



Everybody Wins in Divestitures

New Bain & Company research finds that a systematic and proactive approach to divesting helps companies outperform the market.

By Jim Winger and Jorge Rujana

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It's OK to divest.

Executives hesitate to sell noncore businesses for many reasons. Many are reluctant to shed revenue, concerned about the market's reaction to a smaller company and the challenge of stranded costs. Some worry about selling low, reasoning that with an additional year or two, the business could improve its trajectory. Others have trouble accepting the fact that it could perform better in another's hands. Still others view divestitures as a hassle: a lot of work with which their teams are less familiar. While most companies have at least some track record at buying and integrating businesses, divestitures often require flexing muscles that are underdeveloped.

The good news is that divestitures, particularly ones that strategically clean up a company's portfolio and that are positioned to command an optimal price, can generate shareholder value. They can also create a catalyzing event for improving the remaining business. When done well, they reduce complexity and provide fuel for the company to pump back into its core.

Dispelling divestiture myths

Our recent research and experience working on deals across industries has helped us dispel the myths that have made divestitures an underutilized tool for shareholder value creation. The fact is that companies achieve better results when they take a four-step approach. They need to proactively and selectively prune their portfolios to select the right assets to divest. And when they decide to divest, sellers yield higher multiples by investing the time, talent and money required to make a business attractive for sale, instead of waiting until it's too late and selling quickly. They need to run a smooth selling process that clearly communicates value to buyers and ultimately implement a low-risk carve-out program aimed at minimizing execution costs and future stranded costs.

As part of our ongoing work with divestitures, Bain & Company studied 2,100 public companies and found those engaging in focused divestment outperform inactive companies by about 15% over a 10-year period, as measured by total shareholder return (TSR).¹ The results are even better for companies that combine

focused divestments with a repeatable M&A model. They outperform inactive companies by nearly 40% over a 10-year period and generate more than twice the sales and profit growth. Based on our analysis, \$100 invested in inactive companies in 2005 would have grown to \$181 in 2015. By comparison, the same \$100 invested in a focused divestor that also engaged in frequent and material M&A would have grown to \$252 (see *Figure 1*).

Typically, inactive companies underperform because they don't shed the noncore parts of their portfolio. As a result, they continue to tie up management time and capital in businesses in which they are not playing to win. On the other hand, active sellers free up the time and capital to invest in areas where they are best positioned to grow and lead.

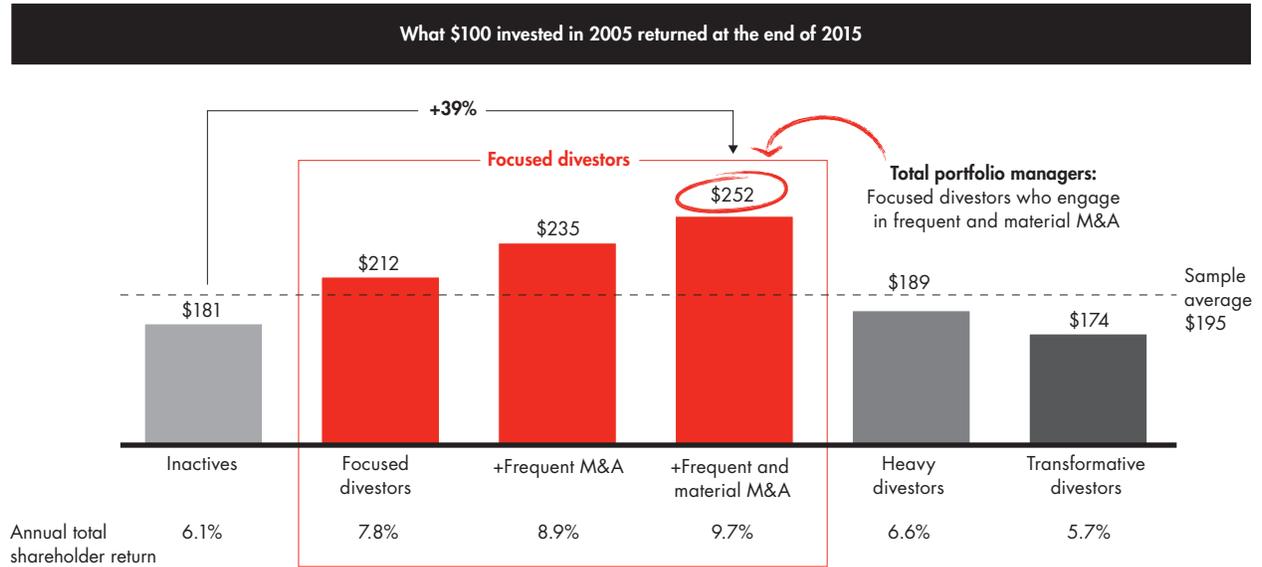
Companies such as Air Liquide and Henkel enjoy the benefits of divestments and repeatable M&A. Industrial gases company Air Liquide made more than 130 acquisitions and roughly 25 divestments over the past decade, contributing to an annual TSR of 11%. For its part, chemicals and consumer goods company Henkel made roughly an equal number of acquisitions and divestments during the same period. Regularly thinning its portfolio has contributed to Henkel's annual TSR of 17.3% over the past 10 years. This compares with an average TSR for a comparative set of companies of 6.2% over the same time period.²

We explored 137 of the largest divestitures conducted by the 2,100 companies in our study to better understand the factors contributing to success in divestitures. Several of the findings were counterintuitive.

For example, companies that divest with the primary stated aim of raising cash to pay back debt don't do particularly well. These companies saw their market caps increase only 1.4% in the three months after the announcement (compared with the three months prior to the announcement). Instead, markets reward strategic sellers. Those that were recognized by equity analysts and other market observers as divesting to focus on their core saw their market cap rise by 7.9% three months following the announcement.

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Figure 1: Focused divestors with a repeatable M&A program outperform inactives by about 40% over a 10-year period



Notes: Cumulative divestment deal value is the sum of relative deal sizes vs. the market cap three months prior to announcement, 2005–2015; deal value assumption used for deals with missing values=1.1% of acquirer’s market cap or 0.9% of divestor’s market cap; n=2,160 companies
Sources: Bain SVC database 2015; Dealogic; Bain M&A database 2016; Bain analysis

Everybody wins

Our research also helped expose a major myth. One of the fundamental barriers that hold many companies back is a widely held fear that they’re selling low. They worry that buyers will win at their expense because multiple studies have shown that companies acquiring carve-outs do better than those that acquire whole companies. Among the reasons: Carved-out businesses often are underinvested in by the parent and can be more relevant to an acquirer’s core. However, it is also true that sellers of carve-outs do better than inactive companies because they generate capital to reallocate to their core and can focus management and scarce resources on the best parts of the business.

There’s a straightforward value equation in divestitures.

On the cost side of the equation, sellers bear execution costs, which can get inflated when a company doesn’t run an organized process and distracts employees for too long. That’s why the best companies identify and

allocate the right people, tools and processes to the asset to be divested, defining an approach to timely separation that will not distract the base business (and a distracted base business is typically much more expensive than any transaction fees).

Longer term, companies can get stuck with stranded costs after the business is sold. These are costs related to everything from IT systems to back-office functions to the physical infrastructure built up to support scale. To minimize these longer-term costs, the most successful divesting companies proactively account for the ways that a sale may create stranded costs in the remaining portfolio and lay a plan to optimize their supply chain, route to market and general and administrative expenses for a more focused company. This can even create a forcing function for a broader companywide transformation if the seller chooses.

On the reward side of the equation, sellers can command the highest price by targeting buyers that have the most to gain and fully preparing the asset for sale. They take

the time required to sharply define the business to be divested, determine what it would take to bring that business to full potential and even implement initiatives that begin to demonstrate the performance gains that could be achieved by the buyer. There are longer-term rewards, too. Sellers win by implementing a divestiture roadmap and repeatable M&A process that reinforces their core—they know what fits and what doesn't, as well as where to double down for the outsized gains that our research has uncovered.

Four steps for successful divesting

Four distinct processes form the basis of value creation through successful divesting. We'll look at them one by one.

Proactively manage your portfolio. Start with the basics of understanding how all of your portfolio businesses contribute to your core and regularly assess them for fit. What is each business's competitive position and ability to win? Do you have the right resources and capabilities to take it to full potential? If not, are there other companies where it would be a better fit? To be attuned to divestiture candidates, evaluate your portfolio from the outside in, anticipating disruption and redefinition opportunities. Only by systematically assessing your portfolio can you identify the business units that would deliver more value in another owner's hands. In the pharmaceutical industry, for example, Bain recently found that companies that combine category leadership with portfolio focus deliver annual total shareholder returns that are more than twice those of companies with diversified portfolios that maintain a tail of smaller positions. (See the Bain Brief "Focus Matters: How Biopharma Can Reward Shareholders.")

Thoroughly plan and prepare to optimize value. Don't race to sell the asset. Create a blueprint for making it attractive prior to selling—even better, begin implementing some of those initiatives prior to sale. We have found that 6 to 12 months is the right length of time to establish the blueprint and demonstrate progress. This allows you to improve the value of the business while you still own it and also demonstrates to a potential buyer what

is possible. Both of these can help you achieve a higher price. Proven success typically raises the profits of the divested business. At the same time, these early successes also point to a better future, which can help to improve valuation multiples that sellers will pay. An important consideration: Include strong talent in the business in the predivestiture period. Good executives can help spur the growth and margin improvement that adds a lot of value.

A major US aerospace and defense company believed that it would not find a buyer for one of its noncore business units—it was pursuing a sale process, although leadership internally believed that its only option was to spin off the business. In the process of preparing an equity story and separation program for the business unit, it identified ways in which the business could thrive outside of the parent. The aerospace company saw far more potential than it had anticipated, in both revenue growth and cost opportunities, and it embarked on a broad-ranging cost initiative. This process helped give confidence to a buyer, leading to a transaction in which the buyer later announced a synergy program based heavily on that cost initiative.

While determining how to increase the value of the divested business, it is also important to do the same for the remaining company. Again, the divestiture process creates a catalyzing event for determining how to right-size the remaining company, beginning by estimating the level of anticipated dis-synergies and developing a plan to offset them. The best companies plan to minimize stranded costs by adapting the infrastructure and the back office, as well as adjusting the IT architecture to match the smaller scale and shape of the post-divestiture business.

Focus your selling process on buyer value creation. Many sellers leave money on the table by shortcutting the divestiture process. Once they decide to divest they may call an investment banker, put an offering memorandum together and move as fast as they can. Based on our experience, divesting companies with the strongest track records take a more thoughtful approach. They devote the required resources to perform reverse due

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diligence to help decide who could create more value and how it could be created—critical knowledge that helps a seller negotiate the best deal.

Develop a short list of potential buyers that would have the most to gain by leveraging their existing capabilities to do better with your business. As part of the selling process, communicate clearly how a buyer could execute on the prescribed initiatives in those first 100 days and beyond. Also important: anticipating a buyer's demands and establishing the principles for any temporary service agreements (TSAs) that you'll need to provide to the buyer as part of the deal; having a clearly thought-out approach makes you a stronger negotiator.

Use the carve-out moment to make the remaining company future-ready. The deal's been made. It's now critical to carve out the old business, adhering to your priorities with a low-risk process that neither imposes risk on the business nor distracts the team. It is also an opportunity to wipe the slate clean and prepare for the future with a more focused business.

We find that the best companies establish a separation management office to plan and execute the carve-out while controlling one-off costs and managing TSA commitments. They develop a well-thought-out internal and external communications plan, optimizing the remaining company's operating model and infrastructure for the future portfolio. They ensure robust TSA governance and then remove the associated costs.

A global beverage company faced a challenge that seemed impossible: selling three large businesses that were ingrained in the parent's global footprint while concurrently integrating a larger acquisition that also has worldwide operations.

The seller set up a world-class carve-out program, taking advantage of well-proven playbooks, and staffing a strong separation management office with top-performing global managers. It organized the program around key decisions that governed the process and ensured adherence to the timetable, an approach that proved to be the most effective way to manage the carve-out and collaborate with buyers for a seamless transition. Overall, the company successfully coordinated the efforts of hundreds of employees across buyers and sellers in dozens of countries, splitting hundreds of supply contracts, designing and implementing separate IT architectures for each business, planning and staffing independent organizations, and negotiating the details for hundreds of TSAs.

The result? The beverage company protected its intellectual property, ensured the right people were in the right jobs and optimized the remaining organization to avoid stranded costs, ultimately allowing the company to generate record-setting synergies and overdeliver on shareholder value creation.

Indeed, as more companies are discovering, divestitures are an important tool in a senior leadership team's arsenal. They can deliver mutual benefits to both sellers and buyers. They are complex, however, and many companies' muscles are not as well-developed with divestitures as they are with acquisitions. As a result, divestitures need careful attention both before and after the sale to deliver outsized value. Companies that regularly prune their portfolio, take an active hand in preparing assets for sale, manage the separation and use the sale funds to acquire core assets in a repeatable M&A program outperform inactives by 40%. That's how divesting can be a win-win for buyers and sellers. 

¹ Inactive companies are those that did not engage in divestment activity over 2005–2015; total shareholder return is defined as stock price changes assuming reinvestment of cash dividends.

² Number of acquisitions and divestments include transactions made by subsidiaries, including by companies acquired over the years. Acquisitions include outright purchase, majority interest and acquisition of asset transactions as reported by Dealogic, thereby excluding partial or remaining interest acquisition or increase in controlling stake. Consortium, intracompany and real estate deals are excluded from consideration.

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