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.
Because divesting is hard, we sought an analytical model to 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.”

- Why? Emotion: Pride, anxiety, neglect, greed, or power.
  “Anyone with money can buy stocks, but only smart people can sell them”

- 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

Order of Buy ≠ 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

**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

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

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”

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

### Rules of Thumb: Private Sector Remedies

<table>
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<tr>
<th>Private Sector</th>
<th>Observations on DoD</th>
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<tr>
<td>• Dedicate a team to divestment full-time, just as you do with acquisitions.</td>
<td>• DoD has thousands of people that work on strategic and investment planning</td>
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<td>• Establish objective criteria for determining divestment candidates—don’t panic and sell for a song in bad times</td>
<td>• Government must still think about fiscal losses</td>
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<td>• Work through all the details of the de-integration process before you divest</td>
<td>• Government should invest to remedy the knowledge shortfall about their investments</td>
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<td>• 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.</td>
<td>• Costs of transition and divestment is often captured in DoD, but an under-appreciated because it takes a long time</td>
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**Rules of Thumb: Government**

**Rule Applied in Government**

- Those that “seem to have a lot”
- Salami-slice
- Programs not sticking to acquisition cost/schedule, e.g., Nunn-McCurdy breaches or near-breaches
- Those with poor performance
- Congressional disregard or favoritism
- Others?

**Observation**

- Goal of bureaucracies is to maximize budgets, yet, proportionally large budgets become a target for redistribution or for “paying bills.”
- Programs are cut across the board, with a strict percentage regardless of impact (“sequester”)
- Programs often get “re-baselined.” Possibly a divestment, often the same money is spread over time.
- Programs that measure may be held to a different standard and are not fiscally rewarded for transparency in effectiveness or efficiency
- Drives, or saves, many divestment decisions, for all military departments alike.
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*

Invest or Divest? *Mixes of Three Criteria*

**High Strategic Value?**
- Yes
- No

**High Performance?**
- Yes
- No

**Economically Sound?**
- Yes
- No

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**Invest?**
- Yes
- No

**Divest?**
- Yes
- No

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1. **Clear**
   - Operations logic critical
   - High performance, core competency
   - Supportable or LPO
   - Invest

   - Operations logic not critical
   - Low performance, not core
   - Too costly
   - Risks UNK
   - Divest

2. **Not Strategic; Performance mixed; cost drives**
   - Operations logic not critical
   - Low, not core
   - Supportable, or Income source
   - Invest

   - Ops Not critical
   - High, core
   - Supportable
   - SR, Watch
   - Invest

   - Limited supportability
   - Divest

3. **Strategic; Performance mixed; cost drives**
   - Operations logic critical
   - Low, not core
   - Learn, partner, or outsource (LPO)
   - Invest

   - High performance, core competency
   - Too costly
   - Risks UNK
   - Divest

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**Additional Notes**
- Clear: Operations logic critical, high performance, core competency, supportable or LPO, invest.
- Not Strategic: Operations logic not critical, low performance, not core, too costly, risks UNK, divest.
- Strategic: Operations logic critical, low performance, not core, too costly, risks UNK, divest.
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 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*

1. **High Strategic Value?**
   - Yes
   - No

2. **High Performance?**
   - Yes
   - No

3. **Economically Sound?**
   - Yes
   - No

4. **Invest or Divest?**
   - Invest
   - Divest

- **Invest or Divest**
  - **Classified Networks?**
    - Supportable or LPO
    - Too costly
  - **ABC?**
    - Supportable, or Income source
    - SR, Watch
  - **Amphibious Assault Vehicles?**
    - Supportable
    - Limited supportability
  - **Data Centers?**
    - Supportable, or Income source
    - Learn, partner, or outsource (LPO)
  - **Mine-Sweepers?**
    - Supportable
    - Too costly
  - **Nuclear Arsenal?**
    - Supportable
    - Too costly

- **Clear**
  - Operations logic critical
  - Operations logic not critical

- **Not Strategic; Performance mixed; cost drives**
  - Operations logic not critical
  - Ops Not critical

- **Strategic; Performance mixed; cost drives**
  - Operations logic critical
  - Operations logic critical
Thank You!