

Thinking big

Can portfolio analysis take corporate planning to the next level?



In this tough economy, companies need to pursue every possible improvement opportunity — including those hidden in their portfolio of businesses. An intellectually rigorous portfolio analysis that looks beyond traditional business segments and financial data can help. But is it worth the effort? Here’s the debate taking place in the C-suite:

| | Point | Counterpoint |
|---|--|---|
| <p>Use portfolio analysis to enhance corporate planning.</p> <p><i>In-depth portfolio analysis and corporate planning can help us get more value from our business portfolio.</i></p> | <p>Portfolio decisions have a much greater impact than most operational decisions and need to be fully informed.</p> <hr/> <p>Standard performance measures and financial statements focus on aggregates and averages and are too watered down to support smart decisions about individual businesses.</p> <hr/> <p>Effective portfolio management requires detailed data that reflects the true economics of each business.</p> | <p>Commonly used metrics, such as contribution margin and EV/EBITDA, are sufficient to analyze the portfolio.</p> <hr/> <p>Existing metrics and reports are good enough for investors and analysts. Why not for us?</p> <hr/> <p>Sounds like a lot of work. Who has time for something like that?</p> |
| <p>Traditional corporate planning is good enough.</p> <p><i>Standard performance measures and financial reporting numbers are sufficient to run the business and manage the portfolio.</i></p> | <p>We already do portfolio analysis as part of corporate planning.</p> <hr/> <p>Right now, we have our hands full just trying to keep the business afloat.</p> <hr/> <p>Portfolio analysis is complex and time-consuming.</p> | <p>But are we doing it right? If we aren’t looking beyond traditional metrics such as contribution and EBITDA, our decisions might be missing the mark.</p> <hr/> <p>When times are tough, it’s especially important to know all of our options. Portfolio analysis can help us address our immediate challenges while positioning the business for the future.</p> <hr/> <p>Although portfolio analysis can be complex, it doesn’t have to take a long time. The analysis for a \$1B to \$6B company typically can be completed in 4 to 6 weeks and only requires direct involvement from a handful of key people.</p> |

My take



Duane Dickson, Principal, Manufacturing Industry, Deloitte Consulting LLP

When the economy was booming, companies could afford to be a little lax about managing their portfolios. But now that things have tightened up, you need to make sure every part of your business is pulling its weight.

The critical issues surrounding effective portfolio management are both simple and complicated. What does your business look like without all of the averaging and smoothing? Where are the hidden opportunities to drive value, competitiveness, and growth? How can your company remove unnecessary complexity, reduce risk, and improve its return on capital? What activities should you stop doing or sell?

Portfolio analysis can help you understand the ways you can structure or strategically improve your business to increase its return on capital. As a CEO or CFO, you can use these insights to shape the organization for growth by taking the long view of cash flow and focusing on value creation as the primary planning objective. But in order to do so, you must understand where value resides in the portfolio by emphasizing profitability and return on capital on a granular, segment-level basis — instead of fixating on revenue, market share, contribution margin, and brand recognition.

Financial statements and other standard performance measures provide a general sense of how your company is doing, but they aren't much help when it comes to making decisions about individual businesses. For that, you need objectivity, a new angle on the data, and an approach that will move the value needle — with a business case that can be demonstrated by the value math. Here are some keys to consider in your efforts to do it right:

- **Choose the right level of detail.** The segments in a portfolio analysis must be granular enough to show real economic differences without getting lost in the weeds. Business segments used for financial reporting often are too broad and don't reflect what truly drives value in the business. Although the appropriate segments are unique to each company, they tend to be similar within an industry. For example, in the consumer products industry, a portfolio analysis is likely to focus on things such as customer and product segments, whereas in commodity manufacturing the focus is more likely to be on capacity utilization and geography. When all is said and done, the portfolio analysis for a large company will typically include between 30 and 200 segments.
- **Crunch the numbers.** Although the raw data to inform your portfolio decisions might already exist, it needs to be gathered and organized to deliver meaningful insight. While the results might not be 100 percent precise, they are likely to be much more useful than the data you currently have.
- **Recognize the obstacles.** Portfolio analysis is a simple concept that can be difficult to execute. Some people are intimidated by the perceived complexity of the analysis. Others get caught up in turf battles and political agendas. Portfolio analysis can provide deep insights to help a company make tough decisions, and people with something to hide might resist the effort because they are afraid of what the analysis will reveal. Of course, that's all the more reason to do it.
- **Challenge conventional wisdom.** The insights from portfolio analysis are sometimes rejected because they fly in the face of conventional wisdom. But, in many cases what's actually happening is that people are simply avoiding tough choices and using conventional wisdom as an excuse to rationalize their behavior.
- **Stay committed.** A portfolio analysis requires sustained commitment and effort. Although the process can start yielding ideas and opportunities within weeks, it takes some work — and a thick skin. Don't fall back to the *status quo* just because things get a little rocky.
- **Put the results into action.** Once you understand the true return on capital for each part of your business, you can allocate your resources accordingly — increasing investment in high return businesses, limiting investment in average businesses, and fixing or divesting businesses that dilute or destroy value.

These days, no company can afford to squander its capital on under-performing businesses and assets. Portfolio analysis can help your efforts to maximize your return on capital and take your corporate planning to the next level. In good times, it can help you boost your overall performance and position your company for continued growth. And in bad times, it just might be the difference between success and failure.

A view from the strategy perspective

Jim Hollingshead, Principal, Corporate and Competitive Strategy, Deloitte Consulting LLP

Don't allow the current economy to trick you into forgetting about the big picture. A business portfolio should have a strategic purpose that goes beyond producing immediate returns. In these challenging times, it might be tempting to shut down businesses that aren't performing well, or to postpone growth projects. But be careful. Although you certainly need to be prudent with investments in a downturn, you don't want to sell low, or react in ways that undermine your long-term competitiveness.

The broader purpose of a portfolio is to help manage risk and enable upside for your business. To that end, a downturn can be a good time to think about investments you should make *now* to capitalize on the market's future direction. There's a good chance the assumptions you made the last time you evaluated your portfolio are no longer valid. Business opportunities that looked small or unattractive might be more appealing today. Industry developments that were three steps away might now be only two steps away. Assets that seemed too expensive might be cheaper. Use portfolio analysis to refresh your view on growth and opportunity. Don't just look for things to cut.

A view from the customer management perspective

Jonathan Copulsky, Principal, Customer and Market Strategy, Deloitte Consulting LLP

When times are tough, it's tempting to clean house on multiple fronts. This includes eliminating customers who are costly to serve and very demanding about price cuts and concessions. The benefits of customer portfolio rationalization can be huge, but it needs to be done selectively. Also, intuition about which customers are profitable is often wrong. If you want to go down this path, consider starting with a fact-based perspective:

- Triage your customers and focus on the few that drive the bulk of your revenues. There's a lot more value associated with fixing these unprofitable "whales" than flushing an unprofitable guppy.
- Scrutinize your transactions with whales to find pricing anomalies. You can't rely on averages or contract prices.
- Build price waterfalls to get a true picture of your pocket margins. You can't afford to make customer portfolio decisions based on gross margins.
- Identify what it will take to make your whales more profitable, and then use the resulting insights to have heart-to-heart conversations about fixing those relationships.

Don't fire a customer until you have exhausted all opportunities to restore the relationship to profitability. Also recognize that improving profitability is not always about raising prices. In some cases, there might be opportunities to work with a customer to reduce costs.

For more information, please visit: www.deloitte.com/us/debates/portfolioanalysis.

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