Ensuring B2B and Supply Chain Continuity at Divestiture

A GXS Thought Leadership White Paper

Divestiture: A Growth Industry

During and after a divestiture, a company should focus on its core competency–such as manufacturing a product or providing a service–rather than the day-to-day operations of its B2B infrastructure.

With "growth" and "increasing shareholder value" likely to be atop a corporation's agenda, focus tends to be on acquiring new businesses rather than on shedding the ones it already owns. Divestiture can, however, be a profitable activity. A study by Bain & Company of 7,315 divestitures completed by 742 companies between 1987 and 2007 showed that an investment of $100 in the average company in 1987 would have been worth $1,000 by 2007.[1] However, the same investment in the best divestitures would have yielded $1,800.

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

A wide range of businesses have found opportunities for divestiture. For example, Ford sold its premium Land Rover and Jaguar automotive operations to India's Tata Motors. Also, Cadbury Schweppes disposed of its Americas Beverages business to Dr Pepper Snapple Group. Danone divested business to Kraft Foods, as well. Further, Raytheon sold its commercial aircraft unit.

The current economic climate indicates that many more high-profile companies could be divested in the coming years.

So who buys these divested operations? Both private equity operations and trade competitors have reasons to purchase divestitures. A small percentage of divestitures are floated off with an initial public offering (IPO) while some will be bought through a management buy-out (MBO). Some approaches are long-term, while others purchase an operation with plans to sell it in a few years. Others see under-used assets in divested operations that they hope will become profitable.

Issues to Consider in Divestiture

There are numerous aspects of any divestiture that can impact the success of the future operation. Much depends on how thoroughly integrated various divisions were to the central organization prior to their separation. Companies with common customer information, integrated enterprise resource planning (ERP) systems, historic records or supply chains clearly face greater challenges than those run completely autonomously while managing their own information technology (IT) and business-to-business (B2B) relationships. In some cases, core IT or supply chain assets may be included in the divestiture. In other cases, the division is completely cast off and has to rapidly re-invent its basic operational functions.

For all divested operations, business continuity has to be a priority. Many companies work over the course of a year to phase out shared central systems, even though it is rarely enough 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 the process and cultural changes that most companies have to manage. Employees who have worked for the larger organization for a long time may feel

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

uncomfortable or threatened moving to a more entrepreneurial environment following a MBO or private equity investment.

Some of the key questions to consider during a divestiture 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 human resources 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 organization 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 human resources? IT services? Supply chain and logistics? Marketing and public relations?

- **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 leave 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?

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

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 should be preserved, which requires 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 with existing suppliers and service 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? Deloitte argues that most supplier and customer contracts will need to be re-evaluated as a result of divestiture.[2] Decisions will need to be made 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 centers? Building or finding such facilities can be a time-consuming process. If there is a limited period for ending use of parent group facilities, then interim outsourced options may be necessary. Further, 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?

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 efficiency. Will the divested operation have to recruit a new logistics department to manage operations? Will new procurement staff be needed?

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, and even basic contact information files need to 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 components 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, divested business, and modern low-cost technology may be more appropriate than a traditional data center. The new owners may also have their own established applications that will need to be adopted.

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

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 on a managed services basis or may choose to shed 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.

Deloitte 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) also help to ensure a successful hand-off. Few experts regard TSAs as long-term solutions, and in many cases, financial incentives are applied to encourage early exits from the agreements. However, they do help to ensure some degree of continuity during this crucial phase. Also, it is important to list any changes needed to licensing agreements, discount arrangements and vendor support contracts in a 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 reinventing 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 different business documents being exchanged electronically, using multiple messaging standards and communication protocols, 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. Given the dependence of B2B management on technology, the process cannot be avoided and must not disrupt business.

Outsourcing the management of a B2B infrastructure can 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 B2B operations with minimal disruption—as long as staff and infrastructure are in place. If that is not the case, the spinoff must very quickly put 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. The divested company must be able to access the parent application during this period and migrate relevant data once the new system is in place. Data continuity can become an issue if trading partners become confused about whether or not they are still dealing with the parent group. Frustrated partners may even become less responsive to data requests.

Similarly, cloning and migrating the old B2B solution is not always quick or straightforward. There needs to be adequate time for testing to ensure that no critical information is lost.

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.

Using a hosted or managed services option can be both an optimal interim solution and a 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 pressing deadlines. Data can be moved to the hosted application ahead of a 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.

Whichever option is chosen, it is important to keep all trading partners and suppliers informed about developments at each stage of the divestiture process. They should be encouraged to maintain the 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 the flow of information is interrupted due to an incorrectly written map or misconfigured 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. New companies that were previously semi-autonomous within the parent group may experience fewer issues, especially if all IT applications and supply chain infrastructures are included in the divestiture. However, when divisions are closely integrated with the parent group, divestiture can be far more complex. Business continuity must be a priority and great attention must be paid to ensuring that B2B relationships are not damaged in the transition.

In most cases, building a new B2B solution or migrating an existing one require time, investment and effort–all of which are likely in short supply for the divestiture transition team. Managed services can be a viable interim solution that frees up the transition team for more urgent tasks. Alternately, at a time when few corporations regard IT or logistics as core activities, divestiture can provide the impetus for outsourcing. After all, companies should be focusing on their new core competencies, not managing a B2B environment.

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