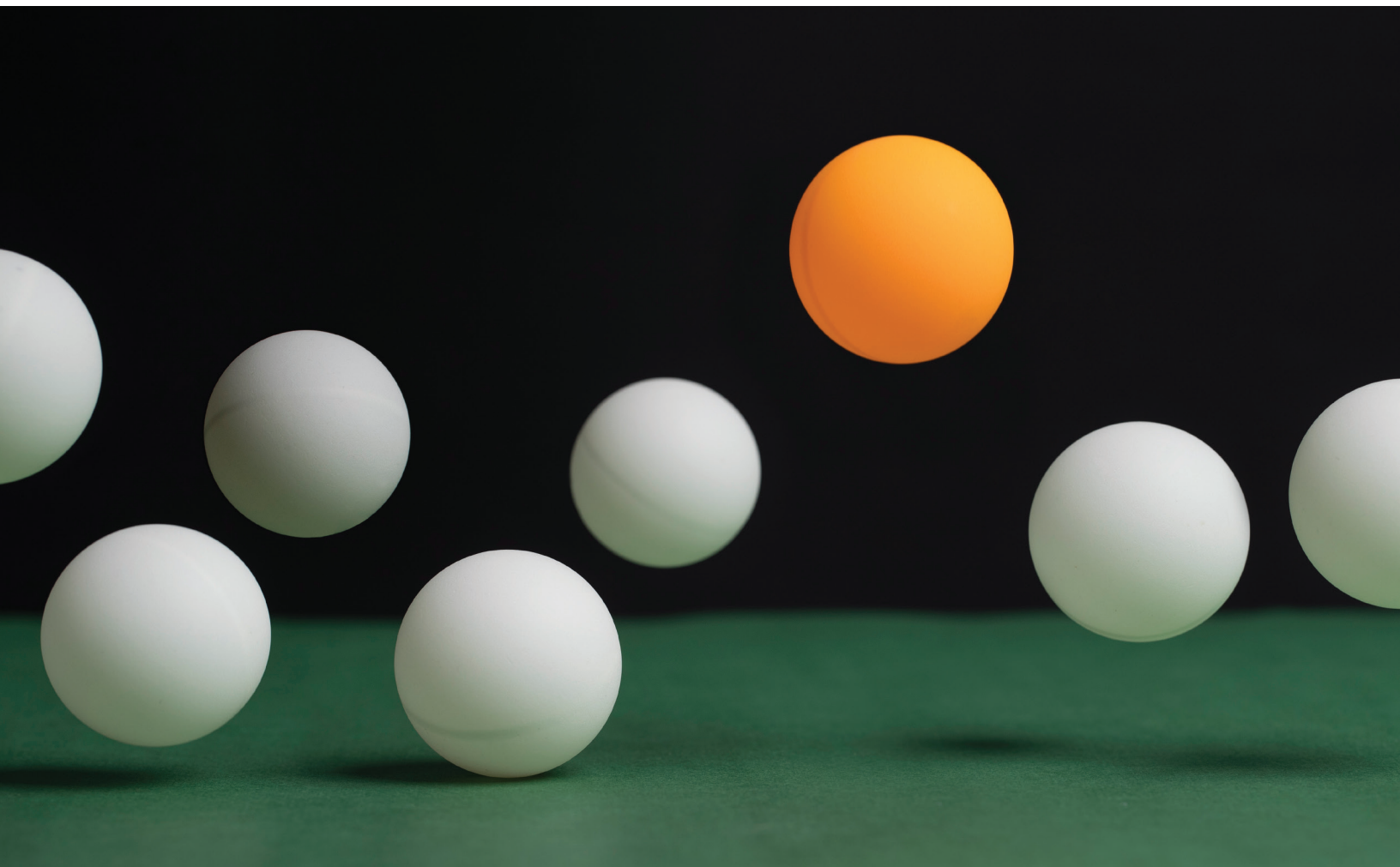


Going, going, gone: A quicker way to divest assets

Speedy separations create more value than those that lumber along, our research finds. Preparation is the key.

Obi Ezekoye and Jannick Thomsen



The decision to divest assets can be a drawn-out one, as companies cite sunk costs, existing capital structures, fear of shrinking, and overly optimistic projections as reasons to hold on just a little bit longer. But when it comes to separations, speed matters—not just in the initial decision to divest but also in how quickly the divestiture process is executed.

Delays in execution can be a sign that management teams have not carefully and objectively considered operational, organizational, and other tactical factors associated with the divestiture. Worse, long deal timelines can suggest the loss of critical talent,

struggles with internal politics, and even key stakeholders’ questioning of the strategic rationale for the deal. And make no mistake, the longer it takes to separate, the more anxious employees, customers, and investors in the market can get.

We evaluated all major divestitures¹ between 1992 and 2017 and examined the excess total returns to shareholders (TRS) one to five years after the separations. Our research showed that, on average, separations completed within 12 months of announcement delivered higher excess TRS than those that took longer (Exhibit 1).

Divestiture teams in these companies acted with speed and confidence—and were more likely to find themselves among the 29 percent of companies in our research base that experienced win-win scenarios in which both the parent company and the divested business achieved TRS in excess of their peers several years after the separation was complete (Exhibit 2).

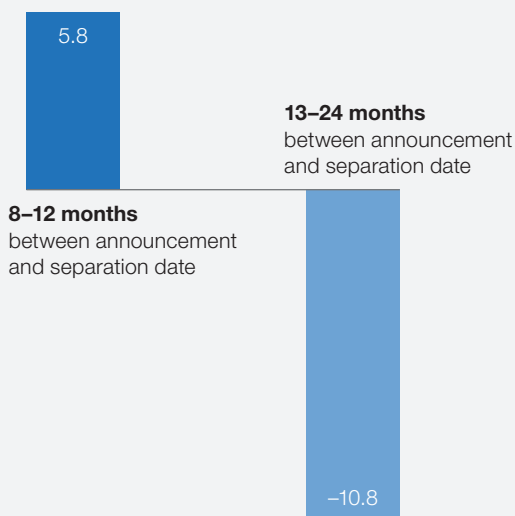
What can we learn from these win-win divestiture strategies? Obviously, each deal is different and has unique characteristics, but the general trend suggests that speed matters. We surmise that the successful divestors in our research base actually “moved slow to move fast”—that is, they carefully thought through the range of strategic and operational considerations before making the public announcement. When it came time to execute, senior leaders in these companies adopted a careful, systematic process for assessing exactly what and when to divest as well as how to manage the task most efficiently.

Toward faster separations

In our work with companies across multiple industries that have sold, spun off, or otherwise separated noncore assets from their organizations, we have seen successful divestors routinely make four tactical moves to execute faster. They establish a dedicated divestiture team that has the skills

Exhibit 1 Urgency matters when it comes to separations.

Parent company’s average excess total returns to shareholders,¹ %²



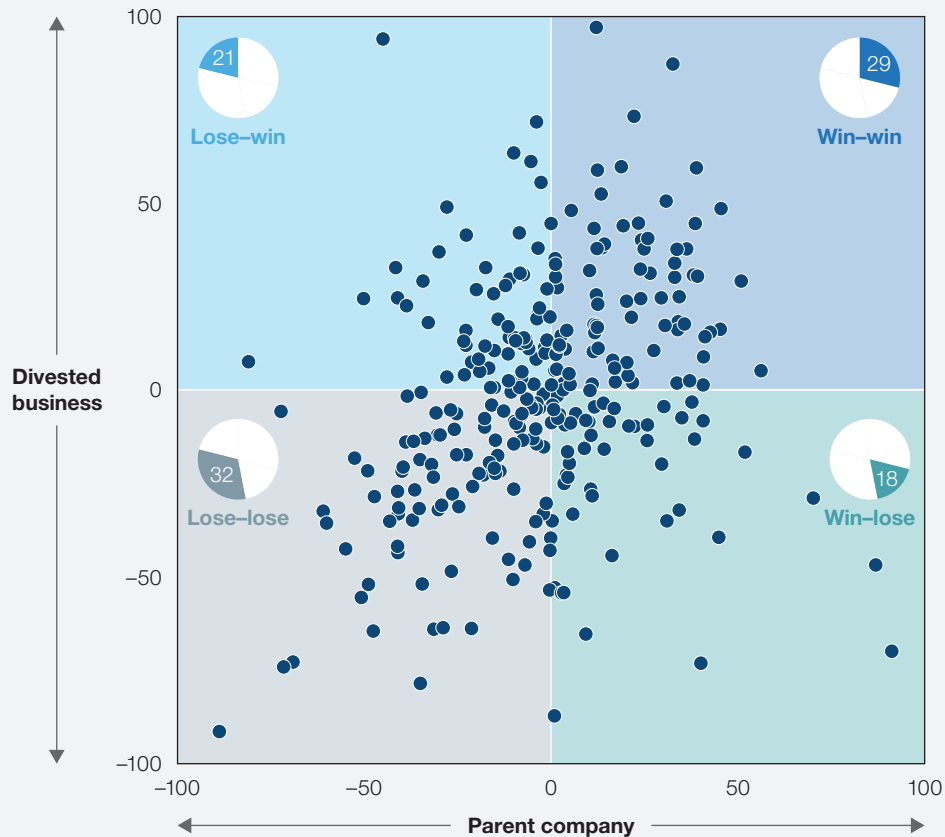
¹ Excess total returns to shareholders a year after separation, benchmarked to the S&P 500 industry-specific index. Research base is 100 large transactions over the past 25 years (Jan 1, 1992, to Dec 31, 2017).

² Parent companies involved in a major divestiture (>\$500 million), n = 130.

Source: S&P Capital IQ, McKinsey analysis

Exhibit 2 Performance varies widely between parent and divested companies several years after separation.

Excess total returns to shareholders 2 years after separation,¹ %



¹Annualized excess total returns to shareholders (n = 298). Scatter plot excludes outliers with performance below -100% or above 100% excess total returns to shareholders. Benchmarked to the S&P 500 Sector Index; tracks performance of all spin-offs >\$500 million from 1992 to 2017.

necessary to ensure efficient management of the deal. They structure incentives so that leaders of the parent company and the soon-to-be-divested company are encouraged to act in the best interests of the departing business. They actively anticipate the complexities associated with disentangling the divested business from the parent company. And they use transition-services agreements (TSAs) sparingly to prevent either side from hanging on too long.

Dedicated team that efficiently manages deals to completion

Even if a company has extensive experience in managing mergers, it might not be able to execute separations efficiently, thereby slowing down deals. The skills required in divestitures are different enough from those used in M&A that even the most sophisticated acquirers often have difficulty contending with complex separation issues while also leading rigorous transaction processes.

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To work more efficiently, the successful divestors we have observed establish a dedicated divestiture team staffed with leaders who have experience in managing such transactions and a clear mandate to run the entire planning, preparation, deal-making, and execution process. One technology company has an “A team” dedicated to managing all the process steps associated with divestitures (big and small). The best candidates for this dedicated team tend to have a general-management background, a keen view of investor expectations, and a clear understanding of the true sources of value for the parent company and the divested company. Senior leadership gives this team time and space away from their “day jobs” and the rest of the organization to ensure that separations are being managed from end to end. By building such a team in-house (and providing regular opportunities for others to cycle through it), the technology company has built lasting capabilities in M&A and divestitures and improved the odds that it can quickly close deals in the future.

Shared incentives for managers in both the parent and divested companies

Managers in a divested business unit might find themselves veering from the parent company’s objectives once they receive indication that the business unit or asset they have been leading has been earmarked for separation. They might, understandably, feel compelled to focus on ensuring that they do all the right things to protect their future in the separate business rather than reflexively managing to the parent company’s goals—actions that can get in the way of efficient execution of a separation.

For their part, senior leaders in the parent company might adopt an “out of sight, out of mind” mentality once a decision to divest has been made. This is a mistake. The parent company owns the separated company until it doesn’t; therefore, the parent company must continue to make all the critical decisions associated with the divested business unit. Senior leaders in the parent company need to put incentives in place to ensure that all activities at the divested company reflect the parent company’s objectives. For instance, the technology company we noted earlier aligned the incentives of the managers of the departing business unit to the characteristics of the sale. It did so not only to ensure that each step in the separation would be expertly managed but also to send the right signals about the deal to buyers and investors.

Test-and-learn approach that avoids delays from restructuring

Too often, senior leaders focus solely on critical issues relating to financial and legal issues associated with separations and miss the equally important managerial and operational implications of a divestiture. The successful divestors in our research balance both. They know financial and legal aspects are central from an investment standpoint—but not the only thing of value. That is why they put much of their focus up front on the operational complexities of disentangling. Senior leaders in the technology company we cited earlier applied a dispassionate, Socratic change-management approach to determining how best to “rewire” complex business functions, physical assets, and reporting lines in the

least amount of time in the wake of separation. Which roles, contracts, data, and processes should be shifted or otherwise changed in the wake of separation? And how long will various transitions take? The dedicated divestiture team considered these critical questions ahead of any public announcement or other investor communications.

Successful divestors know they will need to set up new governance structures for the departing business unit while simultaneously enacting process changes internally. They put an emphasis on ensuring that these systems are airtight before day one. Otherwise, they might end up with errors or delays in critical transactions, stranded costs, and missed opportunities to create more value for the company. The divestiture team at one company put the most critical processes in a divested business unit through a series of pressure tests. For instance, as part of an internal test, it ran through a full order-to-cash process, asking how customer orders were documented, filled, invoiced, and paid for under a range of scenarios. The team was careful to test critical processes in both optimal and less-than-optimal conditions to ensure that the order-to-cash process and other standard operations at the departing business unit would be ready for day one.

Limited use of transition-services agreements

After a deal has been closed, companies often rely on TSAs to ensure that operations are not interrupted. These agreements are exactly what they sound like—pacts in which the parent company agrees to provide infrastructure support, such as accounting, IT, and HR services, after the transaction closes. In some instances, we have seen parent companies use the TSA as a release valve to temporarily avoid addressing stranded costs. In other instances, we have seen managers of divested business units use the TSA as an excuse not to build self-sufficient business functions. Our experience suggests that such agreements should be used as a tool, not a crutch. Companies should minimize the

number of TSAs used, build time limits into them, and structure them to reward mutually beneficial behaviors.

Thus far, we have emphasized tactical elements of successful divestitures. But these factors should not overshadow the need to think strategically and take an unbiased view when making initial divestiture decisions—for instance, objectively considering whether the company is still the best owner of certain assets, exploring multiple transaction types instead of just the most obvious, or using the separation as an opportunity to transform operations. Additionally, executives should be mindful that even in well-managed separations, there may be setbacks (market shifts or other industry factors, for instance) that prompt them to slow down.



Asset sales, splits, carve-outs, and spin-offs are on the rise globally—partly in response to activist shareholders and partly to appease value-minded boards of directors. Companies that make such transactions a critical part of their resource-allocation and portfolio-management strategies have much to gain. But creating value through divestitures isn't automatic. Significant planning and investment by senior leaders are required, as is a commitment to speed and execution. ■

¹ We defined "major divestitures" as deals valued at more than \$500 million.

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