Developing an optimal delivery model

Business in a box: Part 2

Carving out a business for divestment can be a great source of value for companies looking to focus on their core or eliminate underperforming units. Ideally, the seller should present the divested operation to potential buyers as a "business in a box"—a standalone entity prepared to thrive unencumbered by operational, managerial or financial issues.

Setting the stage

It's helpful to understand the macroeconomic conditions that could affect our decision-making approach as we aim to assess and develop our global delivery model (GDM) for carve-outs. Slowing globalization, trade tension and high demand for talent are examples of market dynamics that can affect an organization's GDM structure. The Global Business Alliance found that 77 percent of its members expected the U.S. to become more protectionist on variables such as trade, mergers and acquisitions, and government procurement.[1] This will have a significant impact on processes and talent recruitment for both U.S.-based and U.S.-dependent organizations.

When it comes to deployment of assets, most multinational enterprises mimic the positioning of their sales relative to their home base: 78 percent of assets are deployed in the region associated with 75.7 percent of sales.[2]

As exemplified by the healthcare and life sciences (HCLS) industry, regulatory and compliance requirements—and how they contribute to business continuity—are critically important for their impact on CarveCo's[3] ability to sell and operate in particular countries. An HCLS company's GDM must enable it to address these requirements by ensuring that assets and processes are positioned to reach milestones at the correct time and along the carve-out deal's critical path.[4]

This paper is the second in a four-part series that examines the key phases of the carve-out process:

1. Setting up a carve-out for success
2. **Developing an optimal delivery model**
3. Executing the delivery model
4. Avoiding the pitfalls throughout the process

[1] Verbeke and Asmussen, "Global, Local, or Regional? The Locus of MNE Strategies," The Journal of Management Studies 53:6, September 2016.

[2] Locus of MNE Strategies, 2016, Verbeke, HYPERLINK "https://onlinelibrary.wiley.com/doi/pdf/10.1111/joms.121

[3] CarveCo is the subsidiary, division or other part of a larger business enterprise that is being carved out to be sold or stood up as its own entity.

[4] Critical path is the series of tasks that must be completed for a transaction to finish on schedule.

Why is the delivery model important?

During a carve-out, both CarveCo and the parent RemainCo[5] typically focus on the present rather than setting up the business for long-term success. It's imperative that the organization can transact, pay suppliers and employees, and ship goods on Day 1. But those are mere table stakes in the current state of play, and organizations need to strive for sustainable excellence to validate CarveCo's first-year investment thesis and achieve its growth targets.

A well-defined and well-intentioned GDM of shared, centralized and decentralized services is crucial to realizing a carve-out's deal thesis. Developing the GDM also is a critical step in turning a once-struggling business into a thriving example of efficiency and efficacy that achieves both optimization and economies of scale. What's more, these same services often encompass a carve-out's most complex elements and drive decisions around cost allocations, operating-model entanglements and transition service agreements.

Building the most appropriate GDM for an organization involves addressing key questions across topics such as centralization level, organizational structure per geographic tier (global, regional, country), and ownership and deployment method of tasks and services. The answer to each question depends on CarveCo's unique strategic objectives, global footprint, revenue-generating activities, and market dynamics.

As we look to CarveCo's future, we must evaluate existing support provided by RemainCo and identify what is required to achieve CarveCo's strategic objectives. We therefore need to consider the view through two lenses: first, what is coming from the old organization (RemainCo), and second, what the new one (CarveCo) will need to survive on its own (Figure 1).

Figure 1. What RemainCo will provide and CarveCo will need for CarveCo's survival

Support from the old	Design for the new
• Entanglement logs	• Operating model
• Transition service agreements (TSAs)	• Alignment of personnel and real estate
• Reverse transition service agreements (rTSAs)	• Non-people resource requirements

Complexities and challenges

The development of an organization's design and structure is notoriously challenging and must account for two paramount issues:

1. Which services and processes will be performed, and where?
2. Who will perform these services and processes?

Deciding whether a process or task should be performed in centralized or regional locations (including where management decisions reside) is on the critical path following development of the operational blueprint. (We address the execution of these decisions and plans in the third paper in our series, "Executing the delivery model.")

As the process moves forward, many carved-out businesses attempt to mimic their parent's organizational structure despite lacking the economies of scale, business purpose or, in many cases, operational backbone needed to similarly function. This can lead to dis-synergies, operational inefficiencies and value destruction.

Companies intending to establish a new GDM via the carve-out should watch out for five key potential pitfalls: cookie-cutter structure, TSA crutch, headcount creep, continuous improvement and contextual comprehension (Figure 2).

Figure 2. Potential pitfalls during Global Delivery Model (GDM) development

Challenge	Root cause	Impact
1. Cookie-cutter structure	• Tendency to apply pre-existing methods in CarveCo driven by a "this is how we have always done it" mentality	• Disadvantageous position for CarveCo, as existing operational and organizational model (or a variation thereof) doesn't reflect the organizational design required to accomplish CarveCo's operational and strategic plans • Redundant processes, bloated headcount, inefficient and ineffective ways of working that are not specific to CarveCo
2. TSA crutch	• Reliance on TSAs as an emergency solution in cases where processes are not set up by Day 1 per the planned structure	• Delayed decision making • Increased risk of incomplete readiness for Day 1 • Less time to realize value • Reduced operational independence
3. Headcount creep	• Leadership's expectation that a carve-out is the only opportunity to build teams, combined with belief that hiring more people will solve all the issues at hand	• Increased costs and complexity • Reduced profitability
4. Continuous improvement	• Continuous updates to the carve-out plan to incorporate day-to-day business strategic planning in response to market dynamics	• Delayed closing due to ongoing revisions of original plans including impact assessment, cost analyses and re-approval processes • Increased risk of reverting to RemainCo structure
5. Contextual comprehension	• Changes in terminology and definitions, combined with functional managers' inability to contextualize, can precede prioritization issues	• Increased risk of inappropriate resource allocation and activity prioritization

The global delivery model approach

Creating the global delivery model is more complex than simply centralizing function or team leadership and offshoring back-office teams. An optimal GDM enables the newly carved-out entity to streamline overly burdensome costs and processes that may have hurt its competitiveness.

Decisions about the GDM are a critical component of the increasingly intricate process of assessing and standing up shared services in global carve-outs. These decisions are influenced by reshoring and nearshoring of services as well as shortages of skilled workers.

While offshoring services can be a fundamental step in a centralization strategy, it also can be a blunt instrument for achieving cost efficiencies. By comparison, skilled-worker shortages can create an opportunity to re-evaluate existing processes and resources throughout the GDM methodology, and consider how reshoring solutions may fit the model.

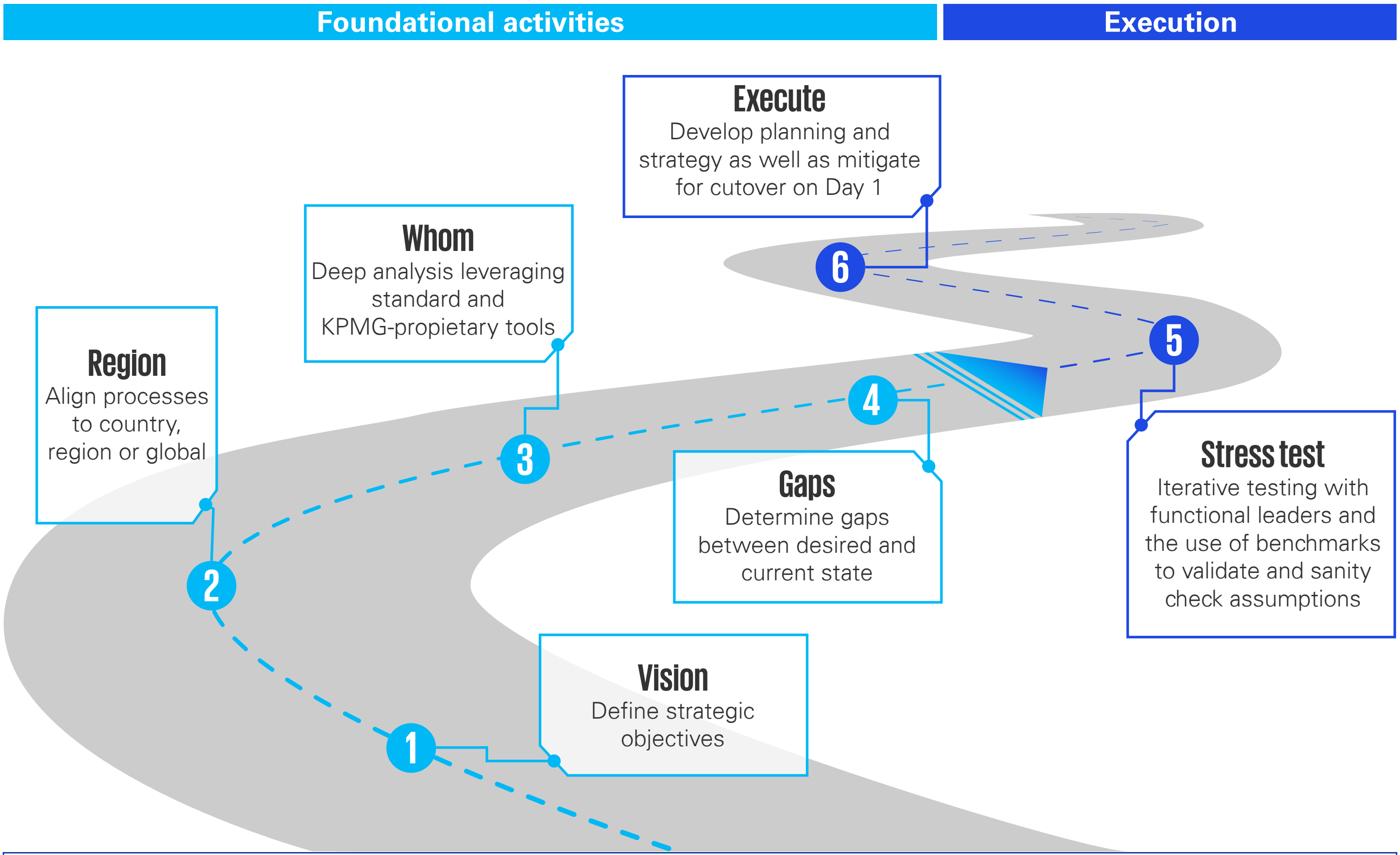
An effective GDM considers individual and cross-function objectives and delivery requirements (such as the appropriate degree of standardization or customization) when determining whether to centralize or decentralize. By contrast, a shared services model is tailored to the business's needs within a single structure.

Processes and headcounts within an organization's GDM should be measured against certain criteria, as there is not a one-size-fits-all index of requirements for personnel, processes or systems within each geographic tier (i.e., global, regional or country).

The 10 criteria in Figure 3 serve as a rubric: The more of them that apply to a function or process, the higher the probability that the function or process should have a centralized structure. If a function or process meets at least five criteria, it's probably a good candidate for centralization—but if it meets more than seven criteria, centralization almost certainly is the right approach.

Figure 3. GDM centralization rubric

1	**Services need to be standardized**	6	**Consistency is needed in completion**
2	**Shared service is cost versus profit center**	7	**Limited in-country expertise required**
3	**Talent needs to be consistent and uniform**	8	**Single reporting and accountability structure**
4	**System needs to be consistent**	9	**Uniform leading practices across service lines**
5	**Process needs to be standardized**	10	**Seamless collaboration beteween service lines**



1. Develop strategic ambitions: What is our "why?"

- Establish CarveCo leadership's aspirations for the future organization in order to provide a panoramic view of "Where we are going?" with a convincing rationale for the carve-out, including why it makes good business sense.
- The leadership team's ambitions will dictate the guiding principles for the distribution of people and processes across global-, regional- and country-level delivery models.

2. Align processes: What happens where?

- Determine which processes will remain local vs. centralized globally or regionally and assess whether any processes are cross-functional.

3. Align roles: Who does what?

- Confirm which role performs a process and the capacity per employee for each process assigned to the role.

4. Identify gaps: What is missing?

- Determine gaps between the current personnel footprint/plan and the targeted future state.
- Identify misalignment and whether to move people or processes.

5. Stress test: Does this work for our organization?

- Conduct iterative pressure tests with RemainCo and CarveCo leadership to validate optimal process global/regional/country alignment, role ownership and workforce capacity. This should include benchmark data where possible.
- Watch for excess workforce capacity, as function leaders may want to overstaff their teams and compromise the GDM from the outset.

6. Execution: How do we achieve this structure?

- Prepare a dry run-through of the model to assess its feasibility. Many ideas that seem great in initial ideation can fail in execution.
- Our next paper in this series, "Executing the delivery model" will cover execution in detail.

Building the right delivery model

A major multinational healthcare device company was carving out a historically unprofitable business unit (CarveCo) that received a high degree of support and services from its parent (RemainCo). This business's footprint spanned markets across five continents. The company brought in KPMG to understand how to structure its operations to increase service levels while reining in costs and building a competitive advantage.

At the outset of the process outlined in the "The global delivery model approach" section on page 4, KPMG primarily engaged with long-tenured RemainCo employees. This proved to be a blessing and a curse: The employees' deep knowledge ensured that the structure inputs were comprehensive, but inadvertently caused them to recreate the RemainCo structure while planning for CarveCo's separation. If RemainCo intended to execute its long-term strategy and maintain a competitive position in the marketplace, CarveCo could not simply become a mini-RemainCo.

Proceeding with the familiar structure could result in CarveCo's repeating the issues and challenges it faced prior to the carve-out, when it would have little-to-no support from RemainCo and couldn't dilute the impact of these challenges within RemainCo's larger P&L.

Where to go from here

The GDM is not an exercise to be completed, checked off the list and filed away—it is a living, breathing element of CarveCo's working operating model. As CarveCo finds its feet as a standalone entity and continues to look for more value-creation opportunities while preserving the GDM, the organization will find that it may need to make adjustments. As long as the initial structure is complete, minor adjustments should not be burdensome.

We've set up CarveCo for success with the blueprint roadmap and comprehensive planning for the transaction, and established its global allocation of people and processes via a GDM. Now it's time to move forward to execution. Our next paper, "Executing the delivery model," will take all the planning materials and explain how best to bring them to life.

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