

# Divestitures

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## What is the issue?

Corporate divestitures are common but complex transactions that are often poorly planned and executed.

## Why is it important?

Without proper planning and adequate resources the divesting company is likely to impair the value of the transaction and, ultimately, reduce the value of the company.

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## Introduction to the concept

Consider the following situation: You recently became the CEO of a company traded on the Toronto Stock Exchange (TSX) with revenues of \$20 billion. The company established itself as a top-tier manufacturer of consumer durables (approximately 20% of revenue) and industrial components for the aerospace and defence industries. The company is poised to have its best year ever, exhibiting strong growth and net profit margins of 10%. A recent annual strategic planning session confirmed some troubling characteristics of the business and identified other issues. After almost a decade in which the consumer and industrial segments exhibited comparable growth and profitability, the consumer business has begun to lag behind its industrial counterpart. For the last three years, the consumer division has grown at a compound rate of 5% and generated a 7% profit margin, while the industrial segment has been growing at a rate of 7% with a 10.5% profit margin. More importantly, this trend is expected to continue into the future as competition in the consumer sector intensifies and market demand remains

depressed in the wake of the recession. Financial analysts have raised questions about the company's lack of strategic focus, putting downward pressure on the value of its stock. After an exhaustive analysis, you and your executive team have become convinced that divestiture of the consumer business is the best path to ensure continued healthy growth of the company, as it will enable the company to aggressively invest the proceeds in its industrial businesses and to optimize



the substantial talents of your management team. Your board concurs and the stage is set for the creation of a divestiture team and the development and execution of a divestiture plan.

Is this situation rare? Hardly. Most corporations, certainly those that take strategic planning seriously, review their business portfolios regularly. In the process, they frequently identify non-core business units that are no longer aligned with the corporation's strategic and growth objectives, making them candidates for disposal.

### What are corporate divestitures?

Corporate divestitures involve the sale of shares or assets, such as business units. These business units may range in size and nature from relatively small, niche assets, such as individual products or product lines, to more substantial assets, such as divisions or subsidiaries.

As illustrated below, the divestiture process is optimized when a structured and disciplined approach is employed. If an assessment of a corporation's business portfolio leads to a decision to dispose of a business unit, implementation of that decision would consist of planning, preparing and executing phases of the divestiture process. Once the transaction has been finalized, the seller then evaluates its performance and ensures that any lessons learned are duly noted, documented and incorporated into the organization's institutional memory and then used for future transactions.

### Why are these transactions important?

Because divestitures are usually material transactions, it is important that they are effectively and efficiently planned and executed. If not, a transaction is almost certain to erode the value of the property being divested and negatively impact the divesting entity's shareholder value.

### What differentiates divestitures from other merger and acquisitions (M&A) transactions?

There may be a tendency on the part of professionals who have participated only on the buy side of transactions (e.g., acquisitions) to view divestitures as the mirror image of those transactions. In fact, there are significant differences between the two, and these differences impact important aspects of the divestiture process. The most notable differences are:

- **Psychology of the transaction.** The acquisition process almost invariably generates enthusiasm and excitement, which usually results in broad-based support for, and a desire to be involved in, the transaction. On the other hand, divestitures have a tendency to be viewed as dead-end transactions that have little pay off for participants. This can lead to organizational indifference and a lack of enthusiastic organizational support, which may result in under-resourcing the transaction. This lack of enthusiasm on behalf of employees adds an additional layer of risk that is generally not encountered with acquisitions.

FIGURE 1 Divestiture process model



- **Planning and rapid implementation of the organizational separation of the entity being sold.** The divestiture counterpart to post-acquisition integration is organizational separation or “disentanglement.” The implementation of an acquisition integration plan occurs post-transaction, whereas divestitures require both planning and implementation of the separation process before the transaction is consummated. Frequently, the entity being divested has been owned by the seller for a protracted period, and thus many support functions have been integrated into those of the seller, making the separation process complex.
- **Preparing and staging the transaction.** Members of an acquisition team focus on review, analysis and validation, whereas those on a divestiture team predominantly focus on preparing and positioning the business for sale.
- **Communication 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. As a result, the business unit is vulnerable to loss of productivity and personnel, and erosion of its assets.

## How professional accountants add value

Professional accountants of the divesting company play a critical role in these types of transactions. Although executed for strategic purposes, divestitures are essentially financial transactions. As such, a fundamentally sound divestiture process draws on the skills and expertise of its professional accountants in the form of:

### Enabling value

- **Project leadership.** The senior professional accountant on the divestiture team plays an equal role along with the corporation’s senior business development executive and legal counsel in shepherding the transaction from beginning to end.
- **Resource coordination.** Professional accountants coordinate the involvement of key external and internal resources such as accounting firms, tax specialists, financial advisors (e.g., business brokers or investment bankers) and operational managers within the seller organization.

### Preserving value

- **Analytical input.** The finance team provides detailed analysis relating to such items as the tax and accounting effects of the potential structures of the transaction (e.g., asset versus stock sales), quantifying disentanglement costs and development of pro forma financial statements to present the business being sold as a stand-alone entity.
- **Operational participation.** Professional accountants are major contributors to operational aspects of divestiture transactions. They must be actively involved in the disentanglement process, the quantification of the impact of decisions made and the management of due diligence. □

This publication is one in a series on *Divestitures*. Guidance and Case Studies are also available on our website. For additional information, please contact Carol Raven, Principal, Strategic Management Accounting & Finance at 416-204-3489 or email [craven@cpacanada.ca](mailto:craven@cpacanada.ca).







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