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Corporate Demerge

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ABSTRACT: The purpose of this report is to throw a light on demerger which primarily involves separating Tata Motors' passenger vehicle (PV) business into a wholly-owned subsidiary. This move allows Tata Motors to focus on its core commercial vehicle (CV) operations while the newly created subsidiary, Tata Motors Passenger Vehicles Limited (TMPVL), focuses on the passenger vehicle segment.

A demerger is a corporate restructuring process where a company separates one or more of its divisions or business units into a new, independent entity. This strategic move is often pursued to enhance the focus and performance of both the parent company and the newly formed entity by allowing each to operate with greater independence and specialization.

The concept of demerger plays a significant role in corporate strategy, enabling companies to unlock value, streamline operations, and improve market competitiveness. Demergers can be driven by various factors, including the desire to focus on core competencies, respond to regulatory requirements, or enhance shareholder value.

INTRODUCTION

A demerger is a process where a company is divided into two or more independent entities. This form of corporate restructuring involves separating a business into different components, which may operate independently, be sold, or be liquidated. Demergers allow large conglomerates to spin off specific brands or business units to either avoid or attract acquisitions, raise capital by divesting non-core components, or establish distinct legal entities for various operations. (1)

Although the term "demerger" is not specifically defined in sections 230 to 232 of the Companies Act, 2013, it is defined in section 2(19AA) of the Income Tax Act, 1961. According to this definition, a demerger involves the transfer of one or more undertakings from a demerged company to a resulting company under a scheme of arrangement.

This transfer must meet the following criteria:

(a) The property of the undertaking being transferred must become the property of the resulting company as a result of the demerger.
(b) All liabilities related to the transferred undertaking must become the liabilities of the resulting company.
(c) The property and liabilities of the undertaking must be transferred at their book values as recorded immediately before the demerger.
(d) The resulting company must issue its shares to the shareholders of the demerged company on a proportionate basis in exchange for the demerger.
(e) Shareholders holding at least three-fourths of the value of the shares in the demerged company (excluding shares held by the resulting company or its subsidiary) must become shareholders of the resulting company as a result of the demerger, without acquiring the property or assets of the demerged company through purchase.
(f) The undertaking must be transferred on a going concern basis.
In short, a demerger involves transferring one or more business operations from a demerged company to a resulting company, with all related assets and liabilities being transferred and vested in the resulting company.

OBJECTIVES

1. To Understand the Concept and Rationale Behind Corporate Demergers
2. To Examine the Structure and Process of Tata Motors’ Demerger
3. To Evaluate the Strategic Implications for Tata Motors and TMPVL
4. To Identify Challenges and Risks Associated with Demerger.

METHODOLOGY

The methodology for this research focuses on examining Tata Motors' demerger of its Passenger Vehicle (PV) business and the broader implications of corporate demergers. The study employs a qualitative approach, relying on secondary data sources and a case study framework. The steps involved in this research are detailed below:

1. Literature Review

The research begins with an extensive review of existing literature on corporate demergers, particularly within the automotive industry. This includes academic journals, industry reports, and case studies on similar restructuring events. The literature review provides a foundation to understand the theoretical underpinnings of demergers and the expected impacts on the parent company and newly formed entity

2. Case Study Analysis

Tata Motors' demerger serves as the primary case study for this research. Through examining this specific event, the study aims to provide insights into the rationale behind corporate demergers and how they can influence company performance. Tata Motors was chosen due to its prominent position in the Indian automotive market, making this demerger a valuable example of how restructuring can reshape business operations and strategy

3. Data Collection

The study utilizes secondary data, gathering information from various credible sources such as Tata Motors' official announcements, financial statements, press releases, industry reports, and media articles. These sources provide relevant details about the demerger process, strategic objectives, and the expected benefits for both Tata Motors and the new subsidiary, Tata Motors Passenger Vehicles Limited (TMPVL).

4. Comparative Analysis

To contextualize Tata Motors' demerger, the study briefly compares this case with other notable demergers in the automotive and related industries. This comparative approach helps highlight common motivations, challenges, and outcomes associated with demergers, allowing for a more comprehensive understanding of how demergers can impact a company's focus and market positioning.

(1)https://www.bcasonline.org/Referencer201516/Taxation/Income%20Tax/amalgamation_and_demerger.html#:~:text=Demerger%20(Section%202(19AA))%3A,liability%20of%20the%20resulting%20company.

TATA MOTORS DEMERGER

Background — Tata Motors, a key subsidiary of the Tata Group, has been a cornerstone of India's automotive industry for decades. The company has a diverse product portfolio, including commercial vehicles, passenger cars, and electric vehicles (EVs). However, the complexity of managing such diverse operations, coupled with industry challenges such as technological shifts, environmental regulations, and changing consumer preferences, prompted Tata Motors to reassess its business structure. The decision to demerge the PV business was seen as a strategic move to streamline operations and sharpen the focus on specific market segments.

In March 2021, Tata Motors announced the demerger of its PV business into a new wholly-owned subsidiary, Tata Motors Passenger Vehicles Limited (TMPVL). This demerger aimed to create a more focused and agile entity that could better respond to the dynamic demands of the automotive market, particularly in the PV and EV segments.

LEGAL FRAMEWORK GOVERNING DEMERGERS

The legal framework for demergers in India is primarily governed by the Companies Act, 2013, the Income Tax Act, 1961, and regulations by the Securities and Exchange Board of India (SEBI). These laws ensure that demergers are conducted transparently, fairly, and in compliance with the rights of all stakeholders involved.

The Companies Act, 2013

Sections 230-232 of the Companies Act, 2013, provide the legal basis for mergers and demergers in India.(1) The Act outlines the procedural requirements for drafting a Scheme of Arrangement, obtaining approval from the National Company Law Tribunal (NCLT), and ensuring that the demerger is in the best interests of shareholders, creditors, and other stakeholders. The demerger process begins with the preparation of a Scheme of Arrangement, which details the terms and conditions of the demerger, including the division of assets, liabilities, and shareholding structure. This scheme must be approved by the boards of directors of the companies involved and subsequently submitted to the NCLT for sanction. The tribunal reviews the scheme to ensure compliance with legal requirements and considers objections, if any, from stakeholders before granting its approval.

The Income Tax Act, 1961

The Income Tax Act, 1961, plays a crucial role in determining the tax implications of a demerger.(2)Under Section 2(19AA) of the Act, a demerger is considered tax-neutral if it meets certain conditions, such as the transfer of all assets and liabilities of the demerged undertaking to the resulting company, and the continuity of the shareholding pattern. A tax-neutral demerger allows the parent company and its shareholders to avoid capital gains tax on the transfer of assets, making it an attractive option for corporate restructuring.

SEBI Regulations

For listed companies, SEBI's regulations add another layer of compliance.(3) The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, require companies to make timely disclosures about the demerger to ensure transparency and protect investor interests. Additionally, SEBI's regulations governing takeovers, insider trading, and substantial acquisitions of shares must be adhered to during the demerger process. AsTata Motors is a listed company, compliance with SEBI's regulations was crucial throughout the demerger process. SEBI's (Listing Obligations and Disclosure Requirements) Regulations, 2015, required Tata Motors to disclose all material information related to the demerger to its shareholders and the public. These disclosures ensured transparency and allowed investors to make informed decisions about the company's future prospects

(1)https://www.mca.gov.in/Ministry/pdf/Companies Act2013.pdf.

(2) https://www.indiacode.nic.in/bitstream/123456789/2435/1/a1961-43.pdf. (3) https://www.sebi.gov.in/

PROCESS OF DEMERGER IN INDIA

1. Planning the Demerger

The first step in the demerger process is planning. The company's management decides which part of the business should be separated and why. They also consider how this split will benefit the company. For example, they might want to create a new company focused on a specific product or market.(1)

Key Points:

- Identify the business segment to be separated.
- Understand the reasons for the demerger.
- Plan how the demerger will help the company grow.

2. Approval from the Board of Directors

Once the plan is ready, it is presented to the company's Board of Directors. The board is responsible for making big decisions, and they need to agree that the demerger is a good idea. If they approve, the process can move forward.
Key Points:

- The board reviews the plan.
- The board gives its approval to proceed.

3. Creating the Scheme of Arrangement

Next, the company prepares a detailed document called the Scheme of Arrangement. This document explains how the demerger will happen. It includes details like which assets and liabilities (such as debts) will move to the new company, how shares will be allocated to shareholders, and how employees will be managed.

Key Points:

- The Scheme of Arrangement outlines all the details of the demerger.
- It includes information about assets, liabilities, shares, and employees.

(1) https://www.indiafilings.com/learn/demerger-companies-act/

4. Seeking Approval from the National Company Law Tribunal (NCLT)

The company then needs to get approval from the National Company Law Tribunal (NCLT). The NCLT is a legal body that oversees company matters. The company submits the Scheme of Arrangement to the NCLT, which reviews it to make sure it follows the law.

Key Points:

- The NCLT ensures the demerger is legal and fair.
- The company files the Scheme of Arrangement with the NCLT.

5. Approval from Shareholders and Creditors

The NCLT usually requires the company to hold meetings with its shareholders and creditors. During these meetings, the company presents the demerger plan and asks for their approval. The demerger must be supported by a majority of shareholders and creditors.

Key Points:

- The company explains the demerger to shareholders and creditors.
- A vote is taken to approve the demerger.

6. Getting Regulatory Approvals

If the company is listed on the stock exchange or operates in a regulated industry (like banking or insurance), it might need additional approvals from regulatory authorities such as the Securities and Exchange Board of India (SEBI) or the Reserve Bank of India (RBI). These bodies ensure the demerger does not harm the public or the economy.

Key Points:

- The company may need to get approval from regulators like SEBI or RBI.
- These approvals ensure the demerger is in the public's interest.

7. Final Approval by the NCLT
Once the shareholders, creditors, and regulators have approved the demerger, the company returns to the NCLT for final approval. The NCLT reviews all the approvals and, if satisfied, gives its final order to make the demerger official.

Key Points:

- The NCLT gives the final go-ahead for the demerger.
- The demerger becomes official with the NCLT's order.

8. Transfer of Assets and Liabilities

After the NCLT's final approval, the assets, liabilities, and employees are transferred to the new company. This marks the completion of the demerger. The newly created company can now

CHALLENGES AND RISKS IN DEMERGER PROCESS

While demergers can offer significant strategic benefits, they are also fraught with challenges and risks. Successful execution requires careful planning, stakeholder engagement, and a thorough understanding of the legal and financial implications.

1. Complexity of Execution: The demerger process involves significant legal, financial, and operational complexities. Ensuring a smooth transition while maintaining business continuity is a critical challenge. Companies must manage the separation of assets, liabilities, and personnel, which can be a time-consuming and resource-intensive process. Tata Motors needs to ensure that the demerger is executed smoothly to maintain business continuity.
2. Taxation Challenges: While the Income Tax Act provides provisions for tax-neutral demergers, meeting the conditions for tax neutrality can be challenging. Companies must carefully structure the demerger to avoid unintended tax liabilities and disputes with tax authorities.
3. Stakeholder Management: Obtaining approval from shareholders, creditors, and regulatory bodies is a crucial aspect of the demerger process. Companies must communicate effectively with stakeholders to address concerns and secure the necessary approvals. Failure to do so can lead to delays, legal challenges, and potential loss of stakeholder confidence.
4. Market Perception: The success of a demerger also depends on how it is perceived by the market. Investors, employees, and customers may have concerns about the future prospects of the separated entities, making effective communication and strategy implementation crucial. Poor market perception can negatively impact the stock prices of both the parent and the resulting company.
5. Regulatory Compliance: As a newly independent entity, TMPVL must ensure strict compliance with all regulatory requirements, particularly in the areas of emissions, safety standards, and environmental impact. Any lapses in compliance could result in legal challenges or damage to the company's reputation.
6. Competition: The Indian passenger vehicle market is highly competitive, with numerous domestic and international players vying for market share. TMPVL will need to differentiate itself through innovation, customer service, and brand positioning to stay ahead of the competition.
7. Synergy Losses: While demerging can lead to greater focus, it may also result in the loss of

synergies that existed when the business units were part of the same entity. This can include shared resources, technology, and economies of scale, which need to be carefully managed post-demerger.

IMPORTANT CASES

1. Tata Chemicals Ltd. Demerger (2018) [(1)]
   - Tata Chemicals decided to split off its consumer products, like Tata Salt, into another company called Tata Global Beverages.
   - The case was reviewed under rules that ensure such business splits are fair and protect the interests of shareholders and creditors.
   - The court approved the split, noting that it would help each business focus better and create more value for shareholders.

2. Tata Communications Ltd. Demerger (2020) [(2)]
   - Tata Communications wanted to separate its surplus land assets into a new company called Hemisphere Properties.
   - This case also involved checking the valuation of the assets and ensuring that shareholders got a fair deal.
   - The court approved the split, highlighting the importance of transparent asset valuation and the creation of focused businesses.

3. Tata Motors Ltd. Demerger (2021)
   - Tata Motors proposed to split its passenger vehicle business into a new, wholly-owned subsidiary.
   - The case was reviewed for compliance with rules about shareholder and creditor approval and other regulatory clearances.
   - The court approved the split, noting that it would help Tata Motors attract strategic investments in its passenger vehicle business.
   - These case show that splitting a business into separate parts involves careful legal review to ensure fairness, compliance with regulations, and that the reasons for the split are sound.The demerger unlocked significant value for shareholders and positioned Reliance Jio as a market leader.

(1) https://blog.ipleaders.in/insight-tata-demerger-case/
(2) https://www.tatacommunications.com/investors/filings/

4. Dabur India Demerger[(3)]
   - Dabur India's demerger of its pharmaceuticals business into Dabur Pharma and its subsequent sale to Fresenius SE illustrates the use of demergers to streamline operations and focus on core businesses. The demerger allowed Dabur to concentrate on its consumer goods business, while Dabur Pharma benefited from the resources and expertise of a global pharmaceutical company.

5. Vodafone International Holdings B.V. v. Union of India (2012) [(4)]
   - Vodafone bought a company called Hutchison Essar, which was based in India, through an offshore deal. The Indian tax authorities tried to tax Vodafone for this transaction, saying it was subject to Indian laws.
   - The Supreme Court ruled in favor of Vodafone, saying that because the deal happened outside India, it wasn't taxable under Indian law.This case highlighted how cross-border demergers (splitting a company into parts) are treated in terms of taxation, especially when different countries are involved.

(3)https://www.dabur.com/our-story#:~:text=Dabur%20India%20approved%20the%20demerger,focus%20to%20both%20the%20businesses.
(4) https://indiankanoon.org/doc/115852355

ADVANTAGES AND DISADVANTAGES OF A DEMERGER

Executing a de-merger comes with certain benefits. But there are downsides and risks associated with this type of business strategy. We've listed some of the most common pros and cons that come with going through a de-merger.

Advantages:

De-mergers are often pursued to enhance shareholder value. One of the primary benefits is that it can increase the value of shareholders' investments. They receive shares in the newly formed company, potentially benefiting financially if the new entity becomes successful.
Moreover, companies that are newly de-merged gain the ability to steer their own course. They can independently make key investment decisions, raise capital, conduct research and development, and

strategize their marketing efforts without needing to align with the parent company’s interests.

Disadvantages:

However, de-mergers can be costly, with significant expenses related to the process. Additionally, the de-merger may result in increased tax complexities. The process must comply with specific corporate restructuring procedures, and any misstep could lead to additional tax liabilities for the new company. Furthermore, the approval of shareholders is required for a de-merger. As it impacts their financial stakes, there's a risk that shareholders may not support the restructuring, potentially hindering the company’s future growth.

CONCLUSION

Demergers are a powerful strategic tool for corporate restructuring, offering companies the opportunity to streamline operations, enhance focus, and unlock value. In India, the legal framework governing demergers is robust, ensuring that these transactions are conducted in a fair and transparent manner. However, the successful execution of a demerger requires careful planning, stakeholder engagement, and an in-depth understanding of the legal and financial complexities involved. As Indian companies continue to evolve in a dynamic market environment, demergers will likely play an increasingly important role in their growth strategies, allowing them to adapt, innovate, and thrive.

The recent demerger of Tata Motors marks a significant milestone in the company's journey towards becoming a more focused and agile player in the global automotive industry. By separating its passenger vehicle business into an independent entity, Tata Motors has positioned itself to capitalize on emerging opportunities, particularly in the electric vehicle market. However, the success of this strategic move will depend on the company's ability to manage the associated risks, execute the transition smoothly, and maintain its competitive edge in a rapidly evolving market.

As the Indian automotive industry continues to transform, the demerger of Tata Motors serves as a case study in how companies can strategically restructure to enhance their focus, operational efficiency, and shareholder value. This essay has provided a detailed analysis of the Tata Motors demerger, highlighting the strategic rationale, legal framework, and potential challenges involved in this significant corporate restructuring initiative.

Consolidated Revenue (FY 2024): ₹4.38 lakh crore Before the Demerger			
S.No	Segment	Revenu	share in revenue
1	Jaguar Land Rover (JLR)	30,66,00,00,00,000	70%
2	Commercial Vehicles (CV)	7,88,40,00,00,000	18%
3	Passenger Vehicles (PV)	5,25,60,00,00,000	2%

Total assets before demerger is 370663 cr			
S.No	Segment	Assets Value	Share in Assets
1	Tata Motors Limited (TML)	22,23,97,80,00,000	60%
2	Tata Motors Passenger Vehicles Limited (TMPV)	14,82,65,20,00,000	40%

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