

Can your portfolio of brands provide the answers you need?

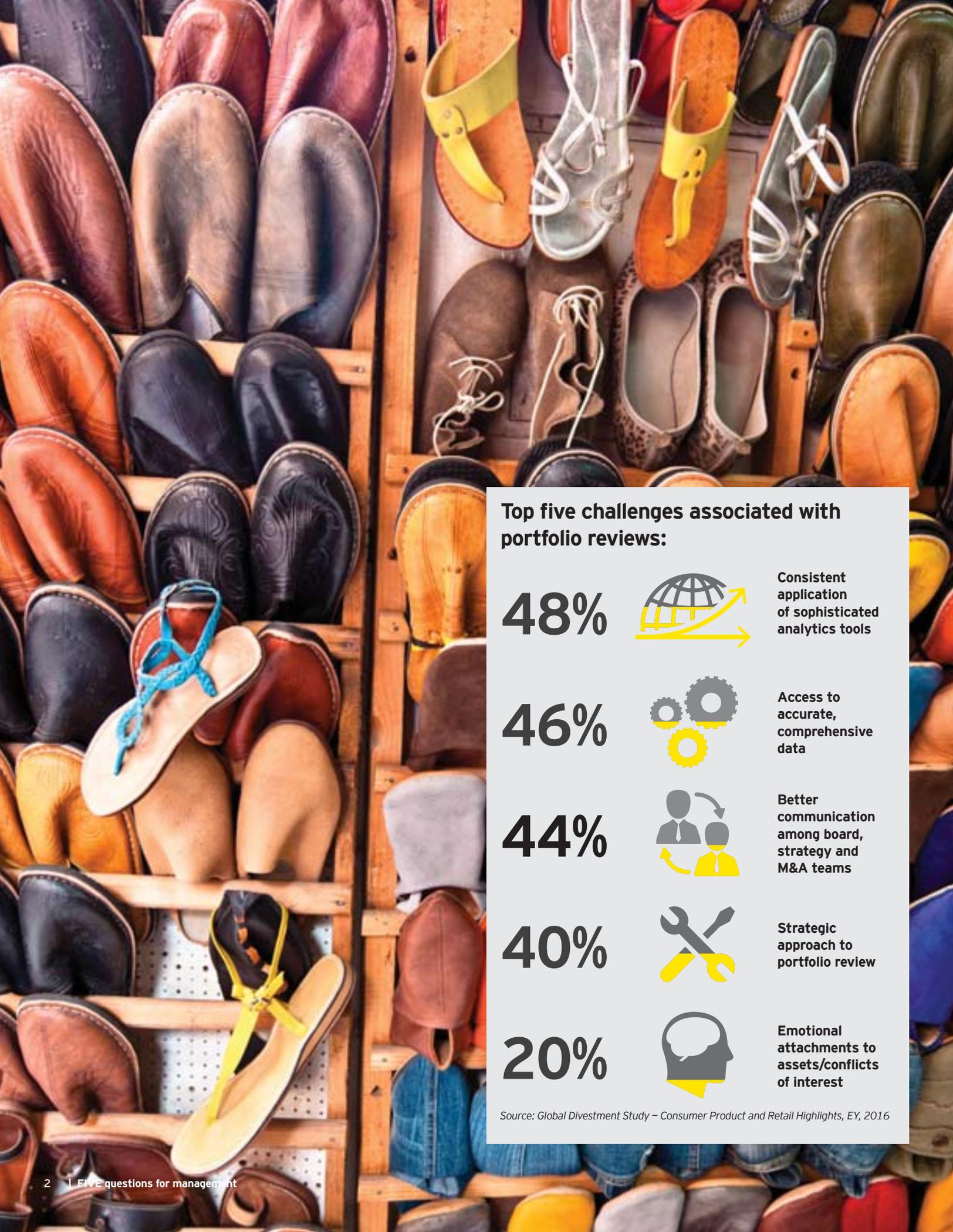
Five questions consumer products companies should consider to optimize their portfolios

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The better the world works.



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Building a better
working world



Top five challenges associated with portfolio reviews:

48%



Consistent application of sophisticated analytics tools

46%



Access to accurate, comprehensive data

44%



Better communication among board, strategy and M&A teams

40%



Strategic approach to portfolio review

20%



Emotional attachments to assets/conflicts of interest

Source: Global Divestment Study – Consumer Product and Retail Highlights, EY, 2016

Consumer products companies must take a more strategic approach to portfolio optimization

Changing consumer needs, stagnant mature markets, volatile costs and disruptive new competitors demand a portfolio strategy that can deliver sustained, profitable growth. Most large consumer products companies have a highly complex portfolio that may comprise dozens or even hundreds of brands, spanning multiple categories. Some of these brands will be performing well and have strong momentum behind them, while others will be struggling and dragging down overall corporate performance and shareholder returns. Even companies with relatively few brands struggle to deliver sustained growth across the entire portfolio.

Allocating scarce resources away from non-performing brands toward the growth engines of tomorrow is therefore a vital exercise. And yet, companies struggle with portfolio optimization. The complexity of their business means that many business leaders perceive that the return from this process is unlikely to outweigh the time and distraction involved.

Given the revenue growth pressures that consumer products companies are currently facing, we believe that a strategic approach to portfolio optimization is especially vital now. Companies should consider five questions for management.

We have observed recurring failures in the portfolio management process:

1
Failure to deploy a periodic, consistent and objective review process

2
Failure to develop actionable portfolio optimization scenarios that link to both category strategy and value creation metrics

3
Failure to identify appropriate standards and to develop a process that overcomes internal biases

Five questions for management

1. Are we treating portfolio management as a strategic imperative?

Although most consumer products companies conduct some form of portfolio review, very often it is policy-driven, retrospective and mechanical. Companies perform a regular review, typically on an annual basis, which may determine that a brand needs to be divested, or that there is a gap in the portfolio that could be filled with the right acquisition target.

Instead, we believe that companies need to adopt a more strategic approach, in which they assess categories and brands in a holistic manner, and communicate proactively with investors about the rationale for portfolio management decisions. This means assessing the consumer opportunity and the competitive landscape across the entire portfolio, balancing short-term and long-term objectives, and developing a clear rationale for capital allocation across brands. It also requires the ability to look beyond the next couple of years, to assess how broader macro trends, such as emerging consumer needs or demographic changes, might affect performance over the longer term.

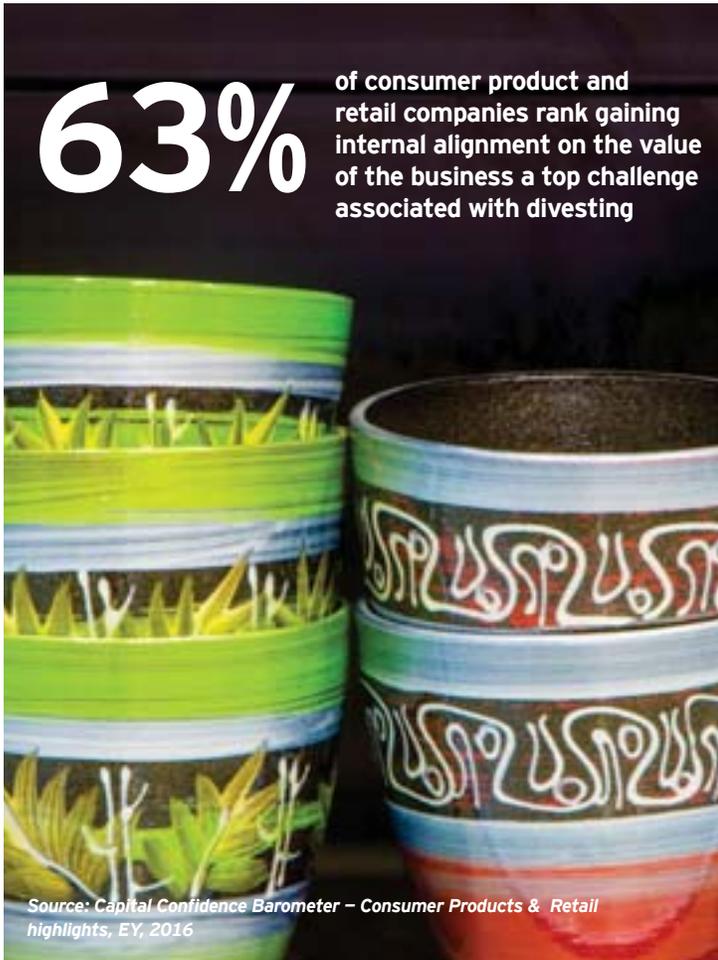
A more strategic approach requires companies to move away from an “annual budget” mindset toward a more fundamental approach. “Often, companies get bogged down in the annual review without looking at the bigger picture,” says Jim Doucette, Americas Consumer Products Strategy Leader at EY LLP. “They’re not looking at the portfolio to ask, ‘What should we fix? What should we keep? What should we exit? Should we even be in that category at all?’”

Michael McGoohan, Vice President and Global Head of Strategy at Mondelēz International, argues that, too often, portfolio reviews are done from a financial, rather than a strategic, perspective. “Being able to take a broad, strategic view of the portfolio and really understand what we want and why it is challenging, but is an essential part of success.”

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2. Is our portfolio analysis truly objective or do we have biases toward keeping certain assets within the portfolio?



Consumer products companies often carry a number of legacy brands that, while well established and perceived as a core part of the portfolio, are no longer performing as they should be. Stripping out these brands from the portfolio allows companies to divert resources toward assets with a higher growth potential.

Often, a key barrier preventing these brands from being sold is a strong emotional attachment to them among the management team. There may be hesitancy around divesting the household brand names that have built up the organization because they are seen as defining the core. There is also natural reluctance to walk away from brands that generate revenue and cash flow, even if they are low margin or non-core.

The process of assessing the portfolio compounds the problem. Very often, companies adopt a bottom-up approach, in which brand managers put forward their plans and these roll up into a category or divisional view. This approach can lack objectivity, however, with portfolio decisions being overly influenced by the quality of the brand analysis. As a result, resources can get allocated to the teams that make the strongest case for their brands, rather than those that genuinely have the highest growth potential.

Looking beyond these emotional attachments or inconsistencies requires companies to adopt a top-down, data-driven approach to portfolio analysis. “Using facts as the basis for decision-making takes a lot of the emotion out of the process,” says Mr. McGoohan. “For example, if a brand has been declining for five years despite a company’s best efforts to fix it, those facts are unlikely to change. Business leaders need to be ruthless in determining whether or not legacy brands are worth as much as they think they are.”

Five questions for management

3. Do we have sufficiently robust data and analytics to challenge and stress test the portfolio, and to explore scenarios based around different sets of decisions?

Good data lies at the heart of an effective portfolio optimization process. Without good data – both internal and external – companies will struggle to make the right decisions. Yet many companies do not have the data at the level they need to make decisions, which makes it difficult to choose what they keep vs. what they divest.

Moreover, companies need to move beyond purely historical data; they also need the tools and technologies, including sophisticated analytics capabilities, to forecast and consider scenarios that describe the direction of a brand and its impact on the wider portfolio. They need to explore the impact of different portfolio decisions on broader corporate performance, and map these against external economic scenarios and consumer trends. A scenario-based approach also helps companies to envisage potential opportunities and ensure that they start making preparations for when these become available.

By embarking on a robust conversation around the range of decisions that are possible, companies will be better placed to explore fundamental questions about the portfolio and challenge the management team's assumptions.

Equally, a scenario-based approach helps companies to understand the implications of the decision to grow, sustain, fix or exit an asset for the rest of the portfolio. "If you sell a brand, there may be other brands in the portfolio that have, until that point, benefited from the scale or the go-to-market capabilities that come with it," says Jim Prevost, Executive Director of Transaction Advisory Services at EY LLP, and a former leader of corporate development initiatives at Mondelēz International and Procter & Gamble. "If you pull that low performer out, then all of a sudden another business, which was maybe in the middle of the pack and reasonably attractive, becomes less attractive as a result."

Allowing a company to understand the impact of scenarios enables managers to take action on the portfolio with greater confidence. "If I am a CFO or CEO, I need to understand how various courses of action impact the metrics for which I am responsible," says Mr. Prevost. "You need a structured, quantitative assessment of the potential outcomes of acting on different scenarios."

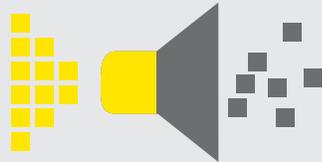
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Most important analytics methods used to assess business unit performance

52%



Commercial analysis, i.e., customer segmentation, market share, size and growth

50%



Predictive modelling, e.g., price elasticity, workforce analytics, sensitivity to market changes

49%



Social media analysis, i.e., customer perception

Top three areas for analytics investments:

70%

Predictive modeling, e.g., price elasticity, workforce analytics, sensitivity to market changes

45%

Commercial analysis, i.e., customer segmentation, market share, size and growth

64%

Social media analysis, i.e., customer perception

Five questions for management

4. Are we using the portfolio management process to determine where we should invest organically – as well as what to sell or acquire?

A good portfolio optimization process looks at every brand and ascribes one of four actions to each one:

Grow



When a brand has momentum on a category basis or has the prospect to gain share and if it's accretive to profits, companies should allocate greater resources in order to maximize its potential. They should work to leverage fully the firm's core capabilities.

Sustain



These are brands that the company believes are long-term assets to be retained, that contribute to free cash flow and profits, and that are consistent and non-volatile. "If a brand is not growing rapidly or is facing other challenges, it still could make sense for the company to retain that brand," says Doug Power, Global Head of M&A at General Mills, "especially if the company is a logical owner for the brand and the value creation from a divestiture is not clear. That said, the company must be especially vigilant in determining the appropriate level of resources and funding for these brands because each brand offers a different value proposition and return potential. A brand might be serving its role in the portfolio, but it might be over- or under-resourced relative to its potential."

Fix



Brands that are typically quite material to the business, but are not hitting their targets. The focus with these assets is to fix them, and apply clear metrics to track their progress. It may be that the brand may have the wrong strategy, management team or marketing plan, or

that it is struggling through a challenging part of the business cycle. In all cases, the first priority is to see if those problems can be addressed. A strict time limit should be applied, however, and, at the end of that period, the brand would either become a "grow", "exit" or "sustain."

"Our brands go through business cycles," says Mr. Power, "and historically we have been successful at renovating our brands during down-cycles and returning them to growth. So, we do not rush to divest a brand just because it is facing challenges or is not growing. We first try to renovate the brand via product innovation, a new strategy and potentially a new leadership team."

Exit



If a brand cannot be fixed, or does not meet performance metrics that have been set for it over a given time horizon, then the difficult decision should be made to exit the brand. This may mean selling it outright, or folding the assets into another business. But the decision to exit only comes after every reasonable effort has been made to fix the asset. "Companies should consider divesting underperforming brands if they are either unfixable, or the company is unwilling or unable to dedicate the required time, resources and funding given competing priorities," says Mr. Power. "Underperforming brands could still have great potential and these are the best divestitures candidates because they offer buyers a clear value creation opportunity, and a reason to pay a high price relative to the company's valuation. General Mills' sale of Green Giant N.A. to B&G Foods last year is a good example of this."



Identifying gaps to be filled with acquisitions

The portfolio review process should also determine whether there are gaps that need to be filled by acquisition. When considering acquisitions, companies need to move beyond a reactive mode and do more than just wait for banks to bring them ideas. Being proactive means that the company has to determine adjacent categories or subcategories in which it wants to compete, but for which its current brands are not well-suited. For example, Hershey's decision to grow beyond sweet snacking probably led to the acquisition of Krave beef jerky.

Once an adjacency has been identified, the company should pursue specific targets and either have plans to approach them, or be well prepared when the opportunity comes along. But basing M&A decisions purely on what is available on the market is doomed to failure. A strategic approach is required that means the range of possibilities in the broadest sense can be considered. "It is not realistic to assume a company can acquire its most attractive targets on a certain date at a certain price," says Mr. Power of General Mills. "You need to take a long-term approach to deal-making to have a successful acquisition program. This includes building relationships with targets, which sometimes makes them actionable, as well as performing significant external due diligence well before targets are actionable, so you are ready when the targets decide to sell."

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Mr McGoohan of Mondelez argues that basing M&A decisions purely on what is available is doomed to failure. "You can make really bad decisions if you're just reacting to what's available on the market," he says. "It narrows your options and you're less certain about what your outcomes will be."

Companies also need to be reaching back earlier into the growth cycle. "We need to be thinking more like a venture capital firm, and placing bets that gain access to the real value part of that growth curve," says Andrew Ross, EVP and Chief Strategy Officer for of ConAgra Foods. "That requires very different models and ways of thinking about how to manage the portfolio, because the failure rate is so much higher in that space."

A structured, data-driven approach to evaluating different scenarios extends to tax as well. Early analysis of the tax impacts of various exit alternatives (e.g., spin-off vs. sale) can influence the ultimate cash proceeds from a deal and the divestiture path to be pursued. Failing to understand the numbers and tax consequences puts the seller at a disadvantage in negotiations, results in delays in the process, and potentially leaves money on the table.

Five questions for management

5. Are we moving quickly enough from analysis to action?

Many companies spend a lot of effort analyzing the portfolio. Few, however, move decisively to convert this analysis into action. There are a number of reasons for this: they may lack the resources to execute; they may spend so long on the analysis stage that they lose confidence in the decisions they have taken; or they may lack confidence in their execution capabilities.

As a result, portfolio reviews risk being an interesting dialog – but with the process stalling at this stage. Strong leadership is essential to ensure that the

analysis moves into concrete action. “Companies need a robust and uniform process that enables them to evaluate brands across divisions, products and categories, along with the ability to link the scenarios with key financial metrics like total shareholder return,” says Greg Stemler, Americas Transactions Advisory Leader for Consumer Products & Retail at EY. “Finally, they need to make decisions around the brand portfolio and push into execution.”





How do you find your optimal balance for profitable growth?

The consumer products and retail industry is out of balance. Companies that over depend on cost efficiencies to boost profits and satisfy shareholders risk irrelevance. They must address long-term structural change by tilting the balance back toward profitable growth.

At EY, we will help you balance strategic choices needed to ignite performance by asking better questions. Better questions will challenge old thinking, filter out the noise and reframe challenges. They'll help you respond to disruptive market change and create innovative strategies that put you ahead of the competition, taking your business to new levels of growth and profitability.

We ask better questions because we combine a deeper and broader range of insights, perspectives, capabilities and experience. Our integrated, global network of assurance, advisory and tax specialists includes 37,000 people focused on your industry, supported by a rich ecosystem of alliance partners.

And when we ask better questions, we will collaborate with you to implement better answers. We will support you at every stage – from boardroom strategy formation, to tactical management planning, to on-the-ground execution. Wherever you are in the world, project by project, market by market, we will build a better working world together.

So, how do you find the optimal balance for profitable growth?

Ask EY.

The better the question.

The better the answer.

The better the world works.

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