



EFFECT OF SPIN-OFF ON SHAREHOLDERS' WEALTH – A CASE OF ARVIND LTD.

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Abstract: Divestitures in Indian corporate are increasing in recent times. Divestitures are seen as one of the means for growth of the business and also to create value to the shareholders. There are various forms of divestitures, in which most of the recent divestitures are in the form of spin-offs. This paper examines the effect of spin-off on shareholders wealth at Arvind Ltd. Four years pre-spin-off and three years post spin-off data is considered for the study. The results showed that operating performance of new company is in increasing trend. The average stock returns in post spin-off announcement period are higher when compared to pre spin-off announcement period average returns.

Index Terms - Restructuring, Divestiture, Spin-off, Value, Event study

INTRODUCTION

Today's businesses need to have an awareness of their performance levels to understand where they are moving. Growth of the business organization is very much important for facing the cut throat competition and to survive. A company can grow organically or inorganically. Inorganic growth strategies like mergers, acquisitions, takeovers, divestitures are considered as fast track restructuring strategies for growth of the business as it gives assistance to organisations to enter into new market, expand their customer base, quick growth in size, employ new technology, etc.

Corporate restructuring is defined as the process of changing the organisation of a business by cutting out or integrating the different departments. It is a comprehensive process, by which a company can consolidate its business operations and strengthen its position for achieving corporate objectives-synergies and continuing as a competitive and successful entity.

Indian corporates are showing more interest in restructuring of their business in different forms. Divestiture is one such form of restructuring activity undertaken to achieve business growth and excellence. Indian corporate world has witnessed many divestiture activities in the last decade. Many big business houses are moving towards divesting their business for increasing the value of the firm.

Spin-off is a form of divestiture, in which a firm is broken into two or more independent entities. Parent company distributes shares of business division which is being separated to its existing shareholders. Spin-off entity remains distinct business unit from the parent company, will have its own management.

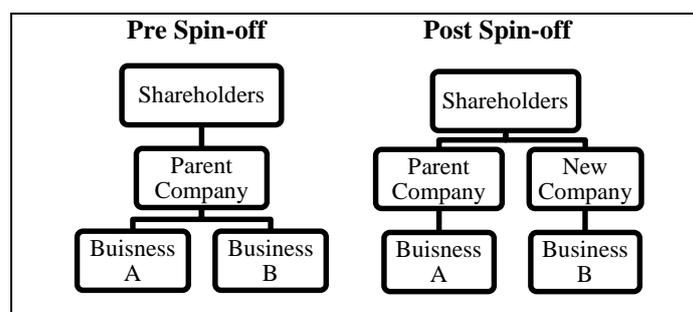


Figure 1: Pattern of Shareholding pre and post Spin-off

LITERATURE REVIEW

Bendre & Apte, (2017)¹ studied the impact of spin-offs on shareholders wealth in India. They are of the opinion that Indian spin-offs are associated with the objective of creating value for the shareholders. They have studied 24 spin-offs that took place during 2012-17 in India. The result showed that demerger activity has an overall positive effect on shareholder's wealth. The most favourable time for shareholder wealth creation remains is from demerger announcement date to the listing of demerged entity.

Vyas, Pathak, & Saraf, (2016)² examined the demergers and the announcement period price reaction of demergers during the period 2012-14. They have studied demergers of 51 companies listed in India using event study methodology. For the purpose of the study stock price performance of 10 days pre and 10 days' post demerger announcement was considered. The study result showed that there is a significant out performance of security during post demerger announcement over the benchmark index.

Veld & Veld-Merkoulova, (2009)³ in their study reviewed the existing empirical evidence on value creation through spin-offs. A significantly positive average abnormal return of 3.02 percent was found during the meta-analysis of findings of 26 event studies on spin-off announcements. The results showed higher returns for large spin-offs, tax or regulatory friendly divestments and spin-offs that led to an improvement of industrial focus. The results showed that the large non-related subsidiary divestiture were received more favourably than the small non-related subsidiary divestiture. Part of the study focused on long run stock performance of spin-offs and found that, long-run superior performance is found only in early studies and not in later studies which have used more refined statistical tests.

Daley et al. (1997)⁴ 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, in which 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 percent Δ ROA) but smaller changes for non-focus-increasing spin-offs (+0.7 percent 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.

STATEMENT OF THE PROBLEM

More number of studies have been carried out globally to study and analyse the wealth effects associated with divestitures. Spin-off, a form of divestiture is gaining force and increasing in recent times in Indian corporate. Shareholders are the most important aspect in the process of divestiture as the divestiture process directly influences the shareholders' value. With this outset, it is important to study the spin-offs in Indian context, to know its impact on business growth and shareholders value.

OBJECTIVES OF THE STUDY

- To study the operating performance of Arvind Ltd. pre and post spin-off
- To Study the operating performance of Arvind Smartspaces Ltd.
- To study the shareholder return during pre and post spin-off period

RESEARCH DESIGN

The present study is Analytical in approach. Population of the study comprise of the companies listed in BSE and undergone for divestiture in the year 2015. Arvind Ltd. is selected using random sampling technique. Hence, the study is limited to Arvind Ltd. pre and post spin-off period and its spun-off entity Arvind Infrastructure Ltd. (currently known as Arvind Smart Spaces Ltd.)

TOOLS OF ANALYSIS

Mean, Standard deviation, Ratio Analysis, Risk, Return were used to analyse and interpret the collected data. Dummy variable model is used to analyse the shareholder returns pre and post spin-off period.

ANALYSIS AND DISCUSSIONS

The figure 2 shows the sector-wise breakdown of spin-off internationally. 22.76 percent of spin-offs are happening in consumer discretionary sector. Consumer discretionary goods include durable goods, apparel, entertainment and leisure, and automobiles. 21.74 percent in industrials. The industrials sector includes companies involved with aerospace and defense, industrial machinery, tools, lumber production, construction, waste management, manufactured housing and cement and metal fabrication. 16.76 percent of spin-offs in financials sector which includes banks, investment funds, insurance companies and real estate. 16.37 percent spin-offs in healthcare sector.

¹ Bendre, M., & Apte, N. (2017). Study of Impact of Spin-Offs on Shareholders Wealth in India. *International Research Journal of Multidisciplinary Studies*, 3(10), pp.1-7.

² Vyas, P., Pathak, B. V., & Saraf, D. (2016). Impact of Demerger Announcement on Shareholder Value : Evidences from India. *Journal of Management & Public Policy*, 7(1), pp.13-26.

³ Veld, C., & Veld-Merkoulova, Y. V. (2009). Value creation through spin-offs: A review of the empirical evidence. *International Journal of Management Reviews*, 11(4), pp.407-420

⁴ Daley, L., Mehrotra, V. & Sivakumar, R. (1997). Corporate focus and value creation evidence from spin-offs. *Journal of Financial Economics*, 45(2), pp.257-281.

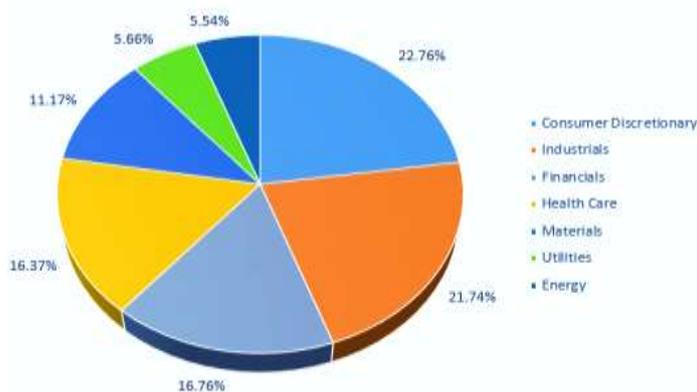


Figure 2: Sector wise Breakdown of Spin-off Internationally

Source: www.indxx.com (accessed on September 10, 2018)

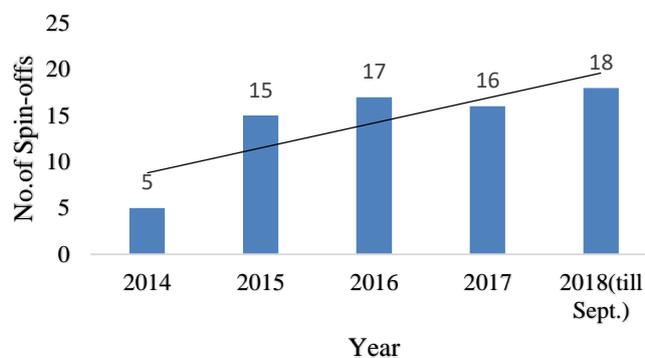


Figure 3: Annual Distribution of Spin-offs

Source: www.bseindia.com

Figure 3 shows the annual distribution of spin-off of BSE listed companies in India. From the year 2014, no. of spin-offs is increasing year by year, shows the increasing trend. In the current year 2018, till September 10th, no. of spin-offs announced is 18, which is all time high compared to the year 2014.

Arvind Ltd.

Arvind Ltd. demerged its Real Estate Undertaking to Arvind Infrastructure Ltd. 19th May, 2015 was the announcement date of spin-off. As approved by the Hon'ble High Court of Gujarat, transferee company i.e. Arvind Infrastructure Limited issued and allotted 1 (One) equity share of Rs. 10 each credited as fully paid up for every 10 (Ten) equity shares of Rs. 10 each held by the shareholders of Arvind Limited on Record Date i.e. on 29th May, 2015. The Spun of entity Arvind Infrastructure Ltd. listed in the stock exchange on 26th August, 2015.

Table 1: Operating Performance of Arvind Ltd. Pre and Post Spin-off

Particulars	2012	2013	2014	2015	2016	2017	2018
Return on Asset %	8.37	4.27	5.21	4.45	4.38	3.64	3.27
Return on Equity %	23.39	11.59	14.63	12.86	12.87	9.69	8.42
Return on Invested Capital %	14.37	11.25	11.56	10.14	9.35	7.65	7.1
Diluted Earnings Per Share	16.9	9.63	13.71	13.21	12.16	12.17	11.95
Operating income (billion)	4.68	5.97	7.97	7.81	7.33	6.4	5.36

Source: Morningstar database

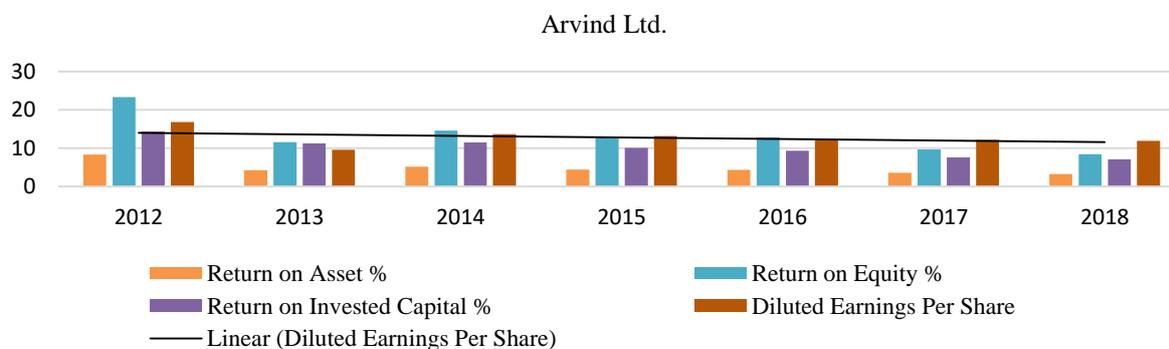


Figure 4: Operating Performance of Arvind Ltd. Pre and Post Spin-off

Table 1 shows the operating performance of Arvind Ltd. pre and post spin-off period. We can observe fluctuation in ROA, ROE and ROIC in pre spin-off period i.e. up to 2015. From 2015 onwards i.e. post spin-off period ROA, ROE and ROIC showing decreasing trend as a result of spin-off of real estate undertaking of Arvind Ltd. in 2015.

Table 2: Operating Performance of Arvind Smartspaces Ltd.

Particulars	2015	2016	2017	2018
Return on Asset %	4.05	5.58	5.47	5.98
Return on Equity %	8.43	12.78	12.42	12.34
Return on Invested Capital %	9.78	12.08	12.06	12.48
Diluted Earnings Per Share	1.06	6.66	7.49	9.7
Operating income (million)	233.44	339.93	430.3	598.66

Source: Morningstar database

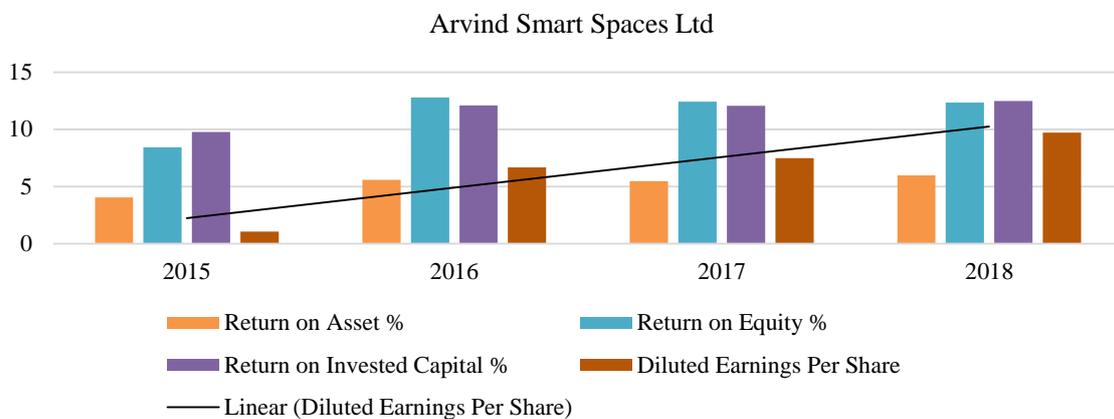


Figure 5: Operating Performance of Arvind Smart Spaces Ltd.

Table 2 shows the operating performance of spun-off entity i.e. Arvind Smart Spaces Ltd. ROA, ROE, ROIC and operating income are showing increasing trend. Diluted Earnings Per share is also showing increasing trend.

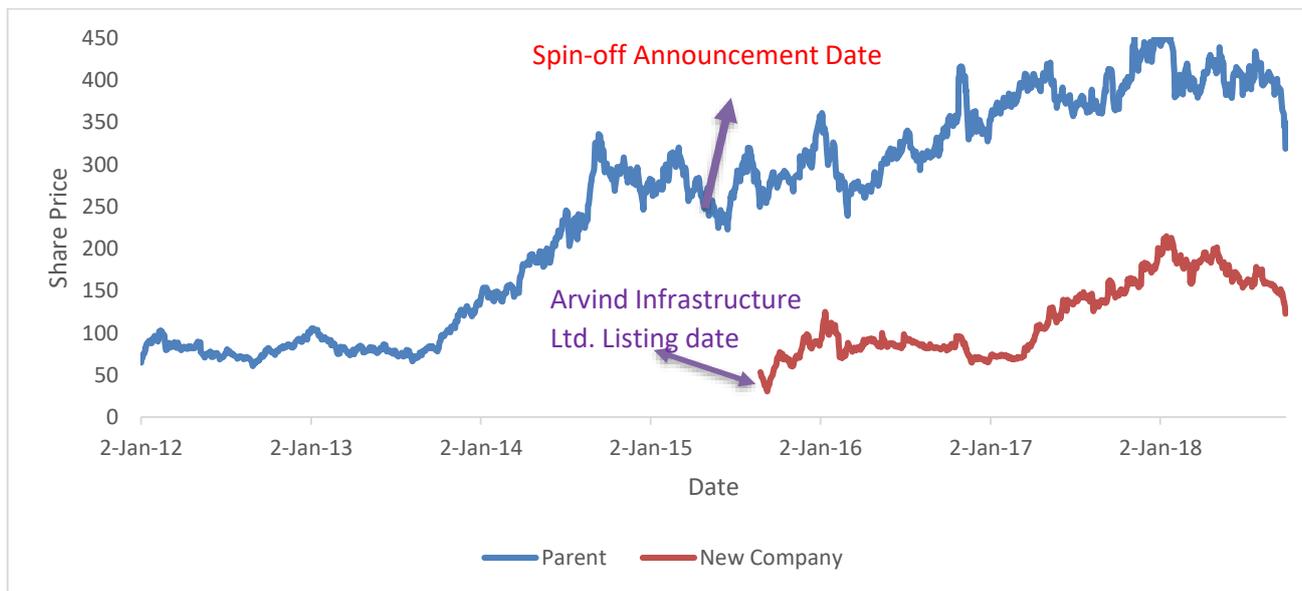


Figure 6: Share Price of Arvind Ltd. and Arvind Smart Spaces Ltd.

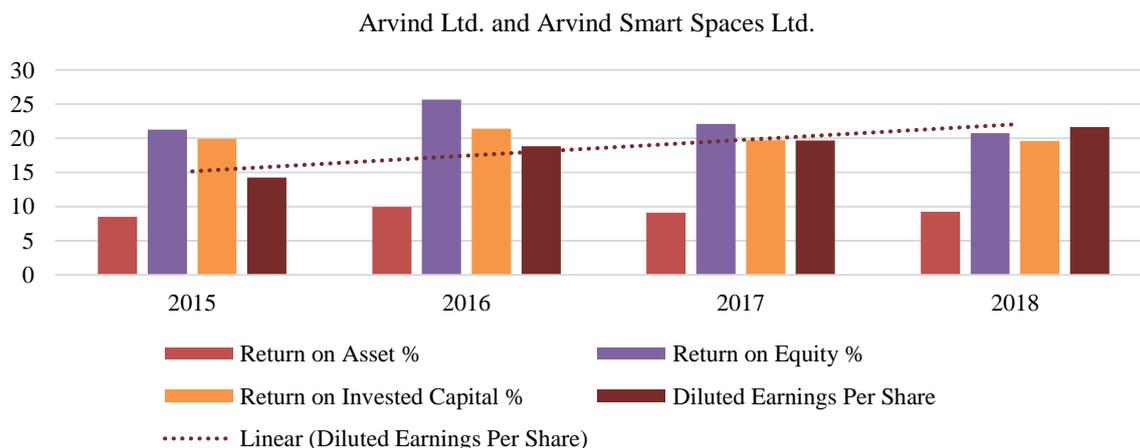


Figure 7: Combined Operating Performance of Parent and Spun-off Entity

Figure 7 represents the combined operating performance of parent and spun-off entity i.e. Arvind Ltd. and Arvind Smart Spaces Ltd. It clearly shows that shareholders are enjoying the benefit post spin-off compared to pre spin-off period. It can be said that 5-3 > 2. Spin-off has resulted in increased earnings for the shareholders.

Dummy Variable Model

The model of return on time period is expressed by using the following model, however, the time periods are classified into two, i.e., the time period prior to 19 May 2015 where the announcement was done and the post time period of 19 May 2015. To build the model the dummy variable is incorporated by defining the dummy variable value of 1 for the post announcement period and the dummy variable value of 0 for the pre announcement period. The specification of the model is

$$Y_i = \beta_0 + \beta_1 D_i + u_i$$

Here Y_i = Mean Return
 D = Dummy variable of Value of 1 for post announcement period, Value of 0 if otherwise
 β_0 = Average Return for pre announcement period
 β_1 = Average Incremental Return for the post announcement period
 $\beta_0 + \beta_1$ = Average Return for the Post announcement period

By using OLS method the above model was estimated and the parameters of the estimated model is presented as follows

$$Y_i = \beta_0 + \beta_1 D_i + u_i$$

\hat{Y}_i	=	-0.000624	+	0.002053	D_i
SE		(0.002784)		(0.004162)	
t		(-0.224043)		(0.493330)	
p		(0.822979)		(0.622384)	

The estimated value of the β_1 is having positive sign, hence, the average return during the post announcement period is higher than the average return during pre-announcement period. But the p value of β_1 is statically insignificant at 5 percent since the p value of 0.6223 is > 0.05 . Therefore, from the model it can be infer that the average return during post announcement period is higher than the pre announcement period but statically insignificant.

Conclusion:

The study result shows that the operating performance of the spun-off entity is showing increasing trend and the combined results of parent and new company is also increasing year by year. The spin-off announcements have positive effect on shareholder wealth in the short run. The model result shows that post announcement average returns are higher compared to pre announcement period average returns. But the test statistics shows that post announcement returns are statistically insignificant.

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