Divestitures and demergers are currently receiving significant press. Over the past few years there have been some significant transactions. For example during 2013, News Corporation has split its’ broadcasting and film assets into 21st Century Fox and publishing assets into news Corporation. Brambles demerged its information management business into a newly listed company, Recall Holdings, while Amcor demerged and listed its Fibre and Beverage packaging business creating the new company Orora. In 2012 Tabcorp demerged its casino operations into Echo Entertainment and in 2011 beer company Fosters split out its wine operations into listed entity Treasury Wines.

These spin-offs are likely to continue. Tesltra recently announced it has sold a majority interest in Sensis, its’ directory arm, to a private equity firm. In 2013, engineering company UGL announced plans to demerge its’ DTZ property services business by 2015. Orica management is reviewing its’ non-mining chemical business after the demerger of paint business Dulux in 2010. Options to spin-off the customer loyalty program and/ or separate the domestic and international operations of the Australian airline Qantas have received significant speculation.

Companies divest subsidiaries, business units and departments for many strategic reasons. However, breaking up can be hard to do. Preparing both the parent organisation and the to-be divested organisation for split often involves substantial effort and many difficult decisions.

While many divestitures are performed to improve management focus, ironically the divestiture process often diverts management focus. The work often continues after the divestiture has taken place and can have substantial impact on the remaining part of the company and the people within it.

The tasks involved in pre-divestiture preparation and post divestiture clean up can differ substantially depending on the role of the divested entity in the group, the level of integration across business units and the method of divestiture. In fact, demergers can be one of the most difficult divestment methods, especially when the demerging businesses are intertwined prior to separation.

This article outlines some of the critical operational tasks involved in the split, indicates the complexity of different divestment methods and provides suggestions to successfully manage a divestment/ demerger.

Reasons for Divestiture and Divestiture Methods

As indicated in Table 1, there are many reasons why senior management may elect to divest a part of the business.

<table>
<thead>
<tr>
<th>Table 1. Strategic reasons for divestiture</th>
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<tbody>
<tr>
<td>□ Refocus business on core activities</td>
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<tr>
<td>□ Enable divested division to supply</td>
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<tr>
<td>parent competitors</td>
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<tr>
<td>□ Raise capital</td>
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<tr>
<td>□ Exit a non-performing business</td>
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<tr>
<td>□ Gain from overvalued market</td>
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<tr>
<td>□ Avoid future capital expenditure</td>
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<td>□ Greater synergies with another owner.</td>
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There are also many ways that management can divest a business unit. These include:

□ Trade sale to another company,
□ Spin-off of a separate company and either giving shares in the spin-off to parent shareholders (demerger) or selling all or a portion of shares to the public,
□ Management buy-out,
□ Establishment of a joint venture with another industry participant,
□ Closing down the business.

The appropriate divestment method in any circumstance will be influenced by whether parent management seeks to retain any power or influence over, or economic interest in, the divested unit. For example, where the divested entity is a major supplier of the parent, the parent may wish to retain some influence over supply,
especially if the supply market is limited. Management may also seek to retain some interest if they believe that the divested unit has significant growth prospects and they decide to retain some exposure to investment gains.

Other factors affecting the divestment method selected include the size of the business unit, buyer interest, level of potential synergies with other owners, current market values, potential staff redundancies, the need for funds and taxation impacts.

**Preparation for Divestment**

Once management has elected to divest a business unit and the method of divestment the serious work of preparation begins.

Depending on the degree of integration between the business unit and the rest of the parent and the method of divestiture significant work is often required to ring fence the operations of the to-be divested business unit and establish required capabilities.

Some of major steps that may be performed in preparation for divestment are:

1. **Establish to-be divested entity,**
2. **Determine assets, liabilities and people to be included in divested entity,**
3. **Build capabilities of the to-be divested firm,**
4. **Establish contract management and purchasing capabilities in the parent,**
5. **Commercialise relationships and processes between entities,**
6. **Develop service level agreements for corporate services to be provided on an interim basis by the parent.**

These tasks are discussed below.

**Establish to-be Divested Entity**

Establishing the to-be divested entity may include setting up an independent board of directors and establishing a legal entity and new name for the spin-off. This is unlikely to be necessary for a trade sale to another company.

**Determine Assets, Liabilities and People to be Included**

Where the unit to be divested is a separate stand-alone subsidiary it can appear quite clear which assets and liabilities and people are likely to be included in the sale. However, in many cases the business unit being sold may not have previously recorded a full balance sheet or profit and loss, with assets, debt and some costs recorded by head office and arbitrary cost allocation to business units.

Often people and assets are shared between business units, especially where shared corporate services are provided. Placing staff can also be difficult due to many organisations and jurisdictions having employee agreements and laws providing employees with the choice of staying with the parent, moving with the divested unit or accepting redundancy.

Often there is a balance required in ensuring both organisations have the required assets and skills to go forward and are not strangled by debt. Often as a result of ensuring both entities are competitive, a number of redundant assets and people are identified that need to be shed.

**Build Capabilities of To-Be Divested Unit**

Where an independent entity is being spun out a number of capabilities may need to be built to enable the new company to operate on a stand-alone basis. This may include new leadership, developing a new strategy, putting commercial services in place and implementing new IT systems and business processes.

Building capabilities is likely to be a greater task where the to-be divested unit is heavily integrated in the parent and does not have its own commercial services. For example, finance, human resources and legal capabilities may need development. Sometimes, the business unit will be spun out prior to the completion of this work and arrangements will be made for the ex-parent to continue to provide services for an interim period.

Where the unit was previously predominantly an internal supplier to the parent and other business units with little external sales, it is likely that sales and marketing capabilities will need to be put in place in the spin-out unit. Much less effort is generally put into building the capabilities of a unit that is to be sold to another company. The business unit is likely to be integrated into the buyer’s infrastructure in order to achieve synergies. In this case, investment by the buyer is unlikely to be recovered through a higher selling price. A trade sale is likely to result in a negotiation over the assets, liabilities and staff transferred.

Often organisations run into difficulties when they continue to informally manage relationships with what was previously an internal business unit.

**Establish Capabilities in the Parent**

Often organisations run into difficulties when they continue to informally manage relationships with what was previously an internal business unit. Where the ex-business unit continues to supply the prior parent, often staff need to be put in place to manage contracts and purchasing between the units and the cost structure of the parent.

**Commercialise Relationships Between the Entities**

Where the divested unit is a major supplier of the unit, commercial arrangements often need to be put in place. This includes commercial contracts at appropriate prices, arm’s length ordering and contract management and monitoring processes. It is important to note that the terms of the ongoing supply contract can have a significant impact on the value of the to-be divested unit and the on-going cost structure of the remaining entity.

**Develop Service Level Agreements for Interim Services**

Where capabilities are not fully built in the divested unit at the time of divestment it may be necessary for the now separated unit to continue to acquire services from
the ex-parent for a period after separation. Likewise, after a trade sale it can take many months for the new buyer to move the newly acquired onto its existing systems and processes, requiring interim services from the ex-parent.

Identifying the cost of the services provided and establishing service level agreements for each of the services can be a time consuming exercise.

**After the Deal**

So now you can relax, right? Wrong! Often the parent organisation is left with oversized corporate services and redundant property and equipment. Significant effort is often required to reduce the costs associated with corporate services and to dismantle some of the bureaucracy; property rentals often need to be 'made good' and efforts made to sub-lease or pay exit penalties; excess equipment and owned property needs to be sold; and relationships with the ex-business unit need to continue to be managed on a commercial basis.

**Comparison of Effort Across Divestment Methods**

Some divestment methods are more resource intensive under different circumstances. Figure 1 indicates that spinning-off a business unit to create an independent business (eg a demerger) generally creates greater divestiture effort than a trade sale to another company. This is due to the need to build a viable spin-off entity.

As Figure 1 suggests, there is also more work where the separating entities are integrated either through the provision of corporate services or through inter business unit supply of good and services.

**Improving the Divestment / Demerger Process**

Divestments can involve significant effort and change for many people inside and outside of the organisation. Impact on the ongoing businesses can be reduced by:

- Understanding the people issues
- Communication with stakeholders
- Establishing a focussed divestment project team
- Utilising a rigorous program management framework.

These areas are expanded below.

**Understanding People Issues of Divestiture**

People issues can be crucial to a successful divestment/ demerger. Both entities require skilled, dedicated managers and staff. However, there may not be positions for all. The challenge is to keep staff focussed on day-to-day business and retaining key people.

Staff potentially involved in a divestiture can go through a range of emotions depending on the perceived opportunities, their attachment to the parent company and their personal circumstances.

Some staff can be excited about the prospect of moving to an organisation where their part of the business is core to the operations. Often, non-core business units are under-funded and employees feel unimportant in the wider organisation. Divestiture can provide them with bosses who understand what they do and the opportunity to compete on a stronger note.

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**Figure 1. A comparison of typical preparation tasks for divestment under alternative divestment methods and different pre-divestment integration**

<table>
<thead>
<tr>
<th>Method of Divestiture</th>
<th>Divestiture / Trade Sale</th>
<th>Spin-Off / Demerger</th>
</tr>
</thead>
</table>
| **Significant Business Between Business Units** | • Determine assets, liabilities and people  
• Establish capabilities in parent,  
• Commercialise relationship between entities | • Establish to-be divested entity  
• Determine assets, liabilities and people  
• Build capabilities of to-be divested unit  
• Establish capabilities in parent,  
• Commercialise relationship between entities |
| **High Level of Centrally Provided Corporate Services (eg Shared Services)** | • Determine assets, liabilities and people  
• Develop Service Level Agreements for interim services  
• Downsize parent corporate services | • Establish to-be divested entity  
• Determine assets, liabilities and people  
• Build capabilities of to-be divested unit  
• Develop Service Level Agreements for interim services  
• Downsize parent corporate services |
| **Independent Subsidiary** | • Determine assets, liabilities and people | • Establish to-be divested entity  
• Determine assets, liabilities and people |
Divestitures and Demergers

Other staff may be excited at the prospect of a large redundancy payout and change of careers. One divestiture had so many staff accept redundancies that the to-be divested unit was no longer viable.

To staff in a stand-alone subsidiary that has been bought and sold before, news of a divestiture may be a non-event.

“Even staff not directly impacted by the current divestiture can suffer from uncertainty as to the future of the company.”

Some staff may be terrified of the prospect of leaving the parent organisation where they may have been their whole career. Divestiture may result in redundancies before the deal and/or after the deal as a new owner integrates the divested business unit into their operations. Even those that survive cuts may have their career plans, responsibilities, compensation and working relationships severely impacted.

The uncertainty for affected employees can be the hardest part. Even staff not directly impacted by the current divestiture can suffer from uncertainty as to the future of the company. Much time and focus can be lost as employees across the whole company worry and gossip about questions such as: Is the sale due to financial problems? Which business unit will be divested next? How safe am I? How are staff going to be treated? Will I have a job?

It is usually necessary to get staff excited about the opportunities in both the to be divested unit and in the parent company. Management may need to put in place staff retention strategies to identify and retain critical staff members. In some cases financial incentives may be required to get divested or redundant employees to see the deal through.

Communication

The best way to reduce uncertainty is communication. Honesty in communication of options being considered, reasons for potential divestiture and likely timetable will reduce the components that employees speculate about.

Communication needs to be broader than the management and staff groups. Knowing how the divestiture fits with the company’s strategy will assist investors and analysts to assess the impact on share values. Customers are likely to be interested in the impact on them. Competitors are likely to spread rumours that are worse than the truth, communicating with customers can reduce the damage. In many cases, the community are critical stakeholders to the company, particularly where the business unit is a major employer in the region.

Many senior management teams mistakenly withhold communications, as they believe there is nothing yet to announce. Decisions are yet to be made. However, announcing the processes being followed and likely timing of decisions can reduce uncertainty.

The Need for a Focussed Team and Structured Process

As can be seen some divestitures lead to substantial pre-separation effort. In some cases many complex and political projects must be performed at the same time. In order to minimise the distraction to both the parent and the to-be divested business unit and still get the preparation done it is often advisable to establish a focussed, full-time team to work on all of the divestiture issues. In some cases, it is necessary to establish a team in the parent and another in the spin-off to build capabilities.

A structured process is often necessary to ensure multiple projects are identified, planned and successfully completed and that senior management is well informed of progress and costs.

“Demergers, where a separate stand-alone company is created, can be the most complex type of divestiture especially where the businesses are integrated prior to separation.”

Conclusions

Divestments can be used to further the strategic goals of both the parent and the divested unit. Do not underestimate the people process and technology effort involved with separating the divested unit, building commercial relationships and moving to reduce costs of the parent company. Divestiture can improve focus in the medium to long term but can often divert management and employee focus in the short term.

Demergers, where a separate stand-alone company is created, can be the most complex type of divestiture especially where the businesses are integrated prior to separation. The businesses need to be separated, capabilities built in each business and excess resources shed.

A divestment or demerger can impact many stakeholders. Negative impacts on both businesses can be reduced through a strong communications program, moving to retain key staff and the establishment of a focussed divestment project team and structure program management framework.

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