CORPORATE DIVESTMENT IN NEW ZEALAND

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ABSTRACT

The propensity of corporate executives and strategists to restructure their companies has intensified in recent years. Although a substantial literature, mainly overseas, has addressed the motives and economic consequences of mergers and acquisitions, comparatively little research has been directed towards corporate divestment activity, particularly in the Australasian region. This research investigates the motives for divestment, and some major factors influencing divestment decision-making of New Zealand listed companies. It highlights the importance of divestment as an integral aspect of corporate restructuring processes.

An inter-disciplinary model of divestment has been developed and explored in this study. Three different but inter-related perspectives - industrial organisation economics; corporate strategy; and finance - capture the various dimensions of divestment activity hitherto unexplored in a single study.

This study relied on mail survey questionnaire as a data collection method. The senior executives of leading companies listed on the New Zealand Stock Exchange were asked to indicate the relative importance of the divestment motives and factors affecting their companies' divestment activities for the past five financial years. Non-parametric statistical methods were employed to test the research hypotheses.

The research results offer strong support for the conceptual model of divestment. This confirms the notion that selected environmental, organisational, and performance factors have significant influences on a firm's motives for divestment, which in turn determines the corresponding divestment strategy formulation and implementation adopted by firms.
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CHAPTER I INTRODUCTION

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CHAPTER I INTRODUCTION

All things small, no matter what they are, all things small are beautiful.

Sei Shonagen

1.1 Background:

If the 1980s qualified as the "Age of Acquisition", then the 1990s promise to be the "Decade of Divestment". This prediction is based on the emerging "small is beautiful" philosophy held by many corporate strategists today.

Traditionally, corporate strength was often perceived to be correlated with corporate size. Synergistic benefits and economies of scale were identified almost universally by strategists who encouraged a portfolio approach to business ownership for large corporations. It was in pursuit of the conventional wisdom of economies and the benefits from diversification that led to the world-wide merger boom of the late 70s and 80s, especially prior to the share market crash in 1987.

However, this conventional wisdom is now subject to many challenges on both management and financial fronts. To quote from Adams and Brock (1986), "bigness has

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1 Quoted from Peters (1988), p. 15.

2 Professor Ray Miles, Dean of Business, University of California at Berkeley, was quoted as describing the 1990s as the "Decade of Large Scale Disaggregation" [see Peters (1988), p. 8]; while Vignola (1974) describes divestment as "the art of letting go" (p. v). Ravenscroft and Scherer (1987) note that the move towards sell-off following acquisition was recognised as early as 1968 by the journal Mergers and Acquisitions which established a regular column of sell-offs in the same year (p. 123).

3 See, for example, Grant and Saunders (1987, p.2), Curran and Stanworth (1982), Binks and Coyne (1983), Toffler (1985), and Peters (1988).

4 Grant and Saunders (1987, p. 2).

5 See, for example, the view expressed by Coyne (1986, p. 152), Hardman and Young (1983, p. 2); and Wright and Thompson (1987, p. 262).
not delivered the goods, and this fact is no longer a secret". Conglomerates that attempt to manage a large portfolio of diversified businesses under different cultures may well result in sub-optimal performance for each of the businesses. There appears to be a general agreement that "corporations should focus on their core activities, identify their strategic and competitive strengths and build on these rather than be distracted by the management of business in which they have no relative advantage".

This observation is shared by Toffler (1985) who comments that:

the corporate environment has changed so swiftly and fundamentally in the past two decades that structures designed for success in an industrial environment are almost by definition inappropriate today [p. 18].

He adds that:

Instead of constructing permanent edifices, today's adaptive executives may have to *de-construct* their companies to maximise manoeuvrability [p. 2, *emphasis added*].

The 1990s is therefore developing as a period when business strategists and management are focusing on divestment. While the trend toward divestment is admittedly more obvious overseas, there are evidences of it developing in the Australasian region. Grant and Saunders (1987) summarise as follows:

This new focus accepts that divestments are as integral to corporate strategy as acquisitions. To sell a business, therefore, is not a denial of corporate virility, a public recognition of failure, but rather a positive sign that the corporation is being well managed and aggressively directed (p. 2).

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7 Grant and Saunders (1987, p. 2).
1.1.1 A Misconception about Divestment

Business acquisition and divestment are frequently misunderstood to be two sides of the same coin, where divestment is simply a reverse acquisition or investment in general. Although it is possible for a company to rotate the procedures and analyses it uses in making acquisition for divestment purposes, the difference between them are crucial and significant. This is summarised by Hayes (1972) that:

Acquisition and divestment are two sides of the same coin, to be sure; but they are opposite sides. While they share certain characteristics, their differences are both numerous and crucial, and they require different approaches, different kinds of information, different methods of analysis, and different management practices (p. 56).

In a sense, acquisition and divestment are comparable to the social events of marriage and divorce.\(^8\) Marriage or acquisition is accompanied by positive expectations, which are readily and joyfully announced publicly.\(^9\) Divestment, or divorce, on the other hand, indicates that expectations were not met. It carries the connotation of an unhappy ending.

1.1.2 An Emerging Trend

As a result of the economic slow-down and the liquidity crunch after the share market crash, the number of fractional divestments has increased significantly. Many of these fractional divestments represented the merger "after-market" - those operating units or divisions which no longer fit the strategy and structure of the acquiring firm.

Comparatively, corporations are forced by economic necessity to re-evaluate their overall strategies more frequently than before. Underlying these companies' primary concern - the

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\(^8\) See, for example, Taylor (1988, p.7).

\(^9\) Ibid, at p. 9.
necessity to disengage themselves from unprofitable activities and to improve corporate liquidity - it is foreseeable that the propensity of corporate strategists and policy makers to restructure their companies will intensify in the future. In a sense, the recent recession coupled with the spectacular collapse of a large number of the "go-go" companies and their preoccupation with pyramidal growth, is encouraging a transfer of power back to managers whose strengths are in operations and finance. In short, rather than waiting until sell-off is forced on them, more companies should look ahead and develop relatively sophisticated rationales for divestment. The company, represented by a portfolio of assets, must be continually reviewed, augmented, and pruned.

1.2 Research Objectives

A substantial literature has addressed the motives and economic consequences of merger and acquisition. On the other hand, comparatively little research has been directed to corporate divestment activity. In the Australasian region, there has not been any empirical analysis on the subject. This is despite the fact that both Australia and New Zealand are experiencing an upsurge in the size and scale of divestment activities. However, Hazledine and Savage (1988) observe that "extensive industrial restructuring of the type New Zealand is currently experiencing implies a considerable degree of 'flux' in the economy as capital exits unprofitable industries and enters growing sectors of the economy" (p. 3). They add that "most economic research on the dynamics of change has been concerned with new investment, ignoring the associated process of disinvestment by firms" (p. 3).

This research predicts divestment activity to increase steadily over the next few years, especially under the present recessionary gloom. This prediction is consistent with the

10 Hayes (1972, p. 59).

11 This is summarised by Jensen (1984).
analysis of the New Zealand Institute of Economic Research that as the pressures of ongoing deregulation and deflation on the New Zealand industry mounted, "it became clear that large-scale disinvestment and rationalisation was unavoidable" [Savage and Bollard (1990), p. ix].

The purpose of this project is to study divestment as a corporate restructuring strategy. The approach taken is to survey the chief executives of leading companies listed on the New Zealand Stock Exchange concerning the motives for and factors affecting their company's divestment activities.

This project highlights the importance of divestment as an integral aspect of the corporate restructuring process. This argument is consistent with the writing of Hayes (1972), Porter (1976), Harrigan (1981), Montgomery et. al (1984), and Tuzzolino (1987) that "divestments that are part of clearly identified strategies should create more value than divestments that take place in a reactionary or piecemeal manner or divestments arising from uni-dimensional or short term performance criteria".12

1.2.1 Research Approach

In this research, divestment is investigated from three different but inter-related perspectives - industrial organisation economics; corporate strategy; and finance respectively. In particular, it explores, within the framework identified above, the following questions:

(i) From the industrial organisational perspective

What is the influence of organisational context variables, such as ownership structure, managerial risk profile, organisational life-cycle, and organisational slack on a firm's divestment decision?

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(ii) From the corporate strategy perspective

What influence do variables like general economic environmental growth, structural exit barriers, and competitive strength of divesting units have on the decision of a firm's divestment strategy formulation?

(iii) From the financial and performance perspective

Does historical context such as a firm's financial strength and performance serve as a potential discriminant of the divestment strategy of firms?

1.3 Significance of Research

It is anticipated that this dissertation will provide a guide for decisions and actions in several areas.

First, it is to be hoped that the theoretical justification coupled with empirical evidence of divestment as a corporate strategic option will provide senior managers, corporate strategists, and policy makers alike with a powerful tool for dealing with organisational and industrial restructuring as a means of adapting to change. For instance, a full understanding and appreciation of the factors which are pertinent to a company's divestment decision making will increase the efficiency with which corporate planners may select an appropriate divestment target. Without such adaptive measures, it is apparent that there can be little prospect of long-term survival for some New Zealand companies in part, and a faster economic recovery for the nation as a whole.

Second, this dissertation represents a pioneering academic investigation into the motives for, as well as the factors affecting corporate divestment in New Zealand. It draws together the available research, most of it from overseas, and enhances our current understanding on divestment by providing additional empirical evidence and theoretical
explanations on the subject. It is foreseeable that this study will generate many contestable and empirically verifiable hypotheses for future researchers.

Given that government intervention will undoubtedly impact on firms, both by affecting the costs of adjustment/restructuring as well as the initial decisions of when and how to divest, this research provides a sound foundation for policy makers to identify regulatory constraints and/or incentives which have significant implications on the performance of firms, market efficiency, and the macroeconomic development of the nation as a whole. Such an understanding is a pre-requisite in making policy decisions that are feasible and desirable under the current economic climate.

1.4 Research Overview

This study is divided into seven chapters. CHAPTER II discusses the definitions as well as the frequency and implication of divestment. Prior studies on the motives for corporate divestment are also reviewed. CHAPTER III catalogues and summarises the relevant literature from three inter-related disciplines, namely industrial organisation economics, corporate strategy, and finance, to provide a theoretical background for this study. The contributions of each discipline to the development of this research are discussed.

CHAPTER IV outlines and develops the conceptual and theoretical framework which forms the basis of this study. It discusses divestment as a corporate strategy option and presents the research model of divestment strategy, along with the factors hypothesized to influence such a decision. The research factors and their discriminatory variables are also defined.

CHAPTER V and CHAPTER VI deal solely with the empirical investigation of the motives for and factors affecting corporate divestment in New Zealand. The former
chapter presents and discusses the rationale for the various methodological choices made. Data sources and selection, along with survey procedures are also outlined. CHAPTER VI then reports the findings of the survey.

Finally, CHAPTER VII discusses the implications of this study and reviews the dissertation, its limitation and provides some future research directions and concluding remarks.
CHAPTER II DIVESTMENT - CORPORATE STRATEGY OF THE 90s

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CHAPTER II  DIVESTMENT - CORPORATE STRATEGY OF THE 90s

2.1 Introduction

The corporate strategy adopted by a company and the consequent direction of action represent its responses to the perceived current weaknesses and the expected environmental changes.\(^1\) Whilst divestment has figured among the solutions proposed by contemporary researchers for firms faced with the problem of adaptation to its changing business environment\(^2\), there has been little systematic attempt to discuss when divestment might be appropriate, the various forms it might take, and when each form might itself be appropriate.\(^3\) This is despite of the strategic significance that has been accorded to divestment as a "legitimate management tool".\(^4\) For when a corporation decides to divest its assets, product lines, subsidiaries, or divisions, it is making a strategic decision whose consequences may alter the fundamental nature of the firm and may well involve a substantial re-deployment of resources and human capital.

In view of the fact that both Australia and New Zealand are currently experiencing an upsurge in the size and scale of divestment activities as well as the expectation that divestment activity will increase steadily over the next few years\(^5\), this chapter highlights the importance of divestment as an integral aspect of corporate restructuring strategy. This

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1 See, for example, Coyne and Wright (1986), pp. 8 - 9, and Johnson and Scholes (1989).


3 One possible reason, as many writers observed, involves the reluctance on the part of management of the divesting firm to discuss the subject since that amounts to a confession of "failure" [see Hayes (1972), Gilmour (1973), Porter (1976), Bing (1978), and Taylor (1988)]. For earlier researches that propose a systematic approach to divestment, see, for example, Lovejoy (1971); and Vignola (1974).

4 Montgomery et. al (1984) explore the impact of divestment strategy on share price performance and find that divestments portrayed as the sale of unwanted units are viewed negatively. They conclude that divestment can be a useful tool of corporate strategy as long as the sale of business unit(s) can be justified as part of a cohesive strategy.

5 See, for example, the comments of Hazledine and Savage (1988), and Savage and Bollard (1990).
approach is consistent with the recent comments by the editor of the *Journal of Applied Corporate Finance* that:

The increasing number and size of stock repurchases, divestitures, spin-offs, and leveraged buyouts are bringing about striking changes in the product mix and organisational structure of American corporations .... The findings of preliminary academic research, however tentative as yet, suggest that we may be witnessing a new phase in the evolution of the public corporation into a more efficient vehicle for building and storing stockholder wealth. The stock market's initial endorsement of this restructuring also suggest that some forms of corporate organisation - most notably, the large conglomerate - may now be under serious challenge from increasingly activist investors, perhaps even in the earliest stage of obsolescence (p. 1).  

It is, however, emphasized at the outset that this research does not propose a single strategy for divestment; each firm that divests must choose the types of businesses it will focus on, the degree it will build on past strengths and competences, and the total amount of pruning and augmentation that is appropriate. To this end, this chapter is divided into four sections. Section 2.2 presents several definitions of divestment that exist in the literature and proposes the appropriate definition of divestment for the purpose of this research. Section 2.3 outlines the frequency and implication of divestments that have been observed overseas, while section 2.4 focuses on the motives for divestment. Some concluding remarks are presented in section 2.5.

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2.2 Corporate Divestment Options

Several definitions of divestment exist in the literature. To name a few, Vignola (1974) describes it as "the dispossessing, ridding, or freeing of businesses, products, plants, distribution facilities, and various other assets owned by companies" (p. v). To Lovejoy (1971), it is "the process of eliminating a portion of the enterprise and the subsequent use of the resources which are freed for some other purposes" (p. 3). Therefore, a divestment takes place "when there is a complete cessation of a part of the enterprise and the disposition of some, or all, of the facilities connected with it by sale, transfer, destruction, or gift". Gilmour (1973) sees it as the counterpart of investment choice in the resource allocation processes. And in a field study of factors influencing divestment decision-making, Duhaime and Grant (1984) define corporate divestment as "a firm's decision to dispose of a significant portion of its assets" (p. 301). Rosenfeld (1984), on the other hand, calls it "an alteration of the firm's productive asset portfolio" (p. 1437).

According to Wright and Coyne (1986), divestment is perhaps most simply described as "the sale by an organisation of one part of itself to another party" (p. 2). Nevertheless, they emphasise that while the impression given by such a definition is that severance of ownership is always complete and final, this does not provide a full description of the process. They then go on to classify various forms of divestment by the nature of the ownership severance involved, the relative frequency with which it takes place and the post-divestment ownership form for the part disposed of [see APPENDIX A].

For the purpose of this research, corporate divestment is defined as "the sale of part of the assets, product lines, subsidiaries, or divisions of a company for cash or securities or some combination thereof". The emphasis is on the development of a voluntary corporate divestment strategy in response to requirements of the competitive market-place.

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7 Lovejoy (1971), p. 3.

8 This definition is similar to that of Weston (1989), and is used in the questionnaires circulated to chief executives of leading companies listed on the New Zealand Stock Exchange, as part of the mail survey exercises - see APPENDIX M.
Seven principal types of corporate divestment are identified to be relevant to New Zealand’s business environment, namely:

(i) **Sell-off** to third parties refers to the selling of some of the assets of a parent firm, such as a subsidiary, division, or product line, to another independent firm;

(ii) **Spin-off** where a company distributes all of the ordinary shares it owns in a controlled subsidiary to its existing shareholders;

(iii) **Management buy-out** where management buys the interest in the unit divested largely with funds borrowed against the unit’s assets and cashflows;\(^9\)

(iv) **Divestment by franchising** whereby a company grants the right to produce, sell or use a developed product, service or brand to the buyers of the unit divested;

(v) **Divesting by contracting out** whereby the buyer of the unit divested obtains the contract to provide specific goods or services to the selling company;

(vi) **Asset swap** which involves exchanging some of the assets of the firm for some of those of another firm with little, if any, funds changing hands; and

(vii) **Liquidation of unit** where no buyer exists for the unit to be divested as a going-concern, and it is financially less costly to cease the operation of the unit concerned.

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All divestment options discussed above are included in the questionnaire circulated to the chief executives of leading companies listed on the New Zealand Stock Exchange [see APPENDIX M, Question 8].

2.3 The Frequency and Implication of Divestment

Prior to a review of the motives for corporate divestment, it is appropriate at this stage to focus on the frequency and implication of divestments that have been observed both overseas, mainly in the United States, and in New Zealand. In this respect, empirical study of the New Zealand experience is very limited and highly economic-oriented.\(^{10}\) Most of the studies attempt to demonstrate "the dynamic nature of any industry, noting the considerable degree of investment and disinvestment that is continually occurring amongst firms at all stages of the business life cycle, as a natural process of readjustment to changing opportunities and costs".\(^{11}\) While there have been other studies of a more sociological or geographical nature, Hazledine and Savage (1988) observe that "they are almost totally limited to discussions of plant closure rather than other forms of the disinvestment process and mainly concentrate on the effects of laid-off employees".\(^{12}\) In contrast, the studies from overseas stem from various disciplines and addresses a much wider range of issues.

\(^{10}\) See the comments of Hazledine and Savage (1988), p. 38.

\(^{11}\) Ibid, at p. 37.

\(^{12}\) Ibid. For Hazledine and Savage (1988), "disinvestment" occurs when a firm subtracts from its stock of durable assets" (p. 3), and "a firm will wish to disinvest when its desired stock of durable assets is less than its actual current stock" (p. 4). It may either involve "complete closure of a plant, firm, production line or product, or a contraction in either of these large enough to require a discrete reduction in its capital stock - human, physical and intangible" (p. 4). Although this definition is unusually wide and is ambiguous (for the meaning of "stock" and "durable" are unclear from the analysis but is crucial to the understanding of "disinvestment"), it nevertheless has the same spirit with the meaning of divestment adopted in this research. For a discussion on the sociological or geographical aspect of disinvestment in New Zealand, see Ministry of Works and Development, "Close Down: A Review of New Zealand Literature Relating to Industrial Close Downs and Mass Redundancies 1980 - 1984", 1985.
2.3.1 Evidence from Overseas

In the United States, divestments have represented a substantial fraction of the mergers and acquisition activity. Grimm's *Mergerstat Review* reported that divestments made up some 35 to 40 percent of merger and acquisition transactions in the 1980s.\(^{13}\) [See APPENDIX B] In an empirical study, Ravenscraft and Scherer (1987) estimate that 33% of acquisitions in the 1960s and 1970s were later divested, while Porter (1987) finds that:

(O)n average corporations divested more than half their acquisitions in new industries and more than 60% of their acquisitions in entirely new fields. .... The track record in unrelated acquisitions is even worse - the average divestment rate is a startling 74%. (p. 45).

When the companies are ranked by divestment ratios, Porter (1987) notes that the range is between 17 percent for the "best" corporate strategies and 87 percent for the "worst" corporate strategies, where 39 percent of the firms divesting fewer acquisitions than they kept, and 61 percent divesting more acquisitions than they kept.\(^ {14}\) What exactly defines "best" and "worst" is unclear from the study.

In the latest study of 271 large acquisitions completed between 1971 and 1982, Kaplan and Weisbach (1990, p. 1) observe that 43.9% of the acquisitions have been divested by the end of 1989.\(^ {15}\) [see APPENDIX C] Consistent with Porter (1987), this overall

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14 See also the comments of Weston (1989), and Weston, Chung and Hoag (1990), at p. 228.

15 Given that divestments were measured through the end of 1989, the authors opine that the observed frequency of divestment represents a lower bound on the total number that will eventually be divested (p. 8). However, they find that the percentage of acquisitions divested varies only slightly with age: 47% of the acquisitions before 1978, 44% of the acquisitions between 1978 and 1979, and only 40% of the acquisitions from 1980 to 1982 have been divested. This pattern above suggests that additional acquisitions, particularly those completed in the early 1980s, will be divested, but the number probably will not be large.
divestment rate is somewhat higher than the 33% estimated by Ravenscraft and Scherer (1987).\textsuperscript{16}

Selected researchers hold that such a high rate of divestment activity is the conclusive evidence of the failure of acquisition and diversification efforts.\textsuperscript{17} This view has been expressed strongly by Porter (1987), as follows:

The track record of corporate strategies has been dismal. I studied the diversification records of 33 large, prestigious U. S. companies over the 1950 - 1986 period and found that most of them have divested many more acquisitions than they had kept. The corporate strategies of most companies have dissipated instead of created shareholder value (p. 43).

However, the view of divestment as failure is not widely shared among researchers. Weston (1989) and Weston, Chung and Hoag (1990) have criticised Porter who characterised his findings as "startling" and "sobering". Given that Porter's sample of 33 companies were relatively mature and they made an average of 115 entries into new businesses and/or products per company during the 1950 - 1986 period as well as constituting somewhat over three new entries per year, Weston (1989) and Weston et al. (1990) argue that those companies were thus "far from passive in coping with the challenges of almost four decades of economic change" (p. 71). According to the authors,

\textsuperscript{16} In the light of such high divestment rates, the authors named above question the typical even-study results that the combined stock market return to acquirer and target shareholders is positive [see, for example, Bradley, Desai and Kim (1988), and Jensen and Ruback (1983)]. In fact, Scherer (1988) concludes that "... the implications of event studies have been contradicted by historical evidence" (p. 71). See Bradley, M., A. Desai and E. Kim, "Synergistic Gains from Corporate Acquisitions and Their Division between the Shareholders of Target and Acquiring Firms", Journal of Financial Economics, Vol. 21, pp. 3 - 40; Jensen, M. and R. Ruback, "The Market for Corporate Control: The Scientific Evidence", Journal of Financial Economics, Vol. 11, pp. 5 - 50; and Scherer, F. M., "Corporate Takeovers: The Evidence Arguments", Journal of Economics Perspectives, Vol. 2, pp. 69 - 82.

\textsuperscript{17} See, for example, Porter (1987), and Ravenscraft and Scherer (1987).
Porter's data "could with equal plausibility be attributed to a vigorous and profitable interaction between corporate strategies and shifting market forces" (p. 71).18

In addition, the results of Kaplan and Weisbach (1990, p. 2) suggest that many divested acquisitions were not failures, ex post. Only 44% of the acquirers, who report an accounting result for the divestment, report a loss on sale, while 42% report a gain on sale; and 14% report that gain or loss is immaterial. Similarly, when the authors compare a sale price to a purchase price for a unit divested, they find that most units are sold for more than they cost: targets are divested at 192% of their purchase price, which when adjusted for the increase in the S&P 500 index over the same period equals 90% of their purchase price19, and 143% of their market value before the initial takeover announcement (p. 2). The authors accordingly interpret their findings as consistent with event-study findings of small negative returns to acquirers and positive combined returns to acquirers and targets.20

Weston (1989) also argues that acquirers may divest targets for a number of reasons which do not involve poor performance on the part of the latter. For instance, an acquirer may divest a business it has improved or a business that once had synergies with the acquirer's core business but no longer does. In this case, both the original acquisition and the subsequent divestment could have increased shareholder value. In actual fact, this view is confirmed by the empirical studies which find significantly positive share price movement to divestment announcements [See section 3.4 of this research].

Alternatively, Kaplan and Weisbach (1990, p. 1) hypothesize that the relaxed antitrust enforcement and financial innovations experienced in the US in the 1980s could have made possible some business combinations that were not viable previously. Shleifer and Vishny

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18 Weston (1989) and Weston et al. (1990) then outline some fundamental weaknesses in Porter's analysis. See Weston (1989), pp. 71 - 72; and Weston et al. (1990), pp. 229 - 230.

19 Although adjusted sale price is negative, the authors opine that it is apparently not failure as suggested by previous work (p. 27).

20 See, for example, Bradley, Desai and Kim (1988), and Jensen and Ruback (1983).
(1990), on the other hand, observe that the high divestment rates during the 1980s in the US were due to the fact that "some acquisitions that led to a relatively efficient allocation of resources in the 1970s may no longer have been efficient in the 1980s when sales to related buyers or leveraged buyouts became feasible".21

2.3.2 Evidence from New Zealand

As mentioned, there is relatively little material available on the incidence of divestment in New Zealand.22 In a recent study on the access to essential facilities in New Zealand, the Ministry of Commerce has expressed its concern that "there is a general lack of sound information on the relative costs and benefits of divestiture".23 This is in addition to the comments by the New Zealand Institute of Economic Research (NZIER) that "the major constraint on testing models of divestment behaviour in New Zealand is the absence of a good quality time series on either firm entry and exit or gross investment behaviour" (Hazledine and Savage (1988), p. 24). Although statistical materials such as the production censuses and the NZIER Quarterly Survey of Business Opinion are publicly available, these publications "are of little help because they treat investment in aggregate terms,


netting out key evidence of disinvestment in an industry and disguising the mechanics of the disinvestment process".24

By utilising the Department of Labour's "CARB" data from 1980 to 1984, Bollard and Harper (1985) rank the manufacturing industries they examined from the highest to lowest exit rate. [See APPENDIX D] Over the period covered, the average exit rates, which amounts to 5.8%, are higher than the average entry rates of only 4.3%. However, the explanation for such a difference and the degree of correlation between the entry and exit rates were not provided for by the authors.

In interpreting the ranking provided by Bollard and Harper with regard to the existence of exit barriers, Hazledine and Savage (1988) observe that "a few of the rankings appear unusual, especially that of the industrial chemicals" (p. 25). They suggest the high exit rate in the industrial chemicals sector as possibly relating to the fact that "in New Zealand this sector is dominated by the production of fertilisers and basic industrial chemicals which (perhaps) have a high imported content and involve relatively unsophisticated production techniques" (p. 25). With respect to the high exit rate observed in the transport equipment sector, they suggest that "this probably reflects the high proportion of establishments in the sector which are boatyards (exactly half of all establishments in the sector) many of which are likely to be small, labour intensive operations; while the high ranking of the iron and steel industries are suggested to be related to "the very small size of the sample for that industry" (p. 25).

Hazledine and Savage then update the Bollard and Harper work to show the actual change in the number of establishments between February 1980 and February 1987. The industries are also sorted on the basis of the Bollard and Harper exit rate. [See APPENDIX E] It was shown that the clothing industry has the highest absolute reduction in the net number of establishments while the "other non-metals" sector has the highest percentage reduction. What is included in the "other non-metals" sector is unclear.

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It is apparent from the discussion above that the limited studies on divestment in New Zealand to date are "purely economic", highly industry-specific\textsuperscript{25}, and topical (i.e. they focus mainly on the structural adjustment adopted by firms as a result of, say, regulatory changes and the corresponding non-price signals to industry). Most findings in these studies are inconclusive and ambiguous, owing to the limited amount of data, and poor quality of the proxies used. For example, in Bollard and Harper (1985) and Hazledine and Savage (1988), the proxy for investment and in turn disinvestment is "employment", which Hazledine and Savage themselves admit as "not very satisfactory in analytical terms" (p. 37).

To summarise, the high divestment rates observed, both overseas and in New Zealand, and the divestment/acquisition ratios analyses, do not provide unambiguous evidence on the success or failure of corporate strategies. Although some divestments no doubt represent efforts to correct previous acquisition mistakes, many others could equally reflect modifications of initially good strategic decisions that required adjustments in response to changes in the external environment. Thus, the increased popularity of divestment lately highlights its importance as a means of allowing firms to follow their perceived comparative advantages and to move corporate resources to higher valued uses or more efficient users.\textsuperscript{26}

\textsuperscript{25} For a summary of industry-specific studies of structural adjustment involving disinvestment, see ibid, pp. 38 - 41.

\textsuperscript{26} Weston (1989), p. 76.
2.4 The Motives for Corporate Divestment

A divestment decision is usually a complex and yet delicate process. 27 Describing it requires, on one hand, delving into the motives (or reasons) for the divestment, and, on the other hand, examining the factors affecting the decisions to divest. This section focuses on the motives for corporate divestment observed by overseas researchers, while Chapter IV discusses the relevant factors affecting divestment decisions of firms.

Weston (1989) observes that "like the circumstances besetting firms at different times in different industries, the motives for divestment activity are many and diverse" (p. 69). He offers a short list of motives for divestment, which are discussed below in fair detail in conjunction with the findings of various researchers. 28 However, it is important to emphasize at the outset that the motives discussed below are not mutually exclusive but in some cases are interrelated, and more than one motive is usually involved in a divestment decision.

2.4.1 Dismantling conglomerates

In the US, the 1960s and early 1970s saw the height of conglomerate merger activity. 29 In this respect, New Zealand's experience is somewhat 15 years delayed where, comparing the 1972-1977 with the 1984-1989 period, Feil (1990) finds that "the proportion of conglomerate mergers rose by in excess of 100 percent" (p. 31). 30 This phenomenon in part represented the prevailing philosophy at that time that an organisation could develop and expand simply by adding new businesses (i.e. through

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27 For example, Taylor (1988) describes divestment as "a delicate process involving complex issues of employees, customers, competitors, suppliers, intermediaries, and usually a lot of money" (p. xiv).

28 Weston (1989) outlines 14 motives for divestment. Some of the motives have been combined in this discussion as they are not, in some cases, mutually exclusive but are inter-related.

29 See, for example, the comments of Hayes (1972), Schmidt (1990), Kaplan and Weisbach (1990).

30 Feil (1990) then interprets his results as consistent with a move away from a focus on a single business area to greater diversification of business operations (p. 31).
external acquisition rather than internal growth)\textsuperscript{31}, and that general managerial capabilities could be profitably transferred to diverse businesses.\textsuperscript{32} However, this preoccupation with diversification and extension came under much criticism in the 1980s and 1990s. Porter (1985) argues that portfolio management ideas have become less relevant as global competition trends have led to a shift away from "growth" to "improving competitive and technological advantages". This has in turn led to a proliferation of business inter-relationships. Aside from the impact of these environmental changes, the emphasis of diversification ignores the need of diversified firms "to rethink and recombine the accumulated results of previous expansion, integration, and diversification".\textsuperscript{33} As Mintzberg (1989) observes, adding all this "strategic baggage" over time leads many organisations to "lose a sense of themselves", and thus "periodic house-cleaning" should involve "not just throwing out the junk, but also rethinking and recombining what is left behind" (p. 55).

This observation is supported by the many conglomerate mergers that have proven to be inefficient combinations over time. Under these circumstances, divestment has thus been used "to reduce the number and diversity of activities that had been assembled in firms" [Weston (1989), p. 69]. Sicherman (1986) observes that "many conglomerates are now feeding a divestiture wave by selling unrelated businesses and

\textsuperscript{31} See, for example, Mintzberg, H., "Generic Strategies: Toward a Comprehensive Framework", in Lamb, R. and P. Shrivastava (eds.), "Advances in Strategic Management", Greenwich, CT: JAI Press, Vol. 5, 1989, pp. 1 - 68. According to Bhide (1989), the most obvious advantages of a diversified firm include (1) the potential for reducing corporate tax (where a company can transfer funds from units with excess cash to units facing cash deficits without the tax payment that might result if the transfer were to be made between two independent companies); (2) a reduction of the consolidated entity's "unsystematic risks"; (3) a reduction of "human capital costs" where the skills and experience of employees can be readily transferred from one unit to another; and (4) greater promotion opportunities and job security for staff as well as investment security for suppliers, customers and shareholders. See, Bhide, A., "Reversing Corporate Diversification", Journal of Corporate Finance, 1989, pp. 70 - 81.


restructuring to concentrate on managerial strength" (p. 3). Montgomery et al. (1984) add that these type of divestments are not usually linked to specific strategic aims of a company, but are often described only in financial terms, without affecting the integrity or direction of the firm as a whole (p. 833). For Gilmour (1973), "the changes toward a greater reliance on hard, profit centre data for measurement of performance (in both the conglomerate and diversified companies) would seem to make it easier to make divestment decisions than it is for the centrally managed company" (p. 4).

2.4.2 Abandoning core business

Weston (1989) sees the sale by a company of its core business to be attributed to changing opportunities or circumstances, rather than as a result of diversification mistake. It may represent the harvesting of successful investments stimulated by favourable market conditions. The purpose is, thus, to make financial and managerial resources available for developing other opportunities. However, the exact opposite interpretation is possible when a company is in dire need of cash for survival [see section 2.4.5 below]. Since the core business or the most desirable parts of the firm normally will bring about the most cash, the sale of these unit(s) may be necessary to save the remaining parts of the firm. In addition, management may decide to sell off desirable businesses, or a part of the firm that has great potential for future years, but which the firm does not currently have the resources to develop [Lovejoy (1971), p. 57].

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34 This is based on the value-additivity principle which hypothesizes that pure conglomeration does not enhance shareholder wealth due to shareholder’s ability to diversify themselves via security markets. See, for example, Myers, S., "Procedures for Capital Budgeting under Uncertainty", *Industrial Management Review*, Spring 1968, pp. 1 - 20.
2.4.3 Changing strategies or restructuring

Divestment may occur as a result of changing technology or market conditions which require a major restructuring of corporate assets. For the 1990s, an emerging industrial trend is for businesses to focus on core concerns. In this respect, Hearth and Zaima (1984) find that the most commonly stated reason is "to divest in order to concentrate on major lines of operation" (p. 15). By divesting operations that are no longer comparable with the long term strategic plans of the firm, management can strengthen its organisation to pursue strategic initiatives. Clarke and Gall (1987) see the divestment of inappropriate businesses in many cases as representing the foundation stone of a good strategy (p. 17). They add that divestment is often crucial in generating funds for further strategic acquisitions or investment and is therefore an integral part of any successful strategy.

2.4.4 Discarding undesirable/unprofitable businesses

In some cases, management cited the "lack of fit" between the parent and subsidiary as the reason for trimming operations to a narrower set of activities, or that the discarded businesses was experiencing poor operating results. According to Anklesaria and Rivetti (1987), "divestment should be the logical consequence when the purpose for investment cannot be fulfilled" (p. 17). In a field study which investigates factors that influenced the corporate divestment decisions of 40 large diversified firms, Duhaime and Grant (1984) find that poor relative performance of the divesting firm in comparison with its industry counterparts and unprofitability of the unit(s) divested are important influences on a firm's decision to divest (pp. 302 and 313). This finding is consistent with the results of earlier research by Vignola (1974) which supports the notion that the primary factor in divestment decisions is the unfavourable performance of the firm's divested units.

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35 See, for example, Peters (1988).


37 This finding is consistent with an earlier observation of Schendel and Patton (1976) that unexpected poor performance and sharply declining stagnation are needed to "spur a firm into action" and that the turnaround of firms in decline "usually requires substantial changes in the business", where divestment of a division or business unit is one such substantial change (p. 240). See Schendel, D. E. and G. R. Patton, "Corporate Stagnation and Turnaround", Journal of Economics and Business, Vol. 28, Spring-Summer 1976, pp. 236 - 241.
On the other hand, some companies may engage in divestment to channel their resources into activities that will provide higher return on investment. In order to bring this about, management must undertake a conscious search for those unit(s) which do not have the potential to provide rates of return comparable to those that could be attained if the company were to shift its resources to other users. However, as Lovejoy (1971) comments, this does not necessarily mean that the company is currently inefficient in its operation of those lower potential unit(s), but that these businesses cannot in actual fact fulfil the objectives set for the firm and as a result they become divestment candidates (p. 57).

The same scenario has also been observed by Alexander et. al (1984, pp. 508-9), Rosenfeld (1984, p. 1438), and Hite et al. (1987, p. 232).

2.4.5 Selling in response to liquidity concerns

Divestment may in some cases be motivated by corporate liquidity problems - bankruptcy, financial distress, or an extended period of losses. Unforeseen circumstances such as poorer than expected earnings or cash flows could create financial problems for a corporation. Among the many possible alternatives, one obvious remedy for the management to improve the financial position of the firm is to sell off some of the assets (and to repay some debt). This motive has also been discussed by Lovejoy (1971, p. 57 - 58), Alexander et. al (1984, pp. 508-9), Rosenfeld (1984, p. 1438), Jain (1985, p. 210), and Hite at al. (1987, p. 232 - 233).

2.4.6 Warding off takeovers

Divestment can function as a takeover defense by removing the "crown jewel" that attracted a takeover threat. For example, a target company can transfer or sell off its crown jewels to a white knight or a new company formed by the target company for the sole purpose of receiving the assets. Alternatively, a target company may acquire additional cash (by selling off liquid assets) to engage in some relatively expensive defenses, e.g. poison pill and "pac man" defenses.

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38 See, for example, the comments of Jain (1985).

39 For a detail discussion on takeover defenses, see chapter 20, Weston, Chung and Hoag (1990), pp. 481 - 529.
2.4.7 Forced divestment

Divestment is a common requirement for obtaining government or regulatory body's approval of a business combination. In New Zealand, section 69A of the Commerce Amendment Act 1990 enables the Commerce Commission to accept written undertakings given by applicants to a merger or takeover to divest of shares or assets specified in the undertaking, which forms part of the clearance or authorisation requirements. This situation arises if the Commission considers a merger proposal to be contrary to the public interest but acceptable if amended in accordance with the undertaking. Concurrently, if the court is satisfied that the parties to a merger or takeover whose share or assets in question have contravened section 47 of the Act\textsuperscript{40}, it may make an order giving directions for divestment of the shares or assets [see sec 85 (1) Commerce Act 1986]. \textsuperscript{41}

The motives for divestment discussed above have been widely identified by overseas researchers, and are not meant to be exhaustive. Many other scenarios probably exist but they are either incorporated in the motives discussed above whenever appropriate or omitted for lack of general acceptance. Examples in the latter category include the wealth transfer explanation\textsuperscript{42}, relaxed regulatory constraints\textsuperscript{43}, improvement of management

\textsuperscript{40} Section 47 of the Commerce Act 1986 prohibits the acquisition of a business or shares if, as a result of the acquisition, any person would be, or would be likely to be, in a dominant position in a market, or the dominant position of any person would be, or would likely to be, strengthened.

\textsuperscript{41} For a detail discussion on this topic, see van Roy, Y., "Guidebook to New Zealand Competition Laws", CCH New Zealand Limited, 1991.

\textsuperscript{42} Miles and Rosenfeld (1983, p. 1598), Schipper and Smith (1983), and Jain (1985) argue that sell-off may be motivated by a desire to transfer wealth. This can be achieved by paying dividends to ordinary shareholders from the proceeds of the sale of assets. Since this effectively reduces the probable payments to bondholders, it results in a transfer of wealth from bondholders to shareholders if the value of the firm is assumed to be unchanged (p. 211). Galai and Masulis (1976) describe the manner in which wealth may be transferred from bondholders to stockholders upon a spin-off:

"The conventional procedure is to take a portion of a firm's assets, often a division relatively unrelated to the remaining operations of the firm, and create a legally independent firm with these assets. The crucial facet of the procedure hinges on distributing the shares of the new equity solely to the stockholders of the parent corporation. In effect, the stockholders have 'stolen away' a portion of the bondholders' collateral since they no longer have any claim on the assets of the new firm" (p. 69, emphasis in original).

\textsuperscript{43} Kaplan and Weisbach (1990) postulate that relaxed antitrust enforcement and financial innovations experienced in the US in the 1980s made possible some business combinations that were not viable
efficiency\textsuperscript{44}, management incentives hypothesis\textsuperscript{45}, information effects\textsuperscript{46}, market spanning hypothesis\textsuperscript{47}, and elimination of negative synergy\textsuperscript{48}.

The findings of selected researchers on motivation for divestment are included in APPENDIX F for completion purposes.

2.5 Conclusion

This chapter has set the foundation for further analyses and discussions in the following chapters. It highlights the importance of divestment as an integral aspect of the strategic plans of all corporations, particularly in adapting to challenges posed by the current

\textsuperscript{44} Schipper and Smith (1983) find that reducing the size and diversity of the asset base under a given management, through the separation of management of the parent and subsidiary, improves managers' productivity and efficiency, as well as increases their efforts to direct resources effectively (p. 448).

\textsuperscript{45} Weston et. al (1990, p. 237) observes that "bureaucratization of management and consolidation of financial statements can stifle entrepreneurial spirit and result in good (bad) performance going unrewarded (punished)". Therefore, divestment has the advantage of an independent share price directly reflecting the market's response to management actions of both parent and subsidiary companies, and more closely linking compensation to performance.

\textsuperscript{46} According to Weston et. al (1990, p. 236), the information hypothesis holds that the true value of subsidiary assets is obscured by the complexity of the business structure in which they are embedded. The supposed stock market preference for "pure-play" or single-industry securities is cited in support of this hypothesis. To the extent that divestment enhances the incentive to gather and analyse a greater amount of publicly available information through the creation of new publicly-traded securities, information effect may explain at least part of the gains from divestment (p. 236).

\textsuperscript{47} According to Weston et. al (1990, p. 238), another theoretical explanation of the motivation for divestment is related to "financial market spanning" or whether financial markets are complete. To the extent that financial markets may be incomplete, divestment increases the number of securities for a given number of possible states of the world. In addition, the opportunity set with respect to investment and financial policies of the parent and its divisions will be expanded. For instance, the parent and the divested subsidiaries may provide investors with a wider range of different investment policies and financial policies, and may package dividends, retained earnings, and capital gains possibilities in different proportions to appeal to different investor clienteles (p. 238).

\textsuperscript{48} Miles and Rosenfeld (1983) argue that insofar as management is unable to replicate the role of financial markets and to eliminate negative synergies that exist in the firm, capital may be misallocated and a divestment, by improving investment decisions, may be value increasing (p. 1598).
recessionary economic climate. Most of the discussions are based on research findings and experiences from overseas, mainly the United States, as the Australasian empirical analysis on the subject is lacking. In this respect, the discussions above provide guidance as to the likely future direction and strategies of New Zealand companies, where New Zealand may learn from changes that have been undertaken by their US counterparts.

In summary, the high level of divestments that have been observed both overseas and recently in New Zealand is interpreted as portraying a healthy and dynamic interplay between the strategic planning of companies and continually changing market forces. It reflects continuing efforts by companies to adjust to changing economic and political environments [Weston 1989, p. 69]. From the corporate strategy perspective, it is an important means of allowing firms to follow their perceived comparative advantages and succeeds in moving corporate resources to higher valued uses or more efficient users; and, as a result, overall corporate efficiency and economic welfare increases.49 Although some divestments inevitably represent efforts to correct previous managerial decisions, many others reflect modifications of an initially good strategy that requires adjustments in response to changes in the external environment. In this respect, the observation of Weston (1989) is particularly apt:

(T)he persistently high numbers and values of (divestment) transactions constitute reliable evidence that the market system is working, ensuring the mobility of resources essential to the effective operation of an enterprise economy (p. 76).

49 Weston (1989), p. 76.
CHAPTER III  LITERATURE REVIEW

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CHAPTER III  LITERATURE REVIEW

3.1 Introduction

Corporate divestment may be viewed from numerous perspectives. In this research, it is investigated from three different but inter-related perspectives - organisation, specifically the economics of industrial organisation; corporate strategy; and finance. Each of these literatures has provided some preliminary guide-lines for addressing corporate divestment strategy issues. It is anticipated that the wider theoretical context of this research will improve our current understanding of organisational responses to the rapidly changing and uncertain business environment, and provide us with more thorough explanations for the popularity of divestment as an integral aspect of the corporate restructuring process.

In section 3.2 the contribution of industrial organisation literature on the nature of divestment is reviewed. The focus is on the "internal structure and organisation" of firms and how these factors affects divestment decision making. From the corporate strategy perspective discussed in section 3.3, the emphasis is on how external environmental factors may influence a firm's divestment strategy formulation. Finally, finance literature covered in section 3.4 provides some useful insights into the relevance of performance criteria, profitability, and financial health in an entity's divestment decisions. Some concluding remarks are included in section 3.5. However, it is important to emphasise at the outset that the purpose of this chapter is not to pass judgement on the relevant literature's normative correctness or descriptive perfection, but to explain divestment in a wider theoretical perspective than the previous research.
3.2 Divestment and Industrial Organisation Economics

Industrial organisation literature (hereafter referred to as "IO") has made considerable contribution to the nature of divestment and the factors which affect it, particularly in relation to asset specificity and the way it affects firm and industry structure.\(^1\) For the purpose of this research, this section focuses on the "internal structure" and "organisation" of firms and how these firm-specific factors affect firms' divestment decisions\(^2\).

In a study on rationalization patterns of New Zealand firms\(^3\), Savage and Hazledine (1990) identify a number of factors that affect rationalization at the firm level, namely:

(i) the nature of the firm's assets;
(ii) management objectives and control;
(iii) the structure of the firm; and
(iv) the costs of adjustment (p. 11).

The authors add that out of all these factors, "it is the first which is probably most important" (p. 11). Their findings are consistent with that of Porter (1976) where three broad classes of exit barrier have been identified, namely:

\(^1\) It is appropriate to point out at this stage that the common framework of analysis in industrial organisation is called the structure-conduct-performance approach in which one studies the inter-relationships between structure, conduct, and performance, often assuming that structure determines conduct, which in turn determines performance. To quote from Caves (1967), "market structure is important because the structure determines the behavior of firms in the industry and that behavior in turn determines the quality of industries performance" (p. 16). The initial impetus to study industrial organisation came from Harvard University in the late 1930s. Since then, industrial organisation has been approached under different methodologies, and the types of topics studied have also been expanded. Since this research focuses on the "internal structure" and 'organisation" of firms, the studies by Oliver Williamson, Michael Caves, Michael Porter, and others are relevant. See, for example, Caves, R., "American Industry: Structure, Conduct, and Performance", 2nd ed., Englewood Cliffs, N. J.:Prentice-Hall, 1976; Caves, R. E. and M. E. Porter, "Barriers to exit", in Qualls, D. P. and R. T. Masson, eds., Essays in industrial organisation in honor of Joe Bain, Cambridge:Ballinger, 1976; Harrigan, K. R., "Strategic Flexibility", in Thomas, L. G., ed., The economics of strategic planning, Cambridge: Ballinger, 1986; M. Marcus, "Firms' exit rates and their determinants", Journal of Industrial Economics, Vol. 16, 1967, pp. 10 - 22; Williamson, O. E., "Markets and Hierarchies: Analysis and Antitrust Implication", Free Press: N. Y., 1975; and Williamson, O. E., "The Economic Institutions of Capitalism", Free Press: N. Y., 1985.

\(^2\) This approach is consistent with the analysis on "determinants of rationalization patterns" in New Zealand by Savage and Hazledine (1990), and the analysis on "factors affecting the ease of disinvestment by New Zealand firms" by Hazledine and Savage (1988).

\(^3\) Rationalisation is defined by the authors as "the way in which a substandard firm makes a deliberate move to improve its performance" [Savage and Bollard (1990), p. 1].
(i) *Structural (or economic) exit barriers* which are characteristics of the technology and the fixed and working capital of a business which impede exit⁴;

(ii) *Corporate strategy exit barriers* which are the relationships between a business and other businesses in the company, as a result of a company's corporate strategy, that deter exit⁵; and

(iii) *Managerial exit barriers* which refer to aspects of a company's decision-making process itself that inhibit exit from unprofitable businesses⁶ (p. 21).

The relevant industrial organisation literature which has been concerned with the four factors identified by Savage and Hazledine above is discussed accordingly.

### 3.2.1 The nature of the assets

As Savage and Hazledine (1990), and Hazledine and Savage (1988) observe, a major theme in IO research is that of "asset specificity" and the way it affects firm and industry structure and behaviour. This approach is taken by Williamson (1975, and 1985), in particular, as his central focus in distinguishing between assets which have value to one

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⁴ Examples of structural exit barriers include *durable* and *specific* assets: the more durable the assets are, the more specific they are to the particular industry, the particular company or the particular location, the less likely it will pay to sell off or shut down an unprofitable business, and the larger the immediate loss the firm will face if it shuts down the business [Porter (1976), p. 22]. In general, the presence of high economic exit barriers would deter firms' timely exits and result in high opportunity costs being incurred [Harrigan (1981), p. 307].

For a detail discussion on durable and specific assets, see Caves and Porter (1976).

⁵ Certain kind of corporate strategy choices can place companies in situations where it pays for them to stay in a business even when the business is earning a chronically unsatisfactory rate of return on investment. For instance, the more complementary or linked the business is to other businesses in the company (i.e. inter-relatedness), the less likely will it be economically justified to sell or shut down the business, and the larger the immediate losses the firm will face if it does so [Porter (1976), p. 23].

⁶ Porter (1976) identified two types of managerial exit barriers: *information-related* (i.e. information needed for divestment decision is seldom routinely collected and thus is expensive to secure) and *conflicting goals* barriers. For example, Hillman (1971) argues that the lack of appropriate data in accounting reports is an important reason why firms fail to exit from businesses that are part of a vertical chain.
(or a few) firm(s) and those which are "fungible", i.e. have some market value. Using Williamson's terminology, four types of asset specificity can be identified: (1) site specificity (i.e. immobile assets, for example, forests or gold mines), (2) physical specificity (e.g. geographical location), (3) human asset specificity (e.g. firm specific skills), and (4) dedicated assets (e.g. assets tailored to meet the requirements of a particular customer).

With regard to divestment, asset specificity may impede the ability of a firm to exit - the "lumpiness" of assets deter exit. This is usually referred to as barrier to exit. Gilbert (1989) defines exit barriers as "the costs or forgone profits that a firm must bear if it leaves an industry", and notes that "exit barriers exist if a firm cannot move its capital into another activity and earn at least as large a return" (p. 520).

Traditionally, IO literature focuses on barriers to entry rather than exit. It was not until Caves and Porter (1976, 1977) that exit barriers were linked to entry barriers. The authors assume barriers to exit as an element of market structure and hence an "ex ante determinant of market conduct and (thereby) performance" because of "their power to inflict persistently subnormal profits" (1976, p. 39 - 40). They observe that the source of exit barriers are "inputs that can become attached to the firm and then command persistently low earnings because they are durable and specific to an activity of the

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8 Gilbert takes severance fees (i.e. redundancy payments) and sunk capital expenditures as likely to contribute to exit barriers.

9 For example, the early work of Bain (1956) observes that "lumpiness" of assets deters entry i.e. by increasing the scale at which firms must operate, a firm can thus increase the impact on industry profitability and discourage entry by a new firm. See Bain, J. S., "Barriers to New Competition, Their Character and Consequences in Manufacturing Industries", Harvard University Press: Cambridge, Massachusetts, 1956.

10 This approach departs from the traditional study of barriers to exit where they are treated as a normative and ex post problem [Caves and Porter (1976), p. 39].
company" (p. 40, emphasis in original). In other words, for an exit barrier to exist, "firms must own assets which are not only specific but also durable". In this respect, Savage and Hazledine (1990) note "if assets are non-durable, then a firm wishing to disinvest will soon be in a position to revise all its input choices as its assets depreciate quickly away. If assets are non-specific, then there will exist a "thick" market on which they can be disposed at their replacement cost. A durable specific asset is one which the firm cannot dispose of quickly at a price matching the value of the inputs required to produce that asset" (p. 12).

In addition to the traditional image of a durable and specific asset (which is typically characterised as a piece of long-lived fixed equipment that is indivisible once installed and specialised to a single output), Caves and Porter (1976) draw our attention to intangible assets which they assert "can be specific and durable and proven even more difficult for a firm to divest" (p. 40). They argue that "impacted information deters the marketing of intangibles because of the difficulty of measuring their output of services, and they are probably often inseparable from the equity (goodwill) of the firm that produced or developed them" (p. 41). They observe that goodwill, for example, is firm and industry specific, and has no expected salvage value for the entrant; "although goodwill assets can be transferred from firm to firm, an unsuccessful firm is unlikely to command a market value for its goodwill asset that will yield a normal return on the investment imputable to that asset" (p. 45). Therefore the entry cost involving expenditure on goodwill assets exposes the firm to a high risk of loss if it must exit; it specifically comprises a barrier to exit (p. 45). Tangibles, on the other hand, do not generally share the same problem.

Caves and Porter then examine the relationship between the structural bases of exit barriers and the sources of barriers of entry, which they note to be interconnected in two ways - technological factors that impede entry are likely to impede exit as well, and actions that going firms can take to deter entry also stay their own departure from the

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market. They further illustrate that each source of entry barriers identified by Bain (1956) can also erect a barrier to exit by a going firm. For example, absolute cost advantages accrued to going firms because they possess some specific resource that would cost the entrant more to acquire than its opportunity cost for the going firm. To fill this requirement, the resource must be at least temporarily specific to the industry and it is unlikely that these assets are scarce without also being durable. Therefore, going firms that enjoy an absolute cost advantage over entrants also find themselves owning durable-specific assets that could comprise barriers to their exit (p. 44 - 45).

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13 The authors then relate their findings to the normative significance of exit barriers where two classes of welfare issues can be raised: (1) Ex ante barriers to exit are a source of social risk in decisions about resource allocation (i.e. they postulate that the cost of that risk cannot be avoided, though it can incurred more or less efficiently); and (2) Ex post exit barriers can generate problems of income distribution and equity when durable and specific assets are truly sunk in their unremonerative uses.
Harrigan (1981) has also explored the relative importance of various factors upon the likelihood that a firm would divest its declining business units. In studying the exit decisions of 61 firms that competed in 8 declining businesses during 1965 - 1978, she finds that the presence of high economic exit barriers, consisting of *durable and specific assets*, could be a highly significant influence on behavioural outcomes by decreasing the likelihood of an early exit (p. 322). The implications of her study suggest that firms will want to plan their exits at the time of entry into a business. Given the short life cycles for new products, it is after all not unreasonable to make provisions for the efficient removal of excessive capital from low or negative growth businesses when contemplating investment.

Alternatively, Shapiro and Khemani (1987) examine the symmetrical relationship between entry and exit barriers by using Canadian cross-section data for 143 manufacturing industries over the period 1972-1976. When the displacing effects of entry are ignored (i.e. that entry causes exit), the authors find a considerable degree of symmetry between barriers to entry and barriers to exit. They conclude that, in general, both entry and exit are deterred in industries where the minimum efficient plant size and its associated capital requirements are high and where multi-plant firms are prevalent (p. 25). That is, mobility is most restricted in industries with large plants and large firms (p. 25). On the other hand, when displacement is considered, the extent of observed symmetry is reduced and only the presence of multi-plant firms deters exit, ceteris paribus. Their results indicate that a lot of exit decisions are in fact the result of displacement.

It is significant that these results are consistent with an earlier finding by Eaton and Lipsey (1980) that "barriers to exit are barriers to entry" (p. 728). According to Shapiro and Khemani (1987), investments in durable and specific assets deter entry by signalling a credible *ex ante* commitment by incumbents to stay in the market. If entry is deterred, exit

is also deterred, *ex post*, because displacement is not possible, and this is illustrated by the high positive correlation between entry and exit across industries as barriers to entry restrict displacement and exit (p. 25).

A related finding is that of MacDonald (1986) who uses the data of 46 US manufacturing industries, and finds large capital commitments reduce both entry and exit rates. Similarly Hamilton (1985) improves on an earlier work by Henderson (1980) to examine the industry closure rates in Scotland by applying "a neo-classical approach to all sizes and types of business" in 65 narrowly-defined manufacturing industries between 1977-1979.\(^\text{15}\) He finds weak evidence of labour intensity (measured by wages plus salaries as a percentage of industry net output), industry growth (measured by the percentage change in employment), and entry rate being related to industry closure rate, particularly for independent businesses. Despite the finding that these coefficients are statistically significant at 95 percent level on one-tail tests, more than 80 percent of the inter-industry variation in closure rates remains unexplained in the study, as illustrated by the low adjusted R\(^2\) of less than 0.2 (pp. 340 - 341).

Perhaps the more interesting application of barriers to exit analyses relates to multi-market interactions. As Gilbert (1989) observes, exit costs depend on a firm's opportunities to move capital into alternative markets. Given that many firms operate in several markets that have similar production technologies and share the benefits of the firm's marketing experience and goodwill, Gilbert argues that "a firm in such a multi-product environment has relatively low barriers to the movement of capital from one market to another" (p. 521). In other words, barriers to exit are low for firms operating in multi-markets that share similar production technologies and in turn benefit from economies of scale. Under such circumstances, Judd (1985) argues that entry should be relatively easy.\(^\text{16}\) That is, as Gilbert (1989) illustrates, "head-on competition with a new entrant reduces an incumbent


firm's profit both in the market where entry occurred and in markets for substitute goods where the incumbent may operate. By leaving the market where the incumbent will compete head-on with the new firm, it can raise profits both in the entry market and in the markets for substitute goods. Therefore anticipating this incentive for exit by the incumbent, a potential rival would be encouraged to enter the incumbent's market" (p. 521). Judd's model is thus a good example of the general proposition in Fudenberg and Tirole (1984) and Bulow et al. (1985) that "strategic behaviour in a particular market is shaped by the competitive effects in related markets" [Gilbert (1989), p. 521].17 This analysis explains, at least theoretically, the incidence of firms exit from a particular market "for strategic reasons".18

As for New Zealand, there is little work which focuses specifically on entry and exit barriers. However, it is worth noting that with respect to the nature of labour input, Savage (1988) distinguishes between "internal" (e.g. rearrangement of jobs, reduction of perquisite, or lower salary) and "external" adjustment methods. He finds that depending on the specificity of human capital invested in workers, firms will utilise a variety of internal methods of adjustment to avoid laying off high valued staff.19 Thus his study may be interpreted as providing some indirect evidence of divestment as "the eventual, observable outcome of a gradual process of adjustment, much of which may be unobservable outside the firm (e.g. in recorded public data)" [Hazledine and Savage (1988), p. 10].

Savage and Hazledine (1990) discuss, in addition to some of the factors noted above, the relevance of capital intensity and technological requirements in relation to rationalisation. Given that large, capital intensive operations are likely to be those which enjoy economies


18 See also section 2.4.3 of this research.

19 See the comments of Hazledine and Savage (1988), pp. 9 - 10.
of scale and that relatively high level of output is required to break even, Savage and Hazledine suggest that firms are likely to engage in price cutting, at least as an initial stage strategy,\textsuperscript{20} in order to maintain high capacity utilisation in the face of lessening in demand. Therefore in the case of a maturing or even declining industry, capital intensity may impede exit.

With respect to the technological requirements, the authors observe that decisions to disinvest may be complicated by the linkages between durable and specific assets and other less durable inputs. They quote the analysis of Caves and Porter (1976) that "if the physical productivity of durable input A depends on its joint use with semi-durable input B, it can pay the firm to replace B even when A's quasi-rents would not justify the initial acquisition cost or replacement of A and B together" (p. 42). In other words, reinvesting in some forms of plant may be a defensive strategy when facing sub-normal profits, if failure to do so would produce a sudden decline in cash flow (because it limits the firm's ability to use other equipment) [Savage and Hazledine (1990), p. 15]. In general terms, the utilisation of both physical and human capital, which regularly requires reinvestment, will increase the fixed costs firms face. If they see no long-term future in the industry, such fixed costs will probably increase the likelihood of immediate rather than gradual withdrawal - that is, they must either reinvest or divest immediately (p. 15).

\textbf{3.2.2 Management objectives and control}

As noted earlier, issues of managerial behaviour may influence a firm's decision to divest, and this is regardless of whether management's skills are specific or not. Caves and Porter (1976) state that:

\textsuperscript{20} See, for example, the endgame strategies suggested by Harrigan (1980) discussed in Section 3.4 of this research.
Management can comprise a barrier to exit even if top management's skills are non-specific, because poor performance of a firm may reduce its managers' mobility by acting as a signal of their competence to potential employers (who wants a loser?). Furthermore, management may derive utility from a large number of exit deterring factors - loyalty to a particular business or community, unwillingness to lay off employees, etc. .... This factor compounds the significance of specific managerial talents and calls for close attention (pp. 42-43).

In other words, firm-specific or product-specific skills of senior management may adversely affect, or discourage, their divestment decisions.\textsuperscript{21} While checks or even disciplining forces are imposed by shareholders, creditors, and the market for corporate control, there is evidence that they leave ample room for the effects of managerial control and objectives [Williamson (1963, 1964)].\textsuperscript{22}

With regard to the managerial exit deterring factors discussed by Caves and Porter above, Gilmour (1973) finds that "divestment decisions are organisationally and personally painful decisions to make" for "the recognition of divestment solution as a viable and acceptable option required some admission of failure or placing of blame on the part of the key decision manager" (p. 13). In fact, divestment decisions were so difficult to make that "virtually all the pre-decision analysis and consideration was highly personal, relatively qualitative, and almost totally undocumented" (p. 56). Interestingly, though somewhat unexpected, it was also discovered that "not only were the (divestment) decisions made at the very highest organization levels, but that virtually all inputs leading to the decisions were provided by high level sources" (p. 15).\textsuperscript{23} Under such circumstances, management comprises a barrier to exit because, particularly as Gilmour (1973) observes, "the web of

\textsuperscript{21} See the comments of Savage and Hazledine (1990), at p. 15.


\textsuperscript{23} In fact, Gilmour (1973) notes the "top management only" involvement covers almost all aspects of divestment decision: from the initial recognition of a "discrepancy" that led to a definition of the need to consider divestment, through creation of a divestment strategy or solution to deal with the discrepancy, to the actual implementation of the divestment decision (p. 15).
personal constraints that surrounded key managers tended to limit their vision of decision options to solutions that were less radical, and in each case, less economically viable than divestment" (p. 13).

Given that management behaviour inhibits exit, it is not surprising to find that in all the companies surveyed by Gilmour, the decision makers were "all new to the companies and the situations they faced" (p. 18). Gilmour argues that "the new managers were less likely to have their vision of a problem clouded or biased by personal loyalties, previous decisions, organisational history, and the need to admit failure or place blame":

They (i.e. the new managers) were fresh. They were unencumbered by the constraining influence of prior commitments. They were not involved in creating the difficulties and as a result their stakes were different, they did not have to lose face when they made the difficult decisions to divest. The absence of all the biasing personal and organisational factors made them better able to attack the difficulties they perceived in a more economically rational manner than their predecessors (p. 22).

In contrast to the view of managers as a possible barrier to exit, there are numerous instances of managers who move from firm to firm actively promoting and managing changes. They are usually known as "hatchet-men", "asset strippers", or "restructuring", and, as Savage and Hazledine (1990) observe, they are put in place to remove exit barriers (p. 16).

3.2.3 Structure and Ownership of the firm

The bearing of firm structure and ownership on divestment is most prevalent in consideration of vertical integration and diversification.24 In the situation where

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24 This observation is consistent with that of Caves and Porter (1976) and Savage and Hazledine (1990).
businesses merge vertically, the upstream business unit may pressure the downstream operation to continue, and vice versa. The first scenario may arise because the upstream business is making good returns, but its output has little alternative use outside the current business organisation. In the second scenario, a poorly performing upstream unit may be under pressure from the downstream operation to continue as the latter has limited alternative input sources.

On the other hand, it has been argued that for large, diversified firms, divestment may be carried out easier. Given that senior management of the overall firm (or group of companies) is separate from the management of each of the individual business units, and since top management of the overall firm is ultimately responsible for making the decision to divest, the sort of managerial barriers to exit discussed above will logically be less to hold. As Caves and Porter (1976) observe, the possibility of internal placement of employees displaced from an extinguished business makes it easier for top management in diversified firms to wield the axe; and "the greater the breadth and extent of the firm's diversification, the less threat does exit from one industry represent to its continuity, the more dispassionate can be the decision to exit" (p. 43). Against this, Savage and Hazledine (1990) note that diversification may allow a firm to avoid facing up to losses in a particular area by averaging out those losses. This is consistent with the comments of Bettauer (1967) that the power to average losses with the profits of other businesses in a diversified entity often nullifies any remaining capital market pressure to divest. However, to the extent that top management was involved in the decision to diversify, they may call for remaining in the business and attempting a turnaround. Therefore, the willingness of a diversified firm to divest undesirable businesses may depend on whether or not top management was initially involved in the decision to enter [Hayes (1972), Gilmour (1973)].

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25 See, for example, Savage and Hazledine (1990), and Caves and Porter (1976).
With respect to ownership, Dunning (1985) examines the role of multinational enterprises in industrial restructuring in the UK and concludes that the mobility of multinational firms across industrial sectors and international boundaries had, on balance, been positive to facilitate restructuring. However, it is also equally conceivable that multinational firms are careful to preserve their local reputation that exit is preferably avoided [Savage and Hazledine (1990)]. Alternatively, they are more likely to be subject to political constraints in their divestment decisions as the consequences of doing so may be costly in terms of, say, job losses.

In short, the effect of firm structure and ownership on divestment is inconclusive from the literature and the importance of this issue by and large varies from firm to firm.

3.2.4 The costs of adjustment

A divestment strategy must involve substantial decision making and some one-off expenses.\(^{26}\) In deciding whether or not to divest, a firm may find it hard to estimate ex ante some of the divestment-related expenses as they are not generally part of the on-going operating expenses. An obvious example is the costs of terminating employment contracts, e.g. redundancy payments.\(^{27}\) However, if a firm decides not to lay off its employees, it may, as Savage and Hazledine (1990) suggest, retain or transfer employees which will be costly too, not just in a direct sense but also in terms of downtime, until the transferred employees are again fully productive (p. 17-18). In addition, there may also be legal costs involved, including dealing with regulatory or government requirements.\(^{28}\) Where

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\(^{26}\) See Caves and Porter (1976), p. 41.

\(^{27}\) In New Zealand, it has been estimated that the economy-wide redundancy payments may have exceeded $850 million during 1988-1989. See Savage, J., "Non-wage Labour Costs in New Zealand", NZIER Contract Report No. 272, Wellington, 1989.

\(^{28}\) In the case of New Zealand, Savage and Hazledine (1990) observe that one may need to take into account the requirements of the Companies Act, the Commerce Act (when business combinations are involved), the Securities Act, and possibly the New Zealand Stock Exchange regulations (p. 18).
divestment relates only to some particular product lines, subsidiaries, or divisions, there are likely to be expenses, at least temporarily, associated with maintaining services on discontinued products, subsidiaries, or divisions. In this respect, the comment of Caves and Porter (1976) is particularly apt:

Some of these costs may be economically fixed, others may be imposed on firms by contractual obligations. These fixed costs of making and executing the exit decision, variable from firm to firm, must be weighted as investments to avoid future losses, and thereby deter exit (p. 41).

As an overall summary, the study by Porter (1976) is relevant. He constructs a number of measures of structural, strategic, and managerial barriers to exit by using the PIMS data of 310 companies. He then uses multiple regression analysis to examine if those measures of exit barriers indeed increased the probability that a business would continue in operation despite chronically low returns on investment, which was taken to signify the presence of exit barriers. He finds that "measures of the durability and specificity of assets, measures of linkages between the business and others in the company as well as the proxies for managerial exit barriers were all important in predicting whether a business was continuing to operate despite low returns" (p. 28), as shown in APPENDIX G.

In general, Porter concludes that (i) the more diversified the company, in which the business is situated, the more likely the company is to continue to operate it even if it is chronically unprofitable; (ii) the presence of shared facilities with other businesses results in higher exit barriers than shared marketing and distribution channels, given the high visibility of shared overhead; and (iii) backward and forward integration between businesses presents higher exit barriers compared to situations where businesses are selling to other divisions (p. 29). All of these findings are incorporated into and tested accordingly in this study.
In short, industrial organisation literature suggests that there may be a wide range of factors which affect firms' divestment decisions, and the speed and feasibility of doing so. These factors generally constitute barriers to exit in relation to the nature of the firm's assets, management objectives and control, firm structure and ownership, and costs of adjustment. Despite much having been written in this area, unfortunately, most of the writings are either descriptive analyses and thus lack empirical evidence, or the proxies used to measure these factors are not particularly satisfactory. Certainly there remains much to be done to examine the practicality and relevance of these factors in the business world, and it is, at least partly, to this end that this research has been motivated.

3.3 Divestment and Corporate Strategy

Corporate strategy literature has contributed considerably to our understanding of the generic competitive strategies, which include divestment strategy, that firms adopt to create a defendable and sustainable position in an industry. As mentioned in previous chapters, divestment is after all an integral aspect of corporate restructuring processes. A review of the literature underscores the role of strategy as a central organising concept and as the most common basis for conceiving the way in which forces in the environment affect an organisation in competitive terms.

One particular aspect of corporate policy literature that is relevant to much of the discussions in this research is the product life cycle analysis (hereafter referred to as "PLC"). The hypothesis is that an industry passes through a number of phases or

29 Consistent with Johnson and Scholes (1989), this study takes a somewhat different perspective between the strategy evaluation at the centre of large, diverse organisation from that at the level of the individual business unit. The former is referred to as "corporate strategy" as against the latter which is called "business strategy". According to Schendel and Hofer (1979), business strategy addresses the question of how to compete in a business, while corporate strategy focuses on which businesses to compete in and how to integrate them. For a detail discussion on this topic, see Hofer, C., W. and D. Schendel, "Strategy Formulation: Analytical Concepts", West Publishing Ltd, 1978.

30 Porter (1980) describes product life cycle as part of the industry evolution processes, which is important in the formulation of competitive strategy (p. 156).
stages, namely: introduction, growth, maturity, and decline.\textsuperscript{31} APPENDIX H illustrates the life cycle model with the corresponding users/buyers behaviour and the competitive conditions at each stage of model.\textsuperscript{32}

Most product life cycle-oriented studies identify "harvest" and "divestment" as the most acceptable strategic prescriptions for declining industries\textsuperscript{33}, although some writers recognise a range of strategic alternatives. Porter (1980) suggests four basic approaches (as shown in FIGURE 3 - 1 below) which a firm operating in a declining industry can pursue individually or in some cases sequentially.

<table>
<thead>
<tr>
<th>Leadership</th>
<th>Niche</th>
<th>Harvest</th>
<th>Divest Quickly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seek a leadership position in terms of market share</td>
<td>Create or defend a strong position in a particular segment</td>
<td>Manage a controlled disinvestment, taking advantage of strengths</td>
<td>Liquidate the investment as early in the decline phase as possible</td>
</tr>
</tbody>
</table>

**FIGURE 3 - 1 Strategic Alternatives in Decline**


\textsuperscript{31} Some writers include a "shake-out" stage between the "growth" and "maturity" stages. See, for example, Johnson and Scholes (1989), p. 72. Nevertheless, there is some controversy about whether life cycle applies only to an individual product or to the whole industries. Consistent with Porter (1980), the view that it applies to industries is adopted in this research.

\textsuperscript{32} According to Porter (1980), these stages are defined by the inflection points in the rate of growth of industry sale, which follows an S-shaped curve because of the process of innovation and diffusion of a new product. In general terms, the flat introductory phase of industry growth reflects the difficulty of overcoming buyer inertia and stimulating trials of the new product. Rapid growth occurs as many buyers rush into the market once the product has proven itself successfully. Penetration of the product's potential buyers is eventually reached, causing the rapid growth to stop and to level off to the underlying rate of growth of the relevant buyer group. Finally, growth will eventually taper off as new substitute products appear (p. 157 - 158). For a detail analysis on how an industry will change over the life cycle and how this should affect strategy, see Porter (1980), pp. 159 - 161.

\textsuperscript{33} The decline phase of a business is characterised in the life cycle model as one of shrinking margins, pruning product lines, falling R & D and advertising, and a dwindling number of competitors [Porter (1980), p. 254]. See also the illustration in APPENDIX H of this study.
According to Porter (1980), the "Quick Divestment" strategy rests on the premise that "a firm can maximise its net investment recovery from the business by selling it early in decline, rather than by harvesting and selling it later or by following one of the other strategies" (p. 270). Given that the uncertainty about whether demand will indeed subsequently decline is greater when a business is sold earlier, Porter adds that selling early usually maximises the value a firm can realise from the sale of its business.

With respect to selecting a strategy for decline that matches the desirability of remaining in the industry with a firm's relative position, Porter (1980) proposes a simplistic framework for viewing a firm's choice strategies, as shown in FIGURE 3 - 2 below.

<table>
<thead>
<tr>
<th>Favorable Industry Structure for Decline</th>
<th>Unfavorable Industry Structure for Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Has Strengths Relative to Competitors for Remaining Pockets</td>
<td>Lacks Strengths Relative to Competitors for Remaining Pockets</td>
</tr>
<tr>
<td>Leadership or Niche</td>
<td>Harvest or Divest Quickly</td>
</tr>
<tr>
<td>Niche or Harvest</td>
<td>Divest Quickly</td>
</tr>
</tbody>
</table>

**FIGURE 3 - 2** Choosing a Strategy for Decline


As expected, divestment strategy is recommended when a firm lacks strengths relative to its competitors, and when the industry structure is unfavourable.
Harrigan (1980) extends the traditional product life cycle literature by focusing on the strategies for declining businesses, which she referred to as the "end-game". Her analysis is generally acknowledged as a thorough, detailed, and "refreshingly original" piece of work in dealing with an area of business management heretofore neglected. Given that divestment strategies are traditionally regarded by strategy analysts to be associated with businesses operating in a declining environment, the study by Harrigan is discussed in fair detail.

Harrigan's analysis is guided by two key hypotheses. First, given the unique characteristics of a particular declining business environment, company strategies for dealing with declining demand will differ. The end-game strategies that a company will adopt, according to Harrigan, differ according to the variations in those factors making up the industrial environment. Second, even when the environment factors are held constant, there may still be no unique strategy for effectively dealing with a declining industry; that is, several business strategies might be appropriate for dealing with declining demand in a given industry environment.

She criticises the product life cycle literature for proposing strategies "which treat all declining industries as if they behave homogeneously in their decline". She observes that "PLC has depicted business decline in terms of generalised truisms" (although she admits this was necessary because the literature tried to aggregate industry behaviour). According to Harrigan:

The PLC's portrayal of competition in a declining industry, although accurate for some scenarios, does not consider industries where the behaviours of competitors have differed. It relies upon the behaviours of firms in a declining industry to be similar, assuming all competitors will interpret the advent of end-game in the same way and will, therefore, respond similarly (p. 3).

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34 See, for example, the comments of Professor J. W. Markham, Harvard Business School, in the foreword to Harrigan (1980). The distinctive merits of her study were recognised in 1979 when it won the General Electric Award for Outstanding Research in the field of strategic planning, awarded jointly by the General Electric Company and the Planning Division of the Academy of Management.

In this respect, she adds:

These studies seem to imply that all industries can offer equally rewarding (or unrewarding) opportunities within the end-game environment. At their worst, they assume that the experiences of all firms within the same declining business environment will be similar (p. 2).

With respect to the characteristics of the strategies suggested for declining businesses, Harrigan considers the options suggested in the PLC literature to be "over-simplified". She challenges the "divestiture strategy advocates" who have argued that products whose primary demand has been replaced by technological substitutes are obsolete and could be divested soon,\(^{36}\) and those writers who have frequently recommended divestiture as the appropriate strategy for minimising the unremunerative uses of managerial resources\(^{37}\) (since excessive managerial time may be devoted to hopelessly declining businesses). In her opinion, "a framework which could be used in assessing which declining businesses are indeed 'hopeless' has been lacking" (p. 5). She identifies the lack of scholarly attempts to sort out factors which influence the strategic choices managers face being the major problem with the traditional analysis of strategies for declining businesses; there is a need for a study which probes beyond the single reason for decline, hence single strategy-type of treatment of end-game (pp. 6 - 7).

In search of generic strategies that are appropriate to businesses operating in the end-game environment, she tests her hypotheses with empirical data obtained through extensive field work and questionnaire returns covering sixty firms in eight industries. The results of her analysis confirmed her hypotheses.

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Within each industry examined, Harrigan identifies at least one firm which performed relatively well and could be recognised ex ante as being in the best position to remain in the industry. This finding suggests that it is possible for firms to perform well in a declining industry, and that analysis of this strategic problem might have enabled some firms to assess their relative strengths and to deduce their positions in the industry more realistically, earlier (p. 368).

In addition, she notes five generic strategies for coping with declining demand, each representing differing degrees of optimism regarding the duration of demand for a firm's products and differing amounts of reinvestments of assets into (or disinvestments from) the business. These strategies are:

(i) Increase the investment (seek dominance);
(ii) Hold investment level;
(iii) Shrink selectively;
(iv) Milk the investment; and
(v) Divest now (p. 15).

Owing to limitation of space, only the "divest now" strategy is explained below.

According to Harrigan, "divest now" means "get out now". It is a sale of business assets, to competitors if necessary, or simply junking them in order to avoid sustaining chronic losses and to release committed cash (working capital) to other uses. The objective of this strategy is, thus, one of prudent timing (p. 18).

She observes that effective execution of divestment (or shut-down) strategy requires the endgaming firm to maintain a flexible asset position (i.e. one which will be relatively easy to liquidate) or a realistic assessment of the salvage value of its assets.\textsuperscript{38} Flexibility is the critical consideration because "the skill with which a divestiture strategy is executed amid

\textsuperscript{38} Harrigan (1980), p. 18.
a rapidly deteriorating resale market can ultimately determine the profitability of a firm's endgaming venture. In considering whether a firm should exit early, she suggested that if competitors are acting in a manner which severely changes the expected earnings of the firm in operations or the expected future marketability of the firm's endgame assets, it would be expected that the "divest now" strategy may be preferred. FIGURE 3 - 3 summarises the relationship between end-game strategy, industry, and competitive factors which Harrigan hypothesizes.

<table>
<thead>
<tr>
<th>Favorable Industry Traits for Endgame</th>
<th>Have Relative Competitive Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Increase the investment&quot; or &quot;Hold investment level&quot;</td>
<td>&quot;Shrink selectively&quot; or &quot;Milk the investment&quot;</td>
</tr>
<tr>
<td>&quot;Shrink selectively&quot; or &quot;Milk the investment&quot;</td>
<td>&quot;Get out now!&quot;</td>
</tr>
</tbody>
</table>

FIGURE 3 - 3 An illustration of the hypothesized relationship between endgame strategy, industry, and competitive factors.

[Source: Harrigan (1980), p. 44]

Despite of the unique role that has been accorded to divestment, this research opines that the product life cycle and end-game explanations do not fully recognise the potential and prevalence of divestment as a useful and legitimate tool of corporate planning and strategy

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39 Ibid.
40 Ibid.
formulation. For example, the fact that divestment, as some researchers argue, contributes to resource mobility essential to the effective operation of an enterprise economy is hard to be explained by the PLC and endgame-oriented analyses.\textsuperscript{41} Instead of being a last resort, many researchers have observed that companies are increasingly accepting divestment as an integral part of the managerial process.\textsuperscript{42}

Alternatively, there exists a large body of corporate policy literature which is, in general, based on the idea that the company has a portfolio of assets, products and activities which should be continuously "reviewed, augmented, and pruned" whenever it is in the company's long-run interest of attaining overall objectives. According to Lovejoy (1971), "executives who hold this philosophy recognise that in order to consider divestment as an alternative, they must have clearly defined standards for the identification of both successful operations and problem components" (p. 10). In other words, they view their companies, in reality, as continuously undergoing some form of reorganisation in accordance with carefully established plans based on clearly established objectives.\textsuperscript{43}

Schmidt (1990) adds that "when strategic considerations are made in a corporation, (divestment) becomes a normal business practice to reshape the direction of the corporation as the goals and objectives change with time" (p. 155).

In a study of the diversification records of 33 large and prestigious US companies over the 1950 - 1986 period, Porter (1987) identifies four concepts of corporate strategy that have been put into practice - portfolio management, restructuring, transferring skills, and sharing activities. For the first two strategies, divestment is regarded as part of the essential strategic prerequisites. He argues that portfolio managers must be willing to sell off losers quickly or to opportunistically divest good performers when buyers are willing

\textsuperscript{41} See, for example, Weston, Chung and Hoag (1990), p. 231.


\textsuperscript{43} Lovejoy (1971), at p. 10.
to pay large premiums, while companies that base their strategy on restructuring must have the willingness to cut losses by selling off units where restructuring proves unfeasible (p. 53).

By and large, Lovejoy (1971) represents the pioneering research which focuses on the technical and practical sides of divestment. Of particular relevance to this study is the conceptual model for divestment proposed, as shown in APPENDIX I. Lovejoy regards "divestment vs. retention" as an integral aspect of planning and control processes. The problem recognition stage provides for adequate means to recognise the existence of a divestment candidate so that a timely economic review of the situation can be undertaken (p. 26). This in turn requires the development and maintenance of a warning system of indicators which will signal management when a full-fledged evaluation of the situation is necessary.

The evaluation stage is designed to determine the potential company short-run and long-run gains or losses associated with each feasible alternative, and to recommend the best available course of action. This requires management to specify the problem, and to identify the causes that offer a logical explanation of the problem. Obviously the next step is to search for and develop possible solutions to the problem. Lovejoy observes that in normal situations, management will initially consider only retention alternatives (p. 28). However, when it becomes apparent that none of these is clearly satisfactory, divestment is then given consideration. Next, Lovejoy suggests that all retention vs. divestment alternatives should be grouped together in their respective classifications to determine the optimal retention vs. divestment plan. The projected gain from retention should then be compared with the gain which is expected to accrue if the resources made available by a divestment are reinvested. He warns of the importance of timing for both the retention and divestment alternatives. When the evaluation exercises are completed, management is then required to make the basic decision as to whether to retain or divest. The final stage

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44 The research was sponsored by the Financial Executives Research Foundation, U. S. A., and it is exceedingly well written and thorough.
then calls for the establishment and *implementation* of controls designed to make certain that the decision is carried out according to plan (pp. 28 - 29).

In *The Divestment Decision Process*, Gilmour (1973) examines the strategic events and processes that interacted to cause divestment in business organisations. He attempts to ascertain what triggered the recognition of a divestment need, where it was first recognised, how and why it gained acceptance, and how it was implemented. He proposes a model of the divestment decision process\(^\text{45}\) (as shown in APPENDIX J) based on three management literature sources.\(^\text{46}\) In a detailed case study of three very different companies, Gilmour finds that strategic analysis or some equivalent tool played no part in the initial recognition of divestment needs in any of the samples. Instead of finding that divestment activities were related to a pre-planned change in corporate direction, Gilmour observes that all the three divestment decisions turned out to be the ultimate responses to stimuli that were not anticipated, although they could have been if strategic analysis had been in use (p. 36). He elaborates that:

\[(\text{I})\text{nstead of forward planning using a 'rational' analysis of the possible effects of future states on environmental opportunities and risks, and on organisational resources and competence, each of the sites failed to anticipate their problems, and when they came, made their initial committing response in a reflex, knee jerk, manner (p. 36).}\]

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\(^\text{45}\) In general terms, Gilmour's "Divestment Decision Process Model" depicts the divestment decision process as one "where observation of a long existing Discrepancy, an act most easily performed by a new unconstrained manager, will activate a latent Personal Commitment to a solution. This personal commitment will arise despite the absence or limited presence of any hard data analytic support and will become an Organisation Commitment to the solution if the Discrepancy observer has the power and inclination to act on the Discrepancy. If he lacks the power he will have to Persuade those who have the power, to commit themselves to the suggested solution. The acts of Persuasion and commitment may go on for several cycles before personal commitment is obtained from those who have the power to effect Organisation Commitment. After the organisation is committed a hard data Rationalisation of the merits of the solution is likely to occur" (p. 58, Emphases in original).

\(^\text{46}\) Four theoretical models were originally chosen in Gilmour's study, namely: the "capital budgeting model" proposed by Joel Dean; the "strategic management model" proposed by Learned, Christensen, Andrews and Guth (1969); the descriptive "Behaviour Theory of the Firm" proposed by Cyert and March (1963); and the "resource allocation process model" proposed by Bower (1970). However, the capital budgeting model was dropped at a later stage as the approach was not used in the initial definition of divestment at any of the samples tested. For detail information of the models chosen by Gilmour, see Learned, Christensen, Andrews and Guth, "Business Policy, Text and Cases", *Irwin*, 1969; Cyert, R. M. and J. G. March, "A Behavior Theory of the Firm", *Prentice-Hall*, 1963; and Bower, J. L., "Managing the Resource Allocation Process: A Study of Corporate Planning and Investment", *Irwin-Dorsey, Homewood, Illinois*, 1970.
Nevertheless, in looking at the situations at each site shortly before and after the divestment decisions, Gilmour identifies that the only significant change in strategic variables was the change in key managers and the effect this had on the way businesses viewed their configuration of environment opportunities and organisation resources (p.37). He accordingly concludes that "divestment decisions were more immediately and primarily the result of changes in the management style, values, and way of looking at things, changes generated by the change in key managers, not by changes in the actual environment or resources" (p. 37).

Duhaime and Patton (1980), on the other hand, find that in the divestment boom experienced by the US during the 1970's, some divestments were the result of attempts to apply portfolio theory to strategic planning. Based on a study of 60 large industrial companies, they observe that most units divested through the use of the Boston Group's Matrix could be classified either as "wild-cats" (i.e. low market share with high market growth rate) or as "dogs" (i.e. low market share and low market growth rate) [p. 44]. Nearly half of the firms under study had established regular procedures for identifying divestment candidates, generally through annual reviews. They emphasise the role of divestment in the planning of corporate portfolios particularly in the treatment of "wild-cat" businesses. Given that maintaining a number of wild-cat businesses in a corporate portfolio will strain a firm's ability to propel any of its wildcats into a "star" position, divestment of one or more wildcats then becomes critical to the success of the remaining wildcats and the firm's total portfolio of businesses (p. 45). They thus recommend divestment as an active strategy, rather than as a last resort defense. This is consistent with the positive relationship between the use of a planning system (to identify divestment candidates) and the perceptions of divestment success or satisfaction with divestment results, observed among the samples.

For firms which depended on formal periodic review procedures to identify divestment candidates, the authors also note that, on the positive side, this approach could be a form of zero-based budgeting to assess each business unit's strategic value to the firm and
presumably protect the firm from desperate, last-ditch divestment situations (p. 46). However, in order to realise any of this benefit, they forewarn that the conclusion favouring divestment would have to overcome whatever political barriers that may exist.

With respect to the most effective means of normalising the divestment process, Duhaime and Patton suggest that assigning divestment responsibility to a specific person in an organisation would impart a degree of legitimacy to divestment and contribute to its acceptance as a normal element of a firm's strategy. Such a move would also provide a central focus for divestment information and ensure that at least one subdivision of the organisation would be continually alert for divestment opportunities (p. 45).

It is significant that the findings of Duhaime and Patton are consistent with that of Montgomery, Thomas and Kamath (1984), and Tehranian, Travlos and Waeglelein (1987) respectively. In an empirical study of 78 divestitures between 1976 - 1979, Montgomery et al. find that divestments that were part of the integrated, strategic plans exhibited statistically significant positive share price effects (p. 838). In contrast, divestments that took place in a reactionary or piecemeal manner or those arising from unidimensional or short term performance criteria were associated with negative share price effects. On the other hand, Tehranian et al. (1987) examine the share price effects of 146 sell-off announcements. They conclude that divesting companies with long-term performance plans experienced a more favourable stock market reaction at the announcement of the sell-off proposals relative to firms without long-term plans. This finding implies that long term planning serves as an effective mechanism to motivate managers to better decisions (p. 933).

At a lower organisational level, Nees (1981) has studied division managers' roles in fourteen divestment decisions. She identifies five strategic and tactical missions that a

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47 With respect to the key initiator in any divestment process, her findings are consistent with Gilmour (1973) as she notes that initiation of divestment is a corporate management task which divisional managers are unlikely to undertake, mainly for economic and psychological reasons. See also the comments of Duhaime and Grants (1984), at p. 303.
division manager undertook in the divestment process of his own division: as information supplier;48 implementor of secondary decisions;49 protector of divisional morale and productivity; host of potential acquirers; and possible buyer. She shows that most successful divestments were precisely those where line management’s co-operation had been elicited at the very early stages and that such a participative management mode is likely to produce better divestment results.

The review above highlights the unique and strategic roles that divestment plays from selected corporate strategy/policy perspectives. In short, instead of treating divestment as the last-ditch alternative, it is submitted that corporations should look ahead and develop relatively sophisticated rationales for divestment. Beside taking it as a useful and legitimate tool of corporate planning and strategy formulation, there are certain benefits for companies to go as far in making provision for exit at the time of entry into a business. In this respect, corporate strategy/policy literature has provided a great deal of analyses on the importance of viewing a company as a portfolio of assets, products and activities which should be continuously reviewed, augmented, and pruned. At a minimum, this body of literature suggests that in the absence of clear and strategic plans, divestment can be a costly event.

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48 Since the middle manager is closest to his field of activities, he is a privileged source of information during the divestment process. Besides, he is also a gatekeeper: he sits at a communication junction and is therefore able to filter or bias upgoing information (pp. 120 - 121).

49 Given that a number of divestments are conditional upon additional decisions which are to be carried out by divisional managers (e.g. prior to sale layoffs), their utmost co-operation is required. As Nees suggested, the personal willingness of divisional managers may speed up or delay the divestment process considerably (p. 121).
3.4 Divestment and Finance

Prior studies of divestment in the finance literature can be classified into two types. The first type considers the effects of corporate divestment, either sell-offs or spin-offs, on capital markets. These studies typically examine the reactions of share prices to divestment announcements. In contrast, the second type is concerned with the wealth effects of divestment on both divesting and acquiring firms. These studies in general examine the division of economic gains between various parties to the transactions. As this research is concerned with the factors underlying divestment decisions of firms rather than the market or wealth effects of such decisions, both types of studies are reviewed only briefly.

The majority of empirical studies of divestment have considered whether divestments result in share price changes. Boudreaux (1975) argues from a theoretical standpoint that a voluntary divestment decision should result in a positive market reaction, though he made no distinction between spin-offs and sell-offs. He assumes that managers usually act in the best interest of the shareholders and will make divestment decisions based on the projected effects of these decisions on the firm's cash flows. Share prices should therefore be a function of these projected cash inflows. Involuntary divestment decisions on the other hand are usually detrimental to shareholder wealth and should always result in negative share price reactions. Results of the "residuals analysis" of a sample of both voluntary and involuntary divestments from 1965 - 1970 confirm Boudreaux's hypotheses.

For the purposes of this study, a sell-off is defined as the selling of some of the assets of a parent firm, such as a subsidiary, division, or product line, to another firm; while a spin-off takes place when a company distributes all of the ordinary shares it owns in a controlled subsidiary to its existing shareholders.

He concludes that announcements of voluntary divestments are associated with unusually positive price movements in the securities of the divesting firms near the announcement date while involuntary divestment announcements are associated with unusually negative price movements in the security of the divesting firms if divestment eventually occurs (pp. 623 and 625).


TABLE 3-1 and TABLE 3-2 summarise the results of these studies and classify them into either sell-offs or spin-offs.

Alexander, Benson and Kempmeyer (1984) study the announcement effect on the common stock returns of a sample of 53 firms that have made voluntary sell-offs between 1964 - 1973. The authors observe that the announcement of sell-offs has a slightly positive impact on the stock return of these firms. However, they also find that "sell-offs generally occur after a period of abnormally negative returns, suggesting the announcement is preceded by the release of negative information about the firm" (p. 503).51

Hearth and Zaima (1984) examined in a similar manner the market reaction to 55 voluntary corporate sell-offs between 1979 - 1981. The authors find (i) significant positive excess returns to shareholders prior to the announcement date; (ii) that the size of the market reaction to a divestment announcement depends on the financial condition of the divesting firm (i.e. the better the financial condition of the seller, the larger the positive market reaction); and (iii) that larger divestments exhibit larger positive excess returns. They conclude that voluntary divestments have significant positive effects on shareholder wealth, and divestments have real economic value (p. 16). This finding is reconfirmed

### TABLE 3.1 RESULTS OF SELECTED SELL-OFF STUDIES

<table>
<thead>
<tr>
<th>Study</th>
<th>Methodology</th>
<th>CAR(%)</th>
<th>Event Dates</th>
<th>t-Stat</th>
<th>Sample Size</th>
<th>Sample Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Sell-Off³</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alexander, Benson &amp;</td>
<td>MAR</td>
<td>0.17</td>
<td>[-1, 0]</td>
<td>0.6795</td>
<td>53</td>
<td>1964-1973</td>
</tr>
<tr>
<td>Kampmeyer (1984)</td>
<td>MKTADJ</td>
<td>0.40</td>
<td>[-1, 0]</td>
<td>1.48</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-0.31</td>
<td>[-1, 0]</td>
<td>1.04</td>
<td>39</td>
<td>[Single divestment]</td>
</tr>
<tr>
<td>Jain (1985)</td>
<td>SIM</td>
<td>-0.40</td>
<td>[-10, -6]</td>
<td>-2.4</td>
<td>1,064</td>
<td>1976-1978</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.70</td>
<td>[-5, -1]</td>
<td>4.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>-0.20</td>
<td>[1, 5]</td>
<td>-1.03</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.45</td>
<td>[1, 10]</td>
<td>insignificant</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1.12</td>
<td>[-2, 0]</td>
<td>2.83</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hite, Owers &amp; Rogers (1987)</td>
<td>SIM</td>
<td>1.66</td>
<td>[-1, 0]</td>
<td>4.08</td>
<td>55</td>
<td>successful sellers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.82</td>
<td>[T -1, T]</td>
<td>1.88</td>
<td>42</td>
<td>only 1963-1983</td>
</tr>
</tbody>
</table>

---

1. MAR = Mean Adjusted Returns model; SIM = Single Index Model; MKTADJ = Market Adjusted Returns model.

2. Event days brackets [ ] are defined relative to the announcement day, T = 0, or the completion day, T. CARS (cumulative average residuals) are those reported in the original research. Not all authors report CARS for [t= -1, 0] separately.


* Statistically significant at x = 0.05.
### TABLE 3-2 RESULTS OF SELECTED SPIN-OFF STUDIES

<table>
<thead>
<tr>
<th>Study</th>
<th>Methodology</th>
<th>CAR(%)</th>
<th>Event Dates</th>
<th>t-Stat</th>
<th>Sample Size</th>
<th>Sample Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) Spin-off</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.34</td>
<td>[0, -1]</td>
<td>6.549**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Schipper &amp; Smith (1983)</td>
<td>MKTADJ</td>
<td>2.84</td>
<td>[-1, 0]</td>
<td>6.61**</td>
<td>93</td>
<td>1963-1981</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.56</td>
<td>[-1, 0]</td>
<td>8.42**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Linn &amp; Rozeff (1985)</td>
<td>MKTADJ</td>
<td>2.8</td>
<td>[-1, 0]</td>
<td>4.63**</td>
<td>53</td>
<td>1963-1982</td>
</tr>
</tbody>
</table>

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5 MAR = Mean Adjusted Returns model; SIM = Single Index Model; MKTADJ = Market Adjusted Returns model.

6 Event days brackets [ ] are defined relative to the announcement day, T = 0, or the completion day, T. CARS (cumulative average residuals) are those reported in the original research. Not all authors report CARS for \([t = -1, 0]\) separately.

* Statistically significant at \(x = 0.05\).

** Statistically significant at \(x = 0.01\).
by a further examination of Hearth and Zaima (1987) where one hundred fifty four voluntary sell-offs, which occurred between 1975 - 1982, were studied. This study also observes significant positive price movements for divesting firms immediately prior to and on the announcement date. However in the case of the acquiring firms, some evidence of positive, although not statistically significant, price movements has been found. These results suggest that shareholders of divesting firms realise economic gains from sell-offs while shareholders of acquiring firms neither gain nor lose. Consistent with Klein (1986), the authors also find that larger returns are usually associated with divesting firms selling off larger portions of their total assets, and the division of gains between divesting and acquiring firms becomes more one-sided in favour of divesting firms as the relative size of the sell-off increases (p. 236).

Consistent with previous studies, Rosenfeld (1984) also observes evidence of share price gains resulting from divestment announcements, although the announcement effect of spin-offs has a stronger positive influence on share prices than sell-offs.52 He, nevertheless, concludes that sell-off announcements, on average, are perceived by shareholders as a positive net present value transaction (p. 1447). However, his contribution to the divestment literature lies in his discussion on how a divestment can result in positive net cash flows to both the divesting and the acquiring firms.

By assuming maximisation of owner wealth as the goal of financial management, Rosenfeld suggests that a sell-off transaction can result in positive net cash flows for the seller, the buyer, or both, although he asserts that this would not happen in a world of full information and perfect capital markets. If the buyer of the divested unit has some sort of competitive advantage over the seller, the price the buyer is willing to pay may exceed the net present value of the assets' future cash flows from the seller's perspective. In addition, if the purchase price falls short of the present value of the asset's future net cash flows

52 This finding is consistent with the empirical studies on spin-off announcements by Hite and Owers (1983), Miles and Rosenfeld (1983), and Schipper and Smith (1983). These studies will be discussed in the next section.
from the buyer's perspective, it then becomes a positive net present value project for both parties (p. 1438).

On the other hand, Rosenfeld argues that, in complete and perfect markets, a spin-off announcement would not alter a firm's value unless shareholders expect the divestment to increase future net cash flows. Such an increase could come from, say, the elimination of negative synergies.

Jain (1985) suggests four scenarios that could lead management to engage in sell-off activity. First, unforeseen circumstances such as poorer than expected earnings or cash flows could create financial problems for a corporation. In some cases, the unfavourable incidences could change the capital structure of the firm. Assuming that the firm was initially operating at optimal capital structure, the changed capital structure would then be suboptimal.\(^\text{53}\) To the extent that the sale is seen as the effort on the part of the management to improve the financial structure of the firm, and that the sale is completely unanticipated by the market, Jain anticipates a positive price reaction on the firm's sell-off announcement (p. 211). Second, in viewing a sell-off as a partial merger, where certain parts of the firm are more valuable to outsiders than to the current owners and it is in the interest of the shareholders that those assets be sold, she argues that the share price reaction to the sellers will therefore be similar to that experienced by the target firms which earn significant positive excess returns around the first announcement.

Thirdly, Jain compares sell-offs to spin-offs. In both situations, a segment of the company is effectively separated from its existing management as a result of the parent's desire to specialise in a limited number of business activities. Since spin-off announcements are known from other empirical studies to be associated with increases in common stock values, Jain expects that sell-off announcements should also be associated with positive

\(^{53}\) It is fundamental to Jain's analysis that an optimal capital structure in fact exists.
stock price reaction.\textsuperscript{54} Finally, Jain suggests that sell-offs may be motivated by a desire to transfer wealth by paying dividends to the ordinary shareholders from the proceeds of the sale of the assets.\textsuperscript{55} Since this effectively reduces the probable payments to the bondholders, it results in a transfer of wealth from bondholders to shareholders if the value of the firm is assumed to be unchanged.\textsuperscript{56} This scenario suggests that sellers would experience a positive stock price reaction.

The results of over 1000 sell-offs first announced between 1976 - 1978 confirm Jain's hypotheses. She finds that voluntary sell-off announcements have a positive effect on the shareholders of both the sellers and the buyers, and the excess returns earned by buyers are smaller than those earned by the sellers. In addition, there was evidence that sell-off announcements are preceded by a period of significant negative returns for the sellers which suggests that the sellers, on average, performed poorly prior to their sell-off activities (p. 209). This is consistent with the findings of Alexander et al. (1984) discussed above.

In an investigation of the valuation consequences of voluntary proposals to sell part or all of a corporate's assets, Hite, Owers and Rogers (1987) find partial sell-offs resulting in

\textsuperscript{54} Previous studies which found significant positive share price reaction to spin-off announcements include Hite and Owers (1983), Miles and Rosenfeld (1983), and Schipper and Smith (1983). These studies will be discussed briefly in the next section.


\textsuperscript{56} Galai and Musalis (1976) describe that 'in effect, the stockholders have "stolen away" a portion of the bondholders' collateral since they no longer have any claim on the assets of the new firm'. See Galai, D. and R. W. Musalis, "The Option Pricing Model and The Risk Factor of Stock", Journal of Financial Economics 3, 1976, pp. 53 - 81.

statistically significant abnormal returns of 1.66% and 0.83% to successful sellers and buyers respectively. Unsuccessful sellers realise gains at the bid announcement of 1.41% which are lost at the offer termination. In contrast, proposals to liquidate the firm are associated with significant average abnormal returns of 12.24%. The authors interpreted the findings as evidence that "asset sales are associated with the movement of resources to higher-valued uses rather than as evidence of market mispricing before the (divestment) announcements" (p. 229).

With respect to the share price reactions of spin-off announcements, the studies of Hite and Owers (1983), Miles and Rosenfeld (1983) and Schipper and Smith (1983) are relevant. They consistently find excess positive returns on and around the announcement date. Hite and Owers (1983) examine share price reactions around the announcement of 123 spin-offs by 116 firms between 1963 - 1981. Abnormal returns of 7.0% were found from 50 days prior to the announcement through to completion of the spin-off.

Miles and Rosenfeld (1983) analyse 55 voluntary spin-offs that occurred between 1963 - 1980. They identify excess positive returns on and around the announcement date. In addition, the returns were greater for large spin-offs than for smaller ones, large being defined as a subsidiary with an equity market value at least 10% as large as that of the parent. This observation is consistent with the findings of Hearth and Zamia (1984) which focuses on sell-offs.

Schipper and Smith (1983) similarly document significant positive share price movement for ninety three spin-offs announced between 1963 - 1981. They suggest one potential source of shareholder gain is productivity improvement, resulting from a reduction in the number and diversity of transactions under one management. This would in turn increase "contracting efficiency". Thus, spin-offs can be viewed as organisational realignments.

In contrast to earlier studies where spin-offs are assumed to be wealth maximisation per se, Linn and Rozef (1985) explore four theoretical frameworks that may predict the
change in shareholder wealth at the announcement of a spin-off.\textsuperscript{57} They find that "the only theory that unambiguously predicts a gain to the parent when it announces a spin-off is the wealth-maximisation theory", and the mechanism for the gain is the elimination of "anergy" (pp. 273 - 274).\textsuperscript{58} The authors also provide additional evidence, in a study of 53 voluntary spin-offs between 1963 - 1982, that the announcement effects of voluntary spin-offs tend to raise the share prices of the announcing firms. This observation is consistent with wealth maximising behaviour of management. Furthermore, the larger share price increases tend to be concentrated in those companies that explicitly communicate anergy motives to investors (p. 289).

To summarise, previous studies of divestment in the finance literature help to establish that investors can gain from divestments. There is clear and independently verified empirical evidence of significant share price gains resulting from divestment announcements to shareholders of divesting firms, while shareholders of acquiring firms neither gain nor lose. Taken as a whole, these studies provide an important theoretical basis for this research by taking into account the financial motivation and implication of management with respect to their company’s divestment activities.

3.5 Summary

From the foregoing literature review, it is clear that corporate divestment is a complex phenomenon best examined from multiple perspectives. From an industrial organisation perspective, organisational context (including the nature of assets), managerial objectives and control, structure and ownership of firm, and costs of adjustment, may be significant

\textsuperscript{57} The theories include the wealth maximisation hypothesis, wealth redistribution hypothesis, size-maximisation hypothesis, and hubris hypothesis.

\textsuperscript{58} According to Linn and Rozef, "anergies are instances in which it is more costly to operate two companies together than it would be to operate them separately" (p. 273).
influences on divestment strategy. The corporate strategy/policy perspective, on the other hand, suggests that influences on divestment decisions may be a function of external environmental factors. Finally, the finance literature provides the performance criteria and establishes the wealth effect of divestments, as illustrated in the significant share price gains resulting from divestment announcements.

In this study, divestment is conceptualised using each of the three perspectives discussed above. It attempts to enrich our current understanding of contemporary restructuring issues, where divestment is an integral part of the processes, and to answer the research question of just what factors govern a firm's decision to divest by reference the New Zealand experience.
CHAPTER IV CONCEPTUAL AND THEORETICAL DEVELOPMENT

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CHAPTER IV CONCEPTUAL AND THEORETICAL DEVELOPMENT

4.1 Introduction

This chapter develops the conceptual model of divestment which forms the basis of this study, and lists testable hypotheses generated from both the model and review of relevant literature. As was noted in the introductory chapter, this project surveys the chief executives of leading companies listed on the New Zealand Stock Exchange concerning the motives for and factors affecting their company's divestment activities. It examines the influences of selected environmental, organisational, and performance factors on these New Zealand listed companies which had undertaken any divestment in the past five financial years.¹

In the following section, a conceptual model of divestment is presented. The segment of the model addressed by this study is also delimited. Section 4.3 outlines the hypothesized motives for divestment and section 4.4 presents the environmental, organisational, and performance factors hypothesized to affect firms' divestment activities. Finally, some concluding remarks are included in section 4.5

4.2 Conceptual Model of Divestment

A general conceptual model of divestment is depicted in FIGURE 4.1. The model hypothesizes that environmental, organisational, and performance factors have significant influences on a firm's motive(s) for divestment, which in turn determines the corresponding divestment strategy formulation and implementation adopted by firms. Within the temporal confines of a dissertation research project, this research focuses

¹ That is, years ending 31st March 1987 to 31st March 1991.
FIGURE 4-1: A Conceptual Model of Divestment Decision-making
specifically on the relationships between selected environmental, organisational, and performance factors and the motives for divestment of firms. The formulation and implementation of the resulting divestment strategy are not examined directly in this study but are inferred from the nature and frequency of divestment activities undertaken by the responding firms. [See FIGURE 6-2 to FIGURE 6-5]

In addition, it is important to emphasize at the outset that the resulting impact of a firm’s divestment on its organisational characteristics, its performance, and, to a lesser extent, the environment it operates in (as depicted by the --- line in FIGURE 4.1) is also beyond the scope of this study.

It is significant that the conceptual divestment model which forms the basis of this research is consistent with the "Basic model of the internal behaviour of firms" developed by Leibenstein (1987). The schematic set of relations of Leibenstein’s model is shown as follows:

![Diagram]

where EPr = external pressure; HPr = hierarchical pressure or internal pressure; E = effort; Per = performance, and PR = pressure reaction.

**FIGURE 4.2** A Basic Model of firm’s internal behaviour

In words, the set of relations depicted in FIGURE 4.2 states that the pressure in the environment, which the firm operates in, is transmitted to the firm, which in turn transmits the pressure internally. Internal pressure\(^2\) determines the level of efforts, which

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\(^2\) Leibenstein (1987) uses the expressions "hierarchical pressure" and "internal pressure" interchangeably.
in turn determine the firm’s performance. Pressure reaction then results as a consequence of performance. It takes into account performance and the external pressure and thus reflects the amount of pressure that the hierarchy will continue to transmit as a consequence of its most recent performance and the nature of the environment. The outcome will depend on whether the pressure reaction approximately equals the internal pressure. If it does, then an equilibrium exists; the firm will be essentially satisfied with its activities and no attempt will be made to change firm behaviour [Leibenstein (1987), pp. 220-221].

The model of a firm’s internal behaviour is relevant because divestment, as highlighted in previous chapters, is an integral aspect of corporate restructuring processes: it is a subset of the internal activities undertaken by firms as a means of adapting to change. That is, divestment activities undertaken by firms represent partly the efforts (depicted by "E" in Figure 4.2) committed by firms in moving towards an equilibrium. However, the main difference between our divestment model and Leibenstein’s internal behaviour model of firms is that a firm in the context of the latter model is a passive taker or reactor to the pressures asserted by the environment. In contrast, a firm in the former has active inputs to influence the environment which it operates in, which is more in accordance with real life commercial experience. Obviously, when a firm changes its organisational structure or commercial activities significantly, as a consequent of either divestment in particular or corporate restructuring in general, such an undertaking will have an impact on the industry and environment which the firm operates in.

The following sections outline the motives for and factors hypothesized to affect divestment activities of New Zealand listed companies. For simplicity, the following abbreviations are used:

\[HM = \text{hypothesized motive for divestment;}\]
\[HE = \text{hypothesized environmental factor;}\]
\[HO = \text{hypothesized organisational factor; and}\]
\[HP = \text{hypothesized performance factor.}\]
4.3 Motives for divestment

For the purposes of this study, a motive for divestment refers to the reason firms sold off part of their assets, product lines, subsidiaries, or divisions for cash or securities or some combination thereof. Interpreted in the general meaning of the term, it includes both goal direction and energizing of behaviour.\(^3\) The motive for divestment is said to be goal directing or steering as it is assumed in this analysis that management acts in the best interest of the company and shareholders. Given that most divestment decisions are widely published, either in the financial press or in the information released by the divesting firm, this assumption is reasonable because shareholders may attempt to remove management should such decisions reduce shareholders’ wealth.\(^4\) In addition, as an inciting response to the pressures exerted by the environmental, organisational, and performance factors outlined in FIGURE 4.1, the motives for divestment prompt management to select one or more of the divestment options identified in section 2.2 of this study.

Following an extensive literature review (see the discussions in section 2.4), this study identifies 30 motives for divestment that may be relevant to the chief executives of New Zealand listed companies. As all of the hypothesized motives are self-explanatory and straightforward, they are not elaborated or substantiated any further. Nor are the motives associated with any particular environmental, organisational, and performance factors as such an attempt is arbitrary, and may even be misleading as there is such a high degree of overlap between the variables. In addition, it is emphasized at the outset that the motives identified below are not mutually exclusive but in many cases are inter-related, and more than one motive is usually involved in a divestment decision.

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The hypothesized motives for divestment are as follow:

**HM1:** Unfavourable performance of the company as compared to industry counterparts;

**HM2:** Loss of competitive advantage due to new institutional or regulatory constraints;

**HM3:** Adverse economic environment;

**HM4:** Shortage of managerial talent;

**HM5:** Good price offered for unit(s) divested;

**HM6:** Loss of economies of scale in production or distribution;

**HM7:** Loss of market share by unit(s) divested;

**HM8:** Changes in tax law, price or other regulations have made divestment possible;

**HM9:** Meeting a corporate liquidity requirement;

**HM10:** High investment obligation in unit(s) divested;

**HM11:** To harvest successful businesses;

**HM12:** To discard undesired/unprofitable unit(s);

**HM13:** To reduce the number and diversity of operating units (i.e. dismantling conglomerates);

**HM14:** To reversing a previous management/investment mistake;

**HM15:** To defend against hostile takeover bids;

**HM16:** To meet government requirements;

**HM17:** To free up managerial talent for other opportunities;

**HM18:** To finance the development of other investments;

**HM19:** To shift resources into units with greater growth or opportunity;

**HM20:** To focus on core activities;

**HM21:** To withdraw from own production in favour of importing;

**HM22:** To focus on units protected by high barriers to entry;

**HM23:** To reduce risk due to over-diversification;

**HM24:** To abandon obsolete technology or expertise;

**HM25:** To withdraw from segments where suppliers are powerful;

**HM26:** To withdraw from segments where customers are powerful;

**HM27:** To withdraw from a product/industry approaching maturity;

**HM28:** To withdraw from segments subject to adverse public image;

**HM29:** To abandon product lines where threat of substitutes is strong; and

**HM30:** To facilitate growth of unit(s) divested as an independent concern.
4.4 Factors affecting corporate divestment

To study the effects of various influences on divestment activities of firms, this research, as shown in FIGURE 4.1, categorises factors hypothesized to be major determinants of motives and thence of divestment decisions into three groups, namely, (i) environmental factors; (ii) organisational factors; and (iii) performance factors. These factors are discussed as follows:

4.4.1 Environmental factors

With respect to the environment in which a divesting firm operates, two sub-categories of factors are hypothesized to influence divestment decisions of the firm, namely, the general economic environmental and regulatory factors. It is emphasised that this sub-classification is not exhaustive and some overlapping is inevitable. Although the sub-classification is somewhat arbitrary, it nevertheless facilitates a systematic and comprehensive understanding of the environmental factors that are hypothesized to have a significant bearing on firms' divesting activities.

The general economic environmental factors reflect the external economic conditions within which the divesting firm and units were operating at time of divestment. The general economic environment is known to affect firms' decision-making, and hence divestment decision-making is no exception. The effects occur because of the differences in, for example, demand and supply of goods and services, availability and costs of raw materials and costs of credit, and the resulting price levels for finished goods and services. Taken together, the interaction between supply and demand will also determine the level of industry growth and technology change, which in turn directly impact upon firms' state of affairs and the appropriate strategies available to them. Hence, it is hypothesized that the general economic environment, industry growth, and technology change impact
upon a firm's decision to divest:

HE1: general economic environment;

HE2: industry growth; and

HE3: technology change.

Additionally, regulatory controls that are currently prevailing in the environment in which the divesting firm operates may affect its divestment decisions. A firm may decide to exit from a particular industry because the cost of over-regulation has constrained the economic feasibility of its operation. Changes in legislation, for example tax law, may result in the divesting firm losing the fiscal incentives which it once had, which in turn changes its competitive advantage. Obviously, the legal environment in which the divesting firm operates will also determine its ability to re-enter at a later stage should the firm decide to exit now. The following factors are hypothesized to be relevant for the purposes of this study:

HE4: cost of over-regulation;

HE5: tax law changes such as loss carry-forward;

HE6: ability to re-enter later;

HE7: changes in competitive advantage due to deregulation; and

HE8: changes in competitive advantage due to removal of tariff protection.
4.4.2 Organisational factors

Section 3.2 above reviews relevant industrial organisation economics literature which has contributed to our current understanding on the *internal structure* and *organisation* of firms and how these firm-specific factors affects firms' divestment decisions. To identify factors that affect divestment at the firm level in New Zealand, this study improves on the categorisation of factors identified by Savage and Hazledine (1990) in their study of rationalisation patterns of New Zealand firms. It is, nevertheless, emphasized that Savage and Hazledine discuss only the firm-specific determinants of rationalisation identified in the industrial organisation literature, applied econometrics literature, macro/labour literature on the Philips curve and a more recent literature on issues on market flexibility.\(^5\)

The majority of the materials reviewed by the authors originate from North America, and hence their application to the New Zealand firms should not be taken as conclusive, or over-emphasized. It is unfortunate that the authors did not discuss the relevance of the factors so identified to the New Zealand environment, nor did they provide any empirical evidence on the subject.

The four categories of factors identified by Savage and Hazledine are discussed accordingly, together with the hypotheses generated.

4.4.2 (A) The nature of assets

Two particular aspects of assets that are frequently cited in industrial organisation literature as affecting divestment activity relate to the *specificity* and *durability* of the assets owned by the divesting firm. With respect to specificity, it means that the "lumpiness" of assets impedes the ability of a firm to divest. On the other hand, durability refers to the situation where a firm cannot dispose of the assets quickly at a price matching

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\(^5\) See the comments of Hazledine and Savage (1988), p. 5.
the value of inputs required to produce the assets owned by the divesting firm. Both characteristics of the assets are usually referred to as "barriers to exit".

To quote from Caves and Porter (1976), the source of exit barriers are "inputs that can become attached to the firm and then command persistently low earnings because they are \textit{durable} and \textit{specific} to an activity of the company" [p. 40, emphasis in original]. Hence, for a barrier to exit, firms must have owned assets which are not only specific but also durable. Additionally, the idea is equally applicable to both tangible and intangible assets.

This study thus hypothesizes the following factors to affect divestment decisions of New Zealand firms:

\begin{itemize}
  \item \textit{HO1}: \textit{asset specificity of the divesting firm}; and
  \item \textit{HO2}: \textit{asset durability of the divesting firm}.
\end{itemize}

Two additional factors that are relevant to the present discussion relate to \textit{capital intensity} and \textit{technological requirements} of the divesting firm. Although capital intensity is frequently used as a proxy for the existence of specific and durable assets, it may in itself, as Savage and Hazledine (1990, p. 14) observe, constitute a significant determinant of the divestment decision, particularly in the case of a maturing industry [Harrigan (1980)]. Similarly, technological requirements, which are evident in the utilisation of both physical and human capital that regularly requires re-investment, increase the fixed costs, and hence the exit barriers, that firms face.

7 See, for example, Savage and Hazledine (1990), p. 12.
9 See the discussion in section 3.2.1 of this study.
Finally, it is submitted that the shortages of key inputs have in numerous instances induced a firm to exit from a particular industry or to divest a particular product. The following five hypotheses, which can be equally applicable to either the firm or unit(s) divested, are thus particularly apt:

HO3: capital investment requirements;
HO4: technological requirements;
HO5: transfer of technology between units;
HO6: sharing of plant and equipment between units;
HO7: shortages of labour;
HO8: shortages of materials;
HO9: shortages of technology;
HO10: shortages of management; and
HO11: shortages of capital.

4.4.2 (B) Management objectives and control

Under this category, the overriding theme is that managerial factors influence a firm's decision to divest; management constitutes a barrier to exit. Managerial exit deterring factors are particularly relevant as it was also discovered that virtually all inputs to the decisions to divest were provided by the "highest organisation levels" [Gilmour (173), p. 15]. At a lower organisation level, Nees (1981) finds that line management's co-operation must be elicited at the very early stage to encourage a participative management mode if a successful divestment is to be accomplished.

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10 See, for example, Caves and Porter (1976) and Williamson (1963, 1964).
Accordingly, the following factors are hypothesized to be relevant to divestment activity of New Zealand firm:

\[ \text{HO12: management resistance to divestment; and} \]

\[ \text{HO13: staff resistance to divestment.} \]

**4.4.2 (C) The structure and ownership of the firm**

The effect of firm structure and ownership on divestment is evident when one examines the overall diversity of a firm. In this respect, the size of the firm, as inferred in the degree of diversity and structure of the firm and in relation to its industry counterparts, may also be relevant, particularly when corporate size has traditionally been regarded as associated with "corporate strength".

Caves and Porter (1976) show that for large, diversified firms, divestment may be carried out more easily if employees displaced from an extinguished business may be placed or absorbed elsewhere in the organisation. However, against this is the observation that diversification allows a firm to avoid facing up to losses in a particular area by averaging out the losses [Savage and Hazledine (1990)]. Besides, a high degree of intra-firm sales and/or purchases (which is frequently used as the proxy of unit inter-dependence) may impede a firm's decision to exit from a particular industry/product without significantly affecting the state of affairs of the units which it desires to retain. The following hypotheses are relevant for this study:

\[ \text{HO14: size of firm in relation to industry counterparts;} \]

\[ \text{HO15: organisational structure of the firm;} \]

\[ \text{HO16: high degree of diversification within the firm;} \]

\[ \text{HO17: overall company diversity;} \]

\[ \text{HO18: intra-firm sales between units; and} \]

\[ \text{HO19: intra-firm purchases between units.} \]
4.4.2 (D) The costs of adjustment

In deciding whether or not to divest, obviously, a firm may need to take into account some of the divestment-related expenses, or costs of adjustment in general. As these expenses are not usually part of the on-going operating expenses of the entity, they may need to be estimated ex ante. Examples include redundancy payments, restructuring expenses, and legal expenses incurred to terminate or renegotiate contracts. When divestment relates only to some particular aspects of the operations, it is likely to incur temporary expenses associated with maintaining services on the discontinued operations. Accordingly, it is hypothesized that cost of adjustment is a factor influencing divestment decision of firms:

\[ HO20: \text{cost of adjustment (e.g. costs of contract termination/renegotiation, redundancy payments)} \]

4.4.3 Performance factors

A firm's financial performance is one of the major determinants of the range of strategic options available to the firm concerned. The total amount of resources, both internally generated and externally obtained, at the disposal of the firm is likewise affected by the firm's past and present financial position. Thus, by assessing the relationship between performance factors and firm's decisions to divest, we can estimate the effect that firm-level financial considerations have on its discretion in making divestment decisions.

In the foregoing reviews of divestment motives, discarding unprofitable businesses is cited frequently as the primary factor in the divestment decision.\(^\text{11}\) For example, Duhaime and Grant (1984) find that poor relative performance of the divesting firm in comparison with its industry counterparts and the unprofitability of the unit(s) divested are important influences on a firm's decision to divest. Harrigan (1981), in her study of divestment

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\(^{11}\) See Section 2.4, part iv.
deterrements, finds that the incurrence of losses increases the relative likelihood of
divestment for declining business units.

It is therefore hypothesized that the following performance factors are significant
determinants of divestment decisions:

\[ \begin{align*}
  HP1: & \quad \text{low return on assets of unit(s) divested;} \\
  HP2: & \quad \text{low revenue growth of unit(s) divested;} \\
  HP3: & \quad \text{low price-earnings ratio of firm; and} \\
  HP4: & \quad \text{low capacity utilisation of unit(s) divested.}
\end{align*} \]

4.5 Summary

This chapter has developed a conceptual model of divestment which forms the basis of this
study. Testable hypotheses regarding both the motives for divestment and factors affecting
divestment activities of New Zealand listed companies are also generated and discussed.
FIGURE 4.3 below summarises the set of environmental, organisational, and performance
factors to be tested. Chapter V proceeds to address the research methodology.
(I) Environmental factors
HE1: general economic environment;
HE2: industry growth;
HE3: technology change;
HE4: cost of over-regulation;
HE5: tax law changes such as loss carry-forward;
HE6: ability to re-enter later;
HE7: changes in competitive advantage due to deregulation; and
HE8: changes in competitive advantage due to removal of tariff protection.

(II) Organisational factors
HO1: asset specificity of the divesting firm;
HO2: asset durability of the divesting firm;
HO3: capital investment requirements;
HO4: technological requirements;
HO5: transfer of technology between units;
HO6: sharing of plant and equipment between units;
HO7: shortages of labour;
HO8: shortages of materials;
HO9: shortages of technology;
HO10: shortages of management;
HO11: shortages of capital
HO12: management resistance to divestment;
HO13: staff resistance to divestment;
HO14: size of firm in relation to industry counterparts;
HO15: organizational structure of the firm;
HO16: high degree of diversification within the firm;
HO17: overall company diversity;
HO18: intra-firm sales between units;
HO19: intra-firm purchases between units; and
HO20: cost of adjustment.

(III) Performance factors
HP1: low return of unit(s) divested;
HP2: low revenue growth of unit(s) divested;
HP3: low price-earnings ratio of firm; and
HP4: low capacity utilisation of unit(s) divested.

FIGURE 4.3 Factors hypothesized to affect divestment activities of New Zealand firms
CHAPTER V  RESEARCH METHODOLOGY

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CHAPTER V RESEARCH METHODOLOGY

5.1 Introduction

This chapter describes the methods used to collect data and the procedures applied in analyzing the data. The study utilises a mail questionnaire survey to obtain the information required. The rationale for its selection is presented in section 5.2. The data collection methods are then explained and their limitations noted in section 5.3. The sample from which data are collected is also described. This is followed by section 5.4 which discusses the statistical procedures and analysis applied to the data. The limitations of the research methods and procedures are discussed in section 5.5, together with an assessment of the possible effects of those limitations on the research results, while section 5.6 provides a summary of this chapter.

5.2 Research Method Selection

Prior research into divestment identified a number of management practices that are considerably different from those associated with acquisition proceedings. The most conspicuous difference is the intense concern with secrecy on the part of the sampled management.¹ This partly reflects the experience that "divestment is a highly sensitive and confidential topic for most firms because of its historical association with failure and the fact that it reflects firm's strategic choices and might be used as an indicator of future strategic direction" [Duhaime and Grant (1984), p. 308].

In this respect, most researchers, who adopted field research or case study methods, have warned about the frustration and difficulty associated with their investigations into the

¹ See, for example, Hayes (1972, p. 57); Taylor (1988, p. 9); and Duhaime and Grant (1984, p. 308).
decision process used by the divesting firms.² This makes mail questionnaire survey a desirable research tool for this study as the respondents will not be required to identify their replies and hence complete anonymity and confidentiality of information can be guaranteed. It was hoped that guaranteed anonymity and confidentiality would bring about a sufficiently high response rate for this study.

Two additional considerations also contributed to the choice of mail questionnaire survey in this study. Firstly, little has been published or made available in public records relating to the specifics of firm's divestment activities. This is not surprising as divestment is traditionally a fairly "sensitive" topic to research into. Duhaime (1981) describes corporate divestment as "a highly confidential topic" (p. 62).

Second, it is relatively low in cost (i.e. questionnaires can be sent through mail, interviewers cannot), geographically flexible, and can reach a widely dispersed sample simultaneously without the attendant problems of interviewer access or the possible distortions of time lag [Kanuk and Berenson (1975)]. Low cost and geographical flexibility are of paramount importance because senior executives of leading companies listed on the New Zealand Stock Exchange are widely dispersed throughout New Zealand. In addition, mail questionnaires are also free from the costs and time consumption of interviewer bias or variability.³ Finally, mail questionnaires, as Kanuk and Berenson (1975) observe, tend to be more valid than either telephone or personal interviews because they permit leisurely and thoughtful replies and enable respondents to check information by verifying their records. The former attribute is important in view of the busy schedules of chief executives surveyed.

² See, for example, Duhaime (1981) and Tuzzolino (1987).
³ See, for example, the comments of Frankel, L. R., "How Incentives and Subsamples Affect the Precision of Mail Surveys", Journal of Advertising Research, September 1960, pp. 1 - 5; Jahoda, M., M. Deutsch, and S. W. Cook, "Research Methods in Social Relations", Vol. 1 and 2, New York: Dryden Press, 1951; and Kanuk and Berenson (1975).
5.3 Sample selection and data collection

A list of all companies listed on the New Zealand Stock Exchange as at 31 March 1991 was initially compiled from *The New Zealand Company Register*. A total of 136 companies were listed on NZSE then. However, the list included six companies in receivership, three in liquidation, one in statutory management, sixteen suspended pending receipt of annual report and which were subsequently delisted, eight companies that were foreign based, and four other companies that were delisted at time of survey. The name of these 38 companies are outlined in APPENDIX K, and all of them were removed from our sample.

A survey questionnaire was despatched to each of the 98 sample companies on Monday, 29 July 1991. For 94 of the companies the survey questionnaire was addressed to either the chief executive, managing director, executive chairman, secretary, or general manager by name. This is in view of the empirical evidence indicating that personalisation of the mailing significantly improves response rates. Such an approach is also consistent with the guide-lines proposed by Gilmour (1973), and Duhaime and Grant (1984) that in a study of divestment decisions, the respondents should be those at the senior level who are in some position that could or did have a significant effect on the evolution of the decision. Duhaime and Grant (1984) add that chief executive officer is "the person most familiar both with the firm’s divestments" and with who else in the organisation that may have the knowledge to respond to the questionnaire (p. 308). Therefore, every effort was made to mail the questionnaires to the chief executive, managing director or executive chairman by name; only failing that were the questionnaires addressed to either the company secretary.

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or general manager by name. However, in four companies, owing to current reorganisation or restructuring, a specific named individual could not be identified and the title "chief executive" was substituted. APPENDIX L summarises the name and position of the respondents, together with the name and address of the companies surveyed.

5.3.1 Survey questionnaire

APPENDIX M provides an example of the covering letter and questionnaires sent. The covering letter emphasizes that the survey focuses on what the chief executive did, rather than what should have been done. For recipients that were not directly involved in the divestment decision-making processes of their firms, the covering letter also requested that they pass the letter and questionnaire directly to the corporate officer involved.

The questionnaire is organised into four sections, namely:

(A) Background information;
(B) Motives for corporate divestment;
(C) Factors affecting corporate divestment; and
(D) Issues related to divestment activity.

Section A of the questionnaire seeks background information of the respondent and his/her company. Respondents were asked whether their companies had undertaken any divestment (i) over the past five financial years; and (ii) in the 1990 financial year [see Question 3, APPENDIX M]. If the answers to both questions were negative, the respondents were asked to return immediately the questionnaire in the self-addressed envelope enclosed. Otherwise, they were asked to proceed to answer the remaining parts of the questionnaires.

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6 They were Air New Zealand Ltd, Mair Astley Holdings Ltd, Rank Group Ltd, and Wilson Neil Ltd.
Section B outlines 30 possible motives for corporate divestment. The respondents were asked to indicate on a five-point scale the extent that their companies' divestment(s) over the past five financial years had been motivated by each alternative. The scale employed was: No importance (1); Slight importance (2); Moderate importance (3); Great importance (4); and Maximum importance (5).

Section C then proceeds to ask the respondents to indicate the extent, using the same five-point scale, that the factors provided were important in the divestment decision(s) of their firms in the past five financial years. The factors were categorised in the questionnaire into those which operate outside the firm and those operating inside the firm or the unit(s) divested, in order to facilitate an easy understanding of their relevance to the divestment activity of the respondents' company.

Finally, section D asked the respondents to indicate their opinions, with reference to the corporate divestment(s) of their respective firms, on 18 statements that were provided by previous researchers. The following five-point scale was used: Strongly disagree (1); Disagree (2); Neither agree or disagree (3); Agree (4); and Strongly agree (5).

Although the questionnaire is long, a respondent could certainly appreciate that each question was essential for the purposes of this study and easy to answer. It is therefore felt the length of the questionnaire is unlikely to have any adverse effect on response rate [Ambler (1977), and Whitley (1985)].

5.3.2 Efforts to increase response rate

A number of considerations have been undertaken to maximise response rates of this survey. Firstly, the questionnaire was pilot-tested within the Department of Accountancy

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at the University of Canterbury. The re-drafted questionnaire was then pilot-tested again with the chief executives of 10 Christchurch-based listed companies, who had kindly agreed to be interviewed at short notice. All of the chief executives interviewed found the questionnaire comprehensive, inspiring, thorough and "user-friendly". They did not believe that any aspect might inhibit their counterparts from replying promptly.

Secondly, the questionnaires were despatched together with an endorsement cum acknowledgement letter from the Dean of Commerce, Professor B. J. Clarke (see APPENDIX N). This approach is consistent with the empirical findings of Scott (1961) that official endorsement or sponsorship elicits higher response rates.8

Thirdly, a stamped return air-mail envelope was enclosed with each questionnaire for replies. Fourthly, a follow-up telephone call was made to the addressee of 35 companies identified to have undertaken a substantial amount of divestment in the past five years, as highlighted by an * in APPENDIX L. This technique has been very effective as most of the addressees who received a follow up telephone call returned their questionnaires.

Fifthly, a reminder letter, as shown in APPENDIX O, was sent to those companies that had not replied after 10 workings days. This technique is inspired by the findings of Whitley (1985) that reminder letters increase the response rate of a survey by up to one hundred percent.9 Finally, as an additional incentive to the addressees, they were asked to enclose their business card should they be interested in receiving a copy of the survey results. Given the large scale of companies surveyed in this study, it was anticipated that the study results will be of interest to many, including the addressees. It was hoped that this might prompt some chief executives to reply.

---


9 Whitley (1985), op. cited.
5.4 Statistical procedures and analyses

As noted in the introductory section, this research asked senior executives of sampled New Zealand listed companies to indicate the relative importance of a range of potential motives for their company's divestment activities, and a range of factors hypothesized to affect the divestment decision makings of their company. The first step taken was to compute the average response or arithmetic mean value for each of the motives and factors. Given that the executives were asked to indicate their opinion on a five-point scale, the mean value for each motive and factor thus ranges from the lowest 1-point to the highest 5-point. Both the motives and factors were then ranked in a descending order according to their mean value.

In section 5.5, the Spearman rank-correlation coefficient was computed to measure the association among two sets of rankings: the divestment motives for the first 10 and the last 10 replies.\(^{10}\) That is, the closer the value of the correlation coefficient is to +1, the greater the agreement between the two rank sets [Duckworth (1968), p. 214]. A t-test can then be used to test any null hypothesis that no association exists between the rank sets.

In short, this study utilises nonparametric (or to quote Ury (1967), "assumption-free") statistical methods to test the hypotheses presented in Chapter IV.\(^ {11}\) According to Bradley (1968), "a nonparametric test is one which makes no hypothesis about the value of a parameter in a statistical density function".\(^ {12}\) In the context of this research, the choice of nonparametrics, as Siegel (1956) observes, has the advantages: (i) to avoid making assumptions about the distribution of the data; and (ii) to appropriately handle the measurement level of the variables in an ordinal manner.

---


5.5 Limitations of the research methods and procedures

The major disadvantages of mail surveys generally relate to low response rates and problems of response vs. non-response bias, which are inter-related. Obviously, the greater the response, the more accurate it will estimate parameters in the population sampled. However, survey findings are representative of the population only if those who do not respond to the questionnaire do not differ in significant ways from those who do respond.

With respect to the first concern, every effort identified in the literature as likely to increase response rate has been adopted in this study, as discussed in section 5.3.2 above. Judging from the very positive response and favourable comments received from the chief executives of Christchurch based listed companies that were interviewed in the pilot-testing of the questionnaire, a low response rate was not considered to be a major problem in this study. This is evident in the sufficiently high effective response rate obtained (see also the discussion in section 6.2).

In relation to the problem of response and non-response bias, although it was not possible to test directly whether the non-response group systematically differed from the response group, efforts have nevertheless been made to extrapolate the differences in motives for divestment, as a proxy of non-response bias, between the first 10 replies with that of the last 10 replies. That is, the larger the differences between these two sub-groups, the higher the non-response bias, which in turn undermines the representativeness of the responses received. The basic assumption behind such efforts is that "subjects who respond less readily are more like those who do not respond at all than those who do respond readily (i.e. those who answer sooner and those who need less prodding to answer)" [Kanuk and Berenson (1975), p. 448].

TABLE 5-1 below summarises the ranking of ten motives for divestment between the first and last 10 responses. The Spearman rank correlation coefficient of 0.93 (which is significant at 0.01 level) shows a very high level of correlation between the two groups of
responses: the executives' responses in the two separate groups showed a high similarity in rankings. As there is no statistically significant difference between the early and late replies, non-response bias is thus expected to be minimal in this study and it is unlikely to affect the representativeness of the overall responses.

The judgement above is consistent with the information gathered from the telephone conversations with eight chief executives who had the courtesy to inform the writer that they would not like to participate in the survey. The main reason for non-response related to the "sensitive" and "confidential" nature of the topic under study, both in terms of the likely effects that divestment information may have on their companies' share price and the fact that it reflects the company's current and future strategic choices, rather than due to any a priori difference in parameters between the respondents and the non-respondents. Also judging from the wide industry distribution of the responding companies (see section 6.2.2), nowhere has an unusual lack of response been noted in this study. It is thus concluded that no significant bias exists within the questionnaires returned and any conclusions drawn thereafter.

<table>
<thead>
<tr>
<th>RANKS OF MOTIVES FOR DIVESTMENT</th>
<th>First 10 responses</th>
<th>Last 10 responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>To discarding undesired/unprofitable unit(s)</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>To focus on core activities</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Meeting a corporate liquidity requirement</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Good price offered for unit(s) divested</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>To shift resources into units with greater growth or opportunity</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Adverse economic environment</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>To finance the development of other investment</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Unfavourable performance of the company</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>High investment obligation in unit(s) divested</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>To reversing a previous management/investment mistake</td>
<td>9</td>
<td>9</td>
</tr>
</tbody>
</table>

**Spearman Rank Correlation Co-efficient**
(significant at 0.01 level)

<table>
<thead>
<tr>
<th>Spearman Rank Correlation Co-efficient</th>
<th>0.93</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student t-test</td>
<td>7.16</td>
</tr>
</tbody>
</table>

**TABLE 5-1** Extrapolation of responses between early and late replies
5.6 Summary

This chapter has summarised the methods by which data were collected for this research and the procedures by which those data were analysed. The selection of mail questionnaire as the appropriate research tool for this study was made carefully by taking full consideration of the sensitive and confidential nature of the topic, as observed by previous researchers. In addition, various considerations had also been undertaken to maximise response rates of the survey. In analysing the survey responses, no hypothesis has been made about the value and distribution of the data; this study utilises nonparametric statistical methods. Finally, the Spearman rank-correlation coefficient was computed to measure the association between the early and the late responses. The high level of correlation between the two groups shows that non-response bias is minimal in this study and is unlikely to affect the representativeness of the overall responses. Results of those analyses are presented in Chapter VI.
CHAPTER VI  RESEARCH RESULTS

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CHAPTER VI RESEARCH RESULTS

6.1 Introduction

This research tests a series of hypotheses on the motives for and factors influencing divestment activities of New Zealand listed companies. This chapter reports the results of the mail questionnaire survey and the hypotheses testing.

Section 6.2 summarises the response rates to the mail questionnaire survey, and some important characteristics about the respondents and their companies. Section 6.3 presents and discusses the results of the statistical tests on the motives for divestment. The statistical results on the environmental, organisational and performance factors hypothesized to affect divestment activities of New Zealand listed companies are discussed in section 6.4. This is followed by the results of the respondents' opinions on selected statements or research conclusions provided by previous researchers, set out in section 6.5. A comparison of differences between the divestors and the non-divestors is included in section 6.6. Finally, section 6.7 summarises the empirical evidence together with some concluding remarks.

6.2 Response Rates and characteristics of the respondents and their firms

From 98 companies sent the questionnaire, the survey saw 66 responses received. After allowing for 7 unusable responses, an effective response rate of approximately 60.2% was obtained. This response rate is similar, although slightly lower, to Feil's (1990) recent mail questionnaire survey on a somewhat opposite study on the motivations of mergers in New Zealand which yielded a 61.8% response rate.

However, when expressed in terms of market capitalisation, the responding companies comprised 79.1% of the total market capitalisation for all companies sent the
questionnaire.\textsuperscript{1} This indicates that most, if not all, major companies listed on the Stock Exchange responded to the survey. Therefore, the survey results and any conclusions drawn thereinafter will be an accurate and non-bias representation of the population.

From a total of 59 usable replies received, 36 companies (representing 61\% of the usable replies) reported undertaking at least one divestment over the past five financial years, while 23 companies (amounting to 39\% of the usable replies) reported otherwise, as shown in TABLE 6.1. The data gathered from these 36 companies forms the basis of the statistical analyses in this study. That is, 61\% of the usable replies are relevant for the purposes of this study and they were analysed vigorously to test the hypotheses developed in Chapter IV. However, the differences between divested and non-divested companies, particularly in relation to corporate size and diversification strategy adopted, are examined in fair detail in section 6.6

<table>
<thead>
<tr>
<th>Number of Replies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 1 divestment in the past 5 financial years</td>
<td>36</td>
</tr>
<tr>
<td>No divestment at all</td>
<td>23</td>
</tr>
<tr>
<td>Total</td>
<td>59</td>
</tr>
</tbody>
</table>

**TABLE 6-1** Breakdown of total usable replies

\textbf{6.2.1 Characteristics of the respondents}

TABLE 6-2 shows the job title of the respondents to the questionnaire survey. The respondents' positions ranged from group accountant to Chairman, but the majority of the respondents were managing directors. This distribution of respondents by their organisation position is similar to the findings of Duhaime and Grant (1984) where most of the respondents were vice presidents, generally of planning or corporate development

\textsuperscript{1} The total market capitalisation as at 31st March 1991 for all companies sent the questionnaire was $15,444 billion [see Buttle Wilson's Investment Year Book 1991]. The responding companies' market capitalisation amounted to $12,224 billion, which represented 79.1\% of the total market capitalisation.
[p.308]. In this respect, the survey findings confirm the overseas experience that divestment decisions were usually made at the very highest organisation levels.²

<table>
<thead>
<tr>
<th>Job Title</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>1</td>
<td>2.8%</td>
</tr>
<tr>
<td>Executive Chairman</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Managing Director</td>
<td>15</td>
<td>41.7%</td>
</tr>
<tr>
<td>Chief Executive</td>
<td>4</td>
<td>11.1%</td>
</tr>
<tr>
<td>Director</td>
<td>1</td>
<td>2.8%</td>
</tr>
<tr>
<td>General Manager</td>
<td>5</td>
<td>13.8%</td>
</tr>
<tr>
<td>Financial Controller</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td>Secretary</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Group Accountant</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

TABLE 6-2 Distribution of respondents by job title

### 6.2.2 Characteristics of the companies

The New Zealand Stock Exchange classifies listed companies according to their sector codes [see Question 2, APPENDIX M]. The distribution of our sample companies according to their sector codes is shown in TABLE 6-3. A total of 14 industries were represented by the sample companies. Given such a wide industry distribution, it is intuitively anticipated that the conclusions drawn from this sample would be a good representation of the population under study.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Sample</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td>Construction</td>
<td>1</td>
<td>2.8%</td>
</tr>
<tr>
<td>Finance and Banks</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Forestry</td>
<td>4</td>
<td>11.1%</td>
</tr>
<tr>
<td>Liquor &amp; Tobacco</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td>Media</td>
<td>1</td>
<td>2.8%</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Transport &amp; Tour</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>1</td>
<td>2.8%</td>
</tr>
<tr>
<td>Electrical</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Investment</td>
<td>4</td>
<td>11.1%</td>
</tr>
<tr>
<td>Meat &amp; by-products</td>
<td>2</td>
<td>5.6%</td>
</tr>
<tr>
<td>Medical supplies</td>
<td>3</td>
<td>8.3%</td>
</tr>
<tr>
<td>Property</td>
<td>5</td>
<td>13.8%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

TABLE 6-3 Distribution of companies by industry group

² See, for example, Gilmour (1973, p. 15), and Duhaime and Grant (1984, p. 308).
To give an indication on the size of the companies sampled, the survey asked the respondents to disclose the total annual gross sales of their companies for both the 1990 and the 1986 financial years. TABLE 6-4 summarises the distribution of companies for various sales ranges.

Out of the total 36 divesting firms which replied, it is intriguing to find that 30 companies (i.e. 83.3%) had increased their annual gross sales approximately 339.3% since 1986. The other six companies reported a 28.1% decrease in sales over the same duration. Although not conclusive without further investigation, this finding nevertheless indicates that a significant portion of listed firms undertook divestments to reshape their corporate strategy, focus and direction as part the efforts to increase corporate size; this being illustrated by the significant increment in their annual gross sales.

<table>
<thead>
<tr>
<th>SALES (million)</th>
<th>1990</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 1,000</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>900-1,000</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>800-900</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>700-800</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>600-700</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>500-600</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>400-500</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>300-400</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>200-300</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>100-200</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>&lt; 100</td>
<td>21</td>
<td>27</td>
</tr>
<tr>
<td><strong>Total companies</strong></td>
<td><strong>36</strong></td>
<td><strong>36</strong></td>
</tr>
</tbody>
</table>

**TABLE 6-4** Distribution of companies by sales (in million)

In addition, it is encouraging to see that as high as 30 companies (i.e. 83.3%) considered the divestment(s) undertaken as part of their routine strategic planning processes. The other 6 companies (which are totally different from the six companies identified above) reported that divestment consideration was not part of their strategic planning exercises, as summarised in FIGURE 6-1. This finding is significant as it indicates that the importance
of divestment as an integral aspect of corporate restructuring process may be appreciated or practised by a sizable proportion of New Zealand's senior managers. However this observation is not totally unexpected given the relatively high level of corporate restructuring activities that have been undertaken by New Zealand companies since the share market crash.\(^3\) Therefore, one could reasonably expect divestment considerations an integral aspect of senior executives' "legitimate restructuring tools" in adapting to change.

![Graph showing divestment part of strategic planning](image)

**FIGURE 6-1** Divestment consideration and strategic planning

6.2.3 Size of divestments

With respect to the divestments undertaken by the responding companies, the majority of the divestments were less than 5% of the company's total assets, as shown in FIGURE 6-2. The frequency of divestment varies between the lowest of one to the highest of 25 divestments in the past five financial years. Eighteen of these companies reported to have undertaken less than 10 divestments, while 4 companies indicated that they had undertaken between 12 to 25 divestments.

![Graph showing frequency of divestment less than 5% of total assets](image)

**FIGURE 6-2** Frequency of divestment less than 5% of total assets

On the other hand, 16 companies reported that they had undertaken between one to three divestments, which amounted to between 5% to 10% of their companies' total assets, with the exception of one company which undertook 15 divestments of such a size, as illustrated in FIGURE 6-3.
FIGURE 6-3  Frequency of divestment between 5% to 10% of total assets

Finally, FIGURE 6-4 shows that 17 companies reported undertaking between one to four divestments that were more than 10% of their companies' total assets, with one company undertaking 7 divestments of such a magnitude.

FIGURE 6-4  Frequency of divestment more than 10% of total assets
6.2.4 Principal type of divestment

The executives were asked to indicate the principal type of divestment which their companies had engaged in. Seven divestment options were outlined in the questionnaire, namely: sell-off; spin-off; management buy-out; divestment by franchising; divestment by contracting out; asset swap; and liquidation of unit [see Question 8, APPENDIX M]. FIGURE 6-5 summarises the findings where the majority (i.e. 77.8%) of divestment activities in New Zealand are classified as sell-off.

FIGURE 6-5 Principal type of divestments in New Zealand
6.3 Statistical results on the motives for divestment

As discussed in section 4.3, the respondents were asked to indicate the relative importance of each of the 30 motives for divestment on a five-point scale. TABLE 6-5 ranks the motives for divestment considered relevant by the respondents according to the mean value of each of the motives.

The respondents identified five motives that were important in explaining the divestment activities undertaken by their firms. This relatively small number of motives for divestment, to some extent, signifies the similarity in economic decisions that firms have to make in a small economy such as New Zealand's.

Examination of TABLE 6-5 suggests several tentative conclusions regarding divestment motives in New Zealand. The use of divestment to discard undesired and/or unprofitable unit(s) is considered of "great importance" in terms of the ranking and the level of mean response. It is the only divestment motive which has a mean response of greater than 4-points. Several reasons may explain the emphasis on divestment as a "house-cleaning" tool.

Firstly, there has been an emerging trend, not only in New Zealand but also internationally, for businesses to focus on their core activities (HM20). Put another way, the prevalent business philosophy is for firms to concentrate on what they do best or "stick to their knitting". In this respect, those unprofitable, undesirable, and peripheral units would be divested.

Second, abandoning unwanted and poorly performed business units in effect enabled the firms to channel their limited resources into higher valued or more efficient users (i.e. HM19), and as a result, the overall corporate efficiency would increase. This finding is consistent with the overseas experience observed by Weston (1989, p. 76).

---

4 See, for example, Peters (1988), and section 2.4 of this study.
<table>
<thead>
<tr>
<th>Motives for Divestment</th>
<th>Mean</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>HM12: To discard undesired/unprofitable unit(s)</td>
<td>4.17 *</td>
<td>1</td>
</tr>
<tr>
<td>HM20: To focus on core activities</td>
<td>3.94 *</td>
<td>2</td>
</tr>
<tr>
<td>HM9: Meeting a corporate liquidity requirement</td>
<td>3.83 *</td>
<td>3</td>
</tr>
<tr>
<td>HM5: Good price offered for unit(s) divested</td>
<td>3.50 *</td>
<td>4</td>
</tr>
<tr>
<td>HM19: To shift resources into units with greater growth or opportunity</td>
<td>3.06 *</td>
<td>5</td>
</tr>
<tr>
<td>HM3: Adverse economic environment</td>
<td>2.97</td>
<td>6</td>
</tr>
<tr>
<td>HM18: To finance the development of other investment</td>
<td>2.75</td>
<td>7</td>
</tr>
<tr>
<td>HM1: Unfavourable performance of the company</td>
<td>2.72</td>
<td>8</td>
</tr>
<tr>
<td>HM10: High investment obligation in unit(s) divested</td>
<td>2.67</td>
<td>9</td>
</tr>
<tr>
<td>HM14: To reversing a previous management/investment mistake</td>
<td>2.61</td>
<td>10</td>
</tr>
<tr>
<td>HM13: To reduce the number and diversity of operating units</td>
<td>2.47</td>
<td>11</td>
</tr>
<tr>
<td>HM11: To harvest successful businesses</td>
<td>2.14</td>
<td>12</td>
</tr>
<tr>
<td>HM7: Loss of market share by unit(s) divested</td>
<td>1.97</td>
<td>13</td>
</tr>
<tr>
<td>HM23: To reduce risk due to over-diversification</td>
<td>1.89</td>
<td>14</td>
</tr>
<tr>
<td>HM4: Shortage of managerial talent</td>
<td>1.81</td>
<td>15</td>
</tr>
<tr>
<td>HM17: To free up managerial talent for other opportunities</td>
<td>1.75</td>
<td>16</td>
</tr>
<tr>
<td>HM2: Loss of competitive advantage due to new constraints</td>
<td>1.67</td>
<td>17</td>
</tr>
<tr>
<td>HM8: Changes in regulations have made divestment possible</td>
<td>1.58</td>
<td>18</td>
</tr>
<tr>
<td>HM6: Loss of economies of scale in production or distribution</td>
<td>1.53</td>
<td>19</td>
</tr>
<tr>
<td>HM25: To withdraw from segments where suppliers are powerful</td>
<td>1.53</td>
<td>19</td>
</tr>
<tr>
<td>HM27: To withdraw from product/industry approaching maturity</td>
<td>1.53</td>
<td>19</td>
</tr>
<tr>
<td>HM26: To withdraw from segments where customers are powerful</td>
<td>1.50</td>
<td>22</td>
</tr>
<tr>
<td>HM21: To withdraw from own production in favour of importing</td>
<td>1.36</td>
<td>23</td>
</tr>
<tr>
<td>HM29: To abandon product lines where threat of substitutes is strong</td>
<td>1.33</td>
<td>24</td>
</tr>
<tr>
<td>HM30: To facilitate growth of unit(s) divested as an independent concern</td>
<td>1.33</td>
<td>24</td>
</tr>
<tr>
<td>HM24: To abandon obsolete technology or expertise</td>
<td>1.28</td>
<td>26</td>
</tr>
<tr>
<td>HM28: To withdraw from segments subject to adverse public image</td>
<td>1.14</td>
<td>27</td>
</tr>
<tr>
<td>HM15: To defend against hostile takeover bids</td>
<td>1.11</td>
<td>28</td>
</tr>
<tr>
<td>HM22: To focus on units protected by high barriers to entry</td>
<td>1.08</td>
<td>29</td>
</tr>
<tr>
<td>HM16: To meet government requirements</td>
<td>1.03</td>
<td>30</td>
</tr>
</tbody>
</table>

* = factors considered important (i.e. greater than 3-points)

**TABLE 6-5** Ranking and mean response for divestment motives

In addition, the comparatively high mean value and ranking for HM9 indicates that a sizable proportion of divestment activities in New Zealand were motivated by *corporate liquidity problems*. This also reflects our interview finding with the chief executives of
most Christchurch-based listed companies where the companies divested because "the bankers were knocking on our doors".\textsuperscript{5} This phenomenon is self explanatory if one examines the list of companies which had been put into receivership, statutory management, and liquidation recently.\textsuperscript{6}

Finally, a sizable number of companies engaged in divestments because a good price was offered for those units divested, \textbf{HM5}. This finding is not unexpected in view of the vehemence of firms to discard "lack of fit" units and to meet their corporate liquidity requirements. On the other hand, some of these firms could have divested to shift their resources into units promising greater growth or opportunity.

In short, the senior executives surveyed do appear to have approached the divestment activities of their firms in a rational manner and have acted to safeguard both the interest of the firm and those of the shareholders. In general, they attempted, on one hand, to increase the overall efficiency of the firms by getting rid of those unprofitable and undesirable units so that the resources made available could be channelled into higher valued users. On the other hand, the objective of increasing the overall corporate efficiency had to be balanced with the urgency of meeting the liquidity requirements of the firms. Therefore, a firm could be more than willing to divest if a good price was offered, particularly if the need to improve its liquidity was vital for the firm to continue operating as a going concern.

\textsuperscript{5} For confidentiality, the names of the companies, unfortunately, cannot be disclosed.

\textsuperscript{6} For a brief list of companies which are currently in financial distress, see APPENDIX K.
6.4 Statistical results on factors affecting corporate divestments in New Zealand

This section presents and discusses the statistical results of factors hypothesized to affect corporate divestments in New Zealand. As noted in the methodology chapter, the respondents were given a list of 32 factors for which they were asked to indicate the relative importance of each of these factor on a five-point scale.

In general, the research results identify a number of statistically significant environmental, organisational, and performance factors which senior executives considered important in relation to the divestment experience of their respective companies in the past five years. TABLE 6-6 shows the mean and ranking of each factor in their respective categories. For simplicity, each category of the factors is discussed first. This is followed by an overall ranking of the factors.

6.4.1 Environmental factors

With respect to environmental factors, the survey results identify general economic environment (HE1) and industry growth (HE2), which are inter-related, to be important influences on firms' divestment decision-making. Both factors have a high mean value of 3.69 and 3.35 respectively. A clear gap is also observed between these two factors and those which are considered not important. The finding of industry effects on divestment is consistent with a recent observation by Hamilton and Shergill (1989) that "the long term performance of a company is tied to the prospects of the industry or industries in which it operates" [p. 95].
<table>
<thead>
<tr>
<th>(I) ENVIRONMENTAL FACTORS</th>
<th>MEAN</th>
<th>RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>HE1: general economic environment</td>
<td>3.69 *</td>
<td>1</td>
</tr>
<tr>
<td>HE2: industry growth</td>
<td>3.35 *</td>
<td>2</td>
</tr>
<tr>
<td>HE7: changes in competitive advantage due to deregulation</td>
<td>2.47</td>
<td>3</td>
</tr>
<tr>
<td>HE5: tax law changes such as loss carry-forward</td>
<td>2.44</td>
<td>4</td>
</tr>
<tr>
<td>HE8: changes in competitive advantage due to removal of tariff</td>
<td>2.44</td>
<td>4</td>
</tr>
<tr>
<td>HE6: ability to re-enter later</td>
<td>2.42</td>
<td>6</td>
</tr>
<tr>
<td>HE3: technology change</td>
<td>1.93</td>
<td>7</td>
</tr>
<tr>
<td>HE4: cost of over regulation</td>
<td>1.22</td>
<td>8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(II) ORGANISATIONAL FACTORS</th>
<th>MEAN</th>
<th>RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>HO11: shortages of capital</td>
<td>3.50 *</td>
<td>1</td>
</tr>
<tr>
<td>HO3: capital investment requirements</td>
<td>3.42 *</td>
<td>2</td>
</tr>
<tr>
<td>HO16: high degree of diversification within the firm</td>
<td>3.37 *</td>
<td>3</td>
</tr>
<tr>
<td>HO1: asset specificity of the divesting firm</td>
<td>3.13 *</td>
<td>4</td>
</tr>
<tr>
<td>HO10: shortages of management</td>
<td>3.13 *</td>
<td>4</td>
</tr>
<tr>
<td>HO15: organisational structure of the firm</td>
<td>3.03 *</td>
<td>6</td>
</tr>
<tr>
<td>HO17: overall company diversity</td>
<td>3.00 *</td>
<td>7</td>
</tr>
<tr>
<td>HO2: asset durability of the diverting firm</td>
<td>2.50</td>
<td>8</td>
</tr>
<tr>
<td>HO14: size of firm in relation to industry counterparts</td>
<td>2.47</td>
<td>9</td>
</tr>
<tr>
<td>HO18: intra-firm sales between units</td>
<td>2.44</td>
<td>10</td>
</tr>
<tr>
<td>HO19: intra-firm purchases between units</td>
<td>2.44</td>
<td>10</td>
</tr>
<tr>
<td>HO4: technology requirements</td>
<td>2.42</td>
<td>12</td>
</tr>
<tr>
<td>HO13: staff resistance to divestment</td>
<td>1.63</td>
<td>13</td>
</tr>
<tr>
<td>HO12: management resistance to divestment</td>
<td>1.31</td>
<td>14</td>
</tr>
<tr>
<td>HO6: sharing of plant and equipment between units</td>
<td>1.25</td>
<td>15</td>
</tr>
<tr>
<td>HO5: transfer of technology between units</td>
<td>1.19</td>
<td>16</td>
</tr>
<tr>
<td>HO9: shortages of technology</td>
<td>1.17</td>
<td>17</td>
</tr>
<tr>
<td>HO20: cost of adjustment</td>
<td>1.16</td>
<td>18</td>
</tr>
<tr>
<td>HO7: shortages of labour</td>
<td>1.03</td>
<td>19</td>
</tr>
<tr>
<td>HO8: shortages of materials</td>
<td>1.03</td>
<td>19</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(III) PERFORMANCE FACTORS</th>
<th>MEAN</th>
<th>RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td>HP1: low return of unit(s) divested</td>
<td>4.17 *</td>
<td>1</td>
</tr>
<tr>
<td>HP2: low revenue growth of unit(s) divested</td>
<td>3.67 *</td>
<td>2</td>
</tr>
<tr>
<td>HP3: low price-earnings ratio of firm</td>
<td>3.20 *</td>
<td>3</td>
</tr>
<tr>
<td>HP4: low capacity utilisation of unit(s) divested</td>
<td>2.72</td>
<td>4</td>
</tr>
</tbody>
</table>

* = factors considered important (i.e. greater than 3-points)

**TABLE 6-6** Mean value and ranking of factors according to their respective classifications
6.4.2 Organisational factors

Additionally, the survey results identify seven organisational factors that are considered important by the respondents. Senior executives considered both shortages of capital (HO11) and high capital investment requirements of unit(s) divested (HO3) the primary factors affecting the divestments undertaken by their companies. With respect to the former, divestment is regarded as an important means of raising capital [Linn and Rozell (1989), p. 154.] The additional funds raised from divestment may, for example, be invested in units promising greater growth or opportunity. However, if the capital investment requirement is too high or if a good price is offered, firms may be willing to divest these units even though they promise favourable returns. This observation, notably, is consistent with the motives of meeting corporate liquidity requirements, a good price being offered, shifting of resources into other units with greater potentials, and the need to discard undesired/unprofitable unit(s) which in turn necessitate the firm to focus on its core activities. These motives were discussed in section 6.3.

The finding that a high degree of diversification within the firm (HO16), organisational structure (HO 15), and overall company diversity (HO17) had a significant bearing on a firm's decisions to divest is well expected in view of the recent New Zealand empirical evidence provided by Hamilton and Shergill (1992) that "diversity drives structural changes" [p. 22].

To some extent, this study confirms the relationship and directionality\(^7\) between diversification and organisational structure originally observed by Chandler (1962), which

has now been extended to the behaviour of New Zealand companies by Hamilton and Shergill. Concerned with the high degree of diversification and the overall diversity within the firm, the survey results suggest that senior executives in New Zealand utilised divestment as essential management tool to consolidate, if not to re-develop from scratch, existing corporate strategies. Needless to say, when a firm changes its diversification strategy or the level of corporate diversity significantly, by way of either divestment or other corporate restructuring techniques, such an undertaking will in turn impact upon its organisational structure.

In the case of New Zealand which has a relatively small economy, it is not surprising that the results indicate asset specificity of the divesting firm (HOI) as an important consideration in the divestment decision making of firms. Being "an island economy" which suggests isolation and parochialism⁸, it is not unusual to find that assets which have alternative uses may not be sold locally. In this respect, Savage and Hazledine (1990, p. 13) urge companies to distinguish between those assets which can be traded regionally or internationally and those which cannot. They highlight the situation of meatworks in rural areas where, although in principle the buildings could be used for other activities, the market for such properties is nevertheless very thin (p. 14).

Contrary to the common theme in industrial organisation economics literature which treats asset specificity and durability hand in hand (see section 3.2.3), the survey respondents however did not consider asset durability an important divestment decision variable. Unfortunately, the main reason for the lack of emphasis on asset durability is unclear from the survey results. Nevertheless, given the observation by Eaton and Lipsey (1980) that asset value depends crucially on its durability, and the survey results indicating low return of unit(s) divested as the single most significant factor affecting a firm's divestment

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decisions i.e. to discard “loser” (see TABLE 6-7), it is likely that firms in New Zealand were realising their assets divested well below their replacement cost.\footnote{See also the comments of Savage and Hazledine (1990), p. 12.}

Finally, the respondents indicated that they undertook divestment(s) because of shortages of management (HO10). Although this finding is contradictory to the previous research observation that management constitutes a barrier to exit (see section 3.2.2), it is nonetheless consistent with the statistically insignificant emphasis being placed on management and staff resistance to divestment (HO12 and HO13 respectively) observed in this study. Furthermore, consistent with the study on company turnarounds in New Zealand by Addison and Hamilton (1988), this finding is significant as it signifies that poorly performing or declining units were divested as there was a lack of good management to turnaround those units.

### 6.4.3 Performance factors

The research results suggest that, all factors considered, comparatively strong emphases were placed on performance factors by New Zealand senior executives in the divestment decision-making of their firms. The mean values for low return of unit(s) divested (HP1), low revenue growth of unit(s) divested (HP2), and low price-earnings ratio of firm (HP3) are statistically significant, particularly for HPI where it has the highest mean value (i.e. 4.17) and ranks top overall as the single most important factor influencing divestment decision makings of firms in New Zealand.

Significantly, this finding is not only consistent with, but also reconfirms, the exceptionally high emphasis placed on the need to discard undesirable/unprofitable units, which was regarded by the respondents as the predominant motive for divestment.
By and large, our empirical evidence extends overseas experience, particularly that in the U.S.A., to the divestment behaviour of New Zealand companies. In a case study of factors influencing the divestment decision making of 40 "Fortune 500" firms, Duhaime and Grant (1984) find that only 7% of units divested performed better than those non-divested units, with more than three-quarters performing worse than the non-divested units (p. 312). Similarly, they find the profit and sales growth rates of the divested units generally compared unfavourably to those of other units and their firm as a whole (p. 312). They substantiate that 40% of the units divested were sustaining losses and 44% were profitable, but at unacceptable low levels, with the remaining only 16% generating acceptable profit.

With respect to the firm’s performance as a whole, Duhaime and Grant find the financial strength of divesting firms (as measured by return on equity) to be lower and unfavourable in comparison to their industry counterparts (p. 310). The poorer performance of the divesting firms will presumably be reflected in their share price (assuming that capital markets are efficient), which largely justifies our finding that senior executives in New Zealand took into account the low price-earnings ratio of their firms as an important divestment decision variable.

6.4.4 Overall ranking of the factors

TABLE 6-7 shows an overall ranking of factors affecting divestment activities of New Zealand listed companies. The ranking provides more than just an interesting summary of statistics. The following discussions offer a number of qualitative interpretations and analyses of the overall ranking of factors.

Firstly, in view of the exceptionally high mean value for HP1, low return of units(s) divested ($\mu = 4.17$), and the high overall ranking for HP2, low revenue growth of unit(s) divested ($\mu = 3.67$), it is reasonable to infer that the principal factor influencing
divestment activities in New Zealand listed companies is to a great extent performance-oriented. This interpretation of the statistical results is affirmed by the over-riding concern of the responding firms to discard undesired/unprofitable units (HM12). In this respect, the comment by Anklesaria and Rivetti (1987, p. 17) is particularly apt: "divestment should be the logical consequence when the purpose for investment cannot be realised".

Second, the considerable amount of emphasis placed on the general economic environment, HE1, reflects the immense pressures that firms faced as a result of on-going deregulation and deflation on New Zealand industries since 1984.10 The underlying premise of this factor is that a firm needs to react if it faces competitive pressures. In the New Zealand context, as Bollard and Savage (1990, p. 2) observe, the removal of regulatory and protective measures has been the most prevalent signal for change. Coupled with the steady increase in international competition and wider external factors11 which affect a range of local industries, it is anticipated that firms needed more than ever to follow closely the latest development in the general economic environment and also the industry growth to assess their strategic measures and, if necessary, to make structural adjustment, either through divestment or other restructuring techniques, to improve their competitive advantage. This observation is consistent with the recent survey finding of Campbell et al. (1989) that, among many external factors, inadequate industry growth (which in turn reduced profitability) was a predominant obstacle for firms seeking to achieve better performance.12

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10 See, for example, the comments of Bollard and Savage (1990), p. ix. APPENDIX P provides a summary of the major economic liberalisation measures and their areas of impact on New Zealand industries between 1984-1990.

11 Examples include external price shocks (e.g. the price of crude oil which sky-rocketed as a result of the Gulf War), and the recessions (or stagnation) which arose in many industrialised nations including the U.S.A.

<table>
<thead>
<tr>
<th>Factor Description</th>
<th>Mean</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low return of unit(s) divested</td>
<td>4.17</td>
<td>1</td>
</tr>
<tr>
<td>General economic environment</td>
<td>3.69</td>
<td>2</td>
</tr>
<tr>
<td>Low revenue growth of unit(s) divested</td>
<td>3.67</td>
<td>3</td>
</tr>
<tr>
<td>Shortages of capital</td>
<td>3.50</td>
<td>4</td>
</tr>
<tr>
<td>Capital investment requirements</td>
<td>3.42</td>
<td>5</td>
</tr>
<tr>
<td>High degree of diversification within the firm</td>
<td>3.37</td>
<td>6</td>
</tr>
<tr>
<td>Industry growth</td>
<td>3.35</td>
<td>7</td>
</tr>
<tr>
<td>Low price-earnings ratio of firm</td>
<td>3.20</td>
<td>8</td>
</tr>
<tr>
<td>Asset specificity of the divesting firm</td>
<td>3.13</td>
<td>9</td>
</tr>
<tr>
<td>Shortages of management</td>
<td>3.13</td>
<td>9</td>
</tr>
<tr>
<td>Organisational structure of the firm</td>
<td>3.03</td>
<td>11</td>
</tr>
<tr>
<td>Overall company diversity</td>
<td>3.00</td>
<td>12</td>
</tr>
<tr>
<td>Low capacity utilisation of unit(s) divested</td>
<td>2.72</td>
<td>13</td>
</tr>
<tr>
<td>Asset durability of the diverting firm</td>
<td>2.50</td>
<td>14</td>
</tr>
<tr>
<td>Changes in competitive advantage due to deregulation</td>
<td>2.47</td>
<td>15</td>
</tr>
<tr>
<td>Size of firm in relation to industry counterparts</td>
<td>2.47</td>
<td>16</td>
</tr>
<tr>
<td>Tax law changes such as loss carry-forward</td>
<td>2.44</td>
<td>17</td>
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<tr>
<td>Changes in competitive advantage due to removal of tariff</td>
<td>2.44</td>
<td>17</td>
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<td>Intra-firm sales between units</td>
<td>2.44</td>
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<tr>
<td>Intra-firm purchases between units</td>
<td>2.44</td>
<td>17</td>
</tr>
<tr>
<td>Ability to re-enter later</td>
<td>2.42</td>
<td>21</td>
</tr>
<tr>
<td>Technology requirements</td>
<td>2.42</td>
<td>21</td>
</tr>
<tr>
<td>Technology change</td>
<td>1.93</td>
<td>23</td>
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<tr>
<td>Staff resistance to divestment</td>
<td>1.63</td>
<td>24</td>
</tr>
<tr>
<td>Management resistance to divestment</td>
<td>1.31</td>
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<tr>
<td>Sharing of plant and equipment between units</td>
<td>1.25</td>
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<tr>
<td>Cost of over regulation</td>
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<td>Transfer of technology between units</td>
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<tr>
<td>Shortages of technology</td>
<td>1.17</td>
<td>29</td>
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<tr>
<td>Cost of adjustment</td>
<td>1.16</td>
<td>30</td>
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<tr>
<td>Shortages of labour</td>
<td>1.03</td>
<td>31</td>
</tr>
<tr>
<td>Shortages of materials</td>
<td>1.03</td>
<td>31</td>
</tr>
</tbody>
</table>

* = Factors considered important (i.e., greater than 3-points)

**TABLE 6-7** Overall ranking of factors affecting divestment activities in New Zealand
Third, the high overall ranking for both shortages of capital (HO11) and capital investment requirements (HO3) brings to light the extent that corporate liquidity problems, which could be exacerbated by the unfavourable economic outlook and industry growth discussed above, had incited the "divestment wave" in New Zealand. All things considered, one obvious means for management to generate funds is to sell off some assets.

In addition, the company diversity/diversification and organisational structure factors (namely HO15, HO16, and HO17) taken as a whole reflect a gradual change of corporate strategy by New Zealand companies. In a study of diversification patterns in New Zealand listed companies from 1975 to 1985, Hamilton and Shergill (1989, p. 3) find that "New Zealand has a relatively high proportion of conglomerate-types (i.e. unrelated and very high diversity); and, hence, a reduced proportion of related diversified companies". This pattern of diversification, according to the authors, seems to differ from that observed overseas, particularly in the UK (Channon, 1973) and U.S.A. (Rumelt, 1974 and 1982). Consistent with overseas research which has shown the financial performance of related-diversified companies to be superior to that of companies in the unrelated or highly diversified categories, our survey results suggest that a sizable proportion of New Zealand firms had over-diversified in the past, and the senior executives of these companies had undertaken divestments to reduce the high degree of diversification and to reorganise the structure of their firms. This approach is congruous with the emerging trend for a business to focus on its core businesses or to "stick to the knitting" (see Peters (1988)).

Related to the over diversification phenomena noted above is that firms needed to spread their already scarce management over a wider range of complex, unrelated and highly

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diversified businesses. As a result, the financial performance of the firm as a whole suffered due to bad management or poor investment decisions, which would presumably be reflected in the low price-earnings ratio (HP3) of the firms. It logically follows that some of the divisions or units acquired previously as part of the diversification strategy would have to be divested eventually, owing to shortages of management (HO10).

Finally, in restructuring the organisational structure consequent of a turning back from the previous diversification strategy, firms focused on the specificity of their assets (HO1) which, in a small economy like New Zealand, will determine the selling prices of those assets.

As a summary, the analyses and discussions of factors by both their categories and overall rankings above lead to the conclusion that senior executives of a sizable proportion of listed New Zealand firms had approached the divestment activities of their firm in a rational manner to reallocate the limited resources to more efficient uses, higher growth and profitable industries or sectors. This in turn signals a change in managerial attitudes, expectations, as well as corporate strategy.

6.5 Respondents' opinion on previous research conclusions

A secondary objective of this study has been to determine the opinions that senior executives held regarding certain divestment issues. As noted earlier, each executive was also asked to indicate the level of agreement-disagreement, on a five-point scale, with respect to 18 statements or conclusions provided by previous researchers. It was hoped that their responses on divestment issues would enable us, firstly, to examine the internal consistency of their responses on divestment motives and factors discussed above, and secondly, to identify overseas research findings that are applicable in New Zealand.
A divestment decision is usually made at the very highest organisation levels with virtually all the inputs leading to the decision provided by high level sources.

Divestments that are part of clearly identified corporate or business level strategies create more value than divestments that take place in a reactive or piecemeal manner or divestments arising from short term performance criteria.

Divestment is often crucial in generating funds for further acquisitions or investments.

Divestments succeed in moving corporate resources to more efficient users; and, as a result, overall corporate efficiency increases.

Divestment decisions set precedents and establish new performance boundaries to signal to the whole organisation in general that management attitudes and expectations have changed.

In the year before the divestment decision, performance of divested units will be less satisfactory than performance of the firm’s other units.

There is higher divestment rate for diversifying acquisitions than for related acquisitions.

A divesting firm earns more for its shareholders if it is in a strong financial position.

The divesting of assets unrelated to a firm’s primary line of business significantly enhances the shareholders’ wealth of the parent (divesting) company.

Divestment represents efforts to correct previous acquisition mistakes.

An acquirer sells a business it has improved or a business that once had synergies with the acquirer’s core business but no longer does.

It may be more difficult to divest a business that was developed internally than one added through acquisition or merger, as the former has strong internal commitment.

A change in management is the primary cause of divestment as the new managers are less likely to have their divestment decision clouded or biased by personal loyalties, previous decisions, organisational history, and the need to admit failure or place blame.

Divestment is primarily undertaken by firms that are performing less well than their industry counterparts.

A divestment decision is organisationally and personally painful to make as it requires some admission of failure or placing of blame on the part of the key decision maker.

Divestment is the evidence that acquisition strategies failed to increase and probably reduced value.

The preparation and presence of analytical data support was never substantial in the divestment decision making process, varying from small amounts to virtually none.

Much of the analytic support, if presented at all, was provided after the decision rather than before it, making it in fact a rationalization of the decision already taken rather than an analysis supporting a possible divestment decision.

FIGURE 6-6 Respondents’ opinion on previous research statements
FIGURE 6-6 shows the average response and relative rankings for each statement. The respondents identified 12 issues that are important to the divestment activities of their firms for the past five financial years, as indicated by an * in FIGURE 6-6. In general, the survey results are found to accord strongly with expectations and the observations on divestment motives and factors discussed above.

Consistent with our observation on the job title of the respondents [see section 6.2.1], the senior executives indicated that the divestment activities of their companies were usually made at the very highest organisational levels, with virtually all inputs leading to the decision provided by high level sources. This finding is similar to that of Gilmour (1973, p. 15).

To the extent that divestments were undertaken for strategic reasons, the respondents opined that, as Porter (1976) and Montgomery et al (1984, p. 831) observe, divestments which are part of clearly identified corporate or business level strategies create more value than those that take place in a reactive or piecemeal manner or divestments arising from short term performance criteria. To a significant extent, the respondents also see the divestment activities of their firm as setting precedents and establishing new performance boundaries to signal to the whole organisation that management attitudes and expectations have changed. This observation is significant as it confirms our supplication that firms should look ahead and develop relatively sophisticated rationales for divestment, rather than waiting until divestment is forced on them, as the company, represented by a portfolio of assets, must be continually reviewed, augmented, and pruned.

Besides, divestment is often crucial in generating funds for further acquisitions or investments. In this way, divestments succeed in moving the limited corporate resources to more efficient users; and, as a result, overall corporate efficiency increases. Likewise, a divesting firm earns more for its shareholders if it is in a strong financial position, where the need for a fire sale is lessened.
With respect to the level of diversity within the organisation, the respondents agreed that there is higher divestment rate for diversifying acquisitions than for related acquisitions, and added that the divestment of assets unrelated to a firm's primary line of business significantly enhances the shareholders' wealth of the divesting firm. In some cases, divestment represented efforts to correct previous acquisitions mistakes, presumably with respect to unrelated acquisitions. This observation is consistent with the overseas experience, particularly U.S.A., documented by Porter (1976) and Kaplan and Weisbach (1990, p. 1).

Generally, in the year before the divestment decision, performance of divested units will be less satisfactory than performance of the firm's other units. This is evident in our analyses of divestment factors that firms divested to discard undesired/unprofitable, low return and low revenue growth unit(s). In addition, a firm may divest a business it has improved on or a business that once had synergies with its core business but no longer does. This hopefully will enable it to channel resources into more efficient businesses or those which will complement its core activities.

Finally, in relation to the managerial side of divestment, the respondents concurred that it may be more difficult to divest a business that was developed internally than one added through acquisition or merger, as the former has strong internal commitment. This accords with the observation by Porter (1976, p. 27).

Contrary to Gilmour (1973, p. 145), the executives opined that a change in management is not necessary to bring about a divestment in New Zealand companies. The argument that new managers are less likely to have their divestment decision clouded or biased by personal commitment in the units divested cannot hold as our analyses above have already indicated that senior executives generally approach divestment activities of their firms in a rational manner.
6.6 A comparison of differences between divested and non-divested companies

This section examines the differences in corporate size and the associated level of diversity between the companies which had divested (hereafter referred to as "divestors") and those which had not (hereafter referred to as "non-divestors"). Such a comparison is particularly apt for the following purposes:

(i) To distinguish the **diversification patterns** between the divestors and non-divestors which in turn highlights the differences in strategies, if any, adopted by the companies respectively;

(ii) To provide additional evidence regarding the **over-diversification phenomenon** which has prevailed in a sizable proportion of New Zealand firms, as observed in this study and also by Hamilton and Shergill (1989); and finally

(iii) To examine the differences in **scope for divestment** between these two groups of respondents.

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**TABLE 6-8** Distribution of divestors and non-divestors by sales (in million)

AVERAGE SALES

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<tr>
<th></th>
<th>DIVESTORS</th>
<th>NON-DIVESTORS</th>
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<tr>
<td></td>
<td>$792.4m</td>
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<td></td>
<td>$131.7m</td>
<td>$97.8m</td>
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TABLE 6-8 summarises the distribution of divestors and non-divestors for various sales ranges. The average sales for the divestors in both the 1990 and 1986 financial years were $792.4m and $331.7m respectively. This is contrasted with the comparatively lower average sales for the non-divestors of $131.7m (for 1990) and $97.8m (for 1986). Put another way, the average sales for the divestors were approximately 600% higher than that of the non-divestors for the 1990 financial year. Although the difference was somewhat smaller for the 1986 financial year, the average sales for the divestors were still 339% higher than that of the non-divestors.

Consistent with the approach taken in section 6.2.2 where sales have been used as a proxy for company size, the comparison above provides some interesting analyses. Firstly, it shows that the divestors were, on average, approximately 3.4 times larger than the non-divestors for the 1986 financial year. The difference has grown even larger for the 1990 financial year where the divestors were six-times larger than the non-divestors. This leads to the general observation that the size of a divesting company is, on average, larger than a non-divesting company; this being illustrated by the significant difference in their annual gross sales.

Second, the observation on corporate size, when interpreted together with the findings of Shergill (1989) and Hamilton and Shergill (1992), will shed additional light on the level of diversity and the resulting scope for divestment between the divestors and non-divestors. In a study of the strategy-structure-performance of 103 companies listed on the New Zealand Stock Exchange on 1 April 1975 and 31 March 1985, Shergill (1989, p. 153) shows that company size in New Zealand is highly correlated with the type of diversification strategies that the company pursues. That is, "size varies directly with the level of diversity: as size increases so does diversity" (p. 153).

Given that divestors were, on average, larger than non-divestors as observed in the survey results, it is reasonable to maintain that, ceteris paribus, divesting companies in New Zealand are generally more diversified than those companies that had not divested. This
general observation reconfirms our earlier finding, together with Hamilton and Shergill (1989), that a sizable proportion of New Zealand firms had over-diversified, and the senior executives were undertaking divestments to reduce the high degree of diversification within the firm. In this respect, it is evident that the level of diversity within a firm increases its scope for divestment, as aptly summarised by Wright and Thompson (1987, p. 265) that:

The M-form of organisation increases the divestability of divisions/subsidiaries and such action in appropriate circumstances can help the M-form function more effectively.

6.7 Summary of research results

The previous sections have addressed the extent of support that was found in this research for the divestment motives and factors hypothesized in chapter IV. In short, the survey respondents identified five motives that were important in explaining the divestment activities undertaken by their firms in the past five financial years, namely:

(i) To discard undesired/unprofitable unit(s);

(ii) To focus on core activities;

(iii) Meeting a corporate liquidity requirement;

(iv) Good price offered for unit(s) divested; and

(v) To shift resources into units with greater growth or opportunity.

In addition, the survey results also identified 12 factors (out of a total of 32 factors hypothesized) that senior executives considered in making the divestment decisions of their firms. They are categorized into environmental, organisational, and performance
factors, and are ranked according to their mean values, as follows:

**Environmental factors**

(i) general economic environment;

(ii) industry growth;

**Organisational factors**

(iii) shortages of capital;

(iv) capital investment requirements;

(v) high degree of diversification within the firm;

(vi) asset specificity of the divesting firm;

(vii) shortages of management;

(viii) organisational structure of the firm;

(ix) overall company diversity;

**Performance factors**

(x) low return of unit(s) divested;

(xi) low revenue growth of unit(s) divested; and

(xii) low price-earnings ratio of firm.

Finally, the respondents were asked to indicate their opinions on 18 statements on divestment provided by previous researchers. The respondents identified 12 issues that they considered important in relation to the divestment activities of their firms. The results are summarised in FIGURE 6-6. In general, the opinions of the respondents are found to accord strongly with expectations.

Overall, it was found that the senior executives surveyed appear to have approached divestment activities of their firms in a rational manner and have acted to safeguard the interest of both the firm and the shareholders. It was also indicated that divestment considerations were part of the corporate strategic planning exercises of a sizable
proportion of New Zealand listed companies. This is not surprising as divestments decisions were generally made at the very highest organisational levels. In additional, the principal factor influencing divestment activities of New Zealand listed companies was found to be mainly performance-oriented. Further discussion of these results and their implications are included in Chapter VII.
CHAPTER VII  CONCLUSIONS AND IMPLICATIONS

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CHAPTER VII  CONCLUSIONS AND IMPLICATIONS

7.1 Introduction

The objective of this study has been to examine divestment as an integral aspect of corporate restructuring strategy. The approach taken is to survey senior executives of companies listed on the New Zealand Stock Exchange concerning the motives for and factors influencing the divestment activities of their companies. This chapter presents an overall summary of the research dissertation.

Section 7.2 summarises the empirical findings of this study, particularly with reference to the extent of support for the conceptual model of divestment developed. This is followed by a discussion on the limitations underlying the study, as set out in section 7.3. The implications of this research are outlined in section 7.4, while section 7.5 outlines some suggestions for future research. Finally, section 7.6 provides some concluding remarks to this chapter.

7.2 Empirical findings and the conceptual model of divestment

This section summarises the empirical findings of this study to illustrate the extent of support for the conceptual model of divestment developed in Chapter IV. In general, the research results offer strong support for this conceptual model of divestment. The model hypothesizes that selected environmental, organisational, and performance factors have significant influences on a firm’s motive(s) for divestment, which in turn determine the corresponding divestment strategy formulation and implementation adopted by firms.

With respect to environmental factors, senior executives considered both the general economic environment and industry growth to be important influences on the divestment
activities of their firms for the past five financial years. To a large extent, the considerable amount of emphasis placed on these two factors highlights the immense competitive pressures that firms faced as a consequence of the public policy reform which had been initiated since 1984 to: (i) improve economic welfare in terms of efficiency and equity gains; and (ii) provide a dynamic economy better able to adjust to sectoral shocks [Savage (1990), p. 27]. Hence, it is fair to maintain that firms need more than ever to follow closely the latest general economic development, both locally and internationally, and also industry growth in determining their strategic moves. In this respect, the appreciation and practice of divestment by senior executives as a "legitimate restructuring tool" is of paramount importance to bringing about the necessary structural changes that will improve the competitive advantages of their firms.

On the other hand, seven organisational factors were identified by the respondents as important divestment-decision variables. Both shortages of capital and capital investment requirements ranked top, among other factors, highlighting the extent that corporate liquidity problems had incited senior managers in New Zealand to resort to selling off assets as a means of raising capital. Likewise, divesting firms were concerned with the high degree of diversification within the firm, its organisational structure and the overall company diversity. These three factors taken as a whole signify a gradual change of corporate strategy and policy by New Zealand companies. When interpreted together with the observation by Hamilton and Shergill (1989, p. 3) which shows a sizable proportion of New Zealand firms to be unrelated-diversified companies, the survey results suggest that divesting firms had generally over-diversified in the past. Consequently, the senior executives of these companies had to undertake divestments to reduce the level of diversity and to reorganise the structure of their firms accordingly. Such an approach is consistent with the patterns of diversification overseas where the financial performance of related-diversified companies was shown to be superior to those companies which focused on unrelated or highly diversified activities [see Channon (1973) and Rumelt (1974 and 1982)].
In some instances, shortages of management had been the instigating factor in relation to the divestments undertaken by some firms. This may be related, at least partly, to the need for firms to spread their scarce management resources over a wide range of unrelated and highly diversified businesses, which would, inevitably, bring about bad management or poor investment decisions. Furthermore, coupled with the observation by Addison and Hamilton (1988), this finding supports the idea that poor performing or declining units were divested because there was a lack of good management to turn these units around.

The respondents also indicated that they paid considerable attention to the specificity of their assets in making divestment decisions. This is not surprising in a small island economy like New Zealand where the marketability of divested assets may be unduly limited, which in turn impacts upon the selling prices of those assets.

Additionally, the survey results show strong support for performance factors. Low return of unit(s) divested ranked top as the single most important factor influencing divestment decision-making of New Zealand firms. Similarly, low revenue growth of unit(s) divested (which is the resulting effect of the unfavourable industry growth observed above), which may in turn directly contribute to the low price-earnings ratio of the firm, were also considered seriously by senior executives prior to undertaking any divestment.

Finally, the respondents indicated five motives (which are internally consistent with the overall survey results on divestment factors discussed above) that were important in explaining the divestment activities of their firms. These motives for divestment are:

(i) To discarding undesired/unprofitable unit(s);
(ii) To focus on core activities;
(iii) Meeting a corporate liquidity requirement;
(iv) Good price offered for unit(s) divested; and
(v) To shift resources into units with greater growth or opportunity.

To a large extent, senior executives in listed companies had utilised divestment as a "house-cleaning" tool during the past five financial years. This approach highlighted the
pressures on firms to discard "lack of fit" or under-performed units, might it be in comparison with other units in the firm or in meeting budgeted targets. This also partly reflected the emerging business philosophy for firms to concentrate on what they do best (i.e. focusing on core activities) or "stick to their knitting". As a whole, the senior executives surveyed appear to have approached the divestment activities of their firms in a rational manner, and with the purposes of channelling the limited corporate resources to more efficient users. As a result, this has increased the overall corporate efficiency.

The divestment motives and factors discussed above are summarised in FIGURE 7-1 to complete and enrich the conceptual model of divestment developed earlier in this study. In effect, the strong empirical support for our conceptual model of divestment effectively confirms the fact that divestment decision is usually a complex and yet delicate process [see section 2.4]. It requires senior executives to take into full account the various circumstances besetting their firms at different times in different industries, this being illustrated in the wide range of factors that had influenced the divestment activities of the responding firms in the past five financial years. Likewise, the motives for divestment activity are also numerous and diverse, with more than one motive usually involved in a divestment decision.

In a sense, the model of divestment depicted in FIGURE 7-1 may be aptly described as "a corporate restructuring/divestment strategy model" since it describes how a corporate restructuring or divestment strategy is formulated, and the resulting impact of the firm's divestment strategy on its organisational characteristics, its performance, and the environment it operates in. It is undoubtedly a prescriptive tool for planning ahead, and the use of the model is based on the unstated underlying assumption that "operating with a rationally formulated and implemented strategy is preferable to the alternative" [Gilmour (1977), p. 34]. In short, it re-emphasises that divestment decision is a rational and strategic undertaking rather than a "crisis reaction".
FIGURE 7.1: A CONCEPTUAL MODEL OF DIVESTMENT DECISION-MAKING IN NEW ZEALAND FIRMS
7.3 Review and Limitations of the Research Dissertation

Interpretations of this study, as indeed of any study, should be tempered by an acknowledgement of its limitations. This section discusses the limitations of the research dissertation, and the restrictions and possible effects that they place on the generalizability of the study's results. In general, scope exists for improving the research design and methodology on several fronts.

Only large companies, specifically those that were listed on the New Zealand Stock Exchange at time of survey, were used in this study. However, this does not seem to limit the generalizability of this study. To have assets, product lines, subsidiaries, divisions or business units to divest without in any significant way jeopardizing or upsetting the operations of the other units or the ability of the firm to operate as a going concern, firms by nature must be diversified and are generally larger. Thus, listed companies represent a large proportion of the total population of firms which could undertake divestment.

As with any questionnaire study, issues of non-response and responses bias (the response rate was 60.2%) arise in interpreting the relative importance and rankings of the executives' responses on divestment motives and factors. Given the fact that the responding companies comprised 79.1% of the total market capitalisation for all companies sent the questionnaire, it is evident that most, if not all, major companies listed on the NZSE responded to the survey. The non-response bias is therefore minimal and is unlikely to affect the representativeness of the overall responses and the conclusions drawn thereafter. This conclusion is also supported by the high Spearman rank-correlation coefficient of 0.93 (significant at 0.01 level) between the early and late responses, outlined in section 5.5.

A large-scale empirical study aims to capture broad and generalizable patterns in the data. As such, many subtleties have to be sacrificed. Those divestment motives and factors that were statistically insignificant have been largely ignored. A clinical approach, coupled to the existing methodology, could perhaps enrich the results of such an enquiry.
In conclusion, although this study was not in any way seriously impaired by any of the above limitations, future research could, nevertheless, be enriched by directing careful attention to such constraints.

7.4 Implications of the Research Dissertation

This study makes several contributions to strategy research, particularly with respect to corporate restructuring strategy. The results of the research have significant implications for senior corporate executives, corporate strategists, public policy makers (whose policy in turn affects the behaviour of corporations) and for academic researchers on corporate strategy issues.

In a general sense, the research findings are useful for corporate policy makers in that they highlight the importance and increase the awareness of certain organisational contingencies. To the extent that corporate executives appreciate the effect that various factors had on others and their motives for divestment in the past, they may be better able to appraise the presence of those factors which are pertinent to the divestment decision-making of their firms and protect against any detrimental effect those factors may have on their decisions. At the minimum, early recognition of divestment influences, as Duhaime and Grant (1984, p. 314) observe, would allow either prompt action to realign the business unit to a viable position in the firm’s portfolio or initiation of divestment while the unit is still attractive to the buyers and thus commanding a favourable price. Put another way, the appreciation of divestment as a corporate strategy option provides corporate policy makers with a powerful tool for dealing with organisational and industrial restructuring.

To illustrate, if the environmental, organisational, and performance factors which this study identified as important divestment decision variables were present in a unit, and the parent company concerned had as part of its strategic measures the motives for divestment
observed in this study, the executives should, under these circumstances, divest rather than attempt to turnaround the particular unit.

In addition, the influence that some factors were reported to have on divestment decisions indicates that it would be appropriate for managers to give those factors due consideration in the design of their formal management system. As noted, poor performance and "lack of fit" were frequently mentioned as leading to the divestment of certain units. It appears that a sizable proportion of firms are not giving adequate attention to such issues in their diversification, acquisition or expansion decision-making. Therefore these firms are entering businesses with less than thorough analysis of the fit of those businesses within their portfolio of other assets or the type of management skills required to maintain those businesses and the possible effect that those businesses may have on the overall diversity of the firm as a whole.

In viewing the company as a portfolio of assets which must be continually reviewed, augmented and pruned, the results of this study should also encourage executives to develop systems and techniques that permit dynamic assessment of the operations and performance of the corporate portfolio mix, facilitate the alignment of subunits, and assure a strategy fit.

Furthermore, the finding that diversity or the level of diversification within the firm is a common influence on divestment decisions has important implications for managers contemplating possible acquisitions of business units. It appears that there are clear financial advantages in acquiring those businesses or expanding into areas that are related to and are able to complement the core activities of the parent. However, the constrain that such an acquisition may place on managerial resources cannot be over-emphasised.

For public policy makers, our empirical evidence suggests that divestment had been approached by firms in a rational manner and on average it had been value-creating or efficiency enhancing. Thus, it logically follows that any attempt to regulate divestment activities or structural restructuring of firms in a wider sense would seem to be counter-

intuitive. For such a policy not only increases the costs of adjustment, which in turn limits
the behaviour of firms, but it may also result in a "welfare loss" to society as a whole
because firms would be handicapped in any attempt to channel the limited resources to
more efficient users.

Finally, the contribution of this study to the advancement of research on corporate strategy
issues is significant. At the start, three inter-related literatures - industrial organisation
economics, corporate strategy, and finance - have been fused into a strategy model for
divestment. This inter-disciplinary conceptualisation captures dimensions of divestment
hitherto unexplored in a single study.

As noted in the introductory chapter, there has not been any empirical research on
corporate divestment in the Australasian region; the relatively large scale of this
pioneering investigation into the motives for as well as factors affecting corporate
divestment in New Zealand listed companies, and the diversity of the firms that
responded, undoubtedly broadens the base for future research. It has taken a lead in the
study of divestment, or corporate restructuring in general, by drawing together the
available research and enhancing our current understanding on divestment by providing
empirical evidence and theoretical explanations on the subject where future researchers
will be able to generate much contestable and empirically verifiable hypotheses.

7.5 Future Research Directions

Although this study served as a major step in developing a strategy perspective of
divestment, many questions remain unanswered. Previously cited limitations of this
research suggest a number of directions. One fruitful possibility would be to use field
research or case study and personal interview methodology to uncover the many subtleties
that have been sacrificed in this study. As Ginsberg (1984) argues, researchers should
attempt to employ combinations of different data sources and data base formation procedures. This comment certainly poses a formidable challenge to strategy scholars.

Since this study has identified important factors which individually are influential, further study of those factors should be pursued to determine their inter-relationship and relative impact on firms’ divestment motives. In this respect, factor analysis may be appropriate.

A closer examination of the units not divested by firms would probably be useful. A paired sample of units within firms could be constructed to study the differences among units divested, units considered but not divested, and those units not considered at all for divestment purposes. However, the extreme sensitivity of such information would probably severely limit the sample size of such a research.

This study finds that divestment decisions are usually made at the very highest organisational level with virtually all inputs leading to the decision provided by high level management sources. An examination of the contributions that lower management levels can make to produce better divestment results promises to be a worthwhile area for future research efforts.

Furthermore, to quote Tuzzolino (1987, p. 98), "researchers have not directed enough attention to the nature of divestment". In this study, divestment has been studied homogeneously. That is, divestment motives and factors are viewed as homogeneous for all types of divestment, may it be sell-off, spin-off, management buy-out, divestment by franchising or contracting out, or the extreme form of divestment namely, liquidation. It may be that the relative importance of divestment motives and factors differ between firms engaging in different types of divestments, although any conclusion here is beyond the scope of this study.

Taking a broader view, this study focussed on the relative importance of divestment motives and factors. Future research linking this research findings to the divestment strategy formulation and implementation would certainly be of great value.
In summary, the development of new approaches, methodological combinations, and higher levels of research is needed. Porter (1987) has labelled corporate strategy both "the darling and stepchild" of contemporary management practice and research. Having integrated various conceptual perspectives, this study provides some guidance for more fertile inquiry into divestment phenomena. It is hoped this study will serve as a template for future research on divestment strategy.

7.6 Summary

Overall, this study has shed some light on the "dynamics of change" that New Zealand has experienced over the past five years. It illustrates the diverse set of conditions and factors that underlie divestment decisions and, by inference, the diverse nature of the strategies that firms must adopt to deal with organisational and structural restructuring as a means of adapting to change, especially under the current economic climate.
ACKNOWLEDGEMENTS

First and foremost, I would like to thank my two supervisors, Professor Bevan Clarke (Department of Accountancy, University of Canterbury, Christchurch) and Dr. Bob Hamilton (Department of Management, University of Canterbury, Christchurch). Professor Bevan Clarke despite his heavy commitments kindly gave his invaluable advice, enthusiastic support, and perceptive criticism at all stages of the study. Likewise, Dr. Hamilton provided invaluable help and an unerring sense of professionalism, and proficiency in his role as thesis adviser and mentor. It is indeed my great privilege to have worked under their brilliant guidance. This study owes a great deal to their dedication and commitment to the cause of research. Words alone cannot adequately express my deep sense of gratitude to them.

I would also like to record my gratitude to the many corporate executives who provided their thoughts and comments by participating in the questionnaire and who have made this study possible, in particular a special appreciation to Mr D. Caselli, of Coopers and Lybrand.

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## APPENDIX A

### Options Available in a Corporate Divestment

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<th>Ownership severance</th>
<th>Relative frequency</th>
<th>New ownership form</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Franchising</td>
<td>Complete; limited period</td>
<td>Frequent</td>
<td>Subsidiary or independent</td>
</tr>
<tr>
<td>(2) Contracting-out</td>
<td>Complete, but trading relationship remains</td>
<td>Frequent</td>
<td>Subsidiary</td>
</tr>
<tr>
<td>(3) Sell-off</td>
<td>Complete; usually permanent</td>
<td>Small sell-offs frequent; part of a series Large sell-offs – function of crisis</td>
<td>Subsidiary</td>
</tr>
<tr>
<td>(4) Management/leverage buy-out</td>
<td>Usually complete &amp; permanent; parent may retain equity interest</td>
<td>Small – frequent Large – becoming more frequent in UK; frequent in US</td>
<td>Independent</td>
</tr>
<tr>
<td>(5) Spin-off/demerger</td>
<td>Split rather than severance; may involve dilution of ownership; usually permanent</td>
<td>Small – frequent, especially in high technology, where management takes equity stake</td>
<td>Quasi-independent</td>
</tr>
<tr>
<td>(6) Asset-swap/strategic trade</td>
<td>Complete, but exchange involved so size of parent maintained</td>
<td>Unusual; small asset-swaps may arise in anti-trust divestitures; large asset-swaps voluntary</td>
<td>Subsidiary</td>
</tr>
</tbody>
</table>

Spectrum of Divestment [Source: Wright and Coyne (1986), p. 3]
## APPENDIX B

<table>
<thead>
<tr>
<th>Years</th>
<th>Net Mergers and Acquisition Announcements</th>
<th>Number of Corporate Divestitures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>1,889</td>
<td>666</td>
</tr>
<tr>
<td>1981</td>
<td>2,395</td>
<td>830</td>
</tr>
<tr>
<td>1982</td>
<td>2,346</td>
<td>875</td>
</tr>
<tr>
<td>1983</td>
<td>2,533</td>
<td>932</td>
</tr>
<tr>
<td>1984</td>
<td>2,543</td>
<td>900</td>
</tr>
<tr>
<td>1985</td>
<td>3,001</td>
<td>1,218</td>
</tr>
<tr>
<td>1986</td>
<td>3,336</td>
<td>1,259</td>
</tr>
<tr>
<td>1987</td>
<td>2,032</td>
<td>807</td>
</tr>
</tbody>
</table>


Merger and Acquisition Announcements and the number of Corporate Divestment: 1980-1987

[Source: Schmidt (1990), p. 5]
APPENDIX C

Table 1

Number of acquisitions*, relative sizes of acquirer and target, and number and percentage of subsequent divestitures by year of acquisition completion. Sample consists of 271 Acquisitions of at least $100 million 1982 dollars.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Acquisitions</th>
<th>Average Target Value as Percentage of Acquirer Value</th>
<th>Number Divested</th>
<th>Percentage Divested</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>8</td>
<td>35.6%</td>
<td>5</td>
<td>62.5%</td>
</tr>
<tr>
<td>1972</td>
<td>4</td>
<td>28.9%</td>
<td>1</td>
<td>25.0%</td>
</tr>
<tr>
<td>1973</td>
<td>9</td>
<td>22.3%</td>
<td>7</td>
<td>77.8%</td>
</tr>
<tr>
<td>1974</td>
<td>7</td>
<td>19.6%</td>
<td>2</td>
<td>28.6%</td>
</tr>
<tr>
<td>1975</td>
<td>7</td>
<td>34.1%</td>
<td>4</td>
<td>57.1%</td>
</tr>
<tr>
<td>1976</td>
<td>16</td>
<td>19.8%</td>
<td>8</td>
<td>50.0%</td>
</tr>
<tr>
<td>1977</td>
<td>30</td>
<td>26.1%</td>
<td>12</td>
<td>40.0%</td>
</tr>
<tr>
<td>1978</td>
<td>39</td>
<td>28.0%</td>
<td>16</td>
<td>41.0%</td>
</tr>
<tr>
<td>1979</td>
<td>45</td>
<td>28.1%</td>
<td>23</td>
<td>51.1%</td>
</tr>
<tr>
<td>1980</td>
<td>30</td>
<td>25.7%</td>
<td>12</td>
<td>40.0%</td>
</tr>
<tr>
<td>1981</td>
<td>34</td>
<td>28.4%</td>
<td>17</td>
<td>50.0%</td>
</tr>
<tr>
<td>1982</td>
<td>42</td>
<td>24.6%</td>
<td>12</td>
<td>28.6%</td>
</tr>
<tr>
<td>Total</td>
<td>271</td>
<td>25.6%</td>
<td>119</td>
<td>43.9%</td>
</tr>
</tbody>
</table>

* Acquisition sample is taken from Mergers and Acquisitions magazine lists of the largest completed deals of the year from 1971 - 1982. Excludes foreign company, insurance company, bank, and railroad acquirers. All acquirers have stock returns available from CRSP. Value of transaction exceeds 5% of the equity market value of the acquirer twenty trading days before the initial acquisition announcement.

* Acquisitions are considered diversifying or not highly related if one of the four most important business of the acquirer and target are not in the same three-digit or four-digit SIC codes industry according to Dun and Bradstreet's Million Dollar Directory.

* Target value is the final purchase price of the target. Acquirer value is the equity market value of the acquirer twenty trading days before the initial acquisition announcement.

Divestment/Acquisition Percentage

[Source: Kaplan and Weisbach (1990), TABLE 1]
APPENDIX D

EXIT AND ENTRY RATES FOR N.Z. MANUFACTURING INDUSTRIES (AVERAGE 1980-84)
(RANKED FROM HIGHEST TO LOWEST EXIT RATE)

<table>
<thead>
<tr>
<th>INDUSTRY</th>
<th>ENTRY RATE</th>
<th>EXPANSION RATE</th>
<th>CONTRACTION RATE</th>
<th>EXIT RATE</th>
<th>NO. OF FIRMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial chemicals</td>
<td>7.8%</td>
<td>13.3%</td>
<td>18.9%</td>
<td>10.8%</td>
<td>11</td>
</tr>
<tr>
<td>Miscellaneous manufacturing</td>
<td>5.0%</td>
<td>30.4%</td>
<td>17.1%</td>
<td>8.6%</td>
<td>66</td>
</tr>
<tr>
<td>Plastic products</td>
<td>2.6%</td>
<td>23.5%</td>
<td>19.7%</td>
<td>7.9%</td>
<td>50</td>
</tr>
<tr>
<td>Glass</td>
<td>7.4%</td>
<td>27.9%</td>
<td>11.4%</td>
<td>7.6%</td>
<td>15</td>
</tr>
<tr>
<td>Clothing</td>
<td>4.5%</td>
<td>19.4%</td>
<td>19.5%</td>
<td>7.2%</td>
<td>141</td>
</tr>
<tr>
<td>Animal feeds etc</td>
<td>4.6%</td>
<td>17.8%</td>
<td>24.3%</td>
<td>7.1%</td>
<td>19</td>
</tr>
<tr>
<td>Pottery and china</td>
<td>16.1%</td>
<td>7.1%</td>
<td>14.2%</td>
<td>7.1%</td>
<td>7</td>
</tr>
<tr>
<td>Furniture etc</td>
<td>3.9%</td>
<td>24.4%</td>
<td>18.8%</td>
<td>6.9%</td>
<td>107</td>
</tr>
<tr>
<td>Electrical apparatus</td>
<td>3.9%</td>
<td>22.3%</td>
<td>13.1%</td>
<td>6.9%</td>
<td>62</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>2.4%</td>
<td>22.9%</td>
<td>21.7%</td>
<td>6.8%</td>
<td>97</td>
</tr>
<tr>
<td>Machinery</td>
<td>3.9%</td>
<td>19.5%</td>
<td>19.1%</td>
<td>6.4%</td>
<td>165</td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>0.0%</td>
<td>19.8%</td>
<td>29.2%</td>
<td>6.3%</td>
<td>8</td>
</tr>
<tr>
<td>Wood and wood products</td>
<td>3.6%</td>
<td>22.1%</td>
<td>15.6%</td>
<td>6.2%</td>
<td>169</td>
</tr>
<tr>
<td>Food manufacture</td>
<td>4.4%</td>
<td>24.5%</td>
<td>17.0%</td>
<td>5.9%</td>
<td>183</td>
</tr>
<tr>
<td>Other chemicals</td>
<td>3.8%</td>
<td>6.8%</td>
<td>16.6%</td>
<td>5.8%</td>
<td>28</td>
</tr>
<tr>
<td>Metal products</td>
<td>3.9%</td>
<td>23.1%</td>
<td>17.0%</td>
<td>5.6%</td>
<td>260</td>
</tr>
<tr>
<td>Measuring etc equipment</td>
<td>2.5%</td>
<td>7.5%</td>
<td>10.3%</td>
<td>5.3%</td>
<td>10</td>
</tr>
<tr>
<td>Textiles manufacture</td>
<td>2.2%</td>
<td>18.8%</td>
<td>21.8%</td>
<td>5.2%</td>
<td>69</td>
</tr>
<tr>
<td>Printing and publishing</td>
<td>5.6%</td>
<td>20.8%</td>
<td>12.7%</td>
<td>4.8%</td>
<td>126</td>
</tr>
<tr>
<td>Beverages</td>
<td>1.1%</td>
<td>14.0%</td>
<td>20.6%</td>
<td>4.8%</td>
<td>22</td>
</tr>
<tr>
<td>Non-ferrous metals</td>
<td>4.9%</td>
<td>20.1%</td>
<td>16.6%</td>
<td>4.7%</td>
<td>16</td>
</tr>
<tr>
<td>Footwear</td>
<td>4.8%</td>
<td>11.8%</td>
<td>27.9%</td>
<td>6.2%</td>
<td>22</td>
</tr>
<tr>
<td>Leather</td>
<td>6.7%</td>
<td>21.2%</td>
<td>19.9%</td>
<td>4.3%</td>
<td>36</td>
</tr>
<tr>
<td>Paper and products</td>
<td>4.0%</td>
<td>14.1%</td>
<td>18.2%</td>
<td>4.0%</td>
<td>26</td>
</tr>
<tr>
<td>Rubber products</td>
<td>2.9%</td>
<td>22.3%</td>
<td>13.8%</td>
<td>3.0%</td>
<td>17</td>
</tr>
<tr>
<td>Other non-metals</td>
<td>2.5%</td>
<td>17.4%</td>
<td>20.7%</td>
<td>2.6%</td>
<td>73</td>
</tr>
<tr>
<td>Petrol and coal products</td>
<td>0.0%</td>
<td>25.0%</td>
<td>12.0%</td>
<td>0.0%</td>
<td>8</td>
</tr>
</tbody>
</table>

AVERAGE: 4.3%  5.8%

COEFFICIENT OF VARIATION: 69.7%  35.2%

CORRELATION COEFFICIENT: 0.4048

(exit between entry and exit)

Exit and Entry rates for New Zealand Manufacturing Industries (Average 1980-1984)

### APPENDIX E

**Net Change in Number of Firms for N.Z. Manufacturing Industries (1980-87)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pottery and china</td>
<td>29</td>
<td>71</td>
<td>42</td>
<td>59.2%</td>
</tr>
<tr>
<td>Glass</td>
<td>65</td>
<td>99</td>
<td>34</td>
<td>34.3%</td>
</tr>
<tr>
<td>Furniture etc</td>
<td>593</td>
<td>708</td>
<td>115</td>
<td>16.2%</td>
</tr>
<tr>
<td>Animal feeds etc</td>
<td>49</td>
<td>58</td>
<td>9</td>
<td>15.5%</td>
</tr>
<tr>
<td>Printing and publishing</td>
<td>847</td>
<td>1001</td>
<td>154</td>
<td>15.4%</td>
</tr>
<tr>
<td>Measuring etc equipment</td>
<td>62</td>
<td>70</td>
<td>8</td>
<td>11.4%</td>
</tr>
<tr>
<td>Plastic products</td>
<td>318</td>
<td>358</td>
<td>40</td>
<td>11.2%</td>
</tr>
<tr>
<td>Machinery</td>
<td>1132</td>
<td>1263</td>
<td>131</td>
<td>10.4%</td>
</tr>
<tr>
<td>Textiles manufacture</td>
<td>467</td>
<td>516</td>
<td>49</td>
<td>9.5%</td>
</tr>
<tr>
<td>Non-ferrous metals</td>
<td>64</td>
<td>70</td>
<td>6</td>
<td>8.6%</td>
</tr>
<tr>
<td>Industrial chemicals</td>
<td>108</td>
<td>118</td>
<td>10</td>
<td>8.5%</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>511</td>
<td>550</td>
<td>39</td>
<td>7.1%</td>
</tr>
<tr>
<td>Miscellaneous manufacturing</td>
<td>351</td>
<td>376</td>
<td>25</td>
<td>6.6%</td>
</tr>
<tr>
<td>Metal products</td>
<td>1716</td>
<td>1836</td>
<td>120</td>
<td>6.5%</td>
</tr>
<tr>
<td>Rubber products</td>
<td>131</td>
<td>137</td>
<td>6</td>
<td>4.4%</td>
</tr>
<tr>
<td>Wood and wood products</td>
<td>966</td>
<td>1012</td>
<td>44</td>
<td>4.3%</td>
</tr>
<tr>
<td>Other chemicals</td>
<td>215</td>
<td>224</td>
<td>9</td>
<td>4.0%</td>
</tr>
<tr>
<td>Paper and products</td>
<td>130</td>
<td>135</td>
<td>5</td>
<td>3.7%</td>
</tr>
<tr>
<td>Electrical apparatus</td>
<td>398</td>
<td>412</td>
<td>14</td>
<td>3.4%</td>
</tr>
<tr>
<td>Food manufacture</td>
<td>1331</td>
<td>1354</td>
<td>23</td>
<td>1.7%</td>
</tr>
<tr>
<td>Petrol and coal products</td>
<td>32</td>
<td>32</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Leather</td>
<td>196</td>
<td>190</td>
<td>-6</td>
<td>-4.2%</td>
</tr>
<tr>
<td>Beverages</td>
<td>145</td>
<td>137</td>
<td>-8</td>
<td>-5.8%</td>
</tr>
<tr>
<td>Footwear</td>
<td>117</td>
<td>110</td>
<td>-7</td>
<td>-6.4%</td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>55</td>
<td>51</td>
<td>-4</td>
<td>-7.8%</td>
</tr>
<tr>
<td>Clothing</td>
<td>822</td>
<td>743</td>
<td>-79</td>
<td>-10.6%</td>
</tr>
<tr>
<td>Other non-metals</td>
<td>471</td>
<td>410</td>
<td>-61</td>
<td>-14.9%</td>
</tr>
</tbody>
</table>

Net Change in Number of Firms for New Zealand Manufacturing Industries (1980-1987)

[Source: Hazledine and Savage (1988), p. 33]
Motivation for Divestment

<table>
<thead>
<tr>
<th></th>
<th>First Priority</th>
<th>Second Priority</th>
<th>Third or Lower Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raise Cash</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provide cash for parent firm’s operations</td>
<td>5.7%</td>
<td>17.8%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Provide cash for more profitable acquisition</td>
<td>.9</td>
<td>2.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Provide cash for acquisition close to firm’s basic business</td>
<td>.9</td>
<td>5.6</td>
<td>8.8</td>
</tr>
<tr>
<td>Defensive</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eliminate unprofitable unit</td>
<td>34.9</td>
<td>11.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Required by government anti-trust litigation</td>
<td>.9</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Obsolescence of products or physical assets</td>
<td>2.8</td>
<td>7.8</td>
<td>11.2</td>
</tr>
<tr>
<td>Poor management</td>
<td>.9</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Foreign political climate</td>
<td>.9</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Aggressive</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in firm’s mission</td>
<td>9.4</td>
<td>8.9</td>
<td>10.0</td>
</tr>
<tr>
<td>Life cycle position of divested unit</td>
<td>4.7</td>
<td>1.1</td>
<td>12.5</td>
</tr>
<tr>
<td>Anticipation of government anti-trust action</td>
<td>.9</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Shift of strategic emphasis to other products or market areas</td>
<td>16.0</td>
<td>23.3</td>
<td>11.2</td>
</tr>
<tr>
<td>Reduce size of firm</td>
<td>0</td>
<td>0</td>
<td>3.8</td>
</tr>
<tr>
<td>Change in firm’s competitive situation</td>
<td>.9</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Change in unit’s competitive situation</td>
<td>4.7</td>
<td>14.4</td>
<td>8.8</td>
</tr>
<tr>
<td>Investment requirements</td>
<td>5.7</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Lack of “fit”</td>
<td>3.8</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Management time demands</td>
<td>1.9</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Other</td>
<td>4.1</td>
<td>3.4</td>
<td>0</td>
</tr>
</tbody>
</table>

Divestment Motives

[Source: Duhaime and Patton (1980), p. 45]

<table>
<thead>
<tr>
<th>Motive</th>
<th>Number of firms with stated motive</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Loosen constraints of institutional or regulatory environment</td>
<td>18</td>
</tr>
<tr>
<td>taxation, price or other regulation</td>
<td></td>
</tr>
<tr>
<td>(2) Improve managerial efficiency</td>
<td></td>
</tr>
<tr>
<td>Separate subsidiary so that management can</td>
<td></td>
</tr>
<tr>
<td>concentrate on primary line(s) of business</td>
<td></td>
</tr>
<tr>
<td>Remove subsidiary which does not fit with other lines of business</td>
<td>8</td>
</tr>
<tr>
<td>and/or long-run strategy of parent</td>
<td></td>
</tr>
<tr>
<td>Facilitate growth of subsidiary as an independent concern</td>
<td>11</td>
</tr>
<tr>
<td>Improve management incentives (usually mentioned</td>
<td>5</td>
</tr>
<tr>
<td>in context of dissimilar lines of business)</td>
<td></td>
</tr>
<tr>
<td>Subtotal</td>
<td>30</td>
</tr>
<tr>
<td>(3) Other</td>
<td></td>
</tr>
<tr>
<td>Enhance investor evaluation of parent and</td>
<td></td>
</tr>
<tr>
<td>subsidiary by separating them</td>
<td></td>
</tr>
<tr>
<td>Remove a source of fluctuation in net income</td>
<td>7</td>
</tr>
<tr>
<td>Subtotal</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
</tr>
</tbody>
</table>

*Stated motives are taken from annual reports, 10-K reports, and the business press. Stated motives are not available in these sources for 35 sample firms.

Divestment Motives

[Source: Schipper and Smith (1983), p. 452]
APPENDIX F (continue)

Table 2
REASONS FOR DIVESTITURES

Announced reasons for 101 divestitures of acquisitions of at least 100 million 1982 dollars acquired between 1971 and 1982.

<table>
<thead>
<tr>
<th>Reason</th>
<th>Number of Divestitures</th>
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</thead>
<tbody>
<tr>
<td>Change focus or corporate strategy</td>
<td>43</td>
</tr>
<tr>
<td>Unit unprofitable or mistake</td>
<td>22</td>
</tr>
<tr>
<td>Sale to Finance Acquisition or Leveraged Restructuring</td>
<td>29</td>
</tr>
<tr>
<td>Antitrust</td>
<td>2</td>
</tr>
<tr>
<td>Need cash</td>
<td>3</td>
</tr>
<tr>
<td>To defend against takeover</td>
<td>1</td>
</tr>
<tr>
<td>Good Price</td>
<td>3</td>
</tr>
<tr>
<td>Divestitures with reasons</td>
<td>103</td>
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</table>

* The reasons are either announced publicly by the corporation or inferred by reporters from the Wall Street Journal, Fortune, or Business Week. When a firm's announcement differs from the reporter's assessment, we use the reporter's assessment.

Divestment Motives

[Source: Kaplan and Weisbach (1990), TABLE 2]
# Business Characteristics that Either Erect Barriers to Exit from Chronically Unprofitable Business or Help Overcome Them

<table>
<thead>
<tr>
<th>Measure of Exit Barriers for the Business</th>
<th>Definition</th>
<th>Hypothesis</th>
<th>Predicted Effect on Likelihood That Unprofitable Business Will Be Exited</th>
<th>Actual Effect</th>
<th>Statistical Significance</th>
<th>Measure of Exit Barriers for the Business</th>
<th>Definition</th>
<th>Hypothesis</th>
<th>Predicted Effect on Likelihood That Unprofitable Business Will Be Exited</th>
<th>Actual Effect</th>
<th>Statistical Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investment intensity</td>
<td>Average investment of fixed and working capital divided by sales at full capacity.</td>
<td>A structural exit barrier. The higher investment intensity, the more durable and specific the assets tend to be and the less likely the firm is to exit from an unprofitable business.</td>
<td>Detests exit from the business</td>
<td>deterred yes exit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>A yes/no measure depending on whether the business shared 10% or more of its plant, equipment and personnel with other components of the company.</td>
<td>Measure of structural and management barriers. The greater the sharing, the higher the exit barriers.</td>
</tr>
<tr>
<td>2. Product Differentiation intensity</td>
<td>The sum of advertising, sales-promotion expense plus product R&amp;D expense, divided by sales.</td>
<td>A structural barrier. The higher advertising and sales promotion, the greater the degree of intangible specific assets and the less likely the exit will be.</td>
<td>Detests exit from the business</td>
<td>deterred yes exit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Yes/no measure depending on whether a business shared more than 10% of its marketing expenditures with other components of the company.</td>
<td>Measure of structural and managerial barriers. The greater the sharing, the higher the exit barriers.</td>
</tr>
<tr>
<td>3. Capacity utilization</td>
<td>Percentage of standard capacity used during the year averaged over the three years.</td>
<td>A structural barrier. We expect a business in difficulty to go through a period of low capacity utilization. But in the absence of exit barriers, capacity would be reduced to match the lower demand levels in the medium to long run. Thus where chronically low capacity utilization is associated with chronically low profits, we have evidence of exit barriers due to durable and specific assets.</td>
<td>Indicates deterred exit from the business</td>
<td>deterred yes exit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Yes/no measure depending on whether a business saw 25% or more of its sales to customers also served by other components of the company.</td>
<td>Measure of structural and managerial barriers. The greater the sharing, the higher the exit barriers.</td>
</tr>
<tr>
<td>4. Relative Price/ Relative Cost</td>
<td>Ratio of management’s estimate of its selling price relative to its competitors, and management’s estimate of its relative costs.</td>
<td>A chronic adverse price/cost relation in persistently low-return businesses (negative sign) would also be associated with exit barriers. Because the price/cost ratio records management’s own perceptions of its competitive deficiency, a management in a persistently low-return business must be deterred from exit either by durable and specific assets or managerial barriers.</td>
<td>Indicates deterred exit from the business</td>
<td>deterred yes exit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Percentage of total purchases of materials, supplies, etc., obtained from other components of the company.</td>
<td>Measure of managerial barriers.</td>
</tr>
</tbody>
</table>

1. The actual effect is the direction of the relationship in the data based on a multiple regression analysis.
2. Statistical significance indicated by "yes" means that there is no more than 1 chance in 20 that the association measured in this test is random.

---

### Barriers to Exit for Chronically Unprofitable Businesses

[Source: Porter (1976), pp. 30-31]
APPENDIX H

Industry Life-cycle Model

[Source: Johnson and Scholes (1989), p. 72]
Retension vs. Divestment Planning & Control Sequence

[Source: Lovejoy (1971), p. 27]
A Model of Divestment Decision Process

[Source: Gilmour (1973), p. 51]
APPENDIX K  Names of companies removed from survey samples

34 Companies removed from survey sample

(A) Delisted as at 31 July 1991
1. Agricola Resources Ltd.
2. Aorangi Holdings Ltd.
3. Arahi Properties Ltd.
4. Australis International Ltd.
5. Further Developments Ltd.
6. Girvan Corporation (NZ) Ltd.
7. London Pacific Ltd.
8. Maxwell Marine Corporation Ltd.
9. Normedia Corporation Ltd.
10. Otago Press & Produce Ltd.
11. Pacer Kerridge Corp. Ltd.
12. Premier Mining Securities Ltd.
13. Venture Pacific Ltd.
14. Waikato Stud Ltd.
15. XS Corporation Ltd.
16. Chambard Property Developments Ltd.

(B) Liquidation as at 31 July 1991
1. Kenwood Stud Ltd.
2. Renouf Properties Ltd.
3. Strathmore Group Ltd.

(C) Receivership
1. Ahead Group Ltd.
2. Carborundum Abrasives Ltd.
3. Crowe Corporation
4. PANZ Corporation Ltd.
5. Smiths Cith Group Ltd.
6. TV3 Network Ltd.

(D) Foreign Based Companies
1. Consolidated Hardwood Ltd.
2. Goodman Fielder Wattie Ltd.
3. Kiwi Gold NL
4. Kiwi International Resources NL
5. McConnell Dowell Ltd.
6. Macraes Mining Company Ltd.
7. Max Resources NL
8. TAG Pacific Ltd.

(E) Statutory Management
1. Ararimu Holdings Ltd.
<table>
<thead>
<tr>
<th>NAME OF RESPONDENT</th>
<th>POSITION</th>
<th>COMPANY NAME</th>
<th>ADDRESS#1</th>
<th>ADDRESS#2</th>
<th>ADDRESS#3</th>
</tr>
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<tbody>
<tr>
<td>Mr. Graham Twiett</td>
<td>Director</td>
<td>Agland Holdings Ltd</td>
<td>PO Box 214</td>
<td>TAUPO</td>
<td></td>
</tr>
<tr>
<td>Mr. R.J. Scott</td>
<td>Chief Executive</td>
<td>Air New Zealand Ltd</td>
<td>Private Bag</td>
<td>AUCKLAND</td>
<td></td>
</tr>
<tr>
<td>Mr. David Brown</td>
<td>Managing Director</td>
<td>Apparel Holdings Ltd</td>
<td>PO Box 1247</td>
<td>CHRISTCHURCH</td>
<td></td>
</tr>
<tr>
<td>Mr. W.C. Evans</td>
<td>Managing Director</td>
<td>Apple Fields Ltd</td>
<td>Mt Eden Rd</td>
<td>AUCKLAND</td>
<td></td>
</tr>
<tr>
<td>Mr. Tom Kain</td>
<td>Managing Director</td>
<td>Arthur Barnett Ltd</td>
<td>PO Box 1948</td>
<td>CHRISTCHURCH</td>
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</tr>
<tr>
<td>Mr. J.N. MacAdams</td>
<td>Managing Director</td>
<td>Ascot Management Corp (NZ) Ltd</td>
<td>Private Bag</td>
<td>DUNEDIN</td>
<td></td>
</tr>
<tr>
<td>Mr. G.W. Weinzink</td>
<td>Managing Director</td>
<td>Asian Properties Ltd</td>
<td>PO Box 3134</td>
<td>WELLINGTON</td>
<td></td>
</tr>
<tr>
<td>Mr. J. Carpenter</td>
<td>Managing Director</td>
<td>Baycorp Holdings Ltd</td>
<td>Level 13 NZIA House</td>
<td>WELLINGTON</td>
<td></td>
</tr>
<tr>
<td>Mr. L. Pyne</td>
<td>Chief Executive</td>
<td>Bank of New Zealand Ltd</td>
<td>BNZ Centre</td>
<td>1 Willis St</td>
<td></td>
</tr>
<tr>
<td>Mr. J. Reil</td>
<td>Executive Chairman</td>
<td>Blandford Lodge Ltd</td>
<td>PO Box 2245</td>
<td>ROTORUA</td>
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<tr>
<td>Mr. David Jewell</td>
<td>General Manager</td>
<td>BNZ Finance Co Ltd</td>
<td>PO Box 369</td>
<td>MATAMATA</td>
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<td>Mr. R. Bonifant</td>
<td>General Manager</td>
<td>Bridgecorp Holdings Ltd</td>
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<tr>
<td>Mr. A.M. Martin</td>
<td>Director</td>
<td>Broadway Industries</td>
<td>PO Box 401</td>
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<td></td>
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<tr>
<td>Mr. John Nicholl</td>
<td>Managing Director</td>
<td>Brierley Investments Ltd</td>
<td>PO Box 4551</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr. R.H. Matthew</td>
<td>Chief Executive</td>
<td>Canterbury Roller Flour Mills Co Ltd</td>
<td>PO Box 5018</td>
<td>WELLINGTON</td>
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<tr>
<td>Mr. M.J. Smith</td>
<td>Secretary</td>
<td>Carr Business Services Ltd</td>
<td>PO Box 24</td>
<td>ASHBURTON</td>
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<tr>
<td>Mr. N.P. Webber</td>
<td>Chairman</td>
<td>Carter Holt Harvey Ltd</td>
<td>PO Box 1433</td>
<td>AUCKLAND</td>
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<tr>
<td>Mr. K.F.L. Carter</td>
<td>Managing Director</td>
<td>Cavalier Corporation Ltd</td>
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<tr>
<td>Mr. A. Timpson</td>
<td>Managing Director</td>
<td>Ceramco Corporation Ltd</td>
<td>PO Box 97-040</td>
<td>Papatoette</td>
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<tr>
<td>Mr. C. Bidwill</td>
<td>Managing Director</td>
<td>City Realities Ltd</td>
<td>Private Bag</td>
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<td>Mr. F.G. Wall</td>
<td>Chief Executive</td>
<td>The Colonial Motor Co Ltd</td>
<td>Level 2 Securities House</td>
<td>WELLINGTON</td>
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<tr>
<td>Mr. G.D. Gibbons</td>
<td>Executive Chairman</td>
<td>Corporate Investments Ltd</td>
<td>PO Box 6129</td>
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<td>Mr. P.H. Maslen</td>
<td>Managing Director</td>
<td>Countrywide Banking Corporation Ltd</td>
<td>PO Box 5445</td>
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<tr>
<td>Mr. P.S. Martin</td>
<td>Managing Director</td>
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<td>PO Box 10-340</td>
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<tr>
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<td>c/- Parker Murray &amp; Co</td>
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<tr>
<td>Mr. R. van Dam</td>
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<tr>
<td>Mr. G.J. Marsh</td>
<td>Managing Director</td>
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<td>Mr. D. Sloan</td>
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<td>Mr. P. Roebuck</td>
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<td>Mr. D. Booth</td>
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<td>Mr. A.R. Fitcher</td>
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<td>Mr. T. Millar</td>
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<tr>
<td>Mr. G. Paykel</td>
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<td>Flexcot Group Ltd</td>
<td>PO Box 13300</td>
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<tr>
<td>Mr. G. Thompson</td>
<td>Managing Director</td>
<td>Fletcher Challenge Ltd</td>
<td>810 Great South Road</td>
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<tr>
<td>Mr. H. Fletcher</td>
<td>Chief Executive</td>
<td>General Properties Corporation Ltd</td>
<td>PO Box 74345</td>
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<tr>
<td>Mr. O.B. Taylor</td>
<td>Managing Director</td>
<td>Gold Resources Ltd</td>
<td>PO Box 8494</td>
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<tr>
<td>Mr. R.A. Radford</td>
<td>Executive Chairman</td>
<td>Grocorp Pacific Ltd</td>
<td>PO Box 99-399</td>
<td>Newmarket</td>
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<td>Mr. R.-J. Gossen</td>
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<td>Halenstein Glascow Holdings Ltd</td>
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<td>SOUTH AUCKLAND</td>
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<td>Mr. P. R. Atkinson</td>
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<td>The Helicopter Line Ltd</td>
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<tr>
<td>Mr. D.M. Robson</td>
<td>Executive Chairman</td>
<td>Heritage Mining NL</td>
<td>28 Ruskin St</td>
<td>Dunedin</td>
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<tr>
<td>Mr. I.M. Robinson</td>
<td>Managing Director</td>
<td>Independent Newspapers Ltd</td>
<td>PO Box 2595</td>
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<tr>
<td>Mr. W.C. Ho</td>
<td>Managing Director</td>
<td>Jardine Morgan Ltd</td>
<td>PO Box 1407</td>
<td>WELLINGTON</td>
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<tr>
<td>Mr. P. W. Grayburn</td>
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<tr>
<td>Mr. D. Babbage</td>
<td>Chairman</td>
<td>Kupe Group Ltd</td>
<td>PO Box 3248</td>
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<tr>
<td>Mr. M. Cotell</td>
<td>Managing Director</td>
<td>Lasercorp Holdings Ltd</td>
<td>PO Box 1446</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr. S. Cotell</td>
<td>Secretary</td>
<td>Lectra Holdings</td>
<td>PO Box 12-143</td>
<td>WELLINGTON</td>
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</tr>
</tbody>
</table>

* = Respondent received a telephone follow-up
## APPENDIX L (cont’t)

<table>
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<tr>
<th>NAME OF RESPONDENT</th>
<th>POSITION</th>
<th>COMPANY NAME</th>
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<tr>
<td>Mr T. Lake</td>
<td>Managing Director</td>
<td>Leisure Lea Corporation</td>
<td>PO Box 3899</td>
<td>AUCKLAND</td>
<td></td>
</tr>
<tr>
<td>Mr A.D. Myers</td>
<td>Chief Executive</td>
<td>Lion Nathan Ltd</td>
<td>PO Box 190</td>
<td>AUCKLAND</td>
<td></td>
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<tr>
<td>Mr A.L. Ferguson</td>
<td>Managing Director</td>
<td>Magnum Corporation Ltd</td>
<td>PO Box 3281</td>
<td>AUCKLAND</td>
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<tr>
<td>Mr P. Mozies</td>
<td>Chief Executive</td>
<td>Mainzal Group Ltd</td>
<td>PO Box 3978</td>
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<tr>
<td>Mr B.I. Sundstrom</td>
<td>Managing Director</td>
<td>Mair Astley Holdings Ltd</td>
<td>PO Box 1477</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr H. Brothers</td>
<td>Managing Director</td>
<td>Michael Hill International Ltd</td>
<td>PO Box 38</td>
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<tr>
<td>Mr J.C. Meycock</td>
<td>Managing Director</td>
<td>Milburn New Zealand Ltd</td>
<td>PO Box 6040</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr P. Liddle</td>
<td>Secretary</td>
<td>Mineral Resources NZ Ltd</td>
<td>PO Box 8494</td>
<td>SYMONDS STREET</td>
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<tr>
<td>Mr P. Bennett</td>
<td>Secretary</td>
<td>New Zealand Duty Free Ltd</td>
<td>14 Andrew Baxter Dr</td>
<td>AUCKLAND</td>
<td></td>
</tr>
<tr>
<td>Mr T. Cowell</td>
<td>Managing Director</td>
<td>New Zealand Light Leathers Ltd</td>
<td>PO Box 2051</td>
<td>TIMARU</td>
<td></td>
</tr>
<tr>
<td>Mr H.D. Kennedy</td>
<td>Executive Director</td>
<td>New Zealand Oil and Gas Ltd</td>
<td>PO Box 3149</td>
<td>WELLINGTON</td>
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</tr>
<tr>
<td>Mr P. Mackie</td>
<td>Chairman</td>
<td>New Zealand Petroleum Co Ltd</td>
<td>PO Box 586</td>
<td>WELLINGTON</td>
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<tr>
<td>Mr P. Fransen</td>
<td>General Manager</td>
<td>New Zealand Refining Co Ltd</td>
<td>PO Box 44</td>
<td>WHANGAREI</td>
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</tr>
<tr>
<td>Mr P. Townsend</td>
<td>Managing Director</td>
<td>The New Zealand Salmon Co Ltd</td>
<td>PO Box 8622</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr P. Lunn</td>
<td>General Manager</td>
<td>Nuhaka Farm Forestry Fund</td>
<td>PO Box 12-158</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr P. Holland</td>
<td>Managing Director</td>
<td>Nuplex Industries Ltd</td>
<td>PO Box 12-841</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr P. Lyen</td>
<td>General Manager</td>
<td>Opio Forestry Fund</td>
<td>PO Box 12-841</td>
<td>CHRISTCHURCH</td>
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<tr>
<td>Mr K. Fisher</td>
<td>Managing Director</td>
<td>Owens Group Ltd</td>
<td>PO Box 1809</td>
<td>DUNEDIN</td>
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<tr>
<td>Mr G. Wells</td>
<td>Director</td>
<td>Parapine Timber NZ Ltd</td>
<td>1 Hinemoa St</td>
<td>AUCKLAND</td>
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<tr>
<td>Mr B. Pevstev</td>
<td>Executive Chairman</td>
<td>Pevstev Corp Ltd</td>
<td>PO Box 882</td>
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<tr>
<td>Mr D. Stoll</td>
<td>Managing Director</td>
<td>PBL Holdings Ltd</td>
<td>PO Box 1397</td>
<td>AUCKLAND</td>
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<tr>
<td>Mr T.W. Thong</td>
<td>Director</td>
<td>Perry Dines Corp Ltd</td>
<td>PO Box 5745</td>
<td>WELLINGTON</td>
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</tr>
<tr>
<td>Mr E. Barry</td>
<td>Secretary</td>
<td>Pharmoex Pacific Ltd</td>
<td>85 The Terrace</td>
<td>NEWMARKET</td>
<td></td>
</tr>
<tr>
<td>Mr G.R. Taylor</td>
<td>Chairman</td>
<td>Platinum Group Metals NL</td>
<td>PO Box 9281</td>
<td>WELLINGTON</td>
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</tr>
<tr>
<td>Mr E. Turnovskiy</td>
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<td>Property Land Holdings Ltd</td>
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<td>Mr B. Rayner</td>
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<td>Mr D. Low</td>
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<tr>
<td>Mr G. Hally</td>
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<td>Regal Union Ltd</td>
<td>PO Box 3515</td>
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<td>Mr T. Shagin</td>
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<td>Regal Salmon Ltd</td>
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<td>Mr D. Gwyer</td>
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<td>Reid Farmers Ltd</td>
<td>175 Crawford St</td>
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<td>Mr A.W. Strange</td>
<td>Managing Director</td>
<td>Renouf Corporation Ltd</td>
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<tr>
<td>Mr R.O. McShane</td>
<td>Secretary</td>
<td>Restech International Ltd</td>
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<tr>
<td>Mr D. Mortarty</td>
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<td>Robson J. Investments Ltd</td>
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<td>Mr T. Smith</td>
<td>Managing Director</td>
<td>Salmon Smith Biolab Ltd</td>
<td>PO Box 931</td>
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<td>Mr D. Anderson</td>
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<td>Sanford Ltd</td>
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<tr>
<td>Mr R.H. Brown</td>
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<td>Scenic Circle Corp Ltd</td>
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<td>Mr J. Todd</td>
<td>Chairman</td>
<td>Shortland Properties Ltd</td>
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<tr>
<td>Mr A.J. Andrejewski</td>
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<td>Southern Petroleum</td>
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<td>Secretary</td>
<td>Spectrum Resources Ltd</td>
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<td>Mr R.L. Every</td>
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<td>Steel and Tube Holdings Ltd</td>
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<td>Mr E.B. Allison</td>
<td>Managing Director</td>
<td>Steven Kam Corporation Ltd</td>
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<td>Mr J.G. Gow</td>
<td>Managing Director</td>
<td>Strada Entertainment Trust</td>
<td>PO Box 35-330</td>
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<td>Mr D.M.W. Lander</td>
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<td>Summit Gold NL</td>
<td>c/- Brandon Brookfield</td>
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<td>Mr R. Robertson</td>
<td>Managing Director</td>
<td>Taylor Group Ltd</td>
<td>PO Box 2388</td>
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<td>Mr N. Wambeke</td>
<td>Managing Director</td>
<td>Transmark Corp Ltd</td>
<td>PO Box 4340</td>
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<tr>
<td>Mr B. King</td>
<td>Managing Director</td>
<td>Triumph Industries Ltd</td>
<td>PO Box 47351</td>
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<tr>
<td>Mr A. Paola</td>
<td>Managing Director</td>
<td>U-Box Business Machines Ltd</td>
<td>PO Box 52-012</td>
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<td>Mr A.W.L. Baker</td>
<td>Director</td>
<td>United Resources Investment Holdings Ltd</td>
<td>PO Box 8494</td>
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<tr>
<td>Mr A. Jamieson</td>
<td>Managing Director</td>
<td>Waste Management NZ Ltd</td>
<td>Private Bag</td>
<td>AUCKLAND</td>
<td></td>
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<tr>
<td>Mr W. Horton</td>
<td>Managing Director</td>
<td>Wilson and Norton Ltd</td>
<td>PO Box 17</td>
<td>AUCKLAND</td>
<td></td>
</tr>
<tr>
<td>Mr C. F. Herbert</td>
<td>Managing Director</td>
<td>Wilson Neil Ltd</td>
<td>PO Box 342</td>
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<tr>
<td>Mr L.J. Parrant</td>
<td>Managing Director</td>
<td>Woodcorp Holdings Ltd</td>
<td>PO Box 3051</td>
<td>AUCKLAND</td>
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</table>

## LIST OF COMPANIES SURVEYED
[Date]

[Name of CEO and address of company]

Dear Sir,

Survey on Corporate Divestment

As part of my research programme in the Department of Accountancy at this University, I am conducting a survey on Corporate Divestment. Our objective is to find out the motives for and factors affecting corporate divestment in New Zealand. This mail survey is sent to the chief executives of leading companies listed on the New Zealand Stock Exchange.

I would greatly value a response from your organisation. This questionnaire should take only a few minutes to complete. Your answers are strictly confidential.

The focus of this survey is on what you have done, rather than what should have been done. If you were not directly involved in the divestment decision making processes of your firm over the past five years, please pass this letter and questionnaire directly to the corporate officer involved.

The questions are organised into four sections:

- Background Information
- Factors affecting Corporate Divestment
- Motives for Corporate Divestment
- Issues related to Divestment Activity

Please return the completed questionnaire in the enclosed envelope. Should you be interested in receiving a copy of the results of this survey, please enclose your business card and I will forward you a copy of the report. If you have any query, please do not hesitate to contact me. Your assistance is much appreciated. Thank you.

Yours faithfully,

Andrew Y. K. CHOW
Assistant Lecturer in Accountancy
QUESTIONNAIRE ON CORPORATE DIVESTMENT

For the purpose of this survey, divestment is defined as "the sale of part of the assets, product lines, subsidiaries, or divisions of a company for cash or securities or some combination thereof".

A. Background Information

1. What is your job title?

2. What is your main line (or lines) of business? [Encircle the appropriate sector code below]

   AGS   Agricultural and associated services
   BLD   Building
   CON   Construction
   ENE   Energy and fuel
   FIN   Finance and banks
   FOR   Forestry and forest products
   LIQ   Liquor and tobacco
   MCM   Media and communications
   MIS   Miscellaneous services
   RET   Retail merchants
   TRN   Transport and tourism
   AUT   Automotive
   CHM   Chemical and fertiliser
   ELE   Electrical
   ENG   Engineering
   FOD   Food
   INV   Investment
   MET   Meat and by-products
   MED   Medical supplies
   PRO   Property
   TEX   Textile and apparel
   MIN   Mining

3. Has your company undertaken any divestment over: [Please circle the right answer]
   
   (a) the past five financial years
   Yes  No
   (b) the 1990 financial year
   Yes  No

If Yes to either question, please go to question 4.

If No to both questions, return the questionnaire in the enclosed envelope. We greatly appreciate your assistance.

4. (a) How many divisions do you have?
    
    (b) How many product types do you have?
    
    (c) How many product lines do you have?

   Comments

<table>
<thead>
<tr>
<th></th>
<th>NOW</th>
<th>1990</th>
<th>5 yrs ago</th>
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<td></td>
<td></td>
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</table>
5. What is the level of your total annual gross sales?
   (a) 1990 financial year $______________
   (b) 5 yrs ago $______________

6. Was the consideration of divestment(s) discussed above part of the strategic planning process of your company? [Please circle the right answer] Yes No

7. For the divestment(s) that your company undertook, how many of them were:
   (a) Less than 5% of total assets __________
   (b) between 5% to 10% of total assets __________
   (c) more than 10% of total assets __________

8. What was the principal type of divestment in which your company had engaged in? [Please check one]
   (a) Sell-off to third parties (i.e. the selling of some of the assets of a parent firm, such as a subsidiary, division, or product line, to another firm)
   (b) Spin-off (i.e. where a company distributes all of the ordinary shares it owns in a controlled subsidiary to its existing shareholders)
   (c) Management buy out (i.e. where management buys the interest in the unit divested largely with funds borrowed against the unit's assets and cashflows)
   (d) Divestment by franchising (whereby a company grants the right to produce, sell or use a developed product, service or brand to the buyers of the unit divested)
   (e) Divestment by contracting out (whereby the buyer of the unit divested obtains the contract to provide specific good or service to the selling company)
   (f) Asset swap (which involves exchanging some of the assets of the firm for some of those of another firm with little, if any, funds changing hand)
   (g) Liquidation of unit (where no buyer exists for the unit to be sold as a going-concern, and it is financially less costly to cease the operation of the unit concerned)

B. Motives for Corporate Divestment

To what extent have the divestment(s) of your firm over the past five years been motivated by the following. Please check the most appropriate box and use the following scale:

1 = No importance  
2 = Slight importance  
3 = Moderate importance  
4 = Great importance  
5 = Maximum importance

1. Unfavourable performance of the company as compared to industry counterparts
   
2. Loss of competitive advantage due to new institutional or regulatory constraints
<p>| | | | | | |</p>
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<td>3.</td>
<td>Adverse economic environment</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>4.</td>
<td>Shortage of managerial talent</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>5.</td>
<td>Good price offered for unit(s) divested</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>6.</td>
<td>Loss of economies of scale in production or distribution</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>7.</td>
<td>Loss of market share by unit(s) divested</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<tr>
<td>8.</td>
<td>Changes in tax law, price or other competitive regulations have made the divestment possible</td>
<td>1</td>
<td>2</td>
<td>3</td>
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<td>9.</td>
<td>Meeting a corporate liquidity requirement</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>10.</td>
<td>High investment obligation in unit(s) divested</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<tr>
<td>11.</td>
<td>To harvest successful businesses</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>12.</td>
<td>To discarding undesired/unprofitable unit(s)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<tr>
<td>13.</td>
<td>To reduce the number and diversity of operating units (i.e. dismantling conglomerates)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<tr>
<td>14.</td>
<td>To reversing a previous management/investment mistake</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
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<td>15.</td>
<td>To defend against hostile takeover bids</td>
<td>1</td>
<td>2</td>
<td>3</td>
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<td>16.</td>
<td>To meet government requirements</td>
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<td>2</td>
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<td>17.</td>
<td>To free up managerial talent for other opportunities</td>
<td>1</td>
<td>2</td>
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<td>18.</td>
<td>To finance the development of other investments</td>
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<td>19.</td>
<td>To shift resources into units with greater growth or opportunity</td>
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<td>20.</td>
<td>To focus on core activities</td>
<td>1</td>
<td>2</td>
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<td>21.</td>
<td>To withdraw from own production in favour of importing</td>
<td>1</td>
<td>2</td>
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<td>22.</td>
<td>To focus on units protected by high barriers to entry</td>
<td>1</td>
<td>2</td>
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<td>23.</td>
<td>To reduce risk due to over-diversification</td>
<td>1</td>
<td>2</td>
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<td>24.</td>
<td>To abandon obsolete technology or expertise</td>
<td>1</td>
<td>2</td>
<td>3</td>
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</table>
25. To withdraw from segments where suppliers are powerful
26. To withdraw from segments where customers are powerful
27. To withdraw from product/industry approaching maturity
28. To withdraw from segments subject to adverse public image
29. To abandon product lines where threat of substitutes is strong
30. To facilitate growth of unit(s) divested as an independent concern
31. Other: Please specify: ________________________

C. Factors affecting Corporate divestment
To what extent were the following factors important in your decision to divest over the past five years? [Use the same five-point scale]

Factors outside the firm
- General economic environment
- Industry growth
- Technology change
- Costs of over-regulation
- Ability to re-enter later
- Low return on assets of unit(s) divested
- Low revenue growth of unit(s) divested
- High degree of diversification within the firm
- Low price-earnings ratio of firm
- Size of firm in relation to counterparts
- Tax law changes such as loss carry-forwards
- Shortages of key inputs:
  - Labour
  - Materials
  - Technology
  - Management
  - Capital

- Change in competitive advantage due to
  - deregulation
  - removal of tariff protection

- Other: Please specify:

> Factors inside the firm or the unit(s) divested

- Asset specificity
- Asset durability
- Technological requirements
- The organisational structure of the firm
- Management resistance to divestment
- Staff resistance to divestment
- Transfer of technology between units
- Intra-firm sales between units
- Intra-firm purchases between units
- Sharing of plant and equipment between units
- Capital investment requirements of units
D. Issues related to Divestment Activity

Please indicate your opinion on the following statements by researchers with respect to corporate divestment. Check the most appropriate box and use the following five-point scale:

1 = Strongly disagree
2 = Disagree
3 = Neither agree nor disagree
4 = Agree
5 = Strongly agree

1. A divestment decision is organisationally and personally painful to make as it requires some admission of failure or placing of blame on the part of the key decision maker.

2. The preparation and presence of analytical data support was never substantial in the divestment decision making process, varying from small amounts to virtually none.

3. Much of the analytic support, if presented at all, was provided after the decision rather than before it, making it in fact a rationalization of the decision already taken rather than an analysis supporting a possible divestment decision.

4. A divestment decision is usually made at the very highest organisation levels with virtually all the inputs leading to the decision provided by high level sources.

5. Divestment decisions set precedents and establish new performance boundaries to signal to the whole organisation in general that management attitudes and expectations have changed.

6. A change in management is the primary cause of divestment as the new managers are less likely to have their divestment decision clouded or biased by personal loyalties, previous decisions, organisational history, and the need to admit failure or place blame.
7. The divesting of assets unrelated to a firm’s primary line of business significantly enhances the shareholders’ wealth of the parent (divesting) company.  

8. A divesting firm earns more for its shareholders if it is in a strong financial position.  

9. It may be more difficult to divest a business that was developed internally than one added through acquisition or merger, as the former has strong internal commitment.  

10. Divestments succeed in moving corporate resources to more efficient users; and, as a result, overall corporate efficiency increases.  

11. Divestment represents efforts to correct previous acquisition mistakes.  

12. Divestment is often crucial in generating funds for further acquisitions or investments.  

13. Divestment is primarily undertaken by firms that are performing less well than their industry counterparts.  

14. Divestments that are part of clearly identified corporate or business level strategies create more value than divestments that take place in a reactive or piecemeal manner or divestments arising from short term performance criteria.  

15. Divestment is the evidence that acquisition strategies failed to increase and probably reduced value.  

16. An acquirer sells a business it has improved or a business that once had synergies with the acquirer’s core business but no longer does.  

17. There is higher divestment rate for diversifying acquisitions than for related acquisitions.  

18. In the year before the divestment decision, performance of divested units will be less satisfactory than performance of the firm’s other units.  

This is the end of the questionnaire. Once again, thank you for agreeing to take part in this study. Should you be interested in receiving a copy of the survey results, please enclose your business card.

PLEASE RETURN THE COMPLETED QUESTIONNAIRE NOW!
Department of Accountancy
University of Canterbury
Christchurch  New Zealand
Telephone: (03) 667-001
Fax: (03) 642-727

[DATE]

[NAME OF CEO]
[ADDRESS OF COMPANY]

Dear Sir,

The Department of Accountancy is indebted to the executives and respondents who, by giving a little of their time, assist our Graduate Students in their research and put them in touch with the realities of the business world. I would be very grateful if you could invest in this project the relatively short time required to complete the questionnaire. Thank you for your co-operation and courtesy.

Yours faithfully,

Bevan J. Clarke
Professor of Accountancy
Dean of Commerce
Department of Accountancy
University of Canterbury
Christchurch New Zealand
Telephone: (03) 667-001
Fax: (03) 642-727

«Date»
«Name of Chief Executive»
«Address1»
«Address2»
«Address3»

Dear Sir,

Survey on Corporate Divestment

Last week I sent you a questionnaire concerning a survey on Corporate Divestment that I am conducting as part of my research programme in the Department of Accountancy at this University. The objective of the survey is to find out the motives for and factors affecting corporate divestment in New Zealand.

I have been very gratified by the response I have received so far. A large number of questionnaires have been returned, and the results are proving to be most useful.

If you have already returned your questionnaire, please accept this letter as my personal thanks. I appreciate your effort and courtesy.

If you have not yet filled in and returned the questionnaire, I invite you to do so at the first convenient moment. Your response is most important to me, and will ensure that an adequate representation from all industries is attained.

In case you have not received the original letter, please find enclosed a secondary questionnaire which can be returned in the pre-paid envelope.

Should you be interested in receiving a copy of the results of this survey, please enclose your business card and I will forward you a copy of the report. If you have any query, please do not hesitate to contact me. Your assistance is much appreciated. Thank you.

Yours faithfully,

Andrew Y.K. CHOW
Assistant Lecturer in Accountancy
### APPENDIX P

<table>
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<tr>
<th>Table 4.1</th>
<th>Major Economic Liberalization Measures in New Zealand 1984-1990</th>
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<td>Deregulation of entry licensing in industry</td>
<td>1984 +</td>
</tr>
<tr>
<td>Partial deregulation of occupational licensing</td>
<td>1985 +</td>
</tr>
<tr>
<td>Removal of other operating barriers in industry</td>
<td>1984 +</td>
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<tr>
<td>Removal of price control</td>
<td>1984-88</td>
</tr>
<tr>
<td>Removal of import licensing</td>
<td>1984-88</td>
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<tr>
<td>Significant decrease in import tariffs</td>
<td>1985-92</td>
</tr>
<tr>
<td>Revision of town and country planning</td>
<td>1987</td>
</tr>
<tr>
<td>Revision of role of producer marketing boards</td>
<td>1987 +</td>
</tr>
<tr>
<td>Abolition of many quangos and quasi-government organizations</td>
<td>1987</td>
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<tr>
<td>Removal of financial controls (interest rate ceiling, reserve ratio requirements, priorities for various sectors)</td>
<td>1984-86</td>
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<tr>
<td>Removal of foreign exchange controls</td>
<td>1984</td>
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<tr>
<td>Liberalization of foreign direct investment</td>
<td>1985</td>
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<tr>
<td>Floating of the exchange rate</td>
<td>1985</td>
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<tr>
<td>Revision of corporate, personal, and direct taxation</td>
<td>1986-88</td>
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<tr>
<td>Corporatization of stage trading activities</td>
<td>1986 +</td>
</tr>
<tr>
<td>Programme of sale of state assets</td>
<td>1987 +</td>
</tr>
<tr>
<td>Review of education and health provision</td>
<td>1988 +</td>
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<tr>
<td>Removal of monopoly rights on state trading</td>
<td>1986</td>
</tr>
<tr>
<td>Deregulation of transport sector</td>
<td>1983-88</td>
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<tr>
<td>Deregulation of financial services sector</td>
<td>1986</td>
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<tr>
<td>Partial deregulation of energy sector</td>
<td>1986 +</td>
</tr>
<tr>
<td>Removal of concessions for favoured investment (e.g. R &amp; D)</td>
<td>1984 +</td>
</tr>
<tr>
<td>Removal of concessions for favoured sectors (agriculture, export sectors)</td>
<td>1984 +</td>
</tr>
<tr>
<td>Establishment of Closer Economic Relations with Australia</td>
<td>1983 +</td>
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<tr>
<td>Reorganization of core government departments</td>
<td>1987 +</td>
</tr>
<tr>
<td>Reform of local government</td>
<td>1989 +</td>
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<td>Deregulation of ports and waterfront work</td>
<td>1989</td>
</tr>
<tr>
<td>Removal of shop trading hours restrictions</td>
<td>1989</td>
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<tr>
<td>Corporatization of some local authority trading activities</td>
<td>1989</td>
</tr>
<tr>
<td>Partial deregulation of shipping</td>
<td>1990</td>
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<tr>
<td>Resource management law reform</td>
<td>1990</td>
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</table>

**Major Economic Liberalization Measures in New Zealand: 1984-1990**

[Source: Bollard and Savage (1990), p. 38]