

# THE IMPACT OF CORPORATE SPIN-OFFS ON SHARE PRICE MOVEMENT

## EMPIRICAL EVIDENCE FROM INDIA

### Abstract

The present study focuses on the effect of spin-off announcements on the stock returns of 24 sample demerged companies in India for the period from 2009-10 to 2018-19. For this purpose, the market model of event study methodology has been applied. The impact of the spin-off is statistically significant on cumulative average abnormal returns of these sample firms for time windows (-2, +2) and (-10, +10) which are 5.088 per cent and 6.609 per cent, respectively, at a 5 per cent level of significance. This study supports the statement that changes in stock returns are strongly associated with the spin-off announcements.

### INTRODUCTION

Corporate rebuilding is instrumental in improving productivity and proficiency by adjusting and rebuilding corporate undertakings. The standard thought processes behind building significantly refers to expanding investors' wealth, cost controls and efficiency improvements (Gupta et al., 2022). Spin-off offers an economic strategy for moving control of corporate resources to bidders who will make more prominent worth (Cusatis et al., 1993). The spin-off works on the exhibition of the parent's stock and expands the number of securities traded on the Stock Exchange (Habib et al., 1997). Lower positive anomalous returns are related to the taxable demerger and significant returns with non-taxable demerger (Krishnaswami & Subramaniam, 1999). A firm that needs external funding could fall back on divestitures; for example, demergers to raise capital at a fair market price after the divestiture (Chemmanur & Yan, 2004). Countless investigations depend on various country settings that demonstrate the positive association between the declaration of the spin-off and anomalous stock returns (Gupta et al., 2022).

### LITERATURE REVIEW

**Mallick and Rakshit (2006)** examined and gauged Dabur India Limited's financial performance prior to demerger with that of parting their business into two fragments utilizing conventional techniques and valuation strategy EVA. Interestingly, Dabur Pharma Limited was found to have an expansion in negative EVA, uncovering a value-eroding segment. **Zakaria & Arnold (2014)** researched the



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performance of 36 Malaysian spin-off entities from 2008 to 2011 period. They examined the performance of spin-off companies against Malaysian index benchmarks and

matched strong portfolios using daily and monthly data. They considered an anomalous return of 5.40 per cent from -1 day to +1 day of demerger announcement. They concluded that the overall findings suggest that short-run spin-offs build (maybe illusory) value. However, there is no proof of long-run market outperformance.

**Duguleana & L. Duguleana (2021)** investigated the financial profitability angle of spun-off entities of Romania. Appropriate statistical and econometric tools of panel data were applied to analyse the sample companies before and after demerger for two sub-periods- 2005-2013 and 2014-2019. An improvement in profitability indicators was seen for all the sample companies post demerger indicating a significant effect on the profitability of these spun-off entities. **James E. Owers & Bruno S. Sergi (2021)** examined the impact of the spin-off on stock returns of demerged undertakings for the period 2007 to 2017. It was found that spin-offs resulted in positive anomalous returns for the demerged enterprises.

**RESEARCH GAP & PURPOSE OF THE STUDY**

This research is due to the lack of empirical studies of spin-offs in the Indian context. The international

studies focusing on shareholders' value generation and Indian researchers emphasized the effect of the spin-off on financial performance and the risk position of demerged entities. Very few studies have focused on the impact of the spin-off on stock return demerged entities in the Indian scenario.

This study determines whether spin-off generates significant average and cumulative average abnormal returns post-spin-off. This study will help the academicians and shareholders get a transparent picture of how the stock market would react to a spin-off announcement, which will help the researchers conduct further research. The shareholders will also get an idea regarding their investment decisions post-spin-off.

The following research question can be formed:

Is there any linkage between the spin-off and the stock market reaction?

**DATA, SAMPLE & METHODS**

In order to conduct this research, 24 samples of demerged companies along with their control non-demerged companies have been taken into consideration. The period of study is from 2009-10 to 2018-19 to negate the impact of the global financial

crisis and Covid-19, which took place during 2007-2009 and 2019-2021 respectively. Given the objective of generating significant stock returns, we have applied the market model of event study methodology [introduced by *Sharpe (1963)*], where we calculated excess returns, cumulative abnormal (excess) returns, average abnormal(excess) returns (AAR) and cumulative average abnormal(excess) returns (CAAR). Cross-sectional t-test is used for the parametric t-test (*Brown & Warner, 1980*). We have applied the cross-sectional t-test of AAR and CAAR to test the significance of the impact of the spin-off on stock returns for both demerged and control non-demerged companies for the given event window.

Further, we have tried to test the significance of AAR and CAAR for different lengths of time within the event window. The spin-off announcement date has been considered the event date. We have considered an event window of 21 days (+10 days, -10 days) from the spin-off announcement) and an estimation window of 100 days for this purpose. We have collected the data from the Capitaline Database and the official website of NSE.

The list of demerged, spun-off and control companies are given below:

DEMERGED COMPANIES	SPUN-OFF COMPANIES	CONTROL COMPANIES	SPIN-OFF ANNOUNCEMENT DATE
1. MANAKSIA LTD	MANAKSIA COATED METALS & INDUSTRIES LTD	1. ELANGO INDUSTRIES LTD.	28/12/2012
2. GREENPLY INDUSTRIES LTD.	GREENLAM INDUSTREIES LTD.	2. STYLAM INDUSTRIES LTD.	30/09/2013
3. SURYAVANSHI SPINNING MILLS LTD.	AANANDA LAKSHMI SPINNING MILLS LTD.	3. SRI RAMAKRISHNA MILLS LTD.	6/1/2014
4. GULF OIL CORPORATION LTD	GULF OIL LUBRICANTS INDIA LTD	4. PREMIER EXPLOSIVES LTD.	29/05/2014
5. ADANI POWER LTD	ADANI TRANSMISSION INDIA LTD	5. ORIENT GREEN POWER LTD.	7/10/2014
6. TANEJA AEROSPACE	AVIATION LTD AND TAAL ENTERPRISES LTD.	6. HMT LTD.	9/10/2014
7. MASTEK LTD.	MAJESCO LTD.	7. ONWARD TECHNOLOGIES LTD.	15/09/2014

8. PUDUMJEE PULP & PAPER MILLS LTD.	PUDUMJEE PAPER PRODUCTS LTD.	8. ZUARI GLOBAL LTD.	17/01/2015
9. CG POWER & INDUSTRIAL SOLUTIONS LTD.	CG CONSUMER ELECTRICALS LTD.	9. V GUARD INDUSTRIES LTD.	3/3/2015
10. MOHIT INDUSTRIES LTD.	BIGBLOC CONSTRUCTION LTD.	10. SHEKHAWATI POLY-YARN LTD.	17/06/2015
11. JINDAL SAW LTD.	JINDAL POLY INVESTMENT & FINANCE CO LTD.	11. SURYA ROSHNI LTD	25/04/2011
12. GENUS POWER INFRASTRUCTURE LTD.	GENUS PAPER & BOARDS LTD.	12. PG ELECTROPLAST LTD.	3/1/2013
13. IDFC LTD.	IDFC FIRST BANK LTD.	13. EDELWEISS FINANCIAL SERVICES LTD.	30/10/2014
14. ALEMBIC	ALEMBIC.PHARMA LTD.	14 LYKA LABS LTD.	29/6/2010
15. KALYANI STEELS	KALYANI INVESTMENT CO. LTD.	15. ASHIANA ISPAT LTD.	1/10/2009
16. CHANDNI TEXTILES ENG. INDUSTRIES LTD.	CHANDNI MACHINES PVT. LTD.	16. LAKSHMI AUTOMATIC LOOM WORKS LTD.	15/7/2016
17. KANISHK STEEL INDUSTRIES LTD.	CHENNAI FERROUS INDUSTRIES LTD.	17. BAJAJ STEEL INDUSTRIES LTD.	18/5/2010
18. INDIABULLS REAL ESTATE	INDIABULLS WHOLESALE SERVICES LTD.	18. TEXMACO INFRASTRUCTURE & HOLDINGS LTD.	26/2/2010
19. HSIL LTD.	SOMANY HOME INNOVATION LTD.	19. CERA SANITARYWARE LTD.	10/11/2017
20. HT MEDIA LTD.	DIGICONTENT LTD.	20. JAGRAN PRAKASHAN LTD.	25/8/2017
21. ORIENT ABRASIVES LTD.	ORIENT REFRACTORIES LTD.	21. WENDT INDIA LTD.	8/12/2010
22. SINTEX INDUSTRIES LTD.	SINTEX PLASTICS LTD.	22. BANSWARA SYNTEX LTD.	29/6/2016
23. STRIDES PHARMA LTD.	SOLARA ACTIVE PHARMA SCIENCES LTD.	23. PIRAMAL ENTERPRISES LTD.	20/3/2017
24. TRANSPORT CORPORATION OF INDIA LTD.	TRANSPORT CORPORATION OF INDIA EXPRESS LTD.	24. JAYKAY ENTERPRISES LTD.	10/8/2015

Source: Authors' own tabulation

We can formulate the following hypotheses in connection with our objective to evaluate the impact of the spin-off on stock returns.

**H01:** There is no significant difference between the average abnormal returns after demerger and the average abnormal returns of the pre-demerger period of demerged and control companies.

With respect to the hypotheses

mentioned above, alternative hypotheses indicate the occurrence of significant differences.

**HO2:** There is no significant difference between the cumulative average abnormal returns after demerger and the cumulative average abnormal returns of the pre-demerger period of demerged and control companies.

Concerning the hypotheses

mentioned above, alternative hypotheses indicate the occurrence of significant differences.

**RESULTS & DISCUSSIONS**

We have taken various time lengths within the event window to check whether the effect of the spin-off on cumulative average excess returns of demerged entities is significant or not for these different time frames.

TABLE I:  
TEST OF SIGNIFICANCE OF RETURNS FOR VARIOUS TIME LENGTHS

Window	CAAR	C Std. E	t-statistic	p value
(-10,-1)	0.02709	0.01804	1.50131	0.1365
(1,10)	0.00614	0.02249	0.27298	0.7854
(-5,-1)	0.01399	0.02207	0.63393	0.5276
(1,5)	-0.00597	0.02208	-0.27046	0.7874
(-5,5)	0.02415	0.02895	0.83418	0.4062
(-2,2)	0.05088	0.02331	2.18282	0.0314
(-10,10)	0.06609	0.0307	2.1528	0.0338

Source: Author's own computation

We have taken seven different time windows (within the event window of 21 days) to verify the results that we have already arrived at. The cumulative average excess return appears to be positive for all time windows except (1, 5 days) time window. Further, Cross-sectional t-tests have been applied to test whether these returns are statistically noticeable or not. The t-statistic of cumulative average excess returns and their p values for most of the time windows indicate that the effect of the spin-off on cumulative average excess returns is not statistically noticeable. However, it is noteworthy

that the impact of spin-off has been found statistically noticeable at 5 per cent level of significance for time windows (-2,+2) and (-10,+10). The cumulative average anomalous returns for the time window (-2,+2) is 0.05088, which indicates the cumulative average abnormal gain for this time window is 5.088 per cent. For the time window (-10,+10), the cumulative average abnormal gain is 6.609 per cent. This finding is consistent with the findings of the research conducted by various researchers in the US market, stating that the announcement of a spin-off causes significantly positive abnormal

returns (Rosenfeld, 1984). Therefore, it can be asserted that there is a significant impact of the spin-off on cumulative average abnormal returns of the demerged entities for these two-time windows.

Now, we have tried to analyse the change in stock returns for control entities due to spin-off.

We have taken various time lengths within the event window to check whether the effect of the spin-off on cumulative average excess returns is significant or not for these different time frames.

TABLE II:  
TEST OF SIGNIFICANCE OF RETURNS FOR VARIOUS TIME LENGTHS

Window	CAAR	C Std. E	t-statistic	p value
(-10,-1)	0.02338	0.02397	0.97569	0.3316
(1,10)	0.01689	0.02005	0.84259	0.4015
(-5,-1)	0.01396	0.01419	0.98368	0.3277
(1,5)	0.02812	0.01562	1.79978	0.750
(-5,5)	0.04096	0.01873	2.18683	0.311
(-2,2)	0.01856	0.01406	1.31984	0.1900
(-10,10)	0.01974	0.03025	0.65249	0.5156

Source: Author's own computation

We have taken seven different time windows (within the event window of 21 days) to verify the results that we have already arrived at. The cumulative average excess return appears to be positive for all time windows. Further, Cross-sectional t-tests have been applied to test whether these returns are statistically noticeable or not. The t-statistic of cumulative average excess returns and their p values for all time

windows indicate that the effect of the spin-off on cumulative average excess returns is not statistically noticeable for all the time windows. Therefore, it can be asserted that there is no significant impact of the spin-off on cumulative average abnormal returns of the non-demerged control entities considering various time windows.

## CONCLUSION

Though the impact of the spin-off is statistically significant on cumulative average abnormal returns of the sample demerged entities on and around the spin-off announcement date, it is important to mention that the impact of the spin-off is statistically insignificant for most of the days within the event window. It is important to note that the spin-off has been found to be

statistically insignificant on average abnormal returns and cumulative average abnormal returns of non-demerged control companies. Thus, it can be clearly stated that spin-off has a significant impact on stock returns of the demerged entities, specifically on and around the event date for time windows (-2,+2) and (-10,+10), wherein these time windows generated a cumulative average abnormal gain of 5.088 per cent and 6.609 per cent respectively.

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## Inviting Research Articles/Case Studies for CMA Agri Bulletin - November 2022 Issue

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**CMA Agri Bulletin: November 2022 Issue, Vol. 2, No. 2**

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