Strategies to deliver a successful tech divestiture

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Navigating the path to a successful tech divestiture

Technology companies have become increasingly adept at using acquisitions to rejuvenate antiquated business models while bringing new innovations and talent to bear. Acquirers have also become skilled at successfully integrating targets into their portfolios.

As tech companies mature and accumulate acquisitions, routinely pruning portfolios through divestitures prepares them against disruptive events. The current COVID-19 crisis is a case in point – our 2020 Global Corporate Divestment study concludes that a majority of technology companies (71%) expect divestiture preparation to increase as a result of the crisis. Technology execs also said they plan to accelerate the sale process with 76% of respondents aiming to complete divestitures within the next 12 months compared to just 45% pre-crisis. To further support our hypothesis, we analyzed portfolio activities during the Great Financial Recession and found that active divestors outperformed their non-divesting peers by 24 percentage points in median total shareholder return.

The need for well-executed divestitures will challenge the skills and techniques of serial tech acquirers. In this paper, we identify six operational levers to help companies successfully navigate their technology divestitures.

Tech divestitures present unique operational challenges that cannot be addressed by the acquisition skill set

Operational lever	Executive owner	Challenges	How divestitures differ from acquisitions
Business perimeter	CEO, CFO, COO, CIO	‣ Solution sets a mix of products and services ‣ Primary vs. auxiliary assets	‣ Financial metrics required at the product and services levels ‣ Granular data and mapping to define deal perimeter
Talent	CHRO	‣ Global workforce requirement of works council and regulatory approvals ‣ Shared R&D and product development	‣ Works council negotiation experience necessary ‣ Product road map and organizational alignment early in the process
Intellectual property (IP) and data	CFO, CPO, Legal, R&D, Tax	‣ Intricate web of in-house and licensed IP assets (e.g., source code, patents, IP contributions, copyrights) ‣ Customer and individual data sets	‣ Structured approach to separate and value IPs ‣ Understanding of various regulations affecting data assets separation
Contracts	CCO, Legal, CPO, CIO	‣ Critical customer contracts run multiple years and comprise complex solution sets ‣ Solutions sets built on technology stacks or platforms with layers of underlying agreements with third parties (e.g., licensing, royalty, revenue sharing)	‣ Fair allocation of strategic value of underlying agreements employed in solution sets ‣ Unbiased pricing for transition services agreements (TSAs) to fulfill contracts for non-consent customers
IT as product enabler	CIO/CTO, R&D	‣ Disparate IT systems enabling solution sets, R&D and product road maps	‣ Timely or accelerated carve-out of complex IT systems
Communication	CEO, CFO, COO, CHRO, Legal	‣ Communications lag with deal progress ‣ Leakage of sensitive or deal information	‣ Playbook for cohesive separation communications ‣ Effective control of information flow

A proactive and disciplined approach to address **six operational divestiture levers** can help a company control the process during negotiations and accelerate speed to close and increase deal value.

1 Unpack tech products and services into a clean deal perimeter

Tech solutions are often a mix of different products and services spread across legal entities, business units and regions. While the primary product for sale is usually clear, its auxiliary revenue, costs, assets, legal entity structure, affiliated people, processes, systems and contracts can be clouded by financial and operational entanglements that make separations complex.

A divestiture also requires separating the P&L of services from that of the product. This is especially important for bundled assets since tech products and services have very different economics and related multiples.

How a SaaS client leads by example

A large software-as-a-service (SaaS) client went through an extensive transactional data analysis and mapping effort to untangle products and services by:

- Identifying revenue and costs at the customer and order level, mapping service revenue to specific products
- Depicting primary and pull-through profitability

Mapping these details helped present a cohesive value story for the tech assets in the perimeter and drove bid multiples higher.

2 Use product road maps to guide your talent mapping and retention strategy

Tech companies generally have a distributed and international workforce that spans product engineering, innovation, sales and marketing, customer success and shared services teams. This presents three unique challenges when divesting:

i. **Defining a clean employee census** – many employees are typically not mapped to a single product or service. Relying on organizational charts alone can be inadequate and often unreliable.

ii. **Timing deal close with works council approvals** – consultations with works councils can be arduous, involving detailed reviews of the divestiture rationale and employee impact.

iii. **Retaining key talent** – exacerbated by a demand-supply gap for tech talent, identifying ways to retain your key people is a must.

A software company's successful talent strategy

An industrial client trying to divest its software business adopted a three-pronged strategy to navigate these challenges effectively. The company:

- Leveraged product road maps to fairly allocate staff
- Developed robust market participation models for each market and negotiated staggered closings to time with works council approvals
- Cast a wider retention net to include quota-carrying sales, engineering and other critical talent with specialized knowledge

3 Disentangle IP, licensing and data to protect your source of competitive edge

For a tech company, IP is a source of strategic competitive advantage and complementary revenue stream.

Tech products frequently rely on multiple IP assets that are shared across many products, resulting in complex many-to-many interdependencies.

Furthermore, these interdependencies are not always rigorously tracked. This necessitates a detailed review of IP entanglements and an assessment of strategic value.

Similarly, the customer and transactional data that tech companies use to derive critical insights requires caution in a divestiture. With increasingly restrictive regulations, data privacy laws dictate what you can share with counterparties during diligence and, in many cases, post-close. These challenges can be further elevated when dealing with individual data in regions such as the European Union. Tech companies can avoid falling out of compliance by guiding data separation and confidentiality control in the early diligence stage.

IP perimeter considerations

In our experience, the IP asset's degree of uniqueness and importance to the business should drive the separation approach. Key decisions on the IP perimeter should also be included in the IP master agreement, a key deal agreement, to prevent any ambiguities.

4 Unwind value flows for critical customer contracts

Tech companies often enter into multiyear customer contracts comprising complex solution sets. These solution sets are built on intricate technology stacks or platforms that have layers upon layers of underlying commercial agreements (e.g., licensing, royalty, revenue sharing) with other third-party collaborators and vendors.

Since these agreements are typically enterprise-wide and shared across multiple products and services, separating them or assigning a portion of their strategic value to the divesting assets can be tricky and mired in unanticipated legal consequences. This becomes especially challenging for the seller when a customer does not consent to assigning the rights and obligations to a new buyer at deal close and instead expects the seller to continue to fulfill the contract through expiration.

Mapping value flows

Anticipating consent issues with shared customers on a tech carve-out, a large SaaS client undertook a detailed review of all critical customer contracts. They then mapped their value flows down to specific commercial agreements that made up the technology stack to unwind each agreement. This allowed fair allocation of value to the divesting assets. It also helped justify pricing for TSAs to fulfill customer contracts that could not be assigned to the new buyer at deal close.

5 Engage IT to help drive the value story and develop a robust separation road map

Tech portfolios typically encompass homegrown business units and acquired businesses that often were not fully integrated.

When executing a divestiture, separating the back-end capability may mean carving out operations at varying stages of maturity that are supported by disparate IT systems. In addition, as tech products and services are often built on shared IT infrastructure, unplanned IT outages during separation can disrupt sales and jeopardize R&D productivity.

How the CIO can help improve deal economics

A well-thought-out IT separation road map provides transparency in operational risks and costs. It also demonstrates the seller's capability in execution, which, in turn, promotes buyer confidence and drives up deal value. The IT separation road map can accelerate stand-up of business-critical applications and infrastructure with an optimal stand-alone cost structure, and guide the seller's effort to proactively identify, manage and reduce stranded costs.

6 Align information flow and communications to the overall tech value story

A cohesive communication strategy, including the narrative and timing of delivery to support the value story, should be developed well before the deal is announced. Sellers need to strike a delicate balance between providing transparency as the deal progresses (with regulators, vendors, etc.) and maintaining necessary confidentiality as the separation decisions take shape (employees, customers, etc.). For the management to orchestrate effective internal and external information flow, it is essential for the separation team to develop a thorough understanding of the deal process and organizational interdependencies that impact communication.

Spotlight on customer communications

If process changes during the transaction affect the way customers place orders, they must be informed in advance to minimize business disruption for both parties. For companies with a global footprint, customers from various countries might have different levels of understanding or concerns about the deal impact and process change. Therefore, communication content may need to be tailored for customers from each country.

The divestiture mindset

While acquisitions and divestitures are both effective tools in the tech executive's strategic arsenal, each requires a distinctly different mindset and preparation.

For acquisitions, buyers typically have latitude to get organized and sharpen their integration strategy to focus on delivering the deal rationale (e.g., strategic growth, consolidation, transformation) while minimizing business disruptions.

In contrast, sellers are on the clock throughout the sale process. They are expected to demonstrate in-depth knowledge of the divesting assets, as well as lay out a clear path to full separation. Any ambiguity regarding the deal perimeter, financials or separation timeline erodes deal value. It may also cast doubt on management competency, prolong deal uncertainty and can negatively affects the business.

Top tech sellers rely on meticulous planning and preparation across each of the six operational levers to attract buyers to their tech assets and to enable smooth and timely separation from the remaining business.

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