SPLIT PERSONALITY

TURNING END-OF-LIFE PRODUCTS AND ASSETS INTO A BUSINESS

Mechanical injection pumps for diesel engines saw a rapid decline in the first years of this century, as tighter emissions regulations drove a need for more advanced fuel monitoring. As a result, one leading maker faced rapidly declining demand and margins on its US and European operations. Normal practice would have been to stop making them.

Instead, manufacturer moved the mechanical pump business to its Indian entity. The firm transferred all manufacturing equipment, and made the unit fully responsible for production, sales, engineering support, and the overall business case. Given this entrepreneurial freedom, the Indian entity found new markets for the pumps, which could now be manufactured at a lower cost. The European and US operations, freed from producing mechanical pumps, focused on advanced electric-injection pumps.

The aging of products and operational assets that require large, up-front investments can be a drag on performance. As a product nears obsolescence, volumes decline, resulting in a diminishing yield from manufacturing facilities, supply chains, and overhead, such as sales and engineering centers. When margins decline too far, production is halted. But a smart alternative is to split off operations of the end-of-life product into a separate entity. That creates revenue potential from assets that would otherwise have been sold off or shut down – and it produces a revenue stream from customers that wouldn't have existed.

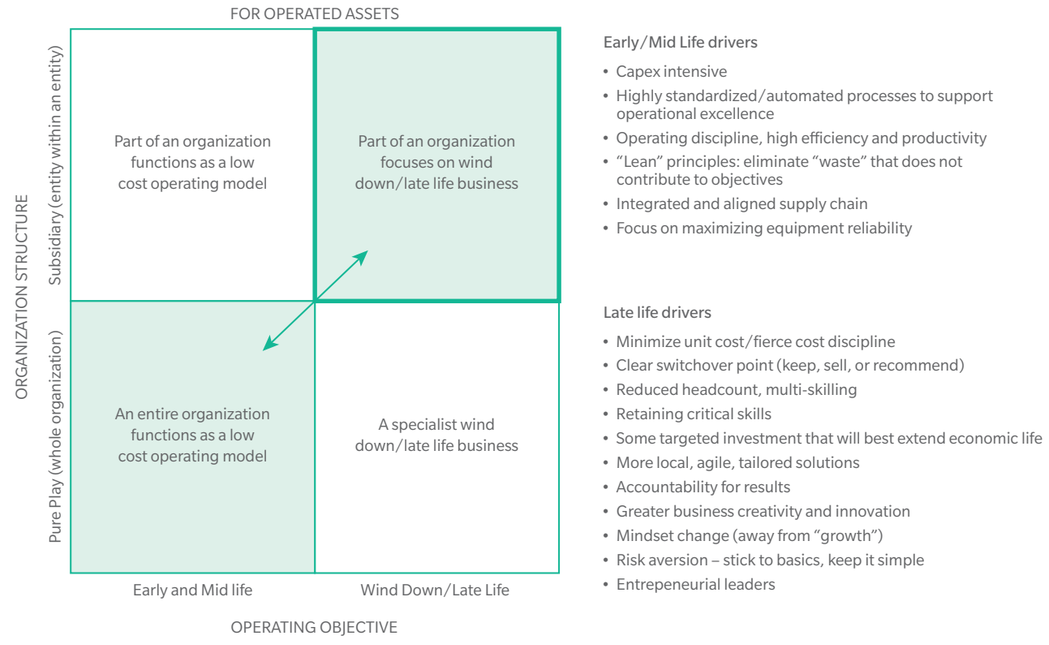
OLD ASSETS, NEW IDEAS

Late-life businesses are tricky, lower-margin setups, so they need to follow several imperatives. First, since they cannot charge a premium for their products and growth prospects are often limited, they have to focus on efficiency and cost reduction, and to streamline their operations. That means a low headcount – and multiskilled staff – and simplified operations and administration, while maintaining quality standards, which often is totally different from the original operation. Advanced, efficient manufacturing techniques such as flexible production setups are also important. To do this effectively calls for a world-class supply chain.

Most importantly, the late-life entity needs to be designed with great care so that it and the main company do not disrupt each other's businesses. While the new entity might take advantage of the existing distribution network, it needs to be clearly differentiated so that it has a distinct personality visible to employees and customers. Especially important is a clear switch-over point where the late-life unit takes over a product's business. Modularization strategies in the original product design will help smooth the transition from an old product to a new one, as it means products and components can be easily swapped in and out of different stages in the production process.

GENERIC DRUG MANUFACTURERS COME OUT WITH A VERSION FOR A FIFTH OF THE PRICE OR LESS

Exhibit 1: New potential from old assets
How to organize a late-life asset operation



Source: Oliver Wyman

This late-life entity also needs the freedom to decide its own strategy – targeting promising niche markets, for example – and responsibility for its results (see Exhibit 1).

One sector where the model has worked is pharmaceuticals. Established global drug giants spend vast sums on research and trials on a new drug in the hope of receiving a stream of revenues for 20 years or so while it is under patent. Once the patent expires, generic drug manufacturers come out with a version for a fifth of the price or less, annihilating the original maker's revenue stream. Some firms have decided they might as well pull in revenues from the generic market. Novartis, for example, gets a subsidiary, Sandoz, to do this. Rules of engagement between the two include a handover date when Sandoz takes over the business of a certain drug. Moreover, the arrangement enables Novartis – via Sandoz – to pursue generic versions of its competitors' drugs when they go off-patent.

In many cases, however, the late-life spinoff is not given enough freedom to pursue its own market strategy and act in an entrepreneurial fashion. It is forced to stick to established norms or rules, and is thus unable to create the independent business model required for success. Alternatively, it might not get enough focus and attention.

Few firms have decided to use the late-life operational model, and even fewer do it successfully. But if managed well, the late-life operation can provide both new revenues and lessons in streamlining for the main company: Low-cost businesses are forced to be very efficient.

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