

Analysis of Motives of Selling Company Assets

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Abstract: *The paper analyses the motives of selling company assets. The evidence is provided that corporate managers undertake asset sales because of poor performance, high levels of financial leverage, and excessive diversification. It is also apparent that companies may have been forced to sell assets owing to pressure from lenders, and from external corporate markets. It is also provided that the market reacts positively to announcements of asset sales. Thus, asset sales create wealth for shareholders. Finally, the market also reacts positively to announcements of firms which state that they are using the proceeds from asset sale to service debt, apparently to avoid bankruptcy costs.*

Keywords: asset sales; corporate restructuring; event study; operating performance.

1. Introduction

An asset sale is defined as the disposal by the selling firm of subsidiaries, divisions or other combinations of fixed assets of a firm through direct transfer of ownership from one corporate entity to another, in exchange for cash or equity. In an asset sale, the transferred subsidiary or division is absorbed within the organizational structure of the buying firm ([12]).

Several hypotheses have been proposed regarding why firms may choose to sell assets instead of some other form of corporate restructuring. The conventional view is that firms sell assets when either the buying firm has a better use for that asset or when the asset is interfering with the existing operations of the selling firm ([4]). This proposition, which is based upon market efficiency, implicitly views managerial activity as being value-maximizing.

On the other hand, [10] suggest that a firm that does not have enough cash to meet its interest payments, or is nearing that condition, has several options. It can reschedule its debt, it can raise cash by issuing new debt or equity or it can sell assets. [10] find that all of these options are costly. Therefore, asset sales sometimes become the most attractive choice in order to avoid the problems that plague debt rescheduling and new security issues. First, proceeds from asset sales are typically used to repay debt. Secondly, cash proceeds from asset sales reduces information asymmetries when dealing with industry insiders. Thirdly, the asset sale also reduces the agency problems in the management of assets.

Large asset downsizings are also accomplished by selling assets ([3]). Thus, following downsizings, firms are more focused, have lower debt ratios and experience increases in operating performance. This suggests that large downsizings are efficient responses to declining business fortunes. Companies also sell their assets in response to excessive diversification. Agency theorists argue that restructuring through asset sales is a correction for over-expansion and over-diversification made by self-serving corporate managers when they increase the size and scope of firms without increasing their value ([6], [7]). Literature has also shown that asset sales and corporate restructuring in general may arise as a result of a reduction in agency conflicts

between company managers and shareholders. In particular, this hypothesis rests upon asset sales occurring in response to some form of managerial disciplinary event.

As the foregoing discussion suggests, there are many reasons and benefits for managers to sell assets. However, the next question is whether asset sales create value. In other words, is the decision to engage in an asset sale a positive Net Present Value (NPV) project? Much of the previous research provides evidence related to these queries. The findings come mostly from event studies at the time of the announcement of the asset sale. The general consensus is that the asset sale announcement is associated with positive abnormal stock returns ([5], [4], and [9]). This finding suggests that asset sales create wealth for shareholders.

There are convincing reasons for the asset sale announcement to be associated with the positive stock return. First, asset sales are associated with the movement of resources to higher valued uses ([4]). Secondly, the asset sale provides funds that management uses to repay debt and therefore reduces the likelihood of bankruptcy ([9]). Thirdly, asset sales increase the firm's focus on core activities and therefore the firm's resources are efficiently allocated ([2]).

Finally, concerning the use of proceeds from asset sales, it has been found that the market reacts positively to announcements of firms that announce a distribution of proceeds, but reacts negatively to those announcements associated with the reinvestment of asset sales' proceeds [8]. This finding is consistent with [6] free cash hypothesis, which states that top management in firms with free cash flow invest in value-destroying projects. The distribution of proceeds from asset sales is therefore perceived by the market as one way of reducing free cash flow available to managers.

In view of the foregoing discussion, the analysis in this paper provides evidence related to three primary hypotheses: first, what factors motivate corporate managers to undertake asset sales? Second, what is the market reaction to announcements of asset sales? What are the market reactions to the stated reasons for the use of asset sale proceeds?

2. Sample and Methodology

2.1 Sample

To examine the above hypotheses, a sample of 399 events was used. Included in the sample, is a UK non-financial listed company that have traded for at least one year following the asset sale announcement. In addition, the firm should have made only one sell-off announcement in any one year, and it should disclose a selling price of a divested asset. More details of the sample are provided in Table 1.

Table 1: Descriptive Statistics for Asset Sales Firms
Panel A: Distribution of Sample Firms by Years

Year	N	Fraction (%)	Year	N	Fraction (%)
1993	41	10.3	1998	75	18.8
1994	47	11.8	1999	27	6.8
1995	72	18.0	2000	79	19.8
1996	26	6.5	Total	399	100
1997	32	8.0			

Panel B: Stated reasons for asset sales and uses of asset sale proceeds

Stated reasons for asset sales			Uses of asset sale proceeds		
Reason	N	%	Use	N	%
Loss making	275	68.9	Debt repayment	128	32.1
Focusing	268	67.2	Investment	55	13.8
Highly-leveraged	198	49.6	Financing	18	4.5
Reason not given	73	18.3	Pay to shareholders	4	1.0
			Use not given	239	59.9

2.2 Methodology

The methodological approach of this paper is an event study that employs accounting-based measures of operating performance. The operating performance is used as opposed to stock returns, as performance metric, because share prices incorporate markets expectations of the value of the firm. The methodology used in this study is strongly influenced by [1]. On the market reaction to announcements of asset sales, the paper uses standard event study methodology.

2.2.1 Matching firm selection

To assess whether a firm is performing unusually well or poorly, there is a need to specify the performance to be expected in the absence of an event in order to provide a benchmark against which sample firms can be compared. In this paper, two benchmarks were constructed and used: (i) the median industry, and (ii) control firms for measuring the expected operating performance. Industry-matching assumes that some of the cross-sectional variation in operating performance can be explained by an industry benchmark. On the other hand, the control firms help to control for mean reversion in earnings ([1]).

2.2.2 Performance measurement: industry-adjusted

A firm's industry-adjusted performance is computed by subtracting the median performance of the industry comparison group from each firm's performance. More formally, P_{it} is denoted as the performance of firm i in year t . The industry comparison group for firm i in year t is PI_{it} . That is,

$$E(P_{it}) = PI_{it}$$

where $E(\cdot)$ is an expectation operator.

2.2.3 Performance measurement: matching firms

To measure performance relative to matching firms, a matching firm is constructed on the basis of industry and pre-event performance. More specifically, a firm is selected as a control firm if it is from the same industry and with ROA within $\pm 10\%$ of the sample firm's performance at the end of the year, prior to any announcement of asset sales.

2.2.4 Statistical tests for abnormal operating performance

The abnormal performance of firm i in year t , AP_{it} , is defined as realized performance, P_{it} , less expected performance, $E(P_{it})$:

$$AP_{it} = P_{it} - E(P_{it})$$

where performance is measured using ROA, and expected performance is based on industry medians and/or control firms.

2.2.5 Abnormal Returns

The abnormal return is calculated as:

$$AR_{it} = R_{it} - R_{mt}$$

where AR_{it} is the abnormal return of firm i on day t ; R_{it} is the actual share returns of firm i on day t and R_{mt} is the market return on day t . The average abnormal return for day t is defined as:

$$AAR_t = \frac{1}{N} \sum_{i=1}^N AR_{it}$$

where N is the number of firms. To measure abnormal returns over a specific interval for firm i , the abnormal returns are summed to give the cumulative abnormal returns (CAR), that is,

$$CAR_i = \sum_{t=T_{1j}}^{T_{2j}} AR_{it}$$

where T_{1j} and T_{2j} are firm-specific event dates (e.g., the press and outcomes dates).

3. Empirical Findings

3.1 Financial Performance

Table 2 compares sample firms with control firms along a number of different dimensions underlying the sell-off decision. Since the control firm selection criterion is based upon the same pre-event performance, there is naturally an insignificant difference in return on assets (ROA) between the sample and control firms. The data indicate that firms that sell assets tend to have higher debt ratios. This is also supported by the interest coverage ratio, which shows that the sample firms had fewer ratios relative to control firms; the difference is significantly negative at the 1% level of significance. Table 2 also shows that the sample firms operate in more lines of business than control firms, with a median of three lines compared with two for the control firms.

Collectively, the information in Table 2 suggests that firms that sold-off assets were more diversified and had a higher leverage in relation to a control sample of firms. Thus, the findings suggest that an important role exists for corporate

re-focusing and lender monitoring in asset sale decisions. These findings are consistent with past empirical research by John and Ofek (1995), [9], and [3]) on the reasons for companies selling assets.

Table 2: Descriptive statistics for sample versus control firms sale year

Variable (1)	Sample firms (2)	Control firms (3)	Difference (4) = (2) – (3)
Observations	399	399	399
ROA	0.1074*** [0.1250***]	0.1118*** [0.1300***]	-0.0044** [0.000]
Debt ratio	0.2514*** [0.2250***]	0.1777*** [0.1650***]	0.0738*** [0.0600***]
Interest coverage	7.22*** [4.940***]	15.64*** [6.935***]	-9.42*** [-1.665***]
Number of segments	2.9396*** [3.000***]	1.9917*** [2.000***]	0.9800*** [1.000***]

Table 3 reports the industry-adjusted changes in ROA for different periods in the 2 years prior to asset sales. The results generally show that sample firms exhibited a decline in ROA prior to an asset sale, which is statistically significant at the 5% level. An analysis of sample firms on the basis of the stated reasons for the asset sale shows that loss making, re-focusing and leveraged firms all experienced significantly negative ROA in almost all the periods of the analysis.

The table reports the mean [median] for selected financial variables at the financial-end prior to asset sales. ROA is defined as earnings before interest, tax, depreciation, and amortization divided by total assets. Debt ratio is the ratio of total debt to total assets. Interest coverage ratio is defined as the ratio of pre-tax profit, plus total interest charges divided by total interest charges. *** and ** denote statistical significance at the 1% and 5% level respectively.

Table 3: Changes in operating performance prior to asset sales

The table reports mean [median] changes in the industry-adjusted ROA prior to asset sale. Cumulative is defined as the difference between year 0 and the median of year -1, and -2. *** and ** denote statistical significance at the 1% and 5% level respectively.

Windows	Whole sample [N = 391]	Loss making [N = 275]	Focusing [N = 265]	Leveraged [N = 198]	Debt repayment [N = 128]	Investment [N = 55]	Financing [N = 18]
Δ -2 to 0	-0.025 [-0.009**]	-0.049** [-0.027***]	-0.012 [-0.010**]	-0.035*** [-0.024***]	-0.023 [-0.009]	0.026 [0.007]	0.001 [0.002]
Δ -1 to 0	-0.008 [-0.004]	-0.028 [-0.026***]	0.004 [-0.004]	-0.034*** [-0.029***]	0.001 [-0.005]	0.028 [0.011]	0.001 [0.003]
Cumulative	-0.031** [-0.011***]	-0.056** [-0.030***]	-0.018** [-0.012***]	-0.045*** [-0.029***]	-0.032 [-0.016**]	0.017 [0.007]	-0.008 [-0.001]

Table 4 reports the industry-adjusted changes in debt ratio over the 2-year period prior to the asset sale year. Sample firms, in general, experienced a marginal increase in financial leverage in the period between year -2 and 0. The analysis of financial leverage on the basis of the stated reasons for sell-offs shows that loss making and re-focusing firms experienced significantly positive financial leverage in almost all the 2-year period prior to asset sales. As would be expected, the leveraged firms experienced significantly

positive industry-adjusted changes in debt ratios in each of the 2 years prior to asset sale.

Table 4: Changes in financial leverage prior to asset sales

The table reports mean [median] changes in the industry-adjusted debt ratio prior to asset sale. Cumulative is defined as the difference between year 0 and the median of year -1, and -2. *** and ** denote statistical significance at the 1% and 5% level respectively.

Windows	Whole sample [N = 391]	Loss making [N = 275]	Focusing [N = 265]	Leveraged [N = 198]	Debt repayment [N = 128]	Investment [N = 55]	Financing [N = 18]
Δ -2 to 0	0.005 [0.003]	0.013 [0.012]	0.016 [0.009]	0.043*** [0.035***]	0.041** [0.029**]	-0.020 [-0.023]	-0.009 [-0.015]
Δ -1 to 0	0.009 [0.002]	0.018** [0.007]	0.013 [0.006]	0.045*** [0.033***]	0.016 [0.007]	0.011 [-0.004]	0.001 [0.000]
Cumulative	0.010 [0.005]	0.020** [0.014**]	0.021** [0.012**]	0.046*** [0.035***]	0.040** [0.026**]	-0.009 [-0.015]	-0.010 [-0.020]

An analysis of the differences between samples disaggregated with regard to how asset sale proceeds were utilized leads to mixed conclusions. The debt repayment sub-sample exhibits significantly positive industry-adjusted changes in debt ratios in some of the periods prior to the asset sale. However, on the other hand, investment and financing sub-samples experienced insignificantly negative

industry-adjusted changes in debt ratios prior to the asset sale.

3.2 Market disciplinary activities and asset sales

In this section, the market for corporate activities which sample firms undertook prior to asset sales are investigated. Specifically, an investigation is conducted into whether

sample firms were subjected to take over pressures (actual or potential), and also into financial distress prior to asset sales.

Table 5: Corporate control activities

The table reports corporate control activities undertaken by sample and control firms over a period of 12 months prior to asset sales for a sample of 399 UK non-financial firms. Takeover pressure is where the company experienced an actual or potential takeover threat. Financial distress is defined as a situation when a firm reorganizes its debt or undertakes debt restructuring.

Activity	Sample firms		Control firms	
	N	%	N	%
Takeover activities	47	11.8	12	3.0
Financial distress	17	4.3	4	1.0

The results, which are presented in Table 5, show that 11.8% of sample firms were subjected to takeover pressure compared to 3.0% for control firms. In addition, 4.3% of sell-off firms experienced financial distress, while the figure was 1.0% for control firms. Taken as a whole, these findings suggest that the decision to undertake asset sales is also activated by lender monitoring and the market for corporate control activity. Thus, external and internal monitoring systems work together to ensure that corporate managers take decisions which are consistent with shareholder wealth maximization ([2] and [3]).

3.3 Stock returns

3.3.1 Market response to asset sale announcements

The analysis of market responses to asset sale announcements is divided into three main areas: all asset sale announcements; the stated reasons for asset sales; and the uses of asset sale proceeds.

3.3.1.1 All asset sale announcements

Average abnormal returns on a day of the asset sale announcements and mean cumulative abnormal returns in various periods surrounding the asset sale announcements are presented in Table 6, panel A. The mean cumulative abnormal returns in the period (-1,1) are 0.75% (p-value = 0.001). These results suggest that the announcement of a corporate asset sale conveys positive information to the market. The positive market reaction suggests that investors perceive the asset sale as a way for the firm to take actions

aimed at improving performance, in particular through the reduction of financial leverage or excessive diversification.

3.3.1.2 Stated reasons for asset sales

Panel B of Table 6 reports results on the market reaction to announcements of asset sales on the basis of the different stated reasons for asset sales. The results are similar across classifications. All sub-samples experience significantly positive abnormal returns in the periods surrounding the asset sale announcement. These results are generally consistent with those of John and Ofek (1995) and [9]. However, unlike John and Ofek (1995), there is evidence that the positive abnormal returns are also associated with firms that sell assets in response to poor performance and high financial leverage.

3.3.1.3 Uses of asset sale proceeds

The abnormal stock returns for sample firms on the basis of the uses of asset sale proceeds are reported in panel C of Table 6. The market is seen to react positively to firms which state that they are using the proceeds to service debt, but there is little evidence that stock prices are significant upon the announcement of asset sales that are used to finance either investment or working capital requirements.

The use of asset sale proceeds results of debt repayment and investment sub-samples are consistent with the financing hypothesis of [8], which predicts that asset sale proceeds will be discounted by investors when retained by the selling firms, owing to the agency costs of managerial discretion ([6] and [11]).

Table 6: Abnormal returns around asset sale announcements

The table presents the abnormal returns surrounding asset sale announcements. Panel A reports abnormal returns for the whole sample. Panel B presents the abnormal returns for the sample firms by the stated reasons for the asset sale. Panel C reports the abnormal returns of sample firms on the basis of the use of asset sale proceeds. *** and ** denote statistical significance at the 1% and 5% level respectively.

Panel A: Whole sample

Statistic	CAR (-1,0)	AAR (0)	CAR (-1,1)
Mean %	0.499***	1.125***	0.745***
Median %	0.262**	0.515***	0.376***
% +ve	56.0	57.9	53.8

Panel B: Reasons for asset sale

Statistic	Focus firms		Leveraged firms		Loss-making firms	
	AAR (0)	CAR (-1,1)	AAR (0)	CAR (-1,1)	AAR (0)	CAR (-1,1)
Mean %	1.159***	0.920***	0.902***	0.790**	1.02***	0.93***
Median %	0.550***	0.467***	0.550***	0.40**	0.60***	0.06***
% +ve	58.2	53.4	56.8	55.2	56.1	57.3

Panel C: Uses of asset sale proceeds

Statistic	Debt repayment (N = 126)		Investment (N = 55)		Financing (N = 18)	
	AAR (0)	CAR (-1,1)	AAR (0)	CAR (-1,1)	AAR (0)	CAR (-1,1)
Mean %	1.276***	1.060***	0.900**	0.584	0.870	-0.400
Median	0.700***	0.750***	0.400	0.367	0.350	-0.420
% +ve	57.1	59.5	52.7	60.0	50.0	33.3

4. Summary and Conclusion

The paper assesses the motives of selling company assets and the market reaction to public announcements of asset sales. The paper tries to answer three questions: first, what factors motivate corporate managers to undertake asset sales? Second, what is the market reaction to announcements of asset sales? What are the market reactions to the stated reasons for the use of asset sale proceeds?

Consistent with the findings of most previous studies, evidence is provided that corporate managers undertake asset sales because of poor performance, high levels of financial leverage, and excessive diversification. It is also apparent, however, that companies may have been forced to sell assets owing to pressure from lenders, and from external corporate markets. The findings in this paper also provide evidence that the market reacts positively to announcements of asset sales. Thus, asset sales create wealth for shareholders. Finally, the market also reacts positively to announcements of firms which state that they are using the proceeds from asset sale to service debt, apparently to avoid bankruptcy costs.

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