



Ensuring B2B and Supply Chain Continuity at Divestiture

Divestiture: A Growth Industry

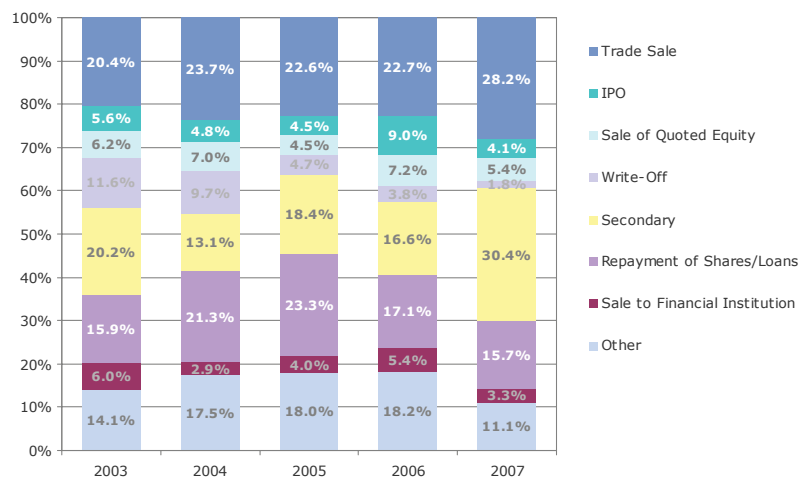
With “growth” and “increasing shareholder value” likely to be on most corporations’ agendas, this focus tends to be on acquiring new businesses rather than shedding those they already own. Divestiture can, however, be a profitable activity: A study by Bain & Company of 7,315 divestitures completed by 742 companies between 1987 and 2007¹ showed that an investment of \$100 in the average company in 1987 would have been worth \$1,000 by 2007. However, the same investment in the “best divestitures” would have yielded \$1,800.

During and after a divestiture, a company should be focused on their core competency, i.e. manufacturing products or providing services for their customers. They should not have to worry about the day to day running of a B2B infrastructure.

Successful divestiture often involves immediate investment of the cash raised in a key acquisition to strengthen core activities or a business re-alignment to re-focus a mature business on new growth opportunities. Divestiture should not be regarded as a quick-fix fire sale to raise much needed capital or to dump problem divisions. The key factor in any disposal is that the business unit or company is no longer core to the parent company’s perceived strategic future plans.

Global figures for divestiture activity are hard to come by, although numbers from the European Private Equity and Venture Capital Association² do give some indication of scale. In Europe in 2007, according to the ECVA, some 2,726 companies were divested, compared with 4,448 companies divested in 2006. (These figures represent annual divestment activity undertaken by private equity and venture capital management companies located in Europe.)

€27 Billion European Divestment (by country of PE firm)



Source: PEREP_Analytics for 2007 figures
Divestments are at cost, not proceeds

Figure 1: Breakdown of annual European divestment at cost by exit route

1. Michael C Mankins, David Harding and Rolf-Magnus Weddigen: “How the best divest”, in Harvard Business Review, October 2008.

2. <http://www.evca.eu/knowledgecenter/statisticsdetail.aspx?id=412>

Divestiture trends vary by country. UK players divested the highest amount with €2 billion (44.4% of the European total) for 1,079 divestments. French private equity houses came second with €5.5 billion (12.9% of the European total) divested, followed by German private equity houses with €9.9 billion (10.7% of the European total). Divestment by sale to another private equity house was the largest exit route by amount (30.4%) in 2007 at €2.2 billion, up from €5.5 billion in 2006, with 412 divestments in 2007 compared with 434 in 2006. Trade sales—when the operation is sold to another company, typically within the same industrial sector—formed the second largest category by amount, increasing slightly to €6.6 billion in 2007 from €5.5 billion in 2006, although this is the most popular exit route by volume (see Figure 1)

A wide range of businesses find themselves candidates for divestiture including: Ford's sale of its premium Land Rover and Jaguar automotive operations to India's Tata Motors, Cadbury Schweppes disposal of its Americas Beverages business to Dr Pepper Snapple Group. Danone's disposal of its biscuit business to Kraft Foods and Raytheon's sale of its commercial aircraft unit to two private equity firms.

And who buys these divested operations? Clearly, according to the ECVA data, private equity operations as well as trade competitors. A small percentage of divestitures are floated off with an initial public offering (IPO) and some will be bought through a management buy out (MBO). Private equity approaches vary too: some are there for the long term, while others expect to turn around an ailing operation within a few years and sell it. No doubt a few are more interested in milking underused assets.

Issues to Consider in Divestiture

There are numerous aspects of divestiture that can impact the success of the future operation and much, obviously, depends on how well integrated the various divisions are to the central organisation prior to separation. Companies with common customer information, integrated ERP systems, historic records, or supply chains clearly face greater challenges than those run completely autonomously while managing their own IT and B2B relationships. In some cases, core IT or supply chain assets may be included in the divestiture. In other cases, the division is literally “cast adrift” and has to rapidly re-invent its basic operational functions.

For all divested operations, business continuity has to be a priority. Typically a year's “phase out” from shared central systems is not unusual, and that is unlikely to be sufficient time to source and implement a new ERP or supply chain system. For companies where supplier accounts are managed centrally, there may be issues over contractual obligations or liabilities, compounded by the inevitability of process and cultural changes that most companies have to manage. Staff who have always worked for the “big organisation” may feel uncomfortable or threatened moving to a more entrepreneurial environment following MBO or private equity investment.

The current economic downturn will continue to see many more high profile companies being divested for the foreseeable future.

Divestitures impact all areas of a company. To ensure smooth transfer of business processes to the divested operation, companies will normally establish transition teams to manage the divestiture process.

Some of the many key aspects to consider include:

- **Business continuity:** What essential systems and processes will remain in place after the divestiture and for how long? Will essential head office staff need to be replaced immediately? Will central outsourcing agreements continue to apply or will new arrangements need to be made? Must shared offices or warehouses be vacated and when? What about joint procurement or sourcing arrangements?
- **Supply chain and B2B relationships:** Will existing arrangements with customers and suppliers still be valid or do new contracts need to be negotiated? How are volume purchasing arrangements/discounts affected? Will historic B2B records (such as performance management or supplier information) still be accessible? Will relationships suffer if central purchasing has been the usual practice?
- **Process change:** What impact will the divestiture have on both established manual and automated systems? What basic changes need to be made in day-to-day activities (such as sending time sheets to a particular HR office)? What about financial procedures or staff recruitment?
- **Systems change:** What new IT systems will be needed and how long will they take to implement? Will an interim solution in the form of managed services or outsourcing be essential? Will this be a better long-term option? Will key staff move to the new organisation or will the handful capable of nursing a legacy application remain with the parent group? What historic information may be lost as systems change that could affect the business? How can business critical applications be secured?
- **Transition services and exit plans:** How much time will there be to plan for the change or are events moving quickly? How much can be outsourced as an interim solution: payroll and HR? IT services? Supply chain and logistics? Marketing and PR?
- **Cultural change:** How can you continue to motivate and inspire staff when a business is up for sale and the future unknown? How many will “jump ship” before the deal is completed? How many will find change challenging? How will compensation packages be affected? Will retention and/or severance packages be needed? Will key staff be poached by the parent group?

Supply Chain Strategies and Issues to Consider in Divestiture

Over the past decade, supply chains have become increasingly global with trading partners stretching across time zones and continents. For large conglomerates these supply chains can often be highly integrated, giving the various operating divisions the benefits of higher volume orders and quantity discounts. Disconnecting some of these relationships at divestiture can be challenging.

Successful trading relationships that have been built up over several years clearly have to be preserved, which means keeping suppliers, customers and trading partners informed about developments. Ensuring that changes to payment processes run smoothly is essential. Suppliers need to know where to send their invoices, who their new contact for payment queries is, and if the new owners intend to alter payment terms.

It is also vital that—at least in the short term—the divested operation maintains continuity in its supply chain and B2B relationships. This may involve establishing new contracts, possibly on not such favourable terms, with existing suppliers and service providers which in turn may trigger a search for new trading partners and providers.

Those contracts will also need careful study by the new owners. Are there penalty clauses that may be triggered or lengthy changeover periods for alterations in terms and conditions? Deloitte³ argues that most supplier and customer contracts will probably need to be re-evaluated as a result of divestiture. Decisions will need to be taken about retaining a contract, as well as assigning, renegotiating or replicating it for the divested business. Tracking down contractual information, especially if not centrally managed, can be challenging for the new owners.

Maintaining continuity may require short-term use of managed services. For example, does the divested company need to establish new warehouses or distribution centres? Building or finding such facilities can be a time-consuming process and if there is a limited “get out” period for ending such use of parent group facilities then interim outsourced options may be essential.

Is shipping and freight forwarding handled by agents appointed by the parent group? Will they continue to act for the division after divestiture or will it be important to change quickly to the preferred suppliers of the new owners? Will that lead to dissatisfaction among key employees who may see carefully nurtured and long-established relationships removed overnight?

Another thing to consider, especially where the divisions are closely integrated, is whether there will be any significant staff changes that may impact supply chain efficiencies? Is, for example, transport management a shared facility with distribution networks and route planning managed by a single team? Will the divested operation have to recruit a new logistics department to manage operations in future? Similarly with product sourcing—buying raw materials or products for re-sale is likely to be handled by the division—but what about products not for resale, such as the pens and pencils, copy paper or workwear? Will new procurement staff be needed before the office stationery cupboard is bare?

Although largely an IT issue, ensuring that supply chain systems and historic records are maintained and extracted from the parent ERP system at divestiture is another task for the transition team. Performance management data, service level records, warehouse management information, even basic contact information files need to be transferred to the divested operation if these are centrally maintained and held.

IT Challenges to Consider in Divestitures

Separating IT environments is generally regarded as one of the most challenging aspects of any divestiture. Most companies spend years integrating and consolidating their IT systems to gain maximum benefit, so extracting a subset of such an operation for the divested division is challenging—to say the least.

Replicating those systems may also be inappropriate. An established ERP application may not be a cost-effective solution for a smaller business, while modern low-cost technology may be more appropriate than a traditional data centre. The new owners may also have their own established applications that will need to be adopted by the newcomer.

In some cases the divested operation would be given a fixed period of time—typically a year—to set up its own systems from scratch while gradually extracting its data from the parent group. Others may continue to run IT on a managed services basis or may choose to “sell” existing IT applications as part of the divestiture. If the divested operation is acquired by a company with a well developed, integrated IT operation then absorbing the newcomer can be comparatively straightforward, but as with any major IT change it can take time for systems to run smoothly.

Deloitte³ suggests six strategies for migrating applications and data:

1. Sell the existing application and data as part of the divestiture.
2. Clone the existing application and data.
3. Create a new application.
4. Migrate the data to the acquirer’s systems.
5. Migrate the data to another existing application.
6. Outsource the functionality and migrate the existing data to the vendor’s system.

Clearly, maintaining data integrity is vital so it is important for any divested operation to keep close links between the acquirer’s IT department (or the new team) and the previous owner’s during the transition phase. Transition Service Agreements (TSAs) are also vital to ensure a suitable hand-over period. Few regard TSAs as long-term solutions and in many cases financial incentives are applied to encourage early exits from the agreement, but they do help to ensure some degree of continuity during this crucial phase. Also, it is important to remember any changes needed to licensing agreements, discount arrangements and vendor support contracts in any TSA.

Increasingly, companies regard both IT and logistics as non-core activities, so divestiture can often provide an impetus to opt for outsourcing or managed services rather than re-inventing the wheel.

B2B Options to Consider in Divestiture

Today’s B2B infrastructures provide machine-to-machine integration between customers and their respective trading partners. These B2B infrastructures can be complex, with

3. “Seven secrets of highly effective divestitures” <http://www.deloitte.com/dtt/article/0,1002,sid%3D2119%26cid%3D185220,00.html>

different business documents being exchanged electronically using multiple messaging standards and communication protocols, each while connecting with trading partners, who may have numerous customized document maps in place. In addition, there may be various ERP integrations, supplier Web portal environments and trading partner management systems which need to be considered during the divestiture process. Moving these B2B applications and services to the divested operation can be complex and time consuming, but given the dependence of B2B management on technology, essential to do and without disruption to the business.

Outsourcing the management of a B2B infrastructure should be regarded as a way of cutting costs, streamlining business processes and more importantly, offering a key competitive differentiator.

If the divestiture includes IT applications, it can be comparatively straightforward to maintain such B2B operations with minimal disruption, as long as staff and infrastructure are in place. If that is not the case, then the spinoff must very quickly put some alternative technology in place to ensure continuity.

Typically there are three options:

- Build a new B2B solution
- Clone and migrate the old B2B solution
- Outsource or opt for B2B Managed Services

Selecting and building new applications can be a lengthy process, especially if there is a limited transition period adding to the pressures. The spinoff must be able to access the parent application during this period and migrate relevant data once the new system is in place. Data continuity could be an issue if trading partners become confused as to whether they are still dealing with the parent group or not, and perhaps becoming less responsive to data requests.

Similarly, cloning and migrating the old B2B solution is not always quick or straightforward and there needs to be adequate time for testing to ensure that no mission critical information is lost. Again, it needs enough time for a transition period and good on-going relations between divestor and divestee to ensure that the operation runs smoothly and data are transferred successfully.

Using a hosted or managed services option can be both an optimal interim solution and long term choice depending on the IT priorities of the divested business. It can also be the preferred choice for a transition team trying to meet a raft of pressing deadlines. Data can be moved to the hosted application in the run-up to divestiture, allowing time for system testing and staff training. In some cases the managed services provider will also take responsibility for data quality and maintenance, which can relieve the transition team of another problem.

Developing a cohesive B2B strategy is essential during a divestiture process. If no strategy is put in place, future company and market-related growth opportunities will be restricted.

Whichever option is chosen, it is clearly important to keep all trading partners and suppliers in the loop. It is important that they are kept informed about developments at each stage of the divestiture process. They should be encouraged to maintain existing data exchange and/or product information activities in order to keep records up to date during the transition phase.

Failure to choose the correct B2B strategy after divestiture could have serious downstream repercussions, not just for the divested company, but for its entire community of trading partners. For example, goods must continue to flow across a supply chain and electronic business documents—such as purchase orders, invoices and shipping notices—need to be distributed throughout the trading community during and after the transition period. If this flow of information is interrupted due to an incorrectly written map or mis-configured communication protocol, this could result in non-delivery of goods or even production stoppages. In summary, a badly implemented B2B strategy could limit the future growth plans for the divested company.

Conclusions

Maintaining supply chain continuity and B2B management are important aspects of any divestiture programme. Spinoffs that were previously semi-autonomous within the parent group may experience less of an issue, especially if all IT applications and supply chain infrastructure are included in the divestiture.

Where divisions are closely integrated with the parent group, i.e. with shared systems and central purchasing or supply chain management operations, it becomes a far more complex issue. Business continuity must be a priority and great attention paid to ensuring B2B relationships are not damaged in the transition.

The basic choices facing the transition team will include:

- Build a new B2B solution;
- Clone and migrate the old B2B solution;
- Outsource or opt for B2B Managed Services

In most cases the first two options take time, investment and effort, all of which may be in short supply among the numerous other priorities facing the transition team. At a time when few corporations regard IT or logistics as core activities, divestiture can provide the impetus to take the outsourced route. After all, companies should be focusing on their new core competencies rather than having a distraction of managing a B2B environment. Equally, as a short-term interim solution, managed services can be a preferred option, helping to maintain continuity while the transition team focuses on more urgent tasks. Outsourcing can therefore be considered as a competitive differentiator, not just a solution to the problem.

**NORTH AMERICA AND
GLOBAL HEADQUARTERS**

100 Edison Park Drive
Gaithersburg, MD 20878
U.S.A.

+1-800-560-4347 t
+1-301-340-4000 t
+1-301-340-5299 f
www.gxs.com

**EUROPE, MIDDLE
EAST AND AFRICA**

18 Station Road
Sunbury-on-Thames
Middlesex TW16 6SU
United Kingdom

+44 (0)1932 776047 t
+44 (0)1932 776216 f
www.gxs.eu

ASIA PACIFIC

Room 1609-10
16/F China Resources Building
26 Harbour Road, Wanchai
Hong Kong

+852 2884-6088 t
+852 2513-0650 f
www.gxs.asia.com



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