

# Wealth creation from high-tech divestitures

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## Abstract

We measure the change in value to sellers and buyers of divested high-tech assets. Sellers and buyers experience favorable announcement effects in response to high-tech divestitures. However, buyers of divested high-tech assets experience more favorable announcement effects than sellers, which is opposite of the related research findings on other types of divestitures. Based on a cross-sectional analysis, the announcement effects for sellers of high-tech assets are more favorable when there is an investment bank advisor, the transaction price is disclosed, and the size of the divestiture is large. The announcement effects for buyers of high-tech assets were also more favorable when there was an investment bank advisor during the tech-bubble period. Overall, the results suggest that the stock price behavior in response to divestitures of high-tech assets is distinctly different from that of other types of divestitures.

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## 1. Introduction

In recent years, high-tech industries such as communications, electronics, computer software and hardware and biotechnology have received an enormous amount of attention from investors. Most “pure” technology companies are young, and their values are based on future growth prospects, as well as potential size of the market. The volatile, competitive and highly

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uncertain nature of the technology industries, distinguishes them from firms in more established industries.

Despite the unique characteristics of high-tech industries, academic research on this area has been rather limited, with most existing studies focusing on acquisitions of high-tech firms. This study fills the gap by focusing on a sample of domestic high-tech divestitures. While divestitures of high-tech assets are quite common, they have not received much attention in finance literature. Furthermore, neither the theory nor the findings about acquisitions necessarily apply to divestitures. The degree of information asymmetry that exists in a divestiture decision is likely to be much higher than in the case of an acquisition. The assets do not have a prevailing market value. The selling firm has first-hand knowledge about the divested asset's worth and should be able to estimate its value more accurately. Furthermore, the selling firm's managers may lack the ability to make a timely divestiture due to their own personal involvement with the divested asset or in an effort to justify past business decisions. Conversely, the buyer must assign a valuation to a divested asset that so far has solely operated within another business.

We find favorable announcement effects in response to high-tech divestitures both for sellers and buyers. However, buyers of divested high-tech assets experience more favorable announcement effects than sellers, which is opposite of the related research findings on other types of divestitures. The announcement effects for sellers of high-tech assets are more favorable when there is an investment bank advisor, the transaction price is disclosed, and the size of the divestiture is large. The announcement effects for buyers are more favorable when there is an investment bank advisor, except in the period following the tech-bubble.

## **2. Literature review and hypotheses**

### *2.1. Announcement effects of high-tech divestitures*

Positive stock price reactions to divestiture announcements have been extensively observed. Not only the sellers (Alexander, Benson, & Kampmeyer, 1984; Rosenfeld, 1984) but also buyers (Jain, 1985) earn positive and significant abnormal returns. Datta, Datta, and Raman (2003) find that asset sales are value-enhancing for the seller, but value neutral for the acquirer. Eastwood (1998) examines a sample of 134 divestments by 41 firms whose stocks are privately owned and bonds are publicly traded, and measures the wealth effects of the divestiture announcements using the bond returns. He finds that on average there is no significant wealth effect associated with the divestments. However, financially distressed firms experience negative and significant bond valuation effects associated with their divestments while non-distressed firms gain when the asset sales are announced.

The share price gains from divestitures are usually explained by the synergistic hypothesis, the financing hypothesis, and the undervaluation hypothesis. John and Ofek (1995) offered insight into the seller's motivation for divesting by emphasizing the business focus as the primary determinant of gains in divestitures. They argued that by eliminating negative synergies with the divested asset, the performance of the seller's remaining assets would improve. They found that business focus increases in the year of the divestiture and profitability improves in the following years. Most importantly, they showed that any increase in performance is restricted to the sellers that increased their business focus. Furthermore, they found that upon announcement, sellers experience positive and statistically significant abnormal returns, which are positively related to post-divestiture performance. They argued that some of the increase in the seller's equity value stems from the anticipated increase in cash flows from the remaining assets.

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