There is a divestment party going on, with company divestments at near record levels. And as at a party, much of the focus is on the “here and now”; how to find the right buyer, and how to get the right selling price. The operational aspects of the divestment is something to worry about tomorrow and the stranded costs even more so. Currently, sellers are often enjoying high exit multiples, which further puts emphasis on celebrating today and consider the cost tomorrow.

However, a successful divestiture does not end with the signatures on the transaction documents. It also involves addressing the changes required post-transaction, including the stranded costs. Neglecting that, and you run the risk of not realising the full value potential of the transaction, or even worse, destroying value.

Our recent study interviewing 600 corporate executives, found that half the respondents saw room for improvement and more than 30% saw significant room for improvement in their approach of mitigating stranded costs1. Our cure for the stranded cost hangover is a simple but effective 3-step “pain-killer”:

1. Size up the stranded costs
2. Develop mitigation plan
3. Execute

1) Source: Creating value beyond the deal report, Mergermarket. Base 2018 survey of 600 corporate executives.
3-step “pain-killer”

1. SIZE UP THE STRANDED COSTS
Stranded costs are typically related to “shared” resources, e.g. assets, services and employees which after a divestiture, remain with you and become underutilized as a result of reduced scope of work. There may also be dis-synergies on top of this, e.g. the loss of purchasing buying power to be considered as part of the stranded cost analysis.

The first step in our cure is to define the operational transaction perimeter and understand how your remaining business and the divested entity will operate post-transaction, including a set of principles on how shared resources will be divided. A smart Seller should have a view of this early on in the transaction cycle.

Simultaneously, the costs for the shared resources need to be quantified. The analysis is likely to require involvement of operational staff who have an insight into the current day-to-day activities, and understand how resources are being utilised in reality as opposed typical arbitrary cost allocations which are unlikely to represent the “true” costs.

Once you have developed a thorough understanding on how shared resources are expected to be allocated between your remaining business and the divested entity, as well as the “true” costs involved, you are ready to move to the second step in our cure.

2. DEVELOP MITIGATION PLAN
You have identified the scope of the stranded costs; now it is time to assign ownership for mitigation actions. Our view that the mitigation planning is delegated to the functional managers in which the areas stranded costs occur. The functional managers, e.g. IT, Finance, HR etc, should be tasked to plan the detailed activities required to remove the stranded costs. There will likely be interdependencies between functions as well as different priorities, hence a cross-functional view of the plans is important.

Best practice is to have an appointed leader to follow-through on the activities and support the functional managers. Once the plans are developed, then stick these into an overall tracker outlining the activities, and the expected stranded cost reduction over time. Typically, it will take between 12-24 months to achieve an acceptable stranded cost reduction given “fixed” third-party costs and likely organisational changes involved.

3. EXECUTE
Once the mitigation plans are developed, it is time to move to the most important step in our cure – execution! Remember that a good plan will not help you if the execution is poor; however, a mediocre plan can typically be “rescued” by excellent execution. So after months of intense work, the closing date is here. Closing may seem to be the end of the journey, but it is as actually signalling the start of the post-transaction world - services under Transitional Service Agreements (TSA) that you have committed to deliver to the divested entity will need to be delivered while at the same time managing down the stranded costs. In the coming months there will be moving pieces affecting the opportunities stranded cost execution: TSA delivery; changes within the functions related to the divestment; and resource capacity issues.

A robust governance model will help you here to coordinate the effort. If possible, you should continue to keep the central coordination you established in the second step of our cure. Strong management will be required to drive the work and prioritize the activities. It is also during the execution step that the deal fatigue will set in. To ensure the stranded cost continue to have management attention, reporting on progress will be an important activity. Therefore, interacting and understanding management’s needs will be a key activity.

Finally, during the execution it is also advisable to capture the lessons learned - what went well and what can be improved next time you make a divestment.

CONCLUSION
How large the impact of the stranded costs will be, are dependent on many factors, but through structured analysis, detailed planning and focused execution, the impact can be anticipated and mitigated. Our 3-step cure provides you a framework for how to effectively avoid the stranded cost hangover.
PwC Sweden is the market leader within auditing, tax and advisory services, with 2,800 people at 34 offices throughout the country. Our purpose is to build trust in society and solve important problems. Our 45,000 clients are comprised of both global and Swedish companies and organisations of all sizes, and public sector entities. We provide guidance to our clients and assist them in achieving their goals, regardless of their stage of development.

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