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During divestitures, sellers increasingly perform their own HR due diligence to put people assets in the best light and get the best price.

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When a corporation grows through an acquisition, it's usually not shy about letting the world know. News releases and press conferences announcing the new empire abound, portraying the company as a surefire success in a business environment where bigger is assumed to be better.
But for every acquirer, there's a divester--an organization that has chosen to sell off a unit, a division, a subsidiary or even the whole shebang.

In contrast to acquirers, even when divestitures make good business sense and pay off, divesters tend to avoid the limelight. Companies may view the process of unloading assets as embarrassing--a signal that senior management committed errors.

"Divestitures are the big secret," says **Valerie Frederickson**, CEO of Valerie Frederickson & Co., a global human capital management consulting firm in Menlo Park, Calif. "They're kept underground because the company doesn't want to be perceived as not doing well."

A similar dichotomy exists between the way acquirers and divesters involve their HR departments in the buying or selling process.

When companies seek out a target to buy, they usually pour substantial resources into HR-related due diligence, meticulously weighing the pros and cons of a purchase, often going outside for specialized consultants.

In contrast, divesters tend to be more reactive. On the selling side, "HR typically gets involved when the CEO comes in and says, 'Here's what we did yesterday,'" Frederickson observes. Instead, she argues, "they should be proactive, helping to put a gloss on what they're selling."

Ross Zimmerman, senior consultant at Hewitt Associates in Lincolnshire, Ill., a consulting firm that handles mergers, acquisitions and divestitures, says his organization works with HR on the buyer's side 95 percent of the time and on the seller's side only 5 percent of the time. But now, with a spate of failed negotiations and deals that critics see as missed opportunities to maximize profits, that ratio seems to be changing. Increasingly, sellers are recognizing the advantages of giving HR a more active role in the divesting process.

Zimmerman estimates that HR can add as much as 5 percent to the selling price by anticipating, accurately assessing and helping to strategically position human capital issues in each of the three phases of the divestiture process: pre-shopping, shopping and shoring-up.

At the very least, with HR in the loop, the divestiture will play out more easily, employees' needs will be spoken for, and the company can better control its reputation.

To Sell or Not To Sell

Once a company's leaders begin mulling the feasibility of divesting one or more pieces of the business, a flurry of activity usually ensues--with general counsel exploring the legal issues, the chief financial officer considering financial ramifications and the chief operating officer reviewing operational concerns.

In this pre-shopping phase, HR should be looking carefully at compensation, succession planning, and the continuity of exiting and remaining entities, says Tom Capizzi, vice president of worldwide HR at Santa Clara, Calif.-based Thales Navigation, a manufacturer and distributor of global satellite positioning, navigation and guidance equipment throughout the United States and Europe. Capizzi has been through six divestitures at Thales, each affecting between 20 and 1,000 employees.

When the executive committee at Thales determines divestiture is a possible option, Capizzi and his HR team move rapidly. "We conduct a reverse due diligence-an evaluation of our entire situation from a human capital perspective--and identify issues and concerns so there will be no surprises. We need to know what we're giving up, what we're willing to offer it for and what the impact will be on our remaining business. CEOs appreciate that because it allows them to make informed decisions."

Pre-shopping is the optimum time for HR to produce a clear-eyed assessment of skills and competencies of key talent at the unit being divested. "Show how you will keep your key home talent while passing along enough to keep the divested piece attractive," says Margie Mader-Clark, vice president of HR and facilities at Sunnyvale, Calif.-based Hyperion Solutions Corp., a producer of business performance management software with 2,600 employees in 20 countries. "You're doing [employee] rankings, keeping in mind that you don't want to sell off your brainpower," adds Mader-Clark, who has handled five divestitures during her career.

Comprehensive due diligence also includes a detailed examination of base salaries, benefits costs and soft costs to determine the financial liability of the unit. Also included is an assessment of what will happen to your infrastructure if you eliminate part of it, and a plan for keeping the group that's targeted for divesting running until the final sale.

For example, when Mitsubishi Corp. recently decided to divest a U.S. chemical company it considered to be underperforming, it involved the company president and top HR executive, Dave Siporin, in the decision-making process.

"I was asked to put together a proposal to retain the key officers and to plan for the after-sale transition," says Siporin, who benefited from a parachute deal and enough time to find his current job as vice president of shared services at Lord Corp. in Cary, N.C., a 2,200-worker company that manufactures adhesives and coatings. "We met and developed a program that included severance and retention bonuses for 40 key players--managers and technical experts tied to the sale."

Inevitably, due diligence will have an impact on the structure of the deal. American Water, a Voorhees, N.J.-based utility with 8,000 employees that provides water, wastewater and other related services, is a case in point. Debbie Krauss-Kelleher, director of compensation and benefits, was called on to provide data to help management structure a divestiture of a 120-employee company. As a result, HR recommended that the sale be packaged to include buyer responsibility for costly retiree benefits.

Sometimes a thorough HR evaluation results in a no-go. "We've gone through them and decided to pull the deal from the table and wait six months because, through our due diligence, I was able to provide them with information about certain managers who could lead a turnaround if given a few months to prove themselves," Capizzi says.

Getting the Best Deal

Although sellers often don't know the motivations of potential buyers ahead of time, HR has to prepare the human assets for the most likely scenario. That means understanding why the buyer wants the assets and tailoring your presentation accordingly. "Get in their shoes and understand what will contribute to enhancing the purchase price and what will bring it down," Zimmerman says.

Think like an investment banker whose job is to package the divestiture. Like selling a house, you may need to do some fixing up so you can get more value. "I've had the experience where you look at the deal as a run-down house," Capizzi says. "You've got to pretty it up, put a coat of paint on it, before a buyer will be interested." In one situation, Capizzi says that Thales Navigation decided to upgrade leadership. "We brought in interim management to run the division, people who knew there was a chance of going with the business if the transition went smoothly.

"But don't overdo it," Capizzi cautions. "One coat is enough."

The question of how much fixing up to do turns on how much the company is willing to spend, says Don Schneider, an HR consultant in Westport, Conn., and former senior vice president of HR at The New York Times Co., where he was involved in a divestiture. "Calculate your ROI [return on investment]. What will it cost to make it more marketable and what will I get in return?" Don't forget to factor in opportunity costs you incur by allocating resources that could be supporting your core business.

In contrast, Anusha Felsher, national manager of HR and administration at Hyundai Auto Canada in Markham, Ontario, says sprucing up assets sounds good but usually doesn't happen. "The only coat of paint I've seen is dropping the price," says Felsher, who handled two divestitures as chief HR officer at Photon Dynamics in Toronto. "Usually, when you consider how much time and energy you'll have to spend managing it when it doesn't benefit your core business, you just lower the price."

Sometimes, lowering the price can be the right move for a seller. It may encourage a quicker sale, improving your cash flow and preserving morale for the remaining workers.

Whatever the final strategy, cover up, distort or withhold key information at your peril. "One of the tenets is to shed light on everything," says Zimmerman. "If you don't reveal the warts, the buyer will think it's cancer and not a wart. I'll uncover things and prepare to reflect them in the best light, assuming the buyer will assign penalty values to things that are not revealed or fudged."

When offers are received and weighed, HR input can be critical. That was evident when EDS France (a subsidiary of Plano, Texas-based Electronic Data Systems Corp.) received two offers for several units it was divesting. The executive team, HR included, struggled with the decision, recalls Jean-Louis Mutte, an HR consultant in Lille, France, who was HR director at EDS France at the time.

"My managing director asked everyone on the executive team to choose among the buyers and explain why," says Mutte. "I recommended selling to the one who put less cash on the table because I believed it would treat the people we were divesting better. I was backed up; we sold to the lower bidder."

Communicating and Preserving

Ideally, HR's participation in the pre-shopping and shopping phases is off the radar screen, confidential and conducted by only a few trusted staff members. But inevitably the news leaks out.

"You've got to be careful what you say and how you say it," Capizzi says. "If you think your discussions are a secret, think again; employees know what's going on. The word gets out sooner rather than later." When it does, HR assumes the challenge of reassuring some understandably nervous people. "HR is asked to keep things running so the wheels don't come off," says Jim Bowers, vice president of Hay Group in Philadelphia. "People get nervous about being acquired. Once the word is out that we'll be sold by March, [employees think] 'I have an annual incentive that's due in June; I may as well leave now. It's good time to bail out.'"

HR should play a lead role in developing and implementing a communication campaign to prevent sabotage, calm possible union unrest and deal with other negatives that may cause a downward spiral before the divestiture deal closes. "Determine what, when and how you can communicate," Schneider says. "When I was VP for HR at The New York Times, I pulled a top-level team together to make these decisions--HR, the CFO, COO and general counsel."

Convey to employees in the unit slotted for "carving out" that it's the best thing that can happen, advises Frederickson. "Tell them that the company needs to be owned by people who know the business, who have more money, and that if it's not spun off, it may go out of business. Coach the management in the company that's being divested to look good so the investors will want to hold on to them. Prepare newsletters, hold town hall meetings--use all the communication tools available to you."

Since leaders who are disgruntled can hurt the sale, offer them bonuses for helping get the best price, Bowers says. In addition, companies shore up their management by folding into their compensation packages change-of-control agreements, or parachutes, that protect executives who are linked to the divestiture--usually at rates equivalent to annual salary for those at the top. Parachutes are effective if done in moderation because they help preserve and enhance the property. But when they make the costs of the acquisition too great, they're aptly called poison pills.

Include assurances for the buyer that key people will stick around during and after the transition. In the Mitsubishi divestiture, HR created three cohorts of employees, all with different termination dates. The first cohort was cut when the deal was announced; the second was offered incentives to stay on until the deal closed; and a few employees were offered positions with the buyer.

Remember too that employees who remain often have a huge investment in the part of the organization that's going away. That puts them at a retention risk. "The company has to reach out to them," says Mader-Clark. "You have to make your people understand the business reasons for the move, and that they're not next in line."

Deal Breakers

Overall, whether HR-related or not, many promising deals crater. Zimmerman estimates that 40 percent of the time, the original deal will fail to close, but that on the second or third effort, the seller will succeed in finding a suitable buyer. Twenty percent will continue to twist in the wind, leaving the seller no choice but to withdraw the deal.

Experts recommend factoring this worst-case scenario into your planning. Consider how you will restore morale and maintain productivity if workers and managers who thought they were being adopted find themselves back home. "Say you're a restaurant chain trying to unload some unprofitable locations, and the deal falls through," says Schneider. "Are you better off with the doors shuttered, or continuing to run it until you can find another buyer down the road?"

Generally, HR miscalculations and omissions cripple but don't torpedo the transaction.

"We've worked on hundreds of deals, and HR side effects and revelations frequently influence the ultimate purchase price. But only in about 5 percent of the cases will they scotch the deal," says Tony Dasilva, partner and northeast leader at KPMG's Compensation and Benefits, People Services Practice, in Boston. "Often the discoveries--golden parachutes, severance commitments or option payouts--will give the buyer ammunition for negotiating a lower price."

Cultural fit, however, is an exception. "Rarely does culture influence the price, but it is the deal killer," Zimmerman says. "It's usually an on/off switch. The buyer sees something so different that would require so much work to integrate that it backs away."

The acquirer who minimizes the impact of culture may quickly find itself holding a fire sale, as Felsher discovered. Her company, steeped in a hard-driving, all-consuming Silicon Valley work ethic in a "carve out" divestiture, acquired a more laid-back Quebec-based workforce. "From the get-go, problems surfaced. Three months later, we began the divestiture."

Felsher's experience is not uncommon. Frederickson estimates today's acquisitions wind up as tomorrow's divestitures, going sour around half the time.

HR Input Is Critical

Whatever the outcome, in the end, unless HR has strategic input in all three phases of the divestiture process---pre-shopping, shopping and shoring-up--critical perspectives will be lacking. The wisdom of proceeding with the divestiture may not be fully explored; profit potential is unlikely to be fully realized; critical people issues may suffer from lack of attention and focus.

Even when HR is in on the ground floor, it has to have its priorities straight. "HR walks a tightrope," Bowers says. "You have to look at protecting people, which is important, but you also have to be thinking about enhancing the value for your employer and making the deal truly attractive for the buyer."

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Although precise data are not available, divestitures number in the thousands annually, occurring with regularity and increasing in frequency, according to Ross Zimmerman, senior consultant at Hewitt Associates in Lincolnshire, Ill., a consulting firm that handles mergers, acquisitions and divestitures.

"When you look at any recording of top [mergers and acquisitions] deals, 30 percent to 40 percent will include a divestiture," he says. "Odds are the bigger your company, the more you'll see divestitures down the road."

When KPMG surveyed Fortune 1,000 company decision-makers in 2002, 73 percent predicted that the annual number of corporate divestitures would increase over the next five years. Usually the driving force in divestitures is finance-related. Either the divestiture target is losing money, not earning enough, or it's a prize asset sold to raise cash for new ventures or to stay afloat.

Increasingly, though, the primary reason is strategic: The company decides the division no longer fits with its core business, such as when PepsiCo pulled out of fast-food restaurants by selling Pizza Hut and KFC.

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