AlixPartners

BEWARE THE R&D ‘EFFICIENCY PARADOX’ IN PE-OWNED COMPANIES

Why you can’t standardize investment in innovation

The traditional private equity (PE) toolkit, which focuses on leanness and cost optimization, doesn't lend itself to research and development (R&D) very well. It's not that R&D cannot be made more efficient—indeed, it can, and we will show you how—but the pursuit of efficiency in innovation takes a different form. If you just apply cost tools to R&D as you would to anything else, you risk running into what we call the efficiency paradox: doing things that save money in the short term at the expense of value in the medium and long terms.

Many PE-owned companies tend to treat R&D as a factory whose sole purpose is to produce the features and products the company sells—investment in one end, widgets out the other. The idea that growth should **scale** with R&D spending is embedded in the investor psyche, and consequently, so is the focus on R&D productivity. But innovation doesn't just support business strategy; it also shapes and reshapes it.

By managing innovation costs as they do any other operational expense, companies miss out on leveraging R&D as a true business partner. The results are often a compromised product-market fit, reduced innovation, and lack of adaptability to changing market dynamics. But PE-owned companies can adopt an alternative approach to avoid common pitfalls—while remaining true to the industry's ethos and goal of getting more output with lower, better-focused input.

Here we explain how the efficiency paradox plays out in real life and how companies could revisit strategic missteps.

HOW THE EFFICIENCY PARADOX MANIFESTS

What happened when the software development lifecycle was 'streamlined'

A PE-owned software company aimed to make its R&D process lean by standardizing, resourcing and streamlining the development methodology of the software development lifecycle. The goals were to cut costs and reduce time-to-market, and the vision was that R&D became highly efficient—a so called feature factory. Each product team or engineering team got standardized and allocated a standard number of product managers, developers, and testers, all driven by benchmarks and industry standards.

In the short term, the company did achieve faster delivery of products. But the rigid process diminished the flexibility needed for innovation, which led to loss of market differentiation and competitive edge in meeting user or buyer needs. The company lost sight of bigger strategic priorities and divorced the flow of innovation from future developments.

ALTERNATIVE APPROACH

Leveraging a value-adjusted or product lifecycle stage-driven resourcing model

A more ideal resourcing model would have been driven by product lifecycle, enabling the company to allocate resources based on whether the product is in the investment, optimization, or exit phase. For example, a product in the 'invest/innovate' stage, the company could allocate more resources and emphasize strategic alignment with business goals. Conversely, for products in the 'exit' phase, it makes sense to reduce resources but ensure the resources are redeployed strategically. For a mature product, more resources should be allocated to deliver on up-time and bug fixes.

This approach ensures that R&D resources get used efficiently and it maintains necessary focus on strategic objectives, thereby balancing innovation and running-the-business where it matters most.

Using R&D resources efficiently

RESOURCING MODEL	R&D RESOURCE LEVEL	CONSIDERATIONS
INNOVATION (experiment and invest)		• Focus on bench scale and pilot projects, minimize investment in production, emphasize sprint and agile capabilities • Requires the most strategic thinking; tends to prioritize speed over quality • Sprint capacity requirements depend on innovation timelines number of bench-scale projects • Investment is generally lower to target ROI
GROWTH (invest and scale)		• Investment level grows, but is focused on winning projects; emphasize quality, features, functionality; link R&D tightly to production and sales • Requires strategic thinking; speed, growth, and market share are measures of success • Sprint capacity requirements high, depending on timelines and size of opportunities
MATURITY (optimize and exploit)		• Product emphasis should be on line extensions, customer retention, profit maximization • Less dependent on strategic thinking; optimization and stability are preferred • Sprint capacity requirements generally lower, depending on volumes and complexity • Resourcing still required to keep products viable and extend life expectancy
DECLINE (keep the lights on and exit)		• Sunsetting a product requires coordination and communication • Sprint capacity can be phased out or redeployed to other products

What happened when a company outsourced support functions

A technology firm heavily outsourced product and customer support functions to cut costs, to instead focus on reducing operational overhead. The goal was to maintain product development speed while lowering expenses. (Sound familiar?)

The unintended consequence, however, was to sever the feedback loop between product development and the customer. As a result, customer issues did not get addressed adequately, which caused costly declines in product quality and customer satisfaction.

ALTERNATIVE APPROACH

Establishing a product feedback loop with a leaner support team

Instead of simply outsourcing the support function, we advised the company to keep the feedback loop intact between the user, the support functions, and the product team. A fit-for-purpose line of communication between support and R&D serves to bolster both product quality and customer satisfaction, and the integration of customer feedback into the development process enables the R&D team to address root causes effectively.

This model still achieves cost reductions through outsourcing and leaner teams but mitigates quality issues by reducing incidents and improving quality. Ultimately, the long-term support costs are lower due to fewer incidents.

What happened when a company rationalized product portfolios based solely on financial performance

The company undercut its own market share. At a manufacturing company, some products were not meeting immediate financial performance targets. The focus was on streamlining offerings to improve profitability—and that meant discontinuing underperforming products.

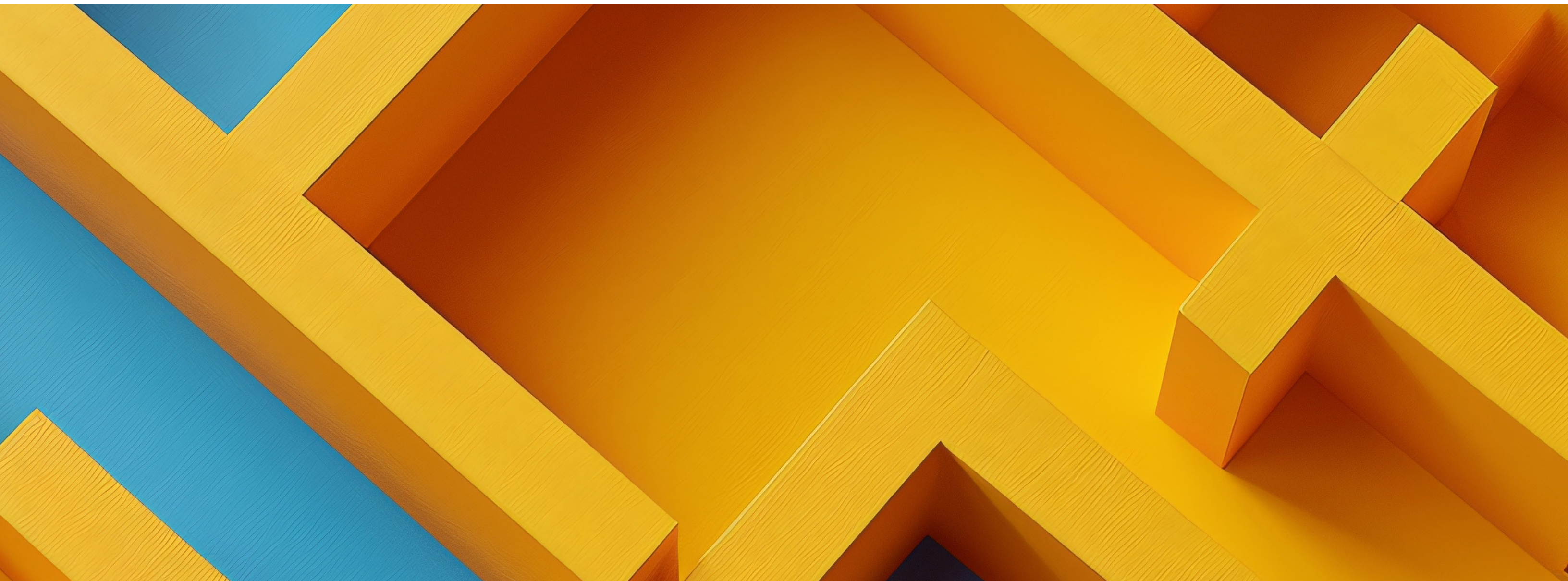
However, this forced the company out of markets and product lines that had played crucial roles in winning larger contracts, in responding to global request for proposals (RFPs), and also meeting regulatory requirements. The company may have saved short-term cash, but committed an 'own goal.'

ALTERNATIVE APPROACH

Assessing strategic value beyond financial performance

The obvious miscalculation lay in the evaluation of the product portfolio under too narrow a set of criteria, and the fix is to think more broadly about the product's strategic value, growth potential, technical complexity, and role in serving existing commitments. Sometimes, companies have to retain products that contribute strategically, even if the products' financial performances are currently suboptimal.

This approach ensures that the portfolio remains aligned with broader strategic goals, preserving the company's ability to win key contracts and maintain compliance, ultimately supporting long-term growth.



True efficiency isn't just about spending less, it's about spending smarter.

The payoff for investment in R&D can seem too long coming, but these examples show how quickly a wrongheaded focus on “efficiency” can undercut not just R&D but also the company as a whole. The examples also show that effective approaches exist for managing R&D performance that are measurable, quantifiable, and powerful - that is, ways that operating partners and portfolio companies can organize innovation to deliver better results for less money. Avoiding the efficiency paradox requires careful navigation at PE-owned companies that are predisposed to fine-tune their investments. The product lifecycle is more complex than an on-off switch, and understanding resource needs from investment to exit will result in a smarter strategy that doesn’t put a kink in the hose.

To avoid the **R&D efficiency paradox**, PE-owned companies should:

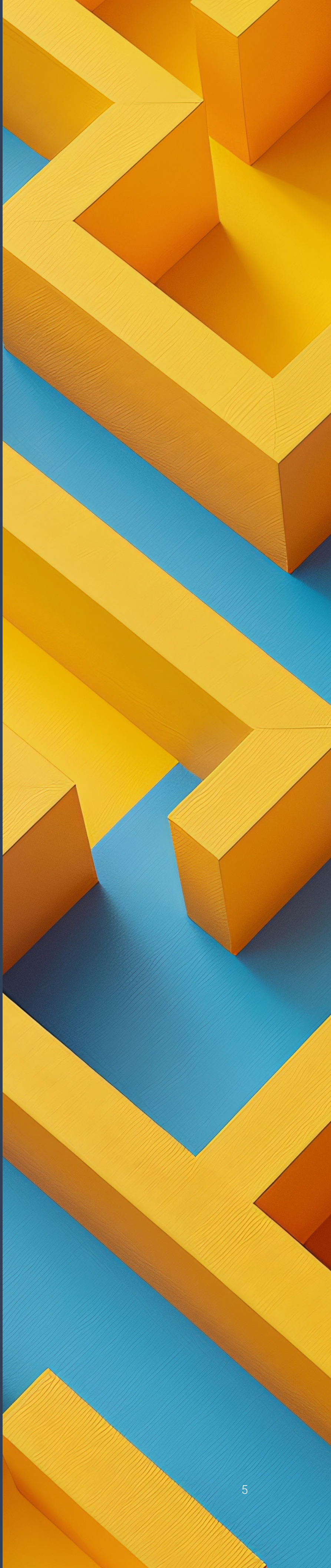
Invest strategically, don’t just cut costs – Efficiency should enable innovation, not stifle it

Align R&D with business goals – Fund products based on lifecycle stage, not benchmarks

Prioritize sustainable growth – Short-term savings should not come at the expense of long-term value

Measure impact in addition to expense – Success isn’t just about cutting spend but maximizing ROI from R&D

Read **part one** and **part two** in this series on the efficiency paradox.



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ABOUT US

For more than 40 years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.