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The value of financing through cross-border asset sales: Shareholder returns and liquidity

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ABSTRACT

We examine a sample of 1458 divestitures of domestic assets by U.S. firms to foreign and domestic buyers over the period 1998–2008. Cross-border asset sales yield higher abnormal returns to the seller than domestic sales. This incremental return is driven by liquidity-seeking sellers engaging in cross-border transactions. Larger seller returns in these international deals are associated with favorable economic conditions in foreign buyers' home markets relative to the U.S. We also find positive abnormal returns for buyers, albeit smaller than seller returns, but no significant difference between buyer returns in cross-border and domestic transactions.

1. Introduction

Asset sales represent a type of financing and corporate restructuring that increasingly extends beyond domestic markets to involve cross-border acquirers. Divestitures by U.S. firms to foreign buyers over 1998–2008 total \$417 billion, representing approximately one-fifth of the value of all U.S. asset sales. Further, according to the Thomson ONE Banker (T1B) database, the number of these cross-border divestitures has increased by 55% compared to 1987–1997, while the growth in U.S. domestic asset sales over the same period is only 25%. In this study we analyze differences in the motivation and value of voluntary cross-border asset sales and their domestic counterparts. Our results highlight the financing nature of divestitures and how the market recognizes foreign sales as a valuable source of funds, particularly to sellers seeking liquidity.

When external funds are scarce or costly, asset sales provide a way of raising capital to finance new investment opportunities or meet liquidity needs. Denis and Shome (2005) find that firms most often downsize by selling assets, and this decision is linked to lower levels of operating performance and higher firm-level debt. Lang et al. (1995) also show poor performers and more leveraged firms to be the most active in the divestiture market and find positive valuation effects related to sellers disbursing the asset sale proceeds to creditors. However, in an oft-cited scenario, Shleifer and Vishny (1992) describe how liquidity problems affecting firms looking to divest may also constrain the potential buyers most likely to get the best use of—and consequently pay the best price for—the asset offered: namely, firms operating in the same industry as that of the seller. Industry-wide distress would deplete the number of firms willing to purchase the asset and reduce the prices offered such that the seller would either refuse to divest the asset or be forced to accept a bid below its nominal value. Empirical work such as Pulvino (1998) and Officer (2007) have found support for this theory.

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However, Shleifer and Vishny (1992) make a related point that has received less attention in the literature: "the United States Department of Transportation has historically prevented foreign airlines from buying assets of U.S. airlines, reducing the access of high valuation buyers to these assets and therefore reducing their prices." More generally, if economic factors simultaneously generate the need for divestitures and depress asset values in the local industry, could differences in business cycles or asset valuation across countries mitigate these issues? Buyer expectations of synergistic gains from optimal asset use and a desire for market expansion can provide motivation for prices offered by foreign firms. Further, counter-cyclical market liquidity advantages such as favorable exchange rates can give a cross-border acquirer greater purchasing power and enhance its ability to successfully acquire an asset. The Boston Consulting Group (2007) describes anecdotal evidence of foreign buyer pricing behavior in the case of a U.S. asset seller finding a European firm which, because of its financial strength, expected synergies, as well as an appreciating euro relative to the dollar, purchased the asset above the seller's minimum price threshold. Additionally, considering the possible presence of cross-border information asymmetry, higher purchase prices by foreign firms could be a result of overvaluation, with equally-likely undervalued bids being rejected by the seller in voluntary divestitures. Overall, selling assets internationally can represent an important channel for liquidity-constrained firms seeking funds for increased financial flexibility.

Using a comprehensive sample of 294 asset sales initiated by U.S. firms to foreign buyers from 29 countries over the period of 1998 to 2008, we document higher abnormal seller returns for cross-border sales than for a sample of 1164 asset transfers occurring between U.S. firms. Seller returns in cross-border sales average 2.80% over a 2-day event window, while domestic sellers average returns of 1.69% over the same period. This differential widens by approximately two-thirds of a percentage point after matching cross-border deals with domestic deals using propensity scores that account for firm and transaction characteristics, primarily due to a decrease of mean seller returns in domestic divestitures. This result follows from our hypothesis that cross-border sales are most valuable to sellers in the presence of liquidity constraints and/or a depressed local industry. Thus, when we match deals based on factors associated with cross-border transactions, we isolate domestic sales in which fellow U.S. firms are less likely to be in a position to pay market value, and "fire sales" to local buyers could be the end result.

To better understand what drives the market reaction to cross-border asset sales, we investigate both the seller's public disclosure of the reasons behind the divestiture and its recent financial performance. Since our goal is to understand the value of divestitures as an alternative source of financing, we focus on *voluntary* asset sales and exclude sales by firms going through bankruptcy. We find that firms stating they want to improve their cash position through divestiture achieve greater positive abnormal returns in cross-border sales when compared to domestic sales done for the same reason. Relatedly, a firm-level analysis of profitability and debt ratios shows that liquidity-constrained sellers experience greater abnormal returns when engaging in foreign rather than domestic asset sales, while no significant difference based on buyer location exists for sell-offs by unconstrained firms. Regression analysis confirms these results and also shows that firms divesting internationally achieve larger returns when the acquirer is new to the U.S. market and when U.S. economic or industry-specific conditions are relatively weak. Treatment models that control for unobserved information linked to cross-border sales suggest their positive effect on seller returns is underestimated, consistent with the poor performance that can lead to divestitures outside the local industry. We attribute these findings to investors rewarding sellers capable of avoiding liquidity constraints in their national market by attracting the strategic interest and financial resources of foreign buyers. Consistent with our main findings, comparisons between cross-border and domestic sales show greater relative liquidity in the segments of foreign buyers, particularly for divestitures motivated by cash needs and for sales of assets belonging to the seller's core business.

Lastly, we evaluate the effect of asset sales on domestic and international acquirers. Generally, a greater portion of a divestiture's value often accrues to sellers, since competitive purchase offers are designed to secure the desired asset amidst other unknown bids. From the foreign buyer's perspective, asset acquisitions may be a valuable way to gain access to the U.S. market, easier than mergers and acquisitions (M&As) where higher levels of disclosure and compliance are necessary. On the other hand, costs of geographic diversification and cross-border information asymmetry could mitigate the synergistic gains of foreign buyers. We find that in a two-day window around the announcement, purchasing firms achieve positive abnormal returns: an average of 0.93% for the full sample. However, the returns are similar across foreign and U.S. buyers and, as expected, generally smaller in magnitude than those of the sellers. Nevertheless, these results suggest that if information asymmetry plays a role in cross-border asset bids, it is not strong enough to prevent foreign buyers from realizing positive abnormal returns. Thus, we cannot say that foreign purchasers overpay in these transactions.

Our evidence of larger seller abnormal returns in cross-border sell-offs is consistent with the following scenario. A liquidity-constrained U.S. firm decides to sell an asset to raise cash. Local economic conditions prevent domestic buyers from meeting the seller's reserve price on the asset or from making a strong offer. In the absence of other competitive bids, the seller could decide to accept the domestic offer, receiving much-needed cash but at a (potentially severe) discount of the asset's perceived value. However, let us assume that the divestiture interests a foreign bidder in the asset's industry looking to expand into the U.S. market who thus highly values the asset and whose purchasing power is strengthened by advantageous macroeconomic factors, such as a favorable exchange rate. In this case, the seller would accept the correspondingly higher (or single satisfactory) bid of this motivated and relatively less constrained international buyer. Despite the costs of cross-border expansion, the foreign buyer's stock price reaction to the sale remains positive due to the growth opportunities and synergies provided by entering the new market. The seller's stock price appreciates as investors recognize the firm's ability to raise much-needed cash when local liquidity is scarce, specifically through a buyer that highly values the asset and has the means to pay accordingly.