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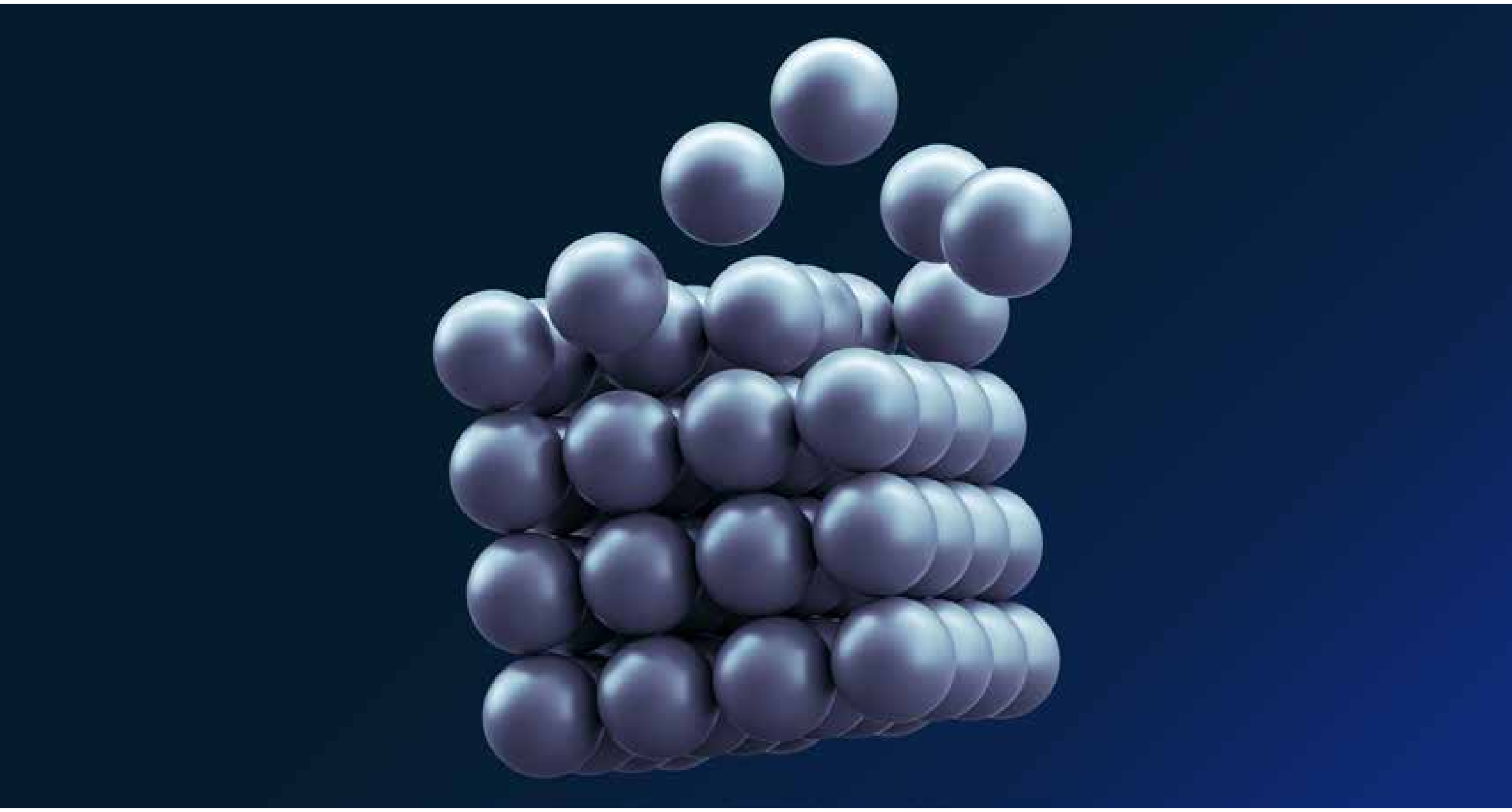
Divesting with agility

Research shows that active, efficient reallocation of resources creates better returns for companies than simply standing pat does. Here's how to make portfolio decisions faster.

by Obi Ezekoye and Anthony Luu



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Recent McKinsey research revealed that, over a ten-year-period, companies that regularly refreshed between 10 percent and 30 percent of their portfolio through acquisitions and divestitures outperformed the market by about 5 percent.[1]

There is value in a proactive approach to asset reallocation. Too often, however, companies hesitate to move critical resources to the more attractive business prospects—refusing to part with even underperforming assets. Why? Corporate-development executives tell us there are number of reasons, including fear of missing out on a business unit's resurgent performance, perceived inability to replace lost earnings, and concerns about shrinking the company too much.[2]

Companies' traditional portfolio-review processes—which in most businesses tend to happen only every few years—can further encourage companies to drag their feet when it comes to divestiture decisions. Meanwhile, with markets moving faster than ever, speed and the commitment to act are both at a premium. Our own research shows that, on average, separations completed within 12 months of their announcement delivered higher excess total returns to shareholders than those that took longer.[3]

Given this backdrop, companies will need to adopt an agile model for managing their portfolios and making allocation decisions. Such a model should emphasize a tried-and-true approach to frequent portfolio reviews that gives corporate-development leaders the detailed insights they need to make divestiture decisions more quickly and confidently.

Agile portfolio reviews

Companies facing resource-allocation decisions must prioritize those business units or assets that can create the most value for the company and those for which the company is the best owner—that is, best able to extract more value than any other potential owner. To that end, regular portfolio reviews can reveal how each business fits within the company's overall strategy. Companies can use the

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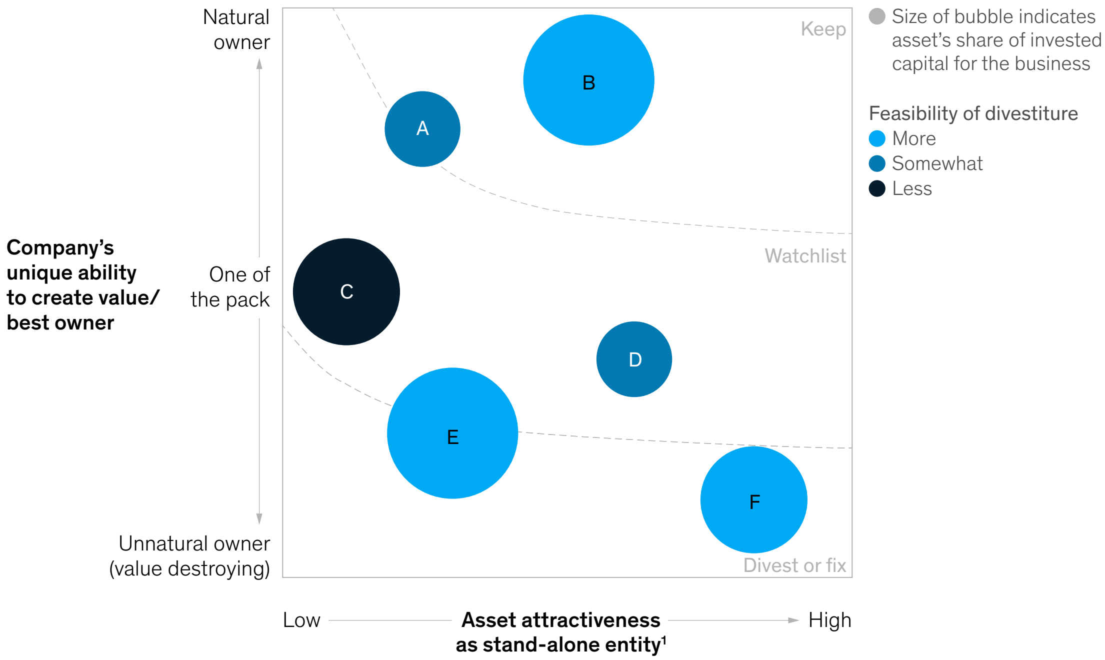
[1] See Sandra Andersen, Chris Bradley, Sri Swaminathan, and Andy West, "Why you've got to put your portfolio on the move," July 22, 2020, McKinsey.com; and Obi Ezekoye and Jannick Thomsen, "Going, going, gone: A quicker way to divest assets," August 6, 2018, McKinsey.com.
[2] See Gerd Finck, Jamie Koenig, Jan Krause, and Marc Silberstein, "What's keeping you from divesting," September 18, 2020, McKinsey.com.
[3] See Obi Ezekoye and Jannick Thomsen, "Going, going, gone: A quicker way to divest assets," August 6, 2018, McKinsey.com.

Exhibit 1

A standardized framework for portfolio reviews can help companies determine which assets to divest and how quickly.

Illustrative framework for asset assessment



[1]Regardless of relationship with parent company.

market-activated corporate strategy framework,[4] which maps the company's unique ability to own or create value from an asset against the asset's attractiveness as a stand-alone entity (Exhibit 1).

But the "regular" three- to five-year time frame for portfolio reviews is no longer sufficient or practical to keep up with markets that are continually churning. Our research and experience in the field reveals the importance of revisiting portfolios and reconsidering ownership status much more frequently. The pace of reviews should match the pace of change in the industry—for instance, semiannually or even sooner if new market entrants, disruptive technologies, or other competitive factors emerge.

To review portfolios more frequently, business leaders must adopt a reliable, repeatable process for doing so—one in which business leaders define the company's portfolio aspirations at the outset and then regularly monitor the company's performance toward those goals. They should assess the speed and frequency with which sources of revenue can be shifted and how resilient a portfolio is to market change; they should rely heavily on standardized metrics—for instance, assigning performance rankings and scores to elements of the portfolio, and continually adjusting those metrics based on the latest information. Business leaders should routinely consider the portfolio's overall performance against peers, for instance, and against investors' expectations.

[4] Frederick W. Gluck, Stephen P. Kaufman, A. Steven Walleck, Ken McLeod, and John Stuckey, "Thinking strategically," June 1, 2000, McKinsey.com.

The information generated by this analysis can reveal to business leaders whether they are truly still the best owner of an asset, as well as how feasible it is to disentangle an asset from the rest of the company. A global manufacturer of industrial goods, for instance, conducted a portfolio review as part of its annual strategic-planning process and identified opportunities to divest a business unit for which the company no longer seemed to be a natural owner. The review also showed that sales operations would be difficult to disentangle: in some countries, the business unit's sales operations would need to sell products that the manufacturer would be divesting along with products that the manufacturer would be keeping. Given this twist, senior management decided to keep the business unit but initiated a plan to formally stand up the business unit so its performance could be tracked and reported separately. In this way, the manufacturer created clear lines of accountability and preserved the option to divest the business unit in the future.

Agile decision making

Even after a thorough portfolio review, executives need time—to consider short-term performance against long-term prospects, for instance, or to get additional buy-in from the board or other key leaders. The good news is that taking an iterative, or agile, approach to portfolio reviews can increase transparency among these business leaders, mitigate organizational inertia and internal biases, and make conversations more inclusive—all of which can help business leaders coalesce around value-creating divestiture decisions as opportunities arise, not after they have come and gone (Exhibit 2).

A global consumer conglomerate examined its portfolio during its strategic review of the business. The company wanted to shift its portfolio toward more profitable segments and wanted to identify the optimal mix of assets, opportunities for divestiture, and potential investment themes. When senior management reviewed the company's goals and performance in prior M&A activity, it found that the company had generally delivered below-average returns compared with internal benchmarks. With these data in hand, and through a series of regular portfolio reviews that followed, senior managers were able to clarify the company's M&A strategy as well as its overarching strategy and how the two could complement one another. This analysis empowered the company to define several M&A themes and pursue investments that

Exhibit 2

An agile approach to portfolio decision making can help companies address increasingly dynamic markets.

	Static decision making	Agile decision making
Assessment approach	• Inconsistent approach; situation specific • Addresses the question, "Should we sell this?" • Subjectivity and organizational politics at play	• Consistent framework; applied to all assets • Addresses the question, "Are we the best owner of this?" • Objective, transparent process and clear metrics help to mitigate biases • Emphasizes feasibility and opportunity to divest rather than infeasible recommendations or "excuses" to defer decisions
Frequency	• Reviews done in response to a crisis or infrequently	• Reviews conducted annually, at least; health checks conducted alongside industry or market events; continual refresh of analyses with relevant data (eg, M&A trends, new technologies, or emerging markets)
Prevailing mindset	• Fear of making big moves to shed under-performing assets; decisions and execution are stalled	• Open to taking action and using creativity to navigate roadblocks before market sentiment moves; incentives are aligned to both grow revenues and create value

were more in line with its overarching strategic goals, thereby increasing the odds of delivering higher returns from its moves.

Having the infrastructure in place to monitor portfolio performance and speed up decisions about divestiture is particularly critical in industries prone to disruption—from new technologies, activist investors, or geopolitical shocks. At one technology company, for instance, business-unit heads are asked to bring both suggested acquisition targets and suggested products to exit at every strategic review. They must make a case for keeping certain products and at times are asked to “trade” a current product in the portfolio for a target they think is worth acquiring. These sessions have forced business leaders to break from the status quo, and they have pushed the management team’s thinking on portfolio moves.

Meanwhile, the incoming CEO at a software company initiated a portfolio review within his first weeks on the job. Growth had been stagnant, and the new CEO was anticipating action from an activist investor. Through the review, he discovered several near and long-term options to divest assets and improve the portfolio. The CEO and senior-management team used the information from the review to set a bold strategy for the firm, as well as a road map for making it happen—which they shared with the activist investor on their own terms. The executive team won over the activist and gained broad support for transforming the company.

Agile portfolio management continues to be one of the biggest levers to improve company performance. It is vital to have a clear, unbiased view of how assets are performing and which ones are still creating value for the company. Agile portfolio managers can use the mechanisms described in this article and others to avoid emotional attachments to legacy assets. And once a decision is made to divest, managers must act—finding ways to creatively navigate potential roadblocks and maximizing value before the market shifts again.

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