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

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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.

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**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.
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.

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**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

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**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.
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.

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**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.
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 affect 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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