Adapt to win

Creating value in an evolving business environment

By Jeff D. Wray

Introduction

Today's business environment is increasingly complex. Enterprises are confronted by rapid shifts in market dynamics, evolving customer preferences, intensifying competition and rising cost pressures. Customers are more aware of their needs and are demanding greater value for every dollar spent. The competitive landscape has broadened, and market participants are increasingly more sophisticated in the way they do business across borders, while looking to optimize their cost structure. Technology is disrupting the way business is being conducted and driving greater product accessibility. As a result, it is becoming increasingly challenging for enterprises to grow or defend their core business, and they need to adapt in order to win.

In today's demanding marketplace, business leaders are often so entrenched in managing day-to-day operations that they seldom have the opportunity to take a step back and assess their current state. In our opinion, this disconnect has led most enterprises to develop linear strategies that fail to consider their priorities, performance and capability gaps as a whole. Without having a deep understanding of an enterprise's starting point, business leaders cannot make impactful decisions that influence the enterprise's successful path forward. Companies that are able to deliver true stakeholder value are those that have developed a culture of honest and periodic self-assessment and re-evaluation.

Business leaders who develop effective strategies are those who balance long-term bets with short-term, tactical decision-making. The three key steps that enable effective, strategic decision-making are as shown below in Exhibit 1:

Exhibit 1: Key steps to enable effective, strategic decision-making

1 Evaluate current state	2 Prioritize strategic issues	3 Drive decision-making
Key parameters: ▸ Industry dynamics ▸ Enterprise performance	Key priorities: ▸ Survive ▸ Transform ▸ Sustain	Key levers: ▸ Product portfolio ▸ Market footprint ▸ Operating model ▸ Cost structure

1 Evaluate current state

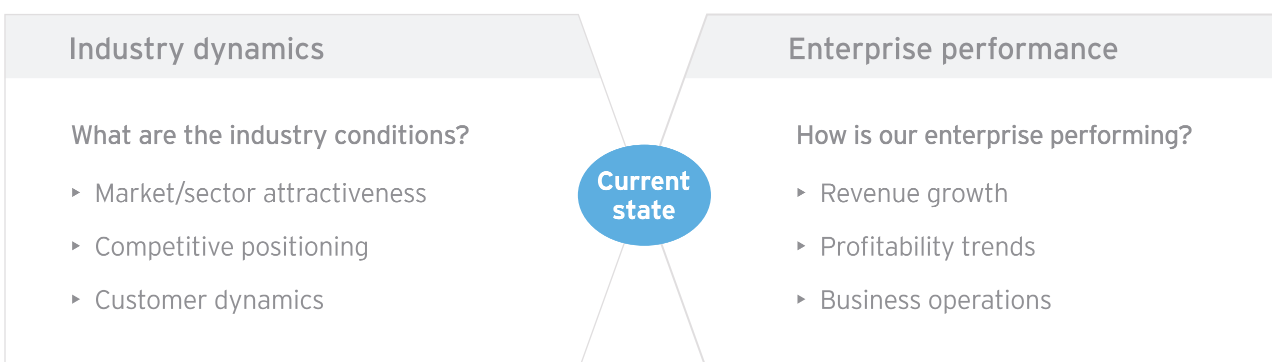
Effective diagnosis of the current state requires an in-depth analysis of an enterprise's commercial positioning and operational performance. As seen in Exhibit 2, there are several fundamental considerations to keep in mind when conducting a current-state diagnostic that can be broadly categorized into industry and enterprise factors. It is imperative to select the appropriate metrics to quantify performance against these considerations in order to understand their gaps and strategic priorities.

To understand an enterprise's performance, business leaders must first develop hypotheses informed by data. A clear definition and aggregation of data against key performance indicators (KPIs) is vital to the evaluation process. A further triangulation of these hypotheses with data points from primary (e.g., expert interviews, surveys) and secondary research is critical in generating meaningful insights. By benchmarking these KPIs to a broader peer set, business leaders can understand how their enterprise has performed relative to competitors. This can help develop further insight into the key drivers limiting better performance.

The primary considerations for an effective evaluation of the **industry dynamics** include:

- **Market/sector attractiveness:** Are the segments, categories and geographic markets we are focused on fundamentally attractive? How has the value chain evolved? What is the growth outlook?

Exhibit 2: Enabling a comprehensive current-state assessment



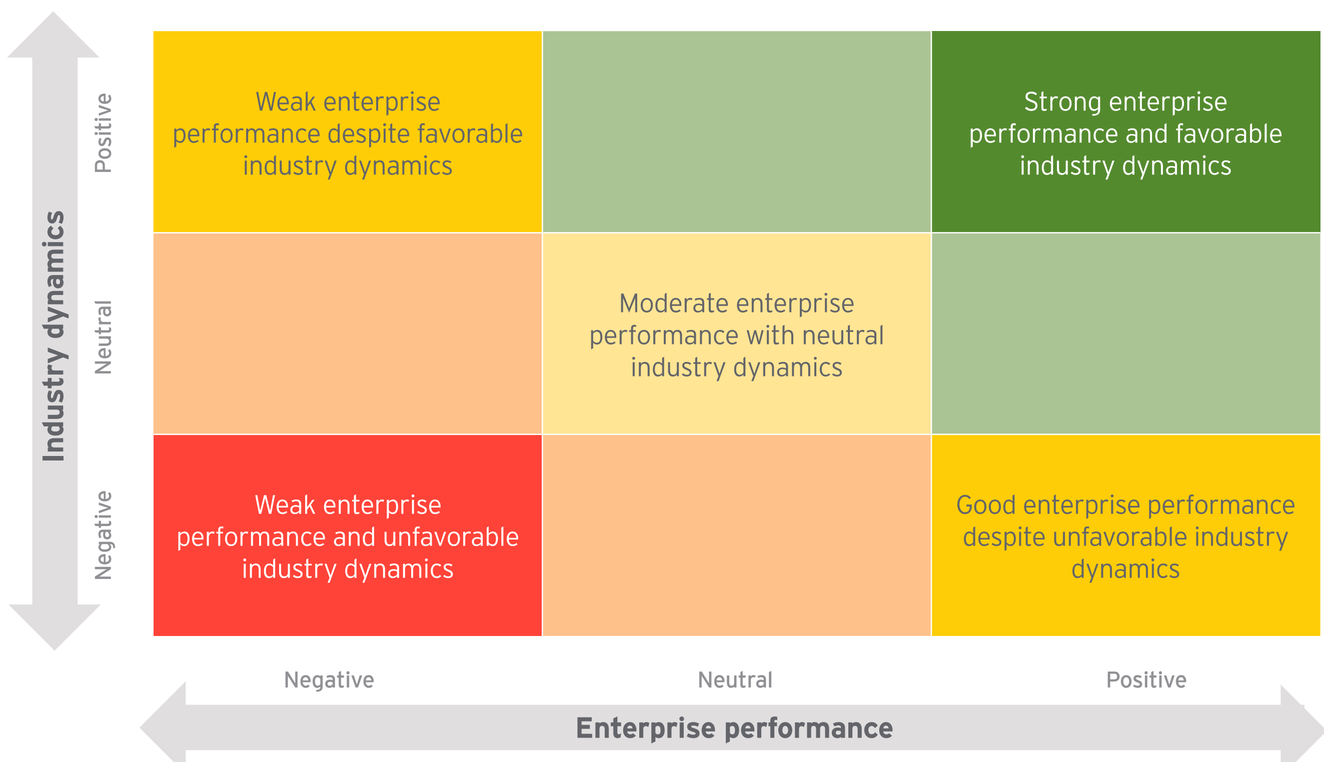
- **Competitive positioning:** How consolidated/fragmented is the competitive landscape? How are we performing on key financial/operational metrics and market share relative to our competitors?
- **Customer dynamics:** How satisfied are our customers? Is our product portfolio aligned with evolving customer needs and changing category and demographic dynamics?

The primary considerations for an effective evaluation of enterprise performance include:

- **Revenue growth:** How has our revenue trended historically, and what is the outlook?
- **Profitability trends:** How has our profitability trended historically? Are we leaving cash on the table?
- **Business operations:** Do we have the right operational processes and business model in place to optimize productivity and maximize sales? How stable is our cash flow? Are we deploying cash effectively?

The changing business climate can create significant commercial and operational challenges. Effective business leaders are able to leverage insights from an evaluation of their current state (refer to Exhibit 3) to prioritize their strategic path forward and thus help their enterprises adapt and win in the market.

Exhibit 3: Current-state diagnostic results



2 Prioritize strategic issues

A robust understanding of an enterprise's current state helps define the potential strategic pathway the business needs to take. At EY-Parthenon, we have developed the "EY-Parthenon prioritization matrix" (refer to Exhibit 4) to aid this process.

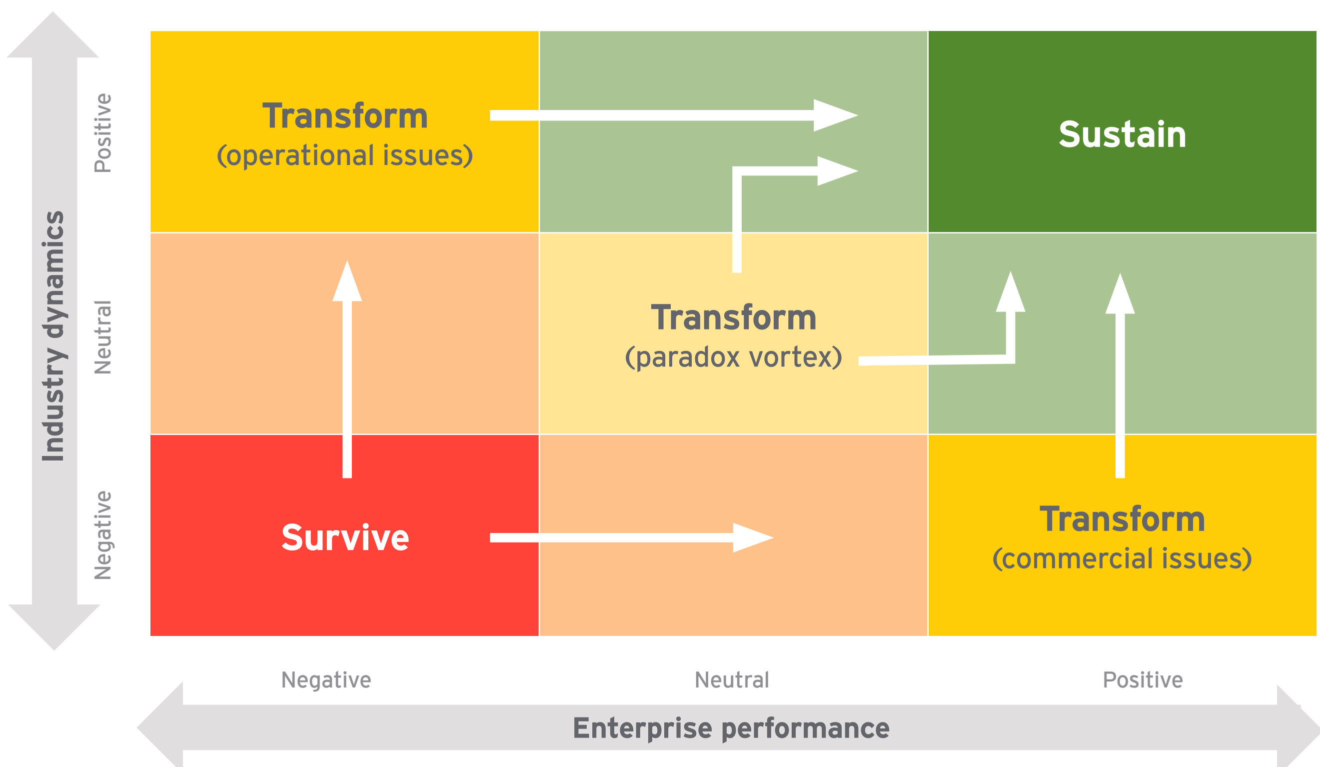
Our framework helps business leaders identify their enterprise's current position based on an evaluation of current state. The enterprise's position in the matrix can help prioritize strategic issues and the path forward based on the enterprise's need to survive or restructure its core business, transform its approach to business as usual, or sustain market position and historical performance levels.

"Survive" mode

Enterprises that generally suffer from a combination of unfavorable market dynamics and weak enterprise performance can be defined as being in the Survive mode. These enterprises struggle with profitability and revenue growth, often because they face high operating costs and a commoditized marketplace. The key issues to prioritize for these types of businesses could include:

- Declining revenues
- Declining profitability
- Negative cash flow
- Inventory obsolescence
- Customer churn
- Key talent retention

Exhibit 4: EY-Parthenon prioritization matrix



"Transform" mode

Enterprises in the Transform mode are those that are at an inflection point in their life cycle and are looking to maximize stakeholder value. Their strategic priorities could be driven by a need to enhance enterprise performance or overcome external market challenges. A few examples of such priorities include:

Operational issues

- Declining profitability
- Long cash conversion cycles
- Suboptimal channel strategy driving limited volume
- Process inefficiencies and throughput constraints

Commercial issues

- Commoditized market
- Legacy products with low competitive advantage
- Disadvantaged value chain positioning
- Customer retention and acquisition

In many instances, enterprises are uncertain how to prioritize operational/cost improvements over product/market strategies; these companies are stuck in what we call the "paradox vortex."

"Sustain" mode

Enterprises that lead their markets are defined as being in the Sustain mode. They are driven by a desire to consistently create stakeholder value by staying ahead of the competition. Their strategic priorities include:

- Defending market position
- Identifying avenues to sustain top-line growth
- Retaining their core customer base while aspiring to attract new customers
- Driving for superior cost structure and operating model excellence

It is important to stress that not all enterprises can be characterized as purely being in the Survive, Sustain or Transform modes. In reality, an enterprise's priorities and issues can fall in between surviving and transforming, or sustaining and transforming the way it does business. Once these priorities have been identified, a road to success must be paved with a set of concrete milestones and staged strategic decisions.

3 Drive decision-making

Realizing strategic objectives requires translating theory into action plans. Business leaders have several tools at their disposal but often struggle to achieve the right balance when making strategic decisions. At EY-Parthenon, we have developed the decision diamond framework, indicated in Exhibit 5, which plots strategic actions along four key dimensions – product portfolio, market footprint, operating model and cost structure – to translate insights from EY-Parthenon's prioritization matrix into actionable steps.

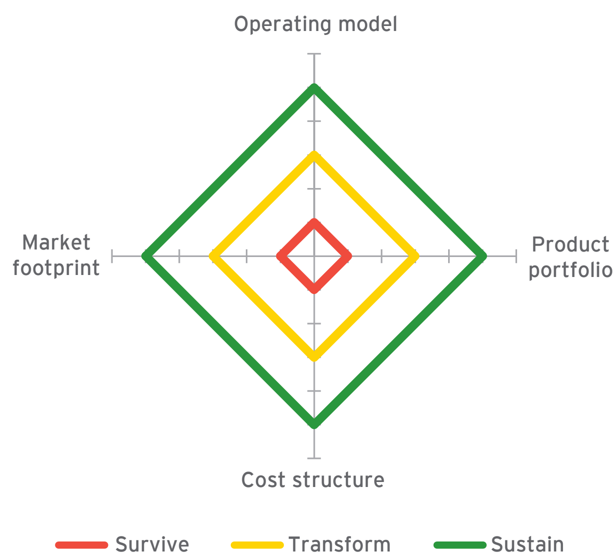
The shape of the decision diamond is characterized by its size and symmetry, reflecting the balance and magnitude of performance against the four dimensions respectively. In our experience, enterprises that lead their market define the optimal shape – a large and symmetric diamond whose outer bounds are calibrated by its performance on each of the dimensions. Most enterprises fall short of this optimal shape due to linear strategies that fail to consider the enterprise's priorities, performance and capability gaps as a whole. Moreover, it is challenging to advance in all four directions simultaneously, and enterprises are often limited by cash on hand and internal resources. Therefore, business leaders should have a good understanding of the current shape of their diamond to then prioritize their actions against relevant dimensions to aspire to the desired shape over multiple evaluation and improvement cycles.

These dimensions can be leveraged either in isolation or in concert to develop an adaptive plan that balances long-term strategic decision-making with short-term tactical decisions and that is in line with the need to survive or to transform or sustain a business.

The key dimensions of the decision diamond include:

- **Market footprint:** Identifying new market opportunities (both across geographies and sectors) and/or rationalizing existing footprint
- **Product portfolio:** Optimizing the product portfolio to meet evolving customer needs
- **Operating model:** Improving process efficiencies and developing optimal business model structure
- **Cost structure:** Rationalizing cost to improve profitability and achieving optimal operating leverage

Exhibit 5: EY-Parthenon decision diamond

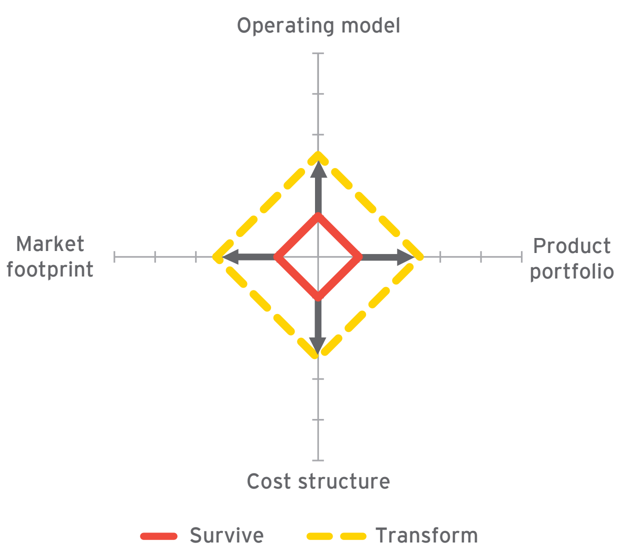


- Enterprises that lead their market define the optimal shape (the Sustain diamond).
- While the optimal shape is the same across markets and industries, they are not comparable, as the performance parameters of each market and industry are unique.
- It is important to stress that not all enterprises can be characterized as purely being in Survive, Sustain and Transform modes.
- In reality, most enterprises do not have a symmetric diamond shape irrespective of their mode; they are characterized by their relative deficiencies and strengths.

Leveraging the decision diamond to Survive

Enterprises in the Survive mode are typically in situations where the need to restructure the business and manage crises becomes paramount. Business leaders could benefit from leveraging all four strategic dimensions presented in EY-Parthenon's decision diamond; however, advancing in all four directions simultaneously is extremely challenging and, at times, counterproductive. Enterprises are also limited by the degree to which they can act against these dimensions, with the most significant limitations being cash, talent and capabilities.

Exhibit 6: Leveraging the decision diamond to Survive



- Enterprises in Survive mode are often limited by cash, talent and internal capabilities.
- Such companies are limited in their ability to act on initiatives across all four dimensions simultaneously.
- Business leaders need to prioritize quick wins and optimize resource allocation on key initiatives to survive.
- Enterprises in Survive mode require multiple improvement cycles to expand the shape of their diamond and progress to Transform mode.

If the priority is to survive, business leaders might consider:

A. **Divesting underperforming business segments:** identify underperforming (high cost base, low revenue growth) business segments, including products, brands and market; develop an efficient and cost-effective carve-out plan for associated assets (e.g., property, plant and equipment [PPE]); divest identified segments to increase liquidity and focus on improving performance of the remaining core business

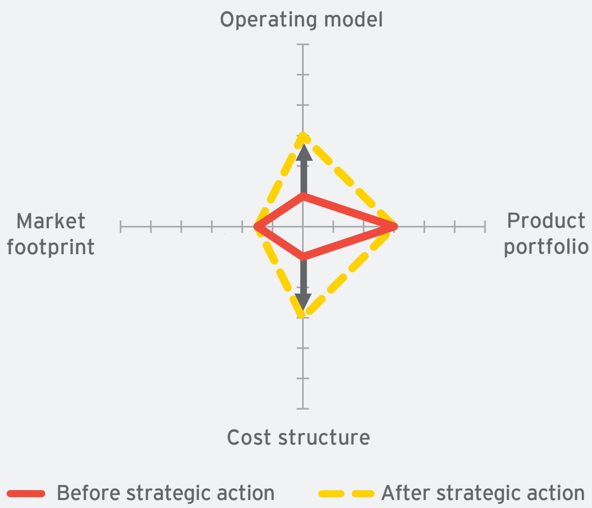
B. **Driving rapid cost reduction in core business:** identify/eliminate drivers of efficiency loss and material waste; reduce nonessential personnel headcount to cut direct and indirect labor costs; track and mitigate nonessential expense purchases; drive vendor consolidation and revisit contractual agreements to achieve procurement-related savings

C. **Improving liquidity through working capital-related quick wins:** restructure vendor and customer payment terms to reduce the cash conversion cycle; drive efficiency in order-to-cash, forecast-to-fulfill and procure-to-pay processes to limit inventory-related costs

D. **Optimizing production throughput:** rationalize capacity and optimize throughput by reducing downtime and eliminating production bottlenecks to prevent stock-outs and reduce production costs

E. **Driving quick wins through strategic investments:** prioritize potential investments to prevent performance rollback and boost stakeholder confidence; invest in potential low-cost technology upgrades to streamline manufacturing processes; hire key talent to support strategic initiatives

Case study: U.S. Steel



Over the last decade, U.S. Steel had been challenged by falling steel prices, an influx of cheap imports from China and falling global infrastructure demand.

To provide further insulation from worsening market conditions, the enterprise launched an ambitious program called "The Carnegie Way" in 2013 to generate greater savings, stabilize cash flows and right-size operations. Since the program's launch, U.S. Steel has made significant progress toward greater profitability, in part, by focusing on:

- Investing in innovation and development of high-strength, lightweight steel
- Improving working capital management to reduce days payable outstanding (DPO)
- Optimizing its supply chain to drive greater operational efficiency

Leveraging the decision diamond to Transform

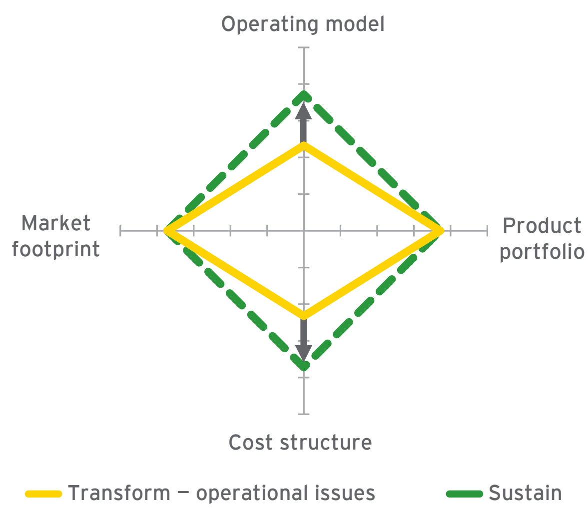
Enterprises in Transform mode are those that need to transform their operating and/or commercial strategy. When an enterprise lags its competitors' performance across key financial and operating metrics in a relatively attractive market, business leaders should consider transforming their operating strategy. However, enterprises faced with challenging or negative industry dynamics should consider transforming their commercial strategy.

Transform – operational issues mode

If the priority is to transform by addressing an enterprise's operational issues, business leaders might consider:

A. **Optimizing route-to-market (RTM) model economics:** Understand the economics and structure of the current RTM model, including cost, price, channel partners, geographic reach and volume lift; evaluate channel partner performance and identify opportunities to top-grade channel partner; re-evaluate arrangements and renegotiate contracts to reduce "cost-to-serve" while not compromising on service levels

Exhibit 7: Leveraging the decision diamond to Transform – operational issues



- Enterprises in Transform – operational issues mode are characterized by below-average operational performance despite favorable industry dynamics.
- They generally have a sustainable market footprint and product portfolio.
- Such companies need to prioritize strategic actions across the operating model and cost structure dimensions.
- They will need successive improvement cycles to achieve sustainability across the operating model and cost structure dimensions.

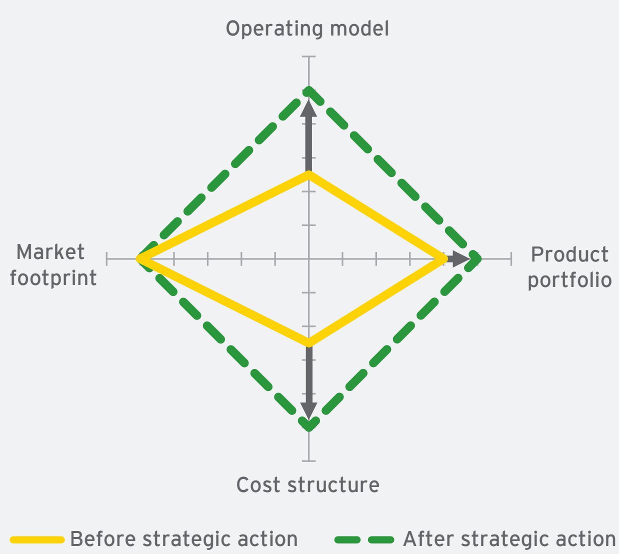
B. **Improving salesforce effectiveness and delayering governance structures:** understand current performance gaps by analyzing key metrics (including salesforce productivity) and customer and salesforce feedback; redefine and ratify a clear sales strategy and set specific team goals, reporting structures and bonus thresholds; target high-value accounts and direct sales resources to opportunities with the biggest payback; ensure customer engagement during the sales cycle

C. **Driving margin expansion:** identify opportunities to increase the blended price point and reduce costs; develop channel-specific pricing and identify cross-sell and upsell opportunities; consolidate supplier base to drive economies of scale; meaningfully rationalize trade and advertising spend to capture customer acquisition-related savings

D. **Refining cash conversion and throughput:** renegotiate and consolidate vendor contracts and payment terms; invest in new technologies to improve throughput and capacity utilization; continue to eliminate production bottlenecks, limit waste and reduce complexity in product design

E. **Improving capital efficiency and fixed cost leverage:** conduct a strategic review of PPE across the value chain to identify underperforming assets on a return on capital employed (ROCE) basis; develop a plan to rationalize selected parts of the production process by either optimizing remaining assets or outsourcing to third-party operators

Case study: Zara



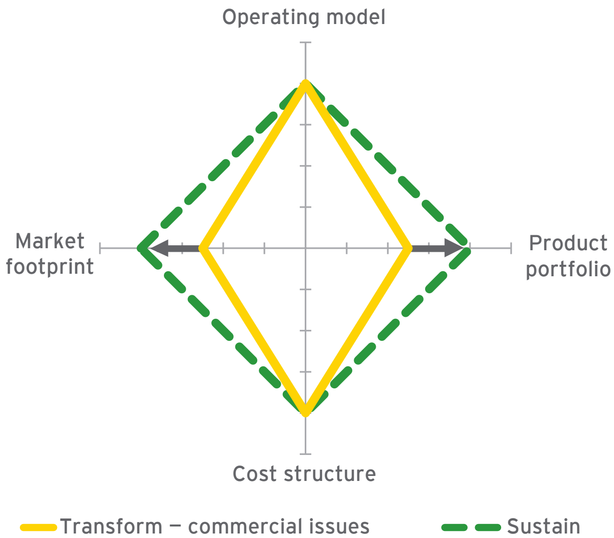
Zara's success in and disruption of the retail fast fashion industry has been driven by its unyielding focus on accuracy and efficiency. The decision to fully integrate the offline and online sales platform, invest in a lean supply chain and establish an effective distribution network has enabled Zara to take a product from concept to customers within weeks after analyzing in a very precise way clients' tastes and preferences. Furthermore, by delivering high-quality products to the end consumer at the right place, time and price, Zara has established itself as the premier destination for high street fashion and online sales at affordable prices. Some of the key strategic actions that have enabled Zara to establish itself as a leader in the right-on-time fashion category include:

- Investing in proximity production and "just-in-time" capabilities to flex manufacturing capacity to meet consumer demand
- Investing in technology and R&D with institutions such as MIT to develop tools that allow the highest precision, both in finding the right fashion offerings and in limiting obsolescence in inventories
- Utilizing centralized logistics and distribution management

Transform — commercial issues mode

If the priority is to transform by addressing an enterprise's commercial issues, business leaders might consider:

Exhibit 8: Leveraging the decision diamond to Transform — commercial issues



- Enterprises in Transform — commercial issues mode are characterized by above-average operating performance despite unfavorable industry dynamics.
- They generally have a sustainable operating model and cost structure.
- Such companies need to prioritize strategic actions across their market footprint and product portfolio to diversify and limit risk to external factors.
- They will require successive improvement cycles to achieve sustainability in commercial dimensions.

A. **Optimizing product portfolio:** evaluate changing customer needs, evolving category dynamics and growth engines in existing product portfolio; optimize portfolio by selecting products to grow, fix, exit and sustain; improve value proposition for core products through investment in technology; allocate resources away from nonperforming stock-keeping units (SKUs) and re-evaluate portfolio on an ongoing basis

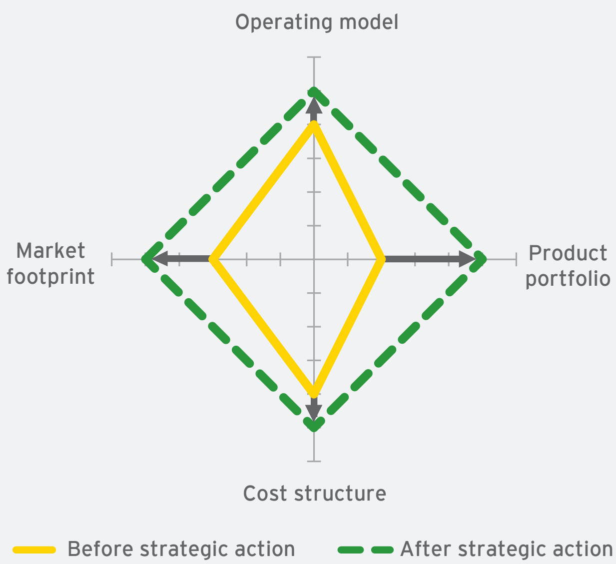
B. **Identifying new markets for growth:** identify attractive, growing segments and/or geographies to enter; determine key criteria for market entry, including market size, investment horizon, time to market and expected return on investment (ROI); determine the need to buy, build or partner

C. **Realigning value chain positioning:** assess defensibility and profitability of current position in the value chain; identify positions of relative power among channel intermediaries; vertically integrate to move toward desired position through inorganic or organic strategy

D. **Rethinking channel strategy:** realign go-to-market (GTM) strategy to adapt to changing customer needs and category dynamics; incentivize intermediaries to increase channel penetration; develop effective "push" and "pull" strategies to maximize sales; build omni-channel capabilities to capture new customer spending patterns

E. **Improving merchandising strategy:** invest in packaging design, SKU assortment to drive growth in shelf share; improve digital and e-commerce platform to support the in-store shopping experience; identify opportunities to increase the blended price point and reduce costs

Case study: Apple



Apple's commercial transformation over the last decade through disruptive innovation has enabled it to establish itself as a major player in the premium smartphone and tablet categories. Its ability to develop and re-invent existing products and market them through an effective channel strategy helped establish it as an innovator beyond its core sector. Furthermore, by supporting high-quality products through a successful marketing campaign, Apple has been able to extend its brand as a cool, innovative and fashion-forward company. Some of the strategic decisions that influenced Apple's commercial success include:

- Investing in R&D to create high-quality, easy-to-use products supported by a robust ecosystem (e.g., iTunes Store, App Store)
- Optimizing the consumer experience at the point of purchase and during product usage
- Continuously innovating its core offerings through additional functionality and/or SKU variations

Transform — paradox vortex mode

Enterprises in Transform — paradox vortex mode can potentially leverage strategic actions that are both commercial and operational in nature. Business leaders looking to address the paradox vortex might consider:

A. **Prioritizing strategic actions:** identify all potential commercial and operational strategic actions available; prioritize actions based on the enterprise's core objectives and capabilities (e.g., resources, technology, processes)

B. **Developing impact scenarios:** assess financial and nonfinancial impact of all strategic actions; quantify risks and benefits associated with key strategic actions; develop a phased action plan to achieve prioritized strategy

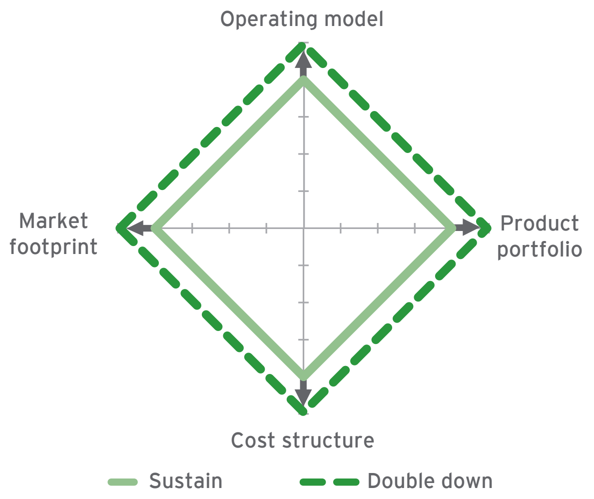
Leveraging the decision diamond to Sustain

If the priority is to sustain market position and historical performance, business leaders might consider the following:

A. **Continuing to invest in core business to drive defensibility and differentiation:** identify areas to maintain differentiation and defensibility, including branding, customer acquisition, intellectual property/R&D and talent; prioritize investments based on strategic goals and core competencies

B. **Identify strategic acquisitions for market consolidation:** identify meaningful and value-accretive acquisition opportunities to increase market share through category, market or vertical expansion; strengthen product portfolio; drive to achieve robust integration to capture revenue and cost synergies

Exhibit 9: Leveraging the decision diamond to sustain market position and historical performance



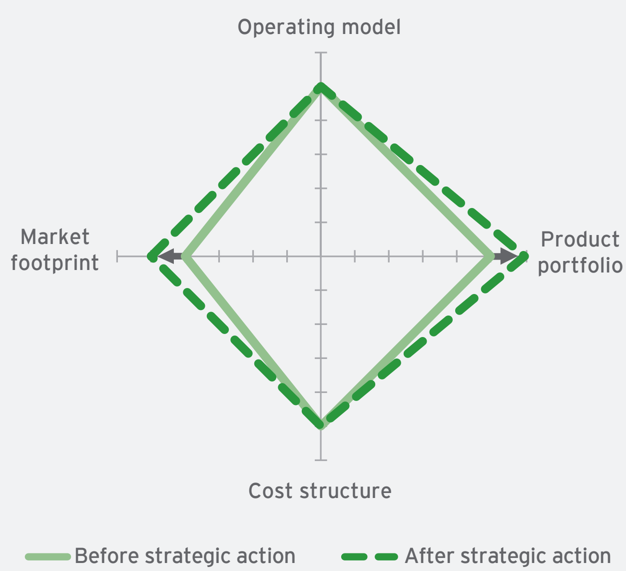
- Enterprises in Sustain mode are market leaders that have achieved the optimal diamond shape; their goal is to double down on their performance across priority dimensions to maintain market position.
- Business leaders need to continue to drive to achieve "best-in-class" operating and commercial performance.

C. **Create new segments/categories:** develop products that have the potential to disrupt the status quo in the current marketplace; drive to enhance the customer experience and deliver best-in-class quality

D. **Continue to strive for operational excellence:** drive toward a leaner cost structure and a best-in-class operating model to continue to improve margins and ensure end-to-end control; refine processes by focusing on data-driven insights to manage performance; conduct periodic stress tests to mitigate potential issues in a timely manner

E. **Strategic divestitures:** assess health of business portfolio to identify underperforming business units (segments and/or markets); measure the marginal value (contribution vs. cost) of business unit to the broader portfolio and enterprise's objectives; make disposal decision

Case study: IKEA



IKEA's ability to grow and sustain market leadership in the retail furniture industry (one characterized by cyclicality and local competition) has been driven by its ability to offer consumers the right product at the right price through innovation in product design, operating model and cost structure. In particular, IKEA's focus on maintaining lean operations and innovating packaging design has enabled it to pass on savings to consumers without compromising product quality and design. Moreover, by focusing on adapting its core offerings to the local market needs, IKEA has been able to capture incremental growth through market expansion. Some of the strategies employed by IKEA include:

- Combining retail and warehouse processes to reduce handling costs and improve in-store experience
- Investing in omni-channel capabilities and new store formats to complement its traditional retail stores with digital hybrids that integrate the online and offline shopping experience
- Continuing to innovate in packaging and product design to reduce inventory and shipping costs
- Rationalizing SKU counts and manufacturing volumes through extensive forecasting and production planning

Conclusion

In today's complex marketplace, linear business strategies do not succeed. To adapt to changing business climates, business leaders will increasingly need to develop multipronged strategies that consider their business's operating model, cost structure, product portfolio and market footprint.

When developing successful strategies, business leaders need to rationalize the trade-offs among timing, economics and competitive response. Some strategies could be slow-moving and accretive but show cumulative results over extended periods, while others could be quick wins that have a shorter turnaround. Business leaders need to view adapting to the changing business environment as a continuous process to stay ahead of the competition and deliver true value to stakeholders. The elements that define this process include:

1. Codifying a process of continuous re-evaluation that includes a current-state diagnostic, issue prioritization and decision-making

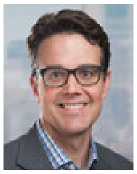
2. Identifying relevant internal and external stakeholders and champions to partake in the process

3. Establishing playbooks to guide the process and defining key metrics to track the outcome of the strategy and quantifying results

4. Working toward achieving or retaining Sustain mode in consecutive re-evaluation cycles

Without creating a culture of self-assessment and re-invention, enterprises risk eroding long-term stakeholder value. Those that are unable to adapt will fail. The journey to unlock value begins today.

Author



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