

Divestment Methods

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Purpose and Outline

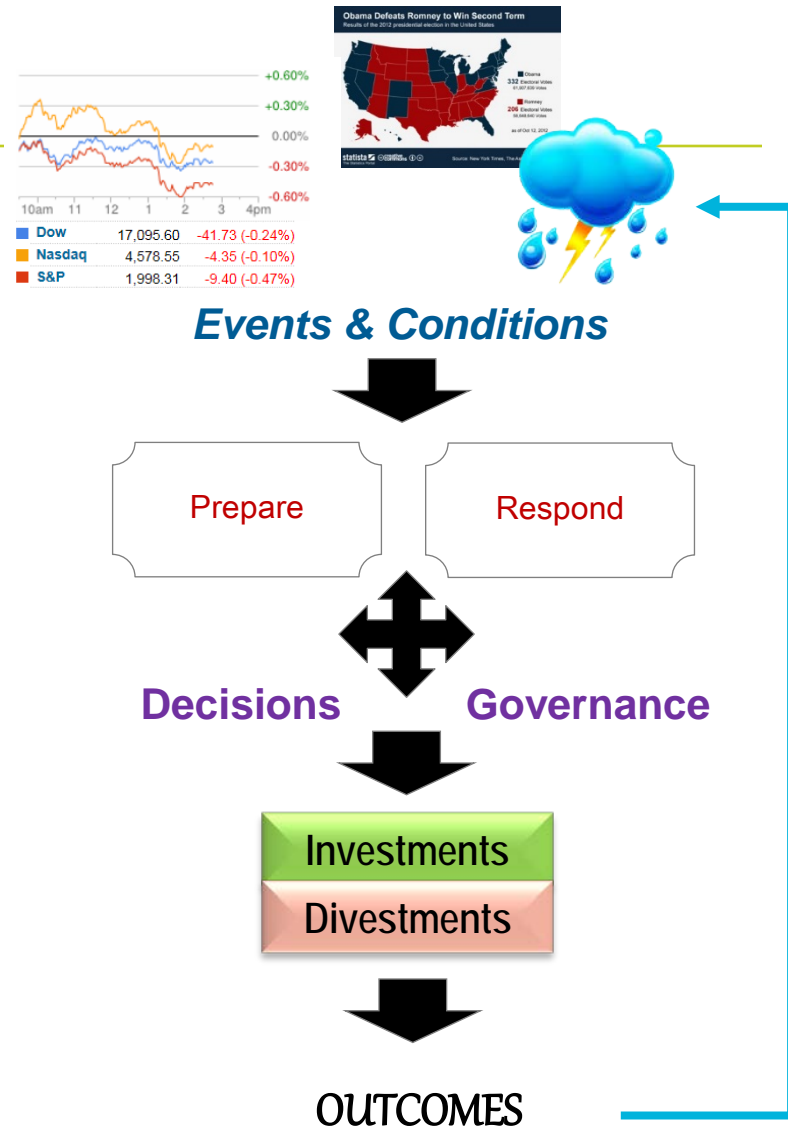
Purpose: Discuss a framework for *divestment* decisions

Outline:

- Investments and divestments are not equal and why
- Rules of thumb (ROT) we adopt as a result
- A divestment model: guide ROT to *prepare* choices
- Recommendations

Introductory Thoughts

- Organizations/individuals make financial decisions to **prepare** for the future and **react** to events or conditions in relevant social, political, resource, or business environments.
- Successful *preparation* requires a persistent process of management; mechanisms must reward good choices.
- Successful *response* requires a continuous and *dynamic* ability to respond to threats, risks, or opportunities.
- Good governance and management processes focus decisions on the outcomes of the organization.
- Because resources are limited, divestment is important, too.



Original Intent

- **Because divesting is hard, we sought an analytical model improve divestment decisions**
- **We found there are:**
 - Reasons deciding on divestments is different from deciding on investments
 - Different, current approaches to divestment
 - Interesting models, but they include investment

we will discuss these today!

Investments ≠ Divestments

“The thought of giving up a once-treasured possession can be an emotional exercise for anyone, even if the object of affection has outlived its use. As investors, we can find it difficult to sell a once-favored holding—even more difficult than the decision to purchase it.”¹

- **Why? Emotion: Pride, anxiety, neglect, greed, or power.**
“Anyone with money can buy stocks, but only smart people can sell them”²
- **But the government is not the stock market...**
 - “Public money” (a.k.a., “not yours”) may bear less emotion, but the mindset space is filled with other emotional elements: politics, power, patriotism, and even altruism.
- **Decisions should be made based on ultimate goals**

1. Franklin Templeton Investments, “The Discipline of Buy and Sell Decisions,” <http://mobius.blog.franklintempleton.com>, March 28, 2013.

2. Mark Brown, “Stocks: The Hard Sell,” Moneysense.com, April 26, 2013, at: <http://www.moneysense.ca/invest/stocks-the-hard-sell>.

Order of Buy \neq Opposite of Order of Sell

Two reasons, especially in the government

Lots of data but limited knowledge

- Gestalt: The whole can be greater than the sum of the parts
- Interdependencies *unlikely* to be well understood
- Imperfect information, lack of causality measurement

Causes pause when we divest, as the “whole” must be taken or comes apart

Weak measures of success

- No common value proposition (e.g., profits or stock prices), normalized value scale, or way to compare impacts of decisions to the “bottom line”
- Size of budgets become \$ meter—does not promote divestment
- The notion of “affordability” is challenging to define/execute

Hard to defend decisions

Rules of Thumb: Biases

- Four types of cognitive biases in decision-making, depending on predisposition toward the investment, drive “rules of thumb”¹

Investment Activity	Cognitive Bias
Consideration of alternative acquisition	<u>Reasoning by analogy</u> : “In the decision process leading to acquisition, decision makers rely on analogies to simpler situations that may bear little similarity to their strategic problem.” <u>Illusion of control</u> : “In the evaluation of an acquisition, decision makers overestimate the potential impact of their expertise on the acquired unit's performance.”
Management of the acquisition	<u>Illusion of control</u> : (see above) <u>Escalating commitment</u> : “Information on declining performance of the unit triggers rationalization and escalating commitment.”
Consideration of divestment	<u>Single outcome calculation</u> : “When divestment of a failing unit is finally considered, it quickly becomes the only course of action considered.”

1. Irene M. Duhaime and Charles R. Schwenk, “Conjectures on Cognitive Simplification in Acquisition and Divestment Decision Making,” *Academy of Management Review*, 1985, Vol, 10, No. 2, 287-295.

Rules of Thumb: Private Sector Remedies ¹

Private Sector

- Dedicate a team to divestment full-time, just as you do with acquisitions.
- Establish objective criteria for determining divestment candidates—don't panic and sell for a song in bad times
- Work through all the details of the de-integration process before you divest
- Make sure you can clearly articulate how the deal will benefit the buyer and how you will motivate the unit's employees to stay until the deal is done.

Observations on DoD

- *DoD has thousands of people that work on strategic and investment planning*
- *Government must still think about fiscal losses*
- *Government should invest to remedy the knowledge shortfall about their investments*
- *Costs of transition and divestment is often captured in DoD, but an under-appreciated because it takes a long time*

1. Michael C. Mankins, David Harding, and Rolf-Magnus Weddigen, "How the Best Divest," *Harvard Business Review*, October 2008.

Rules of Thumb: Government

Rule Applied in Government

Observation

Those that “seem to have a lot”

Goal of bureaucracies is to maximize budgets, yet, proportionally large budgets become a target for redistribution or for “paying bills.”

Salami-slice

Programs are cut across the board, with a strict percentage regardless of impact (“sequester”)

Programs not sticking to acquisition cost/schedule,
e.g., Nunn-McCurdy breaches or near-breaches

Programs often get “re-baselined.” Possibly a divestment, often the same money is spread over time.

Those with poor performance

Programs that measure may be held to a different standard and are not fiscally rewarded for transparency in effectiveness or efficiency

Congressional disregard or favoritism

Drives, or saves, many divestment decisions, for all military departments alike.

Others?

Organizational Thinking: Prepare Divestment Decisions with Three Criteria

- **Strength of a business' structural attractiveness**
[strategic value and business logic]
- **Potential to improve the business or create synergy with other businesses** *[performance]*
- **Economic value, net present value (NPV) and capital flows** *[capital required and lifecycle efficiencies]*

Andrew Campbell and Jo Whitehead, "Making Trade-Offs in Corporate Portfolio Decisions," excerpted from: Campbell and Whitehead, Strategy for the Corporate Level: Where to Invest, What to Cut Back and How to Grow Organizations with Multiple Divisions, Jossey-Bass, (June 2014).

Invest or Divest? *Mixes of Three Criteria*

High Strategic Value?

Yes

No

High Performance?

Yes

No

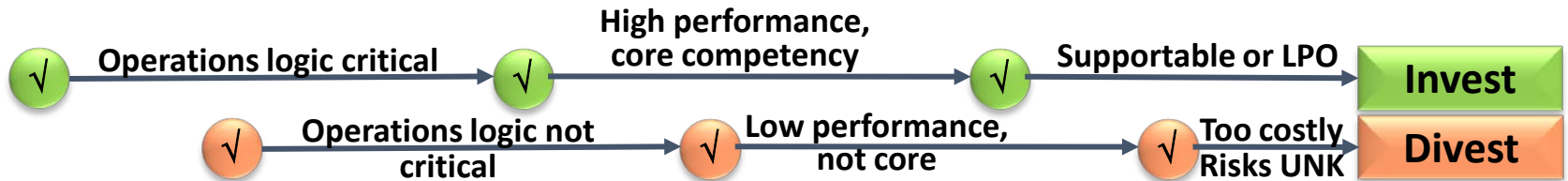
Economically Sound?

Yes

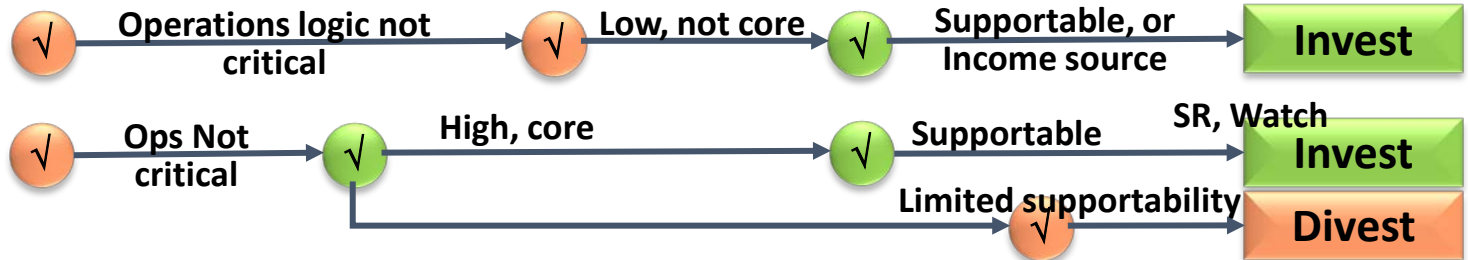
No

Invest?
Divest?

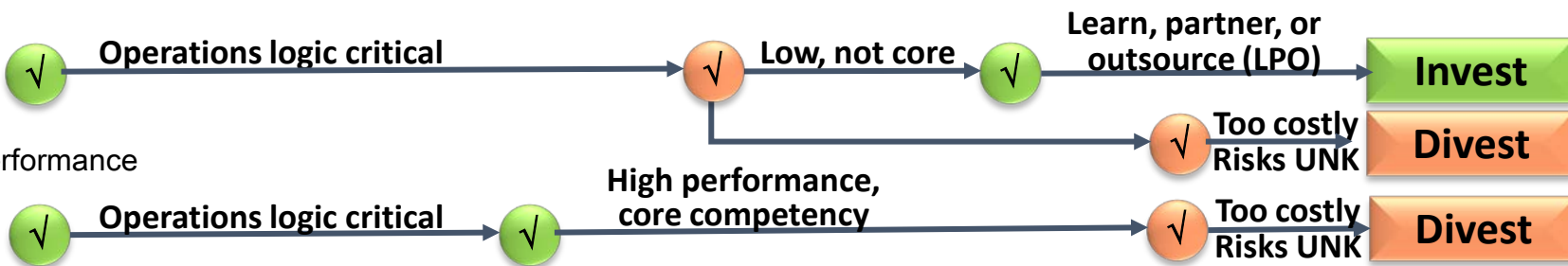
1
Clear



2
Not Strategic;
Performance mixed;
cost drives



3
Strategic; Performance
mixed;
cost drives

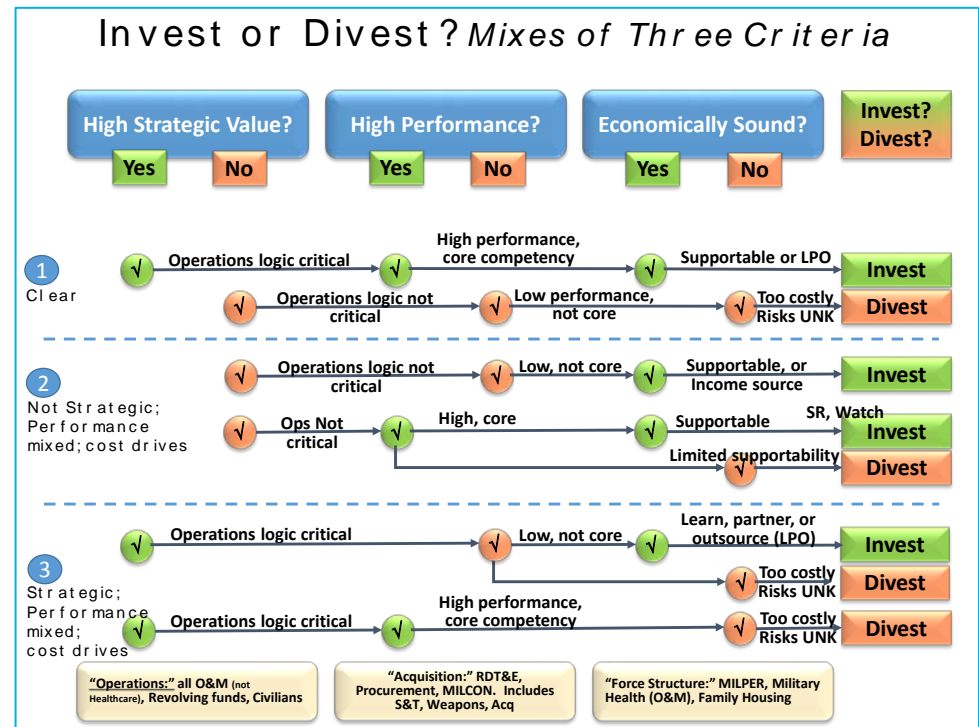


The Human Domain: Responsive and Self-Improving Governance to Avoid Old ROT

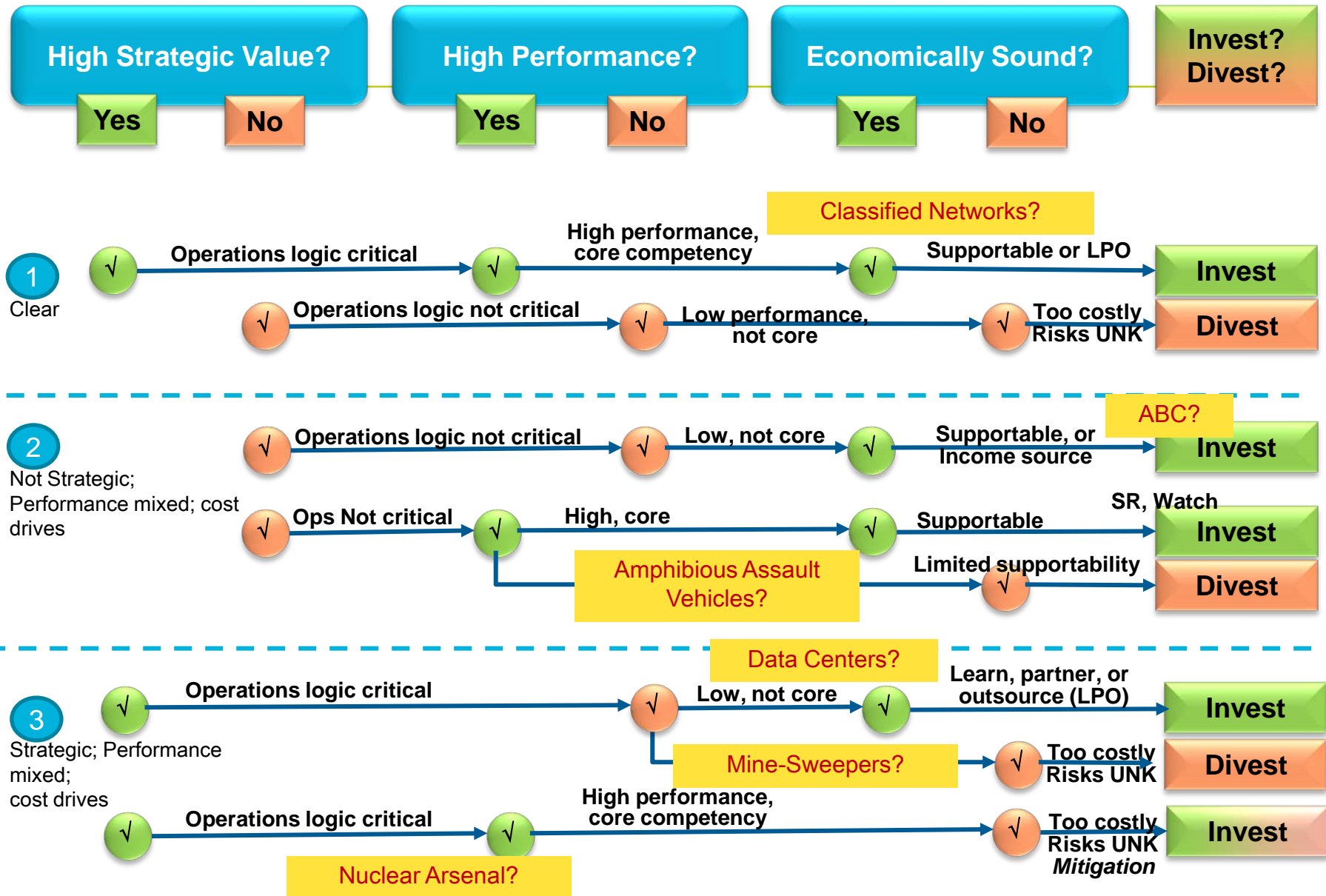
- **DoD needs: knowledge, ability to prepare basic data to “run” through such a model and criteria, rules to judge analysis, and leadership able to respond to operational or budget events**
- **Can they do this?**
 - **“Defense” was able to “chop” nearly \$500B (7-10%) over a ten year period for the Budget Control Act of 2011.**
 - **DoD has no formal “Divestment Panel” or process except for the fallout of the PPBE**

Next Steps: Making Yes No ROT “simple”

- Does DoD already practice this model?
- How is it “tracked?”
- Can we improve how we incorporate “time” in the analytics?
- How can we use Requirements to validate criticality?
- How could governance bodies use this frame to be responsive?
- What other considerations are there?



Invest or Divest? *Examples Discussion*



Thank You!