Divestiture activity is on the rise in today’s global market as companies seek ways to strengthen their organizations, accelerate growth, and meet their strategic goals.

To name a few recent examples, in 2014, Johnson & Johnson divested its Ortho-Clinical Diagnostics business; Solvay completed the divestiture of its US-based Eco Services business; General Electric sold its appliance segment to Electrolux; and Motorola Solutions exited the enterprise space with a US$3.45 billion sale to Zebra Technologies.

Activist investors are pushing corporations to evaluate their noncore assets or sell outright. And for the first time after the economic crisis, all three private equity exit channels (IPOs, secondary buyouts, and strategic sales to corporate acquirers) are concurrently at an all-time high. Buyers flush with cash are entering new growth markets, ready to make deals and willing to pay a premium for the right asset.

The past 20 months have also brought a surge in deals taking place in more than one country; buyers of all types are moving into unfamiliar geographies. These deals bring complexity and pose major challenges — challenges that are often intensified by lack of knowledge and preparation in addressing critical people issues.

A deal may be significantly delayed, for example, because a buyer may not have the HR infrastructure needed to support the transition, or a seller may need time to untangle the business unit for sale from the parent company in order to provide it to the buyer. In both scenarios, the cost, lost time, disruption to customers and employees, and reputational risk for all stakeholders can translate into major revenue loss.

Why should sellers, in particular, carefully consider how they will spend their money, resources, and time on people practices and due diligence? The answer is simple: A well-thought-out approach to selling yields a greater price on exit.

Our experience shows that successful sellers do three key things:

1. Define and implement a comprehensive divestiture strategy, one that lays out a clear road map from strategy to execution.

2. Conduct pre-sale diligence to prepare well for going to market and negotiating the deal — this is critical since it helps both sellers and buyers understand where the value lies.

3. Protect value throughout the sales process by maintaining business continuity and keeping employees engaged.

Having represented both buyers and sellers from corporations of all sizes in a range of industries across the globe, Mercer has found a direct correlation between a seller’s level of preparation and the multiple paid for the asset upon exit: Sellers that fully understand their people practices, have a documented strategy for the transition in place, and clearly define their roles throughout the shop period drive a higher price.
DEFINING AND IMPLEMENTING A COMPREHENSIVE DIVESTITURE STRATEGY

FIRST THINGS FIRST: STOCK OR ASSET SALE?
To shape the right strategy for a divestiture, it’s important to understand the key differences between a stock sale and an asset sale.

A stock sale involves buying the entire company — the lines are clearly drawn. When Berkshire Hathaway partnered with 3G Capital to acquire Heinz through a stock sale, they bought, in effect, the sum total of the Heinz operation. An asset sale, by contrast, involves carving out a piece of the larger operation and selling only a portion of the existing business. A prime example is IBM — the company has a long history of spinning off many of its business operations through asset sales, one of the most notable being the divestiture of its printer business, which became Lexmark.

Regardless of whether a company is conducting a stock or asset sale, developing a robust strategy for planning and managing the transaction is crucial. An effective divestiture strategy achieves several things:

(a) It outlines a clear path to executing the sale by defining key objectives and milestones for each stage of the process.
(b) It addresses the people issues, which are often complex and wide-ranging.
(c) It ensures that the resources are in place to complete the separation work, which frequently occurs over a prolonged period.

Having a comprehensive strategy in place to support these key actions allows organizations to effectively execute a stock or asset sale.

CONDUCTING PRE-SALE DILIGENCE
To successfully implement any divestiture strategy, pre-sale diligence is key. Again, the type of sale will determine the approach to seller’s due diligence. In a stock sale, the buyer gets everything — all the assets, liabilities, and attendant risks are transferred across the board. With an asset sale, however, the lines of separation may not be immediately as clear. Sellers have to look closely at the part of the organization that will be transferred to the buyer and address some key questions: What is the impact of the sale on the asset itself? Which employees will come over with the sale, and who will stay? How are we representing this asset to buyers? How will the sale of this asset affect the larger business and our ongoing operations?

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IDENTIFYING THE ‘NON-NEGOTIABLES’
To develop a selling strategy that maximizes price, sellers must focus on identifying the non-negotiables up front. For instance, a seller may be unwilling to enter into a Transition Services Agreement (and in a seller’s market, it’s becoming more common for sellers to decline to offer a TSA). In this case, part of the selling strategy includes letting prospective buyers know that they will not receive transition support from the seller. This allows buyers to better understand what is actually built into the price and anticipate their responsibilities in assuming the asset for sale. In this selling strategy, it’s also important for sellers to address what the continuing entity will look like because the asset for sale potentially could become a viable competitor post-close.

IMPACT ON THE EMPLOYEE-EMPLOYER RELATIONSHIP
Because the buyer assumes all employees and agreements at close in a stock sale, the entity effectively transitions “as is” with no break in employment programs or contracts — the employee-employer relationship continues uninterrupted. But in an asset sale, things get trickier: Employees are terminated from the seller so they can be rehired by the buyer, which affects severance and termination plans and can potentially trigger other severance liabilities, unless the process is handled appropriately. In addition, an asset sale requires determining shared employees, those working for the main company and providing services at the subsidiary being sold. Determining who’s going with the deal becomes part of the seller’s due diligence — helping the seller understand how to handle those shared employees and represent to potential buyers exactly what, and whom, they’re getting.

Shifting people from one organization to another requires looking closely at how to transition HR programs: With a stock sale, all HR programs come over intact (with attendant assets and liabilities), including the HR infrastructure.
For an asset sale, a key component of the selling strategy is identifying which programs to transition and addressing how employees will be treated when they exit existing programs. Another consideration is determining whether to provide transition services to help make it easier for a potential buyer to take on the asset being sold. All of these issues can have a big impact on the terms of the deal.

PROTECTING VALUE THROUGHOUT THE SALES PROCESS
Conducting thorough seller’s due diligence allows for the best representation of the value of your business to buyers upon exit. As a seller, being educated about the people issues goes a long way toward effecting an orderly transition, minimizing disruption to employee productivity, and safeguarding customer relationships. Sellers can also protect value during the sales process by:

• Clearly representing the quality of earnings as they relate to people issues. All too often, unrealistic expectations and outdated valuations plague the deal. Sellers that work to dispel confusion by giving the buyer a clear view of the impact on assets and liabilities are more likely to achieve success.

• Providing accurate people-related information in each round of the sales process. If people data are not precise and specific, and if sellers don’t cue or sequence the information concerning people appropriately for buyers, it can compromise the sale.

• Documenting a transition strategy that outlines the scope, costs, and required resources. Showing potential buyers that you’re serious about your role as a seller reinforces trust and helps pave the way for a seamless transition for both employees and customers. Defining the transition strategy by identifying, up front, the non-negotiables and the preferred timing and sequencing of events helps establish your credibility as a seller.

COMMUNICATION AND GOVERNANCE
In any transition, it’s important for people to understand their role in the change. Sellers that communicate clearly and transparently show employees and customers that they’re taking the appropriate steps to ensure an orderly transition, maintain business continuity, and set up the buyer for success. Conversely, sellers that underinvest in communications invite risk: Without a clear communication strategy for the transition, issues like retention, severance, and change of control agreements can potentially disrupt business operations and cut employee productivity. Putting a strong governance structure in place to guide the transition also helps ensure sellers address the crucial people issues during the auction process so that they ultimately deliver an asset of value to buyers.

SUMMARY
Defining and implementing a comprehensive divestiture strategy can help organizations maximize price, value, reputation, and execution effectiveness. By conducting thorough pre-deal due diligence, sellers can effectively prepare to go to market and negotiate the deal. Through remediating risks, understanding where costs are coming from, and recognizing how to improve the asset’s valuation, sellers demonstrate to prospective buyers that they are knowledgeable and effective dealmakers — a key part of an effective negotiation strategy, allowing sellers to approach the deal from a position of strength and command the highest price for the asset.

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Mercer’s M&A Transaction Services is the preeminent global M&A advisor on people issues to buyers and sellers in corporate and private equity transactions. To learn more, visit www.mercer.com/mergers-acquisitions.

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