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Asset sales, asset exchanges, and shareholder wealth in China

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Abstract

In this paper, we study a sample of 1376 corporate asset sales and 250 asset exchanges in China between 1998 and 2006. We find that corporate asset sales in China enhance firm value with a cumulative abnormal return (CAR) of 0.46% for the pre-announcement five-day period, which is consistent with the evidence discovered in both U.K. and U.S. For companies that exchanged assets during the sample period, the pre-announcement five-day CAR of 1.32% is statistically significant. We also discover that gains from divesting assets are positively related to managerial performance measured by Tobin's q ratio and the relative size of the asset sold or exchanged. Well-managed (high-q) companies are more likely to sell or exchange assets in a value-maximizing fashion than poorly managed (low-q) companies. Furthermore, asset-seller gains are not related to enhancing corporate focus, but improving corporate focus by exchanging for core assets enhances firm value.
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JEL classification: G14; G34

Keywords: Asset sales; Asset exchanges; China; Shareholder wealth

1. Introduction

The market for corporate control has been extensively researched during the past four decades. For example, Jensen and Ruback (1983), and Jarrell et al. (1988) review much of the scientific literature on changes in corporate control through mergers, takeovers, acquisitions, divestitures, and the like, during the 1970s and 1980s. Mulherin and Boone (2000) further study the causes and effects of acquisitions and divestitures during the 1990s. Many studies including the aforementioned have confirmed that these control transactions generally maximize shareholders' value.

Broadly speaking, corporate divestiture refers to the reduction of assets through sell-offs, equity carve-outs, and spinoffs. There is abundant research examining the announcement effects of these three divesting activities on shareholder wealth in developed economies. For instance, Alexander et al. (1984), Jain (1985), and Hite et al. (1987) document that asset-sale announcements generate significant positive returns for selling firms in the U.S. John and Ofek (1995) identify increasing corporate focus as the source of asset-sale gain. Similarly, Kaiser and Stouraitis (1995) and Clubb and Stouraitis (2002) provide a European evidence on positive stock price reactions during initial announcements of subsidiary sell-offs. Hite and Owers (1983), Miles and Rosenfeld (1983), Schipper and Smith (1983), Slovin et al. (1995), and Mulherin and Boone (2000) all report that U.S. spin-off announcements are associated with strongly significant abnormal returns. Murray (2000), Janssens de Vroom and Van Frederikslust (2000), and Veld and Veld-Merkoulova (2004) find similar results for U.K. and European spin-offs. Regarding equity carve-outs, Schipper and Smith (1986) show that announcements of equity carve-outs produce positive stock returns for parent firms, but Slovin et al. (1995) find significantly negative share price effects on rivals of subsidiaries to be carved-out by a parent firm. Other studies document that the positive wealth effects for parents associated with equity carve-out announcements are due to paying out the proceeds than if retaining them (Allen and McConnell, 1998) and due to synergistic gains (Mulherin and Boone, 2000).

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Table 1
Number of listed entities at the end of 2010.

Type	Shanghai Stock Exchange	Shenzhen Stock Exchange	Total
A Shares	895	473	1368
B Shares	54	54	108
Small and medium enterprise board	0	531	531
ChiNext	0	153	153

Source: KMPG (2011).

As global markets are now more integrated than before, both the issue of corporate governance and the market of corporate control are expeditiously spread from developed markets to emerging markets. The purpose of this paper is to examine the wealth effects of two corporate restructuring activities, asset sales and asset exchanges, in China. Since 1980, China has launched a number of schemes to reform its economic systems, especially regarding state-owned enterprises (SOEs hereafter). The privatization programs during the 1990s were designed to create a modern enterprise system based on the Company Law, which defines an SOE's property right to dispose of its asset, including the equity of the state, and the state's limited responsibility to its shareholders in proportion to its capital contribution (Xu, 2000). By the end of March 2011, the combined market capitalization of China's Shanghai and Shenzhen bourses had not only risen more than tenfold in the past six years to USD 4.2 trillion but also surpassed the Tokyo Stock Exchange which stood at USD 3.6 trillion (KMPG, 2011). Table 1 shows that more than 2000 companies were listed on the Shanghai and Shenzhen Stock Exchanges at the end of 2010. As China continues to restructure its economy, not only have mergers and acquisitions evolved rapidly in recent years in both style and substance, corporate restructuring activities have also followed suit.

The contribution of this paper is threefold. First, this is the first study to our knowledge that uses a large sample of Chinese data to examine the valuation effects of asset sales and asset exchanges. Currently, both equity carve-outs and spin-offs are still technically infeasible in China due to the binding constraints of the securities laws. Second, we identify the factors that may contribute to the positive wealth effects around asset-divesting announcements. Third, amid the roll-out of China's vast privatization program, asset sales are common but asset exchanges are a unique phenomenon in China, not seen in developed economies. A typical asset-exchange transaction can be illustrated by this news clip: "Xian ShengHong Technology Company agreed to exchange the 8th, 15th, 16th, 23rd, 24th, 25th, and 28th floors of Liangyu Building, which has 7045.34 m^2 with a book value of 52.713 million yuan and an estimated market value of 70.858 million yuan, for a 70% ownership of HongPu International Development Company, a subsidiary of HongPu Holdings Inc., which has a net aset value of 63.733 million yuan and an estimated market value of 70.399 million yuan. This asset exchange was considered a fair market value exchange." Hopefully, the results derived from this study shall shed some light on the wealth effects of asset exchanges in China.

The remainder of the paper is organized as follows. Section 2 provides literature review of asset sales and asset exchanges in China. Section 3 describes sample selection and the characteristics of divesting firms. Then, we discuss the event study methodology and present the evidence of positive wealth effects around asset-divesting announcements. The sources of the wealth effects are also identified by running cross-sectional regressions. Finally, we conclude the paper.

2. Literature review of asset sales and asset exchanges in China

The research on asset sales and asset exchanges in China has been anemic at best and most papers published are methodologically flawed with either a small sample size or a short sample period. For example, Wang (1999) examines corporate performance of 41 asset sales and 16 asset exchanges in 1998 and finds that ROE increases 1.99% for companies involving asset sales but declines 2.1% for companies that exchanged assets. Chen and Zhang (1999) study 14 asset sales and 6 asset exchanges in 1997 and report that the cumulative abnormal return (CAR) is statistically insignificant prior to the announcement date, is significantly positive on the announcement date, and declines post the event date. Lu (2000) compares ROEs of 211 Shanghai Stock Exchange listed companies in 1999 two years before and after resturcturing and finds that ROE increases 48.6% for the asset-sale sample but decreases 22.9% for the aset-exchange sample. Chi and Ma (2000), investigating 30 asset sales and 5 asset exchanges in 1998, document that asset sales improve the quality of assets and asset exchanges enhance both asset quality and corporate profitability.

Recently, Luo et al. (2003) discover a negative CAR during the event window (−20, 20) for a sample of 44 asset sales in 1998–2002, but a positive CAR of 0.7% and 0.93% during the windows of (−1, 1) and (0, 7), respectively. Li and Chen (2004) use regression analysis to correlate the wealth effect of 33 asset sales and 28 asset exchanges in 2000 with various performance measures. Their finding supports the financial synergy hypothesis but not the agency cost hypothesis. Jin et al. (2006) examine 100 restructuring companies including 16 asset sales and 25 asset exchanges in 2000 and show a CAR of 4.33% over (−15, 30) for the asset-sale sample but a zero CAR for the asset-exchange sample. Yan and Wu (2010) study 76 divestitures in 2006 and discover an insignificant CAR when companies sold assets.

3. Sample selection and firm characteristics

3.1. Sample selection

The original sample includes all companies listed on either Shanghai Stock Exchange or Shenzhen Stock Exchange that announced asset sales or asset exchanges during 1998–2006. Announcement dates and financial data associated with the restructuring companies were obtained from two sources: (1) the *China Securities Journal* and (2) the CSMAR database. The first press announcement date confirmed by both sources is identified

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