

# A CLOSER LOOK AT THE VALUE OF SPLIT-UPS

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There has been a lot of press about the recent wave of corporate spin-offs and split-ups. Unfortunately, most articles and academic research cover the topic too broadly, lumping small equity carve-outs with corporate breakups, old transactions with new ones, and deintegrating transactions with those aimed at unbundling conglomerates. The results of such examinations are often muted inferences as to value (3-5 percent upon announcement), and confused inferences as to rationale. The real evidence on split-ups is more insightful.

My firm, Finegan & Gressle LLC, conducted an analysis of large corporate split-ups announced

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## EXECUTIVE SUMMARY

*I Most academic research on split-ups, spin-offs, and carve-outs is not detailed enough to help boards of directors meaningfully evaluate whether to set free the diverse pieces of a conglomerate. The author's analysis takes a closer look at large corporate split-ups and finds different excess returns when proactive split-ups are categorized separately from those motivated by competing offers, shareholder initiatives, and desperation.*

*I The author examines deintegrating split-ups, in which obvious operating benefits of combination are outweighed by a desire to eliminate bureaucracy, improve visibility and incentives, and eliminate uneconomic cross-subsidies or inertia, and he compares them with deconglomerating split-ups, in which the resulting pieces have little in common.*

*Many nonconglomerates with highly integrated but overtaxed operations still balk at the notion that deintegrating could empower their pieces to perform better. The evidence on split-ups strongly suggests that many large integrated companies would do well to reexamine the cost and benefit of simultaneously owning and managing competing elements of the value chain.*

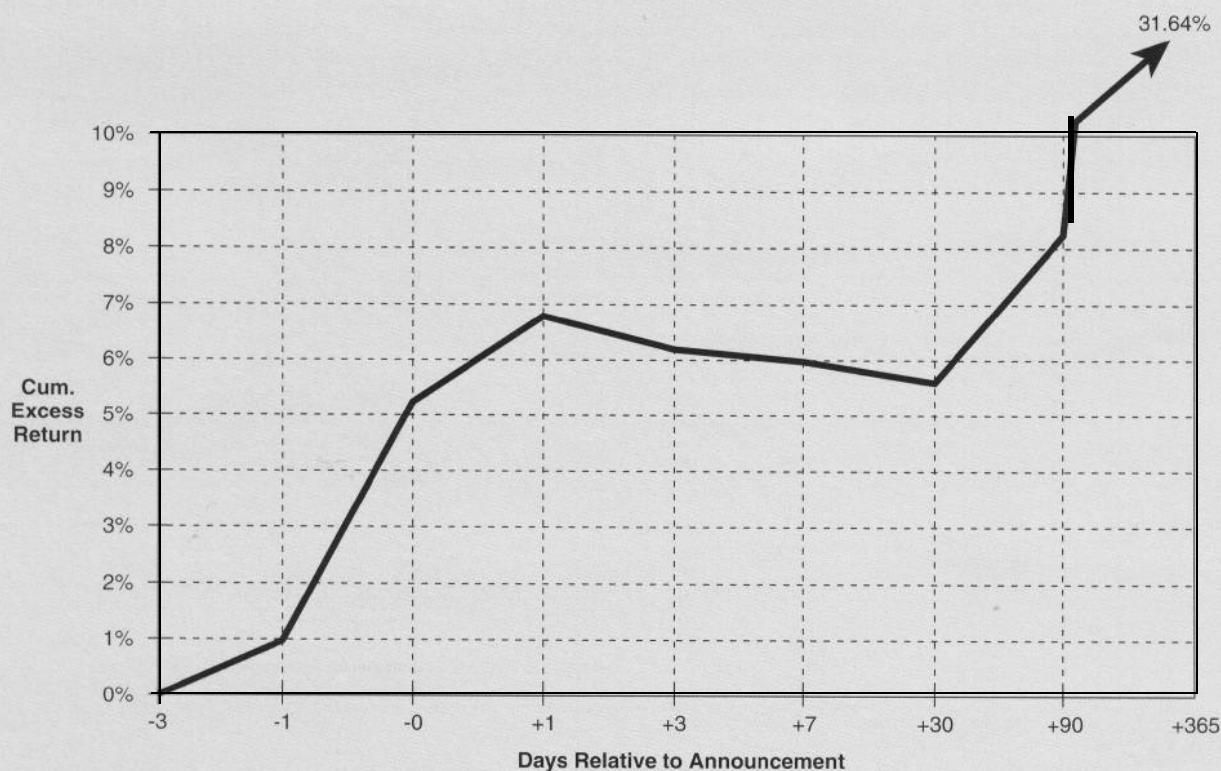
between January 1992 and January 1996. The term "split-up" is defined as the division of a company into two or more publicly traded, comparatively substantial entities through one or more transactions. To be included, the announcement of the split-up had to be significant enough to be recognized by three independent wire services.

In addition, the sample excluded carve-outs in which the remaining company dwarfed the spun-off entity. To be included in the analysis, the carve-out had to, in effect, redefine the parent company's identity and objectives. According to these criteria, Sprint's spin-off of its cellular business was excluded, despite its being substantial, because it represented a disproportionately small percentage of Sprint's total capital, income, and market value. It was not really a corporate division.

Along that vein, we included companies that announced plans to break themselves apart through spin-offs, but later chose to sell units instead. We assumed, reasonably, that the market revalued the

**EXHIBIT 1**

28 Large Corporate Split-ups (1/92-1/96)



company and its prospects on the basis of management's announced mode of division, rather than on the basis of 20-20 foresight. Such was the case with W. R. Grace's announced spin-off of National Medical (later auctioned to Hercules) and Allegis Corp.'s announced spin-off of its nonair businesses. (Hertz, Westin Hotels, and Allegis's stake in Hilton International were each sold separately.)

**SCHOLARLY UNDERSTATEMENTS**

Screened this way, our analysis revealed that most academic research on carve-outs was too encompassing to help boards of directors meaningfully evaluate whether to set free the diverse pieces of a conglomerate, or to challenge the orthodoxy of vertical and horizontal integration.

The most prominent studies, those conducted by Michael Bradley, of The Fuqua School of Management, and Randall Woolridge, of Pennsylvania State University, suggest short-term announcement gains of 3-5 percent, and longer-term gains (once spin-offs are complete) of another 2-3 percent.

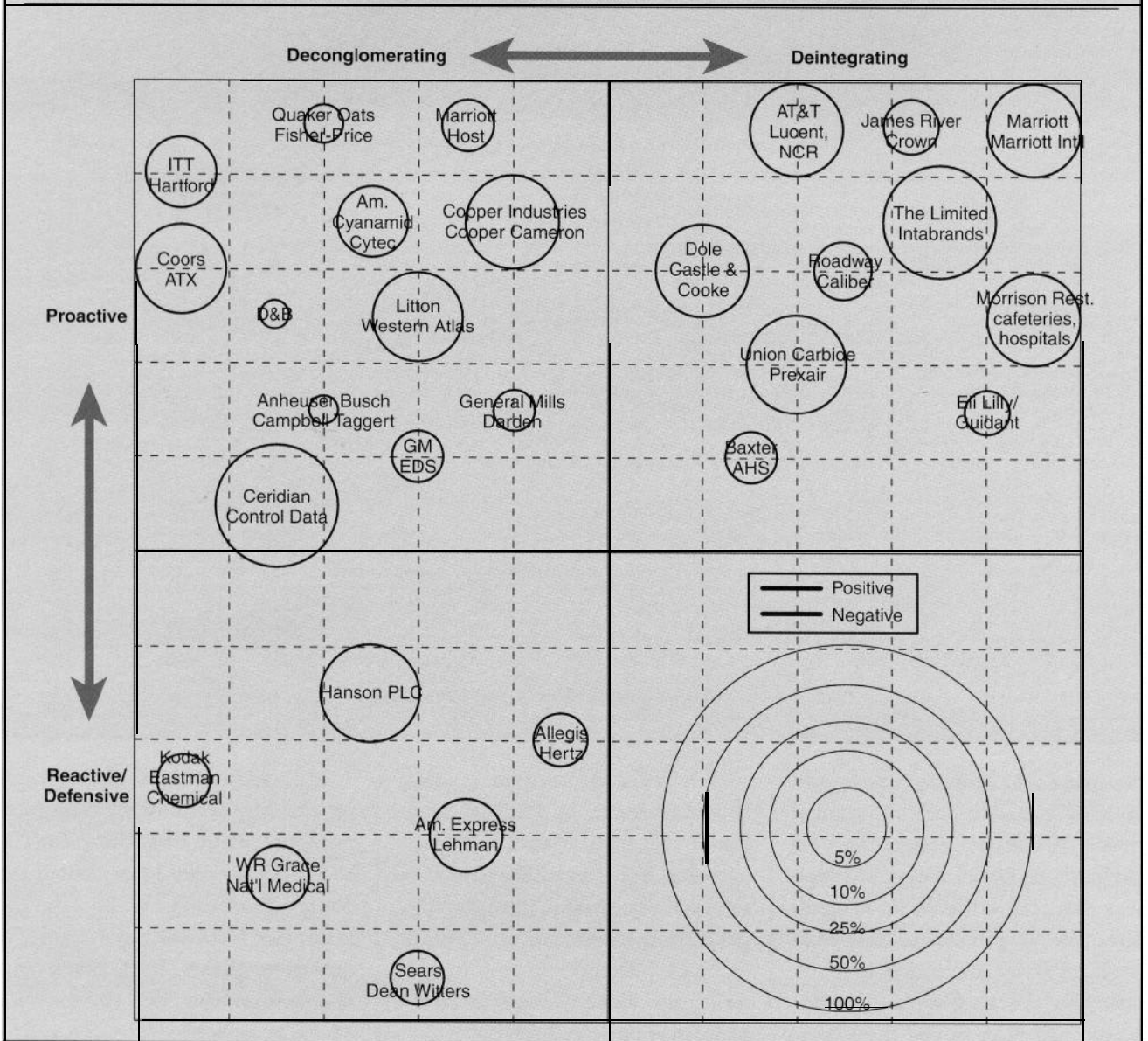
Our analysis of large corporate split-ups is more promising (see Exhibit 1). The average short-term excess return for companies announcing large corporate split-ups during the 1990s was 5.9 percent, the 90-day excess return 8.3 percent, and the one-year return 31.6 percent. ("Excess return" is defined as total stockholder return-dividend plus capital appreciation-above that of a market-weighted index of competitors.)

Not surprisingly, the excess return improves if we separate proactive split-ups like AT&T's and ITT's from those motivated by competing offers (W. R. Grace's National Medical), shareholder initiatives (Sears, RJR Nabisco), and desperation. The short-term excess return for proactive split-ups was 8.0 percent. The short-term excess return for reactive split-ups was -1.9 percent.

Interestingly, the excess return improves if we separate deintegrating split-ups from deconglomerating split-ups (see Exhibit 2). The term "deintegrating split-ups" is defined as those in which obvious operating benefits of combination are outweighed by a desire to eliminate bureaucracy, improve visibility and incentives, and eliminate uneconomic cross-subsidies

**EXHIBIT 2**

**28 Large Corporate Split-ups (10-Day Gain)**



or inertia. The term “deconglomerating split-ups” is defined as those in which the resulting pieces have little in common.

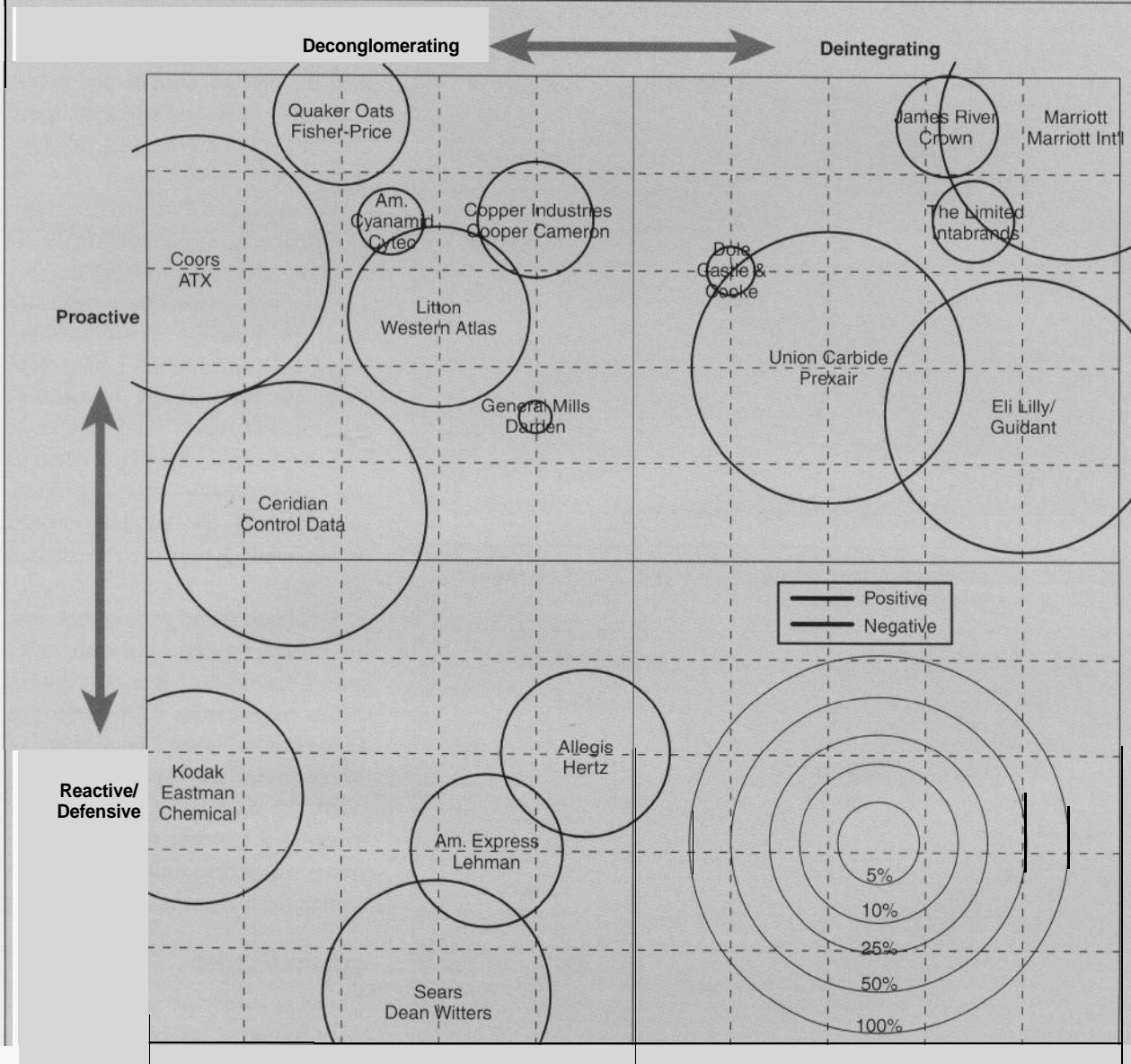
Examples of deintegrating split-ups include The Limited’s decision to split off its highly successful Victoria’s Secret line of lingerie despite presumable overlap with The Limited’s buying and merchandising functions, Eli Lilly’s decision to split off its medical devices business, Host

Marriott Corporation’s decision to split off Marriott International, and Dole Foods’ decision to split off Castle & Cooke despite overlapping management of Hawaiian properties.

Examples of deconglomerating transactions include Sears’ decision to unwind Dean Witter, Discover & Co., Kodak’s decision to spin off Eastman Chemical, and Quaker Oats’ decision to shed Fisher-Price toys.

In many ways, deintegrating split-ups presume greater self-examination and insight than deconglomerating split-ups and greater risk that severing ties may backfire. Yet the evidence on large corporate split-ups is unmistakable. Proactive, deintegrating transactions enjoy announcement effects of 10.1 percent versus 6.3 percent for proactive deconglomerating split-ups. The one-year excess returns are 41.9 and 20.0 percent, respectively (see Exhibit 3).

EXHIBIT 3  
17 Large Corporate Split-ups (365-Day Gain)



More interesting, proactive deintegrating split-ups have withstood the test of time-posting nearly the same excess return in 1995-96 as in 1992-94 (see Exhibit 4). By contrast, the excess return for deconglomerating split-ups has eroded steadily—from a short-term average of 6.2 percent in 1992-94 to 0.5 percent in 1995-96 (see Exhibit 5).

One explanation is that most highly visible conglomerates have already reshaped themselves from

within-decentralizing operations and accountability, and banishing unessential bureaucracy. Conglomerates like ITT, W. R. Grace, and, more recently, Ralcorp were already so mindful of stockholder scrutiny that the breakup announcement merely formalized a streamlining and decentralizing process that had begun several years earlier.

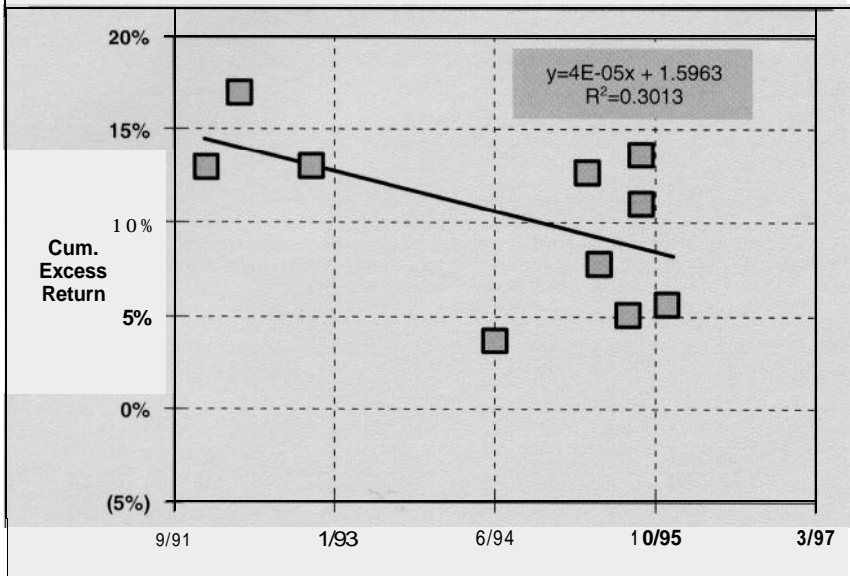
The opposite may be true for nonconglomerates. Many compa-

nies with highly integrated but overtaxed operations still balk at the notion that deintegrating could empower their pieces to perform better; or balk at squarely addressing transfer pricing questions.

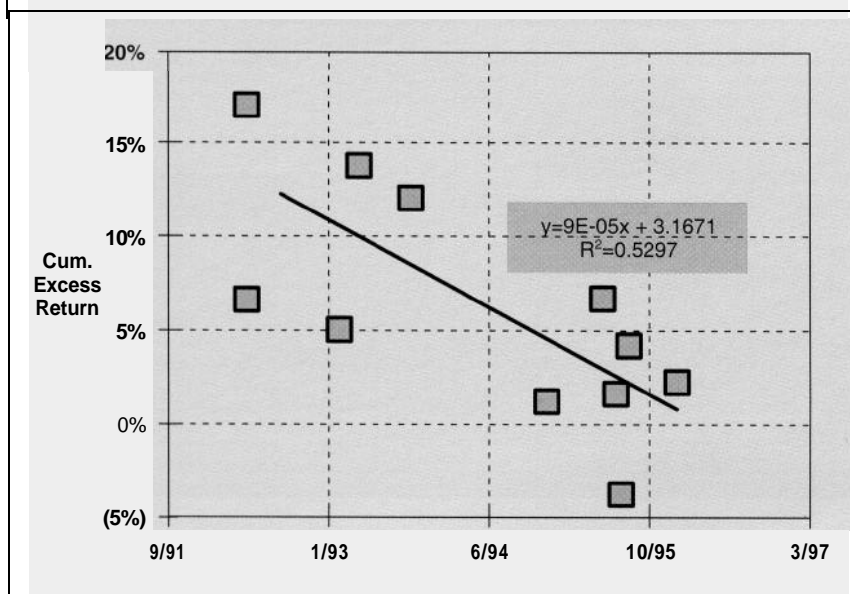
**CASE FOR DEINTEGRATION**

It is perhaps the courage of a few highly integrated (and successful) companies to challenge perceived benefits of combination that the

**EXHIBIT 4**  
**10 Proactive Deintegrating Split-ups**



**EXHIBIT 5**  
**12 Proactive Deconglomerating Split-ups**



market so richly rewards. The evidence on split-ups strongly suggests that many large integrated companies would do well to reexamine the cost and benefit of simultaneously owning and managing competing elements of the value chain.

Of course, dispersion in excess returns is as important as magnitude. The short-term excess return for the

twenty-eight largest corporate split-ups ranged from -12.1 percent to +19.1 percent. The one-year excess return ranged from -19.4 percent to +85.3 percent (see Exhibit 6).

Assuming a normal distribution, the board of a typical large corporation has roughly 80 percent confidence that it can generate a positive market reaction to a split-up

announcement, and roughly equivalent confidence that such a reaction will be sustainable for at least one year. Nevertheless, the sheer range in outcomes, both upward and downward, should encourage boards to examine the data more closely and review a subset that better defines their situation.

We parsed the data two ways: (1) proactive versus defensive or reactive split-ups; and (2) deintegrating versus deconglomerating split-ups. Reactive, deconglomerating split-ups fared badly. Not only was the average announcement effect weak (-1.9 percent), the dispersion in excess returns was also weak-offering little promise of an excess return above, say, 4.5 percent (1 standard deviation).

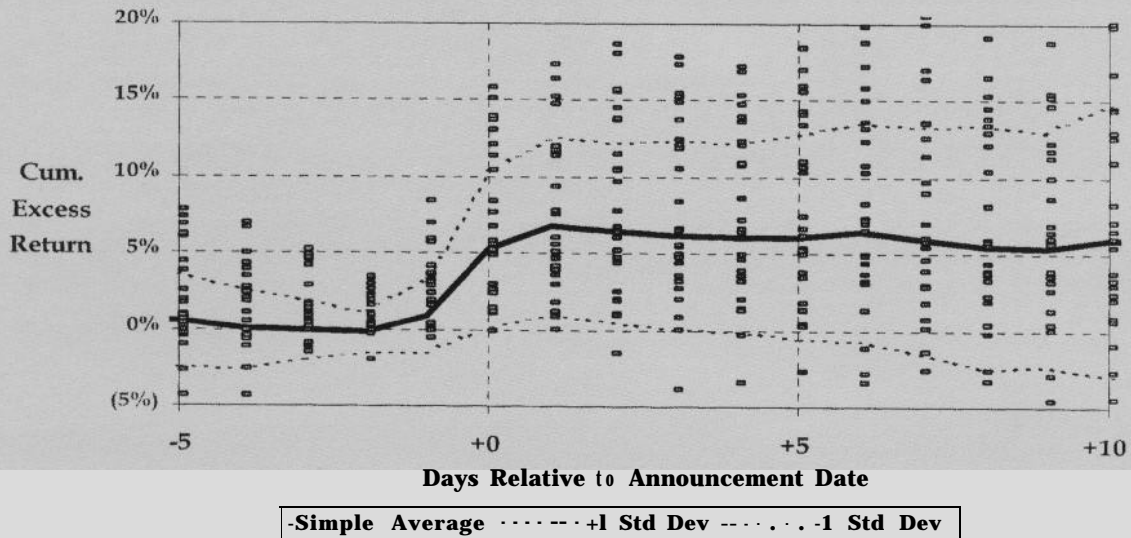
Proactive, deintegrating split-ups, by contrast, were greeted with widespread enthusiasm. Announcement effects ranged from +3.4 percent to 15.9 percent around an average of 10.1 percent (see Exhibit 7). Longer term, the dispersion widened, but from -4.9 percent to +85.3 percent suggesting almost option-like returns for buy-and-hold investors.

## CONCLUSION

There is surely no definitive test for whether a board should consider splitting a company into more manageable pieces. But the majority of articles and research tend to understate the value created by these transactions, the importance of being proactive, and the often substantial hidden cost of overseeing integrated, but occasionally competing businesses.

Viewed selectively, proactive deintegrating transactions hold as much promise for stockholders of the 1990s as takeover premiums did for stockholders during the 1980s. ■

**EXHIBIT 6**  
**28 Large Corporate Split-ups (1/92-1/96)**



**EXHIBIT 7**  
**Magnitude and Dispersion of Reaction (10 Proactive Deintegrating Split-ups)**

