IMPACT OF SPIN-OFF ON FINANCIAL PERFORMANCE - A CASE STUDY OF TRANSPORT CORPORATION OF INDIA LTD

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ABSTRACT

Spin-off is a type of divestiture, is an inorganic growth tool used to restructure an organisation in order to maximise shareholder value. Always it is an argument at global forums that spin-offs improve the financial performance of the parent company as well as the divested company. But the question here is, does that imply in Indian context too? Due to recent and emerging financial concept, there is lack of ample studies on the impact of spin-off on organisational financial performance in India. The statistics on Indian spin-offs in the last five years shows that 93 BSE listed companies have announced spin-offs. To understand the impact of spin-off on the company's financial performance, researcher has chosen Transport Corporation of India (TCI) Ltd., which has undergone spin-off in the year 2016 for the study. The paper is based on the secondary data collected from the annual reports of the selected company and studied the financial performance using profitability, liquidity and efficiency ratios. The result shows insignificance of spin-off on the financial performance of TCI Ltd. in short term. Present study gives the scope for further learning on impact of spin-off on long term performance for both parent and spun-off entity.

Keywords: *Spin-off, financial performance, ratio analysis, divestiture, efficiency*

Introduction

Divestiture is a partial or full disposal of business unit through sale, exchange, closure etc. in different forms. Spin-off is a type of divestiture in which a part of the business is detached and created as a new firm by issuing new shares to the existing shareholders as well potential shareholders. The recent trend in the corporate world shows that the companies are showing more interest in spinning off their business for various reasons, such as better efficiency, economies of scale, alignment of business, synergies etc.

In spin-off, subsidiary of the parent firm will be created as a new firm and the shares of the new firm will be distributed in proportion to the holdings of the parent firm to the existing shareholders of the parent firm. Shareholders of the parent company will hold the shares of the parent company and new firm (Spun-off) after spin-off. The Figure 1 shows the shareholding pattern pre and post-spin-off.

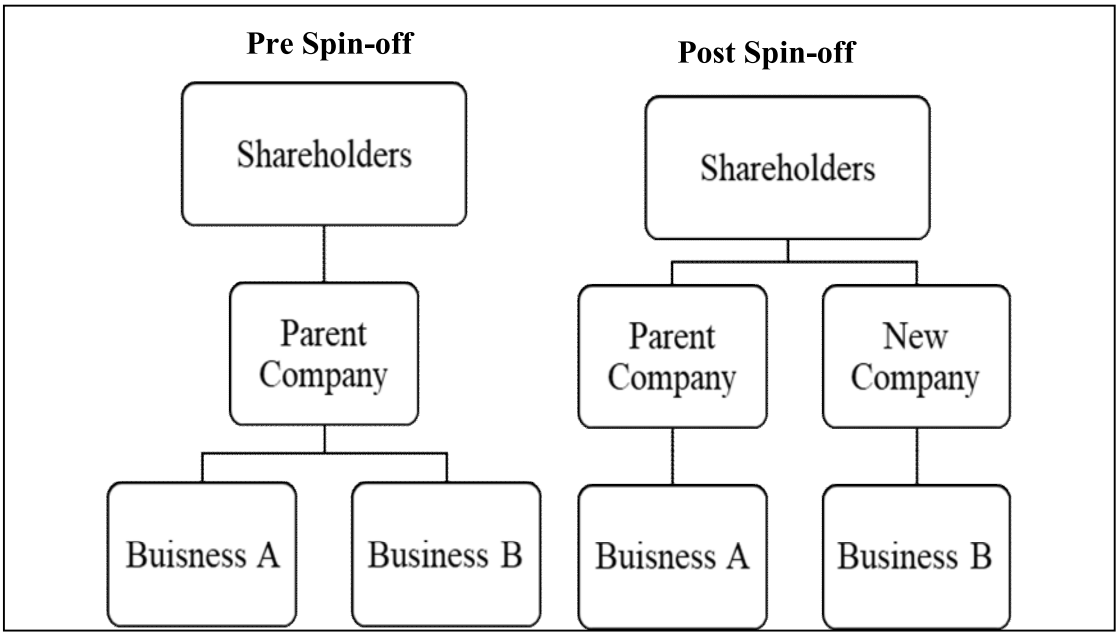

Figure 1: Shareholding Pattern Pre and Post-Spin-off

Literature Review

At the global level spin-off is a very well-known and quite often used in the financial industry. As the usage is very high, there are abundant studies on spin-off which has created the interest of the researcher to understand the scenario of spin-off at international as well as at domestic level from the existing literature. The following reviews showcases the impact of spin-off on shareholders wealth creation and its effects, performance relationships between parent and subsidiary unit etc. which are used as a base for conducting the present study.

Bendre, M., & Apte, N. (2017) studied the impact of spin-offs on shareholders wealth in India. They have considered 24 spin-offs that took place during 2012-2017 in India. The companies were shortlisted based on their size. They have analyzed the parent company market capitalization behaviour around the period of spin-off announcement, spin-off ex-date and combined entity post listing of spin-off entity. The result shows that spin-off announcement date to the listing of spun-off entity period is most favourable time for share-holder wealth creation (80 per cent of the cases have given 49 per cent average returns) and 60 per cent of total stocks have given positive returns with 18 per cent increase in average market capitalization during the spin-off announcement date and spin-off effective date. The study concluded that spin-off has an overall positive effect on shareholders wealth.

Zweiphenning, (2014) examined the wealth effects of 90 completed spin-offs in the United Kingdom during January 1987 to December 2010. The change in corporate focus, the level of information asymmetry, the relative size, board monitoring effectiveness and takeover interest are investigated as possible sources of the wealth effects. The announcement of spin-offs led to a significantly positive wealth effect of 4.46 per cent over the three-day window. There is no evidence for long-term wealth effects associated with a spin-off, as the results are mostly insignificant. Firms with no takeover interests are reported prior to the spin-off announcement, earn a significantly higher return in comparison to those where such interest was present.

Alexander, G, J., Benson, P, G., & Kampmeyer, J, M. (2012) analysed the consequences on shareholder's wealth when a firm announces to disinvest and sell to another firm. The researchers identified that there is increase in abnormal returns on the announcement date. They found that a period of abnormally negative returns is usually followed by selloffs, indicating release of negative information about the firm preceding the announcement.

Semadeni & Cannella, (2011) examined the performance implications of the parent-child relationship post spin-off. Although the parent provided oversight of the child prior to the spin-off, effects of post spin-off links to the child remain unclear. 142 spun-off firms between 1986 and 1997 were selected for the study to examine how oversight and ownership by the parent firm influence stock market performance post spin-off. The results showed that while child firms benefit from some links to the parent, having too many links is negatively related to performance.

Cusatis, P.J., Miles, J.A., & Woolridge, R. (1993) investigated the value created through spin-offs over the 1965–1988 by measuring the stock returns of spin-offs, their parent firms, and parent - spin-off combinations for periods of up to three years following the spin-offs. They saw substantial increase in abnormal returns for spin-offs, their parents, and the spin-off - parent combinations. Both the spin-offs and parents experience an unusually high incidence of takeovers and the abnormal performance is restricted to firms involved in takeover activity. Finally, they suggested that spin-offs lead to a low-cost method of moving corporate assets control to bidders who would create greater value.

Schipper and Smith (1983) test the effect of spin-off on shareholders' wealth. Their sample consisted of 93 spin-offs over the period 1963 - 1981. They have used the market model to estimate the abnormal returns, the findings reveal a significant positive abnormal return to parent companies around the announcement of a spin-off.

Research Gap

The above studies have shown that spin-offs are associated with positive abnormal behaviour on the announcement date and henceforth. It is also observed that most of the literatures focus on enhancement of shareholders value and creation of wealth as an outcome of spin-off at global level, wherein less focus is on impact of spin-off on performance of the parent company both at global and domestic level. Foremost importance is to understand the domestic spin-off status in India, therefore the present study is undertaken.

Statement of the Problem

Recently corporate restructuring in the form of spin-off is gaining global momentum and attracting many companies towards it. Nevertheless, companies have to undergo challenges on business, finance, and growth attributes during the process of spin-off. This has raised the question on its financial performance due to spin-off and also rationale behind the decision on spin-off. Further, in the corporate world, bigger is not always better and companies can perform well, when given total autonomy in decision making, wherein it also gets the advantage of tax benefit and healthier growth after spin-off.

In global context many researches have highlighted the intentions of spin-off and its impact on financial performance and shareholders' wealth. In India, number of companies opting for spin-off is gradually increasing since a decade which definitely shows positive reasons for opting spin-offs and thus encourages to explore the effects of spin-off on financial performance. Therefore, the present study of TCI Ltd. is taken to examine the motives of spin-off and its impact on the financial performance.

Objectives of the Study

The present study attempts to study the motive behind spin-off of TCI Ltd. and analysing its effect on financial performance.

Research Design

The present study is desk research and analytical study. The study analyses the performance of spin-off of TCI Ltd. based on quantitative data. Secondary data – 4 years pre and 4 years post spin-off collected through annual reports of TCI Ltd., are analysed using ratio analysis covering profitability, liquidity, and efficiency of TCI Ltd.

Transport Corporation of India Ltd., an Indian based logistic and supply chain company incorporated in 1958 and got listed in BSE in the year 1995. With expertise spanning over six decades, TCI group has expanded boundaries to offers seamless multimodal transportation solutions in both Indian and International markets. As an interest of the researcher TCI Ltd. has been chosen for the study. TCI Ltd. announced spin-off of its subsidiary XPS undertaking renamed as TCI Express Ltd. in the year 2016. Therefore, four years data, prior and post spin-off is considered for analysing the financial performance.

Data Analysis and Discussions

On October 8, 2015, the Board of Directors of the company has approved a Scheme of Arrangement between Transport Corporation of India Ltd. and its wholly owned subsidiary, TCI Express Ltd. for Spin-off. The scheme states the de-merger of SEBI Registered Intermediaries Business of Transport Corporation of India Limited into TCI Express Limited and to list the TCIEL securities in the Stock exchange. On 14th June 2016, company has intimated the court approval for scheme to BSE. August 29, 2016 was the record date of the Spin-off. The spun-off entity TCI Express Ltd. listed on the stock exchange on December 15, 2016.

Motives behind Spin-off

Transport Corporation of India Ltd. is a business with distinct and diverse activities, which requires focused management and different skill sets. With this primary rationale, TCI Ltd. has proposed for a spin-off and vest the XPS undertaking as a resulting company namely TCI Express Ltd.

- To ensure sustainable long term and profitable growth for achieving focused leadership and management in support to e-commerce space.
- To enhance market share wherein it will enable investors to separately hold investment in business with different investment characteristics thereby enabling them to select their preferred investments which suits their strategies and risk profile.
- Providing continuous customer services.

- Meeting up competitive environment and risks to attract different set of investors and strategic partners.

Financial Performance Indicators and Analysis

General financial performance indicators are profitability, liquidity and efficiency ratios. The year of spin-off is a transitional period i.e., 2016-17, wherein to measure the impact, four years of pre and post spin-offs are considered.

Null hypothesis framed for the study is 'there is no significant impact of spin-off on the financial performance of TCI Ltd.'. In order to arrive at the objectives and to prove the main hypothesis following sub hypotheses are framed.

H_A: There is no significant impact of spin-off in the profitability of TCI Ltd.

H_B: There is no significant impact of spin-off on the liquidity of TCI Ltd.

H_C: There is no significant impact of spin-off on the efficiency of TCI Ltd.

H_A: There is no significant impact of spin-off in the profitability of TCI Ltd.

Profitability ratio indicates the ability of the business to generate earnings relative to its revenue, operating costs, assets or shareholder's equity over time, using data from a specific point in time. Most common profitability ratios found and used as variables in the study are: Return on Invested Capital (ROIC), Return on Assets (ROA) and Return on Equity (ROE). The profitability performance for the select period are shown in Figure 2.

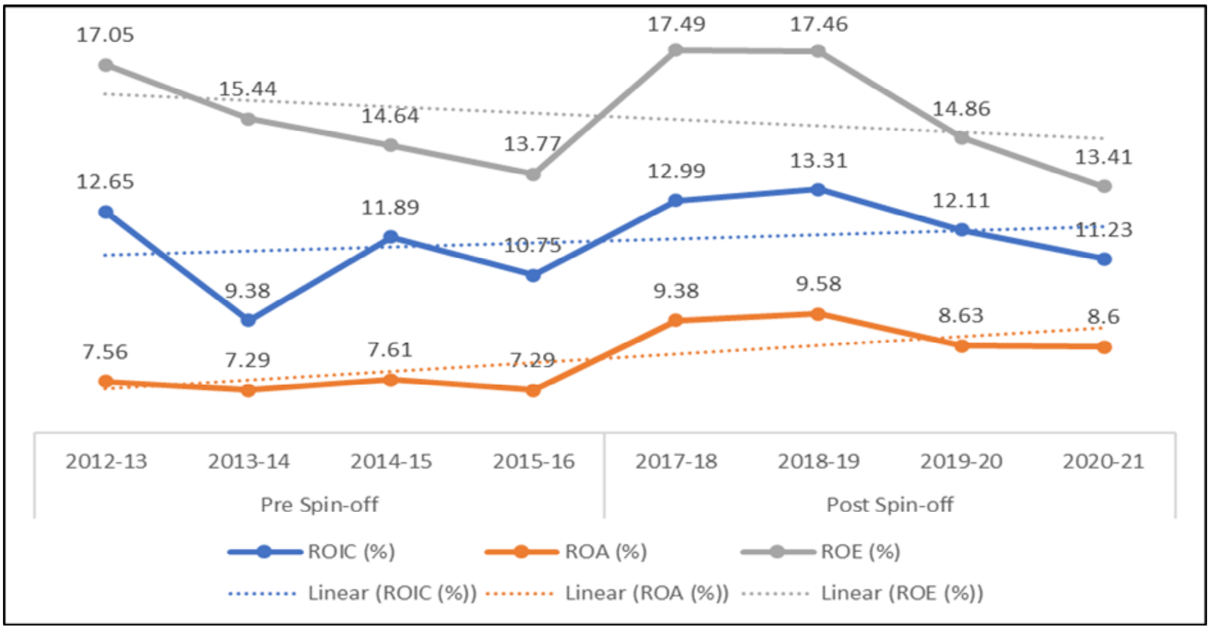

Figure 2: Profitability Performance of TCI Ltd. Pre and Post Spin-off Period

Pre spin-off period trend of profitability indicators has shown decline in respect of ROIC, ROA and ROE with registered average of 11.17 per cent, 7.44 per cent and 15.23 per cent respectively. On the other hand post spin-off period has also shown a declining trend in the selected indicators with an average of 12.41 per cent, 9.05 per cent and 15.81 per cent respectively. To conclude, the overall trend indicates that there is an average increase of 11.13 per cent in ROIC, 21.65 per cent in ROA and 3.81 per cent in ROE, directing towards the positive impact of spin-off on the profitability performance of the company. The study further tests this result with statistical tool paired t-test for checking the same as shown in Table 1.

Variables		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	ROIC_Pre - ROIC_Post	-1.24250	1.85545	.92772	-4.19493	1.70993	-1.339	3	.273
Pair 2	ROA_Pre - ROA_Post	-1.61000	.50259	.25130	-2.40974	-.81026	-6.407	3	.008
Pair 3	ROE_Pre - ROE_Post	-.58000	3.36805	1.68402	-5.93931	4.77931	-.344	3	.753

Table 1: Paired two sample t-test Statistics of Profitability Ratios

Profitability is always accompanied by the risk factor which is visible in the Table 1. All the three variables are directing towards high riskiness. At 5% level of significance, it can be observed that p value of ROIC and ROE is more than standard significance level of 0.05, whereas ROA shows a very minimal significance, which can be ignored. Therefore, the null hypothesis is accepted for all the three variables and concluded that there is no significant impact of spin-off on the profitability of TCI Ltd.

H_B: There is no significant impact of spin-off in the liquidity of TCI Ltd.

Liquidity ratios measure the ability of a firm to meet its short-term obligations as and when they become due. Most common liquidity ratios found and used as variables in the study are: Current Ratio (CR) and Quick Ratio (QR). The liquidity ratios of TCI Ltd. for the selected period are shown in Figure 3.

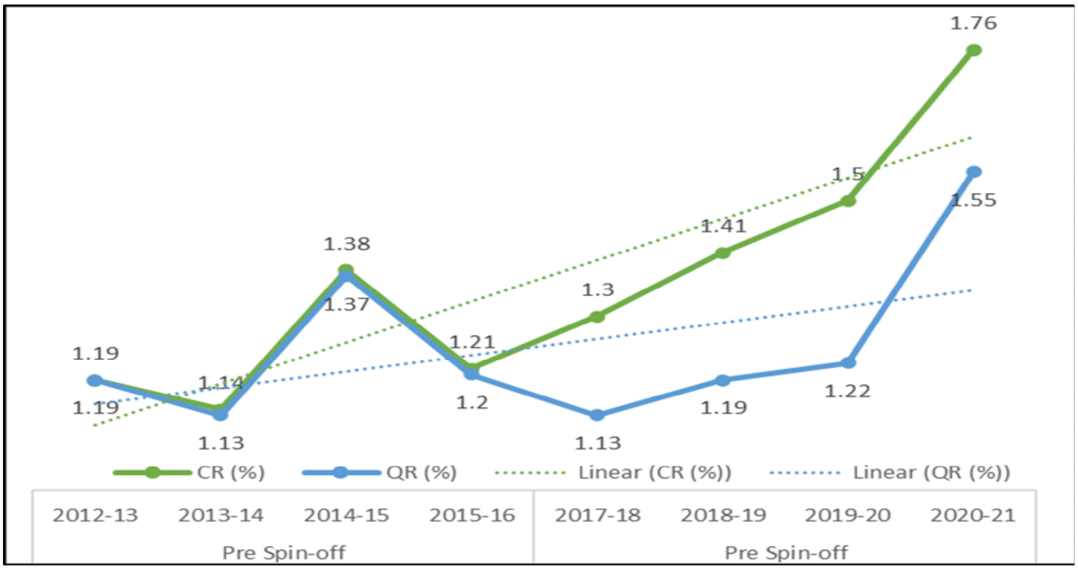

Figure 3: Liquidity Performance of TCI Ltd. Pre and Post Spin-off

Pre spin-off period trend of liquidity indicators is showing volatile movement i.e. first and third year increment and second and fourth year a decline in respect of CR and QR with registered average of 1.23 per cent and 1.22 per cent respectively. On the other hand post spin-off period has shown an increasing trend in the selected indicators with an average of 1.49 per cent and 1.27 per cent respectively. To conclude, the overall trend indicates that there is an average increase of 21.13 per cent in CR and 4.1 per cent in QR, directing towards the positive impact of spin-off on the liquidity performance of the company. The study further tests this result with statistical tool paired t-test for checking the same as shown in Table 2 .

Variables		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	CR_Pre - CR_Post	-.26250	.25025	.12512	-.66070	.13570	-2.098	3	.127
Pair 2	QR_Pre - QR_Post	-.05000	.23452	.11726	-.42317	.32317	-.426	3	.699

Table 2: Paired two sample t-test Statistics of Liquidity Ratios

At 5% level of significance, it can be observed that p value of CR and QR is more than standard significance level of 0.05. Therefore, the null hypothesis is accepted for both the variables and concluded that there is no significant impact of spin-off on the liquidity of TCI Ltd.

H_C: There is no significant impact of spin-off in the efficiency of TCI Ltd.

Efficiency ratios test the ability of the company to use its assets and handle its liabilities effectively in the short term period. Commonly used efficiency ratios like Assets Turnover Ratio (ATR) and Receivables Turnover Ratio (RTR) are used as variables in the study. Efficiency ratios of TCI are depicted in Figure 4.

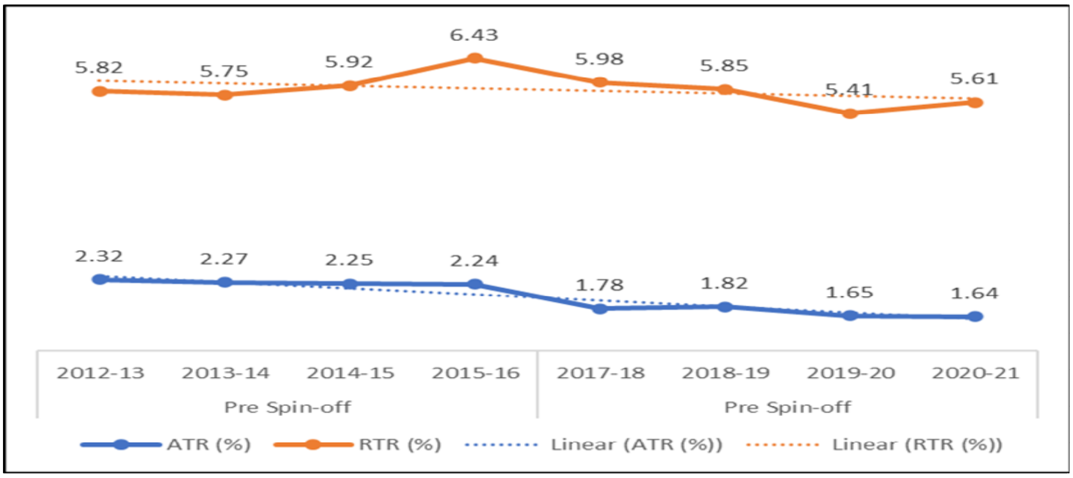

Figure 4: Efficiency Ratios of TCI Ltd. Pre and Post Spin-off

In the above figure ATR shows a consistent decline both in pre and post spin-off periods with an average of 2.27 per cent and 1.72 per cent respectively. In the case of RTR there is a steady increase in the pre spin-off period with an average of 5.98 per cent and declining trend in the post spin-off period with an average of 5.71 per cent. The overall trend shows decrease in ATR as well as RTR by 24.12 per cent and 4.47 per cent respectively. This shows that these efficiency ratios are depicting adverse impact due to spin-off. The study further tests this result with statistical tool paired t-test for checking the same as shown in Table 3.

Variables		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	ATR_Pre - ATR_Post	.54750	.12148	.06074	.35419	.74081	9.014	3	.003
Pair 2	RTR_Pre - RTR_Post	.26750	.16419	.08209	.00624	.52876	3.258	3	.047

Table 3: Paired two sample t-test Statistics of Efficiency Ratios

Efficiency ratios are considered as important measure of current and short term performance of an organisation. Both the variables considered in the study are directing towards high efficiency. At 5% level of significance, it can be observed that p value of ATR shows a very minimal significance, whereas RTR shows a high significance. Therefore, the alternative hypothesis is accepted for both the variables and concluded that there is a significant impact of spin-off on the efficiency of TCI Ltd.

The variables of each indicators show a non-significance in the financial performance of the company except for efficiency variables. In particular asset turnover ratio depicts a very minimal significance which can be ignored, whereas receivables turnover ratio shows a high significance. To arrive at the overall financial performance of TCI Ltd. as an impact of spin-of, one variable of significance will not carry a high impact due to the fact that enormous factors influence financial soundness of any business. Moreover, the nature of the company is logistics and supply chain management which must have a high receivable turnover for the sustainable efficient functioning. The figure 5 presents the financial performance indicators directing towards accepting the null hypothesis of no significant impact of spin-off on the financial performance of TCI Ltd.

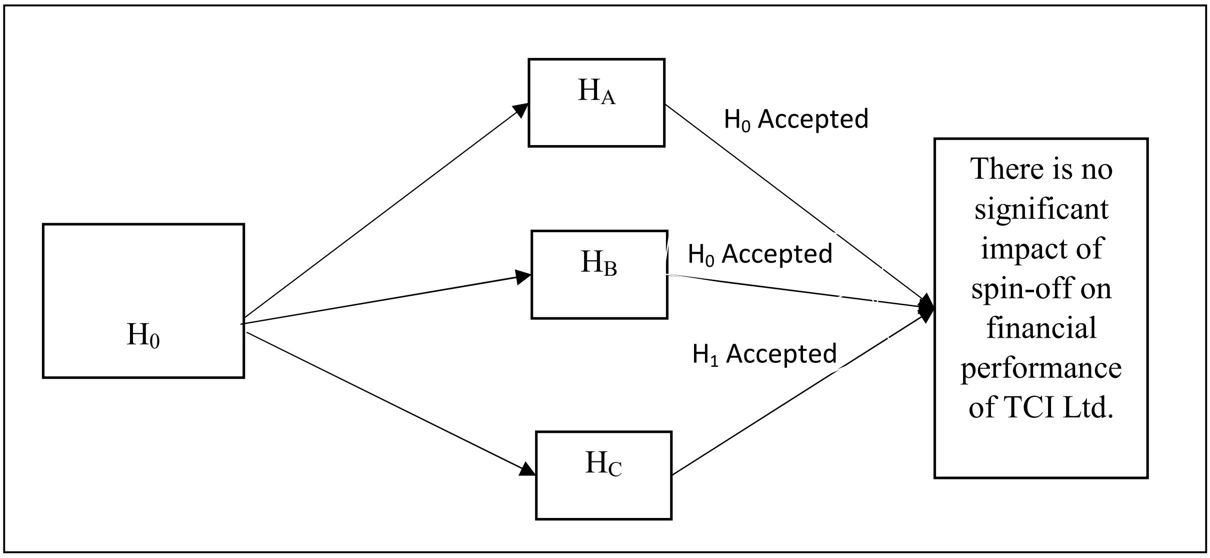

Figure 5: Financial Performance Indicators directing towards Null Hypotheses Acceptance

Conclusion

Financial performance of any business is affected by many factors, one such factor is spin-off. By spinning-off subsidiary and focusing on core business, the parent can perform better. The present study analysed the short term impact of spin-off on financial performance of TCI Ltd. which proved statistically that there is no significant impact of spin-off on financial performance of TCI Ltd. One should perform long-term performance analysis to know the real effect. It can be concluded that, spin-offs do have significant impact on financial performance if executed properly. It aids the parent company management to concentrate on the core business and gives opportunity to the spun-off entity to create its own legacy.

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