



DIVESTITURES: Value Capture Through IT Disentanglement

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Divestitures are an integral part of the organizational strategy for value creation; however, the very word divestment conveys a meaning opposite to “investment” giving it a negative connotation.

About one third of the M&A transactions executed today has a component of divestitures, yet they never emerge from the shadow of Acquisition literature; finding a chapter or a paragraph amongst the integration discipline. M&A and Divestitures are not symmetric opposites of each other as commonly perceived, but come with a unique set of challenges and require slightly different skills than integration. There could be several reasons for divesting an entity, a few of the major reasons are highlighted in the text box below.

In today’s economy, business processes are largely enabled by Information Technology, there is immense data sharing between business units and functional departments within a company. Years of this coupling creates complex problems while divesting a part of the business.

Improper understanding of IT issues, treating it as an operational aspect and de-prioritizing IT decisions could lead to business process breakdowns in both entities. Divestitures bring several challenges to the Information Technology teams that are tasked to play their part in spinning off infrastructure, applications and data into the divested entity. There are several challenges

Divestiture is the release of assets in order to create value. Divestitures can be classified as spin-offs, carve outs, liquidations or entity sell outs.

related to divestitures overall that can affect IT and some of these are mentioned in Table 1 below.

This article discusses the high level objectives of IT during a divestiture, a framework for disentanglement of IT assets, the execution plan for the divestiture and the best practices for such projects based on the authors’ experience in multiple divestiture environments.

DRIVERS FOR DIVESTITURES

STRATEGIC FIT: *Organizations might have portfolios of business which are no longer a strategic fit based on renewed business direction. Organizations will look to divest portfolios in such situation to focus on core competencies.*

RAISING CAPITAL: *Divestiture could help organizations raise capital that could help invest in more strategic projects or to reduce leverage. The divested entity is at times more valuable as a standalone than being integrated into a larger business.*

UNDER-PERFORMING ASSETS: *Organizations could have portfolios of under-performing assets which need to be divested before it impact overall profitability of the organization.*

REGULATORY: *State mandates divestiture to address monopoly or anti-trust concerns as part of M&As. Regulations such as Sarbanes Oxley forced the big 4 accounting firms to divest their consulting business in the early part of the century.*

PSYCHOLOGICAL	<ul style="list-style-type: none"> ▪ Employee & customer uncertainty ▪ Time between decision to divest and actual closure ▪ Resource Constraints
ECONOMIC	<ul style="list-style-type: none"> ▪ Adequate funding and budget ▪ Diminished economies of scale could increase costs. ▪ Operational Complexity / Cost-Benefit ▪ Speed versus Risk decisions
LEGAL	<ul style="list-style-type: none"> ▪ Maintaining compliance with existing legal and regulatory landscape ▪ Aligning with any new regulatory requirements ▪ Contract management with parent entity, suppliers and other third parties
TECHNOLOGICAL	<ul style="list-style-type: none"> ▪ Disentanglement of Data ▪ Disparate and Non-standard systems (applications & infrastructure) ▪ Breaking up licenses and instances ▪ Challenges with data

TABLE 1: CHALLENGES DURING DIVESTITURES

THE BIG PICTURE

The business architecture of an organization hinges around 4 pillars as shown in Figure 1. The four pillars are the customer segment served by the entity, the most profitable components in the value chain or profit pools, the strategic control points and lastly scope of products and services.

The Business Architecture for the entity being created must be agreed upon upfront. The IT strategy should be aligned to the business architecture and a supporting operating model must be agreed upon. This operating model is the end state for IT assets that includes infrastructure, applications and data.

This will help understand the level of entanglement of IT assets as well as IT needs for the parent entity if the business architecture changes after the divestiture.

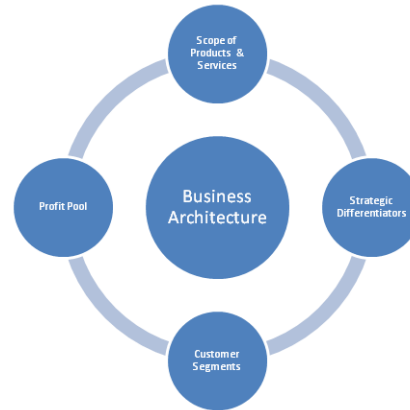


FIGURE 1: BUSINESS ARCHITECTURE

The operating model of an entity can be defined as the crossover between the levels of standardization versus integration of IT within that organization. Based on Figure 2, we could have an organization follow any one of the four scenarios as a model or in a hybrid state trying to transition between models. Either way one needs to capture an accurate snapshot of where the parent entity is today, assess the level of entanglement with the divested entity and arrive at the IT operating model for the divested entity which will determine the end state of IT.

Building the right disentanglement strategy and IT divestiture plan depends on a number of variables like complexity and size of parent organization,

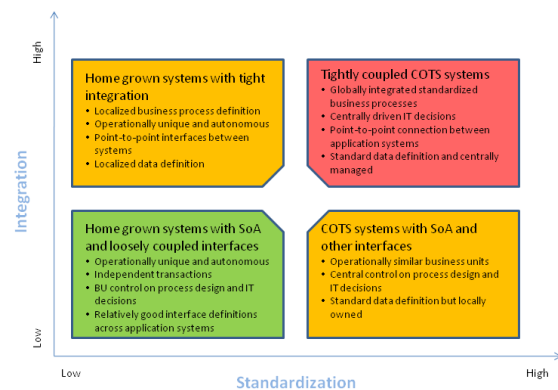


FIGURE 2: LEVEL OF ENTANGLEMENT

Adapted from the Operating Model concept introduced by Sloan Research in 2005; the concept was reused in the book "Enterprise Architecture as Strategy" by Jeanne Ross, Peter Weill & David Robertson.

age of IT systems, type of systems (standard/ COTS), level of customization and custom developed home-grown applications.

A common scenario is the existence of point-to-point interfaces in early ERP implementations, causing very tight coupling with shared services systems like HR, Email, and Finance etc. Such scenarios require high levels of planning, time and resources else they could lead to value erosion. It is not uncommon to embark on a re-architecture project in order to execute a divestiture in such scenarios.

More recent COTS implementations could have standard business processes with more flexible interface architecture, leading to lesser amount of complexities than the above scenario. These tend to pose a moderate level of entanglement and can disentangle with careful planning and execution.

Certain organizations could have custom built or home grown applications residing within their Business Units. In such cases it is likely that the business processes are also local to the Unit and appear to be autonomous. The disentanglement of these systems could be moderate depending on their integration with other interfacing systems.

Organizations with modular IT architecture and SoA like systems would be less complex to divest. These could be easily replaced or integrated with other systems based on the nature of the divestiture (spin off vs. sell out). Depending on the size and type of divesting entity, one or more of these scenarios could arise, accurately understanding the current IT operating model and deducing the same for the new entity is a crucial exercise to be undertaken during planning.

During the planning exercise, it is important to consider a business process view rather than a pure IT asset view, in the end IT assets enable the business processes and turn the business architecture of an organization into its competitive advantage.

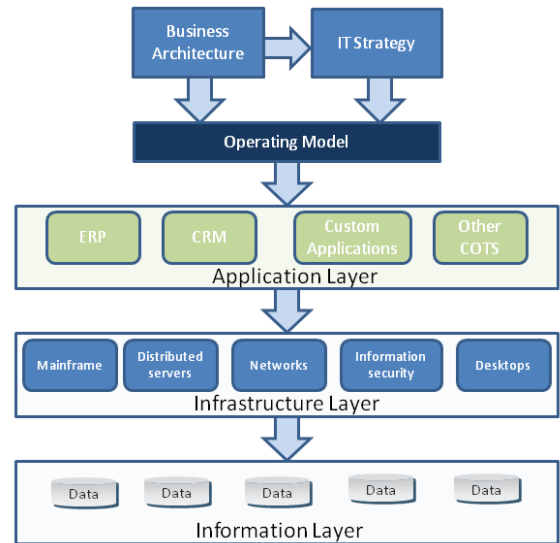


FIGURE 3: INFORMATION ARCHITECTURE LAYERS

BASICS OF DISENTANGLEMENT

Depending on the business architecture, the IT operating model and how long the two businesses have been together, their IT systems could have several interdependencies. Some of these interdependencies will not be scripted or documented and hence in the divestiture world referred to as “entangled”.

The entanglement could exist due to the operating model, integrated bundled products and services leading to integrated R&D systems, production systems, and CRM systems or even percolate to back office sharing.

The disentanglement process is about indentifying all such points of interdependency , document their impact , design alternative scenarios, balance tradeoffs on cost versus risk, implement these alternatives while establishing a controlled termination with the divesting organization.

Planning teams need to take a business process view and delve all the way through various IT layers

IDENTIFY POINTS OF ENTANGLEMENT

In order to preserve the strategic control for both entities, the identification of points of entanglement should be undertaken as soon as the decision to divest is made. Business Unit Personnel, the IT function, application and data owners should be engaged upfront. A cross functional group should be assigned to conduct a due diligence and gather information about areas of interdependence and impact before building a disentanglement plan. The Due Diligence team should document each of these points of entanglement and assign priorities to each which should be in line with the IT operating model of the divested entity (the end state).

In addition, there are several areas where one can look for information used for disentanglement. Start with each of the functions and categorize them as dedicated or interdependent with respect to the new entity.

Another source is the income statement. The income statement analysis should start with revenues and working through sales, cost of sales, GAA and account for major categories of income and revenue flowing. This information should be matched with the needs of the divested entity in terms of products, skills, people, assets, business processes, operational functions and third party costs.

In some organizations internal control data, intercompany services SLAs or the previous M&A integration history of the parent or divested entity would also have information that can aid the disentanglement.

FORMULATE DISENTANGLEMENT STRATEGY

In many scenarios, we find that the business processes to be divested do reside in the entity itself and hence referred as dedicated functions, an example being CRM systems or timesheet reporting, etc.. The interdependent function would be common assets such as datacenters, HR, etc,

and disturbing interdependent assets could mean increase in costs for the divesting entity due to disruption in economies of scale.

At times the disentanglement can be complex due to the divesting entity being dependent on certain functions of the divested entity and might need a soft termination to avoid business disruption. A bi-directional disentanglement review is critical for normal functioning of both entities.

An enterprise wide view of all IT assets must be documented. This could range from datacenters, technology IP or patents and if any of the divested company's assets use them. If they do, then one will need to identify everyone who uses that IP, the owner of that IP, the terms or cost of future usage or if that IP comes from a third party then the contractual obligations to use these in the divested entity.

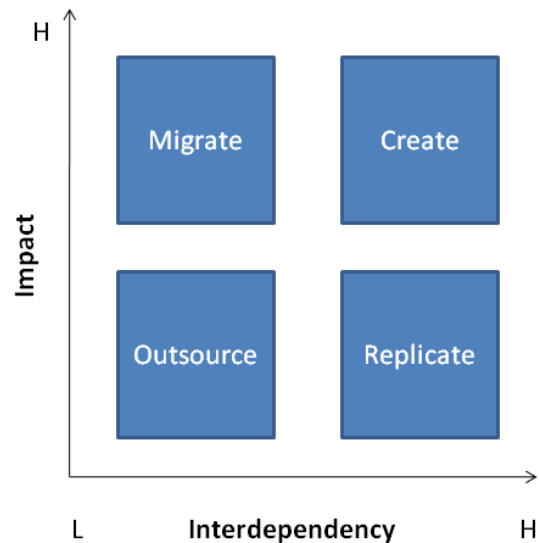


FIGURE 4: DISENTANGLEMENT STRATEGIES

We recommend using a framework and formulate the disentanglement strategy. One such framework is mentioned in Figure 4 that the authors have successfully built and used in different divestiture scenarios.

The areas that have high interdependence as well as high impact on the business have to be created

as standalone capabilities for the new entity and one needs to move rather quickly to create or develop this in the interest of time.

The processes and assets that have high interdependence but low impact would need to be executed in a combination of external procurement and internal replication at a moderate time frame.

The processes and assets that have low interdependence and low business impact would be lower on priority and speed; consider outsourcing these functions to third parties when appropriate or if there is acquirer with the capability this could be transitioned into their organization.

The processes with high impact and low interdependence should be migrated to the new entity to minimize disruption to business. These processes would be able to provide the initial stability in the new entity and could be moved without disruption.

ALIGNMENT WITH BUSINESS ARCHITECTURE

After the business architecture and IT operating model is established for the new entity, one needs to understand what IT assets support them. The key alignment will also determine the mix between standalone capabilities and the ones with dependency on the buyer or perhaps even other third parties.

Lastly this will determine what hardware, software and IT assets are critical, which of those could be a competitive advantage and what platforms would be necessary to operate the new entity.

VALIDATE TRADEOFFS

It is important to look at all scenarios when we start validating tradeoffs, typical areas that are scrutinized are investments, risk, resources, capabilities and people. All these must have direct costs or opportunity associated with them.

All onetime costs need to be captured at the earliest and each item should be validated for the ongoing operational costs in order to arrive at a proper disentanglement solution that will minimize business disruption, protect competitive advantage and optimize costs.

Breaking up instances, additional licensing and asset dilution like datacenters, etc, can have serious cost implications for both entities and hence one evaluates tradeoffs seriously.

DESIGN ALTERNATE SCENARIOS

Once the tradeoff on risk, cost, speed and resources are evaluated, alternate scenarios would emerge. For example, if the shared services set up from the divesting entity can be transitioned to the acquirer but their cost of operations are higher, and then consider outsourcing the shared services to third parties that can help deliver the same service either more efficiently or at a lower cost.

DEFINING TERMINATION

Once the desired end state is established, each process and asset must have a termination defined; each of the divested process could have different sorts of termination depending on several factors. IT and business teams should align on expectations for business processes on day 1, day 30 and day 100.

The parent could be managing a single and consolidated corporate email and could have a security policy requiring immediate severance of all physical and logical connections after closing. This could result in total termination immediately after closing.

In the event there is an acquirer (financial buyer) who does not have operational or back office capacity to take over some of the functions, then the parent could contractually provide some of the basics for a finite period of time while the business develops its own capability.

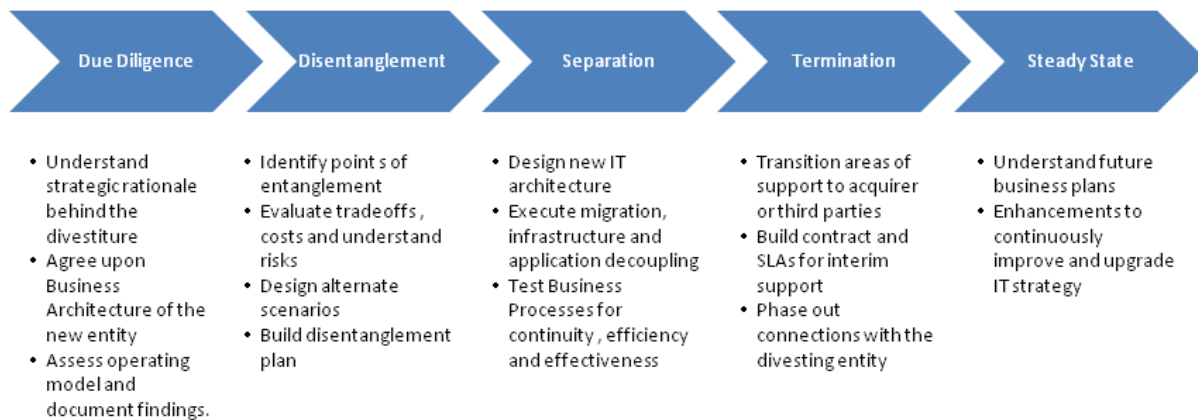


FIGURE 5: PHASES OF AN IT DIVESTITURE

ANATOMY OF AN IT DIVESTITURE

The IT divestiture process is a 5 step process approached in a phased manner.

- Due Diligence
- Disentanglement
- Separation
- Termination
- Steady State

Figure 5, above describes the process of moving the IT assets during the divestiture process and defines the cycle of the role of IT right from the due diligence through moving the new entity into steady state.

Every phase might not come across as distinct and unique in every divestiture, there could be significant overlaps between the phases. The more the level of entanglement, the more the steps in each phase and in some cases an organization could execute more than one phase in parallel rather than in absolute sequence.

One phase could be of a higher priority to one organization than another; it is important to recognize that this is all relative and will change depending on the type of divestiture, the size of the deal, the time on hand, the extent of entanglement, the terms of termination and even the industry or sector of the companies.

DUE DILIGENCE

The process of due diligence begins as soon as the decision to divest has been arrived at, this is very different from traditional forms of financial and legal due diligence.

The Business Architecture and IT operating model will drive the required assets, processes and governance needed in order to support that architecture of the divested entity. Depending on what functions or business processes will need to stand alone in the new entity, the IT architecture would need to be formulated.

A due diligence must be done to uncover the documented as well as undocumented aspects of interdependence of IT systems, personnel, applications and data. A fatal mistake that one often witnesses is the business owners and application owners make the key decisions and involve IT much later in the cycle.

It is crucial for all stakeholders (IT, business process owners, application teams and data owners) to come together and understand the

A disentanglement framework is critical in defining the method and duration of termination

level of commitment to execute the overall project.

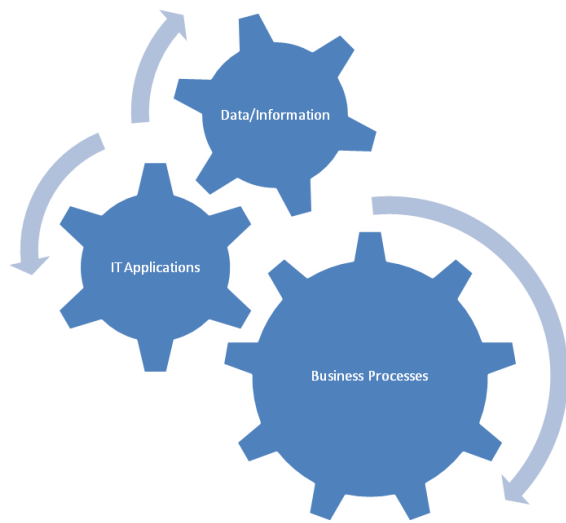


FIGURE 6: INTERDEPENDENCY ECOSYSTEM

This is also a heavy cross functional and coordinated effort; for example business processes, IT and data are so tightly aligned that one needs to take a unified view to avoid any pitfalls and breakdowns.

DISENTANGLEMENT

We have covered the basics of disentanglement in the section above which speaks about a general framework on disentangling.

In this section, we shall look at specific areas such as networks, hardware, software and data. Functional areas such as HR, Production and Billing are usually not regarded as a part of IT, but bear in mind that they are very much IT enabled and the business processes might actually reside on IT applications which are housed on IT infrastructure.

ASSET MANAGEMENT & TRACKING

For the purposes of the disentanglement process, we will consider hardware, software, IP as well as data as “assets” as opposed to tangibles that are usually classified as assets. Each of these has their

own extent, speed, level of transition and termination that needs to be documented.

HARDWARE

Categorize processes and assets that need to be created, migrated, procured or outsourced after the disentanglement strategy is finalized. Asset transfer needs to be in accordance with local laws and regulations of transfer and it is recommended to involve the right legal expert during this exercise. All assets need to be marked, their impact and alternatives be documented and signed off by the appropriate operational and functional groups.

All transferred hardware assets need to meet parent company’s security policy regarding data disposal prior to transfer. Full disk sanitization is a good practice to purge data which is not part of the divestiture from hardware prior to transferring the asset.

INTELLECTUAL PROPERTY & DATA

Intellectual property can include R&D data, Design, Manufacturing or shared practice depending on the industry. In order to protect IP, one needs to use appropriate controlling technologies and tools to maintain the confidentiality and integrity of the data. This is done in consultation with the information security teams.

Tracking data is very important throughout this exercise and adhering to the policies of extraction, controlling, transfer and destruction while documenting any exceptions is very important. The information security, internal audit and legal counsel should be aware of all exceptions and documentation should be provided to them.

SOFTWARE

Movement of software has a different set of considerations. The breaking up of instances or duplicating should be considered only after the issue of “bridge licensing” has been discussed with

vendors. Bridge licensing refers to use of the divesting entity's licenses to the divested entity for a finite period until they have procured their own.

The bridge licensing can be negotiated anywhere between 90 to 365 days helping the new entity reduce initial set up costs. Controls to track usage and expiration should be put in place to monitor any transgressions and exceptions.

Use auto discovery and manual polling of all functions to inventory all existing software. The e-discovery tools do help save time but results are at times cumbersome to decipher and go through, hence both activities need to be done in parallel. Home grown applications should have a review process done by developers and support teams and risk of IP exposure, support contracts, licensing terms, usage terms etc, should be clearly articulated.

SEPARATION

Separating out the networks itself is a good practice to begin with as one has to undertake physical and logical separation. Create new domains at each location behind the segregated networks. This makes it much easier to control disk allocations and enforce group permissions in a more structured manner.

Deploy dedicated licensing servers after the bridge licensing is negotiated, so that issues related to this do not come up at a later stage. Create parallel infrastructure and migrate applications and products in a phased manner and should primarily be driven by business processes rather than functional silos.

End users should be given guidelines to manage their own data using USB flash drives or other portable medium thus reducing data migration costs. Shared data and enterprise level content onto the dedicated servers before divestiture occurs, this can make migration efficient and also eliminate issues around external bandwidth, etc.,

A single owner with access rights to both the old and new company networks should manage the migration. Remember the key is to not take an asset by asset view or divest functional silos, just focus on keeping the business up and running.

TERMINATION

Clean and timely termination is vital for capturing the full value of the divestiture. Clear milestones need to be developed and progress against those need to be tracked. For example, on Day 1, having basic services transitioned like email, helpdesk, etc, and on Day 100 all more complex business processes like procurement, recruitment, etc, can be accomplished.

Improper execution of this phase could prolong the completion and add unforeseen costs for both entities. Inability to identify method and timeline of separation can lead to unwarranted delays and cost surges.

Process related support such as Payroll, Helpdesk, Command Center, etc, whether it is transitioned to a separate new entity, augmented to an existing entity or outsourced need to be transitioned with adequate overlap and testing. Business Continuity Plan need to be strictly adhered to ensure that

TERMINATION ISSUES INCREASE COSTS

A particular divestiture that I was witness to had identified some firewall and data issues during termination that impeded the network separation. This caused the divesting entity to support the divested entity for 5 extra months than planned by supplying hardware, software and connectivity adding to 30% higher costs than planned.

there is minimal or no interruption to business. Technology related transitions for applications and infrastructure need to be tested together with business team of new entity and sign-off to be obtained from relevant authorities. Any deviations in plan identified at this stage need to be brought to divestiture finance & operations team's notice.

For areas where continued support is required from divested entity, SLAs should be planned for the specific durations and need to be transitioned to the relevant teams.

STEADY STATE

Day 1 and Day 100 are two important milestones which are part of the steady state. Day 1 signifies the end state, defined during the Due Diligence. Day 100 is a milestone by when the new entities would have completed one quarter and financial reports would have been published by then. IT metrics should be aligned with the strategic business goals during steady state.

IT BEST PRACTICES DURING DIVESTITURES

- Understand the business architecture and current operating model of the current entity and finalize the same for the divested entity, in order to determine the end state of systems.
- Clearly lay down Day 1, Day 30 and Day 100 milestones, define IT organization metrics and have a senior executive lead the team.
- Conduct a comprehensive due diligence and document interdependencies and impact on business processes for both entities.
- The IT divestiture team must involve cross functional input from all impacted entities from both organizations led by a dedicated leader with ready access to senior management.
- Identify impacted members of both divesting & divested entities and communicate regularly through periodic town-hall meetings and emails.
- Define the process and changes pre-divestiture, during carve-out, on Day 1 and beyond. Set-up a

temporary help-desk during transition in order to enhance stabilization.

- Have an IT Risk Management plan in place that focuses on the 4 As (Access, Accuracy, Availability & Agility) of information risk.
- Use a good disentanglement framework and use it in tandem with other sources such as income statement, previous M&A history and so on.
- Clearly classify IT assets to be created, procured, migrated and outsourced and assign priorities.
- Get legal counsel involved while addressing issues pertaining to IP, patents, licensing and legal requirements.
- Transition Service Agreements to be defined and agreed for process areas where continued support is required from divested entity.
- The financial plan should factor in onetime costs, ongoing costs, opportunity costs and hidden costs that arise from issues like disruption of economies of scale.

CONCLUDING THOUGHTS

Every divestiture has a different rationale for divestment, a different level of entanglement, disparate technologies and the method of execution might vary depending on several factors including the kind of implementation and age if IT systems.

The key lies in keeping a close alignment between; the Business Architecture, the IT operating model, the disentanglement framework and the execution plan.

IT teams must be involved right from the decision to divest and stay involved through the final termination.

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