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1.1 OVERVIEW

Merger and acquisition (M&A) transactions provide organizations with important mechanisms for adjusting to challenges and opportunities in an ever-changing business environment. Divestment activities in general, and corporate divestitures in particular, play a significant role in that adjustment process. They enable organizations to periodically realign their product/service portfolios with the market, to monetize undervalued assets, and to generate cash for higher value uses.

This introductory chapter establishes a foundation for the thorough discussion of the planning, preparation, and execution of corporate divestiture transactions that follows in the remainder of this book. This initial foundational discussion begins with a definition of divestitures, the reasons they occur, why they are important, and the factors that distinguish them from other M&A transactions, and ends with an explanation of how this book can assist those tasked with executing or assisting with these transactions and a summary of key points covered in the chapter. The intervening sections of this chapter describe the three major components of a practical, experience-based approach to managing divestiture transactions. These sections present:

- An overview of a *transaction model* that provides guidance on the planning, preparation, and execution of divestiture transactions
- An overview of a *staffing model* that provides guidance on resourcing and managing a transaction
- A discussion of *enabling principles,* underlying elements of the process that are critical to its efficient and effective execution

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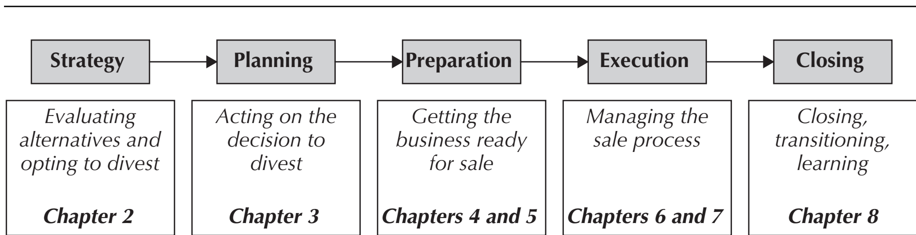

EXHIBIT 1.1 TRANSACTION FLOW

The succeeding chapters elaborate on these themes. Organizationally, they follow the divestiture transaction flow, as illustrated in Exhibit 1.1.

Although there is ample discussion of underlying M&A principles and concepts, the treatment herein can best be characterized as practical and directive. Accordingly, the discussion is focused on process management and the application of experience-based best practices. The pragmatic, transactional approach presented is intended to equip those involved in divestiture transactions with tools that, if employed, will substantially enhance the potential for a successful transaction.

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1.2 CHARACTERISTICS OF CORPORATE DIVESTITURES

(a) INTRODUCTION Corporate divestitures, to be distinguished from the sale or liquidation of an entire enterprise, involve the sale of the stock or assets of portions or segments of a business (a business unit). These business units may range in size and nature from relatively small, niche properties, such as individual products or product lines, to more substantial properties, such as divisions or subsidiaries.

Divestiture decisions are generally made as the result of an organization's disciplined strategic planning or portfolio assessment process, which is briefly discussed in section 1.3(c)(i) and described in detail in Chapter 2, which focuses on investment and divestment options targeted to meet market needs and preferences, to optimally restructure the entity for profitable growth, and, ultimately, to enhance enterprise and shareholder value.

The divestment aspect of this process employs an addition-by-subtraction approach. Its focus is on the strategic objectives of the business and, in that context, considers such issues as the strategic fit

of the various components of the business's product/service portfolio, the historical and prospective financial performance of its individual business segments, and the impact of individual components of the portfolio on the financial markets' perception of the consolidated entity's value. To the extent that individual segments of the business do not support the strategic objectives of the organization, they become candidates for divestment initiatives. Although there are a number of other divestment options available to the organization, such as carve-outs, spin-offs, or joint ventures, arguably the most commonly chosen alternative is the divestiture or outright sale of the business unit.

(b) WHY DO ORGANIZATIONS CHOOSE TO DIVEST BUSINESS UNITS? As noted, the generic reason for divesting is the strategic incompatibility of the business being divested. More specifically, divestiture rationales fall into one or more of these four categories:

1. **Sale of a well-performing but nonstrategic unit.** Clearly, superior financial performance does not equate to strategic fit. However, superior performance can inhibit the decision to divest, because it can mask the lack of strategic fit and it can induce management to equivocate and opt for short-term financial gain. Therefore, the decision to sell a well-performing business unit requires a high degree of discipline on the part of management, and usually is presented in the context of an investment strategy for the proceeds from the sale.
2. **Sale of an underperforming unit that is diluting consolidated growth and profitability.** This rationale is generally based on management's recognition that the targeted unit is no longer well aligned with its market and is not a good candidate for further investment. In such situations, noninvestment or underinvestment is very likely to lead to a downward spiral of deteriorating performance, further lack of investment, and continued poor performance. Unless the property can be realigned with its market, further investment is destined to lead to unmet expectations and the misutilization of both managerial and financial resources. Under these circumstances, management will generally opt to dispose of the unit.

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3. **Sale of a profitable unit to raise cash.** Occasionally organizations sell properties that are both profitable and strategically compatible in order to generate cash. Usually this is done to enable the organization to pay down debt and to restructure its financial position. In relatively rare cases, it may be done to generate operating cash, a rationale that suggests structural business problems.
4. **Sale of a unit perceived by the market to cause undervaluation of the seller's entire enterprise.** The organization's strategy and business structure do not exist in a vacuum and are subject to critical analysis by relevant constituencies, such as the organization's shareholders or the investment community in general. Management must consider that financial markets make their own judgments as to strategic fit and value and that those judgments can negatively impact shareholder and enterprise value. In situations where the investment community perceives that an existing business unit is undermining the value of the larger enterprise, management may feel it is necessary or desirable to take corrective action in the form of a divestiture.

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As all of these rationales indicate, corporate divestitures should not be seen as isolated financial transactions that are executed to eliminate an unwanted business unit or simply to generate cash. Divestitures are reflective of an underlying strategy to reposition or restructure an organization with the objective of enhancing the organization's value.

(c) WHY ARE DIVESTITURES IMPORTANT? As noted, corporate divestitures are an important component of an organization's strategic planning process and any resulting portfolio adjustment decisions. Therefore, it is not surprising that they are relatively common in occurrence, affecting large numbers of organizations annually, as well as many of the managers within those organizations. In addition, they are notable for the substantial transfers of value that result.

More specifically, corporate divestitures have consistently accounted for over one-third of all announced M&A activity from 2002 to 2006, with the number of transactions averaging well over 3,000 during that period (see Exhibit 1.2).

Year	Total M&A Transactions*	Number of Divestitures*	Divestitures as % of Total	Avg. Purchase Price (*in Millions*)†
2002	7,303	2,691	37%	$165.0
2003	7,983	3,188	40%	$130.7
2004	9,783	3,560	36%	$175.5
2005	10,332	3,570	35%	$171.5
2006	10,660	3,375	32%	$228.9

Source: *Mergerstat Review* 2007
*These include all announced transactions. As a result, the numbers are likely to be substantially *understated* since many transactions go unreported.
†Average purchase price is based on transactions where the purchase price was disclosed (1,495 in 2005).

Exhibit 1.2 Divestitures as a Percent of Total M&A Transactions, 2002 to 2006

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The absolute number of divestiture transactions—approximately 16,000 over the five-year period cited—indicates broad involvement by a large number of firms and the management personnel within those firms. As illustrated in the listing of *Divestiture Activity by SIC: 2002 to 2006* in Appendix 1A, these transactions cut across all industries. Although there are notable concentrations in industries such as communications, financial services, and computer products and services, virtually all industries engage in a substantial level of divestiture activity. And many of the most active divesters are large organizations with familiar names. As Appendix 1B demonstrates, they include such companies as GE, Carlyle, Hilton, JPMorgan Chase, Citigroup, Blackstone Group, Honeywell, Clear Channel Communications, Kohlberg, Viacom, Ford, Prudential, Alcoa, Bank of America, Exxon Mobil, and H. J. Heinz.

It is also important to note that these same data indicate that, in addition to transactions being large in volume, the average transaction is also significant in size. From 2002 to 2006, the transaction value of the average divestiture where the purchase price was disclosed was approximately $175 million, an amount that is material to most sellers. In addition, the total value of transactions in which a purchase price was disclosed—only about half the total transactions announced—exceeded $342 billion during that period.

In short, corporate divestitures are pervasive in occurrence and material in effect, both individually and in aggregate. They are a major

component of M&A activity and a significant class of economic transaction. Additionally, within the thousands of divesting organizations each year, tens of thousands of managers are tasked with the responsibility of managing these high-value transactions.

(d) HOW DO DIVESTITURES DIFFER FROM ACQUISITIONS? Those who have participated only on the buy side of a transaction or transactions (i.e., acquisitions) may tend to view divestitures as the mirror image of those transactions. In fact, there are some very significant differences between the two, and these differences impact important aspects of the divestiture process. The most notable differences are:

- **Psychology of the transaction.** Attitudes of executives and managers within organizations that are divesting a property are generally quite different from attitudes of those same individuals toward acquisitions. Acquisitions almost invariably generate enthusiasm and excitement, which usually results in broad-based support for, and a desire to be involved in, the transaction. Despite their importance, divestitures have a tendency to be viewed as dead-end transactions that have little payoff for participants. This attitude can lead to organizational indifference and a lack of enthusiastic support across the organization, and may result in an under-resourcing of the transaction. This tendency and its attendant risks are discussed in detail in section 2.4(c). Suffice it to say here that while all M&A transactions are inherently risky, this psychological barrier to enthusiastic participation in divestitures adds an additional layer of risk that is generally not encountered with acquisitions.
- **Need for intense planning and rapid implementation of the organizational separation of the entity being sold**. The divestiture counterpart to postacquisition integration is organizational separation or "disentanglement," a process that is thoroughly discussed in Chapter 5. Unquestionably, successful acquisitions require a great degree of focus on integration planning and implementation. However, divestiture disentanglement presents different, and in some ways more difficult, challenges. Whereas the implementation of the integration plan is something that occurs posttransaction, divestitures require both planning *and implementation* of the separation process *before the transaction is consummated*. This is an important distinction

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because the disentanglement process can be very complex. The property being divested frequently has been owned by the seller for an extended period of time and its infrastructure is likely to have been integrated into that of the seller. Therefore, separation of the entities requires rigorous analysis and intensive participation on the part of a broad cross-section of both entities' operational personnel. Arguably, the disentanglement process, in contrast to the integration process, is more complex, less forgiving, and definitely planned and performed under substantially tighter deadlines.

- **Need for the preparation and staging of the transaction.** The nature of the activities associated with divestitures is substantially different from those involved with acquisitions. Whereas members of an acquisition team focus on review, analysis, and validation, those on a divestiture team predominantly focus on preparing and positioning the business for sale. For example, the acquisition team *attends* the management presentation, whereas the seller *develops and presents* it. Similarly, the buyer *conducts* due diligence, while the seller *manages* the process. In short, the preparatory activities sellers engage in are substantially different from the evaluative efforts of acquirers and, therefore, require substantially different approaches and skills.
- **Existence of substantial communication and management challenges.** Corporate divestitures present significant communications and management challenges. The announcement of the prospective sale of the business unit generally occurs months before the identity of the buyer is known. In those ensuing months, the selling organization must communicate a message of stability to the employees and customers of the business being divested, in an environment of uncertainty. For employees, this is a particularly challenging time because the announcement will generate a host of unanswerable questions about such things as the timing of the transaction, its impact on their jobs, the effect of the change in ownership on their benefits, and the potential for relocation of the business. As a result, the business unit will be vulnerable to employee demotivation, loss of productivity, loss of personnel, and erosion of its assets.

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To minimize the impact of these vulnerabilities, the organization must develop a well-thought-out and well-executed communication plan (see section 3.8 for a discussion of the content and section 6.3(a) for a discussion of the implementation of such a plan) that addresses both employee and customer concerns and whose message is sustained over this period of uncertainty. That plan and the message it communicates must be complemented by aggressive management efforts to minimize business erosion and employee defection. A major element of those efforts will generally take the form of a retention plan designed to retain and motivate key employees, also discussed in section 3.4. These activities have no clear counterpart in the acquisition process.

- **Lack of a robust knowledge base.** M&A literature focuses inordinately on acquisition activity, to the virtual exclusion of substantive discussion of divestitures. We believe that this lack of attention to virtually all aspects of corporate divestitures in the professional literature is replicated in practice, resulting in a very thin layer of shared or institutionalized knowledge on the topic in most organizations. A major factor influencing that phenomenon is the organizational indifference that is frequently associated with divestiture transactions. In addition, it is in the nature of the transaction to lose a significant number of participants and their acquired expertise. The executive management team of the unit being sold, which may represent as much as half the number of active participants in the process, is routinely transferred with the business upon the closing of transactions. This combination of indifference or inattention and the erosion of the organization's knowledge base conspire to undermine the development of a body of knowledge that can be accessed by participants in future divestiture transactions. (Note that section 8.5 discusses approaches to institutionalizing lessons learned from divestiture transactions.)
- **Need to maintain leverage throughout the transaction.** Parties to all M&A deals try to optimize their negotiating leverage throughout a transaction. In an acquisition of an entire enterprise, the acquirer's, as well as the seller's, leverage might

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be characterized as binary (i.e., throughout the negotiations, the parties maintain leverage by retaining the right to walk away from the transaction if key terms and conditions are unacceptable and cannot be negotiated further). Divestiture transactions have different negotiating dynamics. In the case of a divestiture, negotiating leverage tilts toward buyers when the initial announcement is made and will shift even more dramatically to a buyer if the seller makes an exclusive commitment to that buyer prematurely. This situation arises because the seller has publicly committed to the sale, and a decision to terminate negotiations would present extremely unattractive options, such as reopening negotiations with a previously eliminated bidder or pulling the property from the market. As a result, the seller will want to try to retain as many alternative buyers as possible, for as long as possible, to keep favorable pressure on price and conditions of sale. Doing this generally argues strongly for the use of a public auction process with the involvement of multiple potential buyers, right up to the finalization of the sale (see section 4.6(b) for a discussion of auction sales). If the size of the transaction warrants it, the seller may also find it desirable to keep other options, such as a carve-out, a spin-off, or a leveraged buyout (LBO), on a parallel track, if the potential opportunities justify doing so.

1.3 TRANSACTION MODEL

(a) INTRODUCTION The most progressive organizations active in the M&A arena develop and adapt best practices through trial and error and the thoughtful retrospective analysis of past transactions. These organizations recognize that merger and acquisition activity is more than a series of unique transactions. Although they appreciate that no two transactions are exactly alike, they have come to realize that there are certain disciplines that can be standardized, documented, and improved on, just like any other repeatable business process. Employing a logical, structured approach that incorporates lessons learned from prior transactions and that is built on a platform of thoughtful planning, detailed preparation, and disciplined execution has enabled such organizations to become accomplished managers of M&A transactions.

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Development of best practices in M&A is extremely important because the stakes involved are almost invariably high and missteps are likely to entail substantial actual, as well as opportunity, costs. Corporate divestitures or disposals are subject not only to these risks; risks may be exacerbated by what has been characterized as the organizational indifference, or the "orphan treatment," that can frequently befall them. Even those organizations that have institutionalized best practices in the management of acquisitions historically have been slow to apply the same rigor to divestiture transactions. The potential for orphan treatment is discussed in detail in section 2.4(c), but suffice it to note here that, in contrast to acquisitions, which have a certain cachet that causes executives and managers to want to be associated with them and which attract an abundance of resources, involvement in divestiture transactions has substantially less appeal to corporate executives and managers. As a result, in addition to the lack of a standardized framework for conducting the transactions, they can be at risk to be underresourced.

These largely psychological barriers tend to mask the value creation opportunities that divestiture transactions represent as well as the development opportunities they afford their manager/participants (as discussed in section 8.6(b)). Therefore, the execution of divestiture transactions requires an intense focus on the efficient and effective use of resources and should be based on a highly structured and disciplined process. The discussion that follows presents a best practice approach intended to emphasize the underlying logic and the desirable characteristics of a well-executed disposal transaction.

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(b) BEST PRACTICE APPROACH M&A transactions may differ from each other in numerous ways, but they all invariably should follow a logical sequence of steps designed to get the managers of the process to the optimal solution in the shortest possible time. Our experience has shown that getting out of sequence or eliminating a step in this logical sequence is likely to result, at a minimum, in prolonging the process and may end up suboptimizing value or even causing a failed transaction. Therefore, we believe that a fundamental characteristic of best practices relative to M&A transactions in general, and divestitures in particular, is a disciplined process orientation. Exhibit 1.3 provides an overview of a best practice divestiture process model.

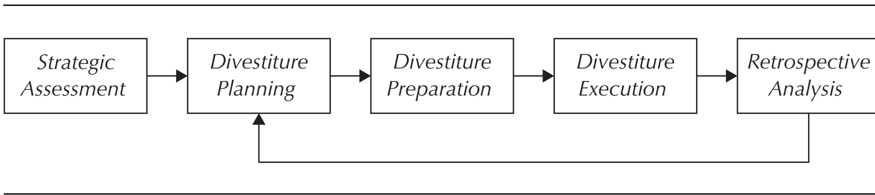

Exhibit 1.3 Best Practice Divestiture Process Model

The model depicted outlines a process that starts with the strategic assessment of the organization's portfolio (generally as part of a periodic strategic planning exercise) and, when appropriate, leads to a decision to dispose of a business unit or units. That decision is followed by the planning, preparation, and execution of the actual transaction. Once the transaction has been finalized, the seller should evaluate its performance and ensure that any lessons learned are duly noted, documented, and incorporated into its institutional memory.

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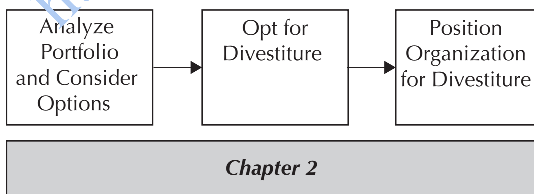
(c) ELEMENTS OF THE DIVESTITURE PROCESS The major elements of the five phases of the divestiture process depicted in Exhibit 1.3 are summarized and illustrated in the sections that follow. Each summary refers to the chapter in which that particular phase of the process is described in greater detail.

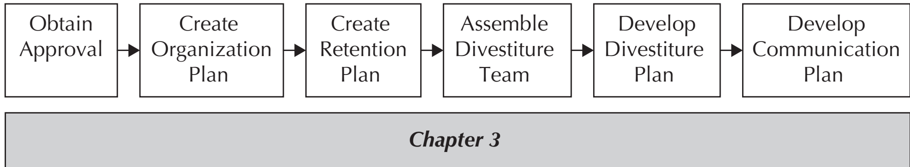
(i) Strategic Assessment. The assessment phase of the process has these components and follows the sequence indicated.



This phase places the proposed transaction within the context of the strategic planning process. Accordingly, it evaluates the organization's business portfolio in relation to its strategic objectives and the dynamics of the market(s) it serves. A key aspect of this evaluation is the thorough consideration of all reasonable strategic alternatives to divestiture, with the objective of ensuring that the course of action

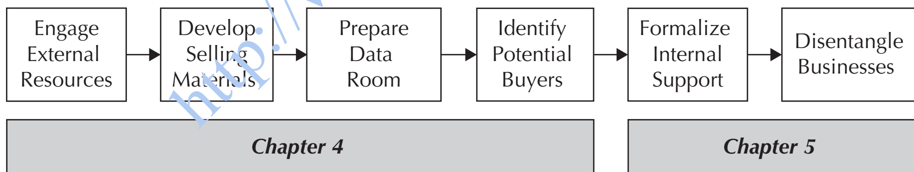
selected is the one with the greatest potential for optimizing shareholder value. The assessment process is discussed in detail in Chapter 2.

(ii) Transaction Planning. The planning phase of the process is depicted in the next illustration.



This is the phase of the process during which the business case is made for the divestiture. It is also when the seller puts into process those measures that are designed to ensure the proper staging and management of the transaction. Doing so includes the development of organization and retention plans, the assignment of a divestiture team leader, the creation of the divestiture team, and the development of the divestiture and communication plans. Chapter 3 describes this phase of the process in detail.

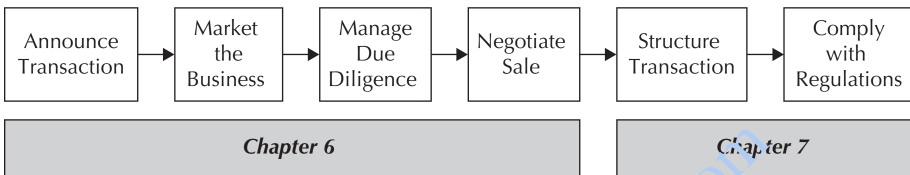
(iii) Transaction Preparation. The sequencing of the preparation phase of the process is depicted in the next illustration.



This phase of the process is focused on getting the business unit being divested ready for sale. It has two distinct components: (1) preparation for the selling process; and (2) preparation for the separation of the business being sold from its parent. The former, discussed in detail in Chapter 4, relates to the first four steps depicted in the illustration and entails the engagement of external resources and the creation of selling materials (i.e., an offering document or prospectus and a management presentation) and the staging of steps that will be used in the course of the selling process. The latter component, described in Chapter 5,

relates primarily to the final two steps depicted and includes formally assigning the internal resources necessary to support the transaction and the initiation of the process of disentangling the business being sold from the seller's organization.

(iv) Transaction Execution. The next chart illustrates the flow of the execution phase of the process.



This phase of the process spans the announcement of the intent to sell through preclosing agreement on contract terms and compliance with any prescribed legal and regulatory requirements. Accordingly, it covers the management of the selling process: announcing the prospective sale, soliciting offers from potential buyers, and managing the due diligence process, all topics covered topic in Chapter 6, and the negotiation of final legal documents and ensuring compliance with regulatory requirements, covered in Chapter 7.

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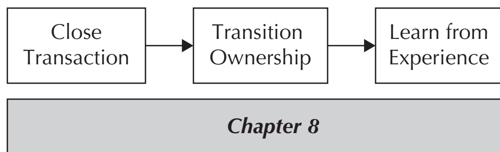
(v) Transaction Close, Business Transition, and Retrospective Analysis. In this phase, as illustrated next and discussed in Chapter 8, the transaction is finalized, ownership is transferred, and process improvement measures are memorialized.



Once the transaction is closed and the business is transitioned to new ownership, the seller should perform a retrospective analysis of the transaction and record all relevant information that can be accessed

by those in the organization who are tasked with responsibility for divestitures in the future. This would entail the identification of lessons learned, both positive and negative, and the documentation of those findings to ensure that these lessons are incorporated into the seller's institutional memory.

1.4 STAFFING MODEL

(a) DIVESTITURE TEAM STRUCTURE Divestitures generally require the participation of a substantial cross-section of functions, and managers within those functions, in the organizations involved in the sale. They also require the involvement of a number of external experts. The internal participants typically can be broken down into two categories: the core team that has day-to-day responsibility for managing the transaction and a group of line managers and subject area specialists whose participation and expertise will be drawn on periodically. External expertise should be engaged based on the needs of the transaction and the availability of specific resources and expertise within the selling organization. The various participants are briefly profiled in the next section and described in greater detail in Chapter 3. In addition, the changing nature of team member involvement, as the transaction progresses, is outlined in this section. This section ends with the description of an alternative staffing approach that may be appropriate for small companies that engage in divestiture activity infrequently and are likely to encounter significant staffing challenges when they do.

(i) Core Team. The core team generally consists of executives from the business development (i.e., the function responsible for strategic planning and merger and acquisition activity), human resource, legal, and finance and accounting functions, as well as the executive staff of the business unit being divested. As noted, this team will shepherd the organization through the transaction.

(ii) External Resources. Divestiture transactions require the support of various external experts. As indicated, the extent to which such expertise is required is situation-specific. However, it will generally include a business broker or investment banker to assist in the sale process and an independent accounting firm to assist in the preparation of standalone financial statements. Depending on the size and

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sophistication of the seller, it may also include the engagement of external legal, tax, or human resource expertise. These participants generally will be intensely involved during the preparation stage of the transaction and, in the case of the broker/banker, the actual selling process.

(iii) Internal Resources. The need for involvement of internal managers is also heavily dependent on the size and nature of the transaction and the degree of interdependency between the business being sold and the parent organization. Generally, the most significant variable in determining the extent of involvement of internal staff is the level of interdependency that has been established between the two businesses. Frequently, the interdependence is significant and requires the involvement of a broad range of line managers within functions such as information technology, facilities management, real estate management, and operations. In addition, as the transaction proceeds toward the negotiation stage, the involvement of members of the seller's executive management team typically will be required to deal with contractual issues.

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(b) POTENTIAL UNDERSTAFFING As noted, the volume and mix of internal and external resources needed is dependent on a number of variables. The burden of determining the nature and extent of support falls on those tasked with managing the transaction. In smaller organizations with limited internal expertise or in larger organizations that are unwilling to dedicate the necessary internal resources, this team leader must evaluate needs quickly and thoroughly to ensure that the initiative is appropriately supported. To the extent that internal resources are not available, or are not made available, the team leader must be empowered to engage outside experts and consultants to fill gaps on the team. A model for doing so is described and illustrated in section 1.4(d). It is incumbent on the team leader to ensure that those who are ultimately responsible for the transaction understand that underresourcing the effort will put the transaction at substantial risk.

(c) EXPANSION, CONTRACTION, AND MODIFICATION OF THE DIVESTITURE TEAM The discussion that follows identifies various key points or stages in the transaction that require the expansion, contraction,

or refinement of the divestiture team. These stages do not neatly coincide with the five phases of the transaction described in section 1.3(c) and may occur "midphase," such as when the core team is formalized midway through the planning process. The points at which the team undergoes significant adjustment are listed next, illustrated in Exhibit 1.4, and discussed in detail in the sections that follow.

- **Nonformalized collaboration.** A period of analysis during which a divestiture is considered and ultimately recommended
- **Formalization of a core team.** The point at which those tasked with the transaction are identified and they initiate the planning process
- **Transaction preparation.** The stage in the process when external resources are engaged and added to the divestiture team
- **Organizational preparation.** The stage in the process when additional internal resources are assigned to the divestiture team
- **Formalization of the negotiating team.** The point when the negotiation team is formed and the role of supporting staff is defined
- **Posttransaction activities.** The stage in the process following the close when the business is transitioned to the new owners and when lessons learned are incorporated into the selling organization's institutional memory

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(i) Nonformalized Collaboration. Nonformalized collaboration is the early assessment and planning stage of the process that precedes the formal creation of the core team. It spans the assessment, approval, organization, and retention planning steps of the process, described in section 1.3. Participants at this stage usually include executives from business development, finance and accounting, and human resource functions, and may also require input from certain specialists, such as tax advisors to determine the tax implications of the option considered. In this stage, the desirability of divesting the property is evaluated, options are entertained, and the decision to divest is made. The initial steps in this stage of the process require substantial strategic and financial analysis, since all options and their implications should be considered.

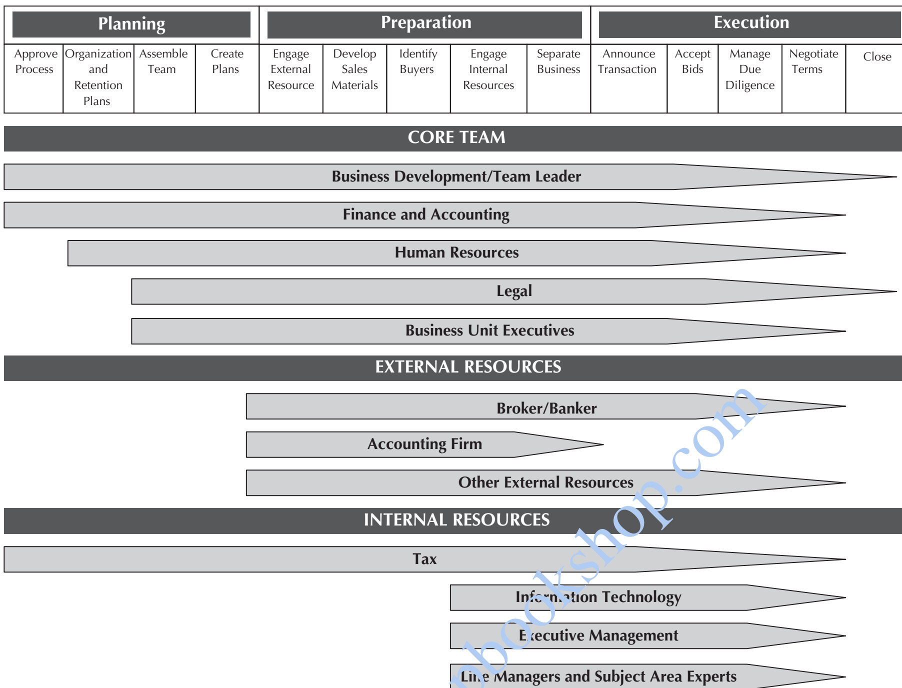

Exhibit 1.4 Divestiture Team: Duration of Participation by Function

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(ii) Formalization of the Core Team. The next stage of the process is initiated by the formalization of the core team. The choice of the individual who will lead the initiative should be established and/or confirmed. More often than not the team leader will be drawn from the business development function, although there may be situations in which that individual will be the lead financial manager in the project or a line executive who is closely associated with the unit being sold. In any event, core team members generally will be drawn from business development, finance and accounting, human resource, and legal functions. The lead attorney in the process often plays a key role throughout and very often functions as a co-equal partner of the team leader. The team will also include members of the senior executive management of the business unit being divested. Those in this group will vary but typically include the chief executive and a number of that individual's direct reports. The relationships within the core team are illustrated in Exhibit 1.5.

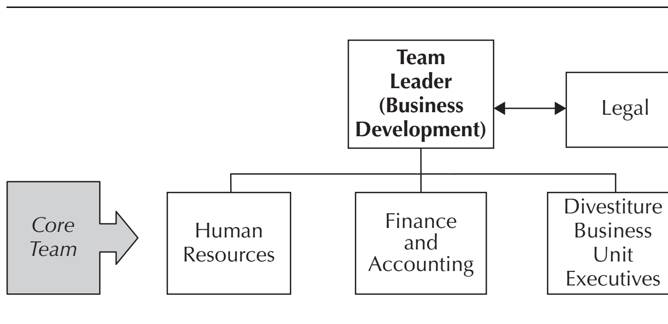

EXHIBIT 1.5 CORE DIVESTITURE TEAM

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In addition to the creation of the team, this is the stage that includes development of the divestiture plan and timeline, the creation of the communication plan, and the initial identification of the internal and external resources necessary to implement the plan.

(iii) Transaction Preparation. The transaction preparation stage of the process is initiated by the identification and engagement of external resources to assist in the preparation of the sale and extends through the actual staging and preparation of the transaction. Activities include the identification of potential buyers, the preparation of stand-alone financial statements, the development of selling materials, and population of the data room. The external parties generally include a business broker and/or investment banker and an accounting firm, and may include other subject area specialists, depending on the nature of the transaction. The expanded team is illustrated in Exhibit 1.6.

(iv) Organizational Preparation. The organizational preparation stage of the process is when the involvement of the internal managers who will assist in the transaction is formalized. Typically these managers include representatives from information technology, facilities management, real estate, and operations functions, and specialists in areas such as taxation, intellectual property, and business insurance. The focus of that involvement generally will be the disentanglement process. Executive management of the parent company will also be apprised of the role they will be expected to play in the process; usually they serve as advisors to decisions made regarding the separation of the businesses

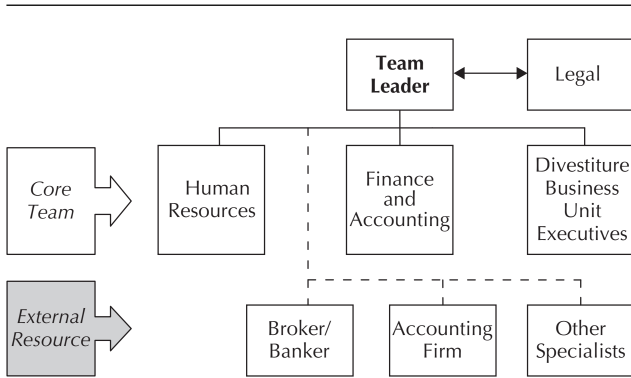

Exhibit 1.6 Expanded Team: Addition of External Resources

and the negotiation of noncompetition aspects of the contract. The addition of these individuals to the team is illustrated in Exhibit 1.7.

(v) Formalization of the Negotiating Team. When the process reaches the stage where the finer details of the contract and supporting documents are to be negotiated, the structure and responsibility of those

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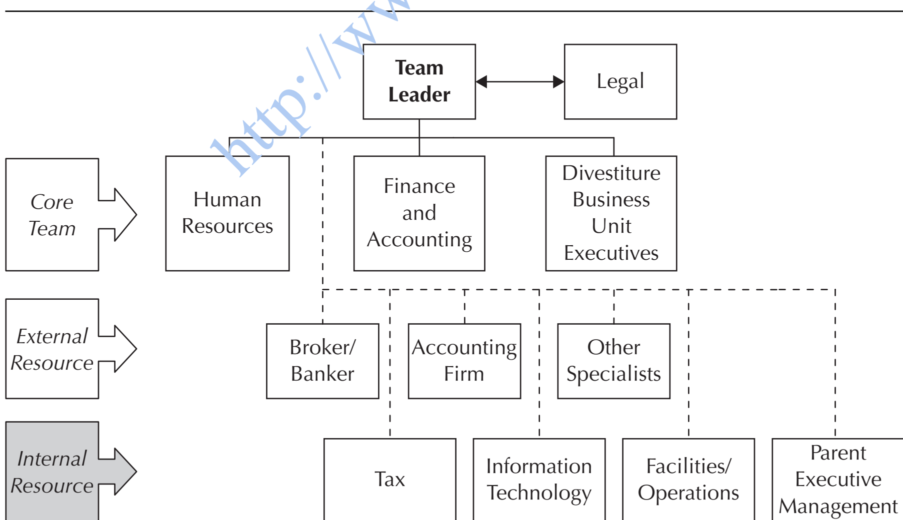

Exhibit 1.7 Full Team: Addition of Internal Resources

on the team should be refined. The selling organization should clearly empower a single individual, usually the team leader, as chief negotiator to represent its position in negotiations. That individual would work closely with, and rely heavily on, the lead attorney to manage negotiations and revise and finalize documents with the buyer as well as ensure compliance with applicable regulations and law. Together, these two individuals would comprise the negotiating team and would directly interface with the business and legal negotiators representing the buyer.

The negotiating lead should have broad authority to speak on behalf of the organization and ready access to senior management when decisions that exceed that authority are encountered. Additionally, the negotiating team should have access to various line managers and subject area experts to review and sign off legal documents and provide input and make recommendations on a wide range of issues that will be beyond the capacity of the lead negotiator to address.

In most instances, some of the participants in the process to this point will have completed their assignments and rotated off the divestiture team. This would include outside accountants, whose work will have been completed, and the business unit executive team, whose personal objectives and fiduciary responsibilities would place them in a conflicted position (an issue discussed more fully in section 7.3(b)). This would generally also include the seller's broker or its banker.

The relationship between the negotiators and the advisory team is illustrated in Exhibit 1.8.

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(vi) Posttransaction Activities. The posttransaction stage of the process is initiated by the close of the transaction. It includes the transfer of assets to the new owners and generally also includes the provision of transition services by the seller to the buyer. At that point, the divestiture team would effectively be disbanded, and services will have been contracted on an arm's-length basis.

The nature and extent of transition services will depend on two variables: the degree to which the transferred business is a stand-alone entity; and the extent to which the buyer has an infrastructure that can support something less than a stand-alone business. For example, a financial buyer (e.g., private equity firm) is unlikely to be able to provide back office support to a business that had relied on the seller for such services.

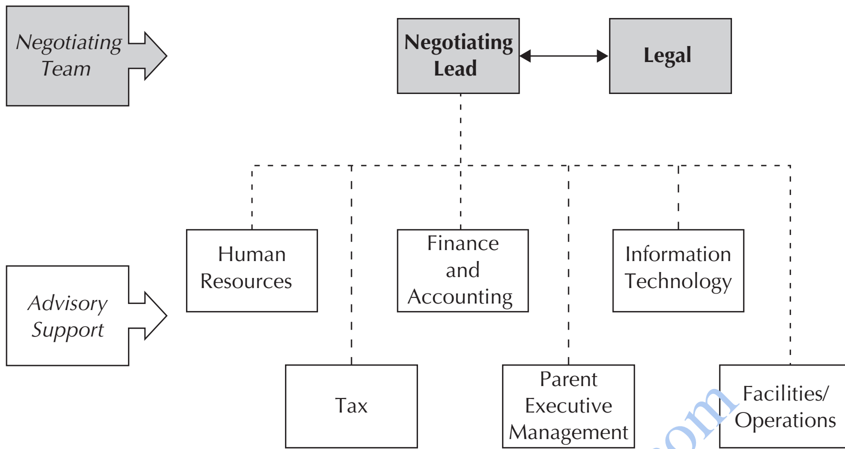

EXHIBIT 1.8 RELATIONSHIP BETWEEN THE NEGOTIATORS AND THE ADVISORY TEAM

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The nature and extent of transition services also will dictate which functions within the seller's organization will be required to remain involved with the business unit after the transaction. As a general rule, the seller will want to limit both the extent of services and their duration.

Ideally, the final responsibility of the team leader will be to review the transaction with an eye toward identifying lessons learned and worth institutionalizing. This is a step that is easily ignored, to the detriment of the organization. Without a feedback process in place, organizations frequently face the prospect of reinventing the wheel with each successive transaction. In more sophisticated organizations, the building of this knowledge base may take the form of entries to a corporate intranet. In other environments, it may take the form of memos, reports, and exhibits housed in a binder that is accessible to those tasked with divestitures in the future. Regardless of the form documentation takes, the objective should be the same: to provide a feedback mechanism for process improvement and knowledge transfer.

(d) SMALL-COMPANY APPROACH We believe that the model just described is the optimal staffing approach to the divestiture process. However, for smaller companies with limited available personnel and

for small transactions generally, the level of internal resources recommended may be unrealistic. A more practical approach for such situations may be to rely on external resources to a much greater extent, under the direction of a project leader. This approach would require the engagement of an M&A advisor, in addition to an M&A attorney, a financial advisor (broker or banker), and, possibly, an accounting firm. It may also require the engagement of other specialists in areas such as information technology and human resources/compensation. This approach would not obviate the need for input and some degree of involvement on the part of line management within the selling company, but it would relieve functional managers of the need to get deeply involved in the divestiture process. They would essentially function as internal consultants. In this approach, the project leader plays a critical role, both directing the activities of the various external advisors and, importantly, making the major decisions related to the deal. While external consultants can do more of the work, they cannot supplant the seller's ownership of the transaction.

The extensive use of external resources would enable the seller to address a void in M&A expertise and to reduce the level of internal distraction. However, this approach comes at some cost. In addition to the financial cost of external consultants, which may be quite significant, it also entails a reduction in the level of accountability on the part of internal management, since it is extremely unlikely that minimally involved managers will be imbued with a sense of ownership in the transaction. While not the preferred approach to the process, it does enable the small company to find a balance between the competing considerations of resource availability, transaction staffing, management accountability, and management distraction. The approach is depicted in Exhibit 1.9.

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1.5 ENABLING PRINCIPLES

(a) INTRODUCTION As reflected in the text, corporate divestitures are protracted, complex, and demanding transactions. In addition, frequently they are conducted in a resource-starved environment. The combination of a demanding transaction and the tendency of organizations to hedge on committing the appropriate level of support heightens the need for those tasked with the disposal to adopt an approach that is

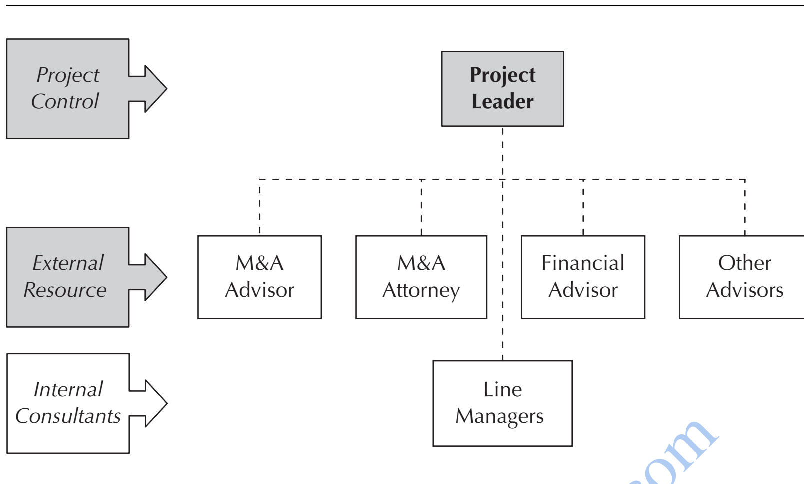

Exhibit 1.9 Divestiture Team: Small-Company Approach

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highly structured and makes optimal use of the resources that are made available. That approach requires a strong focus on high-quality analysis, thorough planning, detailed preparation, and disciplined execution as well as adherence to principles that *enable* the effective execution of the transaction.

It has been our experience that a well-structured process, such as that presented in the preceding section, even when fully resourced, is a necessary but not sufficient ingredient of an effective and efficient transaction. In addition, we believe that the organization conducting the transaction must adopt enabling principles that add rigor to that process. These enabling principles, their rationale, and their impact are discussed next.

(b) EMPOWERED LEADERSHIP Early in the divestiture process, an individual will be assigned to a leadership role and be tasked with managing the transaction. This individual will have responsibility for directing a core team of senior executives and for coordinating internal and external support on an as-needed basis. It is critical to the success of the transaction that this team or project leader is empowered by senior executive management, typically the chief executive officer (CEO) of the selling entity. Empowerment in this context has several aspects. At the appropriate time or times, the CEO must clearly communicate to all relevant parties that the team leader has both the responsibility *and the*

authority to execute the transaction. While such authority cannot be a blank check, it must be defined broadly enough so that the team leader need not continually seek approval to engage resources or make commitments on behalf of the organization. Therefore, the span of authority must be broad, mutually understood by CEO and team leader, and effectively communicated to all relevant parties. Empowerment also implies timely and structured access to the CEO. A predetermined mechanism for communication must be established to assure seamless management of the transaction when issues arise that exceed the decision-making authority of the team leader. Empowerment also implies the commitment of the resources necessary to manage the transaction. The point has been made repeatedly that there is a significant risk of the undercommitment of resources to disposal transactions. That risk must be mitigated by the CEO's willingness to provide, and the team leader's insistence on, access to sufficient resources. Thus empowered, the team leader will be positioned to aggressively execute the transaction.

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(c) TEAM COHESIVENESS AND OWNERSHIP IN THE TRANSACTION

As noted, the project leader will lead a small team of managers—typically, senior executives in the human resources, finance and accounting, and legal functions, as well as the most senior executives of the business being disposed—who will have responsibility for the ongoing management of the transaction. These individuals must approach their roles with a team mentality and a keen sense of ownership of the transaction, reinforced by the knowledge that they are engaging in an important value-creation enterprise. This translates into a commitment to the success of the transaction at the expense of individual personal gain. While this may sound idealistic, in practice it is simply a form of enlightened self-interest, a realization that "credit" will result only from a successful transaction. Key elements of team cohesiveness in the context of the transaction are information sharing, a holistic approach to the project, and a cross-functional managerial approach.

Divestitures are complex transactions, comprised of multiple steps, involving a large number of individuals over an extended period. This creates an environment of constant change. Sharing relevant information completely and quickly is critical to keep the transaction on track. Those running the transaction must also resist the temptation to take a narrow, functional view of their responsibilities. Given the

functional bounds within which they are used to operating, this will require a different mind-set. It means shedding their silo mentality and adopting a comprehensive or holistic approach to the transaction. In this regard, they must take ownership in the entire transaction, not a piece or an aspect of it. An outgrowth of this approach is the need to engage in aggressive cross-functional resource management (i.e., the management of those involved across the organization as well as the contract professionals and consultants who are providing advice and expertise).

(d) CLEARLY DEFINED ROLES, TASKS, AND DELIVERABLES Divestiture transactions entail numerous and diverse activities, frequently involving subgroups of the larger team, and generally occurring over the better part of a year. Effective management of a process of this magnitude requires a high degree of discipline. That discipline can be exercised only by clearly defining (and redefining, when necessary) and unambiguously communicating what has to be done, by whom, and when and by regularly holding those responsible accountable for delivering.

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(e) FREQUENT AND REGULAR COMMUNICATION The need for communication in the context of a divestiture transaction is multifaceted. Communication is critical to the management process. In that regard, it is a lubricant. Although process management communication may take many forms, such as e-mail, formal and informal meetings, conference calls, and telephone conversations, arguably the key communication component should be regular status meetings run by the team leader or subgroup project leaders, as frequently as weekly. This is also where communication intersects with the definition of roles, tasks, and deliverables. These meetings should be structured around formal project management documents that identify assignments, the individuals responsible, deliverables, and their deadlines.

Equally important is the communication associated with protecting the asset being divested. In this regard, communication is a deterrent. The announcement of the prospective sale can be expected to have a disruptive impact on the business unit being sold. Left unattended, disruption can lead to employee defection and business erosion. Effective communication can minimize employee distraction and its impact on the business. Therefore, it is critically important for parent company management to maintain frequent and regular two-way

communication with this employee base. After the initial announcement is made, mechanisms, such as regular meetings and a dedicated Web site, should be established to provide these employees with news and developments relative to the sale as well as to enable them to get timely answers to their inquiries.

(f) AMPLE USE OF DOCUMENTATION The need for formal documentation permeates the entire divestiture process. The process requires deliberation on key issues, the development of a wide array of plans, the management of various projects, and the accumulation and transfer of knowledge. These are all activities that should be reduced to written form whenever possible.

While PowerPoint presentations have become the preferred presentation media in today's business environment, their use should not preclude the development of underlying text documents. Such documents foster quality analysis, informed decision making, and structured thought, and enable clear communication and knowledge transfer. Clear and comprehensive documentation is particularly relevant to the deliberative process. Key decisions, such as the decision to divest, are made based on the analysis of complex issues and the consideration of various alternatives. Written documentation not only provides the opportunity for a clear and complete record, it *drives quality analysis,* the basis for good decision making.

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With regard to planning and project management, perhaps the two most prevalent aspects of the divestiture process, documentation *promotes clarity and structure*. Documentation works in conjunction with the definition of responsibilities and communication, principles discussed earlier, as enabling tools for the management of these transactions. Insofar as the knowledge transfer process is concerned, documentation of lessons learned from each succeeding transaction is fundamental to building and maintaining a contemporary knowledge base for managers of future transactions.

1.6 HOW THIS *GUIDE* CAN HELP

(a) WHY A GUIDE ON DIVESTITURES? As noted, corporate divestitures are generally very challenging yet commonplace transactions. It is therefore surprising that there is little in the way of dedicated discussion

of them in the professional literature. To the extent one can find discussions of divestitures, they appear as sections or, at best, chapters of books on mergers and acquisitions and strategic planning. That lack of published guidance on the topic appears to be replicated in practice. Many, if not most, corporations engaged in M&A activity treat divestitures as poor cousins to acquisitions and tend to deal with them as isolated events rather than repetitive transactions that lend themselves to standardization and process improvement. This volume has been written to fill this void in the professional literature and, by extension, in practice.

(b) WHY WILL IT HELP? The focus of the *Guide* is on process management. Consistent with that focus, it has a distinct transactional orientation and a directive tone. It promotes a structured, practical approach and contains detailed guidance on how to manage all major aspects of the divestiture process. We believe that a work with this orientation will have the greatest benefit to the largest audience, because it spans the entire divestiture process and has application to a broad cross-section of managers who may be called on to play a role in such a transaction.

(c) WHO WOULD BENEFIT? Anyone involved with a divestiture transaction who does not have extensive experience in that capacity will benefit from this *Guide*. However, the nature and extent of the utility of the *Guide* is dependent on a number of factors. From an organizational perspective, its relative usefulness is illustrated in Exhibit 1.10.

Large, sophisticated corporations with active portfolios, such as GE, Microsoft, Cisco Systems, and JPMorgan Chase, have established systems and procedures governing M&A transactions. Even in these organizations, though, the systems and procedures associated with divestitures may be less robust than those associated with acquisitions due to the poor-cousin treatment frequently endured by divestitures. In such instances, the *Guide* can be used to supplement practices that may have been established but not fully developed.

Other Fortune 500 companies with less active portfolios generally do not encounter disposals as often and are less likely to have established divestiture procedures. However, they usually have an M&A experience base to draw on that will provide a foundation for

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	Type of Divester		
	Sophisticated	**Experienced**	**Occasional**
Type of Organization	Fortune 50	Rest of the Fortune 500	Small to moderate-size companies
Experience Profile	Have large, actively managed portfolios. Have established M&A processes but may not have robust divestiture process or adequate knowledge transfer mechanism for disposals.	Have acquisition experience but are unlikely to have established disposal process and are very unlikely to have adequate knowledge transfer mechanism for disposals.	Have limited M&A experience and are unlikely to have established M&A processes in general and even less likely to have an established process for disposals.
Utility of the *Guide*	A best practice template for the disposal process. Supplements established practices.	Systematized guidance for the disposal process. Increases efficiency and effectiveness and provides insights for avoiding major pitfalls.	Provides detailed guidance to those who are likely to be exposed to disposals infrequently.

Exhibit 1.10 Usefulness of the *Guide*

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adequately managing many disposals. These organizations will benefit in the short run from the systematized guidance provided in the *Guide*. And, in the long run, this volume provides the basis for a process improvement approach that would enable users to develop and adapt best practices going forward.

The needs of smaller companies are less frequent but more intense. For them, divestitures are generally an uncommon occurrence. Typically they are viewed as isolated transactions that do not warrant

the dedication of resources necessary to systematize their management. That said, when they are encountered, the need for assistance can be acute. For these organizations, the *Guide* can provide extremely valuable guidance and support.

From a functional perspective, the contents of the *Guide* would be of value to a wide variety of managers, professionals and consultants. However, the primary audience is the front-line manager—the business development, financial management, legal, and human resources executives responsible for the day-to-day management of the disposal process. Undoubtedly, other participants in the process, such as line managers and outside consultants and advisors, would find substantial value in the *Guide* since its comprehensive view of the process provides important context, as well as specific, practical guidance.

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KEY POINTS

1. Corporate divestitures are not isolated financial transactions that are executed to eliminate an unwanted business unit or simply to generate excess cash. Divestitures reflect an underlying strategy to reposition or restructure an organization with the objective of enhancing the organization's value. (Section 1.2(b))
2. Corporate divestitures are an important class of business transaction by virtue of their pervasiveness and their size. They represent more than one-third of all M&A transactions, average approximately $175 million in transferred value, and annually involve thousands of organizations and tens of thousands of managers within those organizations. (Section 1.2(c))
3. Corporate divestitures have unique characteristics that distinguish them from other M&A transactions. Most important:
   - They are often subject to organizational indifference due to the perceived dead-end nature of the transaction. (Section 1.2(d))

- They require intense planning and rapid implementation of *preclosing* structural disentanglement. (Section 1.2(d))
- They present substantial communication and management challenges because of the potential instability that may result from the announcement of the *prospective* sale. (Section 1.2(d))
- The announcement of the prospective transaction creates negotiating challenges not encountered in other sale and acquisition transactions. (Section 1.2(d))

4. Effective divestiture transactions require a high degree of structure. Employing a logical, structured approach that incorporates lessons learned from prior transactions and that is built on a platform of thoughtful planning, detailed preparation, and disciplined execution will enable organizations to become accomplished managers of these transactions. (Section 1.3(b))

5. To the extent that internal resources are not available—or are not made available—for the transaction, the divestiture team leader must be empowered to engage outside experts and consultants to fill gaps on the team. It is incumbent upon the team leader to ensure that those who are ultimately responsible for the transaction understand that underresourcing the effort will put the transaction at substantial risk. (Section 1.4(a))

6. Structure and resources are critical elements of a successful transaction but, in the absence of enabling principles, they are just the roadmap without a means of transportation. Concepts such as empowered leadership, accountability, and effective communication and documentation must be operationalized to ensure optimal results. (Section 1.5(a)–(f))

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APPENDIX 1A

DIVESTITURE ACTIVITY BY STANDARD INDUSTRIAL CLASSIFICIATION: 2002 TO 2006

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Top 10 Industries	
Seller Industry	**5-Year Total of Divestitures**
Broadcasting	1,794
Computer Software Supplies and Services	1,584
Miscellaneous Services	1,395
Leisure and Entertainment	935
Wholesale -and Distribution	640
Retail	576
Banking & Finance	542
Electric, Gas, Water, and Sanitary Services	505
Communications	499
Drugs, Medical Supplies, and Equipment	489

Source: *Mergerstat Review,* 2007

APPENDIX 1B

AGGRESSIVE DIVESTERS: 2005 AND 2006

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Seller 2006	No. of Transactions	Seller 2005	No. of Transactions
UTEK Corp	26	General Electric	17
General Electric	17	Carlyle Group	11
Clear Channel Comm.	11	El Paso Corp.	11
El Paso Corp.	10	Hilton Hotels	10
Federated Dept Stores	10	JPMorgan Chase	10
Bank of America	9	UTEK Corp	10
The McClatchey Co.	9	The Blackstone Group	9
CitiGroup	8	CitiGroup	9
ConAgra Foods	8	Honeywell International	8
Hilton Hotels	8	Clear Channel Comm.	7
CBS	7	Kohlberg Kravis	7
Exxon	6	Viacom	7

Source: *Mergerstat Review,* 2006 and 2007