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# Value creation from financing in equity carve-outs: Evidence from Japan

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ABSTRACT

This study examines whether and how Japanese carve-outs enhance the wealth of their parent companies' shareholders. In considering the differences between U.S. and Japanese carve-outs, this paper focuses on financing opportunities in carve-outs and tests the parent financing hypothesis and the subsidiary financing hypothesis.

Through empirical analysis, this paper finds that the stock of a parent company reacts positively to a carve-out, and it especially reacts positively when the parent company is highly leveraged. In addition, parent companies apparently use funds from carve-outs to lower their leverage and continue to lower their leverage after carve-outs. Thus, the stock market may regard carve-outs as a trigger to reduce a parent company's leverage.



## 1. Introduction

In an equity carve-out, a parent company sells a portion of a subsidiary's common stock through an initial public offering (IPO) and creates a newly listed company. Prior empirical research employing an event-study approach shows that the U.S. stock markets generally react positively toward parent companies conducting carve-outs (Allen & McConnell, 1998; Allen, 1998; Klein, Rosenfeld, & Beranek, 1991; Prezas, Tarimcilar, & Vasudevan, 2000; Schipper & Smith, 1986; Smart & Zutter, 2003). In short, carve-outs generally enhance the wealth of parent company shareholders.

Prior research has attempted to explain exactly why and how such wealth is built. For example, Allen (1998) argues that carve-outs produce an incentive mechanism for managers of subsidiaries.

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