

EUROPE

Governance aspects when selling a disentangled business

by Rick van Dommelen, Pieter Veuger and Casper Scheffer

As deal activity begins to ramp companies are considering strategic moves to sell parts or all of a business. Surveys show that those businesses that regularly and consistently conduct reviews of their business portfolio are most successful in achieving the maximum value for their shareholders. However, especially for companies selling only parts of their businesses (carve outs) it turns out that achieving shareholder value depends fundamentally on how the divestiture process is managed. Having spoken with senior executives at large businesses in the Netherlands about the sale process for carve out businesses, it is clear that good preparation and a structured process are ultimately seen as key factors for success. Aspects include the governance structure of the project, the definition and clarity of the proposition, and finally the execution of the transaction.

The strategy

Generally the decision to investigate an opportunity to sell part of a business is made by the Board of an organisation. The primary aim of the sale is to achieve maximum shareholder value. However, this means more than simply trying to achieve the best price for the business. The general impression created around the transaction is just as important, including the image of the buyer, the buyer's plans for the business, and the buyer's potential to execute the transaction.

In this stage vendors define their primary objectives and often decide which type of buyers to invite to place an offer for the business. By including the buyer's image and trust as objectives, a number of buyers will be indirectly excluded from the sale process.

The preparation

Once the strategy is defined and approved, the CFO, on behalf of the board, often starts the preparation of the process.

In complex transactions where the business is highly interconnected with the rest of the group, the vendor defines the scope of the transaction. The details of the scope are set by the management team often guided by a carve out office established by the head office to produce an independent view on all the key assets, systems, processes, contracts and people necessary to achieve the strategy of the business up for sale.

When selling a business unit, the vendor must eradicate any uncertainties for potential buyers. Transparency of the process and the assumptions, and trust in the vendor are regarded as important factors in optimising the transaction value and, consequently, the success of the sale. It goes without saying that there will be more uncertainty about the value of a business unit that is embedded in the rest of the group. This makes the case for thorough preparation.

However, thorough preparation can conflict with another often envisaged objective: avoiding information on the planned sale being leaked to staff and other stakeholders. Therefore, the teams involved are often small. It is the task of the core team to ensure that the strategy, objectives, principles and priorities are clear and are respected throughout the process.

Clear agreements on the levels of authority for decision-making and internal communication are essential,

if the sale process is to proceed without a hitch. The reality is unfortunately sometimes more fractious. Conflicting decisions may at times be taken at different points during the often hectic process, and may only be noticed at a late stage.

Generally, the management team of the to-be carved out business (especially the CEO and CFO) are only responsible for providing the content of the Information Memorandum and the data room. However, the support of the management team is regarded as important, given that the management team will possibly be responsible for delivering on the business plan once the transaction is completed.

Retention. Split-offs are, more often than not, drastic change processes. The organisation needs to bear in mind that staff will view the uncertainties as a threat to their jobs and their career opportunities. Retention will therefore be a major concern, especially for financial buyers. The terms of the retention package must be chosen with care, because these terms could, over time, conflict with the objectives of potential buyers.

Buyers. As mentioned before, the selection of the type of buyers that will be approached takes place in the strategy stage. The preparation process will to some extent depend on the types of buyers being approached. Strategic buyers are generally considered able to integrate the acquired business into their existing operations. The major advantage of this type of buyer is that they are often well placed to develop an integration scenario themselves. It is therefore not necessary to present the business as an independently operating business along with the corresponding standalone financial information. What is important, however, is that the vendor has and provides an adequate understanding of the current interdependencies between the business unit and the vendor's organisation.

By contrast, financial buyers do not generally have an organisation to integrate the business unit into. They will be looking to have the business function independently once the transaction is complete. As well as information on the current interdependencies between the business unit and the vendor's organisation, the vendor will therefore also have to provide insight into the possible operational and financial situation after the transaction, as well as in the transition process.

This means that the vendor will have to make a wide range of assumptions on the future business model. This is often achieved by establishing a number of working groups. It is very important that there is stringent supervision of the solution ideas proposed by the working groups at this stage.

If the management team of a group company proposes a management buyout, this generally means an immediate change in the decision-making levels of authority and the reporting structure. The business is then put under increased supervision.

The sale process

After the vendor has developed a clear view on the exact scope of the transaction as well as the operational and financial consequences, the vendor can start the sale process. We are aware of several divestment processes in which the sale process was initiated too early, which led to inefficient and time consuming processes.

During the sale process, the role of the management team of the split-off business is limited. The vendor is responsible for selecting and communicating with potential buyers.

The sale process reaches its peak with the final binding bid (signing date). This moment heralds a new stage in the process that lasts until the closing date. In this stage, the number of parties involved increases and the focus at lower levels of management turns to TSA requirements and solutions. It is essential that central deal teams remain involved in this process and in the communication between the two businesses. The business remains part of the vendor's organisation until the closing date, and the

management team continues to report to the vendor.

The execution

After the closing date, the number of parties involved increases again and issues now emerge at all levels which were either not known or not relevant during the sale process. Small issues during the preparation become big issues during the execution. It is exactly these kinds of small issues that can lead to time-consuming differences of opinion after the closing date. The lesson that can be drawn from this is that agreements should be reached in principle before closure but senior management should stay involved until the end of the process to provide a balance between setting the direction of the divestment process and regarding the impact of this process on people, customers and disruption of the core business.

Conclusion

The divestment of part of an organisation has a large impact on various stakeholders and takes a lot of effort and considerable resources. As became apparent from our discussions, the complexity of a divestment process is often underestimated and can disrupt large parts of the organisation. A divestment process – although offering opportunities – poses many risks to both the remaining business and the business up for sale. It takes the right governance structure with rigorous program management by the carve out office to safeguard the value of the businesses and to achieve the strategic goals of the divestment. Other reasons for success are the alignment of management commitment – and incentives – with the goals of the divestiture, a quick execution, and proper Day One preparation.

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