acquisitions/divestiture/demerger/benefits> (Accessed: February 10, 2023).

<sup>11</sup> Vodafone Essar Gujarat Ltd. v. Department of Income-tax (2012) SCC OnLine Guj 4843.

<sup>12</sup> *TheHindu* (2022) “Vedanta demerger details to become clear by March-end, says Agarwal,” 26 January. Available at: <https://www.thehindu.com/business/Industry/vedanta-demerger-details-to-become-clear-by-march-end-says-agarwal/article38330368.ece> (Accessed: February 11, 2023).

shortcomings, there should be greater scrutiny and betterment of regulations that govern demergers.

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