Executing the delivery model

Business in a box: Part 3

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. There are many components to a carve-out: Financials (including tax), quality of earnings, standalone cost, tax/legal entity structuring. However, the papers in this series focus on the operational separation. Throughout this paper, we define execution as the stage that follows target diligence, preparation of the initial target operating model, and getting preliminary functional plans ready. At the time of execution, functional plans have not yet been implemented to achieve Day 1 readiness plans (see our first paper, "Setting up a carve-out for success").

Poor execution erodes deal value

Too often, execution of carve-outs is performed by loosely connected functional groups that operate with a limited view of the deal's scope, combined with a high volume of data and limited communication. So it's not surprising that the success rate of strategy execution is incredibly low: 83 percent of strategies fail due to faulty assumptions and execution.[1]

Successful strategy execution—especially in carve-outs—is made more challenging by the operational structure that companies need to remain competitive in today's market environment. Because companies must function via highly integrated processes and systems in order to achieve their desired operating efficiency, executing a separation of these highly integrated components requires thorough planning and sensitive management.

This paper is the third in a four-part series that examines the key operational 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] "The 5 Pillars of Strategy Execution," Gartner, April 26, 2021

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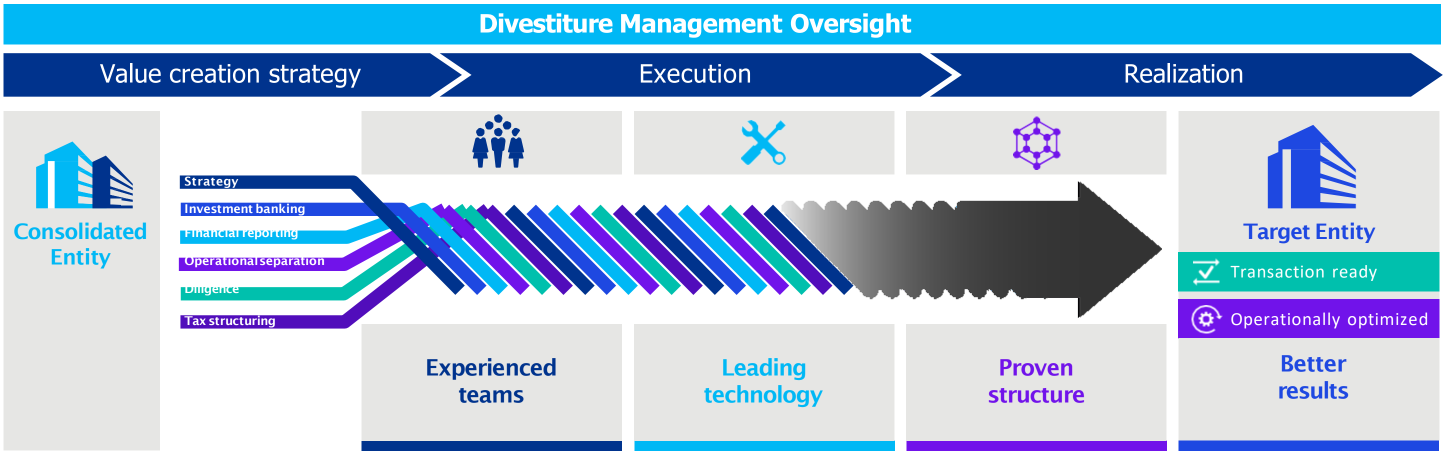

Figure 1 breaks down the divestiture process into the three phases of strategy, execution, and realization. As with the additional components in a carve-out mentioned earlier, our focus is on the operational separation, which requires highly experienced teams to guide the process. Coupled with leading technological capabilities and effective structure, execution involves business leaders' commitment both to thoroughly vet foundational planning (e.g., the blueprint detailed in "Setting up a carve-out for success") and strong project leadership to champion the plan in partnership with operational teams.

Our experience indicates that simply ensuring that these catalysts are in place isn't necessarily enough for a carve-out to succeed. It's critical that companies additionally evaluate numerous upfront factors, perform checks, and prepare risk mitigation strategies for potential hazards and pitfalls.

The foundation of most execution plans is what we call the critical path—it's a specified sequence of activities and milestones that minimizes risks and challenges in order to achieve the deal thesis.

Based on KPMG leadership's combined 200+ years of transaction experience, we see three categories of considerations that should be evaluated when reviewing, planning, and preparing to kick off the execution phase:

Considerations at the starting line

Consideration	Description
Strategy and the critical path	• Establish a clear link between the carve-out strategy and execution to ensure that conducting day-to-day carve-out activities tracks the overall strategy and doesn't get lost in the details. It's easy for day-to-day stakeholders to not see the forest if they're only looking at the trees. • Ensure that the critical path's order of operations comprises tasks sequenced according to dependencies (e.g., a new email requires the establishment of CarveCo's[2] new name/brand). • Focus on transitioning and transfering existing capabilities (rather than optimizing them) during the carve-out process.
People, leadership, and resourcing	• Identify employees who will transfer with CarveCo (especially those supporting shared services) and determine how they will be allocated within the new organizational structure.
IT and data management	• Data ringfencing: Ensure that RemainCo[3] and CarveCo cannot access each other's data in order to adhere to regulatory standards (especially when employing transition service agreements [TSAs] or clones). • While e-commerce should be self-sufficient on Day 1, it's better to leverage TSAs for most other systems to ensure the continuity of operations.

[2] 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.

[3] RemainCo is the parent company or seller that is divesting the CarveCo business.

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Organizations can define transaction failure in the execution stage in four ways, each of which affects RemainCo across four strategic criteria:

	Impact on RemainCo			
	Cost *Increased project cost*	**Focus** *Loss of focus and/or misaligned priorities*	**Time** *Extended carve-out timeline*	**Brand** *Negative reputational impact*
Day 1 is delayed	✓	✓	✓	
Investment thesis is not achieved				✓
Buyer pulls out	✓		✓	✓
Increase in unplanned TSAs		✓	✓	

But how are these considerations put into action? What can organizations do to improve the probability of achieving the deal thesis and realize the carve-out's expected value? We recommend evaluating five strategies for inclusion in your execution plan.

Challenge	Root cause	Impact
1 Soft close/ Dry run	• Prepare and engage CarveCo in a dry run prior to Day 1—ideally two months prior—that includes but is not limited to using separate technology systems, transferring employees, implementing treasury processes, recording transactions and closing accounting ledger, operating TSAs[4], etc.	• Provides sandbox environment for CarveCo to test execution with a safety net if processes, systems, or other components fail. • Early identification allows time to address gaps and make modifications prior to Day 1. • Reveals what is still required for Day 1 in a low-stakes environment.
2 No-regrets and must-haves	• Complete the no-regrets decisions and maintain them throughout carve-out process. • Since carve-outs can be more expensive because they break existing synergies, it's important that all stakeholders understand the transaction's end goals.	• Clear guidance and direction to the team, with firm decision-making and the shared vision of an end goal in mind.
3 Hypercare and tough love	• Anticipate hypercare support need during—and after—the Day 1 cutover. • Use workplan preparations to challenge the teams' assumptions as well as planned capabilities for Day 1 and beyond.	• When combined with soft-close preparation, hypercare can be handled while the carve-out entity is within the parent company. • Challenging prompts stakeholders to account for readiness requirements across stages and system or cross-functional connections.
4 Communication	• Internally, leadership must engage with employees early and often to ensure awareness of all available resources during the transition, and to solicit their input in defining the new organization. • Externally, make customers and suppliers aware of impending changes at the appropriate time for each party.	• Ensures that transferring employees understand the "why" behind the carve-out and are incentivized to remain with CarveCo. • Informing customers and suppliers at the appropriate time enables continuity of operations on Day 1 and beyond.
5 Red Teaming	• Engage internal and external experts without stakes in the carve-out to conduct a perimortem analysis (e.g., "If this is going to fail, how is it going to fail?").	• Outside perspective enables a comparatively objective view of carve-out and potentially identifies risks and/or gaps that may otherwise go unnoticed and result in deal failure.

[4] In a soft-close scenario, TSAs are implemented without charging the providing entity.

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In conclusion

When executing a transaction, organizations must ruthlessly prioritize the strategic initiatives that drive the deal thesis. They should over-emphasize the importance of credible, ongoing communications delivered by the right leaders; continually challenge execution plans to ensure comprehensive risk mitigation efforts; and carefully conduct change management and culture alignment by mitigating potential hotspots and resetting CarveCo's standards for high performance.

These actions all take place while leadership ensures that, as time goes on, the carve-out's initial rationale remains top of mind. The more time that passes—and the further the initial strategy session disappears into the rearview mirror—the more likely it is that the execution team gets lost in the weeds and forgets the deal's true goal.

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