

CORPORATE RESTRUCTURING THROUGH DEMERGER: A CASE STUDY ON HINDUSTAN UNILEVER LIMITED

Radhagobinda Basak*

Abstract Corporate restructuring decisions (demerger, etc.) are taken to enhance sustainability. Sustainability is enhanced if some more value for the stakeholders can be generated. Traditional measures like return on investment (ROI) can highlight short run sustainability well. But, to indicate long run sustainability, we need modern measures like economic value added (EVA). The present study highlights whether corporate restructuring through demerger adds value for the stakeholders. For this purpose, the demerger of Unilever India Exports Limited from Hindustan Unilever Limited has been taken as a case study. Hindustan Unilever Limited (HUL) demerged its fast moving consumer goods (FMCG) exports business into a wholly owned subsidiary Unilever India Exports Limited (UIEL) with effect from 1st April 2011. In this study, financial performance of HUL has been measured in pre and post demerger period respectively. Then performance of UIEL has also been measured after its incorporation. Performance has been measured under traditional and modern approach both. Finally a comparative analysis has been done between the performances in pre and post demerger period. On the basis of the comparative analysis it has been concluded that the demerger of UIEL is a value generating demerger.

Keywords Demerger, Sustainability, Return on Investment; Economic Value Added, Cost of Capital

INTRODUCTION

Demerger refers to transfer of a part of undertakings of an entity to a newly formed entity or an existing entity. The main objective of demerger is achieving sustainability through effective management of resources of a particular unit of an entity.

With the help of traditional measures of financial performance, we can easily judge the sustainability of a firm in the short run. Some traditional measures are net profit ratio, return on investment (ROI), return on total assets, earnings per share (EPS), etc. Of all these measures, ROI is considered as the most comprehensive one. These traditional measures consider the excess of revenue over the operating expenses as surplus. But, truly speaking, this is not the true surplus of a firm. When investors (shareholders, etc.) take the risk of investing their money in an entity, they definitely expect some return over their investment. It is the obligation of a firm to meet its investors' expectation. If we deduct investors' expectation from the traditional surplus, we can get the true surplus of a firm. This investors' expectation is known as cost of capital (COC). The aforesaid true surplus is very often termed as Economic Value Added (EVA) which indicates long run sustainability of a firm.

Therefore, to examine whether demerger enhances sustainability, not only the traditional measures but also the EVA measure is essential. EVA approach tells whether an entity is a value generating or a value destroying unit. For this reason, EVA is more important parameter than ROI

for taking corporate restructuring decisions like merger & acquisition, demerger, etc.

Hindustan Unilever Limited (HUL) demerged FMCG exports business including specific exports related manufacturing units of the company into its wholly owned subsidiary Unilever India Exports Limited (UIEL), with effect from 1st April 2011. In order to fully exploit the opportunity in export market and to provide necessary focus, flexibility and speed to the business, the company decided to demerge its FMCG exports business.

In this present study, an attempt has been taken to examine whether the said demerger is a successful one so far as the question of sustainability is concerned. To examine this, the financial data of the parent company (HUL) in pre-demerger period (2009-10 & 2010-11) have been analysed at first. Next, financial data of both transferor (HUL) and transferee (UIEL) company in post-demerger period (2011-12 to 2014-15) have been analyzed. At last, the conclusion has been drawn based on results found.

OBJECTIVES OF THE STUDY

The present study has the following specific objectives:

- (i) To measure the financial performance of HUL in pre-demerger period by using some traditional yardsticks as well as by modern method,
- (ii) To measure the financial performance of HUL and UIEL in post-demerger period under traditional and EVA approach and

* Maharani Kasiswari College (Affiliated to the University of Calcutta), West Bengal, India. Email: rgbasak85@gmail.com

(iii) To make a comparative analysis of performance in pre and post demerger period to examine the propriety of demerger decision.

RESEARCH METHODOLOGY

The present study is secondary data based. Financial data of HUL and UIEL have been collected from published annual reports of HUL for six years from 2009-10 to 2014-15 and HUL subsidiary annual report 2014-15.

HUL is one of the leading fast moving consumer goods (FMCG) companies in India. It has a long and rich history of operating business successfully. It is a BSE listed company too. When such a reputed company demerges a part of its undertakings, it becomes our concentration to peep into such demerger and also to follow up its consequences. For these reasons, HUL has been chosen as a sample in this study.

Hindustan Unilever Limited (HUL) demerged its FMCG exports business into its wholly owned subsidiary Unilever India Exports Limited (UIEL), with effect from 1st April 2011. Therefore, out of total six years of study period, two years, i.e. 2009-10 and 2010-11 are from pre-demerger period and the rest four years, i.e. from 2011-12 to 2014-15 are from post-demerger period. Financial data of HUL (transferor company) have been analysed for both pre-demerger and post-demerger period. Annual report of HUL for the year 2008-09 was prepared for 15 months. For this reason, year 2008-09 and other previous years prior to this year have not been taken into consideration. That is why; duration of pre-demerger and post-demerger period is not same in the study. Naturally, financial data of UIEL (transferee company) have been consulted only for post-demerger period.

As analysis tools, both traditional and modern financial performance analysis indices have been used. Four traditional measures- Net Profit ratio, Return on investment (ROI), Return on Total Assets, Earnings per Share (EPS) and one modern measure- Economic Value Added (EVA) have been used here.

In our study, the following formula has been used to calculate ROI as a traditional performance measure.

$$\text{ROI} = \frac{\text{Net Profit before Interest but after Tax}}{\text{Average Capital Employed}} \times 100$$

where, Av. Capital Employed = $\frac{\text{Opening Capital Employed} + \text{Closing Capital Employed}}{2}$ and Capital Employed = Shareholders' Fund + Debt Fund.

EVA, as a modern measure, is computed by the following formula.

$$\text{EVA} = \text{NOPAT} - (\text{WACC} \times \text{Average Capital Employed})$$

where, NOPAT = Net Operating Profit after Tax and WACC = Weighted Average Cost of Capital.

Cost of equity is generally computed on the basis of Capital Asset Pricing Model (CAPM) in case of EVA. In this study, cost of equity of HUL has been computed under CAPM. In case of UIEL, cost of equity has been computed under CAPM and Earning Price Ratio method respectively and then the average of the two methods has been taken as ultimate cost of equity.

The sensex data have been collected from the website of BSE. Sensex is highly volatile and subject to socio-economic and political condition of the country. To calculate market rate of return, all these phenomena should be taken into consideration as they are quite natural in capital market scenario. But to regularize the abnormality in capital market as much as possible, a long period should be considered. That is why, in this study, data of sensex have been considered for the period from 2003-04 to 2014-15.

LITERATURE REVIEW

Stern (1990), in his research, showed that EVA measurement reflects the true economic profit of a firm. He suggested that the financial managers should be given incentive as a percentage of EVA so that they can motivate themselves to increase EVA which in turn will maximise the shareholders' return. Stewart (1994) conducted a study on EVA taking a large number of companies throughout the world. It was opined that EVA approach can rightly indicate the sustainable value created by a firm for its stakeholders. Banerjee and Jain (1999) conducted an empirical research in this field. They chose five indicators; earnings per share (EPS), average return on net worth (ARONW), capital productivity (KP), labour productivity (LP), and economic value added (EVA) and established their relationship with market value added (MVA). They took MVA as the base of shareholders' wealth. Top 50 companies from Drug & Pharmaceutical industry in India were selected and data for 8 years from 1990-91 to 1997-98 were analysed. As per their observation, EVA was the most significant indicator of shareholders' wealth. Rakshit (2006), in his study, measured the financial performance of Dabur India Ltd. based on ROI approach and EVA approach simultaneously. As per his findings, there was significant amount of variation between the results of ROI approach and EVA approach. He suggested that the companies should take the decisions relating to choice of strategy, capital allocation, merger & acquisition, divesting business, goal setting, etc. on the basis of EVA measurement as it gives the idea about value creation. Rakshit and Chatterjee (2008) in their study, evaluated the pre-merger and post-merger performance of ICICI Bank on EVA measurement. As per their findings, for two years immediately after the merger, the EVA of ICICI Bank was negative. After that, the company created values and thus ultimately became successful in achieving its goal of corporate restructuring through merger. Chatterjee and

Rakshit (2010) made a study to measure the shareholders' value creation in FMCG industry in India. They took four approaches to measure the shareholders' value creation, namely; the market value to book value approach, the EVA approach, the market value added approach and the shareholders' value added approach. They found that

shareholders' value creation actually emphasizes the present value of future cash flows rather than earnings.

ANALYSIS AND FINDINGS

Measurement of Performance of HUL Based on Traditional Approach

Table 1: Traditional Measures of Financial Performance of HUL (Rs. in Crore)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
1.Shareholders'Fund / Capital Employed:						
Equity Share Capital						
Reserve & Surplus	218.17	215.95	216.15	216.25	216.27	216.35
	2365.35	2443.57	3296.78	2457.77	3060.78	3508.43
	2583.52	2659.52	3512.93	2674.02	3277.05	3724.78
2.Av. Capital Employed	2583.52*	2621.52	3086.23	3093.48	2975.54	3500.92
3.Total Assets	9519.04	10162.66	10958.27	11512.47	12998.40	13634.06
4.Av. Total Assets	9519.04*	9840.85	10560.47	11235.37	12255.44	13316.23
5.Sales	17523.80	19735.51	22116.37	25810.21	28019.13	30805.62
6.EBIT (excluding Exceptional items)	2707.07	2730.20	3350.16	4349.48	4799.71	5523.12
7.PAT [(6)-30% Tax rate]	1894.95	1911.14	2345.11	3044.64	3359.80	3866.18
8.No. of Eq. Shares (crore)	218.17	215.95	216.15	216.25	216.27	216.35
9. Net Profit Ratio (%) [(6)/(5)* 100]	15.45	13.83	15.15	16.85	17.13	17.93
10. Return on Total Assets (%) [(6)/(4)*100]	28.44	27.74	31.72	38.71	39.16	41.48
11. Return on Investment after Tax (%) [(7)/(2)*100]	73.35	72.90	75.99	98.42	112.91	110.43
12.Earnings Per Share (Rs.) [(7)/(8)]	8.69	8.85	10.85	14.08	15.54	17.87

*Closing Amount; Source: Different annual reports of HUL

Measurement of Performance of HUL based on EVA Approach

Already it has been mentioned that EVA is computed by the use of following formula.

$$\text{EVA} = \text{NOPAT} - \text{COC}$$

where, NOPAT = Net Operating Profit after Tax = EBIT × (1-tax rate) and COC = Total Cost of Capital = (WACC × Average Capital Employed). Profit or loss from exceptional items has not been considered in the study. NOPAT was shown in previous table.

Cost of Capital (COC) (K_0)

The capital structure of HUL consists of equity shares only. Therefore, cost of equity will be the cost of capital/weighted

average cost of capital in case of HUL. In computing EVA, generally, Capital Asset Pricing Model (CAPM) is used. Cost of equity (K_e) under Capital Asset Pricing Model (CAPM) is as below.

$$K_e = R_f + \beta (R_m - R_f)$$

where, K_e = cost of equity, R_f = risk free rate of return, R_m = market rate of return and β = risk coefficient.

Interest rate of recently issued 10 years' Government Stock 2024 has been taken as the risk free rate of return and the rate is 8.40% p.a.

To compute market rate of return, BSE sensx return has been calculated at first for the period from 1st April 2003 to 31st March 2015 on daily basis. The average of those 2990 daily returns has been calculated next. Then the average so

calculated has been annualised. This annualised rate has been taken as the market rate of return which is 23.31%.

Now, we shall compute the risk coefficient β . It has been calculated with the following formula.

$$\beta = \text{Cov}(R_m, R_h) / \sigma^2_m = r_{mh} \times \sigma_h / \sigma_m$$

where, R_h = share price return of HUL, σ_m = standard deviation of daily market rate of return (i.e. Sensex return), σ_h = standard deviation of daily share price return of HUL and r_{mh} = correlation coefficient between daily market rate of return (i.e. Sensex return) and daily share price return of

HUL. Here, both the returns have been calculated for the period from 1st April 2003 to 31st March 2015 on daily basis. Further, only the closing indices/prices are considered for calculating the daily returns because closing price represents the sensation of the whole day. Finally, the value of β comes to 0.57.

Putting the values in the equation, cost of equity (K_e) comes to 16.90% p.a.

Now, we have NOPAT, average capital employed and percentage of COC. Therefore, the EVA may be computed as shown in Table 2.

Table 2: Computation of EVA of HUL (Unit of Rs. is in Crore)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
1.Profit After Tax (NOPAT) (Rs.)	1894.95	1911.14	2345.11	3044.64	3359.8	3866.18
2.Average Capital Employed (Rs.)	2583.52*	2621.52	3086.23	3093.48	2975.54	3500.92
3.COC (%)	16.9	16.9	16.9	16.9	16.9	16.9
4.Total cost of Capital Employed (2×3) (Rs.)	436.61	443.04	521.57	522.80	502.87	591.66
5.EVA (1-4) (Rs.)	1458.34	1468.10	1823.54	2521.84	2856.93	3274.52
6.EVA as percentage of Average Capital Employed (%) (5/2*100)	56.45	56.00	59.09	81.52	96.01	93.53

*Closing Amount

Measurement of Performance of UIEL Based on Traditional Approach

Table 3: Traditional measures of financial performance of UIEL (Rs. in Crore)

Particulars	2011-12	2012-13	2013-14	2014-15
1.Shareholders'Fund / Capital Employed:				
Equity Share Capital	2.98	2.98	2.98	2.98
Reserve & Surplus	218.81	256.99	350.34	378.32
	221.79	259.97	353.32	381.30
2.Av. Capital Employed	221.79*	240.88	306.65	367.31
3.Total Assets	486.30	540.33	594.80	575.17
4.Av. Total Assets	486.30*	513.32	567.57	584.99
5.Sales	1048.49	1062.54	1030.46	932.46
6.EBIT (excluding Exceptional items)	130.26	160.60	211.96	147.74
7.PAT [(6)-30% Tax rate]	91.18	112.42	148.37	103.42
8.No. of Eq. Shares (lakh)	29.75	29.75	29.75	29.75
9. Net Profit Ratio (%) [(6)/(5)* 100]	12.42	15.11	20.57	15.84
10. Return on Total Assets (%) [(6)/(4)*100]	26.79	31.29	37.35	25.26

Particulars	2011-12	2012-13	2013-14	2014-15
11. Return on Investment after Tax (%) [(7)/(2)*100]	41.11	46.67	48.38	28.16
12.Earnings Per Share (Rs.) [(7)/(8)]	306.49	377.88	498.73	347.62
13. Return on Shareholders' Fund (%) [(7)/(1)*100]	41.11	43.24	41.99	27.12

*Closing Amount; Source: Different annual reports of HUL

Measurement of Performance of UIEL Based on EVA Approach

Already it has been stated how EVA is computed. Capital structure of UIEL consists of equity shares only. Therefore, cost of equity will be the cost of capital/weighted average cost of capital in case of UIEL. It has also been stated that in computing cost of equity, generally, Capital Asset Pricing Model (CAPM) is used in EVA approach. As per the earlier calculation of our study, risk free rate of return and market rate of return are 8.40% and 23.31% respectively.

Now, we shall compute the risk coefficient β . It is as below.

$$\beta = \text{Cov}(R_m, R_u) / \sigma_m^2 = r_{mu} \times \sigma_u / \sigma_m$$

where, R_u = annual return on shareholders' equity in UIEL (as shown in table III), σ_m = standard deviation of annual market rate of return (i.e. Sensex return), σ_u = standard deviation of annual return on shareholders' equity in UIEL and r_{mu} = correlation coefficient between annual market rate of return (i.e. Sensex return) and annual return on shareholders' equity in UIEL. Here, both the returns have been calculated for 4 years from 1st April 2011 to 31st March 2015 to maintain parity as UIEL came into existence since 1st April 2011. Further, only the closing indices have been considered for calculating the market returns because closing index represents the sensation of the whole day.

To work out annual market rate of return, at first, returns have been calculated on daily basis. Then, yearly total of the returns has been calculated to convert them into annual rate of return. Finally, the value of β comes to -0.2844.

Putting the values in the equation, cost of equity (K_e) comes to 4.17% p.a.

One disparity is already there in our calculation. Market share price return of UIEL should have been considered in computation of β as we have taken the sensex returns as the market return. If the market share price return of UIEL would have been taken, cost of equity might have been different. But, market share price of UIEL is not available. So, we have no other way but to take the return on shareholders' equity. For this reason, we shall not take the cost of equity, calculated in this method, as the final cost of equity. We

shall also calculate cost of equity under Earning Price Ratio Method. The average of the two results will finally be taken as the cost of equity.

Under Earning Price Ratio Method, cost of equity is calculated by using the following formula.

$$K_e = E/P$$

where, E = average earnings per share and P = average market price per share. As market price is not available, net issue price per share at the time of their issue on 1st April 2011 will be considered here. The shares were issued with a face value of Rs. 10 each at a premium of Rs. 1500 each to its holding company. Therefore, net issue price becomes Rs. 1510 each. On the other hand, average EPS for the reported four years is Rs. 382.68. So, cost of equity comes to 25.34%. As there is no clear trend in EPS and no debt instrument is there in the capital structure, this measure may be a good reflector of cost of equity here.

The average of the two costs of equity is 14.76% which will be considered as the final cost of equity (K_e) for UIEL. Already it has been mentioned that cost of equity will be the cost of capital in case of UIEL as there is no other type of instrument in capital structure. Hence, Cost of Capital (K_0) is also 14.76%.

Now, we have NOPAT, average capital employed and percentage of COC. Therefore, the EVA may be computed as shown in Table 4.

Table 4: Computation of EVA of UIEL
(Unit of Rs. is in Crore)

Particulars	2011-12	2012-13	2013-14	2014-15
Profit After Tax (NOPAT) (Rs.)	91.18	112.42	148.37	103.42
2.Average Capital Employed (Rs.)	221.79*	240.88	306.65	367.31
3.COC (%)	14.76	14.76	14.76	14.76
4.Total cost of Capital Employed (2×3) (Rs.)	32.74	35.55	45.26	54.21

Particulars	2011-12	2012-13	2013-14	2014-15
5.EVA (1-4) (Rs.)	58.45	76.87	103.11	49.20
6.EVA as percentage of Average Capital Employed (%) (5/2*100)	26.35	31.91	33.62	13.40

*Closing Amount

Comparison of the Results of Two Approaches

We have four traditional measures and one modern measure of sustainability. To make a comparative analysis and to comment on the results, they are presented in Table 5.

Table 5: Comparison between Traditional Measures and EVA Measure of HUL

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Net Profit Ratio (%)	15.45	13.83	15.15	16.85	17.13	17.93
Return on Total Assets (%)	28.44	27.74	31.72	38.71	39.16	41.48
Return on Investment after Tax (%)	73.35	72.90	75.99	98.42	112.91	110.43
Earnings Per Share (Rs.)	8.69	8.85	10.85	14.08	15.54	17.87
EVA on Average Capital Employed (%)	56.45	56.00	59.09	81.52	96.01	93.53

Each of the four traditional measures is showing better performance in post-demerger period than in pre-demerger period. Rate of improvement in post-demerger period is also good as per traditional approach. On the other hand, EVA approach is showing a brilliant improvement in performance in post-demerger period. EVA (as % of Av. Capital Employed) in 2014-15 is 167% of that in 2010-11. It is a very good achievement.

Table 6: Comparison between Traditional Measures and EVA Measure of UIEL

Particulars	2011-12	2012-13	2013-14	2014-15
Net Profit Ratio (%)	12.42	15.11	20.57	15.84
Return on Total Assets (%)	26.79	31.29	37.35	25.26
Return on Investment after Tax (%)	41.11	46.67	48.38	28.16
Earnings Per Share (Rs.)	306.49	377.88	498.73	347.62
EVA on Average Capital Employed (%)	26.35	31.91	33.62	13.40

All the traditional measures are showing satisfactory results. UIEL is gaining sufficient return on their investment. On the other hand, EVA, as a percentage of average capital employed, is again showing good result. The last year's performance is showing a declining movement in both traditional and EVA point of view. So, the management should be concerned about this. In Table 7, performance has been shown on average basis.

Table 7: Comparative Analysis between Pre-Demerger and Post-demerger Period

Particulars	Pre-demerger Average (HUL)	Post-demerger Average (HUL)	Post-demerger Average (UIEL)
Net Profit Ratio (%)	14.64	16.77	15.99
Return on Total Assets (%)	28.09	37.77	30.17
Return on Investment after Tax (%)	73.13	99.44	41.08
Earnings Per Share (Rs.)	8.77	14.59	382.68
EVA on Average Capital Employed (%)	56.23	82.54	26.32

Our findings are as follows:

- In terms of Net Profit Ratio, both transferor and transferee company are showing better results in post-demerger period.
- Similarly, in terms of Return on Total Assets, both transferor and transferee company are in the way of improvement.
- In respect of ROI, the transferor company HUL has improved a lot in post-demerger period. Besides, the performance of transferee company UIEL is also satisfactory. It is also earning sufficiently on its investment.
- In case of EPS, performance of the transferor company is far better in post-demerger period. On the other hand,

EPS of the transferee company is very high. Face value per share of UIEL is Rs. 10 but that of HUL is Re. 1 only. It is the main reason of this huge difference.

- The transferor company is adding more economic value in post-demerger period. As a newly created entity, UIEL is also generating economic value for its stakeholders at a good pace.

6. Conclusion

Normally, we use the traditional measures to indicate short run sustainability of an entity. On the other hand, EVA measurement indicates long run sustainability. We also know that corporate restructuring decisions are taken to enhance the power of sustainability. HUL demerged its FMCG exports business to achieve this purpose. After analysing the financial data of the transferor company, it has been seen that the performance graph is moving upward in post-demerger period from the view point of traditional and modern measurement approach. Therefore, power of short run as well as long run sustainability of HUL has been enhanced after the demerger. Again, the transferee company UIEL is showing satisfactory performance since its incorporation under traditional and EVA approach. Not only its rate of return on investment is good but also it is generating value for its stakeholders. So, short as well as long run sustainability is being achieved by UIEL after demerger. To conclude, it can be said that the decision of corporate restructuring through demerger was appropriate in HUL.

REFERENCES

Books & Articles

- Banerjee, A., & Jain, S. C. (1999). Economic Value Added and Shareholders' Wealth: An Empirical Study of Relationship. *Paradigm*, 3(1), 99-135.
- Banerjee, B. (1999). *Financial policy and management accounting* (6th ed.). World Press, Kolkata.
- Chatterjee, A., & Rakshit, D. (2010). Measures of shareholders' value creation: An assessment. *Vidyasagar University Journal of Commerce*, 15.
- Khan, M. Y., & Jain, P.K. (2012). *Basic financial management* (3rd ed.). Tata McGraw Hill, New Delhi.
- Rakshit, D., & Chatterjee, C. (2008). Corporate Restructuring through Mergers and Acquisitions: A Case Study. *Vidyasagar University Journal of Commerce*, 13, 79-90.
- Rakshit, D. (2006). EVA based performance measurement: A case study of dabur India Limited. *Vidyasagar University Journal of Commerce*, 11.
- Stern, J. (1990). One way to build value in your firm, executive compensation. *Financial Executive*, Nov/Dec, 51-54.
- Stewart, G. B. (1994). EVA TM: Fact and Fantasy. *Journal of Applied Corporate Finance*, 7(2), 71-84.

Reports & Others

- Annual Reports of HUL from 2009-10 to 2014-15 (Retrieved from www.hul.co.in).
- BSE Sensex data from 2003-04 to 2014-15 (Retrieved from www.bseindia.com).
- HUL share price data from 2003-04 to 2014-15 (Retrieved from www.bseindia.com).
- HUL subsidiary annual report 2014-15 (Retrieved from www.hul.co.in).
- Scheme of arrangement between HUL and UIEL and their respective shareholders (Retrieved from www.hul.co.in).