Human capital carve-out study
Strategies of successful sellers
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Human capital often represents a company’s largest annual operating expense, and employee benefit obligations add significant corporate liabilities. On the other hand, employees form a company’s foundation and drive profitability through product quality, innovation, market leadership and customer relationships. Human capital management can therefore make a carve-out transaction successful, or it can destroy value and even break a deal.

Ernst & Young surveyed more than 100 executives experienced in global corporate divestments to determine how their human capital initiatives impact their deal success. Our Human capital carve-out study highlights current trends and leading practices that can help companies use divestments to achieve key corporate goals, such as raising, optimizing and preserving capital. Divestments can help companies align their business portfolio with their corporate strategy.

Study respondents were able to maximize transaction value and minimize stranded costs by:

1. Preparing for negotiations and expediting the sale
2. Maintaining stable business operations throughout the divestment process
3. Keeping employees engaged and focused on business operations and customers
4. Using the human resource (HR) team to execute a timely and cost-effective disentanglement and business transfer

All key executives, from the CEO, CFO and corporate development officer (CDO) to HR and line managers, should be responsible for coordinating strategy and execution in these areas. The CEO should be the key face of the initiative and drive strategy. The CFO needs to pay special attention to how human capital affects the company’s financial statements and balance sheet. The CDO should highlight the strengths of human capital assets to potential buyers. The HR team must focus on the labor relationships and employee engagement details that it knows best. And managers are often the key to retaining employees.

Respondents believe that the most important factors to executing a successful carve-out is retention of key employees, cost effectiveness and speed to close. However, low cost and speed are two areas that sellers rate themselves as least successful at achieving. The most important steps that help a seller maximize value are preparing rigorously for buyer negotiations, communicating appropriately with employees to keep them productive and engaged in the business, and utilizing the appropriate resources to help execute the transaction.
Maximizing value for a divestment depends on the seller’s ability to negotiate a price that represents the business’s current and potential future value. A carve-out affects all functions of both the entity for sale and the remaining business. Sellers must invest time and resources up front to make sure that they understand all aspects of this complex transaction and can anticipate buyer questions throughout the sale and negotiation process.

Respondents indicate that the greater shareholder value achieved from expedited negotiations far outweighs the time it takes to plan appropriately. A shorter negotiation time often shows a greater degree of seller credibility to the buyer and results in fewer buyer questions and concessions.

### Identifying in-scope employees and providing staffing information to bidders

**How to present your company in the best light**

Identifying in-scope employees is fundamental for preparing accurate financial and operational information for a business. Employee compensation, retirement and benefits expenses, and associated liabilities can vary among employees. For example, a long-serving employee may have higher compensation and participate in an expensive legacy defined-benefit pension plan, while a newer employee in the same position likely has lower pay and less expensive benefits.

The actual liability for a termination indemnity or pension benefit is specific to an actual employee and will follow that employee upon transfer to the stand-alone business. Calculations can be even more complex when business entities are located in multiple jurisdictions. However, when sellers provide greater accuracy in employee financial data for the stand-alone business, they reduce the risk of unexpected information and adverse purchase price adjustments.

In our survey, sellers indicated that their employee selection methods varied based on the buyer type. Respondents reported that strategic buyers most often relied on in-scope employee identification based on the division or business unit. This shows that strategic buyers are more concerned about acquiring a product, service or geography. They are less concerned about acquiring a fully operational business since they can leverage an existing business support structure. In contrast, respondents indicated that private equity buyers wanted to have input into the selection process. Typically, private equity buyers acquire a business as an investment, so the private equity buyer wants the business to be fully operational without being burdened with excess headcount. However, in some jurisdictions, legal constraints determine a seller’s in-scope employee selection.

The following table highlights types of buyers and the corresponding seller employee selection method, in situations where legal constraints do not impose the selection method.

<table>
<thead>
<tr>
<th>Type of buyer</th>
<th>Seller employee selection method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Most frequent</strong></td>
<td><strong>Second choice</strong></td>
</tr>
<tr>
<td>Strategic buyer</td>
<td>Division or business unit designation</td>
</tr>
<tr>
<td>Private equity buyer</td>
<td>Agreement with buyer</td>
</tr>
<tr>
<td>Joint venture or spin-off</td>
<td>Division or business unit designation</td>
</tr>
</tbody>
</table>
Human capital carve-out study

Strategies of successful sellers

Overall, 85% of survey respondents reported that they generally analyze stand-alone financial costs based on the actual workforce, or costs that would be transferred, versus basing cost figures on a general allocation. Calculating actual costs endures greater bidder scrutiny. It also drives a more accurate calculation of expenses and liabilities to be transferred in order to minimize stranded costs at the seller. Therefore, those who reported conducting this analysis regularly reported greater success at maintaining business value in their most recent carve-out.

Successful sellers provide comprehensive employee details that have been reviewed from a buyer’s perspective. These details include benefits, employment agreements, employee demographics, legally required indemnities and others. The review process allows an astute seller to position employee information in the best light possible and identify matters that could decrease value. For example, employee demographic information may indicate high employee turnover rates. High turnover may indicate a problem with business operations due to the high cost of adverse attrition. However, high turnover could result from business restructuring to improve efficiency or a seasonal workforce that flexes to manage costs. Proactively providing such information paints a more positive picture for bidders.

Human capital information about the divested business provided to potential buyers, in order of frequency

- Employee benefits
- Labor cost details
- Incentive plans, including equity incentive details and payments
- Executive employment agreements
- Pension assets, liabilities and cash flows
- Current employee demographics
- Historical employee headcount trends
- Labor union or collectively bargained agreements
- Human capital vendor due diligence reports
- Employee performance metrics
- Cultural surveys and employee satisfaction survey results

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What most companies don’t do, but should
High-impact initiatives that companies are neglecting

- **Provide a cultural assessment or employee satisfaction surveys.** A cultural assessment can highlight the cultural attributes of a high-performing company, such as employee innovation, adaptability, teamwork and capability development. Satisfaction surveys are a good indication of whether in-scope employees are motivated and engaged, or whether the buyer is taking on indifferent or unhappy employees.

- **Prepare a sell-side HR due diligence report.** This document provides a central location for HR information that the buyer wants to know, including the opportunities and risks of taking on the employees. It also lets the seller present HR information in a positive light. Information includes benefits plans, employee numbers and locations, compensation structure (e.g., stock options and bonuses) and attrition rates.

Leading practices

- **Analyze stand-alone financial costs based on the actual workforce, or costs that would be transferred, not simply a corporate cost allocation.** This strategy stands up better to bidder scrutiny and helps the seller understand stranded costs.

- **Provide current employee demographics for “SpinCo.”** This information provides a foundation for all matters to be presented in the financial statements and balance sheet liabilities.

- **Provide employee performance metrics.** While few companies report taking this step, those that do report a greater level of transaction satisfaction because metrics help gauge the level of talent and associated performance levels of the in-scope population.

Questions to ask

- **How will shared service and corporate employees supporting the division be allocated?**

- **Will employees lose the opportunity to vest in pension benefits or have unvested or underwater stock options?** How much is at stake to be lost?

- **Where will the greatest new-hire need be for positions that will not be filled via in-scope employee transfers?**
Human capital carve-out study

I. Strategies of successful sellers
Negotiating transitional services agreements (TSAs)

What should TSAs include, and how long should they last?

Buyers of a divested business expect business operations to continue seamlessly upon acquisition, so they often request a TSA until they can develop internal capabilities. Sellers often think that TSAs are a prudent solution to expedite a negotiation, preferring to give the buyer some concessions rather than potentially lose the deal if it takes them too long to try to predict the investment needed to replace shared services. As the graph at right shows, most respondents (78%) have used TSAs – only 22% have never used one.

In practice, TSAs are often expensive to support and challenging to operate because companies cannot continue to run the same systems. TSAs require an initial investment of time, resources and capital to separate data, contact vendors, partition employees within the system and issue new employee identification, among other issues. And if the buyer makes changes, these temporary systems often require manual work-arounds. For these reasons, many sellers feel that shorter-length TSAs minimize costs – the sooner they are freed from the agreement, the less money a company will have to pay.

However, the study found that when the highest performers used TSAs, they were more likely to use them for a period of more than one year. This trend is a reflection of increasingly complex divestments that involve larger numbers of employees. The cost of providing TSAs is outweighed by the benefit of using TSAs to provide critical HR functions to the divested entity quickly.

The following chart shows that the HR services most frequently provided via TSA were employee benefits, domestic payroll, HR information systems and pensions.

How often have you used TSAs relating to HR services?

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Never</th>
<th>Sometimes</th>
<th>Often</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>22%</td>
<td>37%</td>
<td>26%</td>
<td>15%</td>
</tr>
<tr>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>40%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

When you have used TSAs, which services were provided?

<table>
<thead>
<tr>
<th>Service</th>
<th>Never</th>
<th>Sometimes</th>
<th>Often</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits</td>
<td>13%</td>
<td>33%</td>
<td>44%</td>
<td>10%</td>
</tr>
<tr>
<td>Domestic payroll</td>
<td>11%</td>
<td>42%</td>
<td>34%</td>
<td>13%</td>
</tr>
<tr>
<td>HR information systems</td>
<td>8%</td>
<td>46%</td>
<td>32%</td>
<td>14%</td>
</tr>
<tr>
<td>Pensions</td>
<td>26%</td>
<td>29%</td>
<td>37%</td>
<td>8%</td>
</tr>
<tr>
<td>General HR support</td>
<td>19%</td>
<td>41%</td>
<td>35%</td>
<td>5%</td>
</tr>
<tr>
<td>International payroll</td>
<td>19%</td>
<td>44%</td>
<td>32%</td>
<td>5%</td>
</tr>
<tr>
<td>Expatriate support and taxes</td>
<td>43%</td>
<td>39%</td>
<td>18%</td>
<td></td>
</tr>
<tr>
<td>Recruiting</td>
<td>51%</td>
<td>32%</td>
<td>14%</td>
<td>3%</td>
</tr>
</tbody>
</table>
Leading practices

- Consider the type of support required to sustain global recruiting efforts, especially to fill new positions.
- Understand the extent of the HR technology systems modifications needed to support the TSA schedule.
- Understand the manpower requirements to support the TSA and develop a process map to clarify roles (e.g., managerial versus administrative responsibilities).

Questions to ask

Considering the questions below can help you properly manage the TSA, recover costs and commit only to initiatives you can deliver.

- Which HR services will the divested business need to continue operating seamlessly upon separation from the seller?
- Can HR functions, systems and assets be transferred to the divested business? Are cost-effective third-party options available to provide those services?
- Do you understand the impediments to providing a TSA? For example, are there jurisdictions where the service cannot be provided without a license, such as employment law or payroll processing? Are there benefit plan laws that make providing TSAs difficult (e.g., multi-employer plan rules)?
- Are there employee data privacy considerations in certain jurisdictions?
- Will all third-party vendors permit service continuation to a separately owned company?
- What staffing will be required to support the TSA?
- Are the costs to support the TSA well understood? Consider costs to make changes to support the buyer, such as benefit changes or new employees.
- Does the cost model include recovery of stranded costs that may exist after the TSAs are exited? Which party is responsible for stranded costs?
- What is an acceptable duration for the TSA? Will penalties apply if the agreed duration is extended?
- Has an exit strategy for the TSA been developed in order to support the timeline?

What most companies don’t do, but should

High-impact initiatives that companies neglect

- Include rapid recruiting support in the TSA. Recruiting should be a priority, as it helps maintain business operations by filling open positions created by the carve-out transaction.
- Benchmark to functional cost, service delivery model and maturity model for the size of the division being carved out. Companies that do not benchmark are likely to find it difficult to keep their HR cost basis market-competitive.
Maintain business operations

Labor relations
How companies plan for communications with unions and work councils

A seller’s relationship with labor constituencies can have important financial implications for a divestment. First, maintaining business continuity and operational stability throughout the entire divestment process is critical to preserving value and completing the transaction. Divested entity operations can be quickly derailed or disrupted by labor action. Second, negotiation items can weigh heavily on a company’s balance sheet – e.g., offering a broad-based retention or enhanced severance and expectations regarding pension and retiree benefit continuation. Further, the more prepared the seller, the faster the work council process and negotiations. A short negotiation timeline generally results in a higher degree of satisfaction because the seller gives fewer concessions.

Develop a negotiation strategy early. The survey suggests that it is a leading practice to develop a strategy for union and work council negotiations early in the divestment process: 95% of survey respondents indicated that they began preparing for negotiations before beginning discussions. Employees of the entity being divested can be part of one or more labor unions or work councils in multiple countries. Strategizing early helps the seller understand the labor population’s key concerns, including contracts, reductions in force, profit-sharing or even changes to the lunchroom menu or car policy. Understanding what benefits are important to the labor population, and anticipating potential issues and challenges, puts the seller in a stronger position when negotiating.

Engage at announcement. The survey results indicate that the timing of divestment and employee transition negotiations significantly impacts the outcome. The largest percentage of respondents (41%) waited until public announcement or later to engage in labor discussions. Only 23% of respondents engaged in discussion with labor while planning for the divestment, and the remaining respondents engaged in discussions while the in-scope employee population was being identified.

Many respondents wait until public announcement because publicly listed companies must report intentions of a major transaction and they do not want to release information too soon. Many companies discuss divestment intentions with a labor leader a day or two before announcement to provide at least some advance notice. Not only did most survey respondents take this approach, but those who were most satisfied with their most recent divestment waited until even later in the process.

A benefit of early dialogue is that you can open communication lines with key stakeholders and build goodwill with the labor population. For example, companies sometimes conduct work council consultations, in which they inform employees of how the transaction will impact them. In some countries, companies simply have to inform employees, while in other countries the law mandates employees have to agree to the change before the company can implement it. Initial disagreements lead to negotiations.

Plan and budget for concessions. Eighty-two percent of respondents granted concessions to labor unions or worker representatives to conclude labor negotiations. Sellers should develop a strategy that allows for making concessions during negotiations rather than providing an overly generous opening.

At what point did you engage in discussions with labor regarding the divestiture and employee transaction?
offer. Sellers should also budget for some degree of concessions so they have the money to pay for concessions without having to obtain additional management approval. It is more efficient to not spend budgeted money than to have to halt negotiations to ask for new approvals.

**Consider geographical location in the concessions plan.** Once negotiations commenced, most respondents (53%) indicated that it took between 15 and 60 days to complete negotiations. In addition to preparedness and strategy, and the relationship with labor, the maturity of labor law in the jurisdiction contributes to the length and outcome of the work council consultations and negotiations. Our survey found that labor negotiations took longer and sellers made greater labor concessions in emerging markets such as Russia, Asia and Africa. Emerging markets often have less mature legal and regulatory regimes regarding the employee impact in a divestment, whereas in regions like Western Europe, the process is mature and highly regulated. As companies increasingly seek to grow in emerging markets, they are creating more job opportunities for the labor pool in these markets. While the number of available jobs in other parts of the world is declining and constricting, this influx of job opportunities in emerging markets gives organized labor more leverage than it may have had previously.

**Leading practices**

- Develop a robust labor consultation and negotiation strategy early in the divestment planning process. Prepare to deal with issues early so they do not become impediments to the divestment process.
- Engage with labor leaders as near as possible to the divestment announcement to build trust and a positive working relationship.
- Plan and budget for potential concessions that you are willing to offer labor during negotiations. Understand your maximum offer so negotiators can keep the process moving rather than pausing for new approvals.
- Consider the regional- and country-specific economic climate and labor dynamics in planning for concessions.

**Questions to ask**

- Has the finance team reviewed the proposed labor negotiation strategy and alternative proposals? Has the team considered possible implications on the carve-out financial statements?
- What are likely to be labor’s top concerns in the negotiations?
- Can work council consultations and employee communications help present the value proposition of the divestment to the labor force?

**Demystifying common misperceptions**

- **Misperception:** Labor negotiations should start early.
  
  **Reality:** Most respondents did not start discussions until public announcement in order to preserve confidentiality of the divestment. However, most respondents devoted a high level of effort in preparing for labor discussions.

- **Misperception:** Labor always opposes a divestment.
  
  **Reality:** The most satisfied respondents concluded labor negotiations in 15 to 30 days and provided few concessions. The apparent cooperation by labor reflects that in a difficult economy, the alternative to selling the business may be business discontinuance and job loss. Therefore, organized labor generally recognizes the benefit of supporting a divestment regardless of jurisdiction.

**How much time is typically required to conclude labor negotiations?**

<table>
<thead>
<tr>
<th>Region</th>
<th>Less than 14 days</th>
<th>15 to 30 days</th>
<th>31 to 60 days</th>
<th>More than 60 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other South America</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Europe</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Africa/Middle East</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td></td>
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<tr>
<td>China</td>
<td></td>
<td></td>
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<tr>
<td>Other Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia/Oceania</td>
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</tbody>
</table>
Freezing transfers

How to provide buyers more certainty and expedite the sale process

In a divestment, sellers sometimes freeze the option for their employees to transfer between seller and divested entity in order to maintain business stability and buyer confidence. Specifically, freezing transfers gives buyers more certainty that what they evaluated in the diligence process is the business that will be delivered. This practice also alleviates buyers’ concerns that an unfair selection process could result in undesirable employees being transferred disproportionately to the divested entity. Buyers frequently go so far as to request documentation of the selection management process. However, the in-scope employee population is legally determined in some jurisdictions, so buyers and sellers may have limited negotiation options in those locations.

While sellers identify and “ring-fence” the employees considered to be in-scope for the entity being divested, employees do sometimes request transfers. For example, if the functional leader of the seller realizes that an employee identified as in-scope for the divesting entity has critical knowledge and stakeholder relationships for the seller’s organization, the leader may seek to have that employee transferred back into the seller’s organization. Such transfers can be frozen during the planning phase, the sale process, at closing, at separation or not at all.

Eighty-eight percent of survey respondents froze the option to transfer employees at some point in the process. Of this group, 72% froze transfers during the planning or the sale phase.

Understanding the in-scope population early helps the seller compile financial statements that impact the seller, divested entity and potential buyers. For the respondents who froze transfers during the planning phase (before public announcement), 61% indicated this decision made the separation process less complicated.
They were able to explain to the buyer exactly what the buyer was paying for, they were more prepared and they experienced less back-and-forth in the negotiation process.

While most respondents froze transfers during the sale process (i.e., once the divestment intention is announced and bidders are looking at the business), only 55% indicated this decision made the separation process less complicated. While it is ideal to freeze transfers earlier, many companies may wait until after the public announcement because they need to keep the transaction confidential earlier in the process.

Conversely, 66% of those respondents who froze transfers at separation indicated this decision made the separation process more complicated.

The timing of transfers between entities can lead to employee disruption and confusion. This can then impact all processes that need employee data to disentangle the entity (e.g., HR information systems, payroll, real estate). While information for these functions can be updated with new employee in-scope lists, this process creates additional work for the divestment teams and greater potential for errors and disruptions upon separation.

### Leading practices

- Identify in-scope employees in the planning stages, before the public announcement.
- Make early announcements of strategic review or strategic intent to carve out a business. The announcement affords the opportunity to freeze transfers, address early retirement questions, and control hiring and promotions at an earlier stage in the transaction. This can help minimize risks associated with long announcement delays.

### Questions to ask

- Will you allow transfers out of the business unit?
- Will you create a policy or process for managing new hires, transfers into the business unit, redundancies, promotions, etc.?
- Will you negotiate restrictions on the buyer’s recruitment of your employees post-close?
Manage employee mindset

85% of survey respondents say that employee retention is the biggest driver of carve-out success

Savvy executives understand that managing employee mindset avoids distractions that may result from uncertainty and misinformation regarding workplace dynamics during a divestment. Providing support to employees of the business unit being divested and to those remaining with the seller can help defuse negative feelings and keep the divestment process on track.

Communications may work best for different companies at different times, but one thing is certain: communications must be timely, honest and culturally appropriate.

When to communicate to employees

Some early communications about the divestment and employee selection with a select group of insiders can ensure that adequate skills are available to support decision-making and start divestment preparations. This group is critical to the divestment’s success, so hearing information directly and in the proper context improves retention of these key employees. A significant majority of survey respondents identified key roles in the new organization during the planning phase.

Similar to how companies deal with work council consultations and labor negotiations, most companies wait to notify the larger group of employees until the deal is publicly announced. Of those who identified themselves as satisfied with the divestment outcome, 59% chose this. The potential benefits of communicating to employees upon public announcement can make the message more finite and minimize changes. Others may take this approach because of confidentiality concerns and public company-registrant requirements.

On opposite sides of the spectrum, only one-fourth of respondents communicated the decision to in-scope employees upon their identification, and all of these respondents said that choice either made matters less complicated or had no effect. Twenty-five percent told their employees late in the process, immediately prior to close, but many of them (46%) believe this decision made the process more complicated.

Questions to ask

Sellers should consider the following to determine the potential for complications caused by in-scope employee communications:

- What is the state of labor relations at the business to be divested? Pose this question in all countries where in-scope employees are affected.
- Have there been rumors of a divestment prior to announcement that may help to evaluate employee perceptions about a divestiture?
- How do in-scope employees view the likely buyer?
- What legal requirements will prevail and impact announcement timing and form?
- Are all regulatory aspects of the divestment clearly understood, particularly when the buyer, seller or SpinCo are in different jurisdictions?

How have prior business changes been communicated?

Who to include in communications

Various employee stakeholder groups may represent individual constituencies in the deal disclosure process. For example, employees are likely to turn to immediate supervisors with questions, so briefing that management team on how to respond will help send a consistent message.

Treat each stakeholder group’s concerns individually. Understand each group’s concerns and engage with labor representatives early to build successful outcomes. Typical employee stakeholder groups include:

- General in-scope employees
- Key and critical employees
- Executive leadership and management groups
- Labor representatives such as unions and work councils
- Seller-retained employees

Inform key employees early. Structure communication plans so that key employees are briefed in advance, thereby generating support and
excitement at a senior or influential level. This sentiment should, in turn, cascade enthusiasm through the ranks as employees turn to their managers for information, message reinforcement and support.

Consider culture. Sellers should also consider cultural variants when developing communication plans – labor can be either a deal advocate or foe depending on how the deal is managed and communicated. For example, in some countries, work councils may work alongside a company’s management team to help it succeed; they may have a board seat, vested interest in the company and understand how management functions. However, in the US, labor leaders are outside of the company and are incentivized to work for the sole benefit of the employees. Variations in country labor laws also impact what can be communicated and when. Further, employees in countries with greater labor protection have different concerns than countries without such protections.

Keep unions informed. Keeping unions or work councils informed about the plan and the divestment process builds trust. When appropriate, labor and especially work councils can help in delivering positive messages about the divestment. The time invested to build relationships will likely pay dividends later in the sale process by enabling faster decision-making and avoiding strike action.
The following retention techniques were most closely associated with success in retaining employees

1. Provide enhanced severance protection to employees post-close. Employees worry that if they stay, they could be laid off soon thereafter. But this protection is a way of communicating that the company is committed to keeping the employee and will therefore pay a greater severance if the company is forced to lay off the employee. This tactic alleviates the employee's concern about job loss and reinforces the value proposition for the new company.

2. Make managers accountable for retention. People trust managers. Managers also know employees best and can therefore articulate the value proposition most effectively.

3. Benchmark employee compensation, vacation plans and retirement programs.

4. Avoid severances that are associated with the transaction.

How to retain and engage employees

Sellers should develop a communication program to articulate the value proposition of the divestment and get ahead of adverse attrition and employee distractions. Nearly four in five respondents indicated that they at least “sometimes” rely on such a plan to aid in critical employee retention, including 29% that said it is a tool they “always” employ. While money will always be the key issue for many impacted employees, a strategic communication plan can help them be aware of other possible deal benefits, such as career advancement, job security resulting from a renewed investment in the business or a better work environment.

These findings support the conclusion that a stay bonus is only a temporary stopgap measure that does not address the root cause of adverse attrition in a divestment: uncertainty about the future of one’s career. A one-time bonus will rarely be persuasive enough to overcome the certainty of a good job offer with an established company. The employee may stay long enough to receive the bonus, but the employee will not necessarily be productive and engaged, particularly since a competitor could offer a better value proposition and more job security.

Retention techniques used by respondents compared with success in retaining employees

<table>
<thead>
<tr>
<th>Retention Technique</th>
<th>% Who Use Technique Often or Always</th>
<th>Success of Those Who Often or Always Use the Technique</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stay bonus paid for remaining with the organization to close</td>
<td>7.9</td>
<td>7.0</td>
</tr>
<tr>
<td>Communications to articulate the value proposition for divestment</td>
<td>7.3</td>
<td></td>
</tr>
<tr>
<td>Enhanced severance protection for post-close period</td>
<td>7.8</td>
<td></td>
</tr>
<tr>
<td>Managers accountable for retention</td>
<td>7.9</td>
<td></td>
</tr>
<tr>
<td>Survey to determine concerns of critical employees</td>
<td>7.2</td>
<td></td>
</tr>
</tbody>
</table>
The end goal is to ensure that key employees’ performance and productivity are not disrupted. Employee engagement is particularly important considering that when customers and suppliers feel misinformed, they may get nervous and flee, particularly if employees begin to leave and intellectual capital is key to the company’s value proposition.

### Leading practices

- Inform only a select group involved in the divestment early in order to maintain confidentiality and prepare communications for the larger employee population to coincide with the public announcement.
- Treat each stakeholder group’s concerns individually when developing the value proposition. Employee surveys and focus groups can help identify specific concerns of each stakeholder group.
- Make line managers accountable for retention.
- Provide enhanced severance protection to employees post-close to effectively address employees’ job security concerns.

### Questions to ask

- How autonomous is the business at present? Employees of businesses with greater autonomy generally already identify with that business and are less likely to push back on being in-scope.
- Will employees view the business rationale as beneficial to them?
- Are there cultural reasons employees may have a negative perception about the transfer? For instance, does the seller have a strong brand reputation in a particular country or is employment at the seller considered a status symbol in a country?
Use human resource team to help execute

Companies that do not adequately plan for a carve-out’s tremendous time, resource and information requirements can risk a delayed process, sub-optimal value for the business or losing the transaction completely.

A few key planning techniques seem to drive carve-out execution satisfaction:

- The project team should use an HR playbook, tools and templates to address all steps in the process quickly.
- The team should analyze stand-alone costs relative to the workforce.
- HR executives for the divested company should be included in strategic planning for the transaction.
- The HR divestments team should include a balance of full-time and part-time resources, in-scope and out-of-scope employees, and local representation across regional and global locations.
- Separating the HR function to support the divested business, including creating stand-alone compensation and benefits programs, new HR vendor contracts, a successor HR service delivery model and organization design, as well as an HR systems and technology infrastructure
- Managing legal obligations toward work councils and labor
- Managing stakeholder communications and employee retention and engagement, and mitigating unwanted employee turnover

Success in these areas requires developing an integrated timeline to assign resources, identify interdependencies and execute the plan. Only 30% of survey respondents indicated that HR used divestment tools and templates to guide preparations and project management often or always; only 28% often or always used an HR divestment playbook. However, the survey revealed that these sellers thought that they would greatly benefit from including a playbook in their own lengthy, complex process. Use of a playbook would greatly improve deal satisfaction.

Follow an HR playbook

How to make sure you get it all done, and fast

The HR function plays several important roles in the divestment process:

- Supporting the preparation of stand-alone financial statements and carve-out cost analysis
- Helping manage the employee separation process in areas such as organization design, employee selection, transfer of employment, SpinCo talent management, recruiting and succession planning

<table>
<thead>
<tr>
<th>Activity</th>
<th>Average success in maintaining business value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conduct stand-alone cost analysis related to the workforce</td>
<td>6.6</td>
</tr>
<tr>
<td>Follow an HR divestment playbook</td>
<td>6.9</td>
</tr>
<tr>
<td>Enlist HR to prepare a plan that calculates resources needed for the divestment</td>
<td>6.9</td>
</tr>
<tr>
<td>Include an HR executive for the divested entity in strategic planning</td>
<td>6.8</td>
</tr>
</tbody>
</table>

Rate your frequency of usage and success with the following activities in your divestment transactions (0–10 rating)

- Success of those who often or always use the technique
- Success of those who never or sometimes use the technique
A playbook guides the seller on each step of the carve-out process: what needs to be done, when it needs to be done and who needs to be involved. It covers which resources to call on to mobilize teams, key issue identification, leading practice decisions and underlying logic supporting the decisions, sample work-product tools, and methodology to support the divestiture process. A seller can develop a playbook customized to its organization, or it can use a generic template if it doesn't pursue many divestments.

High performers use HR resource plans to calculate the amount of HR staff they will need globally to execute the divestment and how many fully dedicated HR resources they will need for the core team. Additional leading practices include leveraging the playbook to conduct just-in-time training at kick-off and when onboarding new HR team members during the divestment process.

Survey respondents indicated that they used at least partially dedicated HR specialists to cover the following areas:

- In-scope employee identification
- Executive compensation
- Global equity compensation
- Global pensions and benefits
- Global employee compensation
- HR operations, TSA, vendors
- Payroll, HR information systems
- Retention, redundancy, relocation
- Expatriates
- Employment law
- Onboarding, employment transfer
- Employee communications
- Culture
- Organization structure
- Executive and key talent assessment, selection and alignment
- Perquisites, policies and procedures
- HR financial analysis

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Analyze people-related stand-alone costs

Make numbers stand up to buyer scrutiny

Sellers experience greater deal satisfaction when they perform a workforce stand-alone cost analysis in the planning stages of the divestment. And 57% of respondents often or always complete those calculations; they examine employees and their benefits and build stand-alone analyses based on those to be transferred. Sellers can also allocate current costs to the entity to be divested, but this approach generally is not very accurate and a buyer will likely challenge it.

Include human resources representation in divestment team

Involves those whose coverage area significantly affects company price

An HR executive must be involved in the strategic planning for the divestment, as employee matters across the transaction life cycle can have a significant financial or operational impact on the selling firm, including how the seller prices the company for sale. Employee-related issues that can impact deal price include negotiations with potential buyers, labor relationships and communication, and ability to implement decisions regarding pension liabilities, pending litigation, retiree medical costs and union contracts. Further, in-scope HR individuals are likely to be most knowledgeable about the operations of the divesting entity, and they also may have an inherent interest in the success of the entity once separated from the seller.

Sixty-three percent of respondents often or always have an HR executive involved starting in the strategic planning stages of a divestment, with 28% of respondents sometimes involving them. Those numbers should be higher for strategic sales, but sellers may mistakenly leave HR out of the process when they sell to financial buyers because of a misperception that those buyers are often less concerned about HR issues. When sellers do not include an HR executive, they risk making mistakes in areas that are critical for preparing carve-out financials, such as how to divide and structure the divested entity and how to communicate effectively with labor groups.

Build a diverse divestment team

Include resources that can address all functional areas and geographies within tight timelines

The dedicated teams responsible for human resource disentanglement activities need to focus on each functional area of the business in order to properly manage all issues and interdependencies, and they need to send cohesive reporting to a central steering committee.

Balance part-time and full-time resources. Teams can be composed of a large number of partially dedicated HR professionals and balanced by some full-time personnel. Or, the team can consist of a few, but fully dedicated, HR personnel supporting the divestment.

Most companies (52%) used HR divestment teams composed of both fully and partially dedicated HR personnel. This combination of fully and partially dedicated resources is a leading practice: this team composition can meet divestment implementation demands with fully dedicated resources focused solely on managing the day-to-day planning, coordination and implementation of the carve-out, while subject-matter specialists contribute to function-specific matters, either in a part-time capacity or on an as-needed basis. To avoid lagging timelines, companies can redirect some resources exclusively to the divestment team. If this is not possible, they should supplement with outside experienced professionals.
Sellers can also overcome resource issues by having a resource plan and looking for gaps. Companies often convert their HR work plans into a time-requirements analysis by estimating the amount of hours needed to complete the work plan steps. Next, they identify the source of the HR resource to conduct the activity (e.g., corporate, shared services, business unit generalists). They analyze competing projects and estimate where they will have gaps in either geographical location or functional support teams.

**Balance in-scope and out-of-scope employees.** One caution about team members that will go with the divestment: these employees will eventually begin to identify with the new entity and, as a result, become somewhat conflicted in making decisions that are in the best interests of the selling parent company. While this allegiance is natural and beneficial to the process, the seller should not cede all final decision-making and control to those employees. Instead, the seller should maintain a balanced team that has a shared interest in the success of the divested entity and a clean separation from the seller. Eighty-seven percent of respondents indicated that their HR divestment execution teams were structured this way.

![Graph: Divestment staffing model](image)

Place your divestment staffing model along the following scale as it relates to dedicated HR personnel

**Graph: HR divestment execution team**

Place your divestiture execution team along the following scale as it relates to RemainCo and SpinCo employees

![Graph: HR divestment execution team](image)
Include local representation in cross-border divestments. Sellers should have cross-border representation on divestiture teams to cover all affected regions. In particular, survey respondents faced more challenges in emerging markets because of lack of experienced HR personnel with time to manage a divestment. Most survey respondents noted that they have completed a divestiture involving multiple countries. However, only 44% said their divestiture team included local representation; among those who were most satisfied with their divestments, 59% included local representation.

Unlike other business functions, employment matters are highly impacted by local laws and culture. Therefore, sellers could improve the divestment process by having experienced local presence alleviate the challenges of remotely addressing complex labor relations dynamics and local laws and cultures – particularly considering that the more countries involved in a divestment, the less likely the seller will feel satisfied with the transaction.

Leading practices

- Follow an HR playbook.
- Analyze people-related stand-alone costs.
- Include HR representation in the strategic planning of the divestment.
- Build a diverse divestment team that includes full- and part-time resources, in-scope and out-of-scope employees, and local representation on cross-border divestments.
- Include someone that understands local legal obligations on the team.

Questions to ask

- Do you understand the sequence of HR activities and inter-dependencies across the entire divestment timeline?
- Can you estimate the number of full-time and part-time HR staff to support the divestment process?
- Do you have a divestment playbook highlighting the path forward, key decision points, leading practices, tools and methodology?
- Should you conduct just-in-time training for HR team members as they onboard into the divestment team?
Conclusion

Following years of peak M&A activity and then a global recession that drastically slowed transaction activity, the economy may be approaching some semblance of a middle ground. But particularly considering this still-uncertain environment, organizations across the globe are taking a comprehensive look at their portfolios. Corporations are carving out peripheral businesses that may have been included in a large M&A deal years ago, as well as those that do not align with their strategic priorities.

For leading companies, divestments are as essential to capital strategy as acquisitions. A successful divestiture increases shareholder value while preserving and optimizing capital. However, carve-out divestments are now often more complex, because most involve multiple countries and, therefore, multiple cultures and regulatory bodies. Sellers also face competition for limited buyer capital, which can make capital management a challenge. Sellers should keep in mind the following practices in order to expedite a sale, maintain control over the process and maximize deal value:

- **Strengthen negotiating power**
  by providing sellers with financial information based on actual employee data and expediting the process by understanding the carve-out business’s HR needs before negotiating the sales agreement

- **Maintain stable business operations**
  throughout the divestment process by addressing labor and critical employee concerns

- **Keep employees focused on business operations**
  and customers through targeted communications and retention planning

- **Organize the HR team to help execute**
  a timely and cost-effective disentanglement and business transfer

Buyers want investments that will enhance their business portfolios and growth potential. Sellers can present a compelling message to buyers by considering market opportunities, goals and asset performance and by incorporating the right professionals into the right roles. Both sellers and buyers will benefit by considering the sensitive needs of impacted employees, contractors and customers.

Interesting write-in comments from survey respondents

Some survey respondents wrote in their own answers to questions regarding how they evaluate whether a divestment was successful. Here are what they considered to be the most important factors:

- **Benefit to remaining business.** Companies sometimes focus so much on the business to be sold that they don’t spend enough time on optimizing the remaining business. For example, companies need to think about the new organizational design (e.g., recruiting plan or excess headcount) and how to measure and motivate employees in a new operating environment.

- **Identification of stand-alone value.** With the carved-out business no longer burdened by corporate overhead, the company can hire less expensive labor, outsource to lower-cost jurisdictions, build incentive plans aligned with the new business type, hire different salespeople, and be more flexible than it could be as part of the original parent company.

- **Fair compensation given to C-level employees forced to divest part of their business.** Compensation should be adjusted for the new corporate structure. If the remaining entity is smaller and bonuses are based on a multiple of earnings or certain sales numbers, take-home pay could be significantly lower.

- **Ability to service a TSA.** The selling business should be able to run two payrolls instead of one, including two sets of tax and payroll filings, etc. And they should be able to track costs. The firm also has to handle benefits and Social Security administration depending on which entity an employee is working in.
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