

A Comprehensive Review of Corporate Divestitures: Concepts, Motivations, Performance, and Value Creation

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Abstract
This article presents a comprehensive review of the existing literature on corporate divestitures, a significant strategy within inorganic growth and corporate restructuring. Drawing on numerous published works, including journal articles, books, and reports, the review aims to enhance conceptual understanding, evaluate the need for further study, and identify research gaps in this field. The literature is systematically categorized into four key segments: divestitures - overview, reasons for divestitures, divestiture performance, and value creation through divestitures. The review highlights various aspects of divestitures, from their historical development and procedural elements to their impact on organizational design, financial performance, and shareholder wealth. Studies across diverse geographical contexts, including India, China, Singapore, the US, UK, Germany, Sweden, and Malaysia, are synthesized to provide insights into the multifaceted nature and outcomes of divestiture strategies.
Keywords: *divestiture, spin-offs, firm performance, shareholder wealth*

Introduction

Reviewing published works on a chosen topic is a fundamental step in academic research, with the primary goals of synthesizing previously conducted research and gaining profound conceptual understanding. This process is crucial for evaluating the necessity of further study and identifying existing research gaps within a specific field. This review focuses on corporate divestitures, a phenomenon in the corporate landscape that serves as a relevant strategy for inorganic growth. In emerging economies like India, where the corporate world is rapidly expanding, growth is a key objective for business entities, and inorganic strategies like corporate restructuring, including divestitures, enable organizations to respond swiftly to new opportunities and challenges.

The significance of studying divestitures as a restructuring mode is well-recognized in the literature. This paper structures the review of various published works—such as journal articles, books, and reports—into four broad segments to facilitate a clear understanding: divestitures - overview, reasons for divestitures, divestiture performance, and value creation through divestitures. This segmentation allows for a comprehensive grasp of the concept, motivations, procedural aspects, and performance outcomes of divestiture deals, including spin-offs, and their impact on value creation.

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Divestitures - overview

Divestitures are often viewed as the "flipside of acquisitions," and research has explored the importance of learning from prior divestment experience to successfully complete subsequent acquisition deals. For instance, Doan et al. (2018) found that deal value and acquisition experience influence the impact of learning from divestiture on acquisition deal completion, based on an analysis of 2164 merger and acquisition transactions globally between 1991 and 2010 in the computer and printing industries.

Academics hold differing views on divestment and restructuring; while many support it, others highlight its failures due to poor timing and extraneous considerations. Ogiugo & Omofezi (2018) emphasized that successful divestiture execution requires managers to proceed with caution and at the proper moment to avoid significant errors. Kolev (2016) conducted a meta-analysis of 35 studies, developing a framework for divestiture based on past experiences and identifying strong predictors of divestitures and underlying theories. Key factors significantly impacting the divestiture decision include firm size, firm diversification prior divestitures, and prior unit performance.

The role of mergers in promoting divestment, particularly in old and declining industries, has also been investigated. Nishiwaki (2016) used data from Japanese cement industries to demonstrate that combined businesses had greater incentives to close distribution sites, and these divestitures due to mergers could enhance welfare. Feldman & McGrath (2016) provided an introduction to divestiture and its forms, discussing the historical evolution of divestiture literature and its implications for organizational design, while also suggesting directions for future research.

Fryges & Wright (2014) proposed a classification system for corporate and academic spin-off types, differentiating them based on academic and commercial contexts, and further categorizing them as original startups or derivative startups from existing activities. Brauer & Wiersema (2012) observed a relationship between stock market returns and divestiture position, divestitures occurring at the peak of an industry divestiture wave tend to generate lower stock market returns. Their study considered US companies' divestitures announced and completed between 1993 and 2007, using event study methodology to measure abnormal stock returns.

In the context of Chinese listed companies, Wu et al. (2011) found a negative effect of corporate debt on state-controlled firms' divestitures and that the largest shareholder's ownership concentration reduced corporate divestitures in both state-controlled and non-state-controlled enterprises. For financial managers, Gole & Hilger (2008) provided a structured approach and a divestiture process model for successfully completing divestiture transactions, outlining critical factors. Moschieri & Mair (2008) synthesized existing literature to offer a comprehensive picture of divesting modes, mechanisms, and outcomes, also identifying gaps and future research opportunities.

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Cristo & Falk (2006) evaluated factors contributing to successful corporate divestitures, concluding that a larger parent company and greater revenue size of the divested entity significantly impact the failure rate, lowering it and leading to better outcomes. Datta (2003) analyzed policy changes in US telecommunications, finding that divestiture had a negative effect on productivity but a positive effect on competition. The study also evidenced a strong positive relationship between research and development and productivity in the post-divestiture period, which was nil in the pre-divestiture period. Mulherin & Boone (2000) reported a significant increase in shareholders' wealth from acquisitions and divestitures in 1990, directly related to the relative size of the event, based on a sample of 1305 firms.

Chow & Hamilton (1993) explored the rationale behind corporate divestment, drawing insights from industrial organization (management's viewpoint for divestment reasons), finance (distinction between sell-off and spin-off), and corporate strategy (approaches like product life cycle and portfolio approaches). They also suggested guidelines for future research. Ramanujam & Varadarajan (1989) integrated diversification research from various perspectives, providing a framework of 10 themes for classification and identifying future research areas in divestitures. Schmidt (1987) posited that divestment is a feasible management alternative for unsuccessful business segments, and trimming through divestiture can stimulate corporate growth.

Reasons for divestitures

Navatte & Schier (2017) discussed three main divestiture methods: sale, carve-out, and spin-offs, noting a lack of research in this area despite spin-offs in the US often increasing shareholder value, especially for larger deals. Prezas & Simonyan (2015) analyzed factors influencing the choice between sell-offs and spin-offs, finding that firms with lower pre-divestiture value tend to opt for spin-offs, while sell-offs result in significantly better long-term post-divestiture operating performance. Spin-offs showed larger positive announcement effects, and firms were more likely to spin-off assets during investor optimism.

Martins (2015) observed a decline in capital allocation efficiency after a spin-off in the case of PT Multimedia, which contrasted with prior studies. Johnson (2013) highlighted common obstacles in selling subsidiaries or divisions, such as funding needs, strategic alignment, capital limits, and buyer interest, advising financial executives to carefully structure these transactions. Jain et al. (2011) investigated vertical fragmentation decisions from a product market perspective, concluding that vertical divestitures are less frequent with high contractual issues and more likely in response to positive industry demand shocks, favourable financing conditions, and lower parent firm relative productivity. Efficiency factors were found to influence vertical divestitures. McDonald et al. (2010) detailed tax considerations for mergers, acquisitions, and joint ventures, specifically providing Indian and US tax implications for spin-offs of Indian operations.

Pan et al. (2009) explored undervaluation as a driver for spin-offs, finding that unusual insider trading prior to announcement correlated with higher excess returns, and spin-offs significantly improved long-term market and operating performance only for companies with abnormal net insider purchases. This suggests undervaluation as a key driver and insider trading as an indicator of spin-off quality. Koh et al. (2005) identified motives for divestitures in Singapore, including increasing operational effectiveness, incremental profitability, and liquidity, concluding that corporate divestment is a value-enhancing activity in Singapore.

Chemmanur & Yan (2004) developed a theory for spin-offs based on corporate control, showing positive announcement effects and increased long-term operating performance, with certain spin-off categories displaying positive abnormal stock returns. Dittmar (2004) examined the capital structure of new entities post-spin-off, finding that new firms have lower leverage ratios compared to parent firms and that growth prospects are the main factor affecting subsidiary leverage. This supports the capital structure trade-off theory. Mehrotra et al. (2003) also found that spun-off entities with high leverage exhibited less volatility in operational income and higher fixed assets and cashflow return on assets, supporting the trade-off theory.

Fitzsimons & Levine (1990) evaluated accounting and disclosure requirements for divestitures, categorizing them as disposal of a business segment and discussing related issues like costs, public sales of subsidiaries, and Securities and Exchange Commission reporting. Wright & Thompson (1987) noted the neglect of divestment in accounting and economic literature, observing it as a policy response and solution tool for controlling problems in divisionalized firms. Duhaime & Baird (1987) highlighted the impact of business unit size on divestiture decision-making, advising corporate planners to consider this variable for acquisitions, resource allocations, and management career trajectories.

Divestiture performance

Amiri et al. (2020) empirically tested explanations for divested past acquisitions, finding a positive correlation between performance around acquisition announcements and subsequent divestitures. This disproves the notion of unjustified divestiture reputations, suggesting that investors reward successful divestiture decisions by qualified acquirers. Aggarwal & Garg (2019) observed a significant positive impact of spin-off announcements on the share prices of parent firms in India, based on a study of 76 Indian companies.

Feldman et al. (2016) investigated divestitures in family-owned businesses, finding that family firms are less likely to divest than non-family businesses, especially when family members are CEOs. However, family firms managed by family CEOs exhibited higher post-divestiture performance compared to non-family enterprises and family firms managed by non-family CEOs. Kutscher (2014) analyzed spin-offs in the airline industry, concluding that spin-offs are a sensible course of action when the spun-off division's focus diverges from that of the parent business.

Zweiphenning (2014) found a short-term (three-day window) significant positive wealth effect associated with spin-offs in the United Kingdom. Companies without declared takeover interests prior to the spin-off announcement generated better returns. Byerly et al. (2003) noted that the stock market's reaction to restructuring announcements is more positive the more significant the impact of the restructuring, and that the strategy of pursuing new business opportunities while divesting old ones is valued positively, yielding the largest announcement returns.

Kirchmaier (2003) found negligible long-run irregular returns for European spin-offs, contrasting with statistically significant results from American research, attributing this disparity to financial market inefficiencies. The study also showed that shareholder wealth impacts depend significantly on the size of the spin-off, with small spin-offs faring better. Desai & Jain (1999) investigated whether an increase in focus explains stock market increases linked to spin-offs, finding that long-term abnormal returns for focus-increasing spin-offs were much higher than for non-focus-increasing ones, and that operating and stock market performance were favourably correlated with the shift in focus. They also noted that non-focus-increasing spin-offs are typically used to split failing divisions from the parent company.

Daley et al. (1997) evaluated changes in operating performance post-spin-off, demonstrating improved operating performance for spin-offs with increased emphasis, supporting the hypothesis that spin-offs add value by eliminating undesirable operating synergies and allowing parent management to focus on core businesses. However, Woo et al. (1992) found that American spin-offs do not increase operating performance in the long term, with return on assets, sales growth, and market-to-book ratios even worse than in the pre-spin-off period and stating that the shift in corporate emphasis has little impact on parent companies' operating results within three years. Markides & Berg (1992) summarized literature to highlight types of divestitures and implementation strategies linked to value destruction, aiming to help managers increase success. Alexander et al. (1984) discovered that voluntary corporate sell-offs, though preceded by negative abnormal returns, showed positive returns upon disclosure, suggesting a period of bad news or underperformance prior to the sell-off.

Value creation through divestitures

Steurer et al. (2021) identified various motives for spin-offs, including improving operational efficiency, eliminating poor performance, focusing on core business, and achieving more efficient valuation on the capital market. Their study on Germany found that spin-off announcements are linked with a positive impact on shareholder wealth. Padmanabhan (2018) analyzed demerger announcements in India, identifying positive abnormal results during the event window and significant stock performance in the post-announcement period, suggesting semi-strong form efficiency in the Indian stock market.

Kambla (2017) provided Indian evidence that the spin-off strategy is linked with positive long-term wealth effects, with market response independent of corporate governance system changes. Bendre & Apte (2017) similarly found that demerger activity has a positive impact on shareholder wealth in India, with the period from announcement to listing being most advantageous for wealth creation. Vyas et al. (2016) noted that Indian securities significantly outperformed the benchmark index after demerger announcements. Attruia (2015) concluded that spin-offs have a short-run positive impact, with long-run results depending on the business's capability to create value.

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Uddin (2010) found that parent shareholders in Singapore gained substantial value (15.73%) after spin-offs, correlated with the parent companies' debt-asset ratio, potentially indicating wealth redistribution from creditors to shareholders. Singh et al. (2009) observed an increase in shareholders' wealth after demergers in India, attributed to the elimination of negative synergy unlocking value. Veld & Veld-Merkoulova (2009) reviewed factors influencing wealth effects, observing that returns are higher for larger spin-offs, tax or regulatory favourable divestments, and spin-offs increasing industrial focus.

Brinck & Falk (2009) reported statistically significant abnormal returns for Swedish spin-offs, with intra-industry spin-offs providing much greater cumulative abnormal returns than cross-industry spin-offs. Yoon & Yoon (2007) found that both parent and spin-off business equities in Malaysia gained significant positive abnormal returns, with spin-off company gains being larger than in other countries, and abnormal returns were negatively correlated with age and positively with market capitalization. Bhana (2006) suggested that in South Africa, the market uses information on insider trading and ownership structure to categorize sell-off decisions as advantageous or disadvantageous for investors.

Veld & Veld-Merkoulova (2004) examined European spin-offs, finding a cumulative average abnormal return of 2.62% over a three-day event window, with significantly higher returns for industrial focus-increasing companies, but no link to longer-term superior performance. Cusatis et al. (1993) concluded that value created through US spin-offs can be attributed to profits generated by the spin-offs or parents' takeover activities, largely by providing acquiring companies a productive way to gain ownership of corporate assets.

P. C. Jain (1985) found that sell-off transactions result in significant positive excess returns for both buyers and sellers, with sellers' performance being poor prior to the sell-off activity. Rosenfeld (1984) reported a positive impact of spin-off and sell-off announcements on parent firm share prices, noting that spin-offs "outperform" sell-offs on the event day, with similar economic gains for acquiring and selling firms. Schipper & Smith (1983) observed a large positive abnormal return to parent businesses around spin-off announcements, attributing benefits to enhanced management effectiveness, as well as tax and regulatory advantages. Hite & Owers (1983) also reported significant positive abnormal returns for firms involved in spin-off activities, with positive gains for companies using spin-offs to promote mergers or split operational divisions, but negative returns for resolving legal/regulatory issues. Miles & Rosenfeld (1983) concluded that spin-off announcements have a stronger positive effect on large spin-offs than small ones.

Conclusion and Future Research

This review has systematically presented the multifaceted nature of corporate divestitures, covering their conceptual understanding, underlying motivations, performance implications, and value creation mechanisms. The literature consistently highlights divestitures as a critical tool for corporate restructuring and growth, particularly in dynamic economic environments. While many studies underscore the positive impact of divestitures, especially spin-offs, on shareholder wealth and firm performance, particularly in the short-term and when increasing corporate focus, some findings suggest varied long-term outcomes and emphasize the importance of careful timing and strategic execution. Factors such as firm size, diversification, prior experience, and specific market conditions play significant roles in the success and implications of divestiture decisions.

Despite the extensive research, the sources indicate several areas for further investigation. There is a noted lack of research in certain areas, such as the informational and financial challenges of spin-offs. Furthermore, some studies, such as Martins (2015) on capital allocation efficiency post-spin-off, have produced results that contrast with previous findings, suggesting a need for deeper empirical analysis to reconcile these discrepancies. The historical development of divestiture research also points to continuous evolution and new directions. Overall, the review reveals a rich and evolving field, with ongoing opportunities for research to enhance the understanding of divestitures across diverse contexts and their comprehensive impacts on corporate entities and stakeholders.

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