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Achieving win–win spin-offs

By acknowledging and addressing four factors relating to execution and operations, ParentCo can separate from SpinCo in a way that creates value for both.

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A corporate spin-off can liberate a parent company and a divested business unit from capital and bureaucratic constraints, so they can pursue strategies they couldn't otherwise. Yet their fates often remain linked.[1] For a spin-off to truly succeed, both ParentCo and SpinCo (and their investors) should end up in a place better than the one where they started. Indeed, our empirical research suggests that spin-offs outperform by supporting the long-term growth and value-creation opportunities of *both* entities.[2]

Getting to a win–win outcome is often easier said than done, however. Business leaders run into roadblocks when they make critical decisions about the structure of the arrangements between ParentCo and SpinCo and the execution of the spin-off itself—for instance, defining its scope, allocating talent and resources across both entities, and dealing with capital and stranded costs.

How can business leaders address these obstacles? Our analysis of more than 200 US spin-offs, as well as our experience in the field, point to four factors critical for achieving win–win spin-offs: a quick transition toward growth, operational excellence, leadership time and attention, and culture and talent.

By reviewing and addressing some or all of these factors, business leaders can increase the likelihood that any strategic decisions ParentCo and SpinCo make will ultimately create value for both.

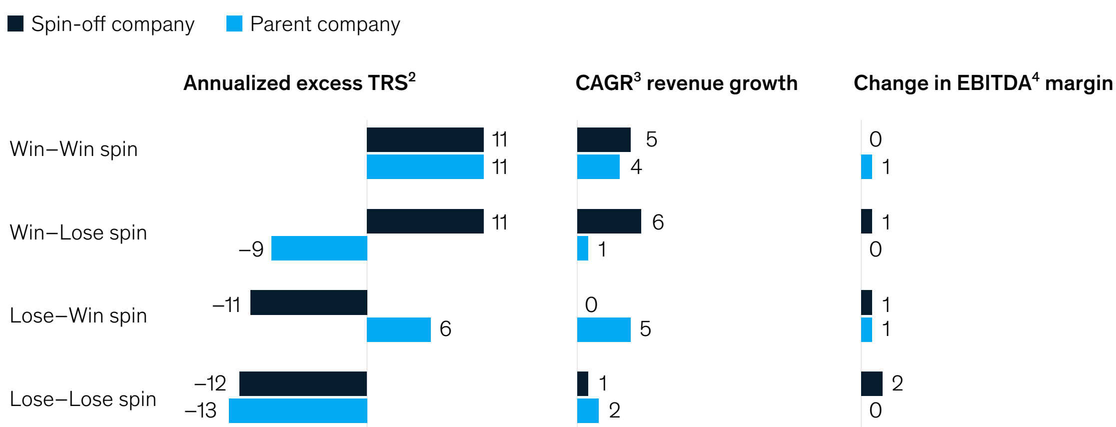
A quick transition toward growth

Our research shows that revenue growth is a critical determinant of a spin-off's success (exhibit). In most cases, the management teams of both ParentCo and SpinCo can adequately explain how growth is part of the spin-off's strategic rationale,

Exhibit

Win–win spin-offs can create significant value.

Analysis of individual deals from separation date to 5 years after,[1] % (n = 230)



[1]Data is based on parent companies involved in a completed spin-off (>$500M) from 1992 to 2019. Benchmarked to the S&P 500 industry-specific index. Excludes deals where length of time between announcement date and separation date was less than 8 months or more than 24 months.
[2]Total returns to shareholders.
[3]Compound annual growth rate.
[4]Earnings before interest, taxes, depreciation, and amortization.
Source: McKinsey Corporate Finance Spin-off data set

[1] We recognize that some spin-offs are tax-free transactions, which may involve other types of strategic and operational considerations.
[2] We reviewed completed corporate spin-offs that occurred from 1992 to 2019 and had a deal value of $500 million or more, as well as five years of available data. We examined a range of deal metrics, including CAGR revenue growth and change in EBITA margins from the year of separation to five years afterward. Data were benchmarked to the S&P 500 industry-specific index. Our data set excludes deals in which the length of time between the announcement date and the separation date was less than eight months or more than 24 months.

alongside improved capital management and other operational changes.

But management teams are typically much less clear about how they will achieve growth. Understanding that "how" is crucial for achieving win–win spin-offs. Teams should come to the negotiating table with concrete plans to create growth and value for both companies. Achieving some quick wins, such as signing marquee deals or partnerships shortly after separation to build momentum for the spin-off, is often a good idea.

Consider the case of one technology-services provider. The parent company offered a range of end-to-end digital products and a technology infrastructure used by hundreds of clients. It saw opportunities to improve its core business so that it could appeal to new kinds of customers and expand into new markets. But capital and operational requirements in other parts of the business were preventing the move; there weren't enough resources to go around. After some internal discussion, business leaders explored spinning off a subsidiary that offered a type of B2B software. The transaction made sense for the software business, since it would be able to forge direct business partnerships with other technology-services companies.

To ensure a seamless transition, managers in the parent company and the subsidiary developed detailed day-one plans, including the creation of clearly defined account-planning teams, as well as an account war room to coordinate the handing off of major customers. For some customer segments, the parent company and the subsidiary also struck limited agreements to continue going to market together as channel partners. Ultimately, both entities benefited from the arrangement: the parent company funneled capital to higher-growth opportunities, and the spin-off grew in segments that previously hadn't been accessible given its association with the parent.

Operational excellence

Companies that successfully execute win–win spin-offs tend to optimize the operating model for both ParentCo and SpinCo. In some win–win spin-offs we examined, companies saw these deals as an opportunity to bolster their operations in high-growth areas—for instance, increasing their marketing expenditures or digitizing the sales process and expanding the sales force in certain segments. In other cases, companies sought to improve, centralize, or simplify the operating structures of the business units; many did so before day one.

A biotechnology company, for instance, recognized that by spinning off a noncore business unit focused on a particular category of therapeutics it could free up significant capital and use those funds to transform its product portfolio. But before the public announcement of the spin-off, the parent company initiated a series of actions to streamline its businesses: for instance, it accelerated its move away from some legacy manufacturing systems while restructuring its IT infrastructure and business processes. In this way, the biotech company could not only prepare SpinCo to compete effectively as a stand-alone organization but also improve operations across the remaining businesses. Through this process, the biotech company identified and reconciled stranded costs as well. Once the spin-off was announced, ParentCo and SpinCo both activated their business strategies sooner than they might have done otherwise and quickly targeted new growth opportunities in their respective specialty markets.

Leadership time and attention

Companies frequently pursue spin-offs to free up management's time and bandwidth to, for example, refocus on the core business or launch a new one. But keeping executives focused on the big picture can be difficult. That's particularly true for SpinCo's executives, who must contend with all the challenges—such as developing and executing new strategies and managing new governance and reporting requirements—of establishing a new public company.

In our experience, many executives spend more time focusing on the mechanics of spinning off units than on the opportunities that deals may unlock or communicating those potential benefits to stakeholders. Many wait until the spin-off is consummated before preparing for what comes next. In such cases, executives may be unable to capitalize on the momentum of the spin-off or, at worst, avoid being overwhelmed by the increased expectations and scrutiny of investors.

Win–win spin-offs require a clear understanding of priorities and a commitment by management to focus on them. The management team of a pharma company's consumer-health spin-off, for example, spent considerable time developing a new narrative and equity story for the spin-off. The team knew it would need to build credibility with a new group of investors and educate them about the unique characteristics of the business and the market. This exercise, which involved leaders from both the parent company and the consumer-health spin-off, helped the spin-off's managers to build a compelling story for investors, analysts, and other key stakeholders. Specifically, the team emphasized that the spin-off had more attractive financial returns and shorter R&D cycles than the parent company did. With this focused attention from management, the consumer-health spin-off enjoyed a relatively smooth path to independence and a successful public listing.

Culture and talent

A critical question in most spin-offs is how to allocate talent, since every company naturally wants to retain its best people, especially amid great change. We observed that the leaders of the most successful spin-offs didn't approach this question as a zero-sum exercise. Instead, they took the time to assess the cultures and capabilities each company would require to succeed in the long term.

Some developed a clean-sheet view of the desired organizational structures in both the parent company and the spin-off. For instance, they identified the critical roles that would create the most value in the new organization and developed and implemented a plan to find the right people to fill those roles by recruiting externally, retraining internally, or some combination of the two.

Shortly after the announcement of a deal, one industrials spin-off sought to establish a culture that was very different from that of its parent company, an established brand with a strong identity in the marketplace. Because of that legacy culture, employees were reluctant to change certain processes (such as the way the company gathered market insights) or to adopt new digital capabilities. Realizing that a cultural shift was needed, the industrials spin-off announced its intention to move its headquarters away from the parent's. The new HQ would be located in a region that could attract more professionals focused on emerging technologies and on experimenting with new processes being adopted in the industry. The HQ move jump-started the spin-off's efforts to build a distinct culture and to adopt new structures and ways of doing things—while helping it to establish itself as one of the new disruptors in its industry.

Spin-offs can give both companies more freedom and improve their performance if executives systematically consider the growth strategies, operations, talent, and cultural changes that each entity will require for a win–win scenario. Our research and analysis suggest that such reciprocity is not just nice to have but also a key requirement for success.

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