



Whitepaper

# Divestiture/Carve-Out: Transforming NewCos into **Nimble, Agile, and Future-Ready Enterprises**

Every merger and acquisition deal has a unique roadmap toward value realization for stakeholders. Divestitures and acquisitions are often opposite sides of the same transaction unless the divestiture/carve-out is for setting up a new organization; but both boost shareholder value.

Bain and Company's M&A Report 2021 suggests M&A deals attributed to improving organization capability and fast-tracking its long-term/short-term goals to drive significant share value and market competitiveness have grown over the last four to five years in several industry sectors such as retail, technology, engineering, and more.<sup>[1]</sup> The crisis in 2020 made it even more expedient for companies to bring in-house critical capabilities in areas such as online delivery, telemedicine, collaboration, and so on.



## Types of M&A

M&As can broadly be classified into four categories:

- **New Entity Formation** through carve-out/de-merger of unrelated business segments (e.g., JCI's divestiture of battery division, UTC's divestiture of aerospace, elevator, and HVAC/fire, and safety division). Typically, deals involving private equity are of this nature.
- **Vertical/Horizontal Merger** (complementary service/portfolio capability enhancement) through divestiture of a business unit from an existing organization and merging into a target company to complement existing service offerings. Good examples would be the Salesforce acquisition of Slack, LTIMindtree acquisition of Lymbyc, Cuelogic, and US retailer Target's acquisition of delivery services business Deliv.
- **Acquisition by a Conglomerate** through the act of expanding business across unrelated services/portfolios. For example, the Reliance Brands acquisition of British toy retailer Hamley's.
- **Acquisition for Market Expansion** through carve-outs in emerging/new, geos as in the case of ABinBev and MolsonCoors.

This article will **focus on the importance of IT divestiture/carve-out** and the approach to **structured planning and IT involvement**. In today's digitally evolving era, organizations are largely enabled by information technology with massive collaboration, data sharing, and connected capability across departments, in an attempt to drive synergies across business and maximize ROI in sharing of value and assets.

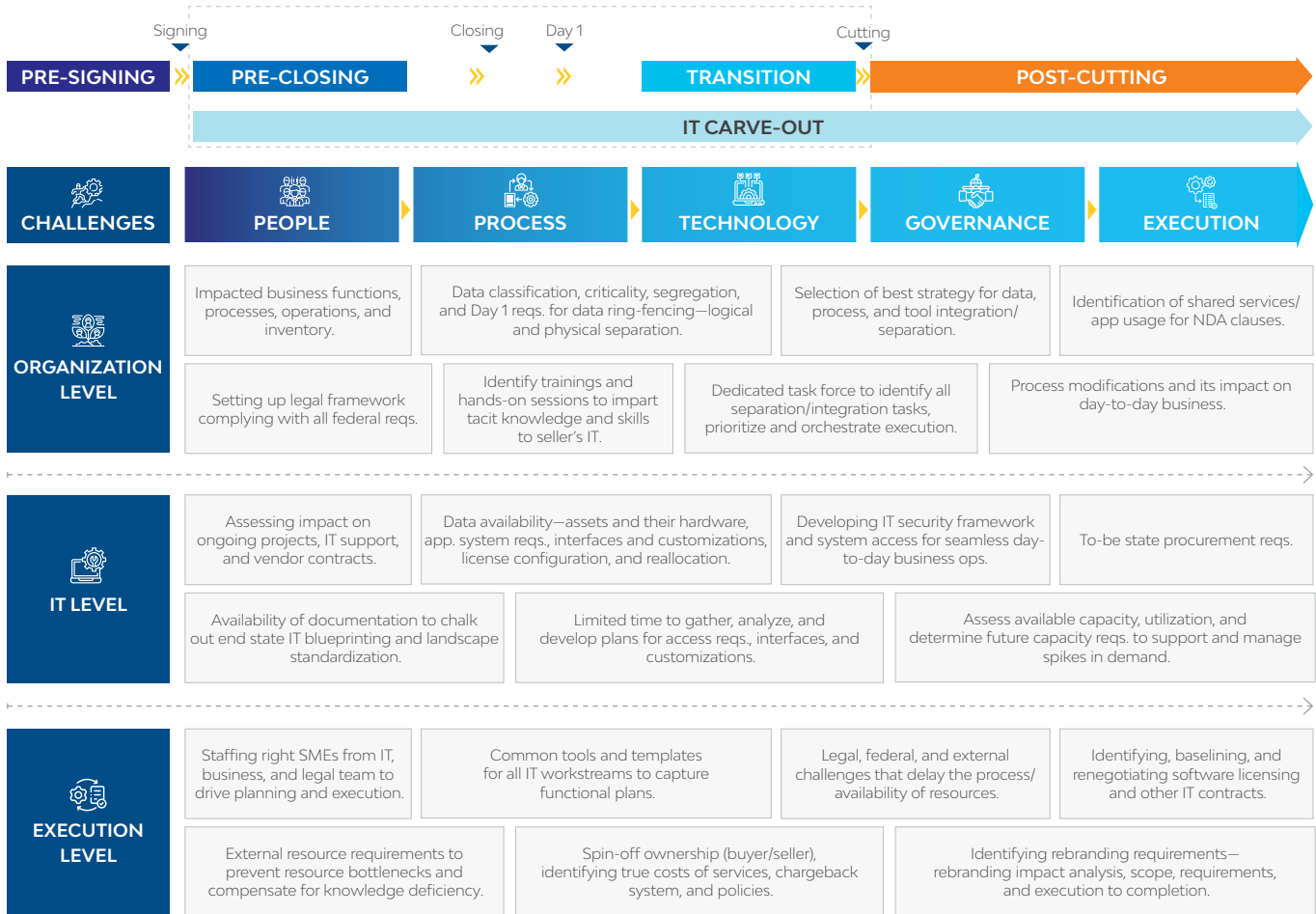
**Underestimating the role and involvement of IT** in divestiture can have a significant impact on an organization. It could result in breakdown on Day one of operations right from human resource operations—people management onboarding, payroll or accounts, contracting/procurement of services—to delivery/execution operations, and ultimately impact customer experience.

Maximizing the value of carve-outs for both the buyer and seller depends heavily on involvement from each party. Carve-outs should be seen as an opportunity for stakeholders, with IT playing a crucial role in realizing the M&A value.

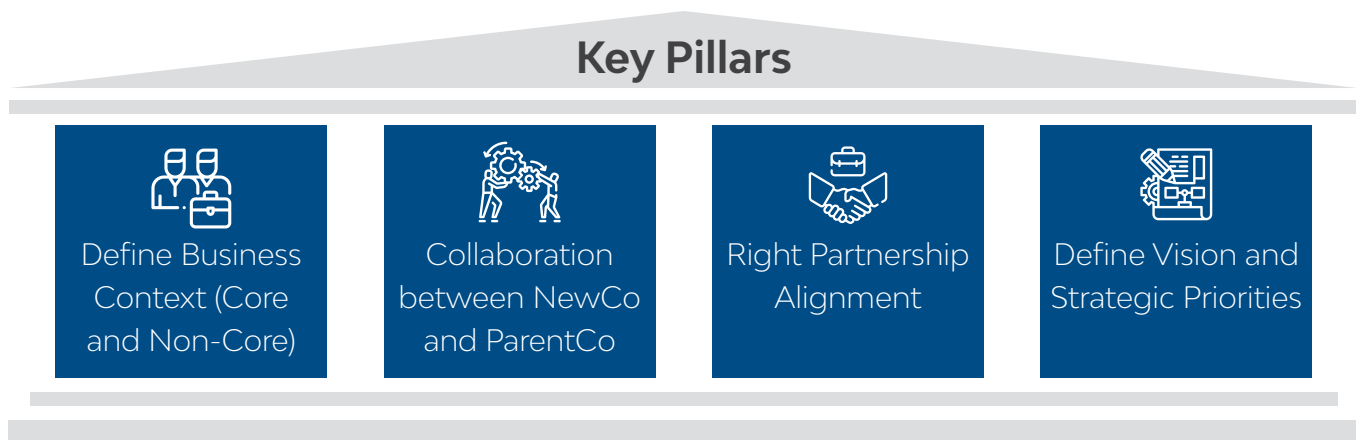
## Key Stakeholders in M&A and their Priorities

SpinCo	Private Equity/Buyer	NewCo	Share Holders
<ul style="list-style-type: none"><li>• How do I fast track the transition process without impact to strategic programs?</li><li>• What are the opportunities to right size retained portfolio and reduce opex?</li><li>• Asset transfer challenges for both end point, DC, etc.</li><li>• Compliance challenges and Zero-day cutover.</li></ul>	<ul style="list-style-type: none"><li>• How do I ensure land safe transition and drive lean setup?</li><li>• How do I Jump start Optimization to reduce TCO?</li><li>• How do I ensure BAU for end customer?</li></ul>	<ul style="list-style-type: none"><li>• How do I minimize risk of business impact and ensure continuity?</li><li>• How do we transform while we transition to reduce tech, debt, and add business value without added risk?</li><li>• TSA ramp-up and overall service transition.</li><li>• How do I reduce cost of TSA?</li></ul>	<ul style="list-style-type: none"><li>• Accelerate the cutover and separation timeline.</li><li>• Ensure zero impact to business and drive projected growth and improve shareholder value.</li></ul>

# Challenges in Divestiture



## Key Elements to Control Carve-out Costs



- **Define business context (core and non-core):** Enables prioritization of pre-(transitional service agreement) TSA, TSA, and post TSA imperatives and sets direction for overall downstream planning for carve-out.
- **Define vision and strategic priorities:** Enables decision-making in execution of carve-out based on immediate, mid-term, and long-term priorities.
- **Right partnership alignment:** Maturity and experience in similar situations drive ability to fast-track some strategic priority items as part of the carve-out or create a foundation for the future, defining strategic north star, and identifying aligned actions, strengthening the business case.
- **Collaboration between NewCo and ParentCo:** Carve-out not only demands that the NewCo minimizes the TSA timeline and eliminates dependency on the ParentCo early, it also determines the right size for the ParentCo. Most carve-outs have seen the ParentCo focus on the TSA terms to avoid business impact. The focus should, in fact, be on right-sizing the ParentCo and leveraging the carve-out as an opportunity to drive lean initiatives and business advantage.

IT carve-outs involve identifying the following components based on the defined business context and priorities

Entity	Planning Elements
<b>Assets</b>	<ul style="list-style-type: none"> <li>• App, licenses, and infra inventory data gathering.</li> <li>• As-is IT architecture, connectivity, and security policies.</li> <li>• End-to-end system, interfaces, and process details.</li> </ul>
<b>Data</b>	<ul style="list-style-type: none"> <li>• High level systems and apps mapping.</li> <li>• End state system and app landscape.</li> <li>• High level IT roadmap.</li> <li>• Interdependencies and critical dependencies.</li> </ul>
<b>Infrastructure</b>	<ul style="list-style-type: none"> <li>• End-to-end system and process flow kick-off with new company.</li> <li>• Process remodel or customization requirements.</li> <li>• Refine IT roadmap.</li> <li>• Current challenges, gaps that needs attention and resolution.</li> <li>• Architecture and strategy.</li> <li>• Licensing requirements.</li> </ul>
<b>Security</b>	<ul style="list-style-type: none"> <li>• Data, IAM, security, and connectivity requirements finalization.</li> <li>• System scalability and procurement requirements—hardware and software.</li> <li>• Migration strategy finalization and portfolio-wise migration planning.</li> <li>• Licensing requirements.</li> </ul>

Executives are more focused on minimizing the TSA durations in the interest of buyers and sellers. IT cost in TSA is seen as a major deterrent in achieving the end goal. For instance, if the parent company was running a shared services model for enterprise functions, the transition could be a painful experience.

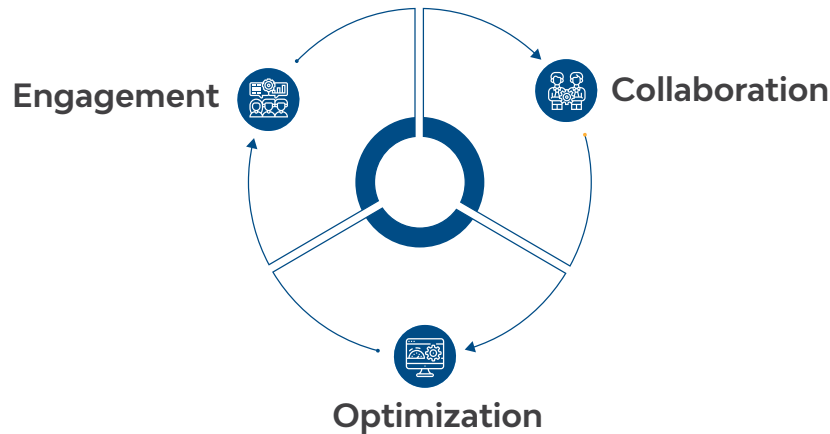
These nuances need thorough due diligence and assessment during pre-carve-out planning and business case assessment to arrive at the right strategy for carve-out and future state vision.

Technology transformation can play a significant role when embarked on at an early stage and integrated as part of divestiture planning and execution. A portfolio which is a carve-out and set up on a cutting-edge digital stack has to offer significant business agility and efficiencies in accelerating business outcomes.

There are multiple transformation themes which can be adopted such as workplace and workforce transformation, virtualization of enterprise through hyperscalers/cloud transformation, building a data-driven enterprise, transforming enterprise portfolios from project-centric to platform-centric models, and transforming complex operations involving a combination of shared, multi-vendor, traditional effort-centric measurement to outcome-centric operations adopting an "as-a-service" model.



## Workplace and workforce transformation



Creating value for the workforce through three key imperatives of workplace transformation involving:

**Engagement** Create variety and flexibility for workforce to engage/interact and choose to drive.

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**Collaboration** Right digital technologies to enable workforce for effective collaboration, work-from-anywhere **leveraging collaboration solutions like O365–MS Teams, Confluence from Atlassian, Slack, etc.**

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**Optimization** Create workspaces (physical and virtual) on clicks in real time to enable workforce as a drive toward implementing the future of software engineering.

Canvas and XFH are examples of a software engineering platform and model for creating the workplace of the future, for creating organizations ground up that are future-ready and driving workforce transformation at the core.

## Virtualization of enterprise through hyperscalers/cloud transformation

Gone are the days when organizations would look at building brick-and-mortar rooms for hosting their enterprise systems and servers. With the advent of cloud technologies with offerings of IaaS, PaaS, and SaaS, hyperscalers are looking at building industry-centric cloud offerings with complete business solutions as cloud native solutions. This enables organizations to virtualize the entire enterprise and build flexible, scalable, and Lego-like systems and solutions leveraging similar micro-services architectures with ability to collaborate across islands of environments across on-premise and multi-cloud hybrid models.

Adopting these technologies in divestitures/carve-outs for NewCos will make them future-ready for private equities to adopt for scalability and agility in future M&A transactions (sell out of carved business post the value realization of the business case).

## Building data-driven enterprises through creation of platform-centric organizations

Enterprises face challenges with data such as duplication, accessibility, trust, quality, size, and scale. Today, organizations are heavily investing in solving three major challenges: addressing visibility issues, how do I measure my process to understand my current state, where is my problem/what do I solve, and finally, the ability to make the right decisions based on available insights.

When it comes to divesting an organization, this data separation becomes an opportunity to transform the data landscape and do it right the first time. It is possible to create a single source of truth using cloud platforms to syndicate data from multiple enterprise systems into a data lake; to build AI/ML at scale leveraging data synergies coming from different enterprise systems to build visibility/insights across the enterprise, creating a 360-degree view across dimensions of operations, customer, product etc. Setting up this kind of data-driven organization will enable the workforce to leverage data-driven intelligence to accelerate value realization.

## Transformation of enterprise platforms (ERP, CRM, MES)

Core business operations are dependent on technology platforms which, based on the diverseness of the ParentCo's business, evolution, and IT stakeholders, over a period would have numerous duplications of systems, redundancy in tool stack, misalignment in right business fit model due to cross leveraging of platforms across diverse business segments. Timing these platform transformations while revisiting the future state solutions is critical to ensure that the core business solutions/platforms are built in alignment with the future state vision. For example:

- Multiple geography-centric ERPs can be consolidated into single ERP with fit for purpose model.
- Adoption of SaaS-based platforms for non-core functionalities where risk is low/medium during carve-out.
- Bulky platforms ill-suited for transition from ParentCo can be looked at from transformation perspective based on NewCo's context.
- Reduce technical debt for moving traditional non-core processes from custom implementation to industry standard platforms (e.g., HR/Payroll to Workday, ADP etc.).

## Transformation of IT operations from a siloed unit to IT-as-a-Service model

Among the most critical expectations from IT organizations are to be flexible, agile, and nimble to cater to changing business needs. Shifting from a traditional resource-centric, project-based outsourcing model to a service-centric model is beneficial for organizations to scale as per business needs. NewCos will have a tendency to extend the ParentCo model to ensure BAU and mitigate business risks associated with multiple changes involved; however it is critical for organizations to look at future state vision/strategy and define the right fit operating model for service contracts with partners leveraging next-gen operating models from service-centric to outcome-based models.

## Conclusion

IT plays a significant role in the success of carve-outs. In our experience across multiple carve-out engagements, we have seen that organizations fail to realize business value or see delayed realization due to lack of focus on IT and involvement of the right partners during pre-carve-out and carve-out planning. Technology transformation needs to be looked at early in the pre-carve-out due diligence exercise as a critical component of divestiture assessment and planning.

The lead time from the divestiture decision to establishing new entities with right planning to achieve desired outcomes—right-sizing of organizations, asset-light, agile, and nimble systems implemented at the right cost—is a key determinant of whether a carve-out business case is successful or not.

### References:

1. [https://www.bain.com/globalassets/noindex/2021/bain\\_report\\_global\\_m\\_and\\_a\\_report\\_2021.pdf](https://www.bain.com/globalassets/noindex/2021/bain_report_global_m_and_a_report_2021.pdf)

## About the Author



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Mohit Navare is an experienced Digital Transformation leader with 20+ years of experience in transforming customer relationships in Fortune 500 companies. He is responsible for driving implementation of strategies, priorities, and realizing true digital value through customer experience and business value realization. He has successfully helmed various leadership roles in delivery, consulting, competency building, and solutioning. He has worked closely with customers advising and driving their transformation initiatives, and been involved several M&A engagements driving end-to-end IT strategy, planning, and execution.

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