

When one just isn't enough:
5 ways to master serial
divestitures



Abstract

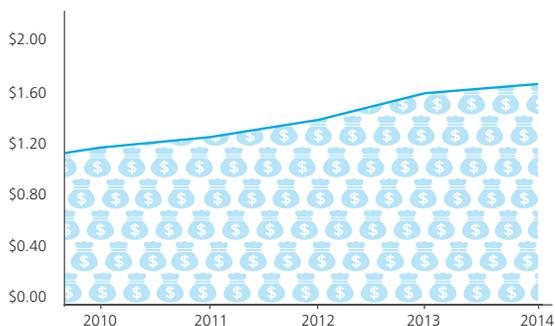


Market conditions are at a tipping point for sellers. Corporate cash reserves remain at all-time highs while un-invested private equity capital and increasing transaction multiples have converged to create a favorable climate for those companies looking to shed underperforming or non-core assets.

Divestiture activity specifically is at record levels. Unique to this current wave of divestitures is the number of companies executing multiple divestitures in rapid succession (serial) or at the same time (parallel). Due to these auspicious market conditions, companies are acting with haste to restructure, and with good reason—*divestitures offer an opportunity to significantly increase shareholder value*. This value creation could, unfortunately, be significantly higher—a recent Deloitte divestiture survey revealed that more than two-thirds of divestitures delivered value that was “about as expected” or “lower than expected”—leaving significant value on the table.¹

Deloitte has developed a unique perspective on what typically drives success and value in these complex transactions.

U.S. Companies' cash holdings (\$T)



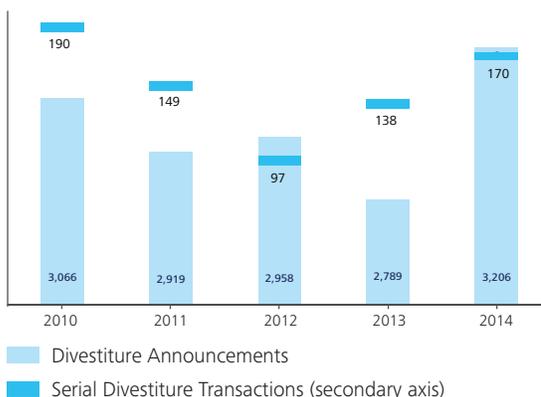
U.S. non-financial companies rated by Moody's
Source: Moody's Investor Service

In addition to Mergers & Acquisitions (M&A) discipline, the characteristics that consistently emerge as key success factors in serial/parallel programs tend to center around:

1. Sequencing and accelerating deals 
2. Restructuring and value capture 
3. Establishing a scalable operating model 
4. Developing and retaining talent 
5. Building a repeatable play 

Each of these elements contributes to an approach distinct from traditional divestitures. This methodology helps balance the risks and demands of a multi-year, multi-faceted endeavor with the incredible value creation opportunity often presented by large, transformational change.

U.S. Divestiture activity



Serial Divestor: Entity engaged in 6+ divestitures
Source: Thompson Financial, MergerStat Review, Deloitte Analysis

¹ “Divestiture Survey Report 2013: Sharpening Your Strategy,” Deloitte Consulting LLP, January 1, 2013. Accessed February 12, 2016. <http://www2.deloitte.com/us/en/pages/mergers-and-acquisitions/articles/divestiture-survey-report-2013.html>.

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1. Sequencing and accelerating deals



The sequencing and timing of transactions is central to planning a serial/parallel program. To that end, the deal planning team and the divestiture execution team need to have an open channel for *two-way communications, visibility into planned deal flow, and a way to communicate specific business complexities that may influence close timing.*

For the divestiture planning teams, beyond enabling identification and execution of long-lead activities for transacting parties, the ability to do early planning helps the Separation Management Office (SMO) influence sequencing and timing based on the following five considerations:

Maximizing deal value: The time interval from announcement of the letter of intent to when the transaction is completed can have unintended consequences on deal value. Diligent planning, particularly if the intended transition is planned for multiple phases, is critical to protecting deal value. This is especially true if the deal entails an asset-only transaction and external market factors can influence the value of the assets over time.

Sequencing by size of deal: There are a range of options when structuring serial/parallel divestitures. A large majority of divesting companies opt for transactions that maximize value early in the program as priority deals, followed by transactions with lower economic value. However, effective sequencing of transactions should also be informed by Buyer readiness, especially in cases where a serial divestiture program has multiple buyers. Buyer readiness can range from deal execution readiness to preparedness for integration of the acquired entity. In scenarios with parallel divestitures, it may be important to also consider internal factors such as transition, deal, and legal team availability to structure and execute transactions simultaneously.

Preference for pilot transitions: Piloting a series of smaller-scale transitions allows for the transition team to assess the effectiveness of the overall SMO process and make any adjustments for future transitions. Piloting also enables de-risking of the transition for the transacting parties as well as customers, employees, and other stakeholders.

Level of buyer sophistication: Sequencing deals especially in multi-phase divestitures should incorporate consideration of the buyers' ability to transact and integrate the divested business effectively. Buyer sophistication on legal and financial matters can also affect program acceleration. Medium and large sized corporate buyers may choose to acquire larger portions or all of the assets to restrict balance sheet impact within a quarter or a year. Smaller buyers on the other hand may choose to acquire over a longer period of time. Program acceleration and sequencing should account for buyer type especially if a serial divestiture program involves multiple buyer types.

Seller diligence: As of part being a prepared Seller in M&A transactions, it is typical for companies to conduct an operational assessment of the divesting assets included in the upcoming transaction prior to Buyer diligence. However, in serial/parallel divestitures, this will be a repeated activity across transactions and should be formalized within the SMO. It is important to have consistent standards, diligence reporting, and remediation methods to better prepare the assets for sale and de-risk Day 1.

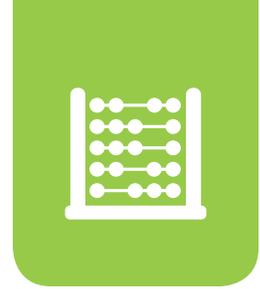
Why are serial/parallel divestitures so difficult?

Sprint divestitures drive towards a quickly approaching Day 1 (when buyers assume operations of the business) and are often difficult because they require an experienced team and a joint dedication to flawless transaction execution.

Marathon divestitures focus on a massive single transaction over the long term and can be difficult because these require succession planning and need to fight organizational fatigue.

Serial/Parallel divestitures tend to be subject to the most challenging aspects of both a Sprint and a Marathon divestiture program. Methods need to be developed and scaled, resources need to be trained and retained, and governance needs to remain consistent yet adaptable. Without proper planning, the challenges that surround a serial/parallel divestiture can quickly paralyze an organization.

2. Restructuring and value capture



As the business changes with multiple transactions, residual operations should also be adjusted to best support the remaining business—while maintaining flexibility for future transactions. *Planning the structure of RemainCo (areas of the business that are still controlled by the seller post divestiture) is perhaps the most critical part of a divestiture program*, the serial component can add the unique challenge of having to continually adjust RemainCo to support the business over multiple deals (and years) in an evolving landscape. Several components often make value capture in serial/parallel environments challenging including accounting for shared/split resources and the timing of stranded cost elimination.

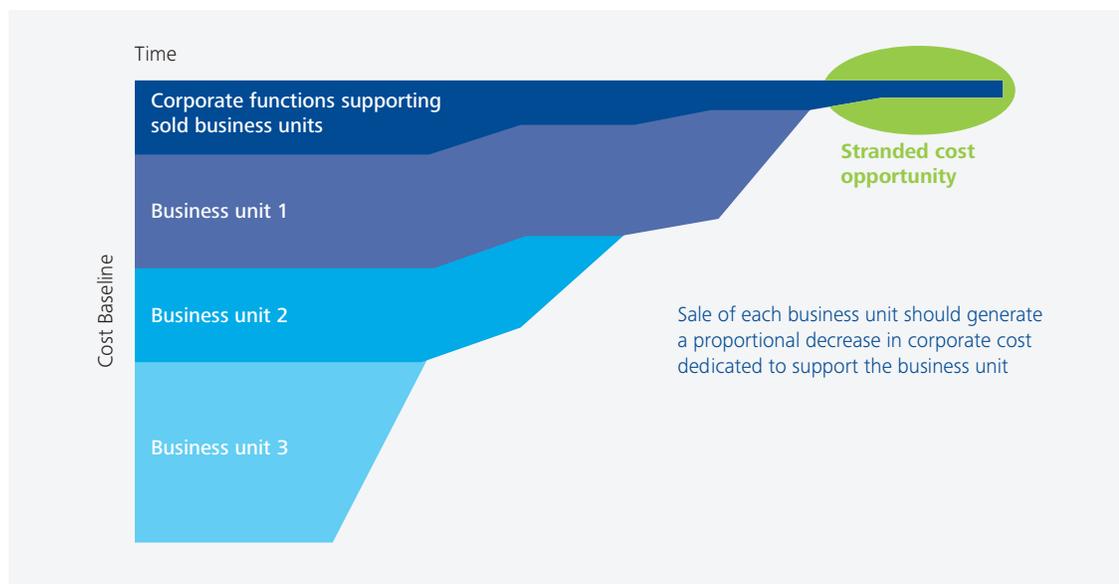
Many divestitures have to deal with shared or split resources. This is particularly important in a serial/parallel environment because shared resources are often in need of a near-term home while waiting for another transition, which will include their transfer, to occur. Back-office functions are a common challenge, but in a serial/parallel environment the front office should be a strategic focus area. Front-office resources may be allocated across multiple divested businesses and may in fact transfer with a future planned transaction. Keeping those resources fully engaged and accounting for the carrying cost should be

considered in both deal valuation and sequencing. Eroding front-office capabilities too early can have devastating consequences on the organization’s ability to maintain and drive growth.

Capturing stranded costs is another area of enhanced complexity in a multi-phased divestiture program. Divestiture teams traditionally plan the future state vs. the current state; stranded costs come out of the delta and can be rapidly captured. The approach should include additional strategy and planning when each individual transaction does not define the end state of the organization (serial environment). In this case, interim or mid-state planning may be necessary. Stranded costs need to be sequenced for capture, and dissected to understand which pieces can be captured as each deal closes. For example, your customer contact center may need to shrink by 10 percent, but you may only be able to capture that in small pieces until your last transaction closes due to the coverage needs and call patterns of transitioning customers.

Completing a detailed stranded cost analysis early in the divestiture strategy and planning process enables you to capture those costs as efficiently as possible.

Stranded cost example



3. Establishing a scalable operating model



A serial or parallel divestiture environment can offer **sellers opportunities to scale their program based on the number of simultaneous transactions as well as the future state roadmap of transactions.** Scaling across transactions can meaningfully reduce separation costs and increase speed to close. Common areas ripe for scaling across transactions are in the areas of Separation Program Management, Transition Service Agreements (TSAs), Contract Separation, Stranded Costs, and Functional Separation (e.g., Finance, IT, HR & Communications, Supply Chain, Risk, Sales & Marketing). TSAs are especially relevant when assessing scale efficiencies in a serial/parallel divestiture program.

When executing a single transaction, TSAs are typically minimized and endured by sellers for as short a period as possible. Recent analysis, however, suggest that sellers typically don't understand their total cost to serve and buyers are underwhelmed with the service—both look to exit quickly.² A more strategic view of the options based on the number and profile of buyers is crucial for a serial/parallel divestiture program.

When dealing with strategic buyers, the TSA need may be low and briefly muscling through TSA light service delivery could be the best option. However, financial buyers or smaller buyers will likely require TSAs. In this case, strategic operating model considerations should be explored, especially if these services are not core to RemainCo's operations. These services would likely include moving the

service organization into a different legal entity, creating a service execution joint venture, or spinning-off the service delivery organization completely. Each have demonstrated strategic and financial costs and benefits, but depending on the duration, size, and complexity of the required transition services, these options can create significant shareholder value. Building scalable operating models into the program is not limited to TSAs. The structure of the SMO is a common example of where structure can impact speed and quality. With multiple deals, several elements necessitate central oversight within deal-specific teams; these include not only TSAs but also stranded costs, stakeholder experience, and coordination of transition-specific decisions which could affect the broader program.

Overall, the success of serial/parallel divestitures relies on inter- and intra-transaction planning and structural considerations spanning beyond the life cycle of any individual transaction. To effectively achieve this, leadership should identify key components of the program that benefit from centralized leadership and coordination. Effective centralized management often reduces costs and increases efficiency by offering a level of specialization to repeatedly and effectively execute a critical component of each transition within the series. A recent Deloitte engagement involving more than 20 divestitures over a two-year period saw a 36 percent reduction in the time required to complete each transition through the use of these scalable operating model techniques.



² "Divestiture Survey Report 2013: Sharpening Your Strategy," Deloitte Consulting LLP, January 1, 2013. Accessed February 12, 2016. <http://www2.deloitte.com/us/en/pages/mergers-and-acquisitions/articles/divestiture-survey-report-2013.html>.

4. Developing and retaining talent



Planning and executing a single divestiture can pull top performers out of their “day job” for three to six months. Similarly, serial/parallel divestitures draw from this same deep pool of top performers, but the program needs are longer-term. As such, *the organization should adopt a long-term view of talent development and management within the program*. Priorities should include formal talent identification and development protocols, growth and rotation opportunities, and robust succession planning for the life of the program. With today’s mobile workforce, investing in talent management is critical to the long-term health of a serial/parallel program as unplanned attrition can potentially halt transactions or erode value capture.

The typical skill set required when executing a single divestiture is deep functional knowledge and strong project management capabilities. However, when coordinating multiple transitions, talent must be equipped to manage priorities across multiple and potentially competing objectives—truly an air traffic controller managing across multiple transactions and ongoing business priorities. Additionally, strong analytical skills enable effective leaders to identify and manage program risks and priorities across divestitures. Stranded costs within a function, for example, are typically identified per divestiture, but the exit cost analysis should be coordinated so that one divestiture isn’t cannibalizing a TSA delivery capability or impacting a capability the business needs to have in place through a later Day 1. The air traffic controller role needs to coordinate effective capture of stranded costs while balancing the contractual obligations of any TSAs; these resources should also reach back into the business to coordinate cost takeout timing with planned projects over the coming months or years of the program.

Serial or parallel divestiture programs can range in size from dozens to hundreds of talented employees. Recruiting is often seen as an administrative necessity rather than a

strategic lever for driving program success. Two important factors that, when addressed up front, can help prevent unplanned attrition are the length of the program (or assignment) and the career development objectives of these candidates (who are often junior associates). Job hopping is more employed by Gen Y workers than it has been by any previous generation—according to the Bureau of Labor Statistics, average employee tenure in 2014 was 4.6 years; However, for workers aged 25–34, the average tenure was 3 years.^{3,4} Fortunately, these complex programs tend to have diverse opportunities for people to rotate roles and take on expanded responsibilities as the program grows—if the talent management program proactively manages this risk. To help minimize unplanned attrition, associates should be provided with clear career path options within the program and a formal annual performance ecosystem unique to the serial/parallel program. This ecosystem should establish goals and advancement opportunities unique to each individual.

As with most high visibility, high intensity corporate programs, fatigue and individual life changes can also drive turnover. Programs should build this into their contingency plan and regularly check the pulse of teams in the program. Without planning for this, a single core resource leaving the program can potentially impact multiple deals or become a single point of failure in a value capture effort. On a recent multi-billion dollar serial/parallel divestiture engagement, Deloitte observed a 70 percent turnover rate across the first two years of the program. The impact of this turnover was minimized through proactive succession planning, quarterly “pulse checks”, and formal program downtime after each deal close. Succession planning included not only understanding who each person’s backup was, but also providing them with the right experiences and trainings to prepare them to effectively step into the new role.



³ “Employee Tenure Summary,” Bureau of Labor Statistics, September 18, 2014. Accessed February 12, 2016. <http://www.bls.gov/news.release/tenure.nr0.htm>.

⁴ Deloitte Analysis.

5. Building a repeatable play



In an environment of rapid and repeated deal activity it is critical to develop a solid and repeatable “play”. Similar to becoming a highly efficient producer of goods, standard processes, tools and activities allow sellers to move resources around interchangeably, accelerate subsequent transactions, and ultimately reduce costs and improve outcomes. For companies contemplating a serial or parallel divestiture program a pragmatic approach to building repeatability is recommended—*build the foundation, develop excellence and scale, and then increase speed.*

Building the foundation should start with the end in mind. In this setting, the end refers to an efficient program able to deliver a flawless Day 1 every time. Developing (or refining) a playbook, building standard tools and accelerators, and creating a centralized infrastructure where standards can be stored and accessed are all foundational elements for repeatability.

Part of this foundation development, should also include allocating time and resources for the SMO to build this solid toolset and approach—this investment can be

expected to yield dividends over the course of the program as it will be leveraged by each subsequent transaction.

Building excellence involves both a continuous improvement element to the program and a culture of collaboration. Continuous improvement needs to happen rapidly in order to incorporate learnings into the next divestiture program. In a serial divestiture environment, teams may only have a few weeks to identify lessons learned and incorporate them into the next round, in a parallel deal environment they may only have days. A strong SMO is critical not only to both supporting the development of learnings, but also to the dissemination of this information throughout the program. When done well, the SMO facilitates sharing information, enhancing tools and approaches, and managing a central repository of standard materials. This center-led approach to standardization can help accelerate the onboarding, training, and rotation of resources as the program expands or contracts.

From the Trenches:

Deloitte recently completed a multi-year serial and parallel divestiture program for a Fortune 100 client. Employing an approach of building the foundation, then excellence, then speed, Deloitte delivered more than 15 successful Day 1s while building scale along the way.

1. **Building the Foundation:** Initial transactions over the first six months took approximately 7.5 months to plan and execute as an up-front investment was made with a small pool of resources to build a repeatable play. Overstaffing functional teams allowed on-the-job-training for needed future program expansion. Robust tool development, training, and building centralized infrastructure for sharing and standardization drove consistency in divestiture execution and results.
2. **Building Scale:** Over the next six months the program completed more than a dozen flawless Day 1s while the number of divestiture teams more than doubled from two to five. With a strong foundation and training program new teams were able to rapidly move up the execution curve and incrementally improve the play.
3. **Gaining Speed:** By the end of the first year of the program the average duration of planning and executing a divestiture went from 7.5 to 5 months, enabling the program to complete an additional ten transactions per year and accelerating value realization. At the same time the average divestiture size increased by 88 percent.

Conclusion

Divestitures are complex endeavors, and adding a serial and/or parallel twist tends to only enhance those challenges. Being laser focused on addressing the unique scale, resourcing, and speed challenges is key to achieving growth and value capture objectives.

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