Monitor **Deloitte.**

Creating a Sustainably Advantaged Portfolio

Future confident

Strategic choices

Strategy can often seem complex, even mysterious. At Monitor Deloitte we believe that it isn't. It is easily defined as a set of choices about winning. Strategy is an integrated set of choices that uniquely positions the company in its industry to create sustainable advantage and superior value relative to the competition. We choose to do certain things, and we choose not to do other things.

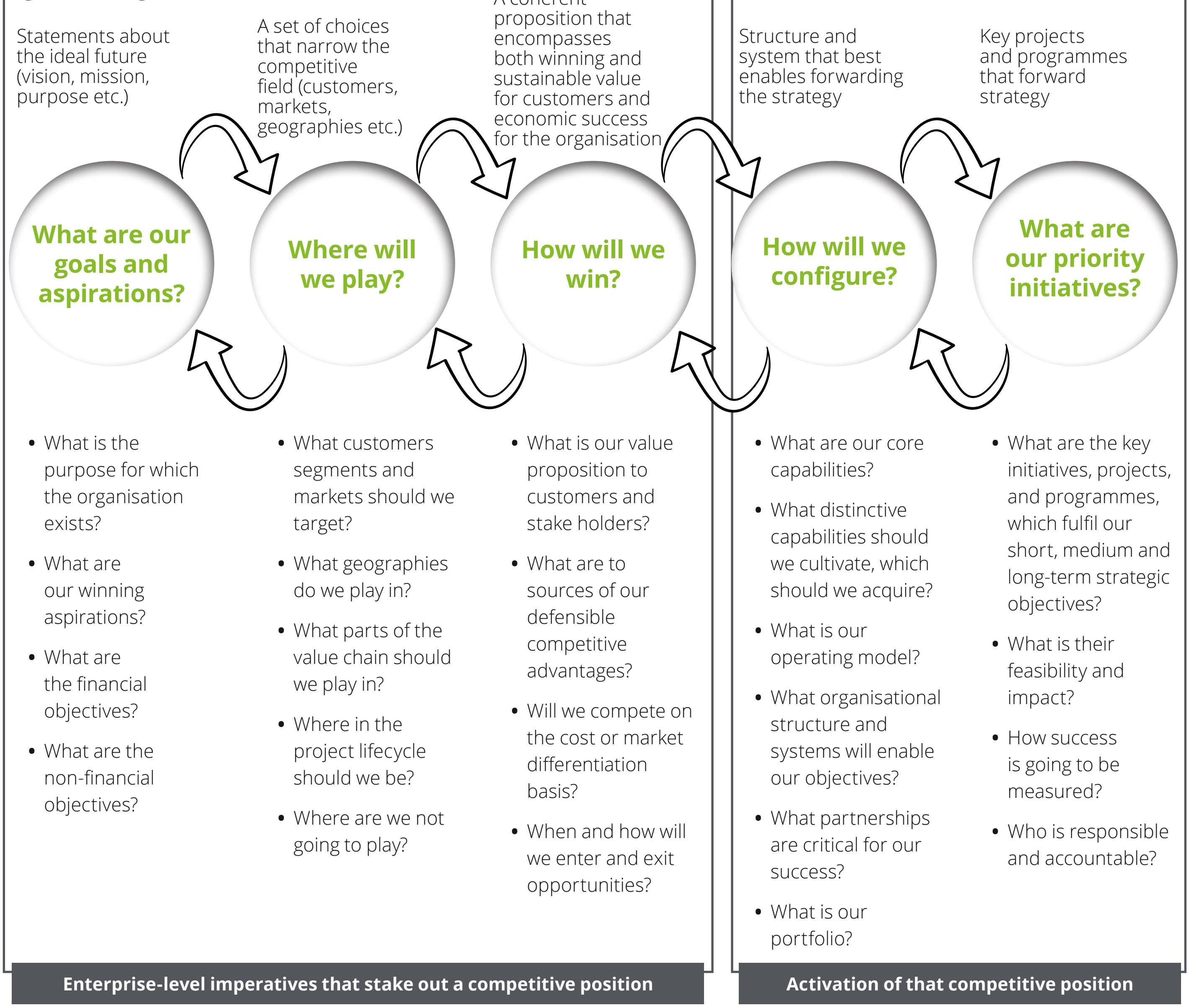
This is simply because we cannot anticipate being successful at everything all the time.

There is never enough time or capital.

The hardest part is choosing what not to do. Often failure to make a clear choice is more detrimental than making a poor choice.

Strategy articulation is a process of making choices by answering a set of fundamental questions in an iterative manner, in which all the moving parts influence one another and must be considered together – we call it Strategic Choice Cascade (refer to Figure 1).

Figure 1. Strategic Choice Cascade



Strategy should connect the dots between how we define winning, the tough choices required to differentiate ourselves from the competition, and how we enable that strategy as an organisation.

Sustainably Advantaged Portfolio Attributes

One of the central objectives of corporate strategy is for executive management to think holistically about a company's portfolio of businesses– conceiving and spearheading ways to make the aggregate value of a company's holdings durable over time, and greater than the sum of its parts.

This vital mission comprises two central questions: in which businesses should we invest? and: how do we create value within and across our businesses?

In other words, where will we play? and, how will we win? at the portfolio level.

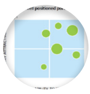
Executives, academics, and consultants have devised numerous frameworks for building and sustaining the optimal corporate portfolio.

Our experience suggests that the most successful portfolios exhibit four broad characteristics.

They are strategically sound, value-creating, resilient and sustainable. Perhaps this seems obvious, but in our experience, maybe because it requires consideration and testing across a wide range of seemingly incomparable attributes, companies seldom apply this Sustainably Advantaged Portfolio approach (refer to Figure 2).

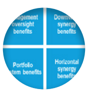
Figure 2. Sustainable Advantaged Portfolio attributes

1. Strategically Sound



1A. Competitively Positioned
Are our businesses competitively positioned in attractive industries?

1B. Balances Innovation
Does the portfolio have the appropriate mix of core, adjacent, and transformational innovations?



1C. Creates Synergies
Do we have synergies that ensure the value of the portfolio is greater than the sum of the parts?

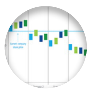
2. Value Creating

2A. Maximises Intrinsic Value
Does the portfolio, as a system, maximise the present value of future cash flows?

2B. Addresses Market Value
Is there a disconnect between intrinsic value and market value that the portfolio must address?

2C. Finds the Right Owner
Are we the value-maximising owner of each of the portfolio?

3. Resilient



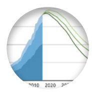
3A. Survives Scenarios
Will the portfolio thrive if the macro environment evolves differently than the expected future?

3B. Builds Optionality
Does the portfolio allow the flexibility to change strategic course in response to uncertain short-term events?

3C. Weighs Feasibility and Risk
Does the portfolio appropriately balance risk and feasibility against the upside potential?

4. Sustainable

4A. Creates Social Value
Will the portfolio make the social impact that society expects of us?



4B. Creates Environmental Value
Will the portfolio adequately improve the environment and address climate change?

4C. Creates Economic Impact
Will the portfolio create economic value to host countries and communities?

Expanding on Figure 2

Strategically Sound

1. A Sustainably Advantaged Portfolio first and foremost must be strategically sound. That means it must foster a strong competitive position, support multiple levels of innovation, and create synergy.

A. When a portfolio is ***competitively positioned***, its businesses in aggregate participate in more structurally attractive markets in which the company has a proven ability to win.

B. An ideal portfolio ***balances innovation*** and supports a spread of innovation initiatives across core, adjacent and transformational horizons, consistent with the degree of threat and opportunity presented by disruptive technologies, disruptive business models, or competitive activity in the industries represented in the portfolio. In so doing, the portfolio will typically improve the competitiveness of the enterprise in the short, medium and longer terms.

C. A Sustainably Advantaged Portfolio ***creates synergy***, adding value above and beyond that could simply be created (and captured) within its existing stand-alone businesses. In other words, the value of the whole must be greater than the sum of the parts.

Value Creating

2. The second core characteristic of a Sustainably Advantaged Portfolio is that it creates more value than alternative portfolio options. But that value must be viewed through three lenses to provide a clearer picture: intrinsic value, capital markets value, and the value of the assets to other owners.

A. Intrinsic value is best represented by the risk-adjusted cash flows (net of investments) a corporation's existing (and expected future) businesses produce and is best measured by discounted cash flow (DCF) analysis. A Sustainably Advantaged Portfolio is simply one whose intrinsic value is greater than that of competing portfolio options, all other things being equal, it ***maximises intrinsic value***.

B. An ideal portfolio is guided by the intrinsic value creation, but it is not blind to the threats and opportunities created by capital markets. It ***addresses market value*** beyond the intrinsic (DCF) value. In theory, market value (driven by market expectations) should align with intrinsic value. In practice, the two measures of value can diverge at a given moment for reasons not related to business performance.

C. A Sustainably Advantaged Portfolio always ***finds the right owner*** and, on balance, over time, will consist of assets for which the current owner is the value-maximising owner. Even if a portfolio owner is creating significant intrinsic value for a business, the owner may not be creating as much value as another owner could. When managers and executives evaluate or redesign their portfolios, they should consider the potential stand-alone value of each business to different potential buyers and compare those values to the intrinsic value of keeping the business within the portfolio.

Resilient

3. A Sustainably Advantaged Portfolio is not only strategically sound and value-creating, it is also resilient

A. An ideal portfolio in aggregate, is more likely to perform well in a variety of different, plausible, future environments, not just one that might reflect an executive team's official future. In other words, it ***survives scenarios*** and even thrives in the face of uncertainty. Best-practice companies use scenarios to stress-test the performance and risk of individual businesses and portfolios overall.

B. A Sustainably Advantaged Portfolio ***builds optionality*** into its portfolio choices, thus enabling multiple potential routes to value in the future. Optionality involves hewing to one path that has many forks and taking one of those forks when a defined event occurs. It keeps a company on one path at a time, preventing it from "letting a thousand flowers bloom" with the attendant costs of watering them all.

C. Ultimately, considering, constructing and refining a corporate portfolio is an exercise in ***weighing feasibility and risk***. The portfolio of today, indicative of a company's current strategy, constitutes a certain risk profile. Alternative portfolio options present different risk profiles in both the nature and magnitude of risk. Sustainably Advantaged Portfolio is one whose feasibility and risk are more attractive than alternative portfolios, given the company's ambition and risk appetite.

Sustainable

4. In the last decade, investors are increasingly applying environmental, social and governance (ESG) factors as part of their analysis process to identify material risks and growth opportunities.

The world has realised that business does have a role in society, beyond simply delivering profit to shareholders and taxes to governments. Society now expects that business should play a positive role in meeting their social, economic and environmental imperatives. Investors, customers, and civil society are demanding this – to the extent that shareholder returns are now also compromised by unsustainable business models.

Sustainability is now a core business and portfolio issue.

A. A Sustainably Advantaged Portfolio ***creates social value*** in aggregate. It delivers social impact to the communities that it operates in as well as to society at large. Social impact is best defined by the intended beneficiaries in terms understood by them. This could include improved living conditions, better education, basic healthcare or other pressing social needs.

B. A Sustainably Advantaged Portfolio also ***creates environmental value*** by meeting society's expectations in terms of improving the environment and addressing climate change.

C. Finally, a Sustainably Advantaged Portfolio ***creates economic impact***, by delivering on the aspirations and expectations of the host countries and communities that it operates in, with respect to the business economic impact. This could be in the form of new job creation, preferential local procurement, or taxes and royalties paid.

They can serve as a ***valuable guide for executives*** in their ongoing work to define businesses

A portfolio of businesses, one that is strategically sound, value-generating, resilient and sustainable, is at the heart of every successful company.

This is particularly relevant in turbulent times as we are currently experiencing. The twelve attributes discussed above describe what a Sustainably Advantaged Portfolio should look like, at least at the most basic level for a typical company (refer to the Appendix for a more detailed illustrative example).

They can serve as a valuable guide for executives in their ongoing work to define the businesses in which they should participate and the ways in which they create value within and across their businesses.

The Process of Building a Sustainably Advantaged Portfolio

There is a well-defined process for creating a Sustainably Advantaged Portfolio (refer to Figure 3). This portfolio-shaping process encompasses three major stages: expressing or assessing a company's current portfolio strategy; developing and choosing among alternative portfolio options; and finally, detailing and acting on the future strategy and its associated execution and change management requirements.

The key to using this process effectively is to tailor it to the needs of the company at that particular point in time. Some companies need help simply articulating or expressing their portfolio strategy so management can align around it.

Others need help assessing whether their current portfolio actually works and will continue to work in the future. Some need help generating options or choosing from among an already-agreed set of options. Others may just need help getting traction on a portfolio strategy which they have already agreed to.

And still others may need to work through the process from end to end. The best counsel on process is for executives to figure out where the company might be getting stuck across this spectrum of steps and customise the portfolio-design process accordingly.

Perhaps the greatest difficulty lies in the fact that there is no standard version of a Sustainably Advantaged Portfolio and no two analyses are identical. Each of the twelve tests needs to be specifically tailored to each company, based on the available data, needs, purpose, focus, context, etc.

Metrics for different portfolio attributes are seldom purely quantitative, more often qualitative, or semi-quantitative in nature, and need to be translated into comparable scoring scales in order to ascertain the whole portfolio effect.

But it is important to conduct multiple tests and view the results in context–no single test, in isolation of the others, will provide you with a truly strategic answer.

Figure 3. Illustrative process for creating Sustainably Advantaged Portfolio.

- Develop and agree objectives hierarchy (weighting factors for Sustainably Advantaged Portfolio attributes), aligned to overall company strategy
- Develop and agree metrics for each attribute
- Develop and agree scoring scales for each attribute, in order to be able to directly compare different attributes
- Apply twelve tests of the Sustainably Advantaged Portfolio to your current portfolio
- Score each attribute of your current portfolio based on agreed scoring scales
- Total the overall score for the current portfolio, across all attributes

- Develop portfolio alternatives and options, aligned to strategic goals and aspirations
- Choose the most plausible portfolio options
- Test chosen portfolio options in the Sustainably Advantaged Portfolio evaluation (as described in the preceding step)
- Total the overall scores for all chosen portfolio alternatives

- Compare total scores of the current and alternative portfolio options
- Consider portfolio variations to improve scores and evaluate trade-offs and alternatives
- Choose the best future portfolio based on its overall score and advantages over plausible alternatives

Conclusion

Of course, building a "sustainably advantaged" portfolio is not easy. It is not a matter of assessing things on just two or three dimensions. It is not simply a matter of evaluating the strength of individual businesses.

Nor is it an arithmetic or algorithmic exercise or a matter of applying a rigid set of criteria to all companies.

In reality, developing a Sustainably Advantaged Portfolio is more about creativity and optimisation than linear calculation. It requires viewing portfolio options through a wide array of lenses, as well as evaluating both individual and system effects. And it requires using criteria tailored to the company in focus and the societal context at hand.

Most of all, however, designing Sustainably Advantaged Portfolios requires hard work: the hard work of wrestling with data, making trade-offs, and making tough choices. In fact, in our view, management must be prepared to hold challenging, data-rich, iterative discussions about what to do (as well as what not to do) when creating a Sustainably Advantaged Portfolio. Because at the end of the day, good strategy is all about choices. And making the right choices is fundamental to sustaining growth and competitive advantage in turbulent times.

In the following Appendix we provide an illustrative example of developing a Sustainably Advantaged Portfolio for a hypothetical large chemical company, ChemCo.

While this example practically demonstrates the process execution, portfolio attribute metrics, scoring scales and the process outcomes, its application to your own company's portfolio will be highly customised and most likely result in significant differences and variations.

APPENDIX

Illustrative: Developing a sustainably advantaged portfolio for a large chemical company

Chemco is a hypothetical large chemicals company with three international business units, each including several strategically distinct businesses, having different bases of competition and/or geographies. Chemco currently considers the following alternative portfolio options:

01. The current course: managed evolution of the existing portfolio that shifts resources towards growth opportunities without disrupting typical revenue drivers.

02. Grow new materials: focus all resources on new materials with potential for growth; complement with aggressive divestitures and acquisitions.

03. Grow legacy materials: redirect resources to legacy materials that demonstrate potential; some targeted divestitures and possible acquisitions.

The twelve tests of Sustainably Advantaged Portfolio custom-designed for Chemco are shown in Figure 4a to 4d. Figure 4a. The twelve tests for Sustainable Advantaged Portfolio: Strategically Sound – illustrative for Chemco (portfolio option 2: grow new materials), to be specifically tailored for every company.

Figure 4.1. The twelve tests for Sustainable Advantaged Portfolio: Value Creating – illustrative for Chemco (portfolio option 2: grow new materials), to be specifically tailored for every company.

1A. Strategically Sound–Competitively Positioned

1A. Competitively Positioned

Example test metrics

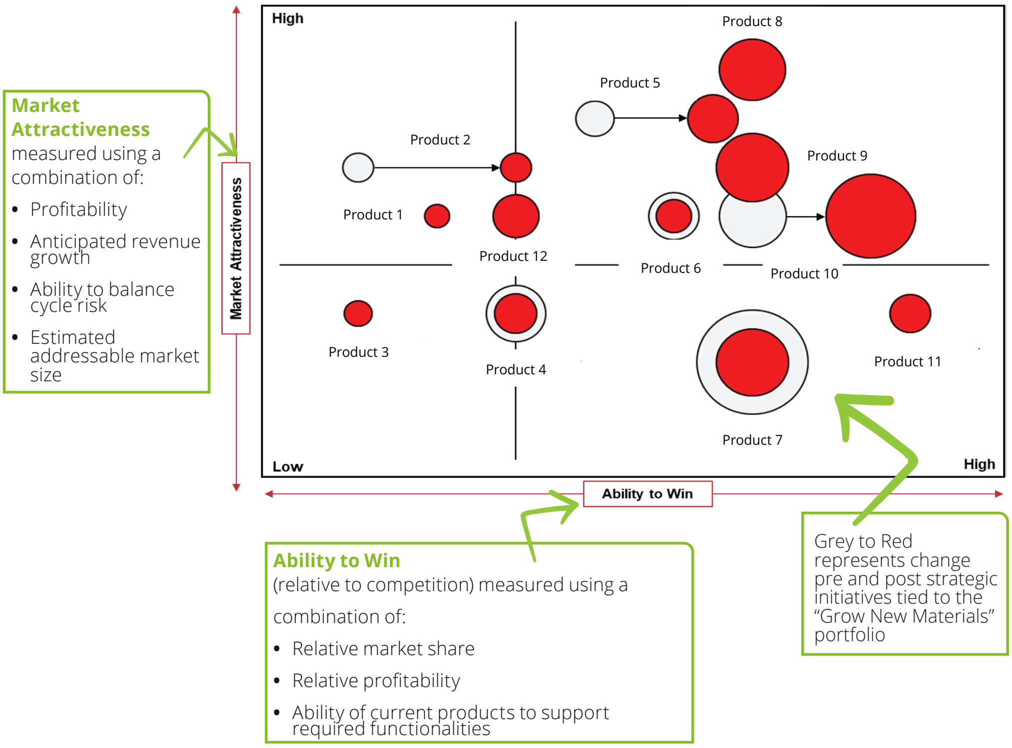
Market attractiveness vs. Ability to win (2 x 2 matrix)

Typical data sources

- Secondary research
- Industry and market reports
- Internal interviews with leadership and executives
- External interviews with subject matter expert

Key considerations

- Scoping the market appropriately is extremely important – avoid being too narrow or too broad
- Remember that each axis should be a blend of metrics
- Make sure to calibrate metrics with internal analysis, management, industry experts, etc.



1B. Strategically Sound–Balances Innovation

1B. Balances Innovation

Example test metrics

New products and technology vs. New markets and customers. (3 innovation areas/horizons: core, adjacent, transformational)

Typical data sources

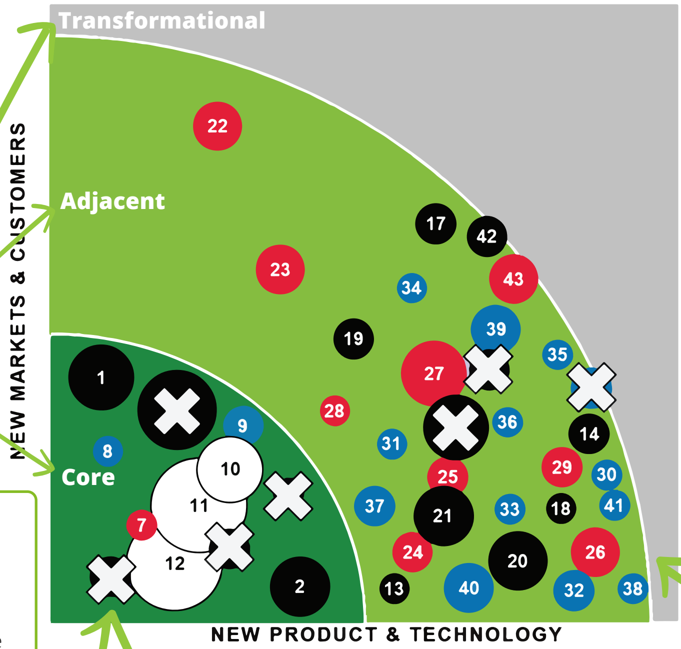
- Financial data (R&D spend)
- Internal interviews with leadership and executives
- External interviews with subject matter expert
- Primary and secondary research

Key considerations

- Interviews with internal management will shed light on how different products/BUs fit into each of the 3 innovation areas
- It is important to vet those internal views with external research for validation
- 70%-20%-10% distribution is just a rule of thumb and varies by industry

Measured using an Areas of the "Balances Innovation" Test Output:

- Transformational (10% goal)
- Adjacent (20% goal)
- Core (70% goal)



Each number/circle represents an existing product group within the portfolio, with an "X" representing divested product groups under the Grow New Materials plan. The size of the circle represents prior year R&D spend

While none of the current product groups exist in the "transformational" space, divestiture frees up funds to purchase products in that category

1C. Strategically Sound–Creates Synergy

1C. Creates Synergy

Example test metrics

Potential revenue synergies:
- Cross-technology solutions
- Cross-selling

Potential cost synergies:

- R&D budget
- Manufacturing budget

Commercial budget

Typical data sources

- Internal interviews with leadership and executives
- Planned acquisitions and divestitures

Key consideration

- This test can be conducted in either a qualitative or a quantitative manner
- A quantitative assessment would be an estimate of revenue and cost synergies using a combination of financial data and interviews with BU leadership

Potential Synergies: Test relied on core revenue and cost synergies that were hypothesized based on planned divestiture / acquisition

Potential Revenue Synergies

Cross-technology Solutions	High *potential for cross-technology solutions through diverse product technologies and ability to invest proceeds from JV*
Cross-Selling	High *potential for cross-selling based on broad and diverse portfolio*

Potential Cost Synergies

R&D Budget	Low *potential due to greater spread required in R&D spend associated with different technologies in a diverse portfolio*
Manufacturing Budget	Moderate *potential due to coherent agile manufacturing strategy across a focused portfolio*
Commercial Budget	Moderate *potential based on coherent value proposition across a high-margin focused portfolio*

We chose to score this test with a qualitative rating of High, Moderate, and Low based on the likely magnitude of the potential revenue and cost synergies

Figure 4.2. The twelve tests for Sustainable Advantaged Portfolio: Value Creating – illustrative for Chemco (portfolio option 2: grow new materials), to be specifically tailored for every company.

2A. Value Creating–Maximises Intrinsic Value

2A. Maximises Intrinsic Value

Example test metrics

ROIC vs. Revenue growth (2 x 2 matrix)

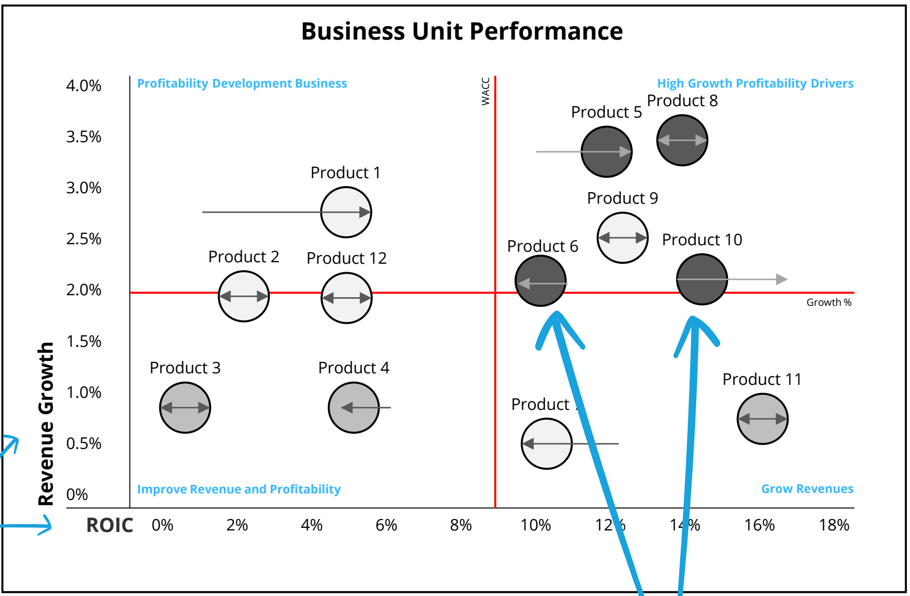
Typical data sources

- BU financial data
- Primary and secondary research
- Projections using 5-year strategic plan

Key considerations

- If performing the analysis on an outside-in basis, data such as ROIC at a Business Unit level may be hard to obtain. In this case other metrics can be used

Relative Intrinsic Value Analysis: The revenue growth/ profitability margin 2x2 is an effective way to measure and compare the value creation of each Business Unit while undergoing a strategic change, such as with the "Grow New Materials" option for ChemCo



Change in Intrinsic Value: Under "Grow New Materials" there are some Business Units with an expected net decrease in revenue growth and profitability margin, but overall there is a forecasted net gain due to the proposed acquisition/divestiture

2B. Value Creating–Addressing Market Value

2B. Addressing Market Value

Example test metrics

Sum of the part analysis

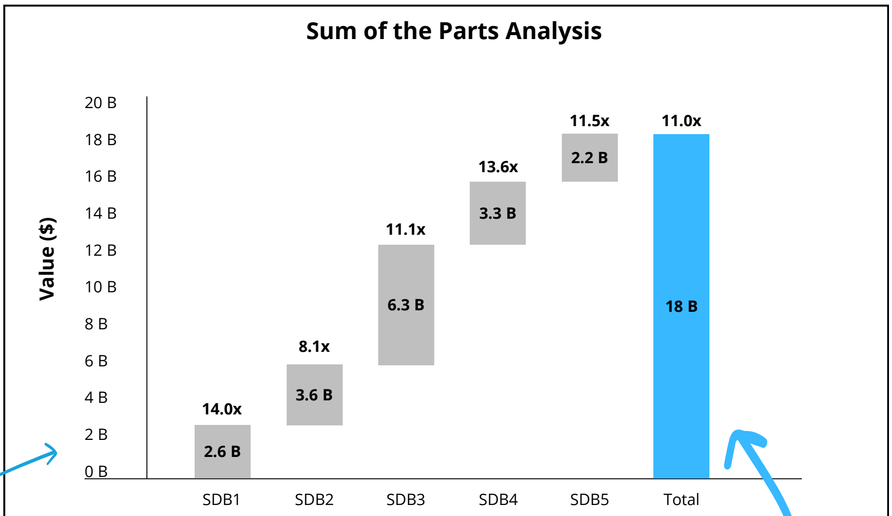
Typical data sources

- BU financial data
- Primary and secondary research
- Projections using 5-year strategic plan

Key considerations

- While these tests are nearly always quantitative, it is possible to customize them to be simpler or more complex based on available data and desired use for the results of the test

Business Unit Financial Analysis: "Addresses market Value" test was done using post M&A transaction financial analysis under the "Grow New Materials" planned acquisition/ divestiture strategy, with a multiples analysis that predicted the Business Unit value after the strategy was implemented



Note: Value of SDBs calculated using 2018 E EBITDA and category multiples

Using estimated 2018 Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA) for each of the business units and category multiples of a peer set gives an estimate of the total enterprise value of the Business Unit and a resulting blended expected trading multiple

2C. Value Creating–Finds The Right Owner

2C. Finds The Right Owner

Example test metrics

Product ownership position vs planned retention/divestiture

Typical data sources

- Primary and secondary research
- BU market intelligence
- Internal interviews with leadership and executives
- Planned acquisitions and divestitures

Key considerations

To adopt a quantitative approach to this test, you could:

- For a target SDB, pick a set of scenarios/buyers to evaluate. e.g., competitor, financial buyer (such as private equity), strategic player (looking at a possible asset combination)
- Run a set of discounted cash flow analyses varying key inputs for each buyer (discount rate, cash flows, growth horizon, etc.)
- Compare across analyses to suggest the right owner

Indicators: We summarised the overall ownership position in a binary fashion - with a check indicating that ChemCo were the best owner and a question mark indicating that they may not be the best owner

	Product Position	Planned Retention/Divestiture
✓	Strong player in market	Retain
✓	Strong player in market	Retain
?	Non-leader in a non-differentiated market	Retain
✓	Strong position in unique market	Retain
?	Non-leader in a non-differentiated market	Divest
✓	Strong player in market	Retain
?	Small player in larger market	Retain
?	Small player in larger market	Retain
?	Not a major player in this market	Retain
?	Non-leader in a non-differentiated market	Divest
?	Not a major player in this market	Retain
?	Small player in larger market	Retain

Ownership Position: We made a qualitative assessment of ownership in this case, based on managerial judgement of ChemCo's relative position to competitors in the market

Green indicates alignment of assessed owner and plan (e.g., Right owner ✓ and plan to Retain product); Yellow indicates misalignment

Figure 4.3. The twelve tests for Sustainable Advantaged Portfolio: Resilient – illustrative for Chemco (portfolio option 2: grow new materials), to be specifically tailored for every company.

3A. Resilient–Survives Scenarios

3A. Survives Scenarios

Example test metrics

Future state of the portfolio under critical uncertainties

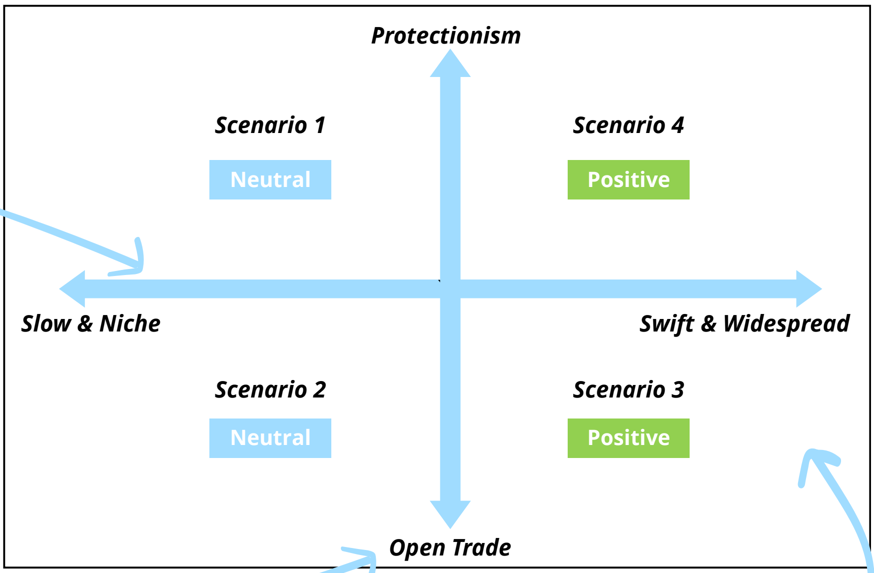
Typical data sources

- Primary and secondary research
- BU market intelligence
- Internal interviews with leadership and executives

Key considerations

- This test is qualitative in nature and must be customized for every application of AP
- It is important to decide at what level in the portfolio this test will be run – at the SDB, BU, or corporate level

Critical Uncertainty #1: Scenario planning exercise revealed the first critical uncertainty to be the speed and breadth of the onset of new and disruptive technologies in one of ChemCo's primary industry sectors



Critical Uncertainty #2: Scenario planning exercise revealed the second critical uncertainty to be global trade restrictions, which could greatly impact ChemCo's portfolio due to the impact on their global supply chain

Each quadrant represents a possible future state for the portfolio and the assessment of Positive/Neutral represents how it will be positioned if that specific future comes to pass

3B. Resilient–Builds Optionality

3B. Builds optionality

Example test metrics

Optionality assessment

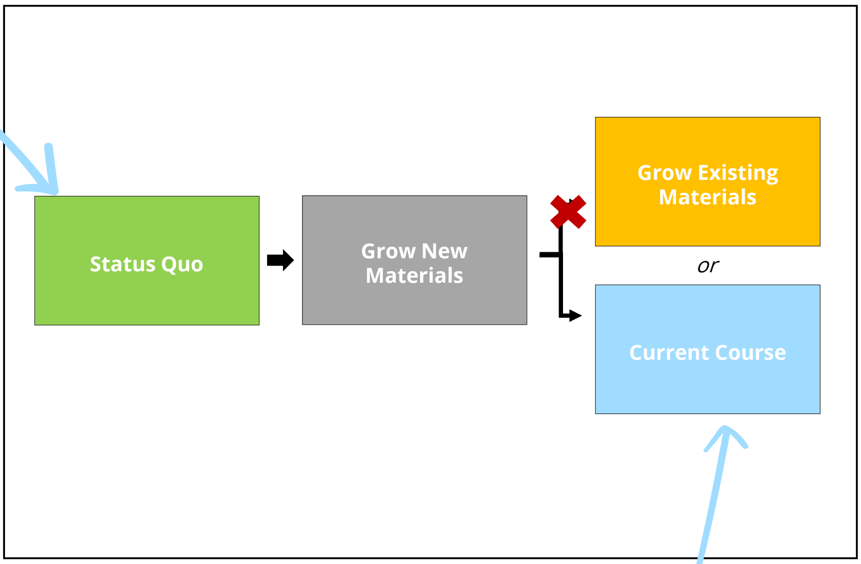
Typical data sources

- Planned acquisitions and divestitures
- Insights from 5-year strategic plan

Key considerations

- Even a very simple version of the optionality test still provides powerful results and is effective in aiding with decision making
- This test is nearly always qualitative, but needs to be specifically customised and tailored to the unique situation that is being assessed

Optionality Assessment: The assessment of optionality centered around considering which strategic options would be available to ChemCo depending on the options they chose



Under the "Grow New Materials" option, ChemCo would be able to pivot back to current course, but "Grow Existing Materials" would no longer be an option due to divestitures

3C. Resilient—Weighs Feasibility And Risk

3C. Weighs feasibility and risk

Example test metrics

Assessment of the most prominent feasibility and risk factors

Typical data sources

- Acquisition and divestiture financial projections
- Primary and secondary research
- BU market intelligence

Key considerations

- Feasibility captures ability to create/execute the new portfolio – e.g., management resources, required capital, technology, and other capabilities
- Risk captures elements such as competitive reaction, regulatory risk, capital markets reaction, M&A integration risk, etc.
- The set of elements considered is dependent on the company and situation

Feasibility & Risk:
We created a list of the most prominent feasibility and risk factors that ChemCo would face under each of their strategic options

Risks	Market Cycle	***Low risk*** *since exposure to industry 1 is balanced with growth in industry 2*
	Customer	***Higher risk*** *due to potential to alienate core customers in industry 1*
	Technology	***Moderate risk*** *due to de-prioritisation of core products that may have technology dependencies with new products*
	M&A integration	***Moderate risk*** *due to bolt-on nature of multiple acquisitions*
Feasibility Constraints	Availability of attractive M&A targets	***Low availability*** *of attractive product targets may pose a risk to growth in priority spaces*
	Ability to finance investments	***High*** *ability to finance future investments due to JV proceeds*
	Business execution	***Moderate feasibility*** *of execution due to operational complexity of JV*

Qualitative Assessment:
We chose a simple high, moderate, and low qualitative assessment for the chosen risks and feasibility constraints

Figure 4.4. The twelve tests for Sustainable Advantaged Portfolio: Sustainable – illustrative for Chemco (portfolio option 2: grow new materials), to be specifically tailored for every company.

4A. Sustainable–Creates Social Value

4A. Creates Social Value

Example test metrics

Social impact categories

Typical data sources

- Financial data
- Integrated annual report
- Insights from 5 year strategic plan
- Capital projects portfolio analysis
- Primary and secondary research

Key considerations

- Targets for spend in each social impact category should be established and benchmarked against the peer group
- An analysis of what the company actually achieves with respect to social impact, should accompany the spend analysis and include:
  - Value inputs
  - Assessment of outputs
  - Measurement of the impact of corporate contributions to community programs (adopting this approach improves program results and enhances reporting to key stakeholders)

Social investment as defined by the London Benchmarking Group includes donations, gifts in kind and staff time for administering community programmes and volunteering in company time

Social impact category	Spend (R million)	% of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA)
Training and education	R 125	0.20%
Housing and local facilities	R 243	0.38%
Health and well-being	R 101	0.16%
Other	R 23	0.04%
TOTAL	**R 492**	**0.78%**
TARGET	**R 540**	**0.85%**

Social investment is shown in spend amount per category and as a percentage of underlying Earnings Before Interest, Taxes, Depreciation and Amortisation Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), less underlying EBIT of associates and joint ventures

4B. Sustainable–Creates Environmental Value

4B. Creates Environmental Value

Example test metrics

Environmental impact categories

Typical data sources

- Financial data
- Integrated annual report
- Insights from 5 year strategic plan
- Capital projects portfolio analysis
- Primary and secondary research

Key considerations

- The environmental impact categories and targets for each category should be established and benchmarked against the peer group and the investors requirements
- Targets should collectively deliver on strategic goals

Environmental impact focuses on minimising harm to the environment and include: energy consumption (measured in terajoule = million gigajoule (GJ), GHG emissions (measured in million tonnes of carbon dioxide equivalent emissions), and total water consumed by source (including water used for primary and non-primary activities (measured in million (Mega) cubic meters)

Environmental impact category	Target	Actual
Energy consumption	20,000 terajoules	19,500 terajoules
Greenhouse gas (GHG) emissions	5,500 kt CO_2 e	5,400 kt CO_2 e
Total new water used	30,000 M m^3	24,000 M m^3
Area disturbed by operations	0 m^2	12 300 m^2

4C. Sustainable–Create Economic Impact

4C. Create Economic Impact

Example test metrics

Economic impact categories

Typical data sources

- Financial data
- Integrated annual report
- Insights from 5 year strategic plan
- Capital projects portfolio analysis
- Primary and secondary research

Key considerations

- The economic impact categories and targets for each category should be established and benchmarked against the peer group and the investors requirements
- Targets should collectively deliver on strategic goals

Economic impact can be defined in a variety of ways: employment (reported as headcount of jobs, not in terms of FTEs) and workers' earnings (the total amount of income paid to all workers and owners, including wages and salaries, employer provided benefits and business owner profits) are the most instructive measures

Economic impact category	Actual	Target
Total jobs	11 200 headcount	12 500
Local procurement	73% Percentage of total	75% Percentage of total
Workers' earnings	R 334 bn total income paid	R 430 bn
Royalties and taxes	R 16.6 bn actual paid	R 18 bn
Forex earnings	R 152 bn	R 180 bn

Metrics for different portfolio attributes are seldom purely quantitative, more often qualitative, or semi-quantitative in nature, and need to be translated into comparable scoring scales to ascertain the combined portfolio effect (refer to Figure 5). The relative importance of specific attributes of the portfolio is recognised by assigning weighting factors (w1, w2, w3 and w4, in Figure 5), which should reflect the objectives hierarchy determined by the strategy.

An illustrative example of scoring logic, scoring scales (based on score range of 0 to 5) and weighting factors (based on equal weighting for all portfolio attributes, w1 = w2 = w3 = w4 = 1) used in Chemco example are shown in Figure 5. However, it has to be stressed that scoring logic and weighting the relative importance of each of the twelve sustainable advantaged portfolio attributes, are not "one size fits all" but must be specifically considered and designed for every company.

Figure 4.5. Scoring logic, scoring scales and weighting factors for the twelve attributes of the Sustainable Advantaged Portfolio – illustrative for Chemco, to be specifically tailored for every company.

1. Strategically Sound weight $W_1 = w_{1A} + w_{1B} + w_{1C} = 1$

1A. Competitively positioned weight w_{1A} = 0.33(3)

- Points are allocated based on the spread of the portfolio across the 4 quadrants of the competitively positioned matrix
- Scoring is as follows:
  - 5 points for every dollar of BU revenue in the top right quadrant
  - 3 points for every dollar of BU revenue in the bottom right quadrant
  - 1 point for every dollar of BU revenue in the top left quadrant
  - 0 points for every dollar of BU revenue in the bottom left quadrant

1B. Balances Innovation weight W1B = 0.33(3)

- Points are allocated based on the spread of innovation projects on the innovation ambition matrix
- Scoring is as follows:
  - 5 points: portfolio achieves perfect alignment with the “golden ratio”
  - 4 points: portfolio partially aligns with golden ratio
  - 3 points: portfolio contains no “transformational” innovation projects
  - 2 points: majority of innovation projects within portfolio are “core”
  - 1 point: All innovation projects within portfolio are “core”
  - 0 points: Portfolio contains no innovative projects/initiatives

1C. Creates Synergy weight W1C = 0.33(3)

- Points are allocated based on the spread of innovation projects on the innovation ambition matrix
- Scoring is as follows:
  - 5 points: portfolio achieves perfect alignment with the “golden ratio”
  - 4 points: portfolio partially aligns with golden ratio
  - 3 points: portfolio contains no “transformational” innovation projects
  - 2 points: majority of innovation projects within portfolio are “core”
  - 1 point: All innovation projects within portfolio are “core”
  - 0 points: Portfolio contains no innovative projects/initiatives

2. Value Creating weight $W_2 = w_{2A} + w_{2B} + w_{2C} = 1$

2A. Maximises Intrinsic Value weight w_{2A} = 0.33(3)

- Points are allocated based on the spread of the portfolio across the 4 quadrants of the Maximises Intrinsic Value matrix
- Scoring is as follows:
  - 5 points for every dollar of BU revenue in the top right quadrant
  - 3 points for every dollar of BU revenue in the bottom right quadrant
  - 1 point for every dollar of BU revenue in the bottom left quadrant
  - 0 points for every dollar of BU revenue in the top left quadrant

2B. Addresses Market Value weight w2B = 0.33(3)

- Points are allocated based on the degree of alignment between the portfolio’s intrinsic value and market value
- Scoring is as follows:
  - 5 points: intrinsic value is 0-5% higher or lower than market value
  - 4 points: intrinsic value is 5-10% higher or lower than market value
  - 3 points: intrinsic value is 10-20% higher or lower than market value
  - 2 points: intrinsic value is 20-40% higher or lower than market value
  - 1 point: intrinsic value is 40-60% higher or lower than market value
  - 0 points: Intrinsic value is greater than 60% higher or lower than market value

2C. Finds Right Owner weight w2C = 0.33(3)

- Points are allocated based on how well each BU performs under the clients control versus another organisation (e.g., competitor)
- Scoring is as follows:
  - 5 points: all BUs perform best under the company’s control
  - 4 points: 85%-99% of BUs perform best under the company’s control
  - 3 points: 75-84% of BUs perform best under the company’s control
  - 2 points: 50-74% of BUs perform best under the company’s control
  - 1 point: 1-49% of BUs perform best under the company’s control
  - 0 points: All BUs perform best under the control of another organisation (e.g., competitor)

3. Resilient weight $W_3 = w_{3A} + w_{3B} + w_{3C} = 1$

3A. Survives Scenarios weight $w_{3A} = 0.33(3)$

- Points are allocated based on how well the company's strategy stands up to a number of potential future states
- Scoring is as follows:
  - 5 points: All BUs are well positioned for all four scenarios
  - 4 points: All BUs are well / moderately positioned for all four scenarios
  - 3 points: All BUs are well positioned for at least 3/4 scenarios
  - 2 points: All BUs are well positioned for at least 2/4 scenarios
  - 1 point: All BUs are well positioned for at least 1/4 scenarios
  - 0 points: All BUs are not well or moderately positioned for any of the four scenarios

3B. Builds Optionality weight $w_{3B} = 0.33(3)$

- Points are allocated based on how prepared the client is across a number of potential short-term events
- Scoring is as follows:
  - 5 points for every dollar of BU revenue in the top right quadrant
  - 3 points for every dollar of BU revenue in the bottom right quadrant
  - 1 point for every dollar of BU revenue in the top left quadrant
  - 0 points for every dollar of BU revenue in the bottom left quadrant

3C. Weighs Feasibility and Risk weight $w_{3C} = 0.33(3)$

- Points are allocated based on the spread of the portfolio across the 4 quadrants of the maximises intrinsic value matrix
- Scoring is as follows:
  - 5 points for every dollar of BU revenue in the top right quadrant
  - 3 points for every dollar of BU revenue in the bottom right quadrant
  - 1 point for every dollar of BU revenue in the top left quadrant
  - 0 points for every dollar of BU revenue in the bottom left quadrant

4. Sustainable weight $W_4 = w_{4A} + w_{4B} + w_{4C} = 1$

4A. Creates Social Value weight w4A = 0.33(3)

- Points are allocated based on the degree of achievement of the social spend target(s), measured as a percentage of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA)
- Scoring is as follows:
  - 5 points: if spend meets or exceeds target
  - 3 points: if spend is less then 10% lower than target
  - 1 point: if spend is 10% to 20% lower than target
  - 0: points if spend is more than 20% lower than target

4B. Creates Environmental Value weight w4B = 0.33(3)

- Points are allocated based on the degree of achievement of the environmental target(s)
- Scoring is as follows:
  - 5 points: targets across all categories are met or exceeded
  - 4 points: outcomes across all categories are achieved within 10% of the target
  - 2 points: outcomes across all categories are achieved within 10% to 20% of the target
  - 0 points: outcomes across all categories are achieved below 20% of the target

4C. Creates Economic Impact weight w_{4C} = = 0.33(3)

- Points are allocated based on the degree of achievement of the economic impact target(s)
- Scoring is as follows:
  - 5 points: targets across all categories are met or exceeded
  - 4 points: outcomes across all categories are achieved within 10% of the target
  - 2 points: outcomes across all categories are achieved within 10% to 20% of the target
  - 0 points: outcomes across all categories are achieved below 20% of the target

Once portfolio alternatives or options are scored across all twelve attributes of the Sustainably Advantaged Portfolio, they can be numerically compared, in order to objectively inform strategic decision-making. An illustrative example of the three portfolio options for Chemco is shown in Figure 6.

Figure 4.6. Comparison of portfolio options – illustrative for Chemco, to be specifically tailored to every company.

Sustainably Advantaged Portfolio attributes		***Option 1***	***Option 2***	***Option 3***
1. Strategically Sound ***W1 = w1A + w1B + w1C = 1***	1a. Competitively positioned w_{1A} = 0.33(3)	2	5	2
	1b. Balances innovation w_{1B} = 0.33(3)	2	2	0
	1c. Creates synergies w_{1C} = 0.33(3)	1	2	2
	1. Total	***1.67***	***3.00***	***1.33***
2. Value Creating ***W2 = w2A + w2B + w2C = 1***	2a. Maximises intrinsic value W_{2A} = 0.33(3)	2	5	2
	2b. Addresses market value W_{2B} = 0.33(3)	2	5	2
	2c. Finds the right owner W_{2C} = 0.33(3)	2	3	5
	2. Total	***2.00***	***4.33***	***3.00***
3. Resilient ***W3 = w3A + w3B + w3C = 1***	3a. Survives scenarios **W3A = 0.33(3)**	2	5	2
	3b. Builds optionality **W3B = 0.33(3)**	5	3	1
	3c. Weighs feasibility and risk **W_{3C} = 0.33(3)**	2	2	5
	3. Total	***3.00***	***3.33***	***2.67***
4. Sustainable ***W4 = w4A + w4B + w4C = 1***	4a. Creates social value **W_{4A} = 0.33(3)**	2	4	2
	4b. Creates environmental value **W4B = 0.33(3)**	2	4	3
	4c. Creates economic impact **W4C = 0.33(3)**	2	4	2
	4. Total	***2.00***	***4.00***	***2.33***
TOTAL PORTFOLIO		***8.67***	***14.66***	***9.33***

It is clear that for Chemco, the portfolio option 2: Grow new materials, which focuses all resources on new materials with potential for growth; complement with aggressive divestitures and acquisitions, delivers the best overall portfolio, across diverse portfolio attributes.

The portfolio option 3: Grow legacy materials, is overall only marginally more advantageous than the current portfolio option 1: The current course, however, it is significantly more "hard value" creating.

While overall scores allow for direct comparison of different portfolio alternatives and options, their levels are only directional, and the real value of the Sustainably Advantaged Portfolio framework lies in the ability to provide an assessment of impact of trade-offs and optionality to better inform the key strategic decisions and choices.

References

Michael Armstrong, Jonathan Goodman and Gavin McTavish, "The Crux of Corporate Strategy – Building an Advantaged Portfolio", Monitor Deloitte, 2015

About the Authors:

Andrew Lane
Director | Strategic Transformation Leader
Deloitte Africa

Jacek Guzek
Associate Director | Strategy, Strategic Sensing and Insight Leader
Deloitte Africa