How divestments make Asia-Pacific companies post-pandemic ready

2021 Global Corporate Divestment Study

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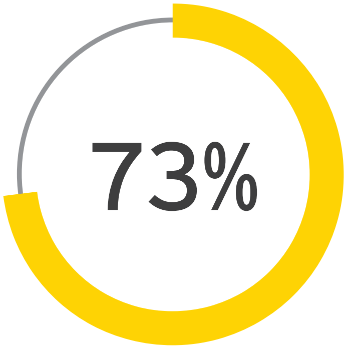
Divestments can support Asia-Pacific companies' efforts to navigate post-pandemic uncertainties and changing priorities.



of Asia-Pacific respondents anticipate selling off a portfolio business in the next two years.

The appetite to divest remains at a notably high level in Asia-Pacific. Almost three-quarters of companies (73%) anticipate selling off a portfolio business within the next two years, according to the 2021 EY *Global Corporate Divestment Study*.

Key drivers behind this proactive stance include environmental, social and governance (ESG) considerations, as well as changing customer behavior, the desire to streamline operating models and pressure from activist investors.

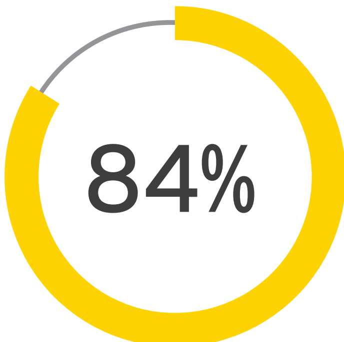
The strength of divestment appetite is especially striking given that Asia-Pacific CEOs report greater challenges in making the case for divestments than elsewhere. More than half find it difficult to explain the reasoning behind a proposed separation to their boards and key stakeholders (53%, compared to 44% globally) and to articulate the separated entity's stand-alone value (56% compared to 40% globally).

These responses show that making the case for a divestment is not always simple. However, CEOs who can construct compelling and well-articulated narratives of how divesting will increase long-term value and reduce risk should help win the support of the board and stakeholders. Anchoring the case in strategic priorities is key.

Growing ESG value imperative, driving structural initiatives

ESG considerations are rapidly gaining in importance for Asia-Pacific companies. This is true for both social and environmental factors.

Although regulations requiring action on ESG and sustainability are less common in Asia-Pacific than some other parts of the world, its large population and frequent natural disasters have made responding to climate change, in particular, a priority. In turn, companies are recognizing a long-term value imperative to act.



of Asia-Pacific respondents affirm that sustainability and social issues directly influence divestments.

This is clear from the strong link that Asia-Pacific companies see between ESG and divestments. Of companies surveyed, 84% affirm that sustainability challenges and social issues are directly influencing their divestment plans. This compares to 47% in EMEA and 14% in the Americas. Divestment of assets more exposed to ESG risks can be part of a broader strategy to diversify and mitigate risk.

Companies also identified climate change as the largest external risk to their businesses after the COVID-19 pandemic in the recent EY *Capital Confidence Barometer*.

Part of this is a recognition among more farsighted companies that the buyer universe for less ESG-friendly businesses is shrinking. While liquidity remains strong for now, particularly from private equity (PE) investors, this cannot be relied upon for businesses with high emissions or other negative ESG profiles.

Conversely, buyers of all types (corporate, PE and special purpose acquisition companies (SPACs)) have strong appetite for businesses with a positive ESG track record. This is especially true in the areas of renewable energy and technology efficiency.

Growing Asia-Pacific focus on ESG is evident from the increasing involvement of company boards. This topic is increasingly treated as a board-level issue, requiring leadership to run ESG committees and consider the interests of broader stakeholders and community.

Both factors are clearly at work in a new trend to split companies with significant environmental or other ESG exposures. This divides entities into heavier-emitting and cleaner or zero-emission divisions. It has been seen mostly in Australia's resource-focused economy so far, but has clear potential to spread further in the region.

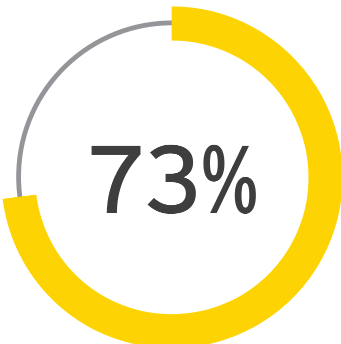
Clearly, splits of this sort can be the precursor to larger structural actions. These can include divestment, demerger as a result of differential valuation, and capital and investment structures that will be largely a function of emissions intensity.

Lately, social issues such as diversity, equality and access to health care have gained focus too. This has been spurred both by the COVID-19 pandemic and social justice movements around the world, be it in the US or in other countries.

Influenced by these global trends, Asia-Pacific companies cite social issues as the most important trigger that helped prompt their last divestment. Over half (52%) identify such issues as a key factor.

Intensified focus on tech directly influencing divestment plans

Asia-Pacific companies' investment in technology has intensified, particularly in the past six months as the longer-term impact of the COVID-19 pandemic on customer behavior has become clearer. Responding to supply chain disruptions during the pandemic has also driven an uptick in this area of investment.



of Asia-Pacific respondents use the divestment earnings to invest in technology.

This development has clear implications for divestments, as investing in technology is already the top-ranked use of proceeds in Asia-Pacific. Nearly three-quarters of companies (73%) use funds raised from their most recent divestment to invest in technology. Only paying down debt — mainly a priority for smaller Asia-Pacific firms with less capacity to absorb debt rollovers at higher rates — comes close as a call on these liberated funds.

Moreover, an overwhelming 89% of Asia-Pacific companies now agree that changes to the technology and competitive landscapes are directly influencing their divestment plans. Although this proportion slightly lags the global reading of 94%, the growing recognition of the priority of technology is evident from the notable rise in this response since 2020 when only 60% of Asia-Pacific companies were of the view.

Pandemic shock pushing supply chain shake-up

Companies in most industries have experienced significant disruptions due to the pandemic — either as supplier or customer. This is prompting efforts to diversify away from overreliance on any single counterparty or market. At the same time, companies recognize that full exits from countries may make future returns very difficult.

These considerations have not resulted in much divestment activity yet. But there is clear potential for them to do so as companies look to reshape their supply chain and manufacturing bases to gain greater resilience.

This trend is intensified by regional geopolitical uncertainties, such as tensions over sovereignty and the imposition of tariffs. Asia-Pacific companies acknowledge political tension and volatility between key markets as the largest geopolitical risk that could accelerate their divestment plans.

Spotlight: South Korea and Greater China

South Korean companies looking to manage portfolios actively

Companies in South Korea report the highest divestment intention in Asia-Pacific. 81% are planning to sell off a non-core business in the next two years and the remainder are open to opportunities. More than a quarter (26%) expect to divest within 12 months.

Mounting pressure from activist investors may be a factor in this. Almost three-quarters of South Korean companies (71%) report that activist campaigns have prompted reviews of strategic alternatives in the past year, compared to an Asia-Pacific average of 59%.

With tensions rising in East Asia, geopolitical uncertainty is strongly influencing companies in Greater China to consider divestments. 42% say this factor makes them more likely to divest, versus 31% of Asia-Pacific companies overall. Nearly half (45%) cite changing regulatory and antitrust environments in key markets as factors that may accelerate divestment plans (34% overall in Asia-Pacific). Greater China companies are actively strengthening their business, with 75% of respondents anticipate divesting in the next two years. Eighteen percent expect to do so within 12 months.

Recommendations

- Anchor the case for divesting non-core businesses in strategic value enhancement and de-risking priorities
- Treat ESG challenges as a long-term value imperative — the buyer universe for businesses with less favorable ESG profiles is shrinking
- Learn the pandemic lesson that diversifying the supply chain reduces the risk of disruption

Conclusion

Divestments can help Asia-Pacific companies navigate the post-pandemic environment successfully. With geopolitical uncertainty high and the need to invest in new technology and to improve performance on ESG criteria now key priorities, selling non-core businesses can provide both the capital to fund investment and the operational streamlining to reduce risk and build resilience.

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