Insight overview

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Transitional Service Agreements – a necessary evil

What are TSAs and why are they are a critical component in the M&A toolbox?

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Following a recent lull, there is a growing consensus that M&A activity will experience a significant resurgence in 2024. Factors contributing to this optimism include a reduction in inflation, signals from central banks about potential interest rate decreases, and the substantial $2.4 trillion in "dry powder" held by private equity firms.

As market conditions improve, a wave of transactions is expected, involving businesses that are intricate networks of interrelated, interdependent, and intertwined services with complex technology infrastructures. The process of disentangling and carving out parts of these businesses has become more challenging than ever. Additionally, the period between deal announcement and closure often proves insufficient for buyers to establish the necessary services to independently support the acquisition, further complicating the transition.

Enter the Transition Service Agreement (TSA), an essential instrument in the M&A toolkit. TSAs are invaluable for maintaining operational continuity, as they ensure that critical functions such as IT, HR, and finance continue uninterrupted during the transition period. This continuity is vital for preserving the value of the acquired business.

However, if not properly crafted and managed, TSAs can lead to over-reliance on costly services. Employees often do not notice any difference in the services they rely on from pre- to post-Day One, unaware that these services are being provided under an expensive TSA.

In this article, we will explore the strategic use of TSAs, including when they are beneficial and when alternative approaches might be more effective.

A well-crafted TSA can be a vital tool for navigating the challenging period between Day One and full autonomy. This period is often difficult because the seller is eager to move forward and invest the proceeds from the sale, while the buyer seeks to independently manage the newly acquired business without relying on the seller's resources or facing any restrictions.

When effectively managed, a TSA can help structure, control, and expedite the Post-Merger Integration (PMI) process to achieve synergy targets. Given that TSA services are time-bound and costly, they should be leveraged to drive PMI by: (a) structuring PMI activities with a focus on integrating the most expensive services first, (b) controlling PMI to reduce dependency on TSA services, and (c) expediting PMI to maintain momentum and pressure within the system.

So, what exactly is a TSA? It is a legal agreement in which the seller agrees to provide, and the buyer agree to receive (for a fee) certain services e.g. IT, finance, HR, real estate, payroll, etc.) to ensure business continuity of the divested business whilst the buyer prepares to receive and operate the new business on its own. It typically has two parts:

Legal Agreement governs the overall contractual provisions of the TSA. Usually drafted by the Legal team.

Schedules capture the descriptions, fees, and durations of services to be provided. These are drafted by the functions that will provide/receive the services.

There could be a scenario where the sellers retained organisation relies on services provided from the divested business. In such a situation a Reverse Transitional Service Agreement (R-TSA) is also put in place. The same principles and legal arrangements still apply, albeit in the opposing direction.

There are many reasons for implementing TSAs. Below are typical situations (with examples) when a TSA is required:

- Assets remaining with seller needed to maintain buyer's operations e.g. shared office space or warehouses.
- Purchased assets and business processes extremely intertwined with the seller's corporate shared services needing significant time and effort to separate e.g. ERP systems to manage the business.
- The buyer lacks the basic infrastructure to maintain purchased asset's operations e.g. distribution channels.
- The buyer will not integrate the purchased asset and will manage as a separate, stand-alone business e.g. when anti-competition laws apply.
- Regulatory or legal constraints forcing buyer to maintain services e.g. until regulator has approved transfer of Marketing Authorisation from seller to buyer.
- A PE buyer wants the seller to continue managing aspects of the acquired business until it finds suitable 3rd parties to take over.

It is also important to know when a TSA should not be required:

- For services that are not provided by the seller such as 3rd party agreements with vendors or long-term agreements (e.g. leases or sub-leases). These can be novated or re-negotiated directly with the third party (often on more favourable terms).
- When data of the divested and retained business is intermingled. Access to such data will be restricted as the seller will not wish the buyer to have access to commercially sensitive data. The seller will want to redact retained business data before sharing e.g. a historical invoice. In such cases a Long-Term Data Access agreement should be put in place. This should be reciprocal as the seller may also require access to the divested businesses data for future audit purposes. GDPR requirements prevent the buyer from having access to personal data (e.g. customer names) that is not relevant to the divested business, so data separation is mandatory.

Despite the complexities in their management, Transition Service Agreements (TSAs) serve as the essential bridge from Day One to full operational autonomy. They establish the guardrails and guidelines needed to navigate the often complex and uncertain transition period. When carefully crafted and diligently managed, TSAs can mitigate the risks of prolonged integration, escalating costs, and potential conflicts between the buyer and seller, ensuring a smoother and more amicable transition.

If you would like to speak to Ash Majeithia further regarding this insight, send your enquiry to: contact@masonadvisory.com

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About Mason Advisory

Mason Advisory has offices in Manchester and London and employs over 100 staff, with plans to continue its expansion. We enable organisations to deliver value through digital & technology transformation, solving complex business challenges, and helping clients set strategy through the intelligent use of IT resources including architecture, cyber, data, digital, operating model and organisational design, service management, and sourcing. We operate in sectors such as financial services and insurance, legal and law, government, health and social care, emergency services, retail, FMCG, transport, and not-for-profit.

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