CFO Insights
Realigning your portfolio for growth

Portfolio realignment as part of a broader business transformation can be a complex, gut-wrenching, time-consuming process. In a slow-growth environment, however, CFOs looking to unlock additional shareholder value may also find it a business imperative.

In fact, the possibility is being examined—and embraced—by many finance chiefs in the current environment. In the Q1 2014 *CFO Signals*™ survey, more than 20% of large-company CFOs say they expect a substantial merger or acquisition in the next year, more than 15% expect a substantial divestiture, and about 14% expect to discontinue operation of a business unit.[1]

Whether their efforts lead to an "advantaged portfolio"—one that is strategically sound, value-creating, and resilient—is not guaranteed, of course. Undertaking such a realignment can obviously help companies identify new assets to help them achieve growth and others to target for divestiture. But by approaching the realignment process holistically and rigorously, companies can also create a portfolio that delivers sustainable growth and better utilizes future investments.[2]

There is no one way to go about the process, however. While companies are increasingly using divestitures to realign their portfolios (see sidebar, "Shedding for growth," page 3), that tactic alone is not enough to build value. And in this issue of *CFO Insights*, we'll examine the steps companies need to take to build an advantaged portfolio, and discuss how CFOs can foster the process.

Four steps to realignment

There are several reasons why portfolio realignment is becoming a business imperative. For one, some companies that did not retool their portfolios prior to the recession have been unwilling or unable to dispose of their value-destroying businesses. Consequently, these companies may now be finding their growth and profitability hampered by overly complex operations, uneven performance, and the need for fundamental improvements in business quality.

Other companies that sold underperforming assets during the recession to raise cash ineffectively utilized the resulting proceeds. Today these organizations may be discovering that they are not well positioned to take advantage of changing economic and credit conditions. Finally, some companies view portfolio realignment as part of a broader, ongoing revitalization process of adding new assets and shedding old ones to address globalization and value migration, or to align with a fresh corporate vision.

Whatever the driver, there are four major steps to creating an advantaged portfolio:

1. Analyze/disaggregate the portfolio and dispose of value-destroying businesses.

Improving the core of the organization begins by assessing the present and future position of each business, and then defining its appropriate role. When disaggregated, many corporate portfolios exhibit a surprisingly wide range of contributions to shareholder value. And equipped with that information, a company can develop a picture of how individual business units are creating or destroying value, and better determine its investment solutions going forward (see Figure 1).

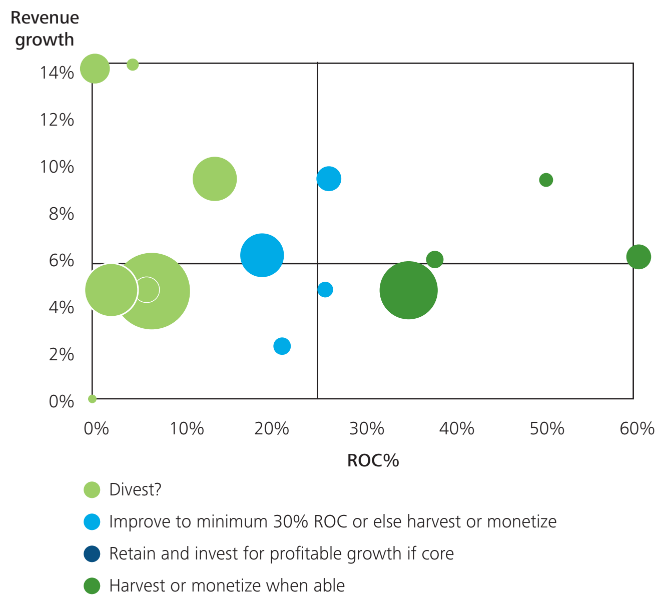
In fact, this first step is an important part of a self-funding approach—one that generates cash for reinvestment—by increasing investment potential among core portfolio businesses. After all, some business units may consume a large amount of corporate assets while making little or no contribution to overall value. One possible indicator: these underperforming assets often perform poorly when measured by return on capital (ROC), which correlates highly to shareholder value and is central to many capital-intensive industries, such as manufacturing, energy, and consumer products.

Case in point: An ROC analysis of a chemical company's business portfolio identified a business unit that was destroying enterprise value despite the fact that it generated 28% of the company's EBITDA. The ROC analysis suggested that as much as $7.70 per share in value was lost due to owning the business. Although selling off the business unit dropped EBITDA by 30% and required a book loss at the time of sale, the parent company's share price rose approximately $7 per share when the deal closed. The value increase was nearly identical to the estimated value lost by holding the business.

CFOs should address both the strategy and the structure of each business to help identify drivers and destroyers of value, structural costs, and growth opportunities by asking the following questions:

- Where is the "magic" made in the business? What does the business do that is different and creates value and profits?

Figure 1. Portfolio segmentation



Source: Portfolio Realignment: A Business Imperative, Deloitte Development LLC 2013.

- How does the business strategy create value? Is the strategy clearly articulated and understood?
- Which assets, customers, markets, and products create value?
- Are the company's sources of growth and innovation engines clearly defined?
- How should business units be redefined to work with strategic and transaction planning?
- Which businesses are currently creating or destroying value?

Companies should resist the urge to move directly to high-growth opportunities without first removing existing impediments to success, either by divesting, shrinking, or not growing businesses with low returns. Assessing whether an underperforming business can or should be fixed requires careful thought. A changing competitive landscape, maturing markets, or large, outdated assets in the wrong part of the world can make transformation a difficult task that consumes precious management attention and resources that could be better applied elsewhere.

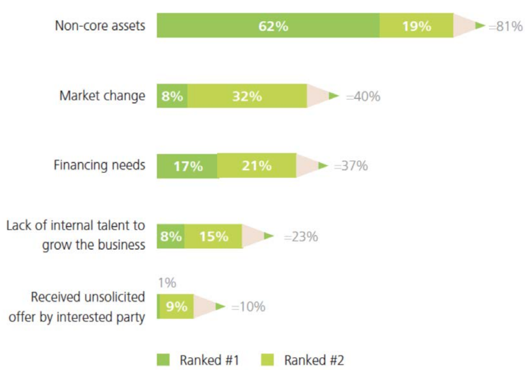
Shedding for growth

Corporate divestitures are increasingly being driven by companies' strategies to focus more on growth and shedding noncore, low-growth assets, and less on financing needs, according to Deloitte's 2013 Divestiture Survey Report.[3]

Among the findings, 81% of surveyed executives indicated that pruning their businesses of noncore assets was one of the two most important reasons for divesting, up from 68% in 2010, the last year the survey was conducted. Meanwhile, 37% of respondents cited financing needs as one of the two most important reasons to divest, down from 46% in 2010.

According to Andrew Wilson, U.S. leader of Merger and Acquisition Seller Services for Deloitte & Touche LLP, the need to raise capital appears to have become less important in driving divestiture deals as the economic recovery has strengthened corporate balance sheets. As a result, divesting is becoming an important tool for implementing corporate strategic goals and making a statement in the marketplace.

Most important reasons for divesting a business



Note: Some percentages do not add up to total due to rounding.
Source: Deloitte's 2013 Divestiture Survey Report, Deloitte Development LLC 2013.

"Using divestitures to advance corporate strategy demands more than getting the traditional deal-execution tasks done properly," he adds. "Having a clear communication strategy for disseminating divestiture plans to stakeholder groups and maintaining strong employee morale during the process also are critical, in addition to the financial analysis required to prepare a deal for market."

One cautionary note: The survey found that only 43% of respondents indicated that their companies evaluate individual business units at least annually to determine whether they should be divested. Slightly more (45%) consider divestiture only when there are performance or strategic issues. "The lack of routine evaluation may cause some companies to miss opportunities or rush distressed units onto market without adequately preparing for sale," says Ellen Clark, managing director at Deloitte Corporate Finance LLP. More frequent evaluations not only can help in identifying opportunities, but they also can help prepare for any board inquiries or evaluations.

The survey reflected the views of executives who have been involved in divestitures, at companies ranging from less than $500 million in revenue to multi-billion-dollar global enterprises. More than three-quarters of respondents were from U.S.-based companies, 60% public and the remainder private.

2. Structurally improve the profitability of other established businesses.
The next step for the organization is to make the remaining assets more accretive to value by improving returns or generating profitable growth.

Structural improvements that CFOs can look to in order to drive increased returns and improve profitable growth within an individual business unit include supply chain or operational improvements; customer and channel enhancements; product and value proposition innovation; new business models (for example, value-priced total customer solutions); asset-light restructuring; and geographic expansion.

3. Grow new businesses through internal development and/or M&A to support long-term vitality and align with company strategy.
The direction and goals of new business growth should be focused on the previously mentioned portfolio analysis questions as they pertain to organic growth opportunities. Creating an advantaged portfolio requires as much discipline when growing businesses as it does when evaluating divestiture candidates. After all, growth solely for the sake of growth consumes critical cash and corporate management attention, and can lead to value destruction rather than value enhancement.

This same lens should be employed when evaluating M&A opportunities. A useful tactic to help screen M&A candidates is to evaluate them against designated criteria, such as geographic location, innovation, and management-oversight needs. These factors may help executives gauge the relative risk and corporate focus required to manage the investment as compared with other opportunities.

4. Evaluate/reevaluate the new portfolio's fit with advantaged portfolio criteria.
Finally, a realigned portfolio, including any new businesses, should be regularly evaluated to determine its fit with advantaged portfolio criteria. To help evaluate whether a portfolio remains "advantaged," CFOs should ask whether the portfolio as a whole meets the following criteria:

- **Is it strategically sound?** In particular, is it weighted toward competitive advantage? Does it carry an optimal innovation mix? Is it configured to create synergy?
- **Is it value-creating?** That is, does it maximize "intrinsic" value? Are we the best owners of the portfolio and each of its components? Are there capital market–driven reasons why we need to alter the portfolio?
- **Is it resilient?** Does it effectively weigh feasibility and risk? Will it be robust across future scenarios? Does it create optionality in the face of near-term uncertainties?

Holistic, transformational, iterative

For CFOs looking to embark on successful portfolio realignment, the following elements need to be embraced:

- **Holistic, top-down approach.** Such an approach, which includes enlisting strong executive leadership, is essential, since asset ownership issues—as well as elements of corporate strategy—are involved.
- **Dispassionate data analysis.** There should be no sacred cows or so-called lemonade stands (small assets). Preconceptions, personal history, and bias can impede success.
- **Transformational, not incremental, change.** Portfolio realignment is not only about cleaning up assets, it should also be driven by an enterprise-wide strategy for growth and renewal.
- **Leveraging informed estimates.** Precision is not always possible in making the decisions necessary to retool a portfolio. Expect multiple iterations to get the data both "right" and representative.

Without a doubt, portfolio realignment takes time and patience. Shedding businesses that management has spent years, even decades, nurturing can be a painful process. Moreover, there is always a cost involved in acquiring or divesting. Companies may also have to overcome resistance to selling businesses that are low growth/low return because they may still reduce total net income/EBITDA.

Still, given the correlation to increased share price, finance chiefs need to consider cleaning up their companies' portfolios to get rid of underperformers and value destroyers. And by approaching the process holistically and rigorously, they can help construct a portfolio of businesses that supports the company's strategic vision and creates sustained shareholder value.

End notes

[1] *CFO Signals*,Q12014, March 2014; Deloitte CFO Program, Deloitte LLP.

[2] Portfolio Realignment: A Business Imperative, Deloitte Development LLC 2013.

[3]Deloitte's 2013 Divestiture Survey Report, Deloitte Development LLC 2013.

Primary Contacts
Mike Armstrong
Director, Monitor Deloitte
Deloitte Consulting LLP
mikearmstrong@deloitte.com

Will Frame
Principal
Deloitte Corporate Finance LLC
wframe@deloitte.com

Jim Manocchi
Director, Monitor Deloitte
Deloitte Consulting LLP
jmanocchi@deloitte.com

Dan Schweller
Partner
Deloitte & Touche LLP
dschweller@deloitte.com

Tom Williamson
Principal
Deloitte Consulting LLP
twilliamson@deloitte.com

Deloitte *CFO Insights* are developed with the guidance of Dr. Ajit Kambil, Global Research Director, CFO Program, Deloitte LLP; and Lori Calabro, Senior Manager, CFO Education & Events, Deloitte LLP. Special thanks to the Deloitte *CFO Journal* and *Risk & Compliance Journal* teams.

About Deloitte's CFO Program

The CFO Program brings together a multidisciplinary team of Deloitte leaders and subject matter specialists to help CFOs stay ahead in the face of growing challenges and demands. The Program harnesses our organization's broad capabilities to deliver forward thinking and fresh insights for every stage of a CFO's career – helping CFOs manage the complexities of their roles, tackle their company's most compelling challenges, and adapt to strategic shifts in the market.

For more information about Deloitte's CFO Program, visit our website at: www.deloitte.com/us/thecfoprogram.