WorldatWork journal
Fourth Quarter 2015

Unlocking Value Through Split-Ups and Stand-Ups


Jeff Cox
Mercer


Chuck Moritt
Mercer

Split-ups and stand-ups account for much of the recent restructuring activity in the marketplace with companies increasingly selling subsidiaries or carving out non-core businesses. And what's driving these decisions? Above all, it's the desire to unlock value.

For example, a major online marketplace recently spun off its digital payment system because of the payment company's need to seize new opportunities in a rapidly changing industry landscape. The spinoff allowed the payment company to adopt a more competitive focus, attract better talent and realize greater value — strategic goals that would have been harder to achieve had the company remained a division of the parent company and not gone solo.

Similarly, a U.S. pharmaceutical company spun off its animal health business, recognizing that it made better business sense to devote its energies to its area of highest profit margins: core prescription drugs. Another organization chose to convert its cybersecurity and data-storage divisions into two separate publicly traded companies. The business recognized that security and information management involve different areas of focus and therefore require distinct strategies to be successful.

© 2015 WorldatWork. All Rights Reserved. For information about reprints/re-use, email **copyright@worldatwork.org** | www.worldatwork.org | 877-951-9191
WorldatWork The Total Rewards Association

As these examples illustrate, splits make a lot of sense under the right circumstances. When companies evaluate their strategic priorities, many are realizing that, as conglomerates, they might be better off operating independently as separate entities.

These transactions present not only considerable advantages but also major stumbling blocks. Many companies can skillfully acquire and integrate other companies and their operations, but they can't necessarily do the opposite: successfully spin off companies. Some companies simply have not executed spinoffs before, so their lack of familiarity with key issues and considerations makes this type of deal significantly more complex.

Numerous additional factors, including geographic location and timeframe, add to the complexity. When companies decide to separate, the split often takes place across multiple countries and the timeframe for these transactions typically is 18–24 months from the initial intent to separate, to the newly formed company's beginning to operate as a separate entity.

THE SEPARATION DEAL FLOW PROCESS

In the course of working with high-performing companies on dozens of split-ups and stand-ups, an end-to-end process for successfully planning and managing these transactions has emerged, with a focus on two critical actions:

1 | Translating strategy into solutions that address the people issues.

2 | Establishing a dedicated, robust process to execute the separation work over a prolonged period.

The separation deal flow process is a framework to support these key actions. It allows organizations to effectively plan and manage these transactions (See Figure 1 on page 72). It is built on the stage-gate model, with discrete objectives for each stage. At the end of each stage, the organization confronts a critical milestone that functions as a go/no go gate to confirm that objectives are met before moving to the next phase.

Stage 0: Decide to Separate

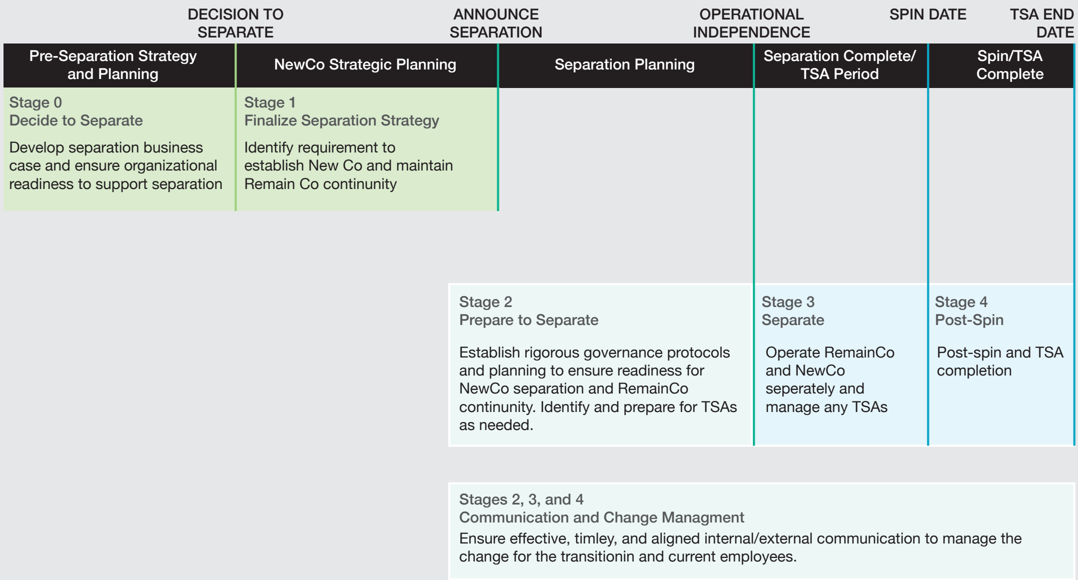
This stage entails assessing the strategic environment in which the company is operating to determine how it will separate and what the separation will look like. Developing a separation road map is critical to address the following key questions:

- Why will an independent company function better than a division or subsidiary?
- How will we do the work? How are we structured to get the work done?
- What resources are required? What kind of people capabilities do we need to complete the work?

Stage 1: Finalize Separation Strategy

The goals of Stage 1 are to identify what's needed to establish NewCo (the entity being created or spun off from the parent organization) and to determine its

FIGURE 1 Separation Deal Flow Process



structure, leadership team and staffing model. It is important to keep in mind the implications for RemainCo (the parent company executing the spinoff), so it can continue to operate without disruption. Staying focused on the parent's operations helps locate logical points of connectivity and separation.

Stage 2: Prepare to Separate

Stage 2 outlines the work to execute the separation. Because timing is crucial, this stage overlaps with Stage 1. Establishing the people, process and structure necessary for the separation occurs while the strategic evaluation of the requirements of NewCo and RemainCo is taking place. Instituting governance protocols ensures NewCo's readiness for the separation.

Stages 3 and 4: Separate and Post-Spinoff

At the end of Stage 2, NewCo and RemainCo are functioning as two separately operating businesses. However, the legal separation has not yet taken place — this is the focus of Stage 3. Before the spinoff date (the date of legal separation), the transition service agreement (TSA) is completed, along with any other final separation activities, to ensure that NewCo is fully independent.

Stages 2, 3 and 4: Communication and Change Management

Throughout these stages, a communications and change-management effort must undergird the separation work taking place, especially in the latter stages. This is critical to realizing the greatest value from the transaction because it ensures that both internal stakeholders (employees) and external stakeholders (customers, suppliers and shareholders) are engaged and their interests aligned.

CRITICAL PEOPLE CONSIDERATIONS

A well-planned process is merely one critical success factor in this type of transaction. Achieving operational continuity during a spinoff also requires that a company fully address people issues, which can be divided into three areas: talent segmentation, HR strategy and communications and engagement (See Figure 2).

Talent Segmentation

During a separation, new roles are created, but talent shortages may emerge, too. Identifying a leadership team for the spinoff early on is vital because new talent

FIGURE 2 **Critical People Considerations**

Talent Segmentation	HR Strategy	Communications and Engagement
- Leadership Team - Organizational Structure and Governance - Staffing Allgnment - Retention Strategy	- Clone-and-Go or Redesign - Transition Services Considerations - Equity and Incentive Program Strategy	- Stakeholder Identification - Effective Change Management Strategy - Focus on Execution

may be needed and critical decisions about how to source talent will have to be made. It is important to remember that the staffing implications impact not only NewCo but RemainCo as well.

A separation requires rethinking organization design, job content, structure and governance. Both RemainCo and NewCo should have a clear workforce plan for how new requirements will be met and how dedicated or shared employees will be allocated. A retention strategy helps identify key talent in both the short term and long term and creates the right incentives for talented people to stay and contribute to the newly separated organizations.

HR Strategy

Because the people issues involved in a spinoff are complex and wide ranging, HR policies and systems must be carefully considered:

- Will NewCo use existing programs (clone-and-go)? Is the parent's administrative structure (payroll systems, and time and attendance systems) easily transferable, or is a new structure needed?
- Should existing costs and risks be transferred to the spinoff or stay with the parent?

- Does NewCo serve similar markets as its parent, or do NewCo and RemainCo need to revise competitive market benchmarking?
- Should employee incentives stay the same?
- How will human resources be administered throughout the spinoff process?
- How do equity plans need to change when ownership changes?

Communication and Engagement

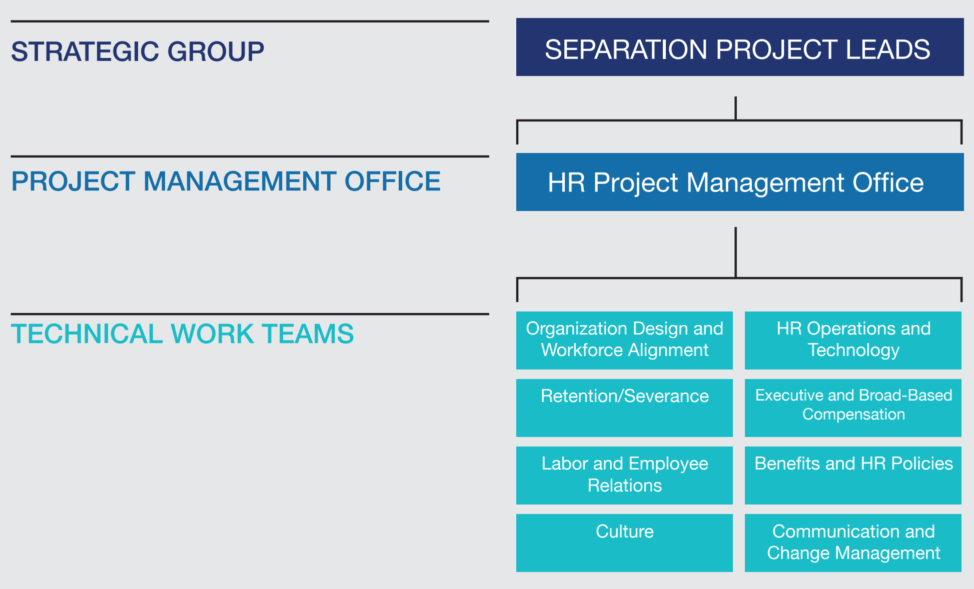
Spinoffs bring major change: Employees may have new roles or bosses or even a new location or terms of employment. Although this creates opportunities for growth, productivity loss poses a substantial risk as the transition proceeds. A clear communication and engagement plan that captures the hearts and minds of stakeholders can combat this danger.

EFFECTIVE ORGANIZATION AND PLANNING

In addition to maintaining a sharp focus on people issues, organizing the right teams to launch the separation work is critical (See Figure 3).

An organization should use its end vision to guide decision making and scoping of the separation work and to equip teams with the information they need to plan effectively. By focusing on major milestones and having a clear view of dependencies within work streams, HR and business/functional areas, a company can successfully navigate the complexity inherent in the spinoff process

FIGURE 3 Structure to Support Separation Planning and Management



Strategic Group

The strategic group's leadership team steers the separation work, aligning it to the strategy. The team establishes project priorities, has final decision-making authority and provides guidance to the HR project management office (PMO).

HR Project Management Office

Overseeing the day-to-day tasks of the transition, the HR PMO ensures that the right resources are in place to complete the work. The PMO proactively manages dependencies, issues and risks by anticipating potential pitfalls and responding to them.

Technical Work Teams

Technical work teams identify and complete the activities required to finalize the separation, prepare recommendations and work with the HR project management office to resolve issues.

In order to realize the full value of a split-up or stand-up, organizations must establish an effective process to manage work over an extended period. In addition, organizations need to focus on their people. Employee disengagement can result in loss of talent and productivity, which in turn, can cause organization performance to decline. A decline in performance can lead to customer dissatisfaction, which requires organizations to spend increased time and energy fixing problems and repairing relationships to avoid losing clients and, ultimately, revenue.

Organizations can avoid these risks by following a well-articulated separation road map, enlisting capable resources to execute the work and partnering with credible advisers who can guide or augment staff to realize the deal successfully. These key actions help organizations ensure operational continuity during these transactions, safeguard shareholder value and fully deliver on strategic goals.

AUTHORS

Jeff Cox (jeff.cox@mercer.com) is Mercer senior partner and M&A Transaction Services Leader. He is based in Chicago.

Chuck Moritt (chuck.moritt@mercer.com) is a Mercer senior partner and M&A Transaction Services Leader. He is based in Washington, D.C.