Can divesting help you capitalize on disruption?

Financial services
Global Corporate Divestment Study 2017

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After years of restructuring prompted by regulatory reform, the financial services sector has demonstrated that it is prepared to deal with disruption from the ground up. The sector has spent a decade redefining business models, using divestments to focus on core competencies and markets. It now faces a new digital challenge.

New distribution channels are emerging, customer expectations are changing and automation is offering potential cost savings across the back, middle and front office. The development of robo-advisors in the wealth and asset management space is just one example of front-end technological disruption.

This year’s financial services Global Corporate Divestment Study reveals that financial services companies are treating this disruption as an opportunity. Flexibility and clarity of purpose seem to be the key messages. Executives are asking whether potential buyers are right for the divestment being considered or whether they should be casting their net wider. They are recognizing their weaknesses and looking for ways to improve. And financial services leaders are looking for new options when it comes to divestments, such as JVs.

Our financial services market perspective and leading practices, coupled with our full global study, offer a detailed exploration of these successful divestment strategies. We hope you find it useful to improve the value and efficiency of your divestments.

**A note from financial services leadership**

Charlie Alexander  
EY Global Banking and Capital Markets Transactions Leader

David Lambert  
EY Global Insurance Transactions Leader

Nadine Mirchandani  
EY Global Wealth and Asset Management Transactions Leader

**Key insights**

**Financial services**

**Strong divestment pipeline**

58% of financial services companies expect to make a divestment in the next two years, higher than across all sectors (43%).

**Alliances with FinTech on the rise**

72% are considering a JV or alliance with a FinTech business to address disruptive threats or to reduce costs.

**Synergies are biggest challenge**

69% find understanding synergies across divisions to be a major challenge when conducting portfolio reviews.

**Developed markets on the hunt**

55% expect the likely buyer of their next divestment to be a foreign financial institution operating in a developed market, up from 43% last year and 38% in our 2015 report.

**Lessons learned**

**Financial services**

**Ask the question: are we the best owner for the business?**

See page 4

**In uncertain times, be ready to act**

See page 5

**Consider the likely buyers and the systems they use**

See page 7

**Consider a wider range of options to achieve strategic goals**

See page 8

Insights from across all sectors can be found on pages 11-30.
Market overview

Digital disruption is the dominant theme in financial services today. Yet, far from being the threat that many anticipated, the arrival of FinTech is reshaping financial services delivery and the way businesses are managed.

While digital disruption is leading to increased divestment in other sectors, most financial services businesses are seeking out JVs and alliances with FinTech firms and other technological innovators.

Almost three-quarters (72%) of executives believe this approach will mitigate disruptive threats or reduce costs, while 59% are opting for outright acquisitions of competing FinTech firms. Just 26% are considering divestments as a result of FinTech’s disruptive influence.

Yet, disruption in the sector is far from new. Regulatory reform over the past decade has created structural shifts as business lines became unviable under capital adequacy and compliance requirements. This prompted many to retrench and reduce their footprint in some markets, focusing instead on core competencies.

Many global players have completed their large-scale divestment programs and the industry is now at the tail end of this cycle. However, our survey results point to further activity, with 58% of financial services executives expecting to sell a business in the next two years. These divestments will be driven by an increasingly granular analysis of portfolio value, with many going further than they might have anticipated a few years ago.

How is your firm responding to the rise of FinTech companies successfully competing in a number of key areas of your business? (Select your top two, where first is most likely.)

- Considering an alliance with a FinTech in areas under threat or to reduce costs: 51%
- Considering acquiring a competing FinTech: 36%
- Considering divestment of a business under threat from FinTech competition: 19%
- No FinTech companies are competing with any components of our business: 1%

“Most of the low-hanging fruit has been divested, particularly in the large global financial services groups. However, we’re still seeing Asian financial institutions selling private banking operations and insurance arms as well as retail banking in specific markets. Many companies are having to dig deeper than they have in the past.”

Chris Locke
EY Financial Services Divestment Leader,
Europe, Middle East, India and Africa
Structural reform is far from the only driver for divestment in today's increasingly unpredictable environment. Macroeconomic volatility, coupled with geopolitical uncertainty, also lead financial services businesses to divest.

More than two-thirds (70%) of financial services executives say that macroeconomic volatility prompted their last major divestment, with 87% saying it would make them more likely to divest in the future. Geopolitical uncertainty was cited by nearly half (47%) as a prompt for their last sale, with 73% saying it would make them more likely to sell over the next year.

In these uncertain times, the benefit of having a clear view of how much a business is worth, both to you and to a potential buyer, cannot be overstated. Consider whether other companies in the same or adjacent sectors could exploit the benefits of scale and extract synergies from the business that may not be available to you. These are potential buyers that may be prepared to pay a premium for a business that is a drag on your capital.

To understand the relative value of your portfolio to your business and to potential buyers, the first steps are defining synergies across divisions, allocating capital according to the latest regulations and assessing risk-adjusted returns. This exercise offers insights into whether holding on to a business is the right course of action or whether capital could be better deployed elsewhere. However, it's also likely to require a change in mindset for many financial services companies.

**Be proactive:** Identify assets that may be valuable to a buyer rather than waiting for a catalyst, such as a need for investment or new regulatory requirements.

**Anticipate shareholder activism:** Financial services businesses remain on watch. In the sector, 45% say they are more likely to divest because of concerns around shareholder activism – higher than the 38% across all sectors who say this. Knowing how to extract maximum value from your portfolio – and demonstrating you are acting on this knowledge – will head off confrontational shareholder situations.

**Leverage enhanced data collected as a result of structural reform:** Regulatory pressure has improved data granularity in financial services. Well over half (58%) of financial services executives say they have a better understanding of the balance sheets of businesses considered for sale as a result of structural reform. Two-thirds say it has enabled them to identify key people, systems, assets and agreements that would need to be addressed in a separation. Yet, far fewer are deploying this data for strategic, value-enhancing decision-making, including M&A. Just over one-third (36%) say it improves their portfolio review process, and the same proportion say it helps divestment execution by providing a better understanding of the interdependency of the businesses being divested.
How is structural reform affecting your divestment activity? (Select all that apply.)

- Improving divestment execution due to a better understanding of legal entity-level dependencies and relationships of a business to be sold: 36%
- Leading to divestment decisions as certain affected businesses become less viable: 41%
- Providing a better understanding of balance sheets of businesses considered for sale: 58%
- Improving divestment execution due to a better understanding of legal entity-level dependencies and relationships of a business to be sold: 36%
- Identifying key people, systems, assets and agreements that would need to be addressed in any separation agreement: 66%
- Improving portfolio review, identifying non-core assets to consider for sale: 36%
- Distracting the corporate development team from pursuing divestments and acquisitions: 17%

“Structural reform has transformed the way financial services businesses consider their portfolios. It has helped them to identify people and systems, and to understand how separate businesses are. Yet, many are not translating this understanding into live situations and really using that information to divest strategically. Ensuring that corporate development has a seat at the table during the process helps bring a more strategic focus.”

Geoffrey Mize
EY Financial Services
Divestment Leader, Americas

In uncertain times, be ready to act

With 51% of financial services executives saying an opportunistic approach was a trigger in their most recent divestment, companies need to be ready to act if they are to exploit these options.

Building optionality into divestment planning means preparing well in advance. Companies need a clear vision of how a business can be carved out with minimal disruption, how long that separation will take and what actions should be taken to maximize the value of the divestment.

Yet, the complexity of business separation is often underestimated. Even business lines that may at first appear to be distinct are often, on closer examination, intertwined with other areas. Retail banking operations in one country, for example, may be ripe for divestment. But they may share costs, networks, distribution channels, systems and people with commercial banking arms that are to be retained.

It’s unsurprising, therefore, that understanding the synergies across divisions is the biggest challenge in portfolio reviews across all financial services executives, with 62% of bank executives, 70% of wealth and asset managers and 74% of insurers saying this.

Given ongoing regulatory changes and the evolving economic environment, what aspects of the portfolio review do you find most challenging? (Select the two most challenging.)

- Understanding synergies across divisions (e.g., cross-selling, risk): 62%
- Capital allocation, reflecting the latest regulations: 55%
- Risk-adjusted returns: 54%
- Cost allocation: 29%
- Banking and capital markets: 20%
- Wealth and asset management: 37%
- Insurance: 37%
Financial services

Capital allocation, reflecting the latest regulations, is also a key challenge for businesses in the sector, mentioned by 55% of financial services executives overall.

**Do the preparation work early:** Once a business has been identified as a potential divestment, get started on preparation, even if a sale isn’t in the cards yet. Ensure you have a rigorous understanding of where there are synergies with other group businesses and what it will take to carve out the business. Consider the current value of the business and what can easily be done that would be accretive to that value. This helps frame the lead time required for divestment.

While the majority of financial services respondents (66%) rank value as the main priority in their last divestment, slow sales processes can result in loss of value. Fifty-one percent of financial services companies say that the performance of the business being divested deteriorated during the process in their last sale. For 46% of executives, a lack of fully developed diligence materials led buyers to reduce the price. Thorough preparation conducted well in advance enables both speed and value retention in the long term.

**Invest in structural reform to sort out potential separation issues:** Regulatory reform means that more and better-quality data is available to define the perimeter of a business. Use this information to shorten divestment lead times and avoid value erosion that can be caused by drawn-out sales processes. Robust intragroup service level agreements with accurate transfer pricing helps increase potential divestment speed as interlinkages are clear and transitional service agreements are easier to write. It can also protect value, for example, where transitional services agreements would otherwise be agreed to based on historic intragroup agreements which may not have been reflective of commercial reality.

**Examine business functions in detail:** Issues can arise in certain areas, such as credit risk behavior, where intellectual property may be shared across businesses. Consider where buyers will need to be fully accountable from day one, such as the aspects of risk and compliance that can’t be outsourced under transitional service agreements.

**Don’t neglect data issues:** Data segregation is often a minefield and the divestment process needs the involvement of the chief data officer early on. Consider who owns the data and how it will be migrated. Recognize that data can dictate transaction structure in certain situations and that the seller may need to retain certain data for a defined period of time for regulatory reasons and/or because of continued responsibility for legacy assets and liabilities.

**Create modular businesses:** When establishing new business lines, think ahead. Consider, for example, how shared services contracts are devised. Find ways to ensure that these can be easily carved out in the event of a future sale.

“Structural reform raises awareness and understanding of a business’s perimeters, both financially and operationally. It also raises questions: could we do things differently for our operational efficiencies and growth objectives? Could we have a better understanding and appreciation of the opportunities and challenges involved? Should we exit a marketplace?”

*Nadine Mirchandani*
EY Global Wealth and Asset Management Transactions Leader
Consider the likely buyers and the systems they use

The last year has seen a shift in the types of buyers executives believe are most likely to acquire financial services businesses. “Foreign emerging market financial institutions seeking global expansion” topped the list in our 2016 survey. This year, this category has dropped to second place, while 55% of financial services executives now consider “foreign developed market financial institutions” among their most likely buyers. Private equity and sovereign wealth funds are also rising on the list.

As traditional regulated domestic competitors become less-likely buyers of financial services assets, sellers need to invest time in understanding these new potential bidders. They must also update the value proposition for this group of buyers if they are to achieve maximum purchase price.

Arguably, selling to overseas and private equity buyers presents a greater challenge than selling to domestic acquirers, for whom synergies and benefits of buying may be more obvious. However, there are some key areas of focus.

Pre-empt likely buyer questions and concerns: If selling to a private equity buyer, it’s likely the buyer will require separate systems (potentially with certain transitional services for a period of time) that are ready to go from day one. For strategic buyers, it’s worth considering their current systems and how they would fit with the business to be divested to ensure that the transfer (or migration) is as smooth as possible.

Balance efficiency with certainty: Where stand-alone systems are required, sellers need to understand and communicate both the cost efficiency of these systems and the ability to execute such a transfer. For example, should replication of existing systems be prioritized to provide execution certainty and speed of completion, or should the business invest in new, potentially more cost-efficient and flexible systems for longer-term benefits? This is a particular issue in the insurance sector, given the complexity and long-term nature of many of the products – small changes in managing policies can have a significant drag on costs over time. Think ahead to determine what the long-term costs will be, as well as potential efficiencies that could be gained, and articulate this to potential buyers. Such transparency can help reduce buyer uncertainty and have a positive impact on the price they are willing to pay.

Consider buyer synergies: Examine the various business functions in the potential divestment and determine where there may be overlaps with potential buyers. Most financial services executives (69%) say they presented synergies to each buyer in their last divestment.

“Insurance companies need to be prepared to tell the commercial and operations story to potential buyers, particularly now that more traditional domestic acquirers are less likely to be on the list. If you’re selling to an overseas inbound or private equity buyer, for example, you have to present with clarity to ensure they understand what they’re buying – this is much more the case than it would be for a local competitor.”

David Lambert
EY Global Insurance Transactions Leader

Who would you view as the most likely buyer for your next divestment? (Select your top two, where first is most likely.)

<table>
<thead>
<tr>
<th>Buyer Category</th>
<th>2017</th>
<th>2016</th>
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</thead>
<tbody>
<tr>
<td>Foreign developed market financial institutions</td>
<td>33%</td>
<td>22%</td>
</tr>
<tr>
<td>Foreign emerging market financial institutions seeking global expansion</td>
<td>18%</td>
<td>27%</td>
</tr>
<tr>
<td>Private equity or sovereign wealth fund investor</td>
<td>19%</td>
<td>24%</td>
</tr>
<tr>
<td>Traditional regulated domestic competitor</td>
<td>22%</td>
<td>13%</td>
</tr>
<tr>
<td>Non-regulated domestic financial institution</td>
<td>27%</td>
<td>23%</td>
</tr>
<tr>
<td>Investors from a “convergent” sector, such as technology</td>
<td>3%</td>
<td>n/a</td>
</tr>
</tbody>
</table>

Most likely [ ] Second most likely [ ]
**Look closely at shared services:** Consolidation of functional activities into shared service centers is becoming more prevalent in financial services, and it can make some aspects of the business easier to separate. However, shared services can also present challenges in transferring businesses because sellers may not be equipped to serve as third-party service providers (for example, providing human resources services).

**Consider due diligence on buyers:** Verify that buyers can both execute quickly and transfer the business to their own platforms within a given time period. Determine whether the bidder has the necessary licenses, can undertake necessary IT development and understands the alignment of products and services in their business. Consider asking buyers to submit integration plans with their bids to speed up regulatory approvals and streamline the transition.

**Pre-empt regulator concerns:** In the banking and insurance sectors, the involvement of regulators in transactions can hold up a deal and impose unexpected conditions. Ensure you can demonstrate that the disposal does not put the customers of the disposed business or your remaining business at risk, and consider how regulators may view potential buyers.

**Consider a wider range of options to achieve strategic goals**

**JVs and alliances**

The disruptive force of FinTech is leading to new partnerships in financial services. As our survey shows, 72% are looking at alliances with these “new kids on the block” in response to threats and as a way to reduce costs.

Symbiotic alliances, thoughtfully executed, enable financial institutions to offer innovative products to customers through new channels. They reduce complexity by cutting through webs of legacy systems and processes with digitization. And FinTech innovators benefit from established players’ distribution and brand recognition, without the need to sell out or sacrifice their entrepreneurial culture.

With blockchain likely to be the next big disruptor for banks, many have already teamed up with innovators on pilot projects. Insurance companies and wealth and asset managers are not far behind – 73% and 70%, respectively, say they are considering JVs and strategic alliance structures for their next transaction as new operating platforms and robo-advisors gain ground in the market.

These new technologies also open up the possibility of partnering with companies in non-financial sectors, particularly when it comes to retail customers.

Partnerships and JVs will, however, ultimately come to an end. Having an exit strategy or end-state in mind from the start will ensure the business can benefit through the full life cycle of such arrangements.

**Private equity**

Private equity and sovereign wealth funds are now considered more likely buyers than in the past, particularly with the rise of financial services specialist funds and increasing experience of the sector in more generalist firms. Yet, private equity could represent an even greater buyer pool than many currently anticipate, given the private equity industry’s record amounts of “dry powder” – highly liquid marketable securities or cash reserves – currently residing in these firms.

In challenging and uncertain market conditions, sellers should look to private equity firms that can invest in subsidiaries, often with a view to making operational improvements to create value and exit when market conditions improve.

"On the buy-side, we’re seeing more alliances and JVs with tech companies, as financial services companies try and take out costs to improve customer experience. Banks don’t want to own the technology; they want to leave the entrepreneur in the driver’s seat while influencing the direction of the technology. They want to understand it, have access to it and use it in mobile apps or other product solutions. They want to get closer to technology and they’re using JVs to do so."

Charlie Alexander
EY Global Banking and Capital Markets Transactions Leader
Conclusion

Future-proof your business

Uncertainty and disruption are here to stay. Financial services companies need to find new ways of building resilience in order to be fit for the future and embrace new growth opportunities.

Keep options open by proactively identifying parts of the portfolio that may be worth more to someone else and preparing businesses for sale well in advance of bringing them to market. Maximize value by considering the full range of possible buyers. And team up with industry innovators to access the new technologies that will define the way financial services are delivered and transform operations.
This is an especially timely Global Corporate Divestment Study. Unprecedented geopolitical uncertainty and technological change are making portfolio and divestment strategy more vital than ever.

Faced with these dynamics, our clients are trying to figure out where it is profitable to maintain a geographic footprint versus when it is time to focus on different markets – and how much it would cost to make a move. They’re also considering how to free up capital to invest in innovation.

We are seeing many companies flee geographies because of short-term fears and wind up with suboptimal valuations on their businesses. We also are seeing companies enamored of new technology without fully considering its effect on the entire portfolio of businesses. But the basis of such transformative decisions must always be a company’s long-term strategy.

So, how should successful companies use divestments to underpin their portfolio strategy? Our survey finds that nearly half of companies plan to divest in the next two years. A divestment can empower a company to put capital to better use, enable a leaner operating model and enhance shareholder value.

This year’s Global Corporate Divestment Study suggests ways your company can thrive amid disruptive market forces: understanding how they affect valuation, efficiently executing a divestment and futureproofing your remaining organization.

With mergers and acquisitions near record levels in 2016 and a dynamic deal market anticipated in 2017, M&A is a cornerstone of today’s corporate route to growth. And where there is a buyer there is a seller; companies reshaping themselves for the future are not only acquiring but also divesting.

As technology transforms business models – blurring sector lines and spurring change in consumer preferences – buying rather than building innovation is often the preferred strategic path to success. In tandem, successful companies are strategically divesting non-core or underperforming businesses in order to fund growth. They are selling assets to refocus and re-energize their core business.

Market fundamentals will likely fuel further recycling of assets. Economic growth is modest and uneven globally and geopolitics has entered a new, uncertain phase. And in a world where product innovation happens daily, executives are perpetually setting new strategic directions. Against this backdrop, those that use divestments to strategically change what is in their control will become the disruptors, rather than the disrupted.
Key findings

Our annual *Global Corporate Divestment Study* reveals a deal-making environment faced with disruptive challenges and senior executives craving an information advantage. Divestment is a fundamental tool for many of those surveyed. Even those not planning to divest in the next two years are evaluating their portfolios more rigorously. Here is what the data tells us leads to divestment success.

Why divest?

76%

say their most recent divestment created long-term value.

55%

say changes to the technology landscape are influencing divestment plans.

Portfolio review

88%

more companies have successful divestments when they understand disruptive forces affecting their sector.

88%

say improved analytics capabilities would help make faster, better divestment decisions.

Lessons learned:

Understand implications of technology as a disruptive force

- Page 17

Better manage your geographic footprint

- Page 18

Consider tax, an increasingly disruptive factor

- Page 19

Divest with strategic intent

- Page 19

Focus on achieving your full potential

- Page 20

Don’t wait until it’s too late

- Page 21

Embed analytics into portfolio management

- Page 21
74% more companies achieve a sale price above expectations when they divest because of technology change versus geopolitical uncertainty. Strategic divestments, including those used to fund new technology, have a positive impact on company value. However, reacting hastily to external forces such as geopolitics can negatively affect sale price. Regardless of transaction rationale, sellers should thoroughly prepare and consider how proceeds will support growth.

Deal execution

63% more companies generate a sale price above expectations when they highlight tax upsides to purchasers.

55% more companies generate a sale price above expectations when they conduct commercial diligence.

Lessons learned:
- Dedicate the right resources
  Page 24
- Establish a governance model
  Page 25
- Conduct commercial diligence
  Page 25
- Remain flexible on the perimeter
  Page 26
- Communicate tax upsides to buyers
  Page 27

Becoming more agile

66% plan to better align investment team and operational management roles.

48% are becoming more disciplined about creating value pre-sale.

Lessons learned:
- Align investment team and operational management goals
  Page 28
- Develop a lean and agile operating model
  Page 29
- Invest in emerging technology platforms
  Page 30
Are you divesting based on strategic reasons or disruptive forces?

Macroeconomic uncertainty, geopolitical instability and technological change are creating unprecedented business disruption. These dynamics, coupled with a low-growth environment, increasing shareholder pressure and changing consumer preferences are prompting a critical decision: how best to allocate capital to gain competitive advantage.

Divestments are a fundamental part of portfolio strategy, especially in a volatile and disruptive environment. Companies are selling non-core and slow-growth businesses to fund investments in their core portfolios. They are putting the capital to good use: from making acquisitions and investments in digital capabilities to expanding product ranges and geographic footprint.

Nearly half of companies globally (43%) plan to divest in the next two years. But what is the “right” reason to exit – how much should you base your divestment decision on strategic rationale versus external market forces? And how should your transaction rationale factor into how you prepare for a divestment?

Companies that expect to initiate their next divestment within the next two years

Our data overwhelmingly shows that divestments pursued primarily in response to macroeconomic and geopolitical instability result in suboptimal outcomes. The data also reveals that companies are feeling pressured to move quickly, often because of these unpredictable market forces. But prioritizing speed often results in a divestment that does not achieve sellers’ expectations.

Conversely, divestments triggered by technology-related opportunities or risks often yield outcomes that exceed expectations.

While companies must always consider how external forces may affect performance, a long-term strategy, rather than short-term influences, should drive the decision to buy, reshape or sell a business.
Sixty percent of companies say that external forces prompted their most recent divestment. Macroeconomic volatility – in oil prices and exchange rates, for example – is the biggest external market force driving companies’ most recent major divestments (62%). Risks or opportunities related to technological change (50%) and geopolitical uncertainty (39%) are other key drivers.

Since the Brexit decision in June 2016, the US elections in November 2016 and the rise of populism around the globe continuing into 2017, many companies are thinking differently about how political changes could affect global trade and corporate growth.

These disruptive forces are expected to have a major impact on future divestment plans, with many companies selling to manage risk.

However, many do so without having access to all information needed to understand the impact these forces could have on their growth strategies. In fact, 53% say understanding the business impact of new disruptive forces is among their key portfolio review challenges – and most say it is their biggest challenge. (See page 13.)

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### External forces increasingly drive divestments ... but should they?

**Q.** Which external forces prompted your most recent major divestment? Select all that apply.

- **Macroeconomic volatility (e.g., currency, oil prices)**
  - Global 62%
  - Americas 56%
  - Asia-Pacific 66%

- **Risks or opportunities related to technological change (including digital)**
  - Global 50%
  - Americas 53%
  - Asia-Pacific 43%

- **Geopolitical uncertainty (e.g., Brexit, anti-trade regulations, monetary policy, regulatory change)**
  - Global 39%
  - Americas 30%
  - Asia-Pacific 59%

- **Concerns related to shareholder activism**
  - Global 23%
  - Americas 28%
  - Asia-Pacific 21%

- **None of the above**
  - Global 15%
  - Americas 14%
  - Asia-Pacific 18%

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### Percentage of companies that say those external forces will increase their likelihood of divesting over the next year

- **76%** Macroeconomic volatility
- **67%** Risks or opportunities related to technological change
- **56%** Geopolitical uncertainty
- **38%** Shareholder activism
Geopolitics’ negative impact on divestment outcomes

Companies that divest because of geopolitical uncertainty are 31% less likely to achieve a sale price above expectations. Those that divest because of macroeconomic volatility are 20% less likely to deliver a favorable valuation.

Our data shows that compared with other parts of the world, companies in Europe, the Middle East and Africa (EMEA) are more likely to divest because of geopolitical or macroeconomic reasons. They are also most likely to prioritize speed over value in a deal – often leading to a lower sale price. Further, 38% of EMEA executives say that their divestment did not create long-term value. This compares to 24% globally.

Conversely, companies that divest because of risks and opportunities prompted by technological change are 21% more likely to achieve a higher sale price than expected.

Overall, companies that divest in response to technological change – rather than geopolitical uncertainty – are 74% more likely to achieve a sale price above expectations. There are four key reasons for this:

• While technological change happens quickly, companies often take time to observe how competitors’ innovations unfold.
• Technological change that reduces an asset’s competitiveness under one owner could be of value to another.
• Divestments strategically pursued to respond to – or get ahead of – technology advances can better enable the company to fund future innovation.
• Since the seller is likely to have a clear divestment rationale, the market response is likely to be more positive than a geopolitically driven sale that may not be clearly articulated to the market.

“‘We incurred more legal costs than expected, and the deal took a lot longer, because we had not taken into consideration changes in the regulatory system. This could have been avoided if we knew how to prioritize these issues and had resolved them more quickly.’”

Executive at a Germany-based life sciences company

Likelihood of achieving a sale price above expectations

- 31% less when companies divest because of geopolitical uncertainty
- 20% less when companies divest because of macroeconomic volatility
- 21% more when companies divest because of technological change

74%

more companies achieve a sale price above expectations when they divest because of technology versus geopolitics.

Q: Do you think the cost of divestment paid off (i.e., do you think it created long-term value)?

<table>
<thead>
<tr>
<th>Region</th>
<th>Global</th>
<th>Americas</th>
<th>Asia-Pacific</th>
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<tr>
<td>Yes</td>
<td>88%</td>
<td>80%</td>
<td>62%</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>12%</td>
<td>20%</td>
<td>38%</td>
<td></td>
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</tbody>
</table>

Global average
Understand the constant disruptive market force: technology

Digital strategy used to be largely the responsibility of the chief marketing officer and chief information officer. But with the entire value chain being disrupted – from procurement through production, recruitment and go-to-market – “digital transformation” has become a major focus for the entire C-suite. Leading organizations are talking less about “digital strategy” and more about “business strategy in a digital world.”

Similarly, 43% of companies plan to use divestment proceeds to invest in digital capabilities. And 55% say changes to the digital landscape, and therefore the competitive landscape, are directly influencing their divestment plans.

Digital disruption forces organizations to take a holistic view of their capital decisions, including divestments. Specifically, companies should:

**Consider how to use market factors to create value**

Understand which new business models are driving material growth, how customer priorities are changing and where scalable growth can be driven. Also identify the non-traditional competitors that might impede competitive advantage.

**Invest in your strengths**

Identify where the organization has momentum in place and brand recognition. Companies should determine the right balance of organic versus inorganic capital investment and strategically use divestments to fuel capital re-allocation. For example, divestments can fund digital enablement and growth in nascent businesses.

**Divesting a non-core business to invest in technology**

A global health care company recently divested a non-core business. The company used the proceeds to buy digital capabilities that would enable it to generate revenue across more areas of a patient’s health care continuum. Instead of helping patients only in the hospital, the technology and data-capture capabilities enabled the company to transfer its client relationship to the home.

**Result:** The company earned a premium valuation, enabling it to fund technological investments. It was able to maximize sale price by carefully preparing carve-out financial statements, designing an efficient tax structure and conducting operational separation work early.

43% of companies plan to use divestment proceeds to invest in digital capabilities.
Strategically manage your geographic footprint

Capital re-allocation has always been a challenge. The difficulty of deciding what and how to sell is now exacerbated by increased geopolitical and economic uncertainty. Companies faced with this situation could consider the following guidelines:

Don’t speed

When faced with potential political or regulatory changes, companies often feel pressured to exit quickly. For example, 43% of companies in Europe, the Middle East and Africa prioritized speed over value (compared with only 18% in the Americas, where companies are less likely to divest because of macroeconomic or geopolitical reasons).

However, speed does not translate into a higher sale price. Sellers that prioritize value over speed are 63% more likely to achieve a sale price above expectations and even complete the deal sooner than those who prioritized speed. Companies should take the time to plan for various scenarios, develop a compelling and credible value story when it’s time to sell, and identify the best buyer pool.

What was your main priority in your last divestment?

<table>
<thead>
<tr>
<th>Priority</th>
<th>Americas</th>
<th>Asia-Pacific</th>
<th>EMEA</th>
<th>Global average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>57%</td>
<td>72%</td>
<td>72%</td>
<td>82%</td>
</tr>
<tr>
<td>Speed</td>
<td>43%</td>
<td>28%</td>
<td>18%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Set appropriate value expectations

Sellers should understand appropriate comparable valuations, have a clear basis for their expectations and seek third-party advice. If a market or geography no longer seems favorable for you, buyers may feel the same way. Sellers also need to evaluate the opportunity costs of not divesting at all – which may mean that the business becomes further starved of investment and creates a drag on the rest of the business.

Did any of the following geopolitical issues impact your decision to divest? Select all that apply.

- Change in regulations: Global 74% (Americas 84%, Asia-Pacific 67%, EMEA 86%)
- Political instability in a region or regions: Global 72% (Americas 44%, Asia-Pacific 70%, EMEA 81%)
- Brexit: Global 51% (Americas 8%, Asia-Pacific 74%)
- Cross-border political sanctions leading to a change in competitive dynamics: Global 42% (Americas 30%, Asia-Pacific 50%, EMEA 33%)
- Anti-corporate political agenda: Global 22% (Americas 25%, Asia-Pacific 17%, EMEA 34%)
- Corporate scandal or other investigation: Global 19% (Americas 19%, Asia-Pacific 16%, EMEA 28%)
Consider a broader set of buyers

Valuation may be an issue in an unfavorable market environment regardless of buyer pool. However, looking for less traditional buyers in adjacent sectors or private equity buyers can increase your chances of a better sale price. Less traditional buyers, in a different market or geography, may be willing to pay more for an asset based on different goals or synergy assumptions. And a bigger buyer pool will increase competitive tension.

Evaluate alternative transaction structures

Companies should remain flexible on the assets for sale. For example, sellers can consider retaining certain assets so the buyer can avoid anti-trust issues, or including intellectual property in the deal through an interest-free license to enhance longer-term value. Further, companies that understand the value of alternative structures to potential buyers are 95% more likely to achieve a sale price above expectations. Conversely, 48% say lack of flexibility in structure of sale is a significant source of value erosion.

Consider tax, an increasingly disruptive factor

A growing aspect of geopolitics is tax policy, which often affects a divestment decision. Recent tax changes globally and expected upcoming reforms are making it more complex than ever to assess the potential tax risk of selling a business. This is confirmed by 48% of companies, for which tax has become a bigger challenge to divestment execution over the last year.

In the US, the prospect of tax reform, including lower corporate tax rates, is having a material impact on taxpayer behavior (e.g., accelerating tax deductions and deferring revenue). And the prospect of investing more in domestic infrastructure projects and border security will lead to inorganic growth, producing a favorable environment for business divestment in those market segments.

Further, divestments of operations have accelerated in such formerly high-growth economies as China, Brazil and India. Tax complexity is contributing to divestments in these countries.

The tax impact on divestment decisions and processes is often underestimated. Early identification of tax complexities is key.

Divest with strategic intent

External disruptions may trigger tactical change, but the most important focus should always be long-term strategy and business fundamentals. Companies that divest because of performance issues that signal long-term value erosion are 25% more likely to have a successful divestment than those that divest because of external forces.

Executives say the most important strategic reason for their last major divestment is a unit’s weak competitive position in the market (28%), followed by opportunistic rationale, including an unsolicited buyer approach (20%), and a business not being considered core (20%).

Despite the prevalence of opportunistic divestments, companies that divest because they need to fund future cash investment requirements are 51% more likely to have a higher valuation multiple post-sale. And those that divest non-core assets are 48% more likely to have a higher valuation multiple. We see these results because markets value companies that have a clear vision and are seen to be acting on that strategy.

What strategic triggers prompted your most recent major divestment? (Select the most important factor and all key considerations.)

<table>
<thead>
<tr>
<th>Reason</th>
<th>Most important factor (%)</th>
<th>Consideration (all that apply) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit’s weak competitive position in the market</td>
<td>28</td>
<td>49</td>
</tr>
<tr>
<td>Not part of the core business</td>
<td>20</td>
<td>36</td>
</tr>
<tr>
<td>Opportunistic (including unsolicited approach by a buyer)</td>
<td>20</td>
<td>45</td>
</tr>
<tr>
<td>Need to fund future cash investment requirements</td>
<td>19</td>
<td>44</td>
</tr>
<tr>
<td>Desire to collaborate with strategic partner (JV or alliance)</td>
<td>8</td>
<td>26</td>
</tr>
<tr>
<td>Negative impact on risk or reward balance of portfolio</td>
<td>5</td>
<td>46</td>
</tr>
</tbody>
</table>

Most important factor Consideration (all that apply)
Do you fully understand the opportunities and threats arising from rapidly changing market dynamics and how they affect the future valuation of your business? Do you have enough information about your portfolio to be able to pivot quickly? A company that understands the disruptive forces affecting its sector and business is 88% more likely to receive a higher-than-expected sale price and is twice as likely to boost its post-divestment valuation multiple.

Most companies (53%) say understanding market dynamics is their biggest portfolio challenge. However, they are having a tough time identifying the criteria they need to benchmark their future performance — and those benchmarks are changing quickly.

As a result, 39% of companies say that shortcomings in their portfolio review process have resulted in failure to achieve intended divestment results.

Focus on achieving your full potential

More than half (55%) of companies say their biggest challenge is making portfolio review a strategic imperative. Particularly with geopolitical, macroeconomic and technological change, company leadership must dedicate time and resources to understanding the gaps between where they are today and how to reach their full potential. Our Full Potential Paradigm™ framework outlines fundamental questions to address these gaps:

**Performance gap**
- Are we operating our current businesses as well as possible?
- Are we earning appropriate margins from each of our businesses based on our relative market share (RMS)?
- Are we achieving appropriate cost reduction through learning and experience?
- Are we achieving optimal pricing given the elasticity of the market and our RMS?

**Opportunity gap**
- Which businesses should be in our portfolio, and how should we deploy capital across them?
- Are we keeping pace with market growth in each of our businesses?
- Where can we invest in organic growth within our current portfolio?
- Where can we consolidate our current markets, or enter new markets, through acquisition?
Perception gap
• Are we getting full credit from investors for the value of our portfolio?
• Are our strategic decisions aligned with how investors value our business?
• Could we improve investors’ perception by better articulating our operating or growth initiatives?

Don’t wait until it’s too late
Forty-one percent of global companies say they have held on to assets too long. Companies also need to take a data-driven, on-demand approach to portfolio review in order to generate buyer interest for assets and act confidently if the imperative to divest becomes unavoidable.

Review your portfolio frequently
• Conduct an in-depth portfolio review once or twice a year
• Review performance quarterly to understand where you are against plan, market dynamics and competitor actions
• Use analytics to constantly interpret internal and external data

Systemically embed analytics in the portfolio management process
How can you better understand divestment success criteria? How can you choose what to sell and how to structure the deal – and remove the human bias from decision-making? Analytics is key to leveraging disruption to gain competitive advantage.

Executives understand that they need analytics to make better portfolio and divestment decisions. But they also know they have not yet spent time working through their data challenges or putting the right set of algorithms in place to improve insight. Most executives (88%) agree that advanced analytical tools would help them make faster, better divestment decisions and improve divestment preparation.

Companies that apply analytics outperform peers
• While only 18% of executives cite effective prescriptive analytics capabilities during their portfolio review, 46% of top performers (those with a higher-than-expected valuation multiple on the remaining business) cite the same.
• While only 21% of executives cite effective prescriptive analytics capabilities during the divestment process, 49% of top performers cite the same.
What “analytics” really means

We define analytics as the transformation of strategic, financial or operational algorithms combined with complex data sets into information, enabling better, faster and more decisive actions. This definition is significantly more complex than modeling in a spreadsheet. Rather, it includes incorporating advanced analysis, algorithm development, and a full range of relevant structured and unstructured data from other company financial and operational data. It also incorporates a variety of external sources, including governments, reporting agencies, weather centers, traffic data centers and social platforms.

The benefits of analytics

<table>
<thead>
<tr>
<th>Type</th>
<th>Why it’s important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Descriptive analytics and visualization (e.g., historical value-based analysis)</td>
<td>• Describes the base business and its historical performance, taking into account strategic, financial and operational dimension and levers • Helps the seller define assets to be included in the deal perimeter</td>
</tr>
<tr>
<td>Predictive analytics (e.g., future outcome and business impact analysis)</td>
<td>Helps identify: • Issues early, allowing the seller time to remedy the issues or prepare in advance for a divestment before it becomes critical • Opportunities to manage top-line synergies through cross-sell and up-sell, based on a mix of mutual and new customers • Cost synergy opportunities • A forecast for future business performance under a new buyer’s control, thereby helping define specific areas for synergies and support more rapid synergy realization</td>
</tr>
<tr>
<td>Prescriptive analytics (e.g., operationalization of predictive scenarios)</td>
<td>Helps: • Optimize portfolio performance and enable decisions as to whether to fix an impaired or non-strategic business or sell it, and when • Assess how to optimize the financial and operational performance of a business given the overall company strategy • Define how to leverage the predicted future performance without compromising other priorities</td>
</tr>
<tr>
<td>Social media</td>
<td>• Helps identify and describe market sentiment about an asset or a transaction • Helps identify customer, supplier, employee and other stakeholder sentiment about the company, brand, products and services • Provides insights to rapidly recognize synergies • Identifies trends that are not evident in internal data and which might affect transaction value</td>
</tr>
<tr>
<td>Other technologies (e.g., robotic process automation, machine learning, artificial intelligence)</td>
<td>• Automates data gathering, data processing and information generation processes • Provides more rapid and on-demand analytics, enabling better and more confident decisions</td>
</tr>
</tbody>
</table>

While many executives say their capabilities in descriptive and predictive analytics are effective, most say more advanced analytics capabilities, such as prescriptive analytics, robotics, machine learning and artificial intelligence, are less effective. However, these same executives expect to significantly increase use of all forms of analytics as part of the portfolio review process over the next two years.

Descriptive analytics help explain performance gap in technology company

In preparation for a carve-out, a middle-market technology company had been unsuccessfully applying traditional analysis to understand why a set of products had been consistently underperforming. The company then applied descriptive analytics to a three-year transactional data set, combined with third-party demand data and demographic data. Specifically, the company analyzed pricing performance at a stock-keeping unit (SKU) level, taking into account market conditions.

Result: The data revealed that the underperformance was related to a specific set of pricing programs that were used at the discretion of sales representatives. The company immediately changed pricing guidelines and improved performance. The company was also able to proactively, and more credibly, communicate the past performance and recent improvements to potential buyers.
Start by leveraging descriptive analytics that focus on historical performance and key business trends for the portfolio and the individual business. Analytics should be automated and available to executives on demand to support decision-making at any point and to evaluate their business portfolio for divestment candidates.

Companies can use these same kinds of analytics to:

- Better describe historical performance and key business trends for a specific divestment. For example, analytics can identify which deal attributes might attract a broader pool of owners willing to pay more for an asset.
- Build a data-driven business case from the lens of the buyer, allowing for easier modeling of different structures to generate the most interest from buyers.
- Remove management bias from the process.

Predictive analytics can be utilized to better forecast market conditions and demand, anticipate future revenue streams and project cost synergies. More advanced analytics, such as prescriptive analytics, should be applied only after adopting descriptive and predictive analytics.

### Percentages of Companies That Plan to Use These Analytics More in the Next Two Years

<table>
<thead>
<tr>
<th>Analytics Type</th>
<th>Percentage of Companies Using Analytics More in Two Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Descriptive</td>
<td>67%</td>
</tr>
<tr>
<td>Predictive</td>
<td>75%</td>
</tr>
<tr>
<td>Financial</td>
<td>54%</td>
</tr>
<tr>
<td>Prescriptive</td>
<td>38%</td>
</tr>
<tr>
<td>Other Tech</td>
<td>45%</td>
</tr>
<tr>
<td>Social Media</td>
<td>20%</td>
</tr>
</tbody>
</table>

### How to Incorporate Analytics into Your Portfolio Review Process

- Obtain greater insight into value drivers, performance and risk: 39%
- Obtain more insight into diligence: 37%
- Better manage risk and post-close valuation: 32%
- Instill greater confidence in divestment decisions: 46%
- More rapidly execute diligence and closing: 45%

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**Analytics is driving the future of portfolio reviews**

Companies are increasingly leveraging analytics across the transaction life cycle to make divestment decisions. For example, executives say they leverage analytics to:

- Obtain greater insight into value drivers, performance and risk: 39%
- Obtain more insight into diligence: 37%
- Better manage risk and post-close valuation: 32%
How can you maximize sale price and long-term value once you decide to do a deal? Since last year’s study, value realization has become more challenging: 76% of companies believe their most recent major divestment created long-term value, down from 84% last year. And senior executives perceive that the price gap – between what sellers expect and what buyers are offering – is growing. So it’s more important than ever to develop a strong value story. Here we summarize some leading practices to improve your divestment outcome.

How should you take action in disrupted markets?

In today’s marketplace, how wide do you consider the price gap between what sellers expect versus what buyers are offering?

- 0%: 24%
- 1%-10%: 32%
- 11%-20%: 9%
- >20%: 35%

Dedicate the right resources

Companies often overestimate the attractiveness of their assets. A frequent, critical mistake is that sellers don’t focus enough on separation planning and diligence materials. Nearly half (47%) say lack of focus and resourcing was a cause of value erosion in their most recent divestment, and 48% say lack of fully developed diligence materials led buyers to reduce their offer. Similarly, companies often regard preparation as a supplement to an employee’s day that can be performed “after hours.” This lack of focus results in loss of buyer interest, value leakage, or even broken processes or failed auctions. Worse yet, during buyer diligence, management often becomes distracted from running the business. They often end up frantically scrambling to respond to buyer questions or challenges to the perimeter that should have been planned for well before diligence.
Establish a governance model

Don’t underestimate the importance of executing these seemingly routine tasks:

- Define a plan and form a transaction team that represents all key functional areas; communicate team objectives to kick off the transaction efficiently and avoid a slow start
- Decide which internal and external stakeholders should know about the transaction and strategic plans before they are public, and develop messaging accordingly
- Set targets, and delegate and monitor progress through reporting, in order to manage divestment complexity and maintain accountability
- Define the timeline and align work streams to key deadlines and milestones to maintain momentum, track progress and target the desired close date—while allowing for long-tail items, such as regulatory matters, order-to-cash establishment, etc.

Conduct commercial diligence

Fewer than half of companies (46%) say their commercial diligence capabilities are very effective. However, companies that do this well are 55% more likely to achieve a sale price above expectations. Today, commercial diligence is much more than just market and competitor diligence. Rather, it should demonstrate the business upside for a potential buyer, challenge the business plan that management prepared, and identify areas for improvement or weaknesses in assumptions. In particular, it examines:

- The business’s product portfolio and routes to market to assess whether they are keeping pace with digital innovation
- Which markets are susceptible to geopolitical disruption
- Customer perception—whether feedback supports the seller value story, and whether issues are being addressed
- What synergies might be available for a potential buyer
- Opportunities to remove cost, improve the supply chain, or expand the offerings or customer base

What do you see as the causes of value erosion in your last divestment? Select all that apply.

- Performance of the business deteriorated during the sales process 50%
- Lack of fully developed diligence materials, leading buyers to reduce price 48%
- Lack of flexibility in structure of sale 48%
- Lack of focus or competing priorities 47%
- Business was not presented stand-alone, meaning financial buyers were “scared off” or had to estimate their own conservative stand-alone costs (leading to lower bids) 34%
- Lack of preparation in dealing with tax risks 32%
- Seller did not implement necessary restructuring prior to sale 31%
- Confidentiality concerns, resulting in lack of clearance for appropriate personnel and inability to provide data to the buyer 30%
- Board decision already made or announced with fixed end date 21%

What happens when you don’t prepare

A Fortune 100 company marketed a global business representing 25% of its revenues. The assets had experienced constant revenue and earnings growth, and so management did not devote proper time for sale preparation. More than 35 indications of interest were received, but only five management presentations resulted and all parties ended up dropping out of diligence. In the end, the company pulled the assets off the market, even after management had devoted significant time to the process during a critical period for the business.

Result: Revenue required 18 months to recover. A process that should have taken less than 12 months took more than two years, and the ultimate valuation was 20% under management’s targeted range. What can you do to avoid this scenario?
Remain flexible on the perimeter of assets for sale

Sellers take a view on which assets are for sale — the perimeter of the deal — but they should also consider whether additional assets could be included or excluded from the deal to make it more attractive to a buyer. Some key considerations include the following.

**Deal perimeter implications**
- Ongoing earnings power of the business post-closing
- Transition services agreements (TSAs) and reverse TSAs
- Tax-efficient acquisition structure for the buyer
- Separation-related requirements, including operationalizing the specific countries in association with the closing
- Talent (e.g., works councils, benefits legally required to transfer)
- Regulatory requirements and related time frames
- Supply agreements
- Stand-alone and one-time costs

**Appropriate level of separation planning**
It is vital to find a balance between too much and too little. Potential buyers should have a clear sense that the business has been properly prepared for sale across the board: in the Confidential Information Memorandum, at management presentations and in due diligence.

**Buyer considerations relative to the desired perimeter**
These may include antitrust considerations, the buyer’s existing infrastructure and legal entities, tax attributes, manufacturing locations and relative capacity, funding relative to select liabilities and settlement processes relative to commingled accounts (e.g., accounts receivable and accounts payable).

**Scenario-driven analytics**
These are not simple spreadsheets. A proper set of analytics employs data relative to the potential transaction that allows for modeling various scenarios and the impact of these scenarios on revenue, EBITDA and working capital. Scenario-driven analytics allow for streamlined deal-basis financial statements and deal model reporting. They also provide the deal team with appropriate data relative to the deal and the remaining organization, and they enable the team to present the impact of the various scenarios proposed by multiple buyers to the C-suite and board of directors.

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**Questions**

In your last major divestment, how would you rate the effectiveness of each of the following steps?

<table>
<thead>
<tr>
<th>Conducting commercial diligence (e.g., market and competitor diligence)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>46%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Focus on the quality of the management team in the divested business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>39%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Continuing to create value in a business even though you intend to sell it</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>39%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Identification and mitigation of stranded costs (those which remain with parent following divestment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>31%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Understanding the value of alternative structures to buyers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>29%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pre-sale preparation to mitigate price reductions for tax risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very effective</td>
</tr>
<tr>
<td>28%</td>
</tr>
</tbody>
</table>

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**Conduct cyber diligence**

No organization is immune from cyber attacks. These attacks can damage transaction value. And data breaches and other attacks are expensive and time-consuming.

When it comes to divestment candidates (“DivestCo”) and cyber threats, some ways to maximize value include:
- Identifying the biggest threats and plans to mitigate them before you engage buyers
- Monitoring avenues of attack against DivestCo that could open up when companies separate
- Developing defensible support for DivestCo’s valuation that considers the potential cyber-event impact on a range of factors – sales, brand and reputation, litigation costs and competitive impact from loss of intellectual property

As for the remaining business (“RemainCo”), some ways to mitigate threats include:
- Identifying internal security monitoring gaps and closing potential avenues of attack against RemainCo that could open post-separation
- Making sure RemainCo’s critical assets, such as intellectual property, are not inadvertently transferred to DivestCo
- Closing gaps among RemainCo’s team members and risk control governance structure caused by separation
- Supplementing security monitoring teams, which are often overwhelmed during the transaction
Communicate tax upside to buyers

Given widespread flux in tax laws across the globe, it is difficult for buyers to identify tax value and opportunities, especially from the outside. The most successful sellers look at their business through the eyes of a buyer and proactively highlight potential tax upsides. Sixty-three percent of executives say that they highlighted tax upsides to purchasers during their most recent divestment — among the most important steps they took to enhance value. Better yet, 48% of executives say it has become easier to offer flexibility in sales structures over the past year. But it’s still not an easy task, and there is still room for improvement. Only 28% of companies say their pre-sale preparation to mitigate price reductions for tax risk is very effective. And of all the pre-sale steps companies say they did not take but should have, highlighting tax upsides tops the list.

When it comes to communicating tax upside, where relevant, sellers should:

- Understand the benefits to buyers of different sale structures
- Provide a detailed tax model to illustrate when tax losses and other attributes will offset cash taxes
- Review historical tax advice and the trail of why positions were taken
- Illustrate the capacity for tax-deductible debt, country by country
- Seek to agree on open tax points with tax authorities where possible
- Highlight tax incentives that could be available
- Outline tax efficiencies that have been considered but not yet implemented

Q. Which initiative was most important for enhancing sale value?

- Presented the synergy opportunity for each likely buyer
  - 21%
- Operational improvements to reduce costs or improve margin
  - 20%
- Highlighted tax upsides to purchasers
  - 19%
- Developed value creation road map (initiatives that potential buyers could implement)
  - 18%
- Extracted working capital
  - 11%
- Enhanced revenue (e.g., product improvement or distribution expansion)
  - 9%
- Prepared vendor due diligence reports
  - 2%

Q. Which step did you not do but now feel you would have benefited from the most?

- Presented the synergy opportunity for each likely buyer
  - 10%
- Operational improvements to reduce costs or improve margin
  - 19%
- Highlighted tax upsides to purchasers
  - 21%
- Prepared vendor due diligence reports
  - 14%
- Enhanced revenue (e.g., product improvement or distribution expansion)
  - 14%
- Developed value creation road map (initiatives that potential buyers could implement)
  - 11%
- Extracted working capital
  - 11%
- Presented the synergy opportunity for each likely buyer
  - 10%

“For the unit that was considered for sale, we always maintained the balance in our operations between continuing to create value and preparing for the sale. We started well in advance so we could look into details before completing the transaction. This allowed us to determine the right value, enhance that value to suit buyers’ requirements and make sure regulatory and compliance aspects were intact. We also kept our operations very transparent, which enabled the buyer to apply their strategies without having to face integration challenges and delays.”

Executive at a US-based financial services company
Once you have divested, how can you develop a flexible operating model that enables your remaining company to move businesses in and out more quickly, efficiently and cost-effectively in the new digital economy? Leading companies are creating greater optionality in a world of frequent portfolio turnover and disruption.

**Take a holistic approach – align investment team and operational management goals**

Most companies (66%) say they plan to formalize the responsibility and communication between the investment (M&A) and operational roles. This step is critical because their key performance indicators (KPIs) are often different and conflicting. For example, the relevant M&A KPI may be to achieve maximum value. However, if an asset sale, in isolation, removes scale and therefore utilization from a production facility, this could adversely affect an operational KPI based on capacity utilization or return on assets employed.

In addition to normalizing operational KPIs for M&A, companies can consider these key ways to accomplish a more holistic, rounded approach to goal-setting:

- Communicate the M&A strategy in detail and involve operations teams in the strategic thinking around operational footprint before launching a divestment process.
Instead of thinking about a divestment as a single event, factor in broader thinking about how the operational footprint will develop over time – consider structuring the sale as an enabler of a broader facility-consolidating plan.

Rather than regarding a divestment as an immediate separation, consider whether a softer approach, such as a longer-term manufacturing agreement, can ease the impact of the separation for both buyer and seller.

Set a mixture of operational and M&A-driven KPIs, including dynamic KPIs specifically linked to the impacts of the separation.

Refine the future operating model to increase business agility and reduce divestment cost and time.

Reassess your operating model to become lean and agile

You should not be doing what you don’t want to do. In disrupted markets, a company may want to consider a fundamental rethink of its operating model. Companies should consider selling what’s non-core (e.g., infrastructure and other back-office assets) and focus on what truly drives growth. This could start anywhere, from outsourcing particular administration functions right up to reimagining the business with everything outsourced. The fundamental premise is to make the cost base as flexible and variable as possible by separating the business model from a fixed cost base.

In addition to replacing some contracts with cloud providers, outsourcing routine business processes and commodity IT services, creating a mobile workforce is an emerging trend that enables a new way of working. Companies are considering what intellectual capital is critical to maintain in-house versus what could be outsourced, especially back-office functions that have enormous benefits of scale.

Only 25% of companies are planning to outsource back-office functions to focus on the core business activities that drive growth. There is clearly room for improvement here. We see large companies, in particular, starting to commission carve-out offices from third-party service providers. These offices serve as a transition point between the seller and the new owner of a divested asset. The carve-out office assumes all back-office functions and can mitigate or completely avoid stranded costs at the seller while also making it much quicker for the new owner to assume responsibility. This not only increases efficiency but can also reduce the time between sign and close.

Questions companies need to answer to develop a tailored operating model strategy

- Are portfolio and divestment decisions affected by concerns about lost capacity?
- Which functions are critical for the business to "own"? Which add to the intellectual capital of the business?
- Is the current supply chain still the optimal way to get products to market?
- Does the operational and employee footprint mesh accurately into the markets in which the business competes?
- Could an alternative transaction structure (e.g., partnership, JV) make exiting a business less painful and potentially add more value?
Invest in emerging technology platforms and innovative companies

Just under half of executives (49%) say they plan to invest in more agile technology platforms (e.g., pay-per-use, cloud infrastructure) to enable a quicker increase or decrease of capacity. In light of recent technology advances, this percentage should be higher.

To increase competitive advantage, companies must take advantage of new ways to reduce costs and enable growth. Particularly as companies consider divestments, some technologies can greatly reduce stranded costs and the need to right-size the business post-sale. For example:

- **Robotics**: automation of manual, rules-driven tasks (e.g., financial reporting, processes of order to cash, payments)
- **Artificial intelligence**: self-learning technologies that provide deeper insights across organizational and customer behavior as they acquire additional data
- **Software as a service (SaaS) and cloud infrastructure**: capacity enablers that scale up or down quickly based on usage, enabling easier separation and lowering fixed costs
- **Digital supply chain and Internet of Things**: tools that help companies track goods, inventory and quality of assets within the supply chain to increase efficiency

How companies can benefit from SaaS

A global consumer food manufacturing company implemented various SaaS solutions across its organization. The result was that the company increased efficiencies and agility across the back office, such as human resources and commercial functions, to better meet the needs of the business. SaaS is an alternative to the standard software installation in the business environment where a user has to build the server, install the applications and configure it. Using SaaS, the company does not pay for the software itself. Instead, it works like a rental – the company incurs lower costs, it requires less maintenance, and the company easily scales capacity up and down.

49% of companies plan to invest in agile technology platforms.
Conclusion

If you’re reading this study – or you’re just trying to stay competitive in 2017 – chances are you’re considering a divestment. So what should you do about it, based on the data in our study? Let’s recap our four questions.

Are you divesting based on strategic reasons or disruptive forces?
In the face of both market disruption and impatient shareholders, the best approach is to review your portfolio more frequently and use analytics to make more effective, quick decisions. But companies also need to take the time to prepare a business for sale – or the likelihood of failure increases.

How should you take action in disrupted markets?
It’s never been more true: thinking like a buyer is critical to divestment success. Sale preparation is vital, even for the best-performing unit. And especially in disrupted industries, flexibility around the deal perimeter and structure can be the ultimate path to success.

Do you know what will change your valuation tomorrow?
Perhaps the most value-damaging action a company can take is holding on to an asset too long. Understanding your performance, opportunity and perception gaps through rigorous portfolio reviews is the best protection against value erosion. These reviews should be fortified through descriptive, predictive and prescriptive analytics.

How can you improve the agility of your remaining business in the new digital economy?
Even after a successful divestment, disrupted markets provide significant opportunities and risks for enhancing the value of the remaining business. It is essential to optimize the remaining company’s operating model and invest in agile technology platforms to make it easier to transact going forward.

How EY can help
EY’s dedicated, multifunctional divestment professionals can help you improve portfolio management, divestment strategy and execution.

Using advanced analytics, we first help you understand your business performance compared to that of your peers and the rest of the portfolio, including assessing the quality of information and developing more reliable data for the evaluation process. We then help you decide where capital can be released from underperforming or non-core activities and reallocated toward higher-growth areas and digital innovation.

Next, we work with you to prepare for a divestment and become an informed negotiator. Our work with corporate and private equity clients includes a variety of divestments, including sales of the entire company, carve-outs, spin-offs and JVs.

For carve-outs in particular, we advise on which businesses are worth investing in and which may be worth more to another owner. Our sector-focused teams can also help you understand the effect a divestment could have on your remaining company’s growth, brand and stakeholders. Further, we can help maximize transaction value by guiding you through preparation and execution and removing any potential bumps in the road before buyers get involved. For example, we can help create a compelling value story by analyzing the growth opportunity; assessing underlying trends; and identifying hidden value in earnings, corporate allocations, real estate, working capital, human resources, IT, operations and tax.

Finally, we assist with negotiations, Day One readiness and managing your remaining cost structure so you can focus on future growth.
About this study

The EY Global Corporate Divestment Study focuses on how companies should approach portfolio strategy, improve divestment execution and future-proof their remaining business amid massive market disruptions. The 2017 study results are based on more than 900 interviews with corporate executives, including 182 financial services executives, between October and December 2016 conducted by FT Remark, the research and publishing arm of the Financial Times Group.

- Executives are from companies across the Americas, Asia-Pacific, Europe, the Middle East and Africa.
- CEOs, CFOs or other C-suite-level executives make up 78% of executives surveyed.
- Executives have knowledge of or direct hands-on experience with their company's portfolio review process and have been involved in at least one major divestment in the last three years.
- While nine industry sectors are represented, the study primarily focuses on consumer products, financial services, life sciences and technology.
- About a one-fourth of corporate executives represent companies with annual revenues of US$1b–US$5b, and 42% represent companies with revenues that exceed US$5b.

Read our sector-specific Global Corporate Divestment Study reports ey.com/divest

- Consumer products
- Financial services
- Life sciences
- Private equity
- Technology

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