Breaking Up

The top 20 questions to ask when divesting a business.
It doesn’t matter whether you are a complete novice or a seasoned veteran, there is always a new twist, or set of circumstances that makes every divestiture uniquely challenging, frustrating, maddening even. But also great fun and certainly career enhancing. That is, if you get it right.

I’d like to share with you the top 20 questions I would ask, if your organisation is contemplating a divestiture. Perhaps not all of them are relevant to you, but I bet some of them are very relevant indeed.

The questions I have posed here come from personal experience having working on multiple divestments over the past 15 years. I also tend to focus a little less on the financial, tax and legal side and instead give weight to problems that are perhaps not so obvious but nonetheless critical to success.

1. **Is it clear why part of the organisation is being carved-out?**

   This is all about stakeholder management and communication. Whether they are employees, executives, suppliers or shareholders, it’s critical from the onset to have a clear, simple and yet compelling story that talks about why the divestment is taking place and what it means to them. For a divestment to work well, the telling and re-telling of the story is key, so people are informed to the extent they need to be, and their support is based on openness and trust.

   *Tell the story. Prepare the simple messages. Ensure the messages are consistent. People will respect and trust you for being clear and attack (or at best be ambivalent towards) your plans and efforts when it’s not.*
2. What would the carved-out entity and retained business look like operationally?

According to a recent survey\(^1\) the most important issue executives face is clarifying the operational links and entanglements.

An ‘Operating Model’ is an end-state representation of how an organisation should operate so it can deliver against its intended strategy. It is rarely done well. This is unfortunate as it’s a core component of M&A analysis. The objective is to look at the entire divestiture puzzle beyond the financial, legal and tax considerations, and see what the end-state of both businesses will look like. It should highlight the major decisions that will need to be made, the risks to be managed, and an appreciation of the scale of work ahead.

*Workshops with key stakeholders key aspects of the Operating Model so there's a joint appreciation on what lies ahead.*

3. Is it clear which capabilities are being retained and which go with the divestiture?

Organisations with a track record in M&A success use the Operating Model notion of ‘capabilities’ as a key starting point to form the basis of their strategic thinking on whether to acquire or divest. A ‘capability’ represents elements of the operating model used to deliver an advantage over its competitors.

With an appreciation of the operational end-state of two businesses, it should highlight what those ‘capabilities’ are and their deep underlying value.

\(^1\) 2015 M&A Outlook Survey, KPMG
This will considerably help you the seller understand what capabilities are being placed on the market, the capabilities truly valued and therefore retained, and the capability gaps created on either side that will need to be bridged pre or post deal.

*Capability analysis and assessment is a highly illuminating exercise. Make sure this is part of your M&A analysis.*

4. **Is it clear what’s up for sale and what’s not?**

   This is about creating a detailed inventory of the all the assets that are being put on the block.

   The Operating Model analysis performed so far will provide the key headings. While the list might start high level at first, over time it should be very detailed as every patent, trademark, document, physical asset and technology component gets logged. ‘The devil is the detail’ as they say. So this exercise will therefore help get into the detail and generate those devilish gaps, risks, tasks and questions that need answers at some point in the divestiture process.

   *An assets inventory is an essential planning and decision making tool.*

5. **Does the sale document really 'sell' the business?**

   This isn’t about having an ‘Information Memorandum’ for the sale. This is all concerned with that key notion of value.

   A business to be divested can offer a considerable number of opportunities that would greatly appeal to a target list of buyers. These capabilities can offer strategic, financial and operational gains and at the same time alleviating pains buyers may presently be having.

   *Have a document that sells!* Advertise capabilities, create value propositions, stir market interest and help maximise the sale price.
6. **How much separation can be performed without knowing who the buyer is?**

Ideally, the divested asset is already a standalone entity, or is capable of being fully carved-out prior to completion of the deal. In reality, it needs time to separate a business and it may not be possible to achieve this without jeopardising the deal timeline and wasting money in the process.

A seller will naturally want to achieve a fast close to the deal. So decisions need to be made on what costs can be incurred upfront in separating out the business. Technology separation is often takes the longest to separate, particularly where core systems and processes are shared. Starting early on this will help speed up the sales process, reduce costs and create better results. Technology however is not the only area. Work on corporate, tax and accounting structures, legal contracts, supply chains can also commence.

However, there will be points where separation cannot occur without knowing the buyer. It may even be preferable to leave something for the buyer to do as part of the value/price proposition. For example, does the buyer have their own general ledger or ERP? Do they have their own core applications? Their own facilities and so on. The answer in some cases is to separate data rather than systems.

*Separate where it makes sense pre-close and help speed up the sales process, reduce transition costs and create better end-state solutions.*
7. Will transitional services be required following completion of the deal?

A Deloitte report found that 80% of executives surveyed provide transitional services to the buyer post-close.

The TSA is a legal agreement quite separate from other sale agreements. It is often the last agreement and sometimes a bit of an afterthought to the sale itself. It shouldn’t be, as developing a TSA can be complex and time consuming task. It needs upfront and proactive effort so an effective TSA can be crafted in a way that post-close costs, risks and time are properly managed. Here a few pointers on creating an effective TSA:

- Start on the business processes that will be transitioned across. Map them out in detail and allocate process owners. Link the processes to the capabilities the seller is transitioning.
- Define what constitutes ‘separation’ and how quickly it is possible to achieve.
- Uncover what capability gaps a buyer may have that would need to be addressed for complete handover.
- Document the true costs of services to ensure it’s clear who pays for them.

*Don’t let the TSA be an afterthought in your deal. Value can be either created or destroyed by the TSA. Make sure it’s not seen as another administrative overhead. Give it the attention it deserves.*

8. Has a plan been developed to address the people side of the divestiture?

The people-side of the divestiture process may seem appear as an unwanted distraction to the deal itself. However, ignoring the needs of management and staff can at best can have unintended consequences, and at worst scupper an entire deal.

People don’t like uncertainty and yet selling a business is fraught with it. A clear plan of communication will help balance the need for confidentiality and the desire for information on how the sale might affect them. Communication is as much about style as it is around substance. Disclose what can be said, address rumours head on, hold informal gatherings with staff so that trust and commitment is not lost.

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2 Perspectives on driving divestiture and carve out value, Deloitte, 2013.
9. **Is there an agreed approach to help close the deal as quickly as possible?**

M&A deals can be weird, irrational and sometimes maddening. Super aggressive timelines are often demanded. So how can a deal be speeded up? Here are a few pointers:

- Ensure there is a good separation plan that maps out the work ahead and who’s going to do it.
- Apply a project management approach with milestones, dates and responsibilities.
- Speed up the buyers due diligence by assigning people ahead of time to support the process.
- Consider conducting a ‘Vendor Due Diligence’ to reduce the time the buyer requires to conduct its enquiries.
- Ensure there is a resource plan to complete the deal.

10. **Are there sufficient people resources to complete the divestiture?**

If there one repeating theme in M&A it’s this: business executives and staff with their day jobs simply run too lean to do anything else.

A Deloitte report[^3] found that 75% of executives surveyed cited lack of resources as a major obstacle.

Something simple like a resource plan that maps internal staff availability and skills to key tasks and deliverables will help show the resourcing gaps and the need for extra staff.

But make sure; where external advisors are used such as auditors, lawyers and investment bankers; it’s important their work is coordinated according to a common plan. Where there is a vacuum in control, advisors have been known to step in and try to take control to meet their own ends rather than the clients. This means duplication of effort and lots of fees!

*Have a resource plan. Know where the gaps are and find ways to fill them. Where external advisors are used, manage them, don’t let them manage you!*

[^3]: Perspectives on driving divestiture and carve out value, Deloitte, 2013.
11. Where a TSA is required, has sufficient analysis been performed on the pricing of services?

The TSA is typically the last agreement to be completed. It’s often rushed through and signed just prior to, or at Completion. To avoid bitterness, debate and destruction of business value, it pays to develop a fair and easy to understand way of charging for services.

But this can be challenging, for two reasons: You the seller may not familiar with providing internal services to an outside party. Secondly, you may not have the systems and tools to even itemise the cost of these services.

This is why the TSA can’t be rushed. Understanding the cost drivers and how to charge for them is key. There also needs to be a way of stepping costs down to coincide with the removal of services so the buyer is less dependent on the seller. Conversely, there needs to a mechanism for stepping costs up where the buyer is taking longer to take full control.

To avoid a disputes and heated exchanges on what should be a honeymoon, don’t leave TSA pricing until the very end.

12. Have additional opportunities for synergy upside been made plain to the buyer?

It’s very common for business cases to be put together to develop additional capabilities only to have funding denied because there isn’t the budget, strategic or political will.

There’s an opportunity to go back and pull the business cases developed in the past, and create a portfolio of initiatives the buyer could fund delivering further business upside. Moreover, it’s likely that other opportunities can be added to the list that never got past the idea stage.

I personally did this for a business around 10 years ago. The opportunities to enhance future profitability of the business through new IT technologies and processes was significant. Following a detailed business case outlining potential synergies, the business attracted an additional 15% price premium.
Dealing with residual costs can offer some unwelcome surprises.

Cost reduction targets might not be enough. It could mean a complete overhaul of expenditure.

There is always more value in a business. Blow the dust off old business cases and give them new life. Go to the staff, who always have the best ideas, on what else could be done if funding was available.

13. Has an ongoing alliance with a potential buyer been investigated?

Buyers and sellers may go their own way after a sale, but it’s not always the case. An ongoing alliance may provide the win-win both are seeking.

By understanding the capabilities affected through the divestiture, it should be possible to see the capability gaps that need to be bridged. For example, the divested entity may serve as a critical distribution channel for the retained business. Alternatively, it may provide call centre and other administrative functions, too costly for the seller to reproduce.

Go for a win-win! An alliance could be made to work through sharing of non-competing capabilities.

14. Has the residual cost structure of the retained business been fully explored?

One of the challenges when divesting a business is how best to manage the cost structure in the retained business. Rather than dealing with this problem once it actually happens it very much helps to be proactive and look at the operating model of the retained business.

The typical response is to call for cost reduction targets to be set so that finances are not impaired through the sale. This however may not be enough, and a more significant overhaul of expenditure is required. For example, the divestment may serve as a catalyst for reducing fixed costs and instead looking for ways to make these variable. In this case, outsourcing of services may become a viable option when previously it wasn’t.

Don’t leave this until reality bites. Make sure there is a plan to manage residual costs post-close.
15. Has a full-time project manager been assigned to the divesture?

Divestitures are one-off events that should be managed using project management tools and techniques. So whether it’s an internal resource or an external specialist, it’s important the person is able to orchestrate the overall effort, maintain control, and work dispassionately on securing the objectives of the deal.

If it’s an internal person, it should be an independent executive who can act as the champion. It’s also preferable for this person to have previously suffered the intellectual hard knocks of M&A life. This brings a fierce kind of wisdom that only experience offers.

An experienced, independent project manager to shepherd the divestiture is not just a good idea. It's mandatory.

16. Has a governance structure and process between the buyer and seller been agreed during the transition?

What may have been informal gatherings to date will need to be on formalised footing once the TSA is put into operation following Day 1. Typically, a Transition Committee is established to oversee the TSA. This committee will meet every week or as agreed. To maintain the formality, they should follow a protocol and set agenda to protect the interests of both parties.

Don’t add pain to the breakup. A simple but effective governance structure will help manage issues, disputes and create continued harmony between the buyer and the seller.

17. Is there a continued focus on operations and sales while the divestiture is occurring?

It is unfortunately a common experience for business performance to suffer during a divestment. It is one of those ever-present dangers where the management team, so preoccupied on concluding a sale, take their eye off achieving operational and sales targets.

So the mantra of ‘Business as Usual’ must be maintained with regular meetings and management targets continuing unabated. This also means being clear on roles – who’s on the project and who’s not.

To avoid drift in performance and erosion in deal value, a continued focus on achieved set management targets must continue before, during and after the sale.
18. Is there a disciplined approach to ensuring readiness for ‘Day 1’.

Day 1 is the critical moment when settlement occurs and the keys to the business are handed over to the buyer. This change of control needs to be as seamless as possible. If not then careers and reputations can come out in tatters.

Well managed divestitures will always have a clear focus on achieving business continuity through checklists, process walkthroughs, rehearsals and readiness assessments. Communications with customers, suppliers, staff and other stakeholders should be in overdrive to help keep them informed and onside. Getting ready for Day 1 may be a small affair for some divestitures, but not always. I recall one requiring nearly a year in planning!

*Day 1 is a time to say goodbye and to celebrate. Let it also be a time determined by planning and precision.*

19. Is there a clear strategy and approach for IT?

IT always has a tough and often thankless role to play. It is nearly always the area that starts first and finishes last in the divestiture process. Moreover, it can be a palpable shock to the CEO on just how long and hard it is to untangle core systems and infrastructure.

Aggressive transaction timelines can be a real challenge for IT departments. So IT needs to think and act creatively on how to provide viable solutions. The best way is always to start with the end goal and working back to the current state. The left to right linear thinking approach just doesn’t work. To help the CIO out, he/she will need to be play an intimate role as the deal progresses. Importantly, the CIO needs to fully understand the Operating Model and capabilities for both the divested business and the retained entity.

Like a project it needs to be managed hard to ensure the deal team and executive stakeholders don’t feel they are being let down. Unlike a project, there’s an element of irrational where plans get ripped up on the spot and replaced with new ones. This is part of M&A life.

*As much as 80% of the divestiture effort can rest with IT. Their role is key to a smooth sale and transition. Involve them early. Hold them close.*
20. Have a set of guiding principles been established between the buyer and seller?

Once the buyer is known and the deal is close to signing, there will be torrent of activities that both the buyer and seller will need to perform leading to completion.

With more people involved, it’s a very good idea to avoid confusion, hesitation and people acting way out of line by having a simple set of guiding principles on how the two should work together.

These principles should answer a number of questions people would have so they understand what their mandate is and where their boundaries are.

*Not having a set of guiding principles can only lead to confusion with well-intentioned people tripping over each other and doing the wrong things.*
Conclusion

Every divestiture is uniquely complex, challenging and frustrating in their own way. On the flip side, it can also be great fun; a time for learning, inspiration and innovation.

Asking good, thoughtful questions is a productive, positive and engaging way of gaining clarity around problems to be resolved. The 20 questions I listed here is the only the start. There are always more questions requiring answers.

So don’t let people tell you that carving out a business is a straightforward affair. It’s not. It can be seriously hard. I hope some of these questions highlight what some of the common challenges.

If you would like to have an informal chat about an upcoming divestiture then contact myself here in Australia. I’m always happy to meet, connect and have the coffee conversation. If you are outside Australia, we have representatives elsewhere too.

ABOUT THE AUTHOR

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