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Mergers, Alliances, Networks and Reconfiguration Strategies

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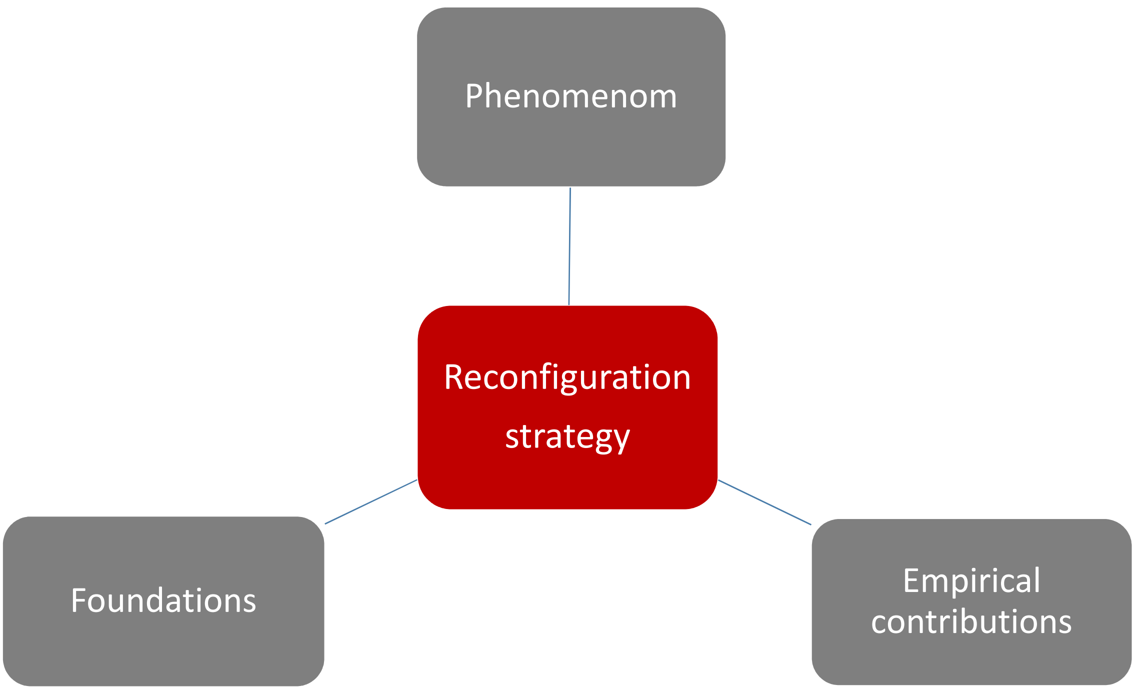
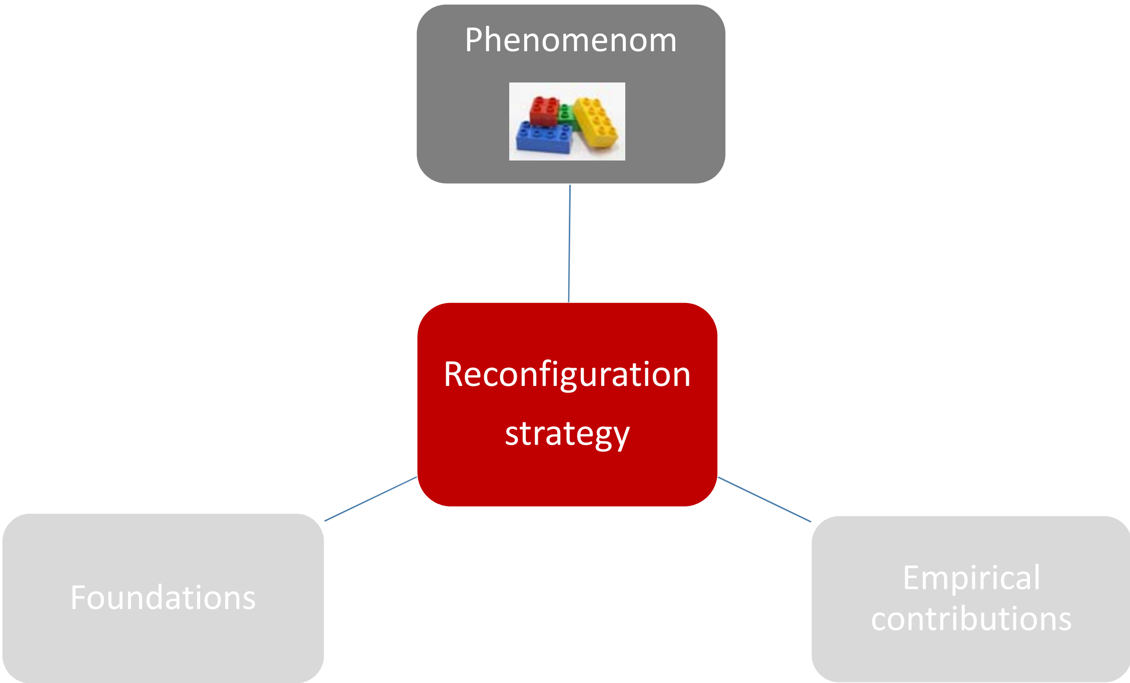




Reconfiguration: Definition

- **Stylized fact in Strategy**: To grow successfully and survive in their competitive environment, firms have to alter and align their resource base with their decisions to expand, retrench or innovate (Teece, 2007; Helfat, Finkelstein, Mitchell, Peteraf, Teece and Winter, 2007; Eisenhardt and Martin, 2000; Helfat and Peteraf, 2014).

- To alter their resource base, firms have to engage in **reconfiguration activities by which they add, redeploy, recombine, or divest resources or business units** (Karim and Capron, 2015)

Resource Redeployment
Business Reconfiguration
Patching
Knowledge Sourcing and Grafting
Resource Recombination
Strategic Assembly
Business Unit Reorganization
Corporate Restructuring
Structural Reconfiguration

Illustration: Danone’s *Health through Food* strategy and Reconfiguration

Divestiture *of indulgent category businesses*

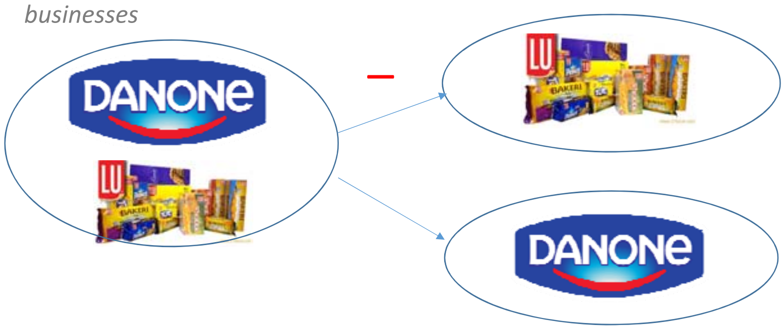
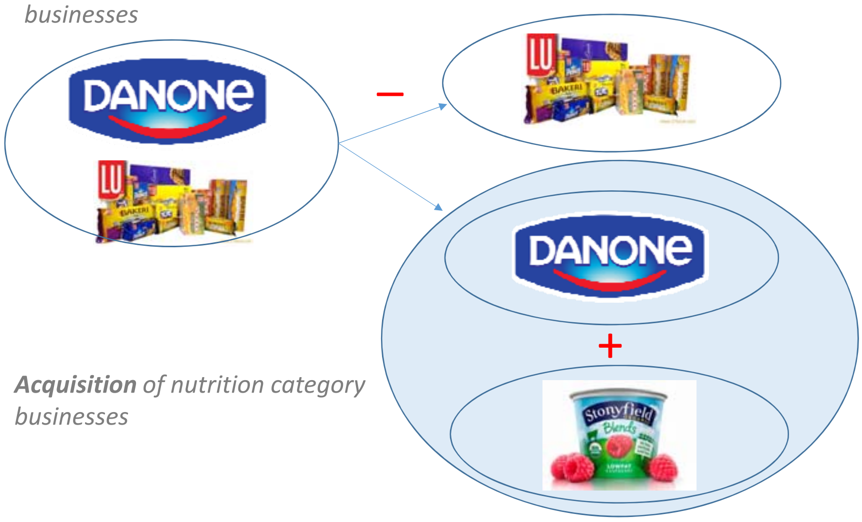


Illustration: Danone’s *Health through Food* strategy and Reconfiguration

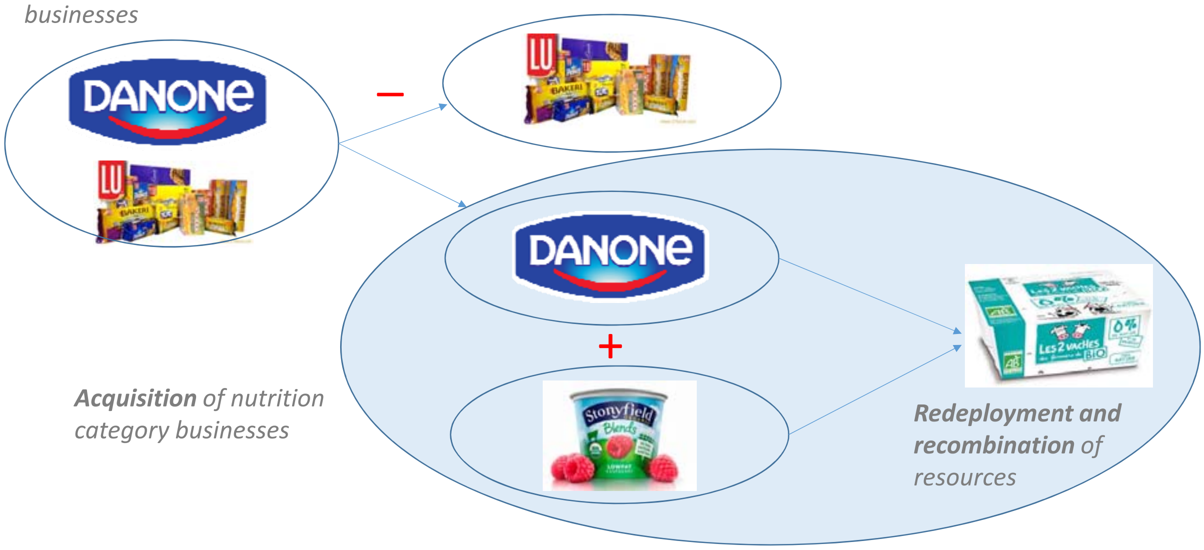
Divestiture *of indulgent category businesses*



Acquisition *of nutrition category businesses*

Illustration: Danone's *Health through Food* strategy and Reconfiguration

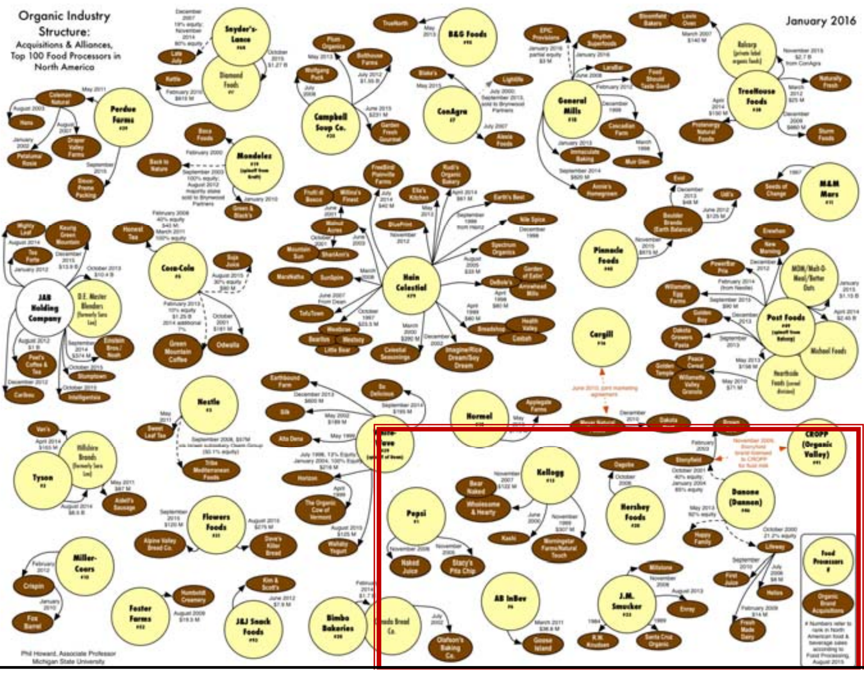
***Divestiture** of indulgent category businesses*



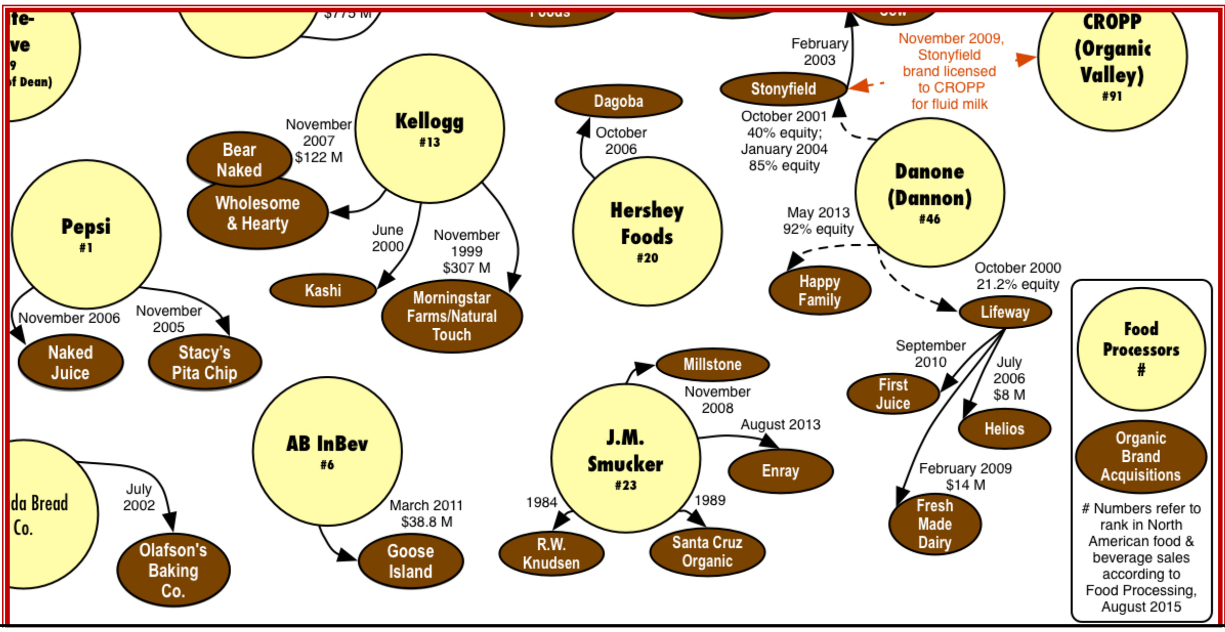
***Acquisition** of nutrition category businesses*

***Redeployment and recombination** of resources*

Illustration: Building organic nutrition capabilities



M&As, Alliances, Networks: Tools for reconfiguration



Three main modes of reconfiguration

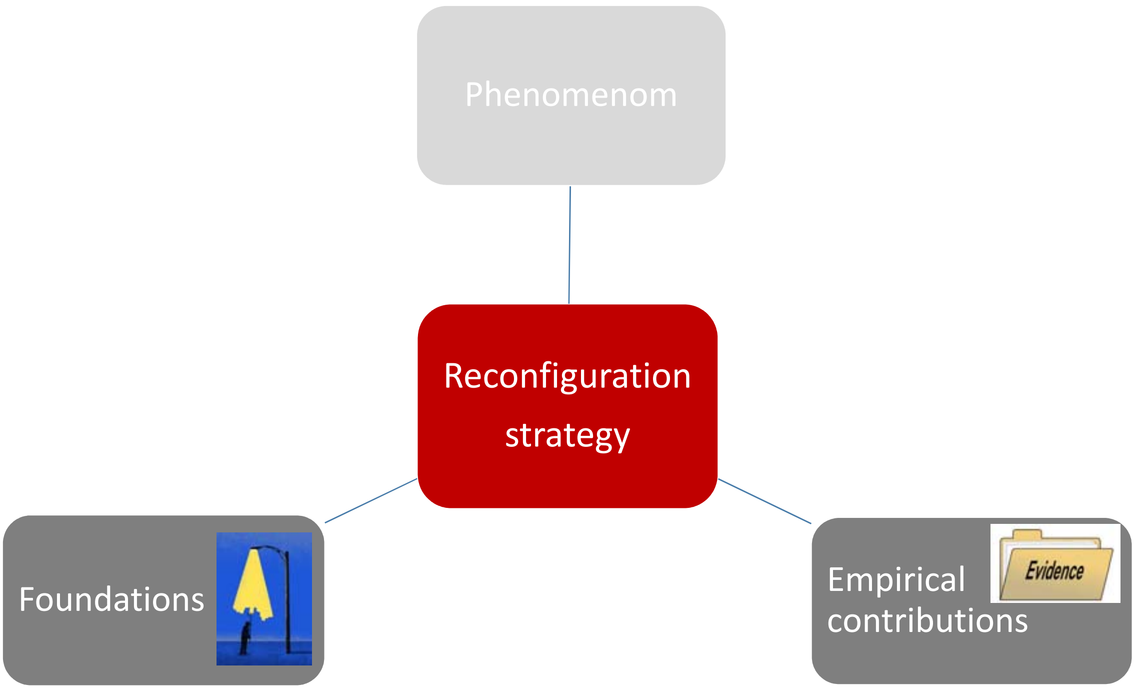
Non-organic reconfiguration modes

Growth	Internal development	Licensing, alliances, JVs	Mergers & Acquisitions
			
Retrenchment	Internal restructuring	Divestiture JVs	Selling assets/shares

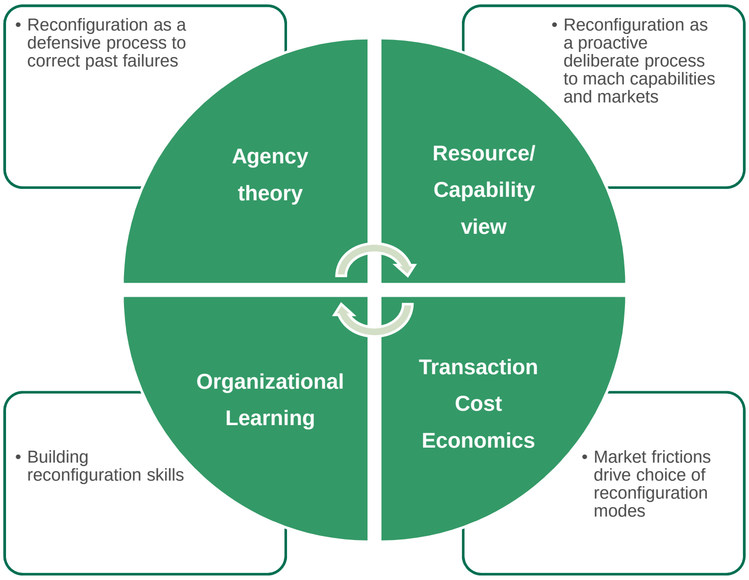
- **When expanding its scope**, firms grow through M&As and alliances to overcome the limitations associated with its internal development such as time or local search constraints.
- **When contracting its scope**, firms divest through sell-offs, spin-offs and JVs to overcome the limitations associated with its internal restructuring such as time or institutional constraints.

Reconfiguration: Core research questions

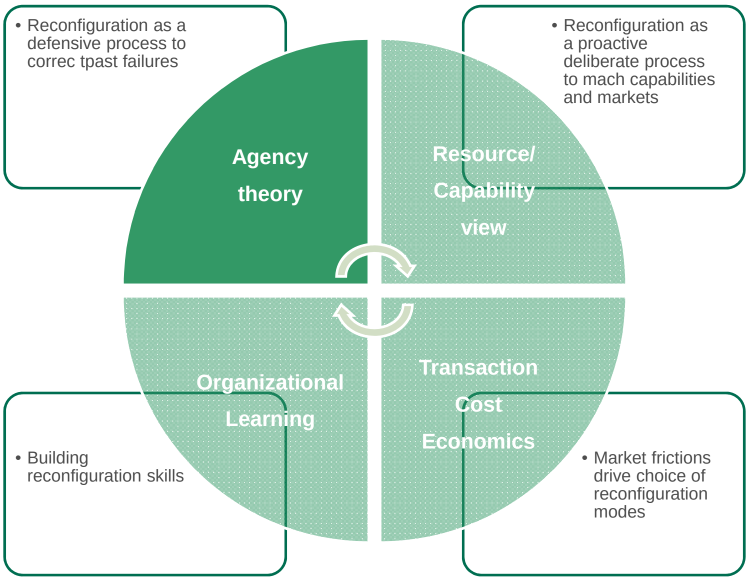
- What drives reconfiguration?
  - Role of entrenched managers vs. economic drivers
  - Drivers of reconfiguration for growth vs. retrenchment
- Which modes of reconfiguration to choose?
  - Choice between use non-organic reconfiguration modes
  - Choice between full acquisition vs. alliances
- How to reconfigure (and learn to reconfigure)?
  - Managing reconfiguration process
  - Building reconfiguration skills



Foundations and Empirical Contributions



Foundations and Empirical Contributions



Agency theory (finance literature) view on reconfiguration

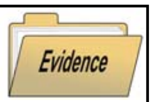
Why to reconfigure?

Premises:

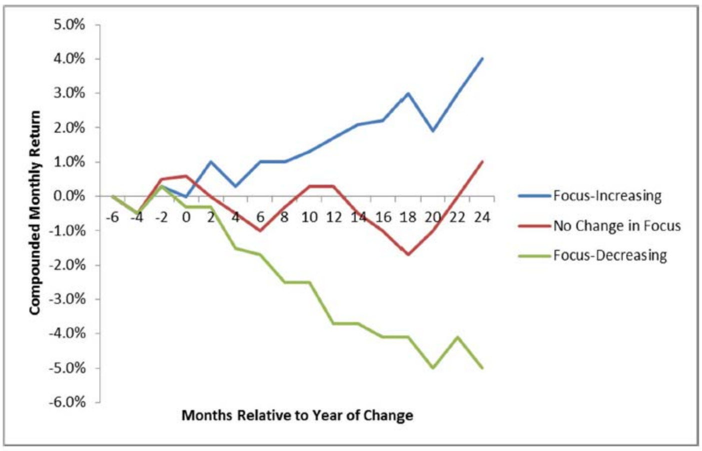
- Empire building/entrenchment motives for pursuing growth reconfiguration (through M&As)
- Growth reconfiguration process is flawed due to:
  - Inefficient internal markets for resource allocation
  - Information asymmetry between managers and investors/analysts
  - Lack of managerial focus and expertise

As a result, reconfiguration strategies to **downscope** the firm are seen as SOLUTIONS to PROBLEMS.

Agency theory (finance literature) view on reconfiguration



✓ The benefits of focus



Source: R. Comment & G.A. Jarell, 1995. 'Corporate Focus and Stock Returns", Journal of Financial Economics

Agency theory (finance literature) view on reconfiguration

✓ Divestitures increase stock market performance

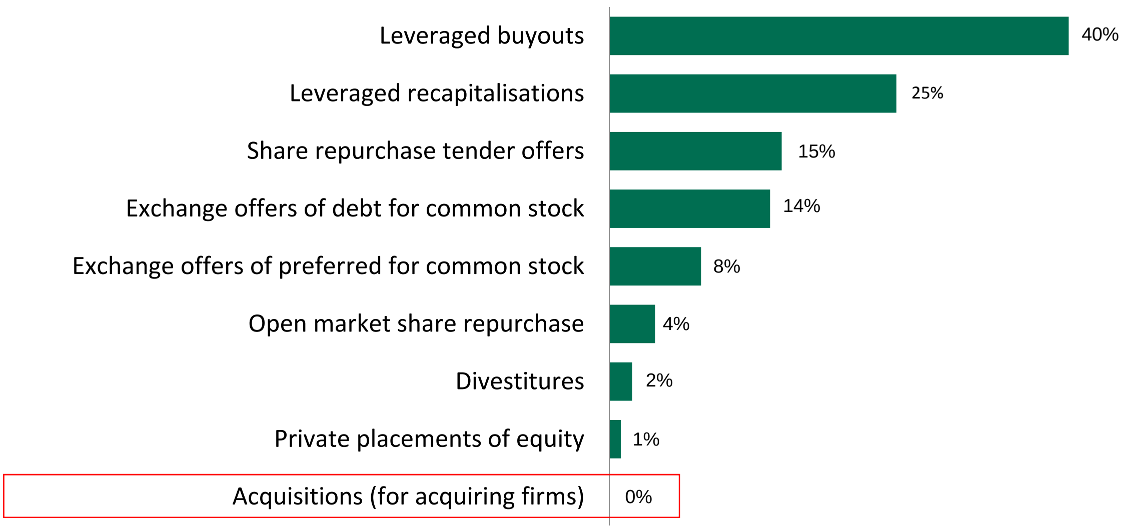
Divestitures (Spinoffs and Sell-offs)		Acquisitions	
Study	**CAR to Divestor**	**Study**	**CAR to Acquiror**
John, Ofek (1995)	+1.5%	Asquith, Bruner, Mullins (1987)	-0.9%
Comment, Jarrell (1995)	+2.2%	Bradley, Desai, Kim (1988)	+1.0%
Daley, Mehrotra, Sivakumar (1997)	+3.4%	Lang, Stulz, Walking (1989)	+0.0%
Krishnaswami, Subramaniam (1999)	+3.2%	Servaes (1991)	-1.1%
Desai, Jain (1999)	+4.5%	Kaplan, Weisbach (1992)	-1.5%
Bergh, Johnson, DeWitt (2008)	+4.7%	Mulherin (2000)	+0.9%
Feldman (2014)	+1.7%	Mitchell, Stafford (2000)	-0.2%
Feldman (2015)	+2.7%	Houston et al. (2001)	-3.5%
Average	**+3.0%**	**Average**	**-0.7%**

Source: Literature review performed by E. R. Feldman, 2015

✓ Divestitures as correction of acquisition mistakes

The shareholder value hit parade

Average share price response to announcement of:

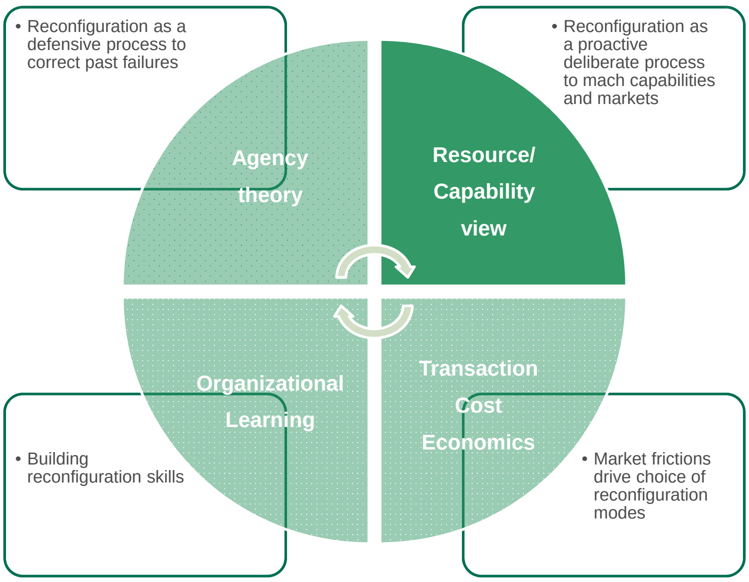


Acquirers’ poor returns persist over time

	Event window	Acquirer returns (across studies)	Number of studies	Sample size
Stock market returns	>180 days-3 years	-10%	103	25,205
	>3 years	-7%	26	5,966
Return on Assets	1-3 years	-2%	29	31,010
Return on Equity	1-3 years	-2%	14	1,790
Return on Sales	1-3 years	-3%	9	14,660

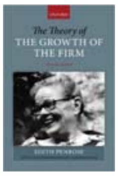
Source: King, Dalton, Daily & Covin (Strategic Management Journal, 2003

Foundations and Empirical Contributions



Capability-view on reconfiguration

Why to reconfigure?



Premises:

- 1959: Penrose
- A firm is a **collection of productive resources** where the choice of different resources uses is made by managerial decision.
- Through experience comes **excess capacity in firm-specific knowledge** and resources that are **subject to market frictions**. Therefore, the firm seeks to expand in directions that will allow the utilization of these excess resources.
- Because of excess resources, firms have to redeploy their resources into new uses

>>> Exploitation of (intratemporal) **economies of scope** (Teece, 1980; Panzar & Willig, 1981)

Capability-view on reconfiguration

Why to reconfigure?

Premises

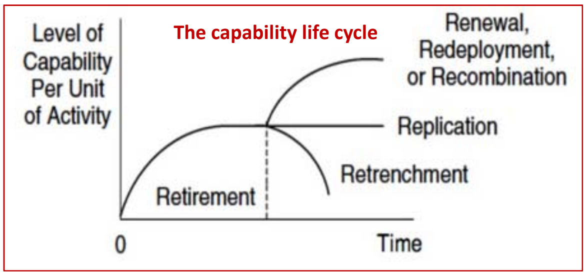
- Extension of Penrose's view: Helfat and Eisenhardt (2004)
- Firms have to reconfigure their resources not only because of the presence of excess resources but also **in reaction to permanent changes** in technologies and market demand:
  - New business opportunities
  - Mismatched capabilities and markets

Exploitation of inter-temporal economies of scope

Capability-view on reconfiguration

Why to reconfigure?

- Inter-temporal economies of scope derive from **entry into new product-markets** in conjunction with partial or complete **exit from old product-markets.**
- The firm **shifts resources from the old to the new business**.
- This redeployment of resources differs from the **contemporaneous sharing** of resources between businesses that underlies **standard intra-temporal economies of scope**



Source: C. Helfat & M. Peteraf, SMJ, 2003

Capability-view on reconfiguration

Why to reconfigure?

- As a result, reconfiguration strategies are part of a **deliberate, dynamic process** by which firms change their resource base by adding new resources, recombining resources or getting rid of resources that not longer fit.

why
- Firm's resources (existing or targeted ones) drive reconfiguration strategies

how
- Properties of firm's resources drive the choice of reconfiguration modes (TCE)

Capability-view on reconfiguration

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Capability-view on reconfiguration

Reconfiguration drivers

Kaul, 2012

M&A & Resource Redeployment & Divestiture

Capron, Mitchell, Swaminathan, 1998

Multi-mode reconfiguration

Karim & Mitchell, 2004
Capron & Arikan, 2016

"Technology and Corporate Scope: Firm and Rival Innovation as Antecedents of Corporate Transactions" (Kaul, SMJ, 2012)

Findings

- Technological innovation by a firm prompt the firm to reconfigure its corporate portfolio—with scarce resources being simultaneously withdrawn from marginal business and invested in new areas of opportunity.
- Firms are found to change their corporate scope in response to rival innovation.
- Technological innovation by a firm is followed by both expansion into new areas through complementary resource seeking acquisitions and divestment out of existing noncore businesses.
- The ability to reconfigure depends on the extent to which resources are fungible and available.

"Asset Divestiture Following Horizontal Acquisition: A Dynamic View" (Capron, Mitchell, Swaminathan, 2001)

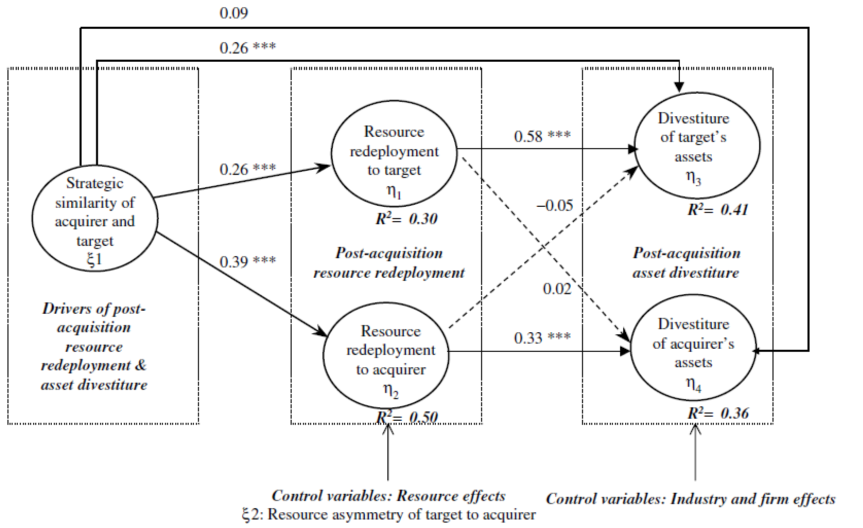
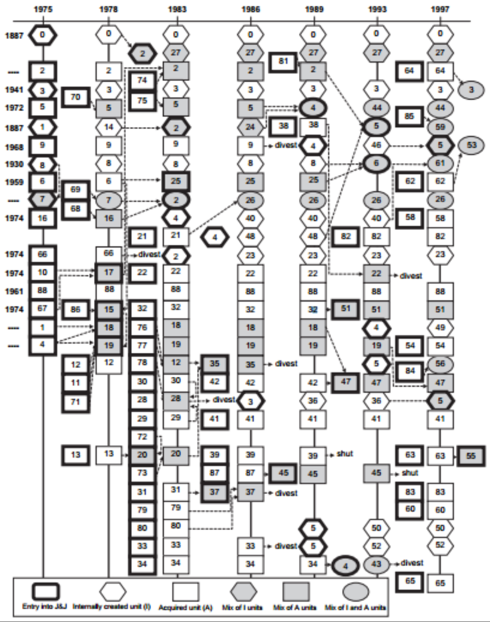


Figure 2. Post-acquisition resource redeployment and divestiture model results (Summary results from Table 6; $^{**}p < .05$, $^{***}p < .01$)

Findings

- Divestiture of unneeded assets is a key part of the post-acquisition reconfiguration
- Resource redeployment leads to divestiture from the business that receives the resources.

“Innovating through Acquisition and Internal Development:
A Quarter century of Boundary Evolution at Johnson & Johnson” (Karim & Mitchell, 2004)

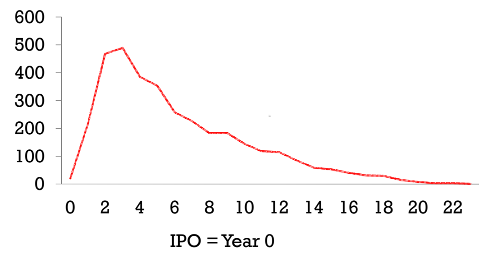


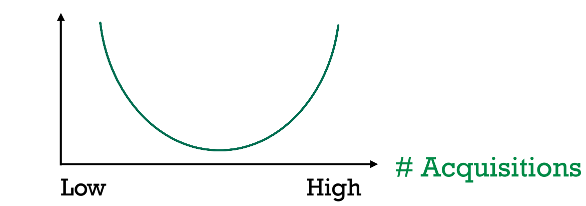
Johnson & Johnson
Business Unit Evolution
1975-1997

Findings

- Firms are more likely to retain internally developed resources and units than acquired resources and units.
- Firms are more likely to reconfigure acquired units than internally created units.
- Being reconfigured sooner and more often, **acquired units are “malleable components of the organization.”**

Surviving the IPO (Arikan and Capron, 2016)
3595 US IPOed Firms (1988-2000)





55% Delisted by end of Year 5

80% Delisted by end of 2012

75% Made 1st deal within first 3 years of IPO

21% Made no deals

4,395 acquisitions 1988-2012

Capability-view on reconfiguration

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why
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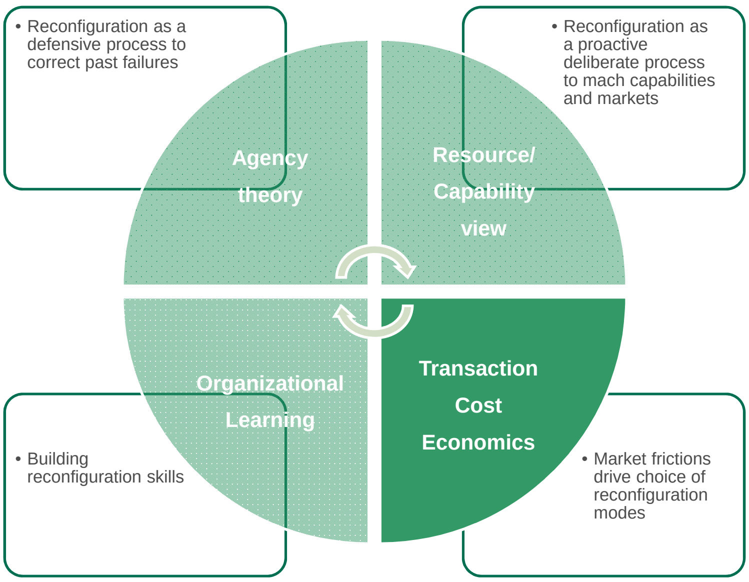
- Properties of firm's resources drive the choice of reconfiguration modes (TCE)

Foundations and empirical Contributions



Transaction Cost Economics view on reconfiguration

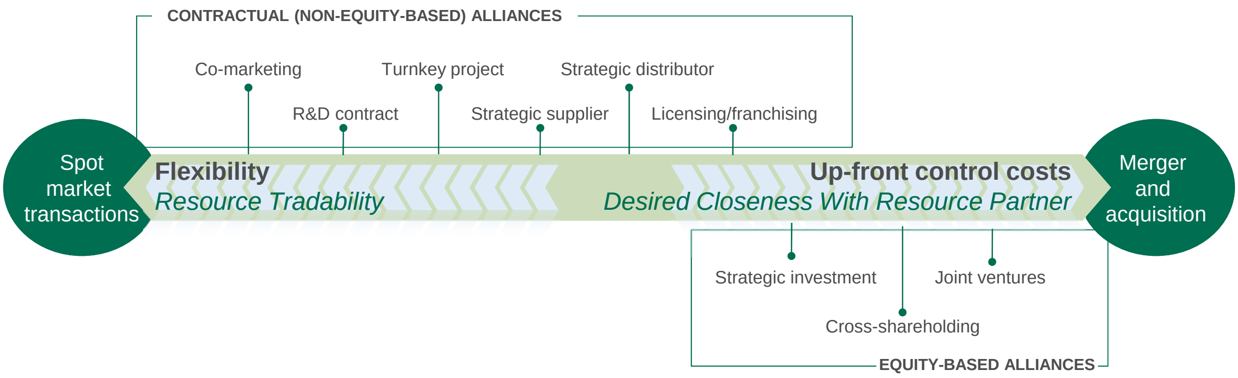
Which reconfiguration modes to use?

Premises

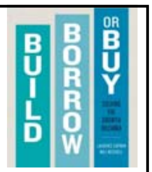
- Managers face substantial internal constraints to adjust their resources and often must turn to external markets to obtain new resources or to apply existing resources into new uses.
- Resource exchange properties generate market frictions because resources are hard to:
  - Search and select - *Akerlof*
  - Trade - *Arrow, Teece, Gans, Stern, Brousseau*
  - Transfer - *Teece, Oxley*
- M&A and sell-off play a substantial role in resource exchange and reconfiguration because of the market failures in the market for resources.

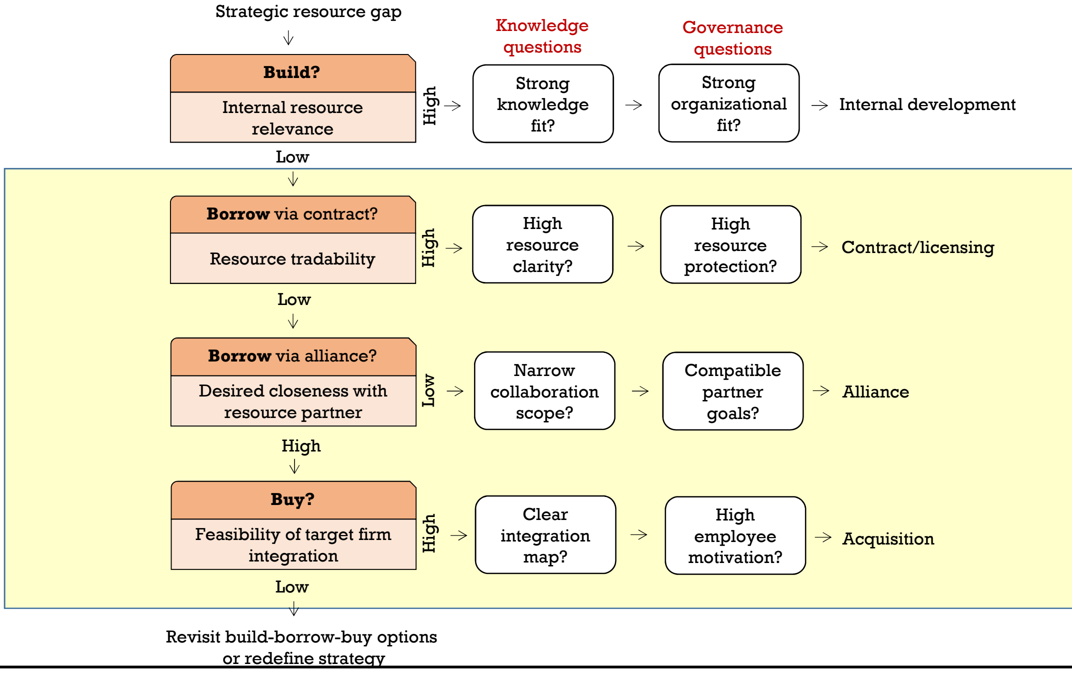
Non-organic reconfiguration modes: A continuum of inter-firm relationships

- Governance needs of the relationship influences the choice of mode of reconfiguration modes:
  - Protection needs
  - Coordination needs



Resource Pathways Framework (Capron and Mitchell, 2012)

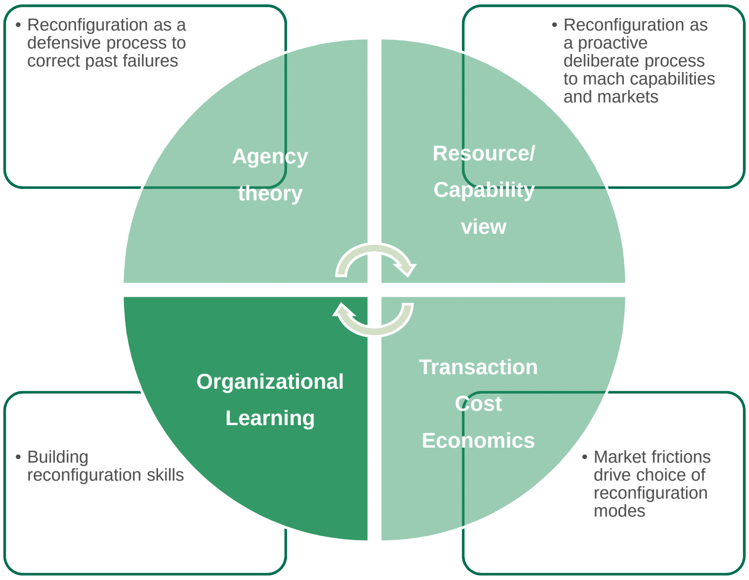




Transaction Cost Economics view on reconfiguration

- TCE-based related literature on M&As and Alliances has shown that as firms face more protection and coordination needs, they choose:
  - equity alliance over non-equity alliances (Gulati, Sampson, Reuer)
  - acquisitions over alliances or licensing (Capron Mitchell, Singh)
- Literature on post-acquisition shows that merging firms redeploy resources following the acquisition, notably those that are subject to market failures (Capron, Mitchell, Dussauge, 1998)

Foundations and Empirical Contributions

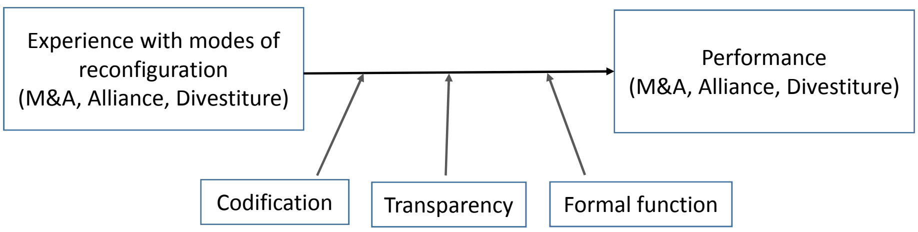


Learning view on reconfiguration

How to reconfigure?

Premises

- Firms can be more effective in their reconfiguration strategies by learning how to reconfigure (i.e. by building reconfiguration skills).
- Learning obstacles: reconfiguration events can be rare, heterogeneous and dispersed.
- Learning requires accumulating experience with reconfiguration activities as well as developing deliberate learning mechanisms to leverage experience (Zollo and Winter, 2002).



Learning view on reconfiguration

- Learning-based studies show **that experience with one particular reconfiguration mode** leads to greater success *under specific conditions*.

- M&A experience improves acquirer's ability to screen, select, price, integrate targets

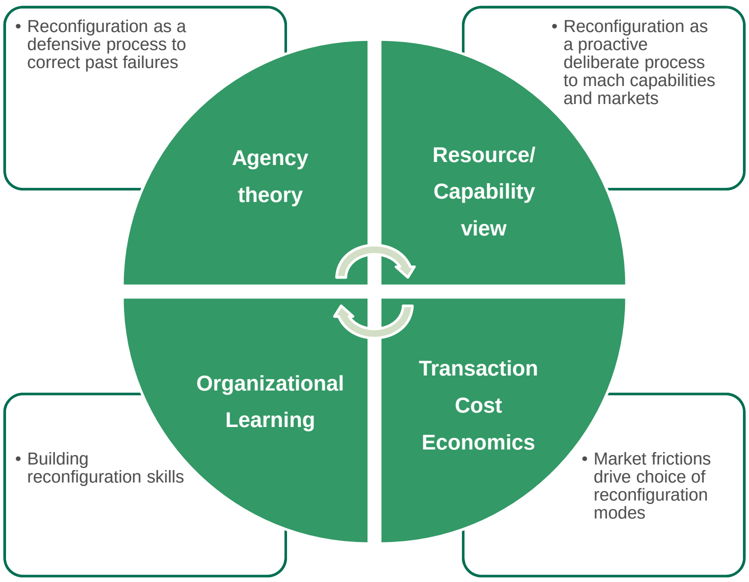
  Mechanisms: Role of codification of knowledge, M&A function (Zollo and Singh, 2004)

- Alliance experience increases firm's ability to screen and select alliance partners, design contracts, manage complex coordination, readjust objectives, and manage conflicts
  - Mechanisms: Role of trust and alliance function (Kale, Dyer, and Singh 2002)

- Divestiture experience helps firms to select buying partners and coordinate with divesting units.

  Mechanisms : Role of transparency and pacing (Mac Grath, Feldman, 2015)

Foundations and Empirical Contributions



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New developments

- What drives reconfiguration?
  - Role of institutional deficiencies (“voids) in emerging markets on reconfiguration (Mitchell)
  - Reconfiguration of market and non-market resources (Gatignon, Mair, Mc Dermott)
- Which modes of reconfiguration to choose?
  - Portfolio of reconfiguration modes (Rothaermel, Stettner, Lavie)
  - Balancing and sequencing modes (Feldman, Mac Grath, Capron, Mitchell)
- How to reconfigure (and learn to reconfigure)?
  - Learning spillovers across modes (Reuer, Zollo)
  - Concurrent learning processes (Bingham)