Divesture: stay or exit

Chapter 7

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Divestiture

- Divestiture refers to the process of reducing the portfolio of the business a firm owns and it is one way to reduce the scope, as alternative to outsourcing
- It occurs when a firm reduces the number of business it is active in
- There are two basic models: spin-offs and sell-offs
- In sell-off the business is sold to another company: we can have two cases, leverage buy out and management buy out
- Leverage buy out happens when the acquiring firm uses large amount of debt for the acquisition

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- If it the management itself who’s making the acquisition, then we have the special case of management buy out
- In spin-off, the shares of the divested business are distributed to shareholders of the refocusing company, while the divested business is listed on capital markets

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- Other two modes of divestures are: equity carve outs and split ups.
- Equity carve out: part of the specific business stocks are sold to the public, part are kept. This is also called IPO. Initially, the parent business keeps around the 80% of shares
- Under a split-up, shares are created in the underlying business, while those in the former parent are dismissed

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- The control remains only in equity carve out case, for some years, for generating further cash and in case of high uncertainty concerning the value of the business

The divestiture decision

- Reasons can be: failing the synergy test; another corporate parent is a better owner
- The synergy test results can be: negative or at least as good as separated business
- In case of a corporate parent is a better owner: in case the corporate parent can have stronger synergies

When does a divestiture occure?

- Unrelated diversification
- Poor operating performance
- Poor stock market performance: to reduce the diversification discount and because analysts are organized by industry, thus, they cannot really appreciate value of synergies
- External pressure
- New CEO

What is the outcome of a divestiture?

- Incresing the shareholder value for corporate parent (spin-off and carve out in particular)
- Another case is the split-off: a business is divested as a standalone unit and no cash is generated

Divestiture

- Definition
- Toward M&A and failures