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Navigating the New Reality: Restructuring for Growth

The transformational changes of the past year have turned restructuring into a value-creation opportunity

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Strategy& perspective on situation, winning strategies for businesses and key trends

Contacts

Strategy&

Amsterdam
Mahadeva Matt Mani
Partner and Global Leader
Transformation Platform,
PwC Strategy& Netherlands
+31-6-22-79-19-63
matt.mani@pwc.com

Düsseldorf
Dr. Peter Gassmann
Global Strategy& Leader and
Global ESG Leader of PwC,
PwC Strategy& Germany
+49-170-3890-470
peter.gassmann
@strategyand.de.pwc.com

PwC

Munich
Thomas Steinberger
Partner and Head of Business
Recovery Services and
Automotive Transactions,
PwC Germany
+49-1511-4264076
thomas.steinberger@pwc.com

Frankfurt
Dr. Joachim Englert
Partner and Head of Advisory,
PwC Germany
+49-151-1427-571
joachim.englert@pwc.com

About the authors

Mahadeva Matt Mani is a Partner at Strategy& Netherlands and advises executives on organization cost and productivity transformation. He works with companies across industries to help them align their business operating models with their strategies, and to achieve significant organization cost and performance benefits.

Thomas Steinberger is a Partner and Head of Business Recovery Services and Automotive Transactions at PwC Germany. He has broad experience in the execution of complex restructuring projects. For the last 15 years, he has specialised in distressed supplier situations in the automotive industry.

Dr. Peter Gassmann is the Global Strategy& Leader and Global ESG Leader of PwC. He leads the European Financial Services Practice and has many years of practical experience in the financial sector with management positions at several national and international banks.

Dr. Joachim Englert is a Partner and member of the Management Board of PwC Germany as well as the Head of Advisory. His areas of expertise include digitization, restructuring and advising companies and lenders in crisis situations.

The authors would like to thank Bastian Lux, Director with Strategy& Germany, and Tobias Baumer, Manager with Strategy& Germany, for their valuable contributions to the study.

Executive summary

The transformational changes of the past year have turned restructuring into a value-creation opportunity

Covid-19 is testing European economies and industries to the limits of their resilience. While hitting some harder than others, the ongoing pandemic revealed multiple weaknesses. However unlikely such a crisis seemed – and it is always difficult to prepare for the unknown – businesses have no choice but to tackle today's challenges head-on and strive to emerge stronger. This puts restructuring and transformation at the top of the agenda, and not only for the companies most affected by Covid-19.

Restructuring has been viewed in the past as a sign of failure. The economic and social turmoil in 2020 however made company leaders across industries see restructuring as a tremendous opportunity to reshape their business for a new era. This makes fundamental transformation an imperative for many, as it can tackle gaps that are difficult to address and that have been accumulating well before the crisis. It can be a powerful tool to set the foundation for more sustainable growth in the future; including enabling companies to repay loans needed to make it through the pandemic.

To successfully re-set businesses for growth, any change program needs to be carefully researched and thought-through. It will not suffice to cut costs across the board, or to invest without cutting sufficiently. Rather, companies must carefully assess all available options, and then take concrete action.

To understand how executives respond to business disruption and the extent to which companies are planning to transform, we conducted a global survey. We asked executives across 11 industries in North America, Europe, the Middle East, Africa (EMEA), and the Asia-Pacific region how they expect the global economy to develop, and what they think this means for their business development and renewal strategy post Covid-19. Although a majority of 60% believes economic conditions will improve over the next 12 months – with 50% expecting their company revenues to grow in 2021 – leaders also foresee big changes coming up.

In total, 4 out of 5 executives anticipate their companies will transform within the next three years in terms of how they operate and/or what they do to create value for customers. The main focus is on developing new digitally-enabled business models and adapting operations for resilience. For some sectors, this includes jobless growth, as well as a significant shift in investments and cost allocations – cutting costs across real estate, human resources and marketing functions, while investing in the areas of technology, cybersecurity and sustainability.

The good news is that executives are very much aware of the key drivers that are likely to dramatically reshape the way most of the world's companies do business. In our overarching report "Navigating the New Reality", we elaborate on the following four key trends:

1. The dramatic acceleration of digitization

2. The growing importance of environmental, social and governance (ESG) goals to foster sustainability and to create value

3. The strong impetus to localize operations

4. Increasing adoption of new ways of working that enable flexibility and collaboration

We believe these trends will be the differentiators in terms of building future resilience. Given how crucial they are to almost any sound business model, executives should not lose track of these trends when developing their transformation agenda.

Combining the capacity to rebound from a short-term crisis and to achieve middle-to-long-term resilience through restructuring is no easy task. But nor is it a Gordian knot. In this report, we will outline recommendations for successfully developing and executing a value-based restructuring plan, including preparing for a more digital, sustainable, localized future, underpinned by new ways of working.

"2020 upended even the most well-prepared business plans – and the uncertainty is set to continue. The pandemic and its consequences have highlighted needs and opportunities for longer term transformation. But your business also has to weather the difficult months ahead. Government support has been a lifeline for many businesses, but it won't be extended indefinitely. Businesses need to prepare now for when these measures are scaled back. The coming months will also see an end to debtor protections, rent freezes and tax deferrals. That's going to heighten the pressure on cash positions that are often already under strain."

Peter Gassmann
Global Strategy& Leader and
Global ESG Leader of PwC

SECTION 1

European market overview

On a country level, multiple factors slow down the recovery in Europe, compared to the US or China: To begin with, sectors hit hard by the pandemic make up a sizable part of European economies, for instance travel and tourism, or automotive. The European financial services sector is also more exposed to the crisis than its counterparts in the US or China; due to its relatively smaller size, lagging digitization, and closer connection to countries and sectors particularly affected by the crisis. Because the EU Recovery Plan has yet to have an impact on the ground, countries with limited capacity for fiscal stimulus (such as Italy and Spain) are not recovering as fast as their peers with deeper pockets (such as Germany).

Compared to the US or UK, the recovery in Europe has also been delayed by the later start of its vaccination program, and also by higher Covid-19 incidence rates in contrast to China.

On a sectoral level, the Covid-19 pandemic has hit some businesses much harder than others. As waves of the pandemic unfurled across European economies and industries, the gap is wide between those countries being hammered, and those benefiting (*see Exhibit 1, page 5*).

This divergence can be described as a **K-shaped recovery**, with some sectors and countries enjoying a strong rebound, while others continue to founder. Our prognoses draw upon analyses and insights from more than 180 research institutes and other academic organizations (find out more in our methodological paragraph below).

EXHIBIT 1
GDP growth rates across key geographies 2021-2023

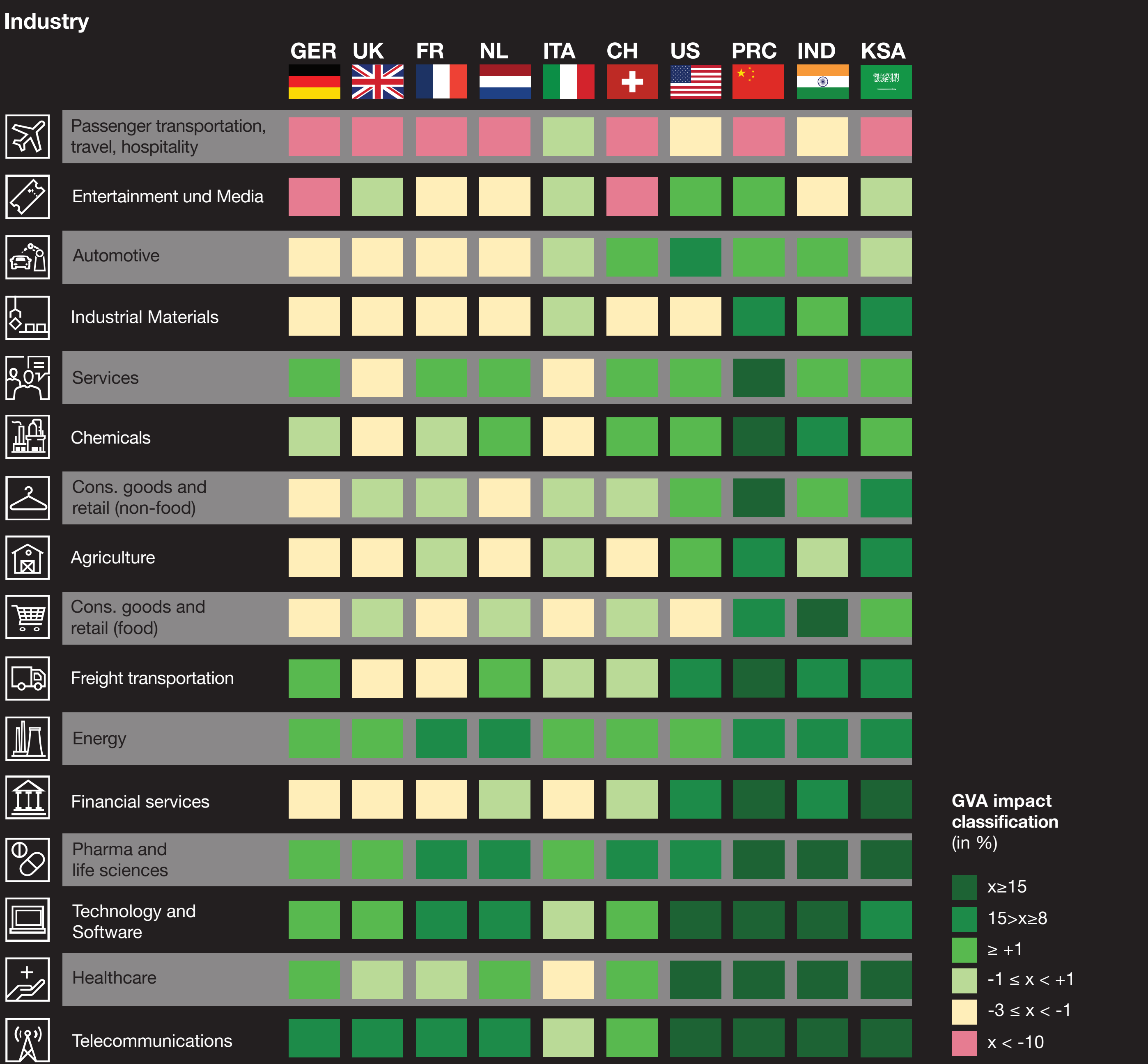
	EU[1]	GER	UK	US	PRC	IND	KSA
2021	3.4	3.3	4.0	4.5	7.8	5.0	2.3
2022	3.7	3.7	5.6	5.2	8.3	10.2	4.8
2023	2.2	2.4	2.3	3.5	4.3	7.4	2.1

1 AT, DE, FR, IT, NL, PG, GR, SP
Note: GER = Germany; UK = United Kingdom; US = USA; PRC = China; IND = India; KSA = Saudi Arabia
Source: Economist Intelligence Unit (Base scenario); Strategy& analysis

Across Europe, there is a growing need for restructuring and fundamental transformation, especially in the industries which have been affected most by the pandemic. Passenger transportation, travel and hospitality, as well as entertainment and media, find themselves in the lower half of the 'K'. But the need for forward-thinking, proactive, and timely strategies in order to emerge stronger from the crisis is equally important for sectors in the upper half of the K-shaped economic outlook (*see Exhibit 2, page 6*).

EXHIBIT 2

Covid-19 cumulative impact overview for 2020-2023



Note: GER = Germany; UK = United Kingdom; FR = France; NL = Netherlands; ITA = Italy; CH = Switzerland; US = USA; PRC = China; IND = India; KSA = Saudi Arabia

Source: Strategy& analysis, IHS Markit

"There are huge differences in the ways sectors are impacted. And even within sectors, there are big differences in how companies are affected, depending on their starting points. There clearly is a rising need for restructuring and fundamental transformation, but there is no one-size-fits-all solution. In each case, the discussion needs to center around where value is in the company, or how it can be generated going forward. Executives need to ask themselves: How can restructuring help remove business segments or product groups that don't have the potential to generate value going forward and protect value, or value potential, in other areas?"

Joachim Englert
Head of Advisory, PwC Germany

Technology and telecommunications companies, for example, are expected to continue their strong performance – at least for now. But they are affected by the four key trends mentioned above just as much as other sectors. Additional challenges to the telecommunication and technology sectors come from clients accelerating their digitization and from the global shortage of semiconductors since early 2021 – needed for making consumer goods like smartphones, for making cars, and for manufacturing industrial equipment such as trucks. These challenges reveal areas where operational overhaul is urgently needed.

Companies active in passenger transport, travel or hospitality will likely be further affected by the impacts of Covid-19. Together with the entertainment and media sector, those sectors are set to be a drag on economic growth across regions. The automotive sector, conversely, now appears to be on track for growth despite being one of the most-impacted industries last year. In general, the impact of Covid-19 varies greatly between sectors. The vast majority of sectors, however, can expect solid growth through 2023.

From an investor's perspective, the timing is good. Private equity houses have ample funds on hand to invest and are therefore well-placed to finance a deals-led recovery, and to help fund investments that enable businesses to keep pace with fast-changing customer needs and seize the opportunities ahead.

"The current crises provides value- and capability-based opportunities for private equity investors. Value-based opportunities exist in countries and sectors hit hard by the pandemic, for instance travel and tourism. Making investments at low valuations, investors can realize capital gains from recovering prices in the subsequent recovery. Conversely, firms can benefit from capability-based opportunities by acquiring targets with skills or capacities complimentary to their existing portfolio – increasing the value of the firm as a whole."

Teresa Schawe
Partner, Strategy& Germany

SECTION 2

Transforming, like never before

The wave of restructuring and fundamental business transformation we are about to witness will be unlike anything we have seen before. Gone are the days of focusing exclusively on financial key performance indicators (KPIs) and aiming to survive until the next financial rebound. Now, it is becoming ever more important to reconfigure the business model when implementing restructuring efforts. The objective is to right-size the business for today and fundamentally reposition it towards new business and growth areas. Executives thereby need to overhaul their enterprise's strategy, capabilities, and culture. Moreover, as the various teams and departments of a company are likely to be affected differently by current and future changes, each aspect of operations is likely to have different restructuring needs.

To understand companies' readiness to address the needed restructuring, we surveyed around 250 senior executives from large, global corporations across a variety of industries and based in North America, EMEA and Asia-Pacific during March 2021, regarding the outlook for their business and specific plans for renewal post Covid-19. The results showed three key insights:

1. Companies plan for growth - and there is a significant increase in the importance of transformation on their agenda

Executives across industries are optimistic about the future, with 60% expecting economic conditions to improve over the next 12 months. Most companies have adjusted to the pandemic, but uncertainty about possible new waves of infection weighs on their future outlook. Beyond financial concerns, the primary operational risk identified is around cybersecurity – well above concerns about levels of consumer demand or supply chain disruptions. Overall, around 50% of respondents expect revenues to grow in 2021, while around 25% expect them to remain stable. Aerospace, industrial products, and non-food retail executives are the most pessimistic: 38% of respondents in those industries expect revenue to decline further. These expectations are in line with the sector forecasts in our scenario model, as particularly retail and industrial products are expected to stagnate in the immediate future.

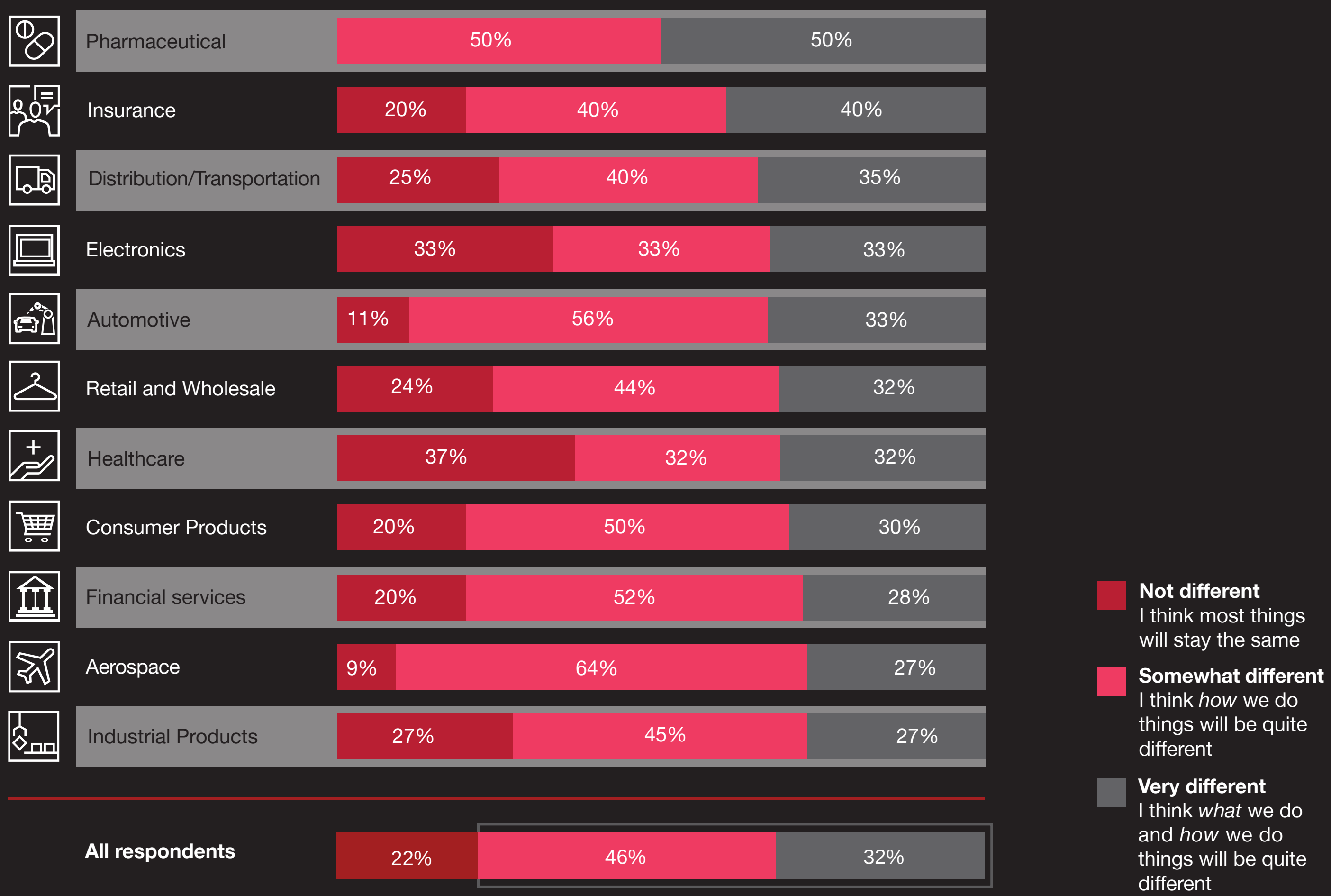
At the same time, most companies see the need to transform substantially. Four in five executives expect their companies to change in how they operate, and/or what they do to create value for clients. And even more than 30% expect to rethink their future company strategy and revisit their value creation plan in light of changes to the industry and markets (*see Exhibit 3, page 10*).

While a quarter of companies have started to reconfigure their businesses, most other companies are still in an early stage of thinking how they can navigate the massive transformation ahead.

60% expecting economic conditions to improve over the next 12 months

EXHIBIT 3

Executives' future outlook on their companies



Question: How different do you expect your company to be 3 years from today compared to pre-Covid-19 times?
Source: Strategy& Restructuring and Transformation Survey, March 2021

2. The primary focus is on building new business models and adapting the operating model to compete with new digitally-enabled capabilities in the future

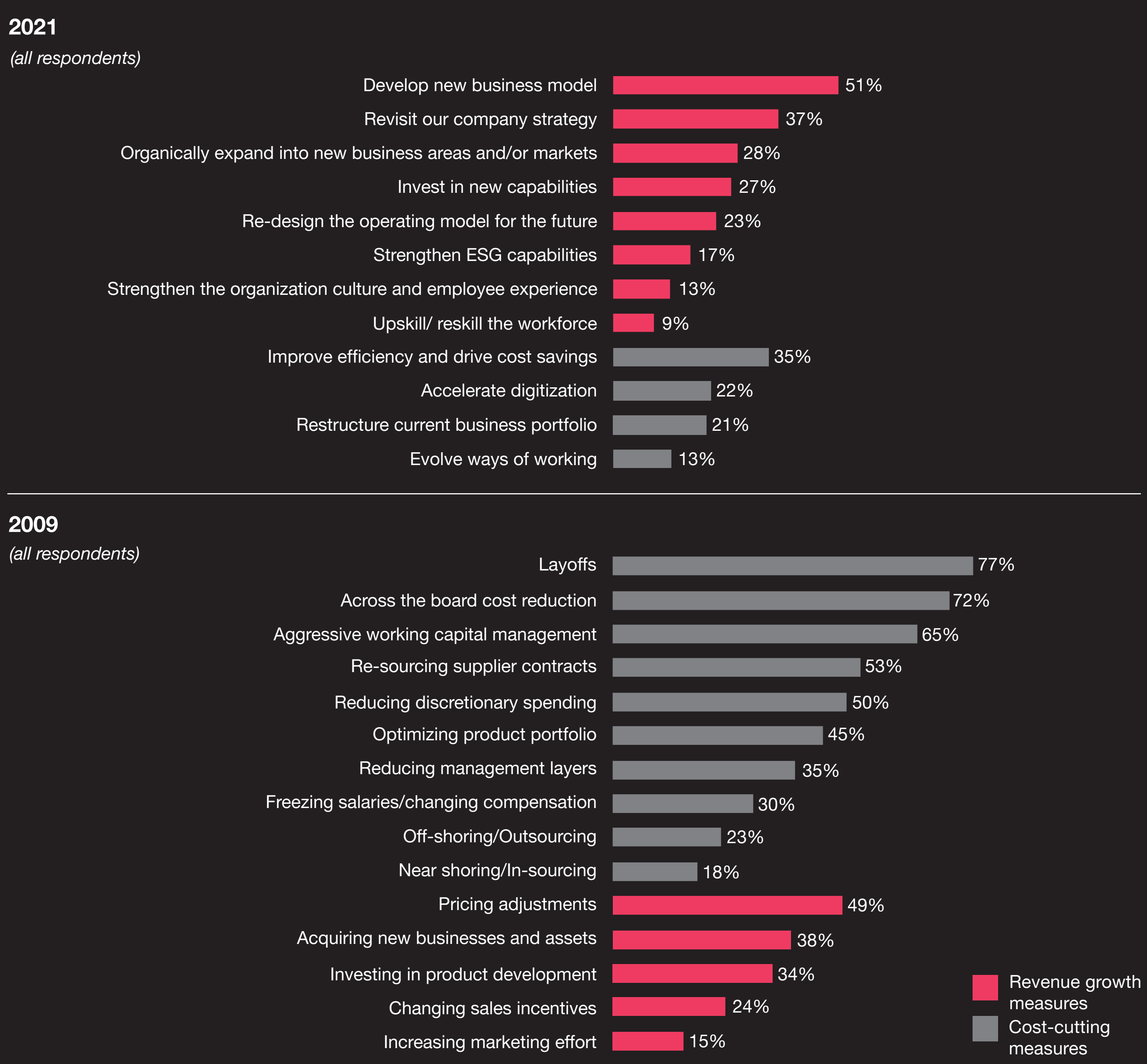
Unlike in previous crises, the pandemic has accelerated the need to fundamentally transform the business in response to a new reality. Measures to boost revenues are most critical, with developing new business models and revisiting the company strategy being the top priorities.

Additional investments of 10-15% go primarily into digitization, cybersecurity and sales to drive top-line growth. Digital investments are primarily focused on developing new products and services that can be integrated with digital business models. This contrasts with, for instance, the Great Recession of 2008/09, when plunging consumer demand and tightening access to finance made companies home in on cutting costs instead of growing their revenues (*see Exhibit 4, page 12*).

“Even before Covid-19, there was a need for businesses to fundamentally restructure to succeed in a more digital and disruptive age. Many companies we work with were already implementing pre-pandemic 'transformation' programs to adjust to rapid digitization, as well as political, social, environmental and other changes. They were evolving their business models, cutting costs, divesting legacy assets and scaling up new technology-enabled business models for future profitable growth. Covid-19 has now become a supercharger for this type of transformation. In that sense, the current environment allows a historic opportunity to reset and generate significant new value - with stakeholders now more willing to support a transformation program, assuming it is done right.”

Mahadeva Matt Mani
Partner and Global Leader Transformation Platform, Strategy& Netherlands

EXHIBIT 4
Strategic priorities 2021 vs. 2009



Source: Strategy& Restructuring and Transformation Survey, March 2021; Strategic priorities recession response survey 2009

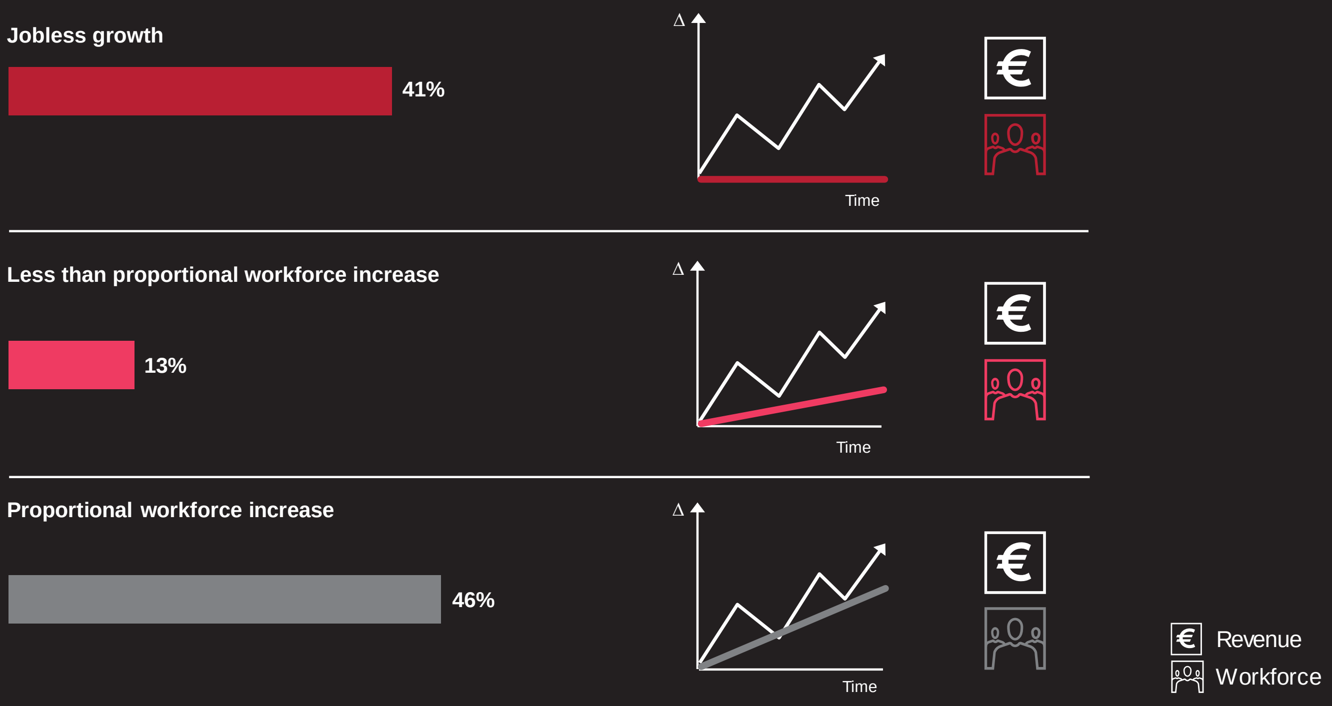
3. Efficiency goals are limited – they are focused on people and business operations, while being enabled by technology

The changes described above imply jobless growth in some industries, as well as a significant shift in the allocation of investments and costs. The aim is thereby to cut costs across functions that are not essential to the future strategic positioning, while investing in areas considered crucial for the firm's success. Companies in our survey are planning to reduce costs across the board up to an average of 11% per function, with the deepest cuts in real estate, research and development, marketing and human resources (*see Exhibit 5*).

The impact on employees will be significant: 37% of companies expect workforce reductions, and the share is even higher among companies with a pessimistic revenue outlook. Conversely, more than 40% of the companies with a positive revenue outlook expect growth without increasing their headcount. This is especially true in the automotive, transport and pharmaceutical sectors. The focus of investments is on IT and digital capabilities (15% of companies), cybersecurity (11%) as well as environmental and health and safety functions (11%).

EXHIBIT 5

Correlation between revenue growth and workforce increase



Note: Respondents with optimistic revenue outlook
Source: Strategy& Restructuring and Transformation Survey, March 2021

Clearly, while respondents see an improving economic situation over the next 12 months, major changes and transformations are high on the corporate agenda. The companies that emerge from the pandemic will be significantly different from those of pre-Covid-19 times. To adapt and emerge stronger, here are three recommendations:

1	**Do not expect a return to the past, but revisit your strategic priorities**	Rethink your future strategy and business model. Look at what is driving your industry and revisit the value creation plan in light of the changes to the industry and markets.
2	**Invest in digitization and ESG as key drivers for growth and to reset costs to new benchmarks**	Leverage digitization and smart ESG investments to implement a new way of working and to develop new business models in line with your revised strategy. Keep pace with new cost benchmarks post Covid-19, and look for areas where you can outperform.
3	**Bring your people with you into the new way of operating**	Make them partners in the process of change – especially in light of the impacts on the workforce, the expansion of digitization, increasingly automated ways of working, and the transition to an 'Office of the Future' – combining both remote and in-office working.

SECTION 3

Value-based restructuring for growth

Previous crises clearly show how companies that act boldly and early emerge stronger and better-placed to prosper in the aftermath. However, too many companies cut costs indiscriminately in order to survive, weakening their capacity to rebound. Others chase deals and investments to boost their valuation. This type of "traditional" restructuring almost always ends up destroying value and saps the organization's energy and morale at the most inopportune time.

Instead, value-based restructuring offers a quick and effective model to strike the right balance when cutting costs and to establish a strong path for sustainable and profitable growth. It is based on a four-step approach (*see Exhibit 6*):

EXHIBIT 6

Value-based restructuring approach

Step 1

Start with a value perspective

Establish a clear position on where and how value will be created in the future vs. how you create value today. Which products/solutions, markets and customers add profitable value and which do not? Use this clarity to guide your investment choices.

1

Step 2

Simulate future profit scenarios to set the right targets

Static top-line assumptions no longer work to plan for the new normal. Modeling different scenarios holistically builds agility and the ability to respond to the next disruption into the plan.

2

Step 3

Zero base the affordable cost structure, differentiated for each business segment

Make "eyes wide open" choices about where to invest, where to cut deep and where to tread water in a way that is aligned with your value perspective.

3

Step 4

Do the work across the value chain

Get to work in every area of the business – including both **what** you do and re-aligning **how** you innovate, produce, sell, serve and deliver. This is not just a one-time exercise of cutting costs. To truly emerge in a position of strength you will need to challenge every part of the business, and transform the organization to enable savings and make the results stick.

4

Source: Strategy& analysis

Step 1: Start with a value perspective

The starting point is to really understand the value each segment of the business is creating for customers today and how that will evolve in the future, given the likely changes in the market. This is a fundamental step, because it is clear that for many businesses, the future will be unlike the past. Covid-19 has dramatically changed the structure of demand and consumer behavior, and some of these changes – such as accelerated digitization, remote working and localization – are more than likely to outlive the present crisis. In this environment historical benchmarks are practically useless. Now is the time to restructure the whole operation, guided by a view of where value will be created. You need to dig deep and really understand the business and its opportunities. A recent client in the technology industry approached this issue by asking two questions: "Which segments will create most value / profit in the future?" and "Where will cash be generated?"

To gain first insights, they performed a portfolio analysis by business segment (product categories, regions, customers). They quickly found that while some segments contributed lots of value, many actually lowered the margin. In addition, they looked at their industry and market trends, then took a bold position, relative to rivals, on the promising future value propositions and revenue models. With a solid understanding of this value baseline, they drew up initial proposals to deliver substantial cost reductions without harming necessary investments in areas important for the future. This was achieved in a disciplined six-week cycle designed to drive them to make tough decisions.

Step 2: Simulate future profit scenarios to set the right targets

A static restructuring approach is inadequate to prepare for the "new reality." To be successful, dynamic scenario thinking is now crucial, along with a rigorous evaluation of the prospects of promising future segments and product categories. When senior executives of an automotive supplier initiated their restructuring discussion, it was vital to obtain a clear and shared understanding of how the market was changing. The executive team developed multiple EBITDA simulations for each business segment, based on assumptions about the degree and speed of market recovery. They found across the probability-weighted scenarios that likely drops in sales resulted in a disproportional drop in margins, because costs could not be adjusted as fast as sales were falling. Understanding the variable and fixed costs associated with each segment helped determine an ambitious yet realistic and sustainable EBITDA target.

Scenario thinking was used at the onset to simulate options for the future shape of the business. They had to decide whether to restructure a specific segment for growth or prepare it for exit. These two fundamentally different starting points for planning a restructuring effort needed to be decided early on, so that they could set the right, differentiated targets for all business segments in their portfolio.

Step 3: Zero base the "affordable" future cost structure, differentiated for each business segment

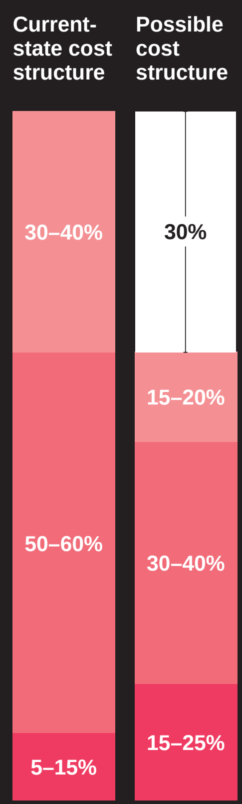
When the chief financial officer (CFO) of our technology company looked at what she could afford to invest to meet future profitability targets, she looked at the cost structure of every business segment. What was affordable differed significantly by business, depending on the value generated by the segment and its future value potential. This enabled executives to set different requirements for revenue growth and cost savings for different parts of the portfolio (business units, product categories and regions).

Zero basing the cost structure for each of the businesses helped clarify where to invest and how to pay for it. For each P&L and balance-sheet item, executives decided what was really needed, nice-to-have, or not necessary. All activities were assessed and re-built in terms of costs and number of staff (full-time equivalents/FTEs) based on the following classification (*see Exhibit 7*):

EXHIBIT 7

Framework for zero-basing the cost structure

Category	Suggested action
Not required Legacy investments and activities that no longer support the go-forward strategy	**Eliminate**
"Lights-on" Bare minimum activities needed to "keep the lights on" in the business	**Aim for cost levels below competition**
Table stakes/entry ticket Basic competencies / activities required by everyone to participate in the industry	**Cut cost to keep a "good enough" quality** **Warning:** What you thought was differentiating may now be table stakes
Differentiating activities Activities that provide you with a competitive advantage and/or are needed for future differentiation	**Invest at levels above peers to gain a competitive advantage**



Source: Strategy& analysis

Step 4: Do the work across the value chain

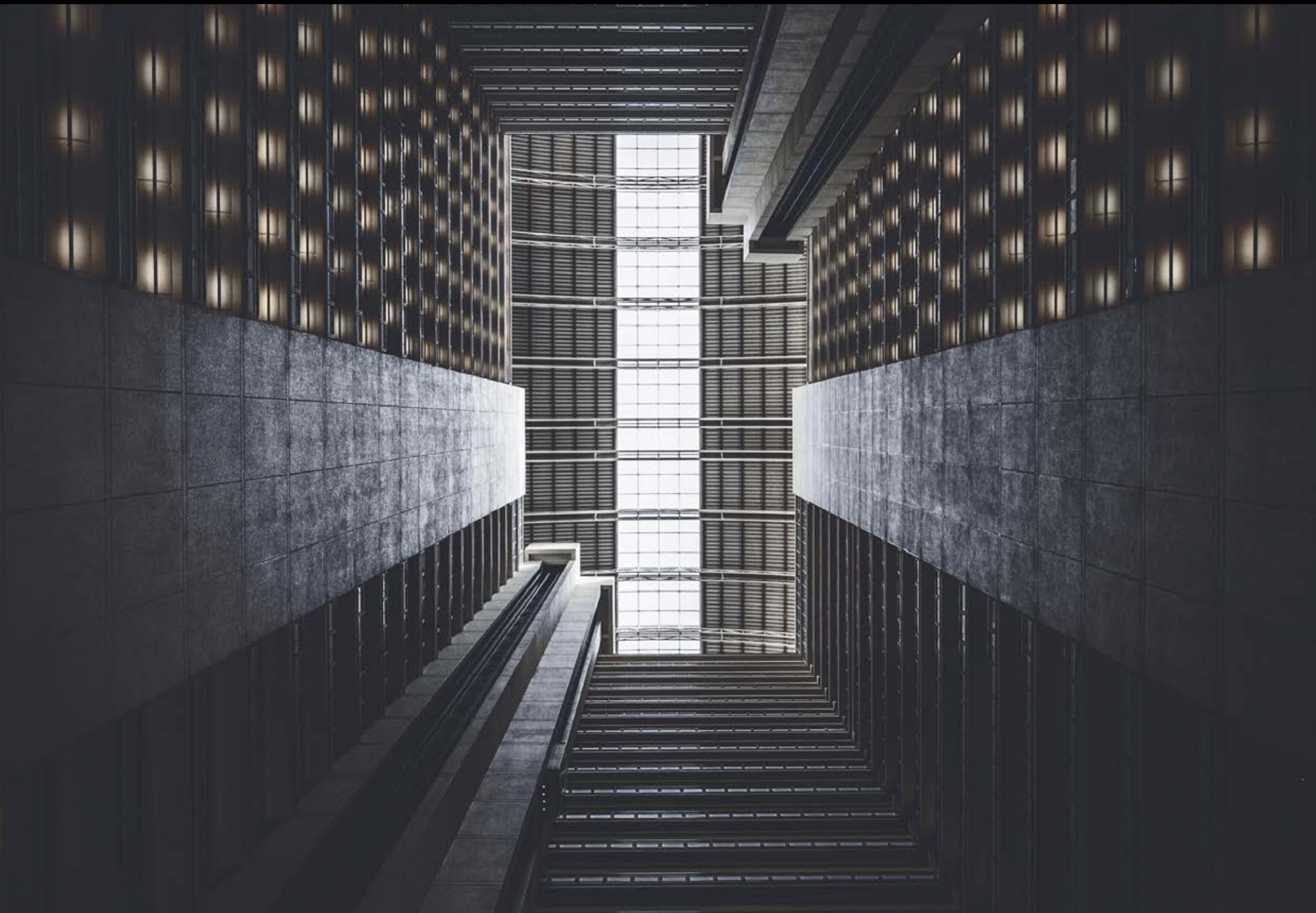
Every element of value creation needs to be worked on in this exercise. No stone can be left unturned – including sales, pricing, production, manufacturing costs, logistics, R&D and G&A functions. Management needs to roll up its sleeves and re-design both what work is done and how it is done. Merely ordering budget cuts and behavior changes won't be enough. Real changes must happen on the front line and shop floor, and need to be embedded through organization levers to ensure lower cost levels are sustainable.

We often find that value creation workshops that involve both management teams and front-line employees in defining and specifying actions can deliver tangible change and value more quickly. Our experience shows that hands-on involvement gets the organization engaged and even excited about the restructuring process, helping everyone feel accountable for achieving a better future, rather than being subject to circumstances and management choices.

> “Although automotive suppliers are undoubtedly better placed than they were during the financial crisis in 2008, with higher cash reserves and better access to loans, we are already seeing an increase in the need for restructuring in the sector in Europe as a result of the economic damage caused by the pandemic. For these restructuring initiatives to succeed, resulting in meaningful change in ways of working and putting the business back on a sustainable growth path, collaboration between suppliers themselves, the OEMs they work hand in hand with, labor unions, finance providers and shareholders, is essential."
>
> **Thomas Steinberger**
> Partner and Head of Business Recovery Services and Automotive Transactions, PwC Germany

Conclusion

Restructuring and transformation need not be feared. Each of the companies we worked with in the examples above emerged stronger from their restructuring. One increased its valuation eight-fold. Value-based change processes can be a powerful lever to unleash organizational energy and create a sustainable, exciting and profitable future. If you find yourself at a corporate crossroads arising from rapid change in your industry or markets, business transformation is a journey we invite you to consider closely.



Methodology

Strategy&’s Covid-19 economic scenarios are based on a consensus of analyses that incorporates more than 180 sources and predictions (including from global research institutes, universities, investment banks, national governmental and supranational bodies, and ratings agencies), as well as financial data on 40 million corporations globally from 35 countries and 16 industries. Estimates according to the V-, U- and L-shaped scenarios at a country and industry level predict a K-shaped pattern as certain economies and sectors diverge. The scenarios have been updated regularly since March 2020.

Strategy&’s Restructuring and Transformation Survey was conducted in March 2021 among senior representatives of ~250 unique companies globally, well balanced across 11 industrial sectors in North America, EMEA and Asia-Pacific. 93% of respondents reported revenues of more than $1Bn, with 64% reporting that they have 10,000 or more employees.

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