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Financing, fire sales, and the stockholder wealth effects of asset divestiture announcements

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Abstract

We examine the impact of financial distress conditions at the individual firm level, the operating industry level, and economy-wide, on the stock price reaction to divestment announcements. This allows us to isolate distinct fire sale and financing theoretical explanations of asset divestments. We find that abnormal returns are significantly lower when firms divest assets during periods of industry-wide distress. During these periods the natural buyers of the divested assets are likely to have liquidity constraints, and so selling firms receive a lower price (Shleifer and Vishny, 1992). Fire sale effects from divestments are driven by financially constrained firms, firms selling core assets, small firms, and increase with deal size. We find some support for the financing explanation of the stock price response to divestments during periods of overlapping firm-level and economy-wide financial distress conditions, suggesting that divesting assets reduce the expected value of bankruptcy costs for selling firms under these conditions.

JEL classification: G34

Keywords: financial distress; fire sale; financing; asset divestment.

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