

Beyond M&A: Spin-offs as a Catalyst for Shareholder Value Creation in India

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Abstract

The yearly pruning of apple trees in an orchard, which is necessary to preserve health and maximize yield, is comparable to divestiture exercises. As a particular type of divestiture, spin-offs cause the parent company's size to decrease. While mergers and acquisitions have historically been the main focus of corporate restructuring, an increasing number of corporations in India have chosen to streamline their operations by spinning off divisions in recent decades. Mergers are generally understood to create synergies, but spin-offs are also anticipated to add value to shareholders' wealth due to increased corporate focus. This study aims to analyse the impact of spin-off announcements on the share prices of companies, focusing on shareholder value addition in the Indian context. Data for the study was collected over a period of one year, from January 2016 to December 2016, and the dates of the announcements were obtained from the BSE database. The population for the research was 16 spin-off

announcements, and 12 announcements were excluded because they fell into various categories such as composite schemes, spin and merge schemes, the resulting companies were not listed, and some announcements involved partial spin-offs. The result was that the research used the sample population of 4 companies, which involved an exclusive spin-off, and the new company was listed on the BSE after the spin-off. The short-term effects of spin-off announcements were examined using the event study methodology, and the cross-sectional dependence of abnormal returns was examined using the crude adjustment method t-test. The study results consistently show that spin-off announcements increase shareholder value by having a positive impact on shareholder wealth.

Keywords: *divestiture, spin-off, shareholder's wealth, , event study, abnormal return*

Introduction

Just as smart apple farmers meticulously prune their trees by removing dead, weakened, or even vigorous limbs that hamper overall growth, a similar disciplined approach is vital for the sustained health and productivity of any business enterprise. This analogy underscores the essential lesson for managers regarding the strategic exercise of divestitures. While companies traditionally dedicate considerable effort to acquiring new businesses and refining existing operations for rapid growth, divestitures offer a complementary and powerful pathway to achieve growth and sustainability. Divestitures entail the deliberate choice to retain economically desirable business segments while eliminating those that are no longer making a sufficient contribution, frequently as a result of a changing business environment, new competitors, changing consumer preferences, the availability of raw materials, or advancements in technology.

Instead of focusing only on acquisitions or new projects for growth targets, a thorough and comprehensive focus on divestitures can encourage managerial thought toward regular divestiture initiatives where necessary. The company and its

shareholders could benefit greatly from such a well-thought-out divestiture program.

A unique type of divestiture which leads the parent company's size to decrease is spin-off. Corporates in India have been strategically shrinking by spinning off one or more divisions in recent decades. While spin-offs are generally anticipated to increase shareholder wealth by allowing for a greater focus on core operations within the newly separated entities, mergers are frequently linked to the creation of synergy. When a company spins off, it creates two or more separate legal entities. The shareholders of the parent company get a share of the new businesses in proportion to their ownership of the parent company. The new business, called the "resulting company," becomes its own decision-making body and no longer has to report to the parent company. It's important to remember that after the spin-off, the same stockholders still own both the parent company and the new company. The purpose of this study is to examine the impact of spin-off announcements on the stock prices of Indian companies, particularly in terms of their short-term value to shareholders.

Literature Review

Schipper & Smith, (1983) test the effect of spin-off on shareholders' wealth. Their sample consisted of 93 spin-offs over the period 1963 - 1981. Using the market model to estimate the abnormal returns, the findings reveal a significant positive abnormal return to parent companies around the announcement of a spin-off. By the same token, Hite and Owers (1983) report significant positive abnormal returns to shareholders of 116 firms involved in spin-off activities during the period 1963 - 1981.

Alexander et al., (1984) found that voluntary corporate sell-offs lead to positive announcement returns, yet that these returns were preceded by a period of negative abnormal returns. The authors state that this suggest that voluntary sell-offs are preceded by a period of negative news about the company, yet it could just as well be that the company was performing poorly. The authors do not consider this point of view.

Cusatis et al., (1993) measured the impact of spin-offs on changes in operating performance in the long-run. Their sample is based on 51 American spin-off events between 1972 and 1986. The results present that American spin-offs do not improve operating performance in the long-run. A

three-year post-spin-off period shows even lower return on assets, sales growth and market-to-book ratios than in the period before the spin-off. Moreover, the authors claim that the increase in corporate focus has no impact on the operating performance of parent firms within three years after the spin-off.

Daley et al. (1997) investigated changes in operating performance of parent firms after a spin-off was undertaken by examining the return on assets in the time period of two years prior to the spin-off until two years after the spin-off. The used sample consists of 85 spin-offs, whose 60 are focus increasing spin-offs and 25 are non-focus-increasing spin-offs. The authors show improvements in operating performance for focus-increasing spin-offs (+2.3% Δ ROA) but smaller changes for non-focus-increasing spin-offs (+0.7% Δ ROA). This result is consistent with the statement that spin-offs might create value by removing negative operating synergies and allowing managers of the parent firm to focus more on their core operations.

Mulherin & Boone, (2000) view divestitures and acquisitions as a way to adapt to the environment. Their results are consistent with the synergistic theory of corporate restructuring which states that changing economic conditions and industry

shocks influence restructuring activity. It is about adapting to the environment and not reacting to a weaker economy. They concluded that both divestitures and acquisitions lead to positive announcement returns and that this effect is related to the size of the particular event.

Byerly et al., (2003) find that prior levels of diversification (single-, related-constrained-, related-linked- and unrelated businesses) and the mode of restructuring influence the stock market's reaction to restructuring announcements. The research found out that the more significant the impact of the restructuring is, the more positive the stock market's reaction is. The authors also find that strategy of pursuing new business opportunities while ditching a few old ones is valued positively by the stock market. This type of change also brings about the largest announcement returns.

Research by Kirchmaier, (2003) reports only insignificant long-run abnormal returns for European spin-offs over a time period of one and two years after the restructuring. This is very surprising since many American studies came up with statistically significant figures. Kirchmaier explains this discrepancy by the difference in capital market efficiency between the countries. Furthermore, the long-run

analyses demonstrated that the size of the spin-off plays an important role in shareholder wealth effects. Small spin-offs (+6.4%) were far more successful than large spin-offs (+1.6%) based on a sample of 29 spin-offs.

Many of the previous researchers in relation to growth and success of companies had been concentrating much on the concept of mergers and acquisitions as a vital tool to reach their end. However, the theoretical literature available and also the practical applications of the concept of divestitures have proved to contribute for the growth and success of companies. These facts have not been either highlighted or further probed by the researchers to the extent it ought to have been. This has left a substantial gap in the objective of research in furnishing enough relevance for the benefit of the corporates in identifying additional mechanisms through divestitures for growth and prosperity. Perhaps the gap has occurred because of the partial reasoning of the researchers viewing the implication of the buyers' perspective on growth and success, literally ignoring the approach from the seller's point of view, which should have been complimented in the research done so far in many instances. Hence the concentration of this study is on the impact of spin-off in respect of value addition to shareholders.

Data and Methodology

Data

This study was undertaken to examine the influence of the spin-off announcement on the share prices of Indian companies. The researcher initially contemplated the demographic of Indian spin-offs registered on the Bombay Stock Exchange (BSE). The data covered a year, from January 2016 to December 2016, and the dates of the announcements came straight from the BSE corporate announcements database. There were 16 Indian spin-off announcements in the original group. However, 12 of these spin off announcements were taken out of the study for different reasons, such as composite arrangements, spin-and-merge transactions, cases where the new company stayed unlisted, or partial spin-offs. The researcher then chose a final sample of four companies that had gone through an exclusive spin-off. After the spin-off was finished, the new company was listed on the BSE. The announcement date was the day that the company officially told the stock exchange about its decision to spin off, after getting approval from the shareholders' meeting. Daily share price data for these securities were obtained from the BSE, and the S&P BSE 500 index was utilized as a proxy for market movement to calculate expected returns.

Methodology

Finance literature authenticate that even study methodology is extensively used in evaluating the impact of a certain event on the stock prices. Hence, event study methodology has been used in the present study to examine short-term stock price reaction to the announcements of spin-offs. Along with event study descriptive statistics and correlation is also calculated. The following are the steps in event study methodology:

The first step in the event study methodology is to define the event date (the date on which the event is first announced to the public). The date on which the company informs BSE about its board approval of spin-off is considered as announcement date in the study. These dates are identified from the corporate announcements of BSE.

The next step is to describe the estimation window (period prior to the event) and event window (the period around spin-off announcement date). Estimation window of 160 days (-181, -21), event window of 41 days (-20 to +20) is considered in the study. During the event window, the stock market reaction to the announcement is studied through cumulative abnormal returns. Fama et al. (1969) advised to study the abnormal return before and after the announcement

date also. The abnormal returns for different windows (-20, -15), (-15, -10), (-10, -5), (-5, 0), (-1, 0), (-1, +1), (0, +1), (0, +5), (+5, +10), (+10, +15), and (+15, +20) have been considered in the study. To assess the expected returns Market model is used.

Regression of stock's returns against market index is done to calculate the expected returns. The strategic issue in event study is to determine the part of the price movement that is essentially affected by the event under study. It is imperative to measure the effect of the specific event on stock returns. This generates the concept of Abnormal Returns (AR). The AR is the difference between the actual return and the expected return on a particular day.

The following equation is used to calculate the abnormal return.

$$AR_{jt} = R_{jt} - E(R_{jt})$$

The market model relates the return of a security to the return of the market portfolio as per the following equation:

$$R_{jt} = \alpha_j + \beta_j R_{mt} + \epsilon_{jt}$$

where, $t = -181, \dots, -21$, α_j is a constant term for the j^{th} stock, β_j is the beta of the j^{th} stock, R_{mt} is the market returns, and ϵ_{jt} is an error term. The parameters of the model will be assessed by using the time-series data from the estimation period before

every particular announcement. The estimated parameters will be used in the calculation of ARs for each day in the event window. These will then be compared with the actual returns during the event period. The daily excess return, that is, the AR of firm j for the day t (AR_{jt}) is estimated from actual returns across the event period and the estimated coefficients from the estimation period as per the following equation:

$$AR_{jt} = R_{jt} - (\alpha + \beta R_{mt})$$

where $t = -20, \dots, +20$

The average abnormal return (AAR_t) for each day in the event window is calculated as per the following equation:

$$AAR_t = 1/N(\sum AR_{tj})$$

where N is the number of companies.

The cumulative average abnormal return (CAAR) for day t , is defined by:

$$CAAR_t = \sum_{k=-20}^t AAR_k$$

To consider any cross-sectional dependence of the abnormal returns over the observation period, t-tests are performed using the crude adjustment method suggested by Brown and Warner (Rosenfeld, 1984)

Analysis and Findings

Descriptive statistics of abnormal returns are shown in Table No. 1. Average

abnormal return over a period of 202 days (estimation window plus event window) of CG Power is 0.0002591, Mohit Industries - 0.000577, GB Global 0.000121 and TCI Ltd. Is 0.000564. Overall TCI Ltd. Has

highest positive average return and Mohit Industries has negative average abnormal return. We can also observe high volatility in returns of Mohit Industries.

Table No. 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
CG_Power	202	-.039398	.058957	.00025911	.017655741
Mohit_Industries	202	-.130526	.128508	-.00057703	.031001307
GB_Global	202	-.044696	.068397	.00012189	.017400684
TCI_Ltd	202	-.081965	.168864	.00056433	.024447080
Valid (listwise)	N 202				

Correlation is calculated to know the relationship among returns. Table No. 2 shows the correlation among returns of 4 companies.

Table No. 2: Correlation of Returns

		CG_Power	Mohit_Industries	GB_Global	TCI_Ltd
CG_Power	Pearson Correlation	1	-.102	-.018	.039
	Sig. (2-tailed)		.147	.803	.585
	N	202	202	202	202
Mohit_Industries	Pearson Correlation	-.102	1	.068	-.026
	Sig. (2-tailed)	.147		.337	.709
	N	202	202	202	202
GB_Global	Pearson Correlation	-.018	.068	1	.013
	Sig. (2-tailed)	.803	.337		.853
	N	202	202	202	202

TCI_Ltd	Pearson Correlation	.039	-.026	.013	1
	Sig. (2-tailed)	.585	.709	.853	
	N	202	202	202	202

We can observe positive correlation among abnormal returns of companies except Mohit Industries. Mohit Industries has negative correlation with CG Power and TCI Ltd. and positive correlation with GB

Global. GB Global also has negative correlation with CG Power. It can be said that the returns are moving in a same direction.

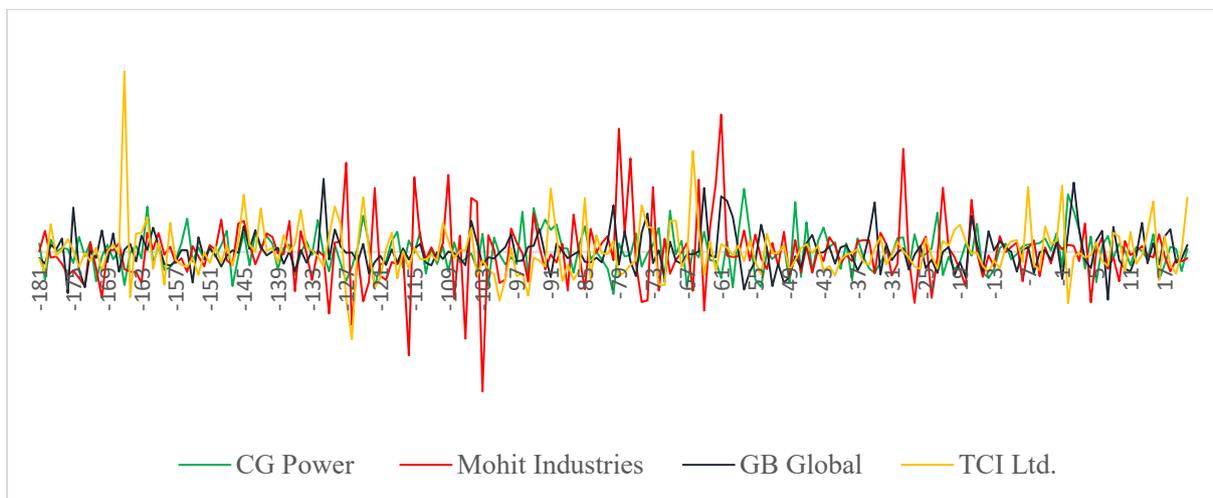


Figure No. 1: Abnormal Returns during Estimation and Event Window

Figure No. 1 displays the abnormal returns of CG Power, Mohit Industries, GB Global and TCI Ltd. for a period of 202 days (estimation period plus event period). Massive volatility in the abnormal returns of Mohit Industries can be observed.

Event study is conducted to analyse the impact of spin-off announcement on share price. Table No. 3 denotes the day-wise AAR and CAAR over the event window. AARs and CAARs have been calculated for all 40 days in the event window.

Table No. 3: Analysis of day-wise Abnormal Returns

Day	AAR	CAAR	t	p values
-20	-0.005674	-0.005674	-0.601484	0.589932
-19	-0.002616	-0.008290	-0.275058	0.801128
-18	-0.009595	-0.017885	-0.895246	0.436622

-17	0.019271	0.001386	1.475975	0.236431
-16	0.008085	0.009471	1.269952	0.293657
-15	-0.018510	-0.009039	-8.928292	0.002964
-14	-0.006788	-0.015827	-0.689094	0.540277
-13	-0.009068	-0.024895	-2.316491	0.103415
-12	0.003316	-0.021578	0.506835	0.647176
-11	0.003862	-0.017716	2.395535	0.096260
-10	0.001929	-0.015787	0.542574	0.625135
-9	-0.000246	-0.016033	-0.036392	0.973256
-8	-0.007458	-0.023491	-1.005436	0.388761
-7	0.018844	-0.004647	1.345859	0.271020
-6	-0.003425	-0.008072	-0.462032	0.675503
-5	-0.007889	-0.015961	-1.096987	0.352810
-4	0.010541	-0.005420	2.097562	0.126859
-3	-0.002456	-0.007876	-0.601676	0.589820
-2	0.011776	0.003900	5.884065	0.009796
-1	0.006122	0.010021	0.313768	0.774250
0	0.007535	0.017556	0.357418	0.744444
1	0.025990	0.043546	1.645444	0.198429
2	0.007667	0.051213	1.045864	0.372469
3	-0.000467	0.050746	-0.050510	0.962891
4	-0.012872	0.037875	-0.989819	0.395233
5	-0.001993	0.035882	-0.220361	0.839735
6	0.007629	0.043512	1.251144	0.299566
7	-0.014611	0.028901	-1.196422	0.317465
8	0.007718	0.036619	1.022985	0.381607
9	-0.003224	0.033395	-0.346317	0.751971
10	-0.005874	0.027521	-0.844815	0.460261
11	-0.003717	0.023804	-0.460621	0.676408
12	-0.002246	0.021558	-0.669856	0.550898
13	0.007593	0.029150	1.126989	0.341750
14	-0.000484	0.028666	-0.073433	0.946083
15	0.016675	0.045341	1.497499	0.231185

16	-0.011842	0.033499	-1.178316	0.323625
17	0.003366	0.036865	0.501756	0.650349
18	-0.001214	0.035651	-0.136391	0.900151
19	-0.008787	0.026864	-1.856139	0.160444
20	-0.008261	0.018603	-2.165354	0.118975

It can be observed in Table No. 3 that the abnormal returns being 0.02599 is the highest on Day 1, i.e. next day of announcement of the spin-off. Day 1 has a t-value of 1.645 which is insignificant at 5 per cent level. Apart from Day 1, Day -7 and Day -17 also shows high abnormal returns. Day -7 has abnormal return of 0.0188 and Day -17 has abnormal return of 0.0192. day -2 has a abnormal return of 0.0117 with a t-value 5.884 which is significant at 5 per cent level. This signifies that the information about spin-off starts

impacting the stock price of the parent company even before it is officially announced. This could be due to the information leakage before it officially strikes the market. As per Table II, the market's response to the spin-off. The CAAR is maximum on Day +2 signifying that the returns to the shareholders would be highest on Day +2.

Further Table No. 4 analyses the AAR and CAAR over different intervals during the event window.

Table No. 4: Analysis of AAR over different intervals

Interval	AAR	CAAR	t	p
(-20 to -15)	-0.009039	-1.988538	-33.828561	0.000057
(-15 to -10)	-0.025258	-2.122233	-36.102949	0.000047
(-10 to -5)	0.001755	-0.178103	-3.029855	0.056317
(-5 to 0)	0.025628	1.738537	29.575603	0.000085
(-1 to 0)	0.013657	0.167796	4.944160	0.015873
(-1 to +1)	0.039646	0.579157	13.933527	0.000800
(0 to +1)	0.033525	0.500715	14.753706	0.000676
(0 to +5)	0.025861	0.447009	7.604411	0.004719
(+5 to +10)	-0.010354	-0.083446	-1.419571	0.250802
(+10 to +15)	0.011946	0.143941	2.448686	0.091787
(+15 to +20)	-0.010064	-0.834236	-14.191833	0.000758

The AAR of 0.039 is maximum for the interval of (-1, +1) with a t-value of 13.93 which is significant at 5 per cent level. The interval (0, +1) and (0, +5) also shows a positive AAR of 0.0335 and 0.0258 respectively. Both are significant at 5 per cent level. The CAAR for the interval (-5, 0) is the highest. This makes the interval to be highest return giving interval in the entire event window period. After Day +5, the stock prices of the parent company do not seem to be impacted by the spin-off announcement. Table No. 4 shows that AARs are significant for interval before the official announcement of the spin-off except one interval, namely (-10, -5). After the spin-off announcement, AAR is significantly positive for the interval (0, +1) and (0, +5). After that AAR is not significant for any other interval except (+15, +20). For this interval the AAR is significantly negative at the 5 per cent level.

With this we can say that the stock prices of the parent company start getting impacted before the official announcement of the spin-off.

Conclusion

The results for the sample of 4 spin-offs show that spin-off announcements have a positive effect on shareholder wealth and such announcement increases shareholder value. The spin-off

announcement has a significantly positive impact on the stock prices of the parent company. The impact starts coming two day before the official announcement and remains till two days

after the official announcement. The CAAR is highest on Day +2. The pre-announcement period is more affected more in terms of impact on share prices as compared to the post announcement period. The shareholders of the parent company gain as a result of the spin-off announcement.

Contribution to Literature and Managerial Implications

This study addresses a substantial gap in the existing research by focusing on divestitures, specifically spin-offs, from the "seller's point of view" in the Indian context. While much of the corporate restructuring literature emphasizes mergers and acquisitions, our findings underscore the vital role of strategic divestitures in value creation, aligning with some international studies (e.g., Schipper & Smith, Hite & Owers) that found positive abnormal returns around spin-off announcements. The observation of pre-announcement market reaction also contributes to the understanding of market efficiency and information dissemination around corporate events in India.

For corporate managers, these findings carry significant practical implications. The consistent positive market reaction to spin-off announcements should propel management teams to seriously consider divestiture initiatives as a viable and effective strategy for value creation and sustained growth, not just as a reaction to distress but as a proactive tool for corporate restructuring. Spin-offs can enhance shareholder value by allowing both the parent and spun off entities to increase focus on their core competencies, potentially leading to improved operational efficiency and market recognition. Managers should also be aware of the market's anticipatory behavior and the potential for information leakage, which necessitates stringent internal controls around such sensitive corporate actions. The short-term nature of the most significant positive impact suggests that the immediate market gains are largely realized within the first few days around the announcement.

Limitations and Future Research

Despite these valuable insights, it is important to recognize the limitations of the research. The small sample size of only 4 companies significantly affected the generalization of the results. Although rigorous selection criteria have been applied, future research should include a larger and more diverse sample of Indian spin-offs in order to increase the statistical power and greater applicability of the results. Furthermore, the limited one-year period (January 2016 to December 2016) may not fully capture long-term performance trends or market behavior in various economic cycles. Future research may extend the observation period and possibly conduct long-term performance analyses (such as Cusatis et al. or Daley et al.) to determine whether initial short-term gains are sustained over time. Further research could also explore specific factors influencing different reactions between companies (e.g. industry, reason for bankruptcy, size of the bankruptcy entity, management decisions after bankruptcy) in order to better understand the bankruptcy phenomenon in India.

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