

Cost restructuring vs. business portfolio restructuring

By

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Visibility on the global economy is currently declining, given geopolitical uncertainties and their impact on energy prices, the short- and medium-term consequences of the development of artificial intelligence, the massive industrial disruptions associated with the energy transition, and—more particularly in Europe—the persistent lack of growth. The probability of a crisis in the near term is high, and companies are anticipating it by reducing costs.

This article is a republication of a 2008 article written on the eve of the 2008–2009 crisis. The dates and some of the data have been updated to reflect the current context.

One advantage of a crisis is that it forces decision-making. What are the decisions that will differentiate winning companies from their peers by 2028?

Restructuring Costs

Restructuring costs, lowering break-even points, and being more selective in investment projects are the natural reactions of companies faced with a crisis. These responses help maintain positive cash generation, preserve room for maneuver, or simply survive.

In the case of a simple economic slowdown, they are easy to implement. In the case of a severe recession, they run into a wall. It is not possible to reduce costs by an average of 20 to 25% in an already well-managed company without fundamentally calling into question the company's business model, its portfolio of activities and geographies, its mix of customers and products, and its growth potential when the inevitable economic rebound occurs. Fundamental trade-offs must be made, requiring restructuring efforts to be differentiated according to strategic priorities.

This presupposes, at a minimum, that those priorities have been clearly defined.

At any given time, a significant portion of costs is linked to developments or renewals that one may decide to continue—or not.

These are costs or investments tied to growth in certain areas (commercial expenses, new production capacity, R&D, advertising investments, etc.), incurred ahead of the revenues they will help generate. In times of crisis, should companies chase all opportunities, or concentrate their resources on only the most promising development axes?

They are also renewal or adaptation costs (equipment, technologies, product ranges, etc.) that are necessary simply to stay in the game. In certain activities, during a crisis, it is neither necessarily possible nor desirable to continue all historical activities that one lacked the courage to restructure in the past.

Provided these costs can be identified, they can be stopped, reduced, or deferred if the company has a clear view of its strategic priorities. The impact of a highly differentiated restructuring on financial statements is significant.

Why simply cut costs in marginal, no-growth activities in which the company will never be competitive or sufficiently profitable? Shouldn't one instead start by halting renewal investments in capacity, R&D, and marketing, and attempt to maximize short- and medium-term cash generation at the expense of the long-term sustainability of these activities?

To what extent can costs, prices, renewal investments, and discretionary investments in “cash cows” be optimized without jeopardizing structural positions vis-à-vis competitors? What are the critical sizes below which one should not fall? Does size truly create strong value across all the businesses considered? Which customer, product, or country segments can be skimmed off without causing damage? Can product or service quality and value be adjusted relative to price?

And why cut commercial, industrial, and technological costs and investments in fast-growing new businesses in which the company is competitive, if these are precisely the strategic priorities that represent the company's future?

Restructuring costs using the traditional, “averaged” approach (cutting overheads, optimizing procurement, improving industrial productivity, reducing indirect costs, etc.) is a reasonable response to a normal crisis. In the case of a recession, however, relying on this form of restructuring alone is misguided, as it very quickly reaches its limits. The real response lies in restructuring the portfolio of activities and geographies. This is the only approach that allows for a strong and differentiated rebalancing of costs and margins, and that properly repositions the company in terms of competitiveness and growth as it emerges from the crisis.

Restructuring the Business Portfolio

How can the portfolio of businesses and geographies be radically restructured beyond extreme differentiation in cost reductions, authorized investments, imposed cash-flow generation, and the necessary divestments—which are always difficult and poorly valued in times of crisis?

Industry consolidation through the acquisition of struggling competitors at low prices is a classic strategy used by companies to increase their market share in certain areas or simply to reach critical scale in others.

Is it better to do this to strengthen positions in mature markets, or to continue growing and improving competitiveness in new, fast-growing markets?

The answer is simple. At equal profitability, one euro of investment is worth two to three times more to the shareholder if it is invested in a business or geography with strong growth (10–20% per year) than if it is invested in a low-growth business or geography (3% per year).

In times of crisis as in normal times, companies should invest and improve their competitiveness only in activities that deliver strong growth. Investing to correct past mistakes, or to further strengthen low-growth activities, creates little value. In mature industries, the gains resulting from industry consolidation and cost synergies are ultimately largely passed on to customers.

Company leaders naturally tend to want to build leadership positions in the businesses they entered at the beginning of their careers. This is a strategic mistake. What shareholders want is not leadership in the businesses of the past, but in those of the future.

What Kind of Recovery from the Crisis?

What will change as a result of the recession taking shape over 2026–2028? Very little. China will continue to grow through and after the crisis at 5–6% per year and will represent an increasingly significant share of major global markets (and between 35% and 40% of global manufacturing output), despite demographic stagnation. India is following the same trajectory, with a delay of several years.

The digital economy and its various components will also continue to grow, benefiting the major North American and Chinese leaders that dominate it.

The United States should continue on a trend of 4–5% growth (or more in nominal terms if inflation increases). Europe will continue its structural underperformance at 2–3% per year since 2008, with no real growth (0–1% per year excluding inflation).

Within these Western markets, legacy businesses, products, and services that have reached maturity will face even greater competitive pressure and declining prices and margins. Conversely, certain businesses or niches will grow at 10–20% per year for longer or shorter periods, with attractive margins—raising questions about those that rely primarily on government subsidies (which are not sustainable in Europe). Which ones will these be?

With few exceptions, 70–80% of the revenues of large Western groups today come from low-growth businesses and countries (1–3% per year). Only 20–30% of revenues are generated in high-growth businesses or countries (8–15% per year). As a result, their average growth rate rarely exceeds 3–5% per year, below—or at best equal to—the average growth of the global economy (around 5% per year).

Which groups will be able, through and beyond the current crisis, to significantly alter this balance?

Conversely, what will be the value of companies that, through industry consolidation in mature markets, further increase the relative weight of low-growth activities in their portfolios?

The real issue must not be misunderstood. Long-term value creation for shareholders is not possible without growing significantly faster than the overall economy. Cost reductions are essential but insufficient. They provide the means to continue financing the company's growth, but they do not indicate how to accelerate that growth. In any case, their impact is limited if the business portfolio is not fundamentally reshaped.

Maintaining or increasing competitiveness is also unavoidable. It is not solely driven by cost reductions—and it is worth two to three times more in growth activities than in mature ones.

The only real challenge during and beyond the crisis is growth and its financing.

The winners will be companies that significantly and competitively reposition themselves in high-growth businesses and/or countries over the long term.

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Estin & Co is an international strategy consulting firm, with offices in Paris, London, Zurich, New York and Shanghai. The company assists senior executives of major European, North American and Asian corporations with their growth strategies, and managers of private equity firms with the analysis and valuation of their investments.

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