

## **The Deal**

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### **DIVESTITURE: MANAGING MANAGEMENT AND COMMUNICATIONS**

**Part two of our series on how a corporate M&A team can lay the groundwork for the successful sale of a business unit or division.**

**by David G. Monderer**

There's a bull market in divestitures these days. Major companies such as General Electric Co., Del Monte Foods Co. and Unilever Group have well-known business units on the block, and many lower-profile sales are in the works as well.

Unfortunately, not all of these transactions will go as smoothly as they could. Experienced divestors know there are a thousand and one things a corporate M&A team must do to lay the groundwork for a successful sale. But other sellers, newer to divesting, may be less aware of the extensive preparation needed. Some may even suffer from a little overconfidence based on their experience as buyers -- when, in fact, a buyer only enters a divestiture midway through the process, after much of the preparation has been done.

That's the reason for this two-part primer on preparing for a divestiture, of which this is the second installment. The goal isn't to explain how to produce an offering book, how to contact buyers or how to handle other important but more obvious steps. The subject at hand is basic readiness -- the long list of issues a divestor must face in the months before potential buyers are even contacted. In Part 1 (Corporate Dealmaker, Spring 2008) we looked at timing, use of investment bankers, the details of a carve-out, employee concerns and preparation for due diligence. This time we focus on two overarching concerns that affect the entire process: how the M&A team should deal with management at both the corporate and business-unit levels and the equally sensitive topic of communication about the sale.

Let's start with corporate management. It is the responsibility of the M&A team to give top executives a realistic understanding of the timing and process, starting with an understanding of the many unknown items at this stage of the process. You can only guess at how much interest you'll receive, who the possible buyers will be and whether you'll find any problems (or even showstoppers) when getting ready for due diligence.

Management will also ask about the likely selling price, and here too you'll need to explain the inherent uncertainties. Good comparables for a unit of the company may be hard to find. There's no data available on the many units sold through private sales, and there may not be any good public company comparables to use, especially if your unit is relatively small.

Be careful as well about understating the time required to get to closing. Collecting the due

diligence information and deciding what you are actually selling can take months. These activities will require a considerable amount of time on the part of people who have day jobs to do. Senior management must make it clear that this is a high-priority project and help supply the resources necessary to do the job.

Top managers may also need to be told that, contrary to their hopes, the closing date of the sale will not necessarily mark the end of the company's involvement with an unwanted or failing business. Issues concerning the divested unit can continue for years, depending on the liabilities retained and representations and warranties provided to the buyer. I have seen examples of lawsuits retained by a seller who needed to defend the suits for many years, consuming management time and costing a great deal in legal fees. Though some buyers will acquire a business with no representations or warranties, something that gives them a distinct advantage when bidding, most will not. The seller must aggressively negotiate for minimal reps and warranties to prevent troublesome and possibly long-term involvement after the sale.

Working with the unit managers and key employees of the business unit presents a different set of issues. These are the people being divested, but they are also the people you need to help sell the business. They are conflicted from the day they are told of the divestiture right through to closing. And you will never know for sure to whom they are giving their allegiance, the seller or the prospective buyer. There will inevitably be a shift of allegiance at some point in the process, whether subtle or direct, and you need to be able to manage the impact it will have.

Telling unit management that the business will be sold is a major step. When you reveal the decision, you immediately make the managers nervous about their job security. Will they go with the business? Will they keep their jobs long term? To whom will they report? Who will be the buyer? What about their accrued benefits? What about future benefits? If they have a defined benefit plan, what will happen to their pension? The pension question is particularly important to someone who may narrowly miss achieving an important milestone because of a sale. The better managers can address many of their concerns by avoiding the sale altogether and quickly moving to another company, which can be devastating to your sale prospects.

It is critical, therefore, to have a performance-based retention plan ready for key managers before you tell them about the sale. The demands you'll be placing on them are huge: They'll have to maintain the health of the business while at the same time assisting with the sale process. Time-based retention payments may also be necessary for certain key employees whose sudden departure could alter a buyer's willingness to continue in the process.

If the business you're selling is a failing one, you must decide whether existing management should stay involved during the sale process. How will the buyers view this management team, since they were the ones who created the problems, or at any rate failed to fix them? Are these managers able to keep things together during the sale?

It may be best to replace the existing management with temporary managers who can run the operation during the sale and then turn it over to the buyer's management team. If the buyer is already in the business, this may be a good approach. But a buyer who is new to the business may actually see the incumbent management as a group that can execute a turnaround after separation and regard inexperienced replacement management as a negative. It's a delicate issue,

and careful consideration is a must.

Often, when a unit's managers learn that the company wants to sell the business they're running, they express a desire to be the buyer. My recommendation to sellers is: Just say no. Allowing for a management buyout in the midst of a sale process will become the ultimate conflict for unit management. You need management to put the best face on the business, regardless of its financial state, and to talk about the great opportunities that lie ahead for the business, whether or not previous management was successful with the concepts.

If management feels they have the opportunity to acquire the business, will they really be in a sales mode with other potential buyers? Additionally, unit management is the most inexperienced of all potential buyers. They may understand the business, including all its faults, but they are ill prepared to operate a standalone business unless the unit is already a wholly owned subsidiary. And in any case, they will lack the financial means to pull off the transaction and will need to spend significant time finding financial backing and knowledgeable acquisition experts. This activity will be a huge distraction to their two primary functions: running the business and assisting you with the sales process.

Finally, if you do allow management to pursue the sale for themselves and it ultimately fails, either through their inability to obtain backers or as a result of not reaching a final agreement on price or terms, they will at best be discouraged and demoralized and at worst antagonistic with the selling company management. Therefore it is best to have an established policy that you do not allow management buyouts and immediately state this policy when the question arises. This will quickly end the discussion and focus management on what needs to be done to make a sale and procure their future.

As noted, key managers will, at some point in the sales process, transfer their allegiance to the buyer. This often happens once the agreements are signed but can even happen early in the process, when the managers develop a favorite buyer. It may be necessary to install temporary managers in the unit to guard against decisions that are detrimental to the seller or to place new guidelines and policies on the unit. The corporate M&A staff, if closely involved, can help spot these kinds of issues as they arise.

A critical decision you will make is whether to publicly announce your desire to sell the business. For very large divestitures, it may be impossible to keep them secret for a long period of time. So it would be better to make the announcement before the rumor mill forces you to respond. But waiting as long as possible and until you are ready to entertain prospective buyers will shorten the time the public is aware of the sale. Making a public announcement may preclude the problems that come with trying to keep the process secret but introduces a host of other issues. The sale process will last for many months, and a public announcement will mean disruption to the business until an agreement is reached and announced. Suppliers may look to change terms of supply. Competitors will use the time to create doubt in the minds of customers, who may in turn delay purchases or buy from the competitors because they are uncertain about future support.

You will have a nervous workforce throughout the process, and you won't have anything to report to them or to the public until you have reached agreement on a sale, likely many months

after first announcing. If your company is public, stockholders may initially see the sale as a positive but then grow weary of waiting for news. And if you decide not to sell at some point, you will have a lot of explaining to do. Even if you decide against a public announcement, the unit's management may wish to announce the sale process to the employee base. It's not unusual for managers to want to "level" with employees and to argue that the process will be easier to run if there's open communication about it.

However, a limited announcement to employees is also a slippery slope. Telling all the employees is sure to make everyone nervous, and productivity will decline as the sale dominates every conversation. The best performers will begin to seek other jobs, inside or outside the company. Employees will also expect frequent updates and will not be satisfied with silence during the many months before the signing of agreements.

And can you really keep a process secret from the public if you tell a large block of employees? The word will leak out, and you will have the same problems as if you made a public announcement, although now it will have been tacitly announced in an unmanaged way. It is best to limit disclosure to as few people as possible and to have standby statements at the corporate level for handling any rumors or questions that arise.

But note that secrecy brings its own complications. For example, plant tours must be handled in a way not to raise suspicion. If people in suits are never seen on the shop floor, don't start suddenly parading groups of buyers in suits through the production facilities. Management presentations can be given in other locations, and due diligence rooms can be housed in lawyers' offices. Even buyers wearing logo'd clothing during tours or the way people sign log-in sheets can raise unwanted suspicion.

When you are finally ready to announce the sale, you may want to do so first to your key constituents. After all, you wouldn't want your best and largest customer to read about it in the newspaper. For private companies, this generally isn't a problem. Employees, customers and suppliers can be addressed in a method that makes the most sense. However, if either the seller or buyer is a public company or the transfer of the unit is a material event for either party, you will need a coordinated and well-planned approach to inform each party at the same time the public is informed. This will give the news to that best customer without risking an insider-trading issue.

There are countless opportunities during the divestiture process for disruption and unexpected occurrences. Management will be distracted from its primary role of running the business. Rumors may create speculation among employees, suppliers, customers and competitors. Business may deteriorate right up to the closing of the sale. Falling revenue and/or increasing costs can have a severe impact on the interest of potential buyers or the price they are willing to pay. A deteriorating business, especially late in negotiations, can be catastrophic, since you will have limited choices at that point and the buyer will gain significant leverage.

The solution is for company management to pay extra attention to the business being divested -- just the opposite of their natural tendency. But instead of giving in to the temptation to just turn the business over to the M&A group and move on with other issues, company leaders must focus on additional monitoring and assistance to unit management. Offering unit managers financial

incentives for keeping performance on plan, or even improving performance, may be necessary and will pay dividends in the form of a smoother negotiation and closing.

These are just some of the many issues you will face in a divestiture. The use of your corporate M&A experts, as well as experienced outside professionals, can help you identify and handle concerns that arise during the lengthy divestiture process. Preparation, as in any major endeavor, is a key to a smooth and successful process. - *David G. Monderer*

*David Monderer retired from Eastman Kodak Co. as corporate vice president and head of the worldwide mergers and acquisitions organization. In this capacity, he was responsible for the completion of approximately 200 M&A transactions totaling more than \$9 billion, of which more than 70 were divestitures. Monderer now works from Fort Myers, Fla., and acts as a consultant to companies doing acquisitions and divestitures. He is also a certified dispute mediator assisting parties with alternative dispute resolution. Monderer is on the Advisory Board of Corporate Dealmaker and can be reached at **[dmonderer@comcast.net](mailto:dmonderer@comcast.net)**.*