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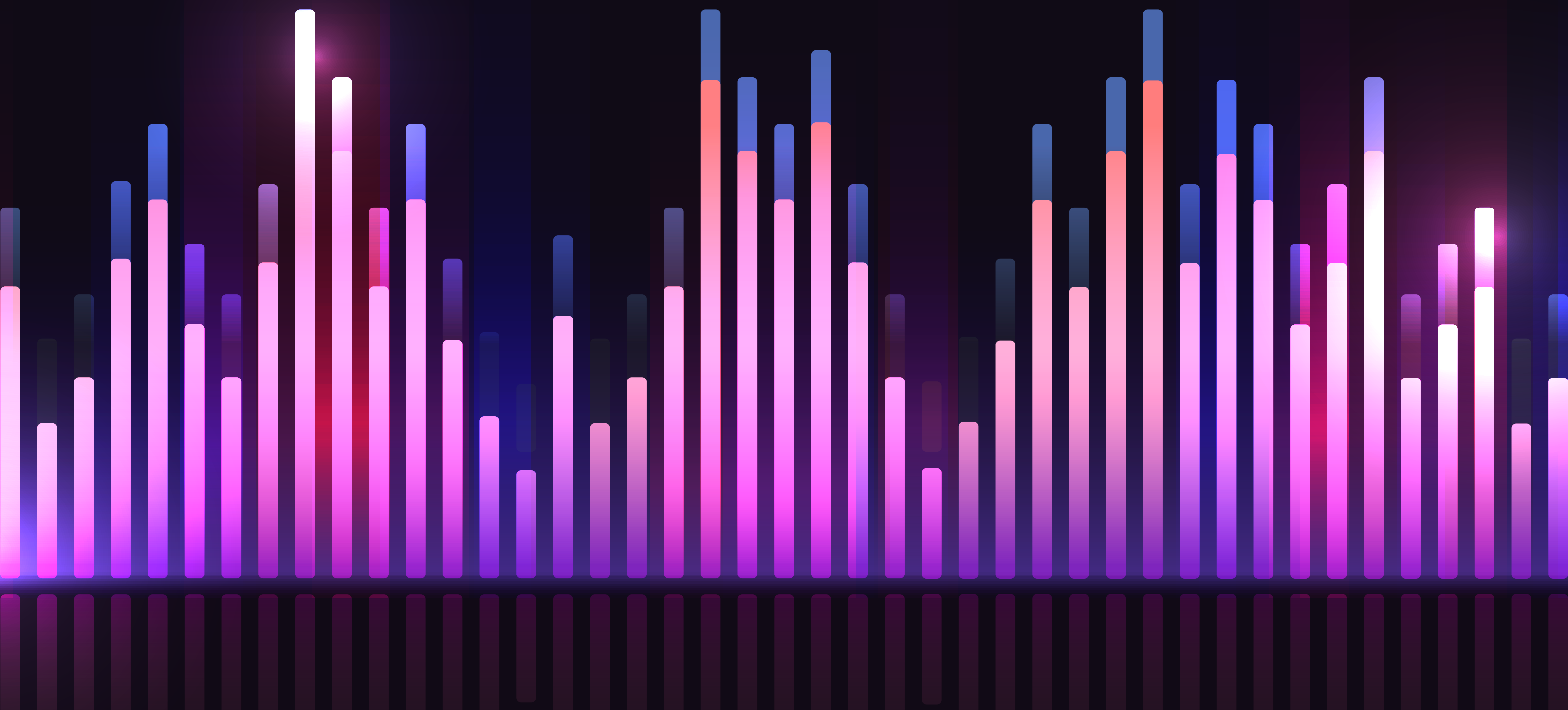


GETTING PRODUCT RATIONALIZATION RIGHT

How winning companies restructure their portfolios to drive sustained growth

In an uncertain economy, the optimization of a company's portfolio of offerings is crucial for ensuring sustainability and growth. Portfolio rationalization reduces complexity and improves efficiency, enabling companies to allocate resources effectively. When such rationalization is carried out with an understanding of customers' perceived values and by innovating rapidly—through the use of artificial intelligence (AI) and data analytics—it becomes a tool for growth as well as for cost and margin management. With a better-defined portfolio, a company can attract and retain more customers and put sales, marketing, and investment dollars to their most profitable use. Furthermore, a redesigned product portfolio enables a company to look for new opportunities from a strong and well-defined core.

That's the what and the why of portfolio rationalization, which we described in detail in **'Reconfiguring to win: How companies are rationalizing their product portfolios to survive and thrive in uncertainty.'**

HOW ABOUT THE HOW?

Our experience has shown it's important to make decisions according to underlying strategic principles and to create a framework to guide a company's actions. Principles and a framework are necessary because rationalization should not be a one-and-done process. Some companies simply identify low-profit businesses or products and then bring out the axe—a simplistic approach that often leaves a company weaker, not stronger. A single-minded and shortsighted focus on margin raises the risk of achieving quick savings but at the expense of strategy and capabilities.

A better process begins with articulating principles in four areas: **strategy, growth, organization,** and **people**. You want to strengthen your value proposition in the long run and create opportunities for growth. You want to become an organization that is more flexible than it was before. And you want to protect the people in the organization and enhance the roles of those who will lead it to future success. Here are the steps to take in following the four principles.

1

Iteratively strengthen your core value proposition

Beware of moves that enhance short-term profitability at the expense of core, differentiating capabilities. Your goals are to continuously strive to outperform competitors and to maintain an edge in the market; rationalization should help you achieve them. Certain portfolio questions—What should stay? What should go? What should grow? What should shrink?—need to be answered in the context of your value proposition and your differentiating assets and capabilities. If your value proposition is cost leadership, work that; if it's innovation or product quality or operations and logistics, use portfolio rationalization to strengthen those areas. At the same time, get consensus about which assets and activities are table stakes and which are differentiators—like centers of excellence, regional dominance, and proprietary data. This knowledge will tell you what not to cut, but it can also do more: it can uncover outsourcing opportunities and reveal parts of your business that are blocking or draining resources away from what really matters.

2 Place the right bets on growth

While you're taking a microscope to costs, you should also pick up a telescope to envision where the business needs to go. Understanding your value proposition and differentiating capabilities tells you where to invest, as well as where to cut. If you could build a product or service portfolio from scratch, what would it look like? If you could look back on your business from 5 or 10 years in the future, what would you hope your team had done today? What's the best use of resources that rationalization frees up? What innovation investments should be protected from cuts—or even given more support?

3 Increase organizational flexibility to meet market needs across commercial, operations, and administrative teams

Portfolio rationalization creates two connected opportunities to make your company more nimble. One is to use the process to replace slow-moving functions with empowered teams that have access to real-time data, thus increasing both the speed and the reliability of decision-making. And second, rationalization can foster cross-functional collaboration between commercial and operational teams—for example, by redesigning sales and operations planning to increase cash generation and EBITDA. Revenue and supply chain war rooms are good examples of that—in the form of action-oriented teams that connect different functions without building bureaucratic structures.

4 Focus on people to build human capability as you strengthen the business

We have seen too many cases of portfolio rationalization in which people were afterthoughts, with human resources finally brought in to clean up at the end, which is a profoundly misguided approach. It's the wrong economic choice in a world in which human capability and intellectual capital are greater sources of value creation than physical and financial assets are. At minimum, you need to:

1 Understand the key talent priorities and politics that align with product priority and

2 Identify, cultivate, and retain top and high-potential employees wherever they are in the company.

Rationalization is also likely to create important new opportunities for future leaders.

WHAT IS THE FRAMEWORK AND PRACTICAL APPROACH?

AlixPartners recently used a framework to help a $1-billion medical device company whose five business units operate in more than 60 countries. The framework, alignment, and companywide collaboration prepared the ground for rapid implementation and results and led to both an increase in contribution margin by 660 basis points and an increase in EBITDA from 17 to 22% in two years, as well as the identification of a $100-million-in-revenue carve-out opportunity.

Companies should establish a repeatable framework to put these principles into practice and make rationalization more—well—rational. Making specific product evaluations based on commercial and operating complexity and market attractiveness is critical in the context of strategy and profitability. To do that, it is important to first align on metrics of profitability and complexity and then thoroughly learn what drives those metrics. That alignment and that learning together will facilitate a comprehensive assessment of the current state, identify areas that require improvement, and help remove politics from decision-making.

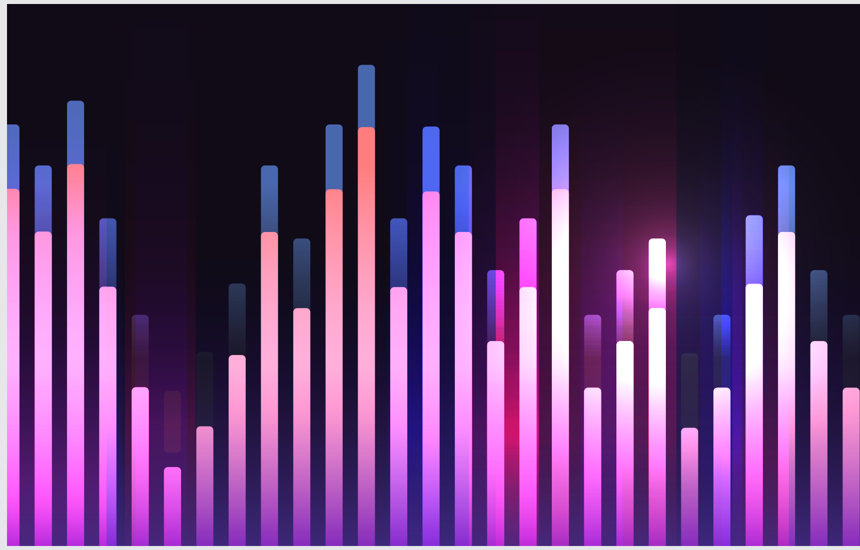
Second, companies need to determine the optimal portfolio that aligns with their corporate strategy, considering such factors as market demand, trends, profitability, and competitive advantage. Those considerations involve evaluating each product or service and making informed decisions about whether to retain, divest, or invest further, thereby surgically reshaping the portfolio, not just cutting it.

A FRAMEWORK LIKE THE FOLLOWING ONE CAN GET THE RATIONALIZATION PROCESS OFF TO A GOOD START

	MARKET COVERAGE Which markets are most and least profitable? Which markets have highest and lowest growth prospects? Which markets can we exit most practicably?	**COMMERCIAL COMPLEXITY** How can we optimize our commercial activities in the markets we serve? Does our go-to-market structure fit those markets?	**OPERATIONAL COMPLEXITY** What operational and manufacturing inefficiencies can be eliminated by rationalization? What positive efficiencies can be gained?
STRATEGIC ALIGNMENT Do rationalization decisions adhere to company strategy? Do decisions align with product and market priorities?			
PRODUCT PROFITABILITY AND GROWTH Are we taking actions on low- or negative-growth or low- or negative-profitability offerings?			
Does the sum of our decisions improve overall profitability?			

By applying the framework, a company's senior leadership can begin with strategic alignment, gaining a shared vision of where the company's leaders want the business to go in the next three years, combined with an analysis of revenue and gross margin trends for each business unit to identify firm portfolios with the strongest right to play and right to win.

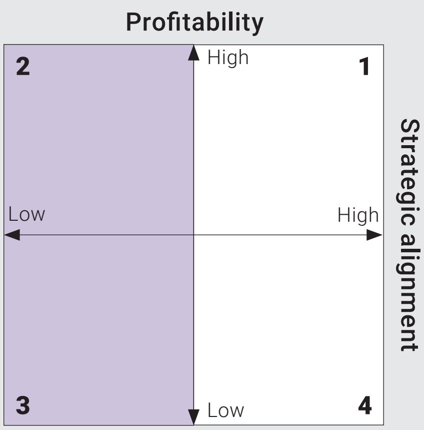
To make the right decisions, a company may find it critical to develop product rationalization scenarios. One scenario might prioritize strategic alignment and give profitability a back seat. A different scenario might do the reverse, instead emphasizing profitability. A third might propose a hybrid, designed to find the best mix of alignment and profitability, as in the following exhibit



FUTURE-STATE PORTFOLIO SCENARIOS WITH PROFITABILITY AND STRATEGIC ALIGNMENT AS THE KEY FRAMEWORK LEVERS

SCENARIO 1

Rationalize by strategic alignment

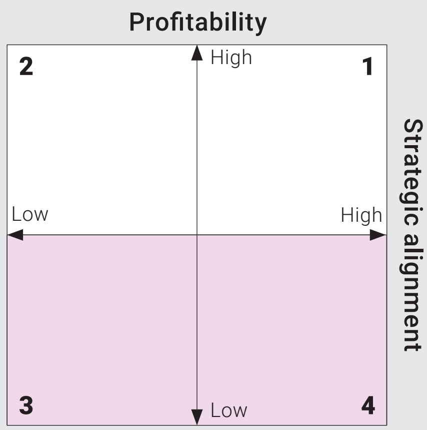


Quadrant 2, 3

- Rationalize product portfolios with low strategic alignment
- Exit low-focus markets or change go-to-market structure of low-focus markets

SCENARIO 2

Rationalize by portfolio profitability

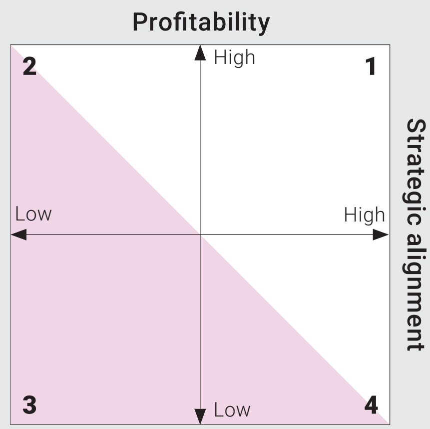


Quadrant 3, 4

- Rationalize product with low profitability
- Exit markets with low profitability or change go-to-market structure of markets with low profitability

SCENARIO 3

Hybrid rationalization



Quadrant 3 + select cases in 2,4

- Rationalize products and exit markets with low alignment and low profitability
- Investigate for rationalization any portfolios and markets with low alignment or profitability

PUSH FOR TANGIBLE OUTCOMES

Specific recommendations will result according to the approach. The following five-step process will ensure you get the results you want.

STEP 1

Align on metrics and know the drivers of complexity

By evaluating metrics and analyzing cross-portfolio performance, companies can identify underperforming products. Then, by assessing complexity drivers and understanding cost structures, they can gain insights into areas for improvement.

STEP 2

Determine the optimal portfolio based on strategy

(e.g., grow, retrench, and rebound). Such a determination involves setting targets for each product portfolio, outlining sales and profitability goals for three to five years, and identifying conditions that need to be met or, in better words, **'what would have to be true'**—as management thought leader Roger L. Martin put it in *The Design of Business: Why Design Thinking Is the Next Competitive Advantage* (Harvard Business Press, 2009)—to achieve those targets. Forecasting at the cash flow level becomes important because it determines the amount of investment allocated to each product line and the expected returns. Additionally, a capability assessment should be conducted that includes benchmarking and making build-versus-buy decisions to ensure the portfolio is aligned with the desired strategy.

STEP 3

Define the specific areas to be addressed

Every rationalization involves commercial, operational, and general and administrative functions; and if the goals are to prepare the soil for growth and to cut costs, then rationalization also involves assessments of investment needs and investment capabilities. It's in this part of the process that executives should be able to set specific, achievable financial targets they can build from the bottom up, not just pull out of the air. For example, one way we recently did this is by conducting workshops with key stakeholders in the organization to 1. align on the importance of portfolio rationalization to grow the company profitably as a business, 2. acknowledge commercial complexities such as distributor contracts and relationships as well as regulatory costs in various markets, 3. define operational complexities such as stranded costs and excess capacity.

STEP 4

Analyze risks and dependencies

The execution road map for rationalization has to include evaluations of several risks and dependencies. Among them are the temptation to sacrifice long-term gain for short-term benefits, the danger of cutting the wrong features or items during the optimization process, and the possibility of unintended knockoff effects, such as elimination of loss leaders and complementary products that drive traffic and attract profitable customers or cause damage to a vital channel. There's also the risk of cutting too fast or the reverse: stopping when the job is only half done. It is important to have an experienced, senior team engaged in all aspects of rationalization. Experience is especially important here, because those who have been down this road before know where the blind corners, the dangerous shortcuts, and the speed traps are. Another risk to be cautious of is cutting too fast—without considering the broader implications. On the other hand, there are risks of not cutting enough stock-keeping units (SKUs) or products to mitigate that risk. It is also important to allocate resources to growing products or reduce fixed costs appropriately.

STEP 5

Governance and robust cadence

In any large change program—whether it's rationalization, restructuring, or anything else—it is advisable to implement quick wins and adopt a phased cross-functional approach, but at the same time, it's essential to establish and keep up a steady, strong pace, so as not to just grab a piece of low-hanging fruit and sit in the shade enjoying it. One crucial aspect of setting and maintaining a cadence is to align cross-functionally on the metrics, goals, and timelines for each portfolio of products. Alignment ensures that everyone involved understands the objectives, measures success consistently, and is accountable for results. Regular quarterly reviews play vital roles in reassessing the portfolio and preventing scope creep—or retreat.

CONCLUSION

Portfolio rationalization is crucial for companies in an uncertain economy so they can navigate rough waters and achieve long-term success. By optimizing their product portfolios, companies can allocate resources more effectively, reduce complexities, and improve operational efficiencies. They can focus on core products and strategic areas while also remaining agile and open to new growth opportunities.

Again, remember: portfolio rationalization should not be one and done. Instead, it should be an ongoing process as executive leadership works to maximize—and accelerate—value creation over time. Although some companies may be tempted to focus on immediate results and short-term solutions such as price increases or immediate cost reductions, those tactics may not lead to sustainable growth and in fact can hurt customer loyalty and competitiveness in the long run.

In summary, it is essential that companies adopt strategic approaches that align with their long-term visions and enable them to pivot for growth and capitalize on emerging trends. With the right frameworks in place and with committed teams of seasoned executives and advisors, companies can successfully navigate the challenges of an uncertain economy and position themselves for sustained growth and profitability.

AlixPartners

CONTACT THE AUTHORS:

Jason McDannold
Partner & Managing Director
jmcdannold@alixpartners.com

Yale Kwon
Director
ykwon@alixpartners.com

Phani Bhamidipati
Director
pbhamidipati@alixpartners.com

Justin Casey
Senior Vice President
jcasey@alixpartners.com

Aditya Eswar
Vice President
aeswar@alixpartners.com

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.