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Do spin-offs really create value? The European case

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Abstract

We study wealth effects for a sample of 156 spin-offs from 15 different European countries that were announced between January 1987 and September 2000. The cumulative average abnormal return over the 3-day event window is 2.62%. This number increases to 2.66% for the subsequently completed spin-offs. The cumulative average abnormal return is 3.57% for completed spin-offs by companies that increase their industrial focus and only 0.76% for non-focus increasing companies. The difference between these two sub-samples is significantly different from zero. These results are in line with previous studies for the US. The long-run returns in excess of matching firms are mostly insignificant for parents, subsidiaries and pro-forma combined firms. This result suggests that, unlike US spin-offs, European spin-offs are not associated with long-run superior performance.
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1. Introduction

There is a broad consensus in both the academic and the popular literatures that spin-offs tend to create value for shareholders. This consensus is based on evidence from a number of studies indicating that, on average, the announcement of a spin-off by a US firm is associated with a positive abnormal stock return. Moreover, shares of firms completing spin-offs appear to exhibit excess returns over periods of up to 3 years following the restructuring. During the last decade, spin-offs have become more popular in Europe, perhaps due to the documented positive wealth effects in the US. The large number of European spin-offs completed in recent years provide us with an opportunity to examine whether the conclusion that spin-offs tend to create value only applies to US firms or whether it is more broadly applicable.

A spin-off is a pro-rata distribution of the shares of a firm's subsidiary to the shareholders of the company. No cash transaction takes place. After the spin-off, the shareholders of the parent company hold shares in both the parent company and the subsidiary. Announcements of spin-offs by US firms are associated with strongly significant abnormal returns that range from 1.32% to 5.56%. [3] Spin-offs of companies that increase their industrial focus by divesting a division in a different branch than the parent company are associated with higher abnormal returns than spin-offs of companies that do not increase their industrial focus (see e.g. Daley et al., 1997; Desai and Jain, 1999). In addition, Krishnaswami and Subramaniam (1999) also find that firms with higher levels of information asymmetry exhibit higher abnormal returns in the announcement period. These results show that the market efficiently responds to the spin-off announcements by incorporating expected future benefits into the current stock price.

A number of US studies also find long-run superior performance of spun-off firms and their parents. Cusatis et al. (1993), Desai and Jain (1999) and McConnell et al. (2001) find that parents and subsidiaries, involved in a spin-off, outperform matching firms. Contrary to the results for the announcement period, the finding for the long-run excess returns is remarkable. According to the efficient market hypothesis, the positive effects of the spin-off should be incorporated in the announcement date returns. An interesting question is then whether spin-offs are really associated with positive long-run excess returns or whether the US results were a consequence of chance. Fama (1998) argues that studies finding significant long-run returns receive more attention in the academic and the popular literature because they are more interesting. For this reason Fama (1998) and Lyon et al. (1999) argue that it is useful to study such anomalies out-of-sample. In case of spin-offs it makes sense to study spin-offs outside the US. This gives us out-of-sample results on the long-run performance of companies involved in spin-offs.

[3] See e.g. Rosenfeld (1984), Copeland et al. (1987), Slovin et al. (1995), Johnson et al. (1996), Daley et al. (1997), Desai and Jain (1999), Krishnaswami and Subramaniam (1999), Mulherin and Boone (2000) and Maxwell and Rao (in press).

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