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)
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

- **Growth**
  - Internal development
  - Licensing, alliances, JVs
  - Mergers & Acquisitions
  - divestiture JVs
  - selling assets/shares

- **Retrenchment**
  - Internal restructuring

- **Non-organic reconfiguration modes**
  - Licensing, alliances, JVs
  - Mergers & Acquisitions
  - 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

Phenomenom

Reconfiguration strategy

Foundations

Empirical contributions
Foundations and Empirical Contributions

- **Agency theory**
  - Reconfiguration as a defensive process to correct past failures
  - Market frictions drive choice of reconfiguration modes

- **Resource/ Capability view**
  - Reconfiguration as a proactive deliberate process to match capabilities and markets

- **Organizational Learning**
  - Building reconfiguration skills

- **Transaction Cost Economics**
  - Reconfiguration as a defensive process to correct past failures
  - Market frictions drive choice of reconfiguration modes
Agency theory (finance literature) view on reconfiguration

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.

Evidence

✓ The benefits of focus

![Graph showing the benefits of focus](image)

Agency theory (finance literature) view on reconfiguration

- Divestitures increase stock market performance

<table>
<thead>
<tr>
<th>Divestitures (Spinoffs and Sell-offs)</th>
<th>Acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Study</td>
<td>CAR to Distor</td>
</tr>
<tr>
<td>John, Ofek (1995)</td>
<td>+1.5%</td>
</tr>
<tr>
<td>Comment, Jarrell (1995)</td>
<td>+2.2%</td>
</tr>
<tr>
<td>Daley, Mehrotra, Sivakumar (1997)</td>
<td>+3.4%</td>
</tr>
<tr>
<td>Krishnaswami, Subramaniam (1999)</td>
<td>+5.2%</td>
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<tr>
<td>Desai, Jain (1999)</td>
<td>+4.5%</td>
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<tr>
<td>Bergh, Johnson, DeWitt (2008)</td>
<td>+4.7%</td>
</tr>
<tr>
<td>Feldman (2014)</td>
<td>+1.7%</td>
</tr>
<tr>
<td>Feldman (2015)</td>
<td>+2.7%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>+3.0%</strong></td>
</tr>
</tbody>
</table>

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:

- Leveraged buyouts: 40%
- Leveraged recapitalisations: 25%
- Share repurchase tender offers: 15%
- Exchange offers of debt for common stock: 14%
- Exchange offers of preferred for common stock: 8%
- Open market share repurchase: 4%
- Divestitures: 2%
- Private placements of equity: 1%
- Acquisitions (for acquiring firms): 0%
Acquirers’ poor returns persist over time

<table>
<thead>
<tr>
<th>Event window</th>
<th>Acquirer returns (across studies)</th>
<th>Number of studies</th>
<th>Sample size</th>
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<tbody>
<tr>
<td><strong>Stock market returns</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt;180 days-3 years</td>
<td>-10%</td>
<td>103</td>
<td>25,205</td>
</tr>
<tr>
<td>&gt;3 years</td>
<td>-7%</td>
<td>26</td>
<td>5,966</td>
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<tr>
<td><strong>Return on Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-3 years</td>
<td>-2%</td>
<td>29</td>
<td>31,010</td>
</tr>
<tr>
<td><strong>Return on Equity</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-3 years</td>
<td>-2%</td>
<td>14</td>
<td>1,790</td>
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<tr>
<td><strong>Return on Sales</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>1-3 years</td>
<td>-3%</td>
<td>9</td>
<td>14,660</td>
</tr>
</tbody>
</table>

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

Foundations and Empirical Contributions

- Reconfiguration as a defensive process to correct past failures
- Reconfiguration as a proactive deliberate process to match capabilities and markets
- Building reconfiguration skills
- Market frictions drive choice of reconfiguration modes
- Agency theory
- Resource/ Capability view
- Organizational Learning
- Transaction Cost Economics

• Resource/ Capability view
• Reconfiguration as a proactive deliberate process to match capabilities and markets
• Market frictions drive choice of reconfiguration modes
• Building reconfiguration skills
Capability-view on reconfiguration

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 (intragenerational) **economies of scope** (Teece, 1980; Panzar & Willig, 1981)

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Capability-view on reconfiguration

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**
The capability life cycle

Why to reconfigure?

Capability-view on reconfiguration

- 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

- 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)
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 no 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)

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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)

**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.
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)

Delisting

IPO = Year 0

# Acquisitions

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

- 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)

Foundations and empirical Contributions

- Reconfiguration as a defensive process to correct past failures
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Transaction Cost Economics view on reconfiguration

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
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)
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Agency theory
Resource/Capability view
Organizational Learning
Transaction Cost Economics

Learning view on reconfiguration

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).

Experience with modes of reconfiguration (M&A, Alliance, Divestiture)
Performance (M&A, Alliance, Divestiture)
Codification
Transparency
Formal function

How to reconfigure?
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

- Market frictions drive choice of reconfiguration modes

- Reconfiguration as a proactive deliberate process to match capabilities and markets

- Reconfiguration as a defensive process to correct past failures

- Building reconfiguration skills

- Agency theory

- Resource/Capability view

- Organizational Learning

- Transaction Cost Economics

- Market frictions drive choice of reconfiguration modes
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)