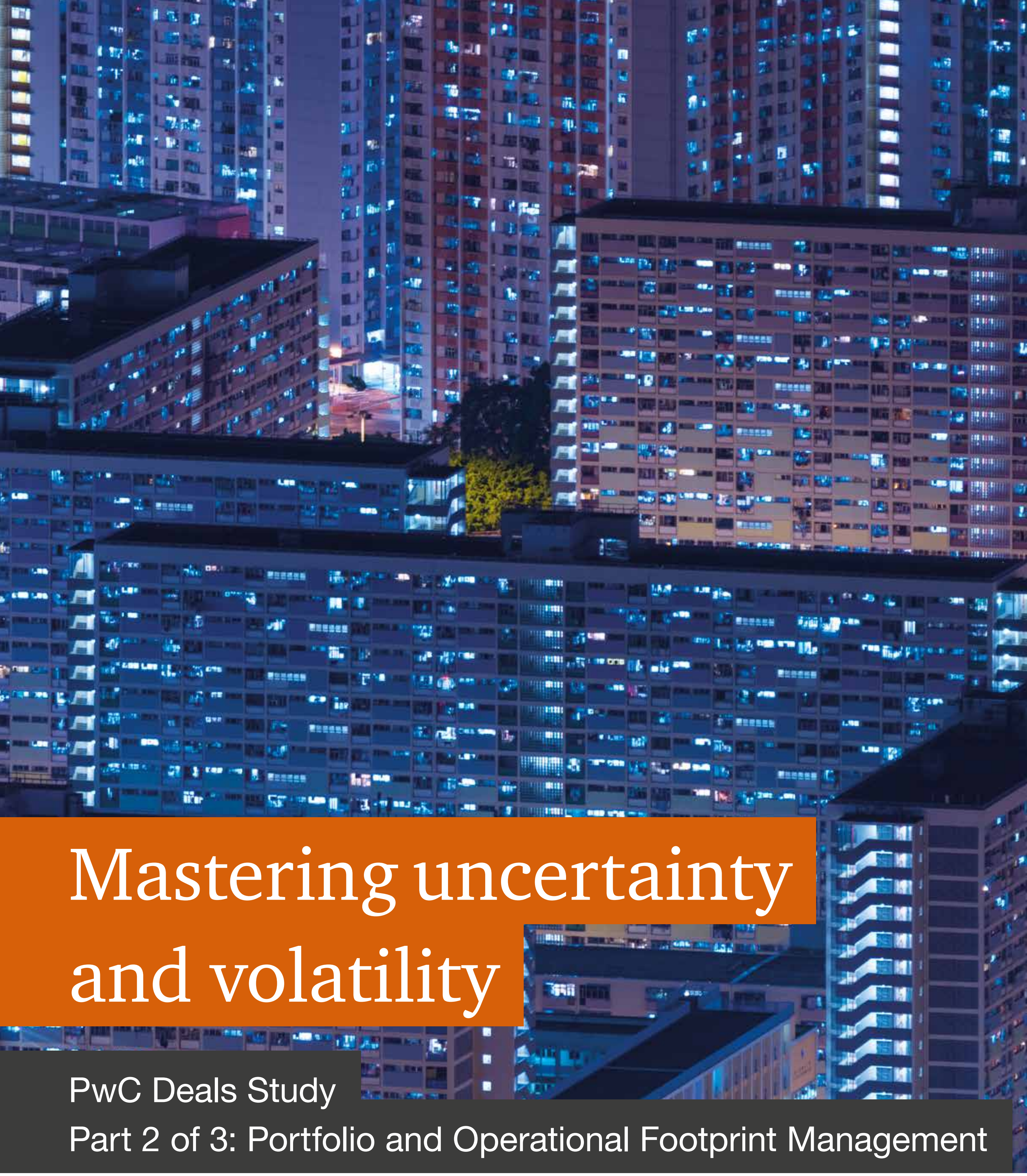

Mastering uncertainty and volatility

PwC Deals Study

Part 2 of 3: Portfolio and Operational Footprint Management

pwc

In cooperation with

KANTAR

TU Darmstadt CORPORATE FINANCE

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PwC Deals Study
Three-part study
Part 1: Market Environment & Strategy Process – Optimism on uncertain grounds
Part 2: Portfolio and Operational Footprint Management – Mastering uncertainty and volatility
Part 3: Carve-out as a Strategic Tool – Unlocking value through carve-outs

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Study motivation and contacts

Study motivation

In our daily interactions with our clients, we are constantly looking for ways to improve their competitive positioning and reimagine what is possible, using measures from across the deals spectrum. Naturally, this includes looking into the future and making reasonable assumptions on how corporate environments and markets will develop, which trends and regulations will come up, and how our clients can best contribute to a brighter and more sustainable future. But over the last few years we have found that looking into the future in this way is becoming more and more difficult, complicated by layers of opacity which conceal huge amounts of volatility, uncertainty, complexity and ambiguity (VUCA). It is almost certain that this trend will further intensify, so the ability to rein in and successfully navigate VUCA waters will be a key success factor in future markets. Because of this, we have made VUCA the focus of our study. A wise choice, as the outbreak of the current pandemic – which came shortly before we finalized the study design – showed.

Key focus questions include: what do top executives think of market environments? What are their future prospects? How does the current pandemic impact their market situation and prospects? How are they adapting their portfolio and operational footprint management approaches? Which role do strategic measures such as carve-out play? The design and focus of our study offers unique peer-to-peer insights from top executives to top executives, helping them clarify their understanding of market environments and implement new approaches to strategic and operational management to successfully master VUCA.

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A Study focus

Corporate environments have become increasingly volatile, uncertain, complex and ambiguous (VUCA). The triggers are very diverse. They include new regulations, changing consumer preferences, environmental hazards, political tensions, technological innovations and pandemics, as recent events have shown. This has a severe impact on corporates and top executives, which need to find ways to navigate VUCA waters successfully.

In cooperation with Kantar and the Technical University of Darmstadt, PwC conducted a three-part study with focus on companies in the DACH region (Germany, Austria, Switzerland) with an annual turnover of more than €300m. A total of 157 decision makers (board level, M&A/strategy lead or similar position) participated in the study, and the distribution of participants is representative across countries, industries and company size in scope.

In part 1, the study examines how decision makers perceive the current business environment and future prospects and how that impacts their strategy processes – we have published this already in October. In part 2 – which is being published now – it explores the impact it has on their portfolio and operational footprint management approaches. Finally in part 3 – to be published in December – , it will focus on the role of carve-outs as a strategic tool in particular.

Overview focus areas of the three study parts

Part 1

Market Environment & Strategy Process
Optimism on uncertain grounds

published in October 2020

Part 2

Portfolio and Operational Footprint Management
Mastering uncertainty und volatility

out now

Part 3

Carve-out as a Strategic Tool
Unlocking value through carve-outs

to be published in December 2020

B Executive summary

The study offers highly relevant and exclusive insights into the current mood of top management and their strategic agendas. It also offers advice on possible inconsistencies, discrepancies, logical flaws and white spots, and thus helps decision makers validate, challenge and refine their strategic agenda to avoid committing fatal mistakes. The second chapter of the study focuses on how decision makers manage their corporate portfolio and operational footprints in times of increasing uncertainty and volatility. It analyzes, to what extent corporates have implemented respective tools and methodologies and how transparently and objectively these are used. Also, the study analyzes various trigger and their role to drive the maturity of professional management approaches.

Key findings

- Given the increased volatility and complexity of modern markets, our hypothesis suggested this will force companies to professionalise the maturity of their portfolio and operational footprint management tools and methodologies.
- 80.9% of decision makers indicated that their company has at least partially implemented a strategic fit assessment (SFA). Thereof only 43.3% stated that the SFA is being conducted transparently and follows largely objective criteria. Only 10% of the decision makers indicated that they would sell a business unit quickly if the SFA identifies it as non-core business.
- 72.7% of decision makers stated that their company has at least partially implemented an operational fit assessment (OFA) to assess the complexity of their operational footprint. Thereof only 36.0% stated that the OFA is being conducted transparently and follows largely objective criteria. 78% that have implemented an OFA stated that they consistently implement the measures derived from it.
- Comparing both portfolio and operational footprint management tools, we see that slightly more companies have implemented an institutionalised SFA (80.9%) than an OFA (72.7%). Also the maturity of the SFA is higher with 43.3% stating it is being conducted transparently and based on objective criteria vs. only 36.0% providing that statement for the OFA.
- 81.5% of the decision makers are expecting a linear or exponential increase in the complexity of their business structures and operational entanglements. Yet they do not take this as an impetus to professionalise their management approaches and thus waste the opportunity to prepare in good time.
- The maturity of strategic and operational management tools appears to be binary: there is either a very high level of maturity and consistent implementation across all relevant dimensions, or there is a very low level of maturity – with almost nothing in between.
- Our findings make it clear that executives need to enhance the level of professionalism and maturity of their approaches to portfolio and operational footprint management to successfully master rising levels of complexity and stand out against competition. The earlier they take bold and decisive action and invest in their tools and methodologies, the easier they will be able to master uncertainty and complexity successfully!

4 of 5
companies have at least partially implemented a strategic fit assessment (SFA).

Only 10%
of the decision makers indicated that they would sell a business unit quickly if the SFA identifies it as non-core business.

About 3 of 4
companies have at least partially implemented an operational fit assessment (OFA).

78%
that have implemented an OFA stated that they consistently implement the measures derived from it.

C Mastering uncertainty and volatility

In the first part of our three-part study, we shed light on the current market perceptions of decision makers and their expectations for future development of market VUCA and market attractiveness. We then analysed how these market conditions impact strategy processes among corporates. This revealed great optimism among decision makers regarding market conditions, paired with great confidence in mastering the challenges ahead. But what are these decision makers doing operationally to master the challenges ahead and justify their optimism and confidence?

The second part of our study sheds light on these questions and analyses the maturity and professionalism of corporate portfolio management and operational footprint management approaches. As we have argued, companies need a detailed understanding of corporate environments and markets in order to identify growth opportunities, technological trends and possible risks. This detailed understanding helps them to develop strategies that best exploit market potential and thus stand out against competitors. A strategy needs to be implemented and delivered through the corporate portfolio, so a regular assessment of how well the corporate portfolio matches corporate strategy is crucial – this is what we call a strategic fit assessment (SFA). SFAs regularly define core and non-core business areas and enable strategic measures to be identified, such as investments or acquisitions for the core business and disposals or restructuring for non-core business areas.

When implementing these strategic measures and managing the operational footprint of a company – e.g. to enhance efficiency or improve risk profile – a detailed understanding of operational entanglements and process flows is crucial. Based on this understanding and transparency, executives can assess whether their company's operational footprint matches the needs of the business, or they can deliver seamlessly strategic measures such as carve-outs – this is what we call an operational fit assessment (OFA).

"Companies need increasingly mature and consistent portfolio management approaches with focus on agility and flexibility to successfully master the challenges of increased market dynamism and volatility."

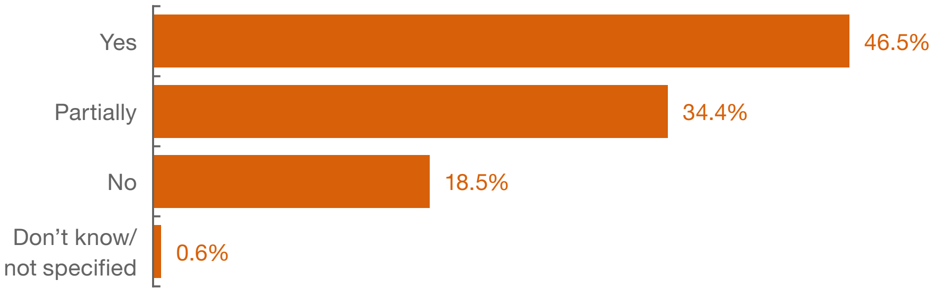
Gerald Eibisberger

Our hypotheses for part 2 of our study are that as dynamism, volatility or uncertainty of market prospects increase, adaptability and agility of corporate strategy and corporate portfolios also need to increase to allow the company to constantly adapt to ever-changing market environments. As a prerequisite, companies will need increasingly mature and consistent portfolio management approaches. The worse and more volatile the market prospects are, the more pressure companies will have to constantly review and adapt their strategies to mitigate risks and move towards a more prosperous development path, and the more sophisticated and professional the management approaches will have to be in order to incorporate this transformative change into their portfolios.

The same reasoning holds true for operational footprint – the more volatile the market environment, the more transparency companies need to have with regard to operational entanglement and operational structures. Otherwise, they will struggle to take quick measures to mitigate volatility strikes such as drops in demand or supply shocks, or to deliver strategic measures such as carve-outs or integrations. Therefore, our hypothesis for operational footprint is that the degree of implementation and maturity of operational footprint management tools increases with the expected level of volatility.

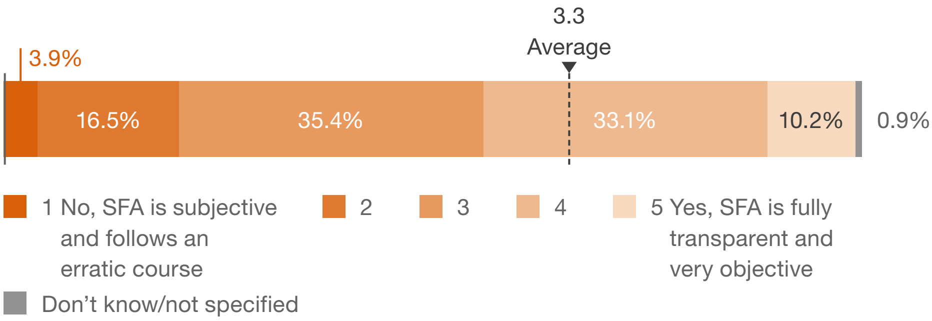
Let's now take a look at how these hypotheses are reflected in our results: how mature and professional are corporates' approaches to portfolio management and operational footprint management? Only around half of the decision makers surveyed (46.5%) indicated that their companies have implemented an strategic fit assessment (SFA), while an additional 34.4% said they have at least partially implemented one. The remaining 18.5% of participants stated that their companies have not implemented a regular, structured SFA.

Fig. 1 Has your company implemented a structured and regular strategic fit assessment (SFA)?



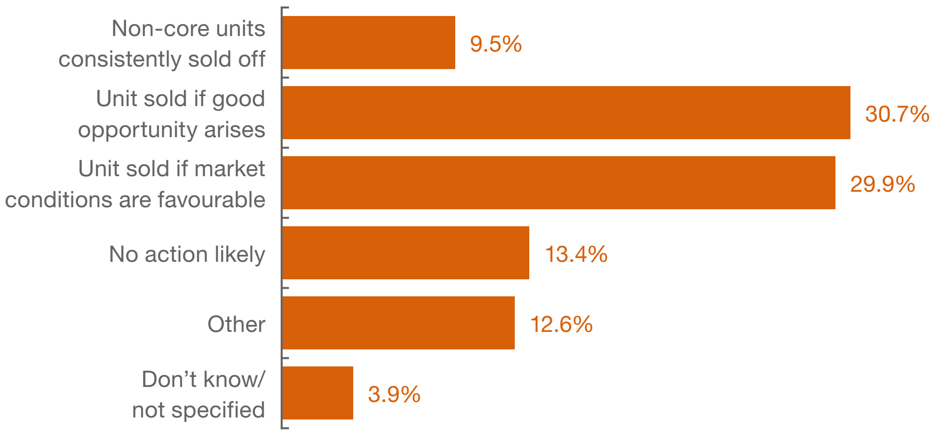
Of the 80.9% of companies which have fully or partially implemented an SFA, only 43.3% said that the SFA is being conducted in a transparent way and following objective criteria. In contrast, the majority of companies (55.9%) stated that their SFA process is often very subjective and follows a more erratic course.

Fig. 2 Does your company's SFA follow clearly operationalised and measurable criteria?



Once the SFA has been conducted, it is crucial to implement the strategic measures derived from the assessment promptly and consistently, otherwise it is no more than a strategic idea and cannot deliver any benefits. Only 9.5% of respondents said that business units would consistently be sold quickly if the SFA identifies them as no longer being core business. A further 30.7% said that business units of this nature would only be put up for sale if a special opportunity came up, 29.9% stated that they would only be sold if market conditions were favourable, and 26.0% stated that either no measures at all, or other non-sale measures would be planned.

Fig. 3 How would you react if one of your business units is identified as non-core according to the strategic fit assessment?



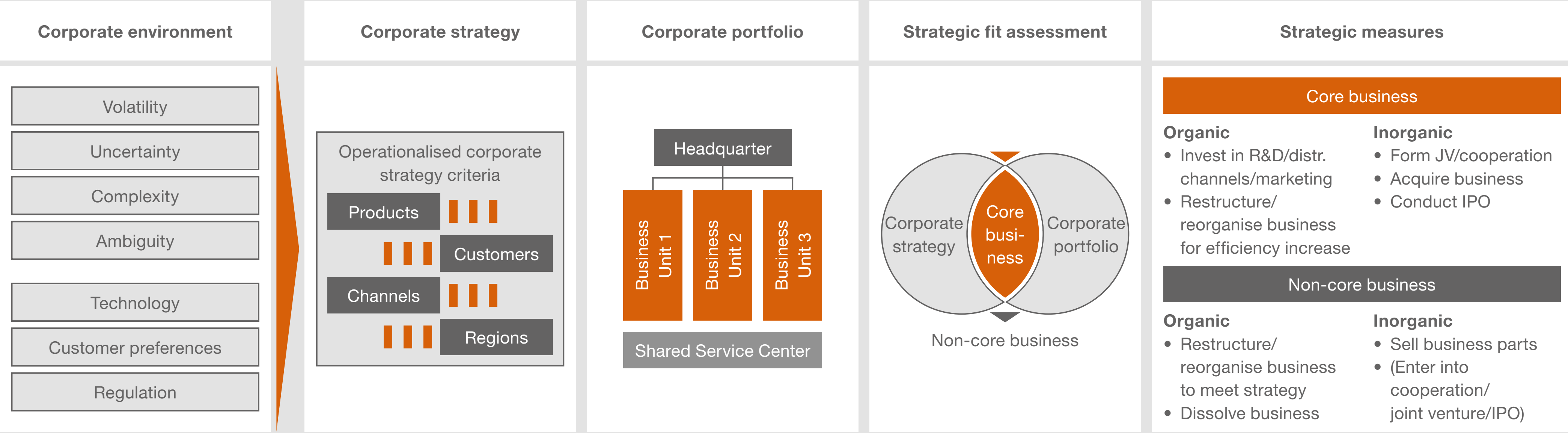
"Companies tend to be either very mature regarding their strategic methodology and tools or very immature, with little in between. This suggests that the first steps are the barrier to entry that need to be overcome, and the tendency afterwards is to go for a big solution."

Manfred Kvasnicka

Excursus: PwC Portfolio Review Methodology

Fig. 4 Strategic portfolio management approach

Constantly reviewing and adapting the corporate strategy makes sure it fits dynamic corporate environments; conducting strategic fit assessments ensures the portfolio optimally supports the strategy



Understand and assess corporate environment

Define corporate strategy to optimally exploit corporate environment

Build corporate portfolio that delivers corporate strategy

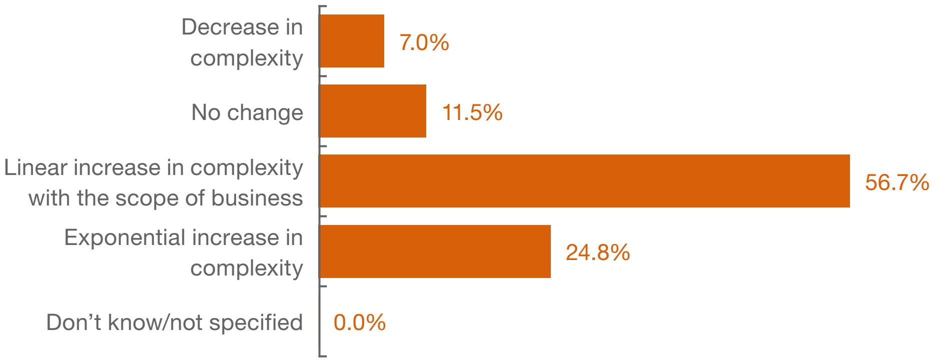
Review how corporate portfolio supports corporate strategy; core vs. non-core business definition

Derive strategic measures to optimise strategic fit

As well as thorough strategic portfolio management to constantly optimise strategic fit, companies must also keep an eye on their operational footprint, which serves as the operational backbone for delivering the portfolio seamlessly and effectively. Corporate business structures have become increasingly globalised and operational footprints have become more integrated and complex over the last few decades; this trend is expected to continue in the future, but might be diminished by recent volatility strikes such as the current pandemic. This is because these volatility strikes direct attention away from achieving efficiency by all possible means towards reducing risk exposure and enhancing reliability and resilience of business structures.

As regards the complexity of operational entanglement in their businesses over the next five years, more than half (56.7%) of the respondents expect a linear increase in complexity as the scope of their business grows. A further 24.8% of participants anticipate an exponential increase in complexity, and 18.5% of respondents anticipate either no change or a reduction in the complexity of operational footprints.

Fig. 5 How do you expect the complexity of operational entanglements in your company to change over the next five years?



The more complex the operational footprint and its business structures are, the more important it is for decision makers to have a detailed understanding of these complexities – only then can they define and implement optimal measures for managing these structures to meet the demands of volatile environments. As mentioned above, the formalised process of identifying, assessing and managing operational entanglement is what we refer to as an OFA.

In our study, only 26.8% of the decision makers surveyed indicated that their company has implemented a structured and regular OFA, and a further 45.9% stated that they have partially implemented one. Almost a quarter of decision makers (24.2%) stated that they have no OFA established. The study results do not demonstrate any statistical relationship between the existence and maturity of an OFA, and the company's expectations of how the complexity of their operational entanglement will develop over the next five years – a fact that decision makers should critically reflect on. They need to answer the question of how to master overwhelming complexity.

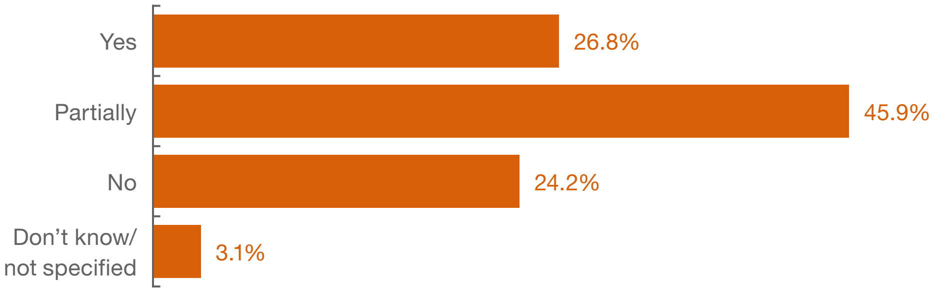
"Volatility strikes, such as the current pandemic, direct attention away from achieving efficiency by all possible means towards reducing risk exposure and enhancing reliability and resilience of business structures."

Tobias Huesmann

"More than 75% of study respondents expect a linear or exponential increase in the complexity of their business structures, yet fail to take this as an impetus to professionalise their management approaches and thus waste the opportunity to prepare in good time."

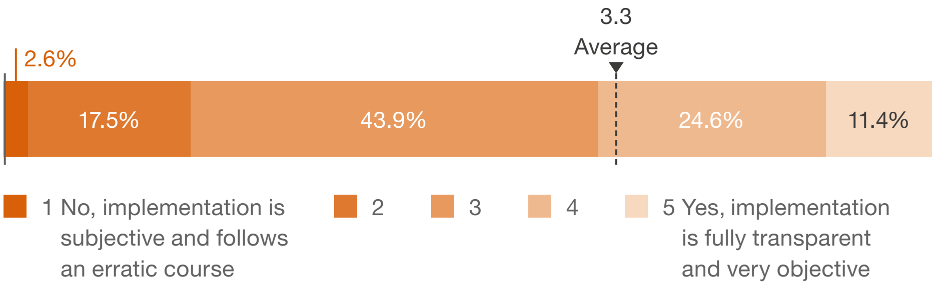
Gregor Zach

Fig. 6 Has your company implemented a structured and regular operational fit assessment (OFA)?



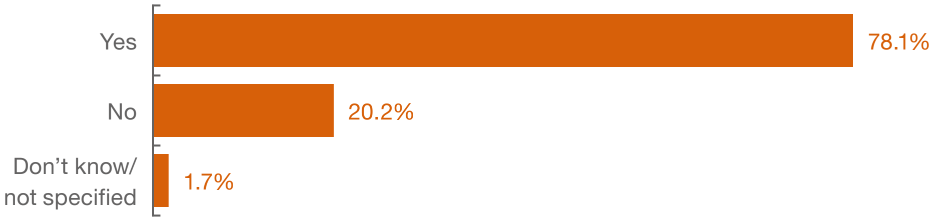
Of the 72.7% of companies which have fully or partially implemented an OFA, 36.0% said that their OFA is largely transparent and follows objective criteria. 43.9% stated that their OFA is only moderately transparent and objective, while 20.2% of respondents believe that their OFA has little transparency and largely follows subjective criteria.

Fig. 7 Does your company's operational fit assessment follow clearly operationalised and measurable criteria?



Our findings also reveal that if an OFA is in place, 78.1% of respondents expect that its findings and the measures derived from it are likely to be implemented. Only 20.2% of decision makers did not expect these findings and measures to be implemented.

Fig. 8 Do you expect measures derived from your operational fit assessment to be implemented?



Comparing SFAs and OFAs, we can see that slightly more companies have implemented an institutionalised SFA (46.5% fully, 34.4% partially) than an OFA (26.8% fully, 45.9% partially). The difference in the number of respondents who feel that their SFA/OFA has been partially implemented (34.4% SFA vs. 46.5% OFA) does not relate to the perceived transparency and objectivity of the SFA/OFA criteria – both average 3.3 on a scale from 1.0 to 5.0, with a slight tendency towards more transparent processes and objective criteria. This means that the respondents do not consider their SFA/OFA to be only partially implemented because of poor-quality characteristics (e.g. lack of transparency or objectivity), but rather because only certain components of a fully-fledged SFA/OFA have been implemented. Among the companies that have an institutionalised OFA in place, it is remarkable how many expect its findings to be consistently implemented (78.1%), many more than would be the case with an SFA. However, it should be remembered that operational measures are easier to implement than portfolio measures, as executives have full control over operational measures and do not usually rely on the market to implement them.

Our results show a statistically significant relationship between SFA implementation and OFA implementation: companies which haven't implemented an SFA are less likely to have an OFA, and vice versa. Another statistically significant relationship can be found between the objectivity and level of consistency with which SFA measures are implemented, and the objectivity of the OFA. The same applies to the implementation of OFA measures – there is a statistically significant relationship between the objectivity and level of consistency with which SFA measures are implemented, and the implementation of OFA measures. This shows that companies tend to be either very mature regarding their strategic tools or very immature, with little in between.

Regarding the anticipated development of the complexity of operational footprints, we had assumed that the more complex the operational footprint is expected to become, the more likely it would be that corporates would have implemented institutionalised assessments of operational entanglement. However, the survey results show no statistically significant relationship between the expected change in complexity over the next five years and the implementation of an OFA. The same holds true for the development of market VUCA and market attractiveness for the respondents' own businesses in the next five years – neither factor has any statistical impact on whether corporates have implemented an SFA or an OFA. This illustrates that professionalisation of strategic approaches and management methods seems to be driven not by business needs or market environments, but by some other opaque factor.

As we argued in the first part of our study, rising levels of market VUCA will inevitably lead to more changes in the corporate environment, and thus to more adaptation needs of strategy and resultant adjustments to corporate portfolios. Given their advantages in terms of speed and impact, we argued that inorganic development measures will become more important than organic measures. Specifically, we surveyed the anticipated role and importance of carve-outs. Only around a third of respondents (35.7%) said that they had completed a carve-out over the last five years, while a majority (55.4%) expect the importance of carve-outs to remain stable over the next five years. Also, there is no statistical relationship between the expected importance of carve-outs and the establishment or quality of an SFA/OFA – an indication that portfolio management is still not based on institutionalised, solid, transparent criteria.

"Measures derived from operational assessments are implemented more consistently than from strategic assessments – understandable, given that executives have better control over operational measures and do not usually rely on the market to implement them. But ease of implementation must not be confused with impact."

Tobias Huesmann

"The greater the anticipated changes in the revenue sources of the core business, the more sophisticated the strategic processes need to be to keep pace with market dynamics."

Hannes Orthofer

Fig. 9 Has your company completed a carve-out in the last five years?

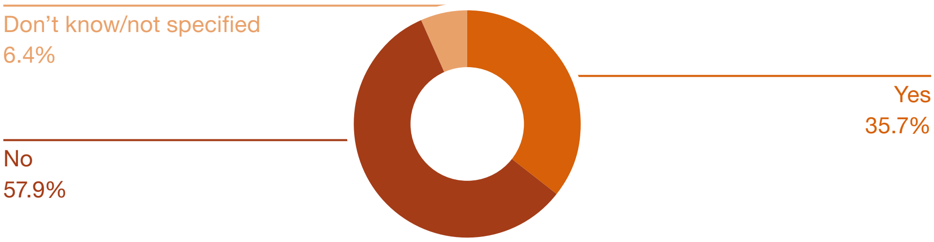


Fig. 10 How do you expect the importance of carve-outs to change over the next five years?

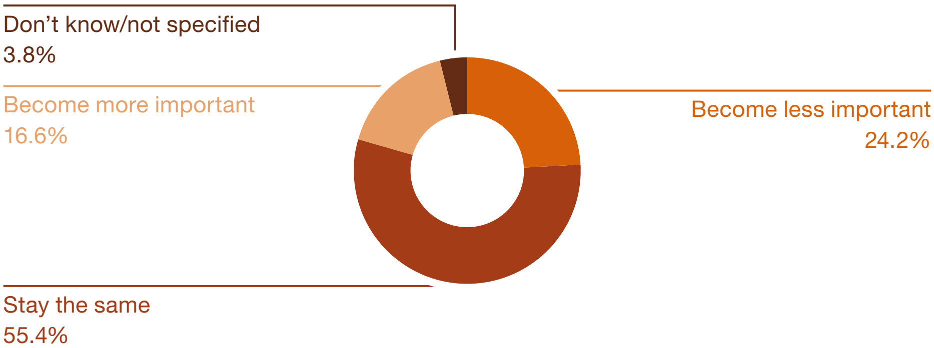
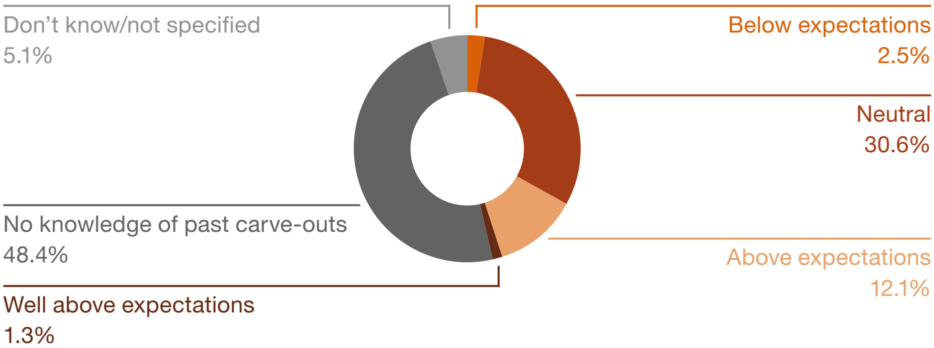


Fig. 11 How would you assess the overall success of your past carve-out projects in relation to the original expectations of your company?



D Country view

The study sample includes in total 157 companies, of which 105 are from Germany (66.9%), 29 from Austria (18.5%) and 23 from Switzerland (14.6%). Thus the distribution of companies across countries slightly overrepresents German companies, and slightly underrepresents Austrian companies, yet in sum provides a reasonable representation in terms of share of GDP.

Overall, the three countries in scope of the study have a moderate spread and fluctuate around the full sample average. It appears that German decision makers perceive the maturity of their strategic and operational tools and methodologies less advanced than Swiss and Austrian decision makers.

Fig. 12 Has your company implemented a structured and regular strategic fit assessment (SFA)?

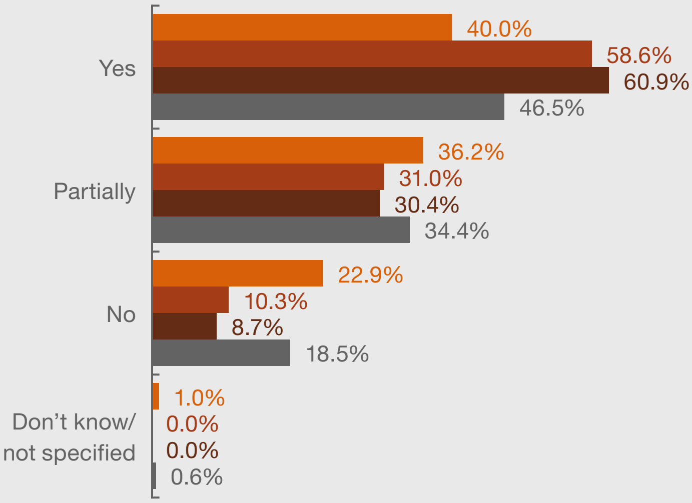
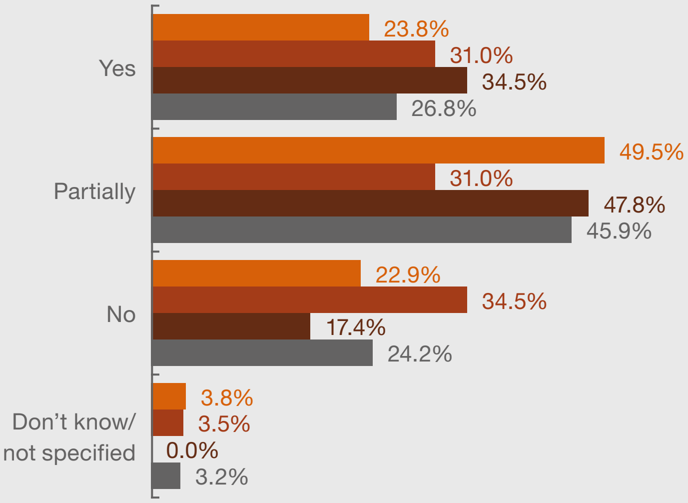


Fig. 13 Has your company implemented a structured and regular operational fit assessment (OFA)?



Germany Austria Switzerland Full sample

Fig. 14 Does your company's SFA follow clearly operationalised and measurable criteria?

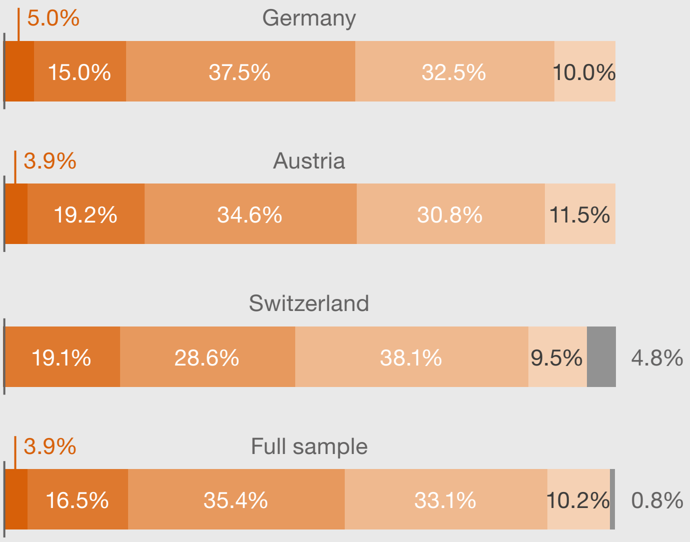
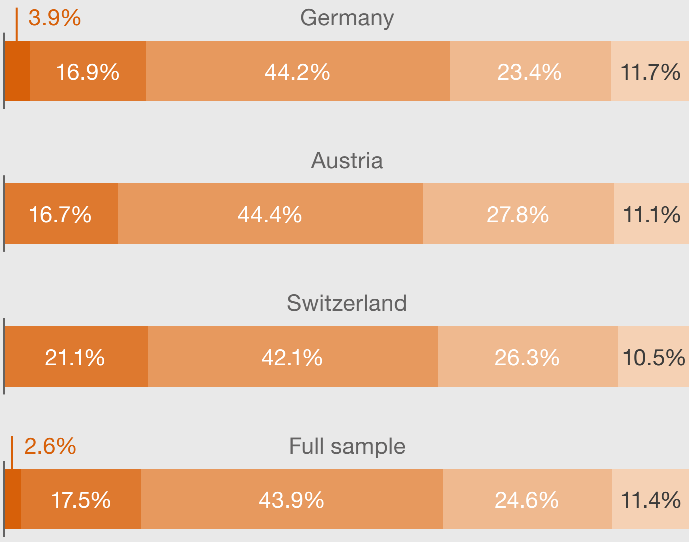


Fig. 15 Does your company's OFA follow clearly operationalised and measurable criteria?



1 Not at all, it is rather a subjective and erratic process
2
3
4
5 Fully, the process is transparent and very objective
Don't know/not specified

E Discussion

Our study offers a unique opportunity to gain insights into how decision makers manage their corporate portfolios and operational footprints, and how the maturity of the relevant strategic approaches and methodologies is driven by market environments or business needs.

Our results show that there is still a limited level of maturity and professionalism in the way companies manage their corporate portfolios and operational footprints. Many companies do not have institutionalised approaches and methodologies in place, and those that do often fail to apply these approaches and methodologies in a transparent and consistent way, or based on objective and precisely defined criteria. This indicates that key strategic and operational management decisions are still being taken based on insufficiently sound reasoning and information – a clear competitive disadvantage, as professional methodology and objectivity significantly outperform gut feeling, especially in times of rising volatility and transformative change.

The most remarkable finding is that the degree of implementation of SFAs and OFAs – and their level of maturity – bear no relation to any typical drivers. For example, we would expect increased VUCA to drive the implementation of proper portfolio and operational footprint methodologies – how else can a global corporate be successfully navigated through VUCA waters? We would expect mediocre future prospects to drive the professionalisation of strategic toolkits – how else could a company identify the most suitable turnaround measures? We would expect that greater changes in the revenue sources of the core business would encourage more sophisticated strategy processes – how else could a company give its portfolio a new dynamic and edge, ready to move towards a brighter and more competitive future? Yet none of this appears to be the case, which indicates that professionalisation of strategic and operational management tools is following its own, erratic trajectory.

Another interesting finding is that the maturity of strategic and operational management tools appears to be binary: there is either a very high level of maturity and consistent implementation across all relevant dimensions, or there is a very low level of maturity – with almost nothing in between.

In sum, these findings make it clear that executives need to enhance the level of professionalism and maturity of their approaches to portfolio management and operational footprint management to successfully master rising levels of complexity and stand out against competition. The implementation of enhanced capabilities, methods, tools and approaches to manage portfolios and operational footprints needs to be consciously planned and will take considerable time and effort. However, investing this effort will yield significant returns and serve as a key enabler for continued profitable growth, innovation and robust operations.

"Neither market prospects nor anticipated VUCA levels appear to trigger professionalisation of strategic and operational management tools. This seems to be following its own, erratic trajectory, so top executives need to set the right incentives as stimuli."

Tobias Huesmann

"Companies are showing great confidence in their ability to master uncertainty and volatility – yet the low maturity and professionalism of their strategic and operational management approaches put that confidence on shaky ground."

Gerald Eibisberger

F About the study

This study focused on all companies in the DACH region with an annual turnover of more than €300m (gross sample: 2,546 companies). Authorities, consultancies and the like were excluded. After adjusting the gross sample, 1,832 companies were deemed eligible for participation and contacted. Subtracting the neutral defaults, the net sample amounted to 1,688. From the latter group, 157 companies participated. Among the participating companies, 105 are headquartered in Germany (66.9%), 29 in Austria (18.5%) and 23 in Switzerland (14.6%). The sample represents a variety of industries (energy, utilities, mining and infrastructure; healthcare, including pharmaceuticals; industrial products and business services; the retail, consumer market and leisure sector; technology, media and telecommunications; others).

We asked Kantar (formerly Kantar EMNID), an independent third-party survey company to conduct telephone interviews with these executives. Kantar is one of the world's leading provider of market and social research and offers data and evidence-based insights with the highest level of quality. From the sample set of 157 participants, 150 interviews (95.6%) were conducted by telephone and seven (4.4%) were conducted as online surveys.

Respondents participating in the telephone survey were guaranteed anonymity for themselves and their companies and were screened to ensure they had direct, first-hand knowledge of the strategic issues their organizations dealt with. Of the 157 respondents participating in the survey, 27.0% were board level or equivalent. The remaining 73.0% held leading positions from corporate strategy, M&A, as well as further relevant decision-making positions.

The data study design was prepared in cooperation with TU Darmstadt. The subsequent data analysis was conducted by the Chair of Corporate Finance (TU Darmstadt) under the direction of Prof Dr Schiereck. TU Darmstadt is one of the leading technical universities in Germany with high international visibility and reputation.

Fig. 16 Country distribution of surveyed companies

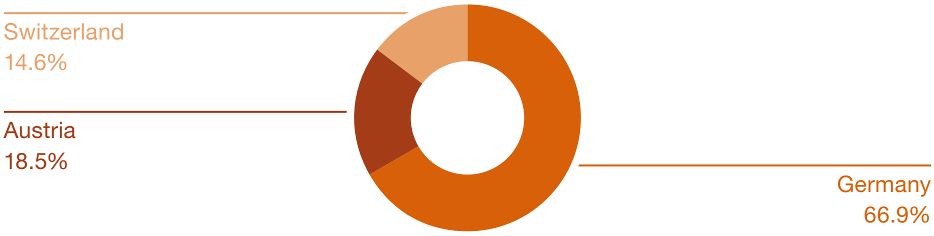


Fig. 17 Main industry of surveyed companies

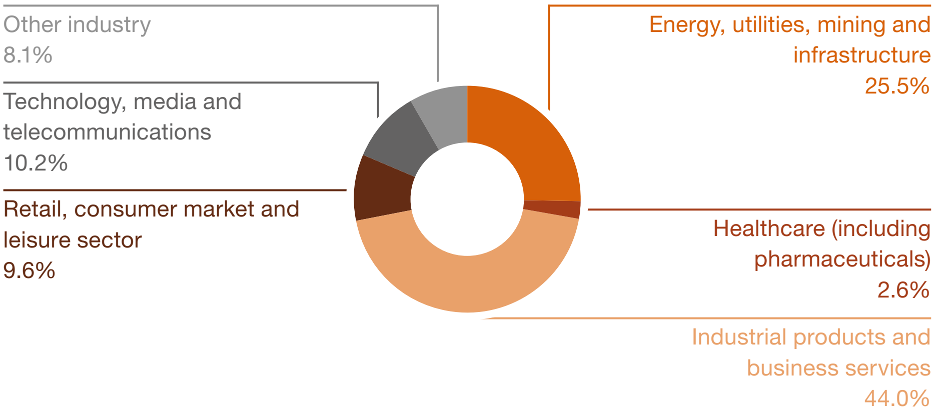
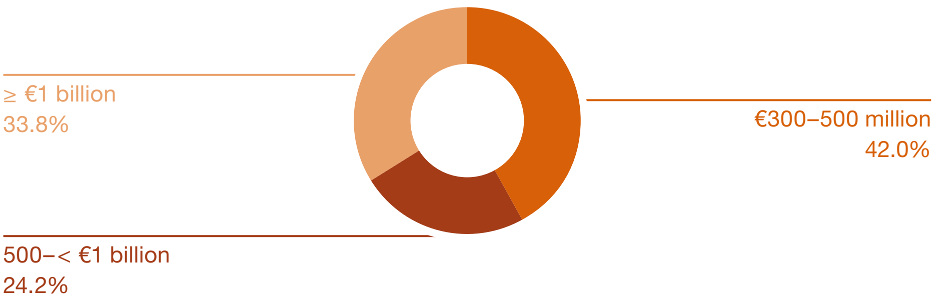


Fig. 18 Annual turnover of surveyed companies



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From the world's leading multinational companies to start ups, from family businesses and governments to charities and private individuals, our clients come in all shapes and sizes. Our goal? To build trusted relationships and work with them to create the value they're looking for. We're a network of firms in 157 countries with more than 276,000 people who are committed to delivering quality in assurance, advisory and tax and legal services. With our know-how and our expertise, over 1,200 experts in 5 locations in Austria support our clients in terms of finding solutions for complex questions. Find out more and tell us what matters to you by visiting us at www.pwc.at.

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About Technical University of Darmstadt

TU Darmstadt is one of the leading technical universities in Germany with high international visibility and reputation. According to recently published rankings of the magazine WirtschaftsWoche, the business economists of the faculty of law and economics of the Technical University of Darmstadt are among the top 5 in Germany, Austria and Switzerland. With rank 17 (out of more than 2,500 professors) the chair of corporate finance at the Technical University of Darmstadt performs as the best finance chair among the rankings of the management professors with the strongest research capabilities.
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About Kantar

Kantar (formerly Kantar EMNID) is one of the most renowned and long-established survey institutes in Germany. As part of the Kantar Group, the world's leading provider of market research and social research, Kantar offers data and evidence-based insights at the highest level of quality. Kanter has a complete, unique and rounded understanding of people around the world: how they think, feel and act, globally and locally in over 90 markets. Arthur Guzy directed the support of Kantar.