The power of portfolio renewal and the value in divestitures

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A letter from PwC Deals leaders

It's our pleasure to share with you this study on portfolio strategy, divestitures and value creation. Successful leaders know that smart management of their business portfolio is critical to delivering positive returns to shareholders. Many executives are eager to engage in acquisitions but often shy away from, or pause before initiating, a divestiture. Why? And does this reluctance matter?

Our study answers this question by analyzing the psychology behind the decision-making process and the value created by divestitures. Many forces combine to dissuade executives from parting with a business. The study explores the wide range of internal and external influences that affect the speed and effectiveness of portfolio decisions and divestitures. These findings are more than a point of view — they're the result of rigorous statistical modeling.

In the evolving technological and economic environment, understanding the power of portfolio renewal and the value in divestitures has never been more important. Making your business stronger requires deliberate and decisive action as well as breaking the stigma of handing over a business to another owner. Only then can you rejuvenate your business, refresh your capital and increase shareholder value.

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Key findings

Divestitures are an underused lever for value creation

From 2018 to 2022, S&P 500 companies acquired businesses 4.4 times greater than they divested assets, a PwC analysis found. This is up from 3.7 times in the prior five-year period.

Only about 40% of respondents in our study believe that their company fully embraces divestitures, with about 25% being reluctant or having no consideration for divestitures. Many said divestitures are a sign of failure.

The skeptics should think again. Companies that both acquire and divest outperform their industry index during the years following the transactions. For companies that announced a divestiture over the past decade, the median increase in stock price around the date of announcement was 3.8% compared to their industry index. And the top 25% of these companies achieved double-digit stock price increases (above 10.4%) compared to their industry index.

Where does the uplift come from? A divestiture can allow your company to focus time and resources on the businesses that are the ideal strategic fit. It can give the divested business the opportunity to thrive under new ownership.

The winning formula

Companies that have been shown to generate greater total shareholder return (TSR) are proactive in their portfolio review, have divestitures in their DNA and act with speed. We call it the winning formula.

The probability of a positive TSR is 99.5% when a company possesses all three of these attributes. However, of the 2,500+ survey respondents, only 13.8% of companies have the winning formula in place at their organization.

- Only 39% of survey respondents reported having a robust and comprehensive portfolio review process.
- A proactive orientation that helps identify a business that doesn't fit sooner has been shown to increase the chances of delivering a positive return to shareholders by five times for public companies.
- Attempts to fix a business instead of divesting are often misguided. Of the companies that tried to fix a business unit rather than divesting, 57% said the unit's performance deteriorated or stayed the same.
- The odds of considering a divestiture increase by two-and-a-half times if you have a positive attitude toward divestitures.
- The odds of considering a divestiture are three-and-a-half times greater when a company's board is actively involved in the portfolio review process.
- The likelihood of doing a divestiture is 65% higher when there's a reinvestment plan as part of a company's divestiture strategy.
- The research shows that acting with speed increases the likelihood of a positive TSR. For instance, when the time between announcement and close was less than 12 months, the median seller had greater excess returns compared to its industry peers.
- More than 75% of survey respondents report experiencing major delays during the execution process.

Inertial forces at play

Creating value through a divestiture can hinge on how well you recognize and act on the "fit signal." That's when a company realizes that one of its business units, products or brands might not be the ideal strategic fit going forward.

Emotions and biases are important sources of inertia. Their covert nature makes them difficult to identify and address, yet they're often more influential than clearly visible financial variables.

Navigating value traps during the separation is key to preserving deal value.

Introduction

The decision-maker's journey, the power of portfolio renewal and the value in divestitures

Companies evolve, and their leaders are on a continuous journey to navigate the right path forward. Portfolio management — in which companies draw their corporate boundaries through expansion, contraction and other reconfigurations — is critical.

Through extensive research and analysis, we found that companies that decided to divest sooner rather than later while successfully navigating value traps tended to generate greater total shareholder return (TSR). For corporations, even small gains in TSR can translate to significant value. Yet we also found that many corporate decision-makers remain reluctant to divest — or would rather attempt to fix the business first.

Portfolio review is often too infrequent, ineffective and insufficient to help a company efficiently reconfigure and drive long-term growth. Portfolio reviews require attention to the internal and external business environments. They also require courage as leaders revisit past decisions and confront decisions shaping the future. Effective capital and resource allocation rests in the balance of managing short-term discomfort in hopes of long-term strategic growth.

Success can hinge on how well you recognize and act on the "fit signal." That's when a company realizes that one of its business units, products or brands might not be the ideal strategic fit going forward. While companies focus a lot of time and resources on identifying growth potential, they often miss a divestiture fit signal. The fit signal is similar to the soft tone played over headphones during a hearing test. But companies that pay attention through robust portfolio reviews can recognize — and act on — the signal even though it's not the loudest tone in the hearing test.

For many executives, there's a stigma with divestitures — a belief that parting with a business is admitting defeat. They choose to stay the course or invest more in a business unit in an attempt to fix it. By comparison, leaders who act quickly to chart a new path and free — sell — the unit can deliver more value for shareholders.

The decision to divest often requires objectivity and courage, and taking four critical actions can help refocus your company for a stronger future.

- Proactively and consistently assess your portfolio against your core strategy.
- Make timely decisions with the understanding that speed improves returns.
- Infuse divestitures into your corporate DNA.
- Navigate inertial influences behind divestitures and decision-making.

To be sure, staying the course with a business that fits or investing to fix an underperforming business may be the optimal decision. But when a business no longer aligns with your core strategy, it's critical to increase shareholder value by recognizing the fit signal and moving quickly to divest.

How our study is different

Research methods often rely on either historical or survey data. This first-of-its-kind study goes further by combining quantitative and qualitative research with proprietary analysis and modeling to derive statistical observations (which were often at odds with the gut instinct of corporate strategists). The portfolio review process hasn't been studied in academic literature, meaning it has not, until now, been tested with empirical evidence. In addition to total shareholder returns, this study also extends into behavioral science, measuring emotional and cognitive factors along with structural ones.

PwC's study includes:

A survey of 2,566 senior leaders who have meaningful knowledge of strategy, portfolio review and/or the divestiture process, with rigorous statistical modeling of the survey results.

Intimate interviews with 29 senior members of management and board members with decision-making responsibility.

Collaboration with academic professionals who have researched executive behaviors and who advised on new research questions, conducted interviews and helped with statistical modeling.

Extensive analysis of historical financial and deal data at the company and business unit level.

Overcoming the stigma of divestitures

Many executives are eager to engage in acquisitions but often shy away from or pause before initiating a divestiture. Only two-fifths of survey respondents say they fully embrace divestitures, with about a quarter reluctant to divest or consider divestitures. An analysis of historical data also shows that companies are reluctant to embrace divestitures compared to acquisitions.

Overcoming an acquisition bias

Businesses divested by S&P 500 companies relative to their acquisitions

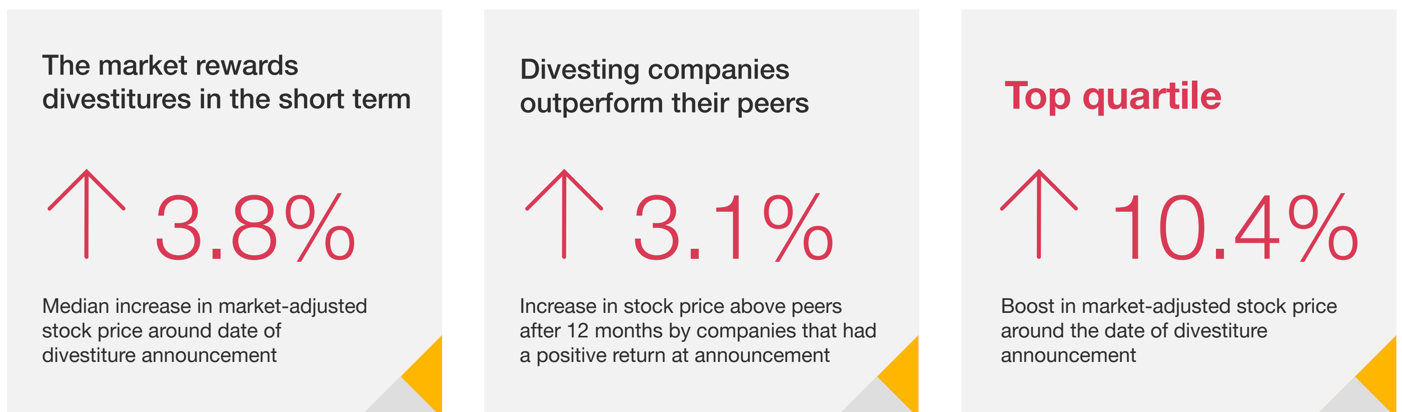
	Divestitures	Acquisitions
2013-2017	2	7
2018-2022	2	9

Source: S&P Capital IQ data as of January 2023

Although companies are acquiring businesses faster than they are divesting them, companies that did both in 2020-22 **earned a median return of 9.1%.**

Divestitures should be a more critical part of corporate strategy due to their value creation potential. Over the past decade, the median company that made a divestiture saw an increase in its market-adjusted stock price around the date of announcement, with the top quartile receiving a **10.4% boost**. Furthermore, we tracked the companies that had a positive return at announcement over the next 12 months, and at the end of this period, their stock price outpaced industry peers.

How divestitures have created value

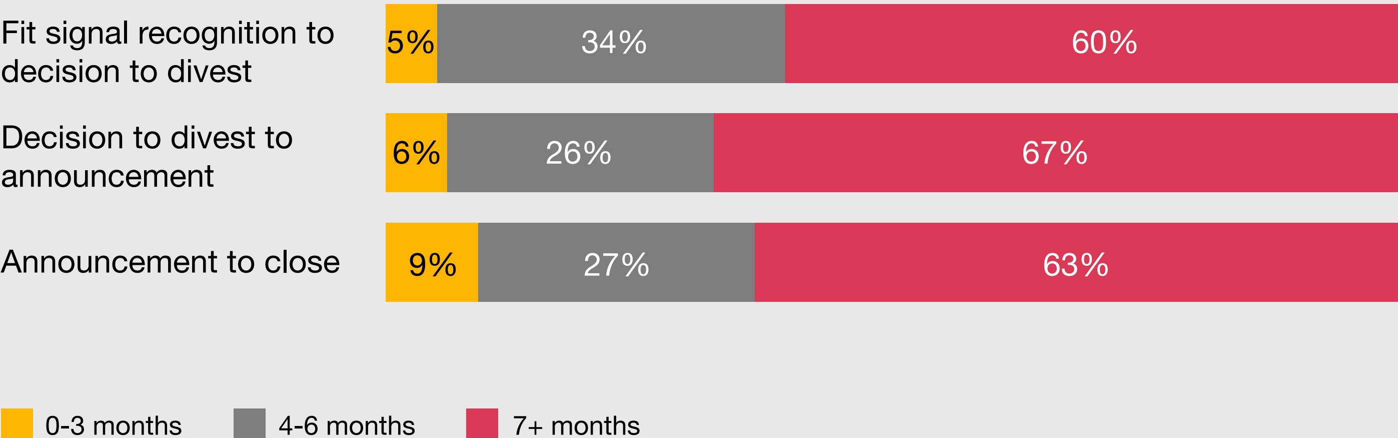


Note: Public companies trading in a major US stock exchange, excluding financial services companies, that executed a divestiture of more than $100 million and that was greater than 10% of its market capitalization between December 31, 2011, and October 31, 2022. Market adjusted relative to industry index.
Source: PwC analysis of Capital IQ data on 297 transactions between December 31, 2011, and October 31, 2022.

A reluctance to divest isn't the only problem. Just putting the key in the divestiture ignition doesn't guarantee fast execution or higher TSR. Even though a divestiture can help create value, about three in ten companies took more than a year to announce the transaction after making the decision to divest. In our experience, this is too long because it risks eroding TSR. We also found this is longer among companies with greater operating margins, revenues and business units. Just over a quarter took more than a year to close the deal, and this also is longer among companies with greater operating margins, revenues and business units.

How long does a divestiture take?

Respondents report divestiture duration by phase with respect to the largest divestiture undertaken in previous three years



*Totals do not equal 100% due to rounding

Source: The power of portfolio renewal and the value in divestitures, 2023

Survey questions:

- What is your best estimate of the length of time between when your company first recognized that the BU might need to be divested and when the actual divestiture decision was made? Respondents: 2,505.
- What was the approximate time period between the decision to divest (the point in time management concluded the BU would be divested, irrespective of whether the transaction was eventually executed) and the announcement date (the date the transaction was publicly announced)? Respondents: 2,505.
- What was the approximate time period between the announcement date (the date the transaction was publicly announced) and the date the transaction closed (the sale agreement had been executed and ownership transferred, or in the case of a spin-off, the distribution date)? Respondents: 2,466.

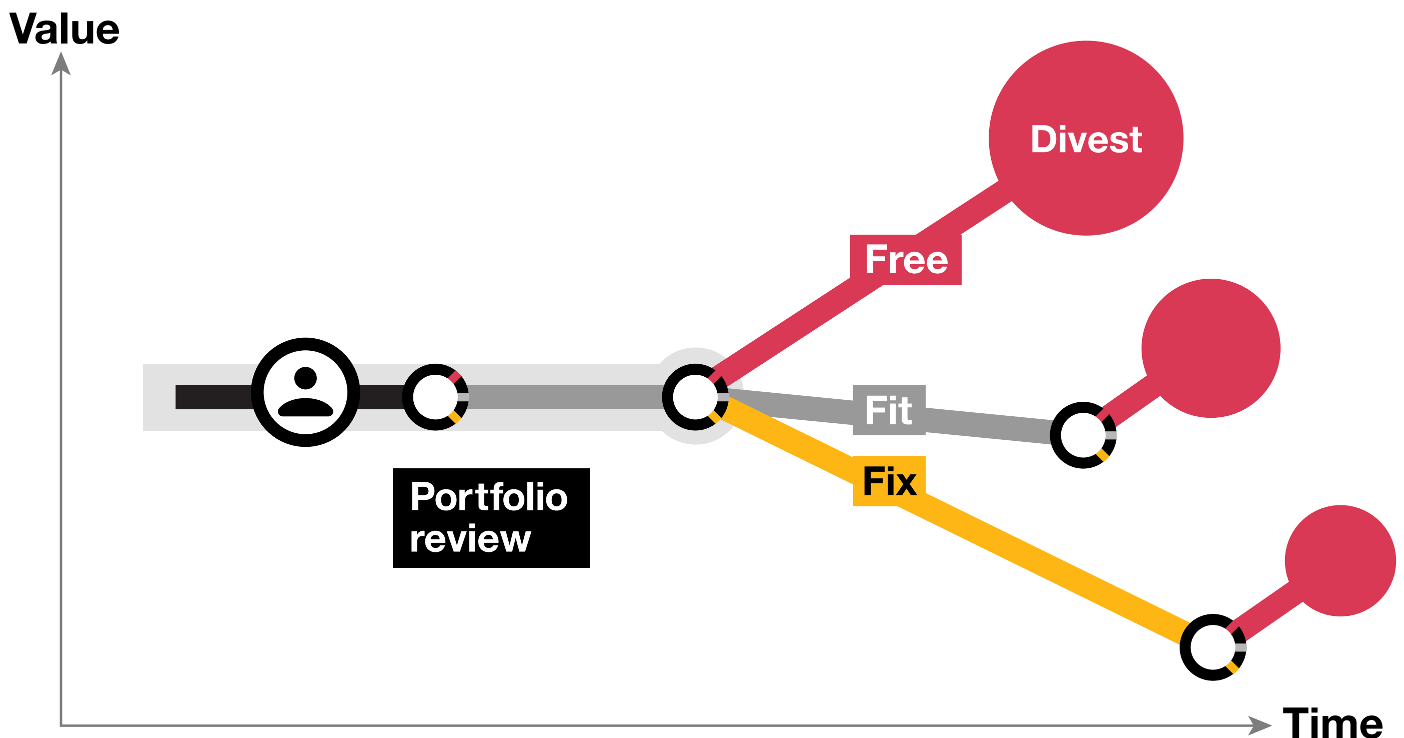
Assessing the fit signal

What do we mean by fit, and how should you assess it? Start by asking key questions about the business. If none of these conditions are met, there's a high likelihood you aren't the most optimal owner.

Key question	Description/Illustrative examples
Are the revenue and/or cost synergies with the rest of the portfolio significant enough to generate an appropriate capital return?	This is probably the simplest to answer. For example, does the business share manufacturing, distribution channels or a sales staff? Consider a soft-drink maker that also owns snack brands. The sales team that visits retail stores can be the same for both product lines and can take orders for both types of products simultaneously.
Does the business unit or parent have untapped capabilities that can improve capital returns?	Many times, the salesforce and distribution channels may be very different, but the parent company may still possess capabilities that can help a business succeed. This can include marketing skills like those found in a consumer goods company with a diverse portfolio of business, where the parent provides marketing skills that are above what any individual business could deliver on its own. Industrial companies are another example. They might have managerial skills that provide a competitive edge in delivering quality and above-average cost structures.
Does the parent company possess top-tier insights that drive differentiated results?	Industry insight also can help secure a business unit's place within a portfolio. For instance, understanding government contracting can allow a business to own a diversified set of portfolio companies whose major customers include state and federal governments. In another example, large oil producers understand global energy market dynamics, giving them an advantage over niche players.
Does the business perform relative to expectations, and are the capital allocation priorities aligned with the rest of the company?	Other questions address specific skills or activities that the parent company possesses that may enhance the value of a business. Often, some of these conditions are met, but the parent company discovers the business is still underperforming — perhaps because the parent isn't able or willing to provide the level of capital needed. Previous attempts to improve its performance have consumed time and resources that could have created more value if applied to other initiatives. The portfolio review is based on objective and quantifiable criteria that in sum can provide an optimal approximation of the corporate strategy.
Does the business fit into the overall corporate strategy and vision?	It's critical to know how well the corporate portfolio delivers the corporate strategy. Executives should consider a business unit's value contribution to the overall company and the synergies between the two. These types of fit signals can indicate how the unit supports strategic goals.

Fit-fix-free fallacy

When a business unit no longer fits, the right decision is to free it (sell it). Maintaining the status quo and continuing to operate the business as though it fits — or worse, investing precious resources to attempt to fix it — destroys value. By comparison, leaders who recognize a lack of fit and quickly chart a new path can deliver more value for shareholders.



57% of the companies that tried to fix a business unit rather than divesting said the business unit's value deteriorated or stayed the same.

A business unit that isn't a good fit with the core business is a strategic problem. Strategic problems can't be adequately addressed with tactical remedies. Companies that are reluctant to divest often don't recognize there's a fit problem until the business unit's financials begin to deteriorate. Even after recognizing a problem, executives may misdiagnose the situation, thinking they can control the situation and fix the problem instead of having to sell the business unit.

When these executives undertake divestitures, they frequently do so reactively, such as selling a business unit only after years of neglect, poor performance or failed attempts to fix performance. Belated, ad hoc transactions without a strategic plan can erode value.

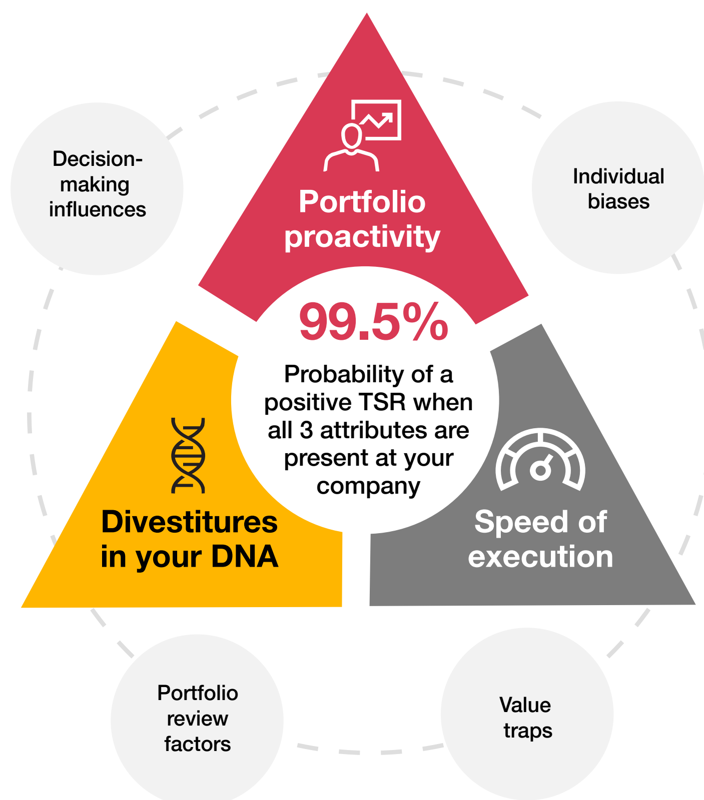
The building blocks of divestiture value creation

The decision to divest: Inertial forces at play

Many forces combine to discourage divestitures, burning up precious time that could be better used to build value. The corporate environment, or what we call the decision-making context, can impact the speed and effectiveness of portfolio decisions and divestitures. The inertial influences affecting divestitures — essentially, a reluctance or hesitation to divest — have both rational and what economists call “bounded rational” aspects.

Rational inertial forces include entanglements, tax considerations and other costs associated with a divestiture. Bounded rational aspects essentially involve decisions that can’t be perfectly rational because decision-makers have cognitive limitations and aren’t omniscient. They include both emotions and cognitive biases. An organization’s attitude toward the portfolio, for example, affects the decision-making process and management’s ability to recognize fit signals. Executives individually also are influenced by constraining factors. Finally, value traps, when unaddressed, are likely to erode shareholder value.

The winning formula



Only 13.8% of survey respondents claim to have all three components of the winning formula in place.

Portfolio proactivity

A proactive orientation shows a **two and a half times increase** in the chances of delivering a positive return to shareholders. For public companies, there's a five times increase in the likelihood of a positive return.

Our experience and research show that the quality and thoroughness in portfolio review processes vary considerably. A proactive portfolio review is one in which thorough analyses are performed using financial and nonfinancial data, as well as analyses of current and future competitive environments. This process can help you recognize a business that doesn't fit and/or should be freed (sold) faster.

The more comprehensive the decision-making process, the more likely you are to consider and to execute a divestiture. Consideration and execution become even more important as companies grow. In the case of companies with revenues in excess of $1 billion, the study shows they're more reluctant to pursue a divestiture than smaller firms.

Divestitures in your DNA

It's not surprising that most respondents report that their companies don't actively embrace divestitures as part of strategic decision-making. Some held views ranging from a relatively neutral opinion — usually just employing divestitures to address negative financial performance — to an outright refusal to even consider divestitures.

A company's DNA is a blueprint that orchestrates its development, functioning and growth trajectory. Without a consideration of divestitures, problems can linger, posing a risk to growth.

We identified traits exhibited by companies that had divestitures in their DNA, including a willingness to consider and decide to divest a business (regardless of whether they ultimately executed the deal). Traits that influence a company's DNA include thorough portfolio analysis, attitude, the existence of reinvestment plans and board involvement, among other elements.

Companies that consider divestitures multiple times per year (have divestitures in their DNA) are **more likely to deliver a positive TSR** when they actually complete a divestiture.

The likelihood of a company to both consider divestitures in their decision-making process and ultimately decide to divest are **nearly two-and-a-half times greater** for companies that have a positive attitude towards divestitures versus companies that are reluctant to consider divestitures.

Finally, a reinvestment plan is a key aspect of the divestiture strategy. When it's a key part of the initial divestiture decision, the likelihood that a company will decide to divest at least once per year is **65% higher**. Companies with divestitures in their DNA can increase their chances of achieving greater shareholder return.

Speed of execution

Acting with speed — from recognizing the lack of fit to closing a divestiture — has been shown to increase the likelihood of a positive TSR. The less time that elapses between the fit signal to the announcement of a divestiture, the more likely your company will realize a positive TSR. Although the sample of divestitures in which the seller has disclosed pre-announcement financials of the business being sold is very limited, available information suggests that sellers who announce a divestiture more quickly after the unit's profit weakens tend to be rewarded with better post-announcement shareholder value creation.

Years prior to announcement	Median seller 3-month relative TSR
0*	2.4%
1	-0.1%
2	-1.6%
3	-2.8%
4	-4.7%
5	-9.3%

*Year of announcement
Source: The power of portfolio renewal and the value in divestitures, 2023

In addition, closing a deal more quickly post-announcement is associated with positive excess returns versus industry peers. For instance, when the time between announcement and close was less than 12 months, the median seller had greater excess returns compared to its industry peers — **and even greater returns when close was less than six months.** When the time was more than 12 months, the median seller underperformed industry peers.

Navigating value traps during the separation process is key to preserving deal value. The survey found that delays related to the execution workstreams occurred **75-80%** of the time. Defining the right deal perimeter, managing the divestiture process and talent and reducing stranded costs can make the difference between a divestiture that delivers rather than erodes value. And while it might sound obvious, having a team that possesses divestiture skills and experience can give you an advantage.

Understanding the inertial forces: Findings and insights

What's slowing companies down and making executives reluctant to divest? Emotions and biases are among the most nettlesome sources of inertia that delay strategic decision-making. Their covert nature makes them difficult to identify and address, yet they're often more influential than clearly visible financial variables. Better understanding of the cognitive pitfalls of the divestiture process can help you address the inertial roadblocks to executing a deal.

From qualitative interviews and quantitative survey research, we identified specific inertial factors that impact timeliness of an effective portfolio review and decision to divest.

Decision-making influences

Context is important. While some factors have a greater influence than others, the evidence proves that the forces of inertia directly impact an organization's ability to make optimal, timely decisions and increase value through portfolio renewal. You can't eliminate all inertial forces, but you can overcome those forces by understanding their influence and by employing strategies to overcome them.

Attitudes matter

Companies with a more positive attitude toward divestitures are about two-and-a-half times more likely to both consider divestitures in the decision-making process and ultimately decide to divest. Attitudes play a key role in divestiture decision-making speed. Our qualitative research found that those attitudes are reflected in one of two personas: actively embrace and reluctant. Reluctant divesters prefer to kick the can down the road on a nonstrategic business unit and typically divest a business only after value has eroded.

Only two-fifths of survey respondents indicate that their company embraces divestitures. Those respondents said divestitures were part of the routine strategic decision-making process. One software company executive characterized the prevalence of divestitures as a strategic option.

"We are pretty methodical about divestitures … and first and foremost it is embraced, it is understood, it is normal, no hard feelings," said an executive at a media company.

An insurance company executive noted that divestitures were ingrained in company culture. "It's something that is completely embraced by the company, its culture, the notion of … continuous portfolio management and capital allocation."

The attitudes of reluctant divestors varied from hesitation to active resistance. A media company executive remarked that his CEO wasn't enthusiastic about divestitures as a strategy and noted, "We're not going to be able to divest ourselves to greatness." Another media company executive and a software company executive described divestitures as a strategy of "last resort."

Size matters

The likelihood that large companies (revenues greater than $5 billion) will consider a divestiture once a year are 38% lower when compared to smaller companies (revenues less than $5 billion). **As companies get bigger, their divestiture decisions typically take longer, which may negatively impact TSR.** While larger companies typically make more investments in their decision-making practices, those investments impact speed and efficiency. More bureaucracy can create bottlenecks, and additional decision-makers and a lack of accountability also can be obstacles.

Based on the interviews, executives believe size matters, which may influence their decisions to divest.

Management incentives

The interviews with executives indicate that management incentives influence the divestiture decision-making process. Too often, incentives and compensation programs are tied to a too-narrow vision of a company's performance. There are many options in use today, ranging from revenue or growth measures to return measures such as earnings per share (EPS) and TSR.

Interestingly, the more that return on investment capital (ROIC) and operating margin influence executive management incentives, the less likely a company is to divest. There are instances where executives avoid a divestiture because they fear hurting their profitability. "Like most companies, management is rewarded for growing the top and bottom line," one executive from a consumer products manufacturer said.

"If you're a CEO of a large company… you want to be the CEO of an even larger company. Nobody becomes a CEO to become a CEO of a smaller company," one tech company executive stated.

An executive at an industrial manufacturing company said, "We don't want to reduce the size of the company. It has its own implications from investor appetite point of view or investor excitement point."

"If you have a company you believe in, it's really tough to shrink to greatness," said an executive at an engineering company.

As part of the interviews, many executives said budget relief (or lack thereof) caused a delay in the divestiture decision-making process. According to an executive at a medical devices manufacturer, “The current policy is that if a business divests the product line, they don’t get budget relief for that. So they have to fill that budget hole for the next year, which is a huge disincentive for doing this.”

“We don’t really adjust comp down. But again, if you’re now carrying more overhead and your returns are lower, that’s going to affect you. It’s better to have something that absorbs all those costs than to try and find a home for them. It’s either tough emotional work where you have to restructure the organization or financial, which you’re getting hit personally on your compensation,” said an executive at an industrial products manufacturer.

Position of strength

More than half of the companies in the survey that decided to divest had at least a 5% compound annual growth rate (CAGR), and a third had an operating margin of at least 11% at the time of the divestiture decision. While there’s sometimes a stigma associated with divestitures, these findings demonstrate that many companies are choosing to divest while in a position of strength, indicating that **divestitures don’t have to be a signal of distress.** As a chemical company executive noted, “It’s important to make [a] divestiture [decision] when times are good. When you are not forced to do it. When you have plenty of time to decide when the market has a stronger bid for some business.” In addition, based on the research, companies that divest from a position of operating margin strength have been shown to have a higher likelihood of a positive TSR.

Operating history, legacy business and founder influence

Overall, the research shows that companies with longer operating histories are less likely to decide to divest and also take longer in their portfolio review process. “The businesses that we hold often are rooted in our history,” said an executive at a manufacturing company.

An executive at a media company recalled one leader’s reluctance to divest. “You’re about to walk away from a space where you were the leader,” he said. “He had an obligation to the employee base that he knows intimately. So all of those things were inputs into the decision, and there was definitely a sense of emotion.”

“So there is sometimes an emotional attachment to businesses, and selling them feels like giving up, and you never want to give up on one of your children, right?” said an executive at a manufacturing company.

The influence of a founder also can be particularly difficult for the company's decision-making process. When a business unit is associated with its founder, it's more likely that a long time will elapse between recognition of the need to divest and the decision to divest. When the business unit being divested is associated with the company's founders, our research indicates there is a **66%** chance the decision to divest will take greater than six months. Based on our research and experience, longer divestiture decisions are associated with lower TSR.

A communications company executive noted how closely one business unit was associated with the company's identity and said founder involvement delayed the divestiture decision. "There are family members involved with the company that recognize we probably waited too long to divest," he said. "They had been burned by falling in love with the heritage and the aspects of the business before."

Divestiture experience

There's no substitute for experience. The research indicates that serial divesters are more likely to consider a divestiture and ultimately decide to move forward — and their probability of generating a positive TSR is **98%**.

Prior acquisition

Our research indicates that when a business unit stems from a prior acquisition, the company is less likely to divest that business.

Anecdotal evidence suggests that senior leaders often have political capital — or even just pride — attached to a deal they orchestrated. "From a perception perspective, doing a divestiture is like admitting failure that your business didn't succeed, that it was either an organically driven part of the company or, in some cases, it was an acquisition that didn't work out relative to its original objectives," said an executive at a medical technologies company.

Data shows there is a **71% decrease** in likelihood that a company will divest when the business unit in consideration relates to a prior acquisition.

Entanglements and stranded costs impact decision-making

According to an executive from a consumer products company, "We have a particular set of assets that I think in a perfect world we would have sold years ago. But because of the particulars of it and where it's manufactured and some other things, it just creates a lot of stranded overhead for us, and we haven't solved that yet."

Perceived entanglements and stranded costs play a major role in driving the decision-making process. Nearly 40% of survey respondents cite business unit cross synergies as a significant factor in their decision-making process. In addition, nearly one-third indicate that management thought it would be difficult to disentangle the business unit, which greatly impacted the time between the fit signal and the decision to divest.

More than **50%** of survey respondents indicated that the difficulty of disentangling a business was a significant factor in a decision not to divest.

Tax consequences

In the survey, **62% of respondents report that tax issues play a role in delaying the decision-making process** to divest a business. In many divestiture scenarios, the tax costs of separation steps can impact the economics of the proposed transaction. Although sometimes very significant, the costs may be able to be managed. The tax consequences of a transaction can sometimes be improved through qualification for tax-neutral separation/spin-off programs, offset with other tax attributes, and allocation of consideration among transferred assets and jurisdictions. In some cases, the impact of holding periods and the availability of tax rulings may inform the timing of a deal — for example, if the tax cost of a separation step can be significantly reduced after the passage of time and/or upon receipt of a favorable tax ruling.

Individual biases

Humans have biases designed for survival, but the word bias has a negative connotation that can conjure feelings of moral failure. Biases aren't inherently good or bad, but they do play a key role in motivating behavior. While business decisions may not literally be survival choices, they are influenced by rational and bounded rational forces that can interfere with the decision-makers' journey. For instance, biases can lead to inertia — a reluctance to divest — in corporate decision-making just like non-emotional factors such as entanglements or tax considerations. Bringing biases, emotions and cognitive factors (such as overconfidence, status quo bias and confirmation bias) into our conscious decision-making is critical. They affect the timeliness and objectivity of decision-making, trading off long-term shareholder value for near-term security or comfort.

Executives aspire to be rational decision-makers. They leverage data and processes to structure assessments and make decisions. Regardless, gut instinct and biases pervade decision-making and impact outcomes that are often at odds with rational and optimal shareholder value decisions. Our study identified very clear examples that directly impacted outcomes for companies. Understanding them provides a roadmap through the decision-making process, making it important to watch for information that gives you a sense of what influences you. The more you're aware of your own biases, the more intentionally you can drive decisions.

Overconfidence

Overconfidence can lead management to believe it can improve the performance of a noncore business. Despite recognizing the fit signal and conducting a rigorous decision-making process, executives often try to fix the business based on the belief that they can turn things around. Our regression analysis found that executive overconfidence and hubris leads to delays in a decision to divest. This commits additional capital to a lower ROIC business and delays the inevitable divestiture, which may further erode shareholder value.

"One problem is the over-optimism that certain times management and the operators can turn things around," said an executive at a media company. "Every year, we do a strategy. Every year, we have some five to ten big things that will turn around the business."

"There are probably very few businesses that are willing to concede that they can't improve an asset. I think that most businesses have a tendency to let problem businesses go on for way too long," said an executive at a medical technology company.

Status quo bias

Humans often resist change, even when it's in their best interest, and executives aren't immune. Status quo bias — a preference for keeping things the way they are — shows up as management's reluctance to initiate strategic change, such as by ignoring a fit signal. If you're not committing more capital to a business, staying the course may seem safer than making the optimal decision to divest, with loss aversion prevailing over improving value and reallocating capital. At the 2022 PwC Deals Exchange, Cass Sunstein, a specialist in behavioral economics, observed, "Conservatism can be very wise, but it can also lead to a systematic bias in the direction of retaining a course of action that, while not catastrophic, is inferior to something that would be better. And status quo bias helps explain why organizations often get stuck in patterns that it would be good to revise."

We found real-world examples of this during interviews with executives. Take the experience of an executive at an industrial company:

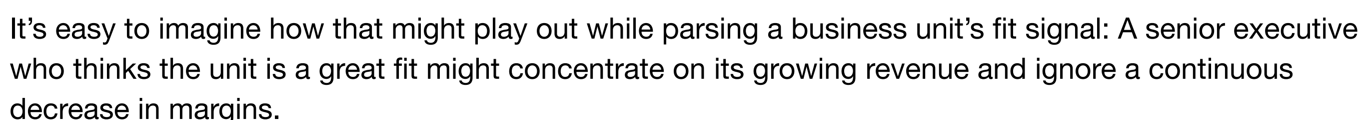
"And even if we have to sell it, let's wait for two or three years. Fix it. Improve the financial performance and sell it at a better price compared to what we can sell at this point of time. That's one of the factors and might be, at least in my mind, the biggest factor in terms of their decision-making and the time that goes on."

An executive at a manufacturing company described examples he's seen of status quo bias: "You're like, OK, can we survive this? Is there something we can do to innovate or cost-cut our way out of it? So you do try a number of things internally to repair the business. And then after you string enough of those losses together — and they do have to be annual losses — and then if you happen to get a win in between, God help you, it stretches it out again."

Confirmation bias

New information can be inconvenient, especially if executives have a formal portfolio review process. Confirmation bias plays into a management limitation to seek out new information that could impact the trajectory and speed up decision-making. Neuroscientist and author Beau Lotto observed the strength of confirmation bias in eye-tracking research that he's conducted. "You'll actually look for information to confirm what you think to be true already, because to have that challenge will actually increase your stress," he said.

"And if I show you data to show you that you're wrong, and if you tied your identity to that, you're actually more likely to believe what you already believe. I've just shifted you to faith because you have no empirical evidence. And once you shift someone to a faith base, you can't shift their view."



It's easy to imagine how that might play out while parsing a business unit's fit signal: A senior executive who thinks the unit is a great fit might concentrate on its growing revenue and ignore a continuous decrease in margins.

Regret and loss of prestige

Emotions clearly play a key role in decision-making, whether executives realize it or not. Emotional elements were the second most prevalent theme in our interviews, and two prominent themes emerged: regret and loss of prestige.

Regret and loss of prestige are both particularly powerful motivating factors. Management's emotional attachments to certain business units or team members can create anticipation of regret with a decision to separate. Divesting a business unit also may be interpreted as a tacit admission that previous management decisions were a mistake.

An executive at a healthcare services company provided a theoretical example of regret.

"I've spent 20 years of my career building up something, and now you're going to sell it off?" the executive said. "There's absolutely a personal sense of ownership or attachment, and there is the fear as well."

While a new owner can be a better fit and provide the business with more attention and resources, C-suite leaders can still be ambivalent about divesting. "There are some folks that just can't see through that business decision," said an executive at an industrial products company. "They roll by their emotions more than they do their need to have this business running for future generations."

Loss of prestige — where divestitures are perceived as embarrassing for management with internal or external stakeholders — is another important emotional consideration. Bigger is often assumed to be better, and anything that cuts revenue, headcount or size is seen as a step back.

Mitigating human nature

So what can executives do to overcome human nature beyond understanding these implications exist? Consider status quo bias, which increases resistance to considering a divestiture. Designing a formal, persistent portfolio review process can help nudge executives into regularly examining the business unit's fit in the parent company.

Confirmation bias might detract from the quality of the portfolio review. Consider how reviews factor in a cost-benefit analysis that shows the return on the divestiture compared to the costs associated with disentangling the business. Comparing the TSR for keeping the legacy company compared to selling it and reinvesting the proceeds into a core strategy also could help alleviate confirmation bias.

Additionally, the company's board could make capital allocation and reinvestment alternatives a standing agenda item, opening the aperture for the potential divestiture's proceeds to create value. Together, this can help company leadership focus on the better use of capital, while managing emotions and biases.

Portfolio review factors

Executives must navigate both inertial aspects and individual emotional elements that influence decision-making. The research identified a number of process factors that have the greatest effect on decision-making, including formality, comprehensiveness, board governance role in portfolio review and a reinvestment plan that can impact the decision to divest.

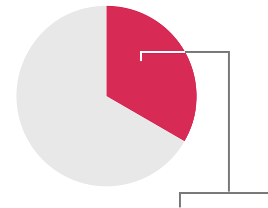
Formality (frequency)

Companies often recognize the fit signal as part of a portfolio review/annual operating planning cycle. Almost all survey respondents said they conducted formal portfolio reviews. But the thoroughness of the formal reviews — including their frequency and standardization, or lack thereof — varies considerably.

Review processes ranged from low formality, relying on infrequent ad hoc analysis, to the highly formal process based on an annual plan, updated quarterly or more frequently, and including thorough, standardized analysis.

“We don’t have a formal portfolio review process,” said an executive at a media company. “We have that on the growth side, but on the divestiture side, we don’t have a regular cadence of reviews around which businesses we would divest.”

Those with reluctant attitudes toward divestitures also had a less formal portfolio review processes than those firms that actively embraced divestitures.



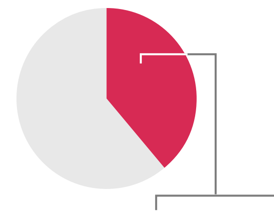
Just over **1/3** of survey respondents reported having a formal and standardized portfolio review process

The power of portfolio renewal and the value in divestitures, 2023

Comprehensiveness

Companies analyze a range of data sources in their portfolio reviews. Too often, though, companies rely solely on historical financial data. A robust portfolio review includes analytical data combining both historical and nonfinancial information, as well as an analysis of the current and future competitive environment, including potential market adjacencies.

The relationship between the comprehensiveness of the data and decision-making is mixed. Higher levels of analytical comprehensiveness are shown to increase the likelihood that companies will consider and decide on a divestiture.



Only 39% of survey respondents reported having a robust and comprehensive portfolio review process

The power of portfolio renewal and the value in divestitures, 2023

The degree of analytical comprehensiveness impacts decision-making

In considering divestitures	In deciding to divest
The likelihood that a company will consider a divestiture is 45% higher when that company has a comprehensive analytical approach to portfolio review.	Among companies with revenue in excess of $1 billion, the likelihood of ultimately deciding to divest is 60% greater when there is a robust, multi-faceted approach to portfolio review.

An interesting related finding was that for companies with revenues in excess of $1 billion, a more comprehensive review process actually tends to lead to a lengthier decision-making process — which suggests more is not better. Companies would benefit from carefully designing their portfolio review process to avoid analysis paralysis.

Board governance

According to the survey, 88% of respondents say their board is involved with the portfolio strategy review process at least annually, but the frequency ranged from ad hoc to yearly.

The research shows that the degree of board involvement in the strategic portfolio review process has a significant positive impact on the likelihood that companies consider divestitures. Board involvement also accelerates the execution process.

Where boards have significant impact

Considering a divestiture (divestitures in your DNA)	Decision speed	Announcement speed
For companies with boards that participate in the portfolio review process several times per year, the likelihood that those companies will consider a divestiture is three-and-a-half times greater than those with boards that participate once per year or less.	When boards are involved in portfolio review more than once per year, the probability that a decision to divest will take fewer than six months increases 21%.	When the board is actively engaged with management in divestiture decision-making, the probability of a divestiture announcement taking fewer than six months is 17% higher compared to when the board has limited involvement.

An executive at a medical technology company said of his board, “They were brought along through the process, and their feedback was taken very seriously along the way and incorporated, before it actually got voted on for approval. So the board was very, very impactful in shaping the outcome.”

Reinvestment plans

Business units that lack fit divert capital and resources that would create more long-term value if those resources were nurturing strategic fit. Divesting releases capital that can be reinvested in more strategic initiatives possessing higher returns on capital.

The more robust a company’s plans for reinvestment as part of a portfolio review are, the more likely the company will decide to divest at least annually. Nearly 60% of companies that executed a divestiture reported having a reinvestment plan for the proceeds at the time of the initial divestiture decision. This is also where active board involvement demonstrated its utility: When the board is involved in the decision-making process, reinvestment plans are closely linked to an initial divestiture strategy.

Based on our experience, the lack of a reinvestment plan can inhibit companies from deciding to divest. Absent a reasonable alternative, executives are more susceptible to status quo bias and the urge to fit or fix instead of free a business. An example highlighted by a manufacturing executive pointed out that companies' analysts will typically focus on the use of proceeds if no plan for them is announced. "You have to balance growth and appearance to investors," the executive said. "Just because you divest them doesn't mean you will have appreciation that investors have a clear story of what you will do with the proceeds."

The likelihood that a company will decide to divest at least once per year is shown to be **65%** higher when a reinvestment plan was a key aspect of the initial divestiture decision.

Value traps

Almost 30% of companies took more than a year to announce the transaction after their decision to divest. Over 25% of those companies took more than a year to close the deal.

Once the decision to divest is confirmed, it's full steam ahead with the execution process. The company has likely laid out a timeline and will begin to orchestrate a series of separation objectives that impact all levels of the organization. This is one of the most critical times in the divestiture journey, as delays during execution can lead to lower TSR and, based on our experience, lower deal value.

The research shows that the less time that elapses between the decision to divest and the announcement of a divestiture, the more likely there will be a positive TSR. Yet, **more than 75% of survey respondents report experiencing major delays during the divestiture execution process.**

Shareholders, board members, analysts and potential buyers have expectations around the estimated timing of an announced transaction. But delays impacting execution are common. The study sought to understand some of the common themes for delays from the time a divestiture decision is made to the time the transaction actually closes.

Below are the top areas causing major delays in the execution process — both revealed in the research and consistent with our experience. Executives should remain aware of these value traps to confirm an appropriate mitigation plan is in place wherever possible to help avoid delays and get a deal done at optimal value.

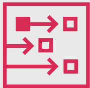
Roadblocks delaying getting the deal signed	Big rocks that created most delays during execution	Top areas identified for improvement during the separation process
Competing corporate initiatives	Tax and legal entity structuring	Separation management office (i.e., governance and project management)
Expectation gap in price	Managing stranded costs	Reducing stranded costs and improving RemainCo
Lack of in-house separation expertise	Business process and systems separation	Business process and systems separation
Buyer identification and contract negotiation	Audited carve-out financial statements	Contract separation

Source: The power of portfolio renewal and the value in divestitures, 2023

Value traps can be controlled and mitigated. Experience with divestitures has been proven to be a differentiating factor in the outcome achieved. Building the team to do so includes both experienced company resources and engaging the right external advisors to mitigate execution risk and increase speed to market.

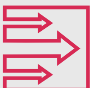
Making divestitures part of a company's DNA

Building the right processes, mindset and infrastructure for divestitures takes time. Organizations have to overcome existing divestiture stigmas and change their thought process. Delaying that process can be costly, as holding on to non-core assets will continue to dilute shareholder value. A sale shouldn't be thought of as a last resort; organizations should incorporate divestitures as part of their strategic plans the same way they do for inorganic expansions. Below are recommendations to help companies make divestitures part of their DNA.



Periodically conduct an objective and thorough portfolio assessment. This should be a continuous process and a key component of annual strategic planning activities. Identify biases that may exist and review the five assessing fit questions every cycle to help provide objectivity. And remember, leading companies regularly share the portfolio analysis with their boards and bring them into capital and resource allocation conversations.

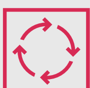
Establish value as a common denominator. Most traditional portfolio reviews evaluate the revenue and margin contribution of the businesses to the overall organization. When considering divestitures, it's important to look at future cash flows that take into account the revenue growth, margin and capital required. Looking at the future and using value as a common denominator gives you an objective view of performance directly linked to shareholder value. By contrast, traditional metrics can just reflect one point in time and often miss the shareholder value view of the equation. When evaluating the portfolio, it's important to consider the intrinsic value contributed or eroded by each business unit.



Overcome the stigma of divestitures. Divestitures start with tone at the top. Short-term size and scale issues, typically cited in the survey as reasons for "trying endlessly to fix what is broken," as well as allocated budgets shouldn't hinder long-term value creation. Executives should be compensated for driving overall shareholder value as opposed to being incentivized based only on a particular business or segment performance.

Develop robust analytics that help identify the fit signal. Companies often lack the management information systems and data to really understand what is happening with a business. It is difficult to evaluate a business unit's performance with no understanding of what is happening at a granular level.

Determine which metrics are right for each business. Companies often apply the same performance metric across very diverse businesses. Not all businesses should be measured by the same ruler. For instance, managers of a business in a fast-growing space should focus on revenue growth while a business in a low-growth space should focus more on profitability and margin. Successful companies not only have the systems and data to measure timely performance but the right metrics as well.



Establish a process to act quickly once the fit signal is identified. Decisive companies tend to capture more value than slower ones. There are many value traps embedded into a divestiture process and the faster a company can tackle them, the better.

Conclusion

Divestitures are a critical component in an executive's value creation toolbox. They allow a management team to more effectively allocate time and capital by moving on from businesses for which their company is not the ideal owner. Being proactive in portfolio reviews and having divestitures in your DNA are key components of the winning formula. Speed also is an important component in both the portfolio review and execution processes. By understanding the forces that cause delays, executives can move faster, helping to improve their chances for creating value and positioning the company for strategic success.

Acknowledgments

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We wish to thank our colleagues Natali Dobbs, Christy Conklin and Sonu Balwani for their contributions to this research.

Research methodology

We adopted a mixed methods research approach that combined quantitative and qualitative elements.

- Interviews with 29 high-ranking corporate decision makers, including board members, CFOs and corporate development executives.
- An online survey of 2,566 corporate decision makers fielded in July and August 2022. All respondents were from companies with $100 million or more in revenue and had at least two business units. The survey excluded the financial services and government sectors. The survey results were then subject to statistical analysis to derive key results.
- Regressions on the survey data in which we analyzed responses across roughly 175 individual survey questions that measured (among other things) sentiment toward divestitures, market conditions and company profile characteristics as well as the execution, timing and business outcomes of divestitures. To draw inferences around the drivers of divestiture execution, timing and outcomes, we leveraged leading practice in logistic regression modeling to identify meaningful predictors along with measurement of the magnitude to which these drivers impacted divestiture activity.
- Historical analysis of past divestitures to test value creation using a third-party data vendor.

How PwC can help

Executives should constantly evaluate their business to determine how each business unit, product or brand's performance aligns with corporate strategy.

Our PwC deals strategists can help you create value, whether by crafting corporate strategy, assisting with portfolio assessment, freeing a non-strategic asset or improving an underperforming asset's performance. If your strategy is to ultimately free a business, our unparalleled separation approach reduces complexity and extracts maximum value. PwC's human-led, tech-powered approach uses data-driven insights that detect risks and opportunities at deals speed. It helps you make better decisions significantly reducing internal disruption and maximizing value for you and your shareholders.

Strategy

Portfolio assessment and deal strategy: How does your current portfolio fit with your strategy and contribute to overall shareholder value? Are you continuously assessing your portfolio to understand where you should invest, harvest or divest to maximize value? Our deal specialists use a mix of data-driven methodologies to create an objective assessment to assist you with portfolio strategy.

Separation execution

Separation management office: Developing the proper momentum up front across workstreams is crucial. PwC can help coordinate enterprise-wide divestiture efforts and manage dependencies in support of the deal team and executive management. Our separation management office is more than just project management. We combine strategic perspective and disciplined execution management to align objectives and drive value while leveraging technology that translates into real-time, data-driven decision-making.

Tax structuring: Understanding the corporate strategy and underlying legal and regulatory requirements is critical to designing and implementing a legally viable and tax efficient transaction. PwC can help you create the most optimal tax structure while navigating compliance complexities.

Business diligence: Management needs to analyze a divestiture from a buyer's point of view to identify risks and opportunities that may impact value before buyers conduct their own diligence. Learn how to better identify a business's value drivers and analyze the quality of earnings, stand-alone costs and other operational details.

Separation execution (cont.)

GAAP carve-out financial statements: Carve-out financial statements are usually required for regulatory purposes and/or financing, and stakeholders will often want to bridge this information to the deal financials. Even when not required, buyers and sellers gain more confidence when deal financials are anchored to statements. Carving out entangled businesses from disaggregated data sources adds more complexity. But PwC has proprietary technology to automate this process and help reduce execution risk while limiting business disruption.

Separation plan: Working with your core separation team, we develop detailed plans covering pre- and post-Day 1 separation points so you can manage critical Day 1 risks and actions, as well as key steps to establish the standalone capabilities. We provide a structured implementation approach that adapts to your needs, enabling effective management of the separation.

Human resources and organization design: Who stays with RemainCo and who goes with DivestCo? How can you maintain productivity through a disruptive divestiture process? Our HR and change specialists know that transparent communications ensure everyone can move as smoothly as possible through this transition.

Technology roadmap: IT is the most complex area for many divestitures. PwC has built a world-class global team of IT divestiture professionals with experience executing large and complex divestitures. Our teams have both industry and IT domain expertise in applications, infrastructure, organization/operations model, cyber, cloud and much more. We have pre-defined future state IT architectures that help enable cost-reduction, minimize one-time cost, expedite transaction close, reduce TSAs and enhance deal value.

Transition service agreements (TSAs): Identifying transition services required by either the seller or carve-out business after close is crucial to any successful exit strategy. Our depth of experience provides valuable insights around separation strategy, including reducing TSA.

Transformation

Stranded cost reduction and transformation: Our Fit-For-Growth Approach focuses on delivering sustainable value by fundamentally helping you rethink how your company creates value. We can help you make strategic choices about cost management, capability development and organizational and cultural evolution to drive transformative performance improvement.

Operations transformation: Should you decide to “fix” your underperforming businesses, PwC can help you reimagine your operations strategy, systems and processes to drive transformation.

Managed services: PwC’s managed services deliver strategic business operations across the enterprise. Shifting strategic business operations to PwC increases your ability to focus on accelerating your organization’s priorities.

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