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Deloitte M&A Views podcast:
Everyone wants a quick close: How divestiture operating models help

Transcript

Greg Jarrett: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions. I'm Greg Jarrett and today, we discuss divestiture operating models. We're joined today by Louise Chang, a principal in Deloitte's Mergers and Acquisitions (M&A) practice where she advises life science executives through the M&A life cycle to transform and position their organization for future growth, and Varun Budhiraja, a Deloitte Consulting LLP principal in the mergers and acquisitions practice and a leader within the pre-deal advisory practice.

Gregg Jarrett: Thanks for taking the time. Louise, let's kick things off with you. Divestiture is a complex word on its own. It sounds complicated. Is there something about the actual action of divestiture that makes it more complicated than your typical acquisition.

Louise Chang: Yes, there is. Companies with multiple business lines that have achieved economies that scale and some degree of efficiency over time are likely to have commingled entities that share infrastructure, processes, and people. Therefore, these businesses have a higher degree of shared services and streamlined financial processes. So, when a particular business unit or assets are being sold, companies are rarely prepared for the complex disentanglement process, while also trying to run the core business. The challenge is how to thoughtfully plan and execute the separation without disrupting both the divested business and the remaining business.

This can be very challenging, as the seller and buyer will have differing priorities, and numerous complex issues to work through, such as establishing a new and often international legal entity structure, disentangling the sales, supply chain in order to cash processes, and lastly, even just managing the system and other IT implications on ongoing operations in reporting.

Through our experience doing numerous divestitures, we have demystified, an approach to creating the appropriate divestiture operating model that will address all of these and other issues during the early stages of executing a divestiture.

Greg Jarrett: Louise, you used the term or phrase divestiture operating model. Can you define that for us?

Louise Chang: How we define a divestiture operating model is the interim construct that governs how the divested business works during the period between when a divestiture transaction closes and when the buyer fully operates the business, independent of the seller. And during this interim period, the seller provides some services to keep the business running and then the buyer is typically responsible for paying for these services. As companies go about designing this divestiture operating model for day one, we've noticed time and time again that our clients are not connecting the dots across all aspects of the business. And then, therefore lose a lot of precious time between the sign to close period, exploring operating models that just don't end up working. Our approach outlines the five tried and true divestiture operating model options that we recommend using as a starting point to determine the strategy and approach, and subsequently, streamlining the setup process.

Greg Jarrett: So, five options. Varun, is there a typical or optimum model that you recommend and why would a company choose this model?

Varun Budhiraja: There is really no single typical model, as such. But ultimately, all of the divestiture operating models end up being one of the five primary options that I will cover briefly.

First and foremost, we really want our clients to understand the concepts and assumptions behind the operating models and then we delve into the options and the spectrum of choices. Generally, you have to take into consideration the variables and parameters that are specific to the deal situation and as well as the client and target landscape and structure. Some of these considerations include commercial, operational, people matters, economics, and financial reporting, to name a few. The five options can best be, you know, be described like a spectrum from which the clients deliberate, how to pick the right model.

The first one is sort of a full transition model where the business activities, including customer transactions, are handled by the buyer on its systems on the day of close. And this is generally a best fit for long-term strategic spin-offs where you have to set up a stand-alone structure in a fully operational company.

The second option is a full carve-out with a platform TSA where nearly all day-to-day operations do remain on the seller's systems and then there is a full-platform TSA, which includes core functions, enabling functions, and several knowledge transfer activities. And this is typical when there is an accelerated sales timeline, due to regulatory or antitrust reasons.

The third option of the spectrum is an agency model, in which all of the primary operational activities, including customer transactions and collections, are handled by the seller in its legacy systems on behalf of the buyer. And this is a standard model you see in Europe and other markets where the runway to close isn't long enough for a full transition.

The fourth option is a wholesale distributor agreement, where the seller acts in the local market as the distributor on behalf of the buyer. The buyer cannot perform the sale for legal, regulatory or operational impacts reasons. And this is a common option we see in the Asia-Pacific markets, where the unique and complex regulations requiring this type of work around on, at close.

The last option which, believe it or not, we have seen on one extreme is the net economic benefit arrangement, where the seller continues to operate the business in the ordinary course and just pays the buyer the net profits of the local operations at month-end. And this is a unique choice that is made by buyers for long-tail markets when the seller has operational expertise and know-how in that market and the buyer really lacks that expertise and infrastructure in the market.

Those are the options again, on the spectrum. By starting with one of these five options up-front, buyers and sellers can reduce a lot of unnecessary churn around close and allow the focus to stay on enabling the model and on the higher priority transaction activities.

Greg Jarrett: And Varun, is Deloitte uniquely positioned be able to help with this choice?

Varun Budhiraja: Yes. I want to emphasize that Deloitte can engage in several forms with our clients on both sides of the deal, sellers' and buyers' side, and across the deal cycle. Whether the clients are in the pre-deal stage contemplating a carve-out acquisition or sale, or they're in the diligence process between finding quotes, which is where the bulk of our work occurs, or post-close, where we get involved in stand-up integration or optimization work, Deloitte can bring its years of experience and expertise and knowledge in this space. And another point I want to emphasize is that we bring a multidimensional approach, where we help with financial, tax, operational, TSA, and program management aspects to help a client identify the issues, build the right solution to effectively close the deal, and then drive value and impact, post-close.

In addition, we can engage with clients on live engagements or via workshops to drive the strategy and solution around divestiture operating models. We bring our Deloitte divestiture operating model tool kit, which essentially takes this multidimensional framework and helps us identify this in a live simulation environment, to help them select the appropriate option and discuss the impact and implications of the choices. Particularly, meet the objectives of trying to come up with a different term operating model, and choose that model with the right trade-offs in mind, and focus and adjust the model to the unique business requirements of the deal and the local market requirements. And finally, just investigate specific tax and finance implications, so the client is really well prepared to ensure a smooth financial process in the transition.

Greg Jarrett: Louise, as we wrap this discussion up, is there a way you can help tie this all together for us?

Louise Chang: Absolutely, the key thing to remember is, choosing this divestiture operating model, is an iterative decision. We do recommend that you make that decision early on, but it is one that evolves after, as you continue to learn more about the transaction and the business that you're selling. It is also a negotiation between the buyer and seller during that sign-to-close phase. So, key thing here, starting the discussion early with one of these tried and true models will really work and help the buyers eliminate unnecessary churn and help us focus on key issues that drive value and ensure business continuity which is, a real, as we all know, a good recipe for a smoother and more efficient transition.

Greg Jarrett: Thanks Louise and thank you Varun. We've got some good perspective here on divestiture operating models. I'm Greg Jarrett. Thanks for listening to Deloitte M&A Views, sponsored by Deloitte's M&A Institute. This podcast is provided by Deloitte and is intended to provide general information only. This podcast is not intended to constitute advice or services of any kind. For additional information about Deloitte, go to www.Deloitte.com/about. We also release new podcasts regularly, and if you subscribe, you won't miss a single one.

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