Issue 6, December 22, 2017

# FIND YOUR REAL SOURCE OF VALUE

## Tangled conglomerates are falling out of favor, and rightly so

Investors are out of love with conglomerates, and understandably so: for outsiders, there is often no logic to the combination of businesses that have been tacked together over time. Organizations become top heavy because complex and costly hierarchies evolve to manage the structure, and the true value of the best-performing divisions is hidden. As a result, the shares underperform.

Activist investors have naturally stepped into this space, calling on boards to focus on fewer core activities, with clear lines of accountability, to improve performance and boost returns. Notable examples are Nelson Peltz of Trian calling for a simpler operating model at Procter & Gamble, and Dan Loeb pushing for change at Nestlé.

Other high-profile organizations have administered their own medicine: General Electric plans to divest at least $20 billion of businesses after a disastrous year for its shares, and German rival Siemens is spinning out divisions to redeploy capital.

“Investors want to be able to understand the business model and see how the cash flows work, which may involve a fairly fundamental restructuring of the business,” says Malcolm McKenzie, corporate transformation leader for Alvarez & Marsal in Europe.

> **“Nothing has ever become better by ignoring the reality.”**
>
> Joe Kaeser
> CEO, Siemens

To be sure, not all conglomerates are seen as ripe for change – Amazon and Google are highly successful examples of portfolio companies. However they have grown up in the digital age, unencumbered by 100 years of history, and can still move quickly because their businesses are based on data rather than people.

“Older conglomerates that have not fully responded to digital disruption will often find it more convenient to carve out businesses, to satisfy the street and to make the organization more agile,” says Joe Berardino, Managing Director of Alvarez & Marsal’s corporate transformation practice. “Those at maturity need to repot some of their old businesses outside the organization, or have leaders that can effectuate true change and slim down the organization without being hindered by company politics.”

In this environment of rapid digital change and increasing activist pressure, a growing number of organizations have come to the realization that they need to untangle an overly complex structure to drive shareholder returns. However achieving this is incredibly difficult.

"When you move to, for example, three simple business lines, it raises questions about why you need the head office structure that existed to manage the complexity," says McKenzie.

Moving to a lower-cost, leaner model is "a complex restructuring job that most businesses will not have experience with," he adds.

The boards that most effectively get to grips with simplifying their business take the following steps:

> **"Leading companies through the fire is something we have been tested in many times."**
>
> **Malcolm McKenzie**

- Establish where the real source of value is – this is nearly always where the cash flow is.
- Having done so, establish the role of the head office in a simpler business, and the clear lines of accountability.
- Push the head office functions down into the lines of business – if they don't want to pay for the functions, get rid of them.
- Work quickly through an agreed set of actions with the support of an outside firm, in a way that is closer to a restructuring partner than a traditional strategy advisory firm.

"Leading companies through the fire is something we have been tested in many times," says McKenzie. "The end result? You get better performance with better focus and accountability, and you can tell your story to investors in a way they understand. Both of these keep you away from the attention of activists."

## GOT A QUESTION? CONTACT AN INFLUENCER

**ANSWERS ARE ONE CLICK AWAY**

**JOE BERARDINO**
jberardino@alvarezandmarsal.com

**MALCOLM MCKENZIE**
mmckenzie@alvarezandmarsal.com

For general inquiries, please email us at corptransformationnewsletter@alvarezandmarsal.com