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CORPORATE STRATEGY

Tools for Analysis and Decision-Making

Many companies are not single businesses but a collection of businesses with one or more levels of corporate management. Corporate strategy refers to how they compete. Written for managers, advisors, and students aspiring to these roles, this book is a guide to decision making in the domain of corporate strategy. It arms readers with research-based tools needed to make good corporate strategy decisions and to assess the soundness of the corporate strategy decisions of others. Readers will learn how to do the analysis for answering questions such as "Should we pursue an alliance or an acquisition to grow?", "How much should we integrate this acquisition?" and "Should we divest this business?". The book draws on the authors' wealth of research and teaching experience at INSEAD, London Business School, and University College London. A range of learning aids, including easy-to-comprehend examples, decision templates, and FAQs, are provided in the book and on a rich companion website.

PHANISH PURANAM is the Roland Berger Chair Professor of Strategy and Organization Design, and Academic Director of the PhD programme at INSEAD. He was previously Chair of the PhD programme at London Business School. A leading researcher, teacher, and advisor in the areas of corporate strategy and organization design, Phanish has won several honours for his work. He received his PhD at the Wharton School (University of Pennsylvania).

BART VANNESTE is Associate Professor of Strategy at the UCL School of Management. He researches and teaches corporate strategy, with a focus on the design and management of inter-organizational relationships. He received his PhD at the London Business School.

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"Puranam and Vanneste will change how you think about corporate strategy. They offer rigorous principles, frameworks and exercises to address some of the most crucial challenges of business leaders... A must-read for business students, business development professionals and senior executives."

Laurence Capron, *The Paul Desmarais Chaired Professor of Partnership and Active Ownership*, *Professor of Strategy*, *INSEAD*

"... There are no better guides than Puranam and Vanneste. *Corporate Strategy* combines analytical rigor and an academic foundation with easy-to-grasp real world application. Brilliant!"

Nirmalya Kumar, *Member-Group Executive Council*, *Tata Sons*

"*Corporate Strategy* is a wonderful book! Refreshingly clear and practical...this book will change the way we teach and practice corporate strategy."

Costas Markides, *Professor of Strategy and Entrepreneurship*, *Holder of the Robert P Bauman Chair in Strategic Leadership*, *London Business School*

"This book provides a unique guide to business students and practicing managers who seek a comprehensive understanding of the factors to consider when making strategic decisions for multi-business firms."

Constance E. Helfat, *J. Brian Quinn Professor in Technology and Strategy Tuck School of Business at Dartmouth*

"Puranam and Vanneste have provided a thought-provoking articulation of the key aspects of a strong Corporate Strategy... Well worth the read for any practicing strategy executive".

Vishal Dixit, *Head of Group Strategy at a FTSE-100 telecoms operator and former McKinsey management consultant*

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Introduction: what this book is about and how to use it

We wrote this book to help you make **good corporate strategy decisions** and perform sound analysis of the corporate strategy decisions of others, on the basis of knowledge obtained from **research**. Since this is the goal of the book, it is useful to be clear about the key terms in the statement above.

Corporate strategy refers to the strategy that multi-business corporations use to compete as a collection of multiple businesses. These businesses may each constitute a division within the corporation (or be bundled together with very similar businesses into a division), or may each be a legally distinct company, whose shares are held by a parent company. This book and its contents are applicable to all of these types of firms.

By **good decisions** we mean something quite specific. In the world of management, it is tempting but incorrect to define good decisions solely in terms of good outcomes. Because decisions are made with limited information and are not easy to reverse even after better information comes along, it is better to think about good decisions as those that (1) are the best given current information (and also feature a recognition that current information may not be complete), and (2) can be explained and defended to others. The first criterion is a straightforward one and requires little explanation. The second comes from the organizational context in which corporate strategy decisions are made. They must ultimately be evaluated and implemented by others who must be convinced and motivated by them.

Relatedly, this book is about **decisions**, not topics. It is written to provide an active guide for decision-making. This goes beyond a passive understanding of what corporate strategy is (which is the

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focus of a typical textbook). Rather, our goal is to help a reader with limited prior knowledge to (a) make a good decision on a concrete corporate strategy issue (e.g., should we pursue organic or inorganic growth, should we acquire or ally with this firm, or should we keep or divest this business) and (b) offer a well-reasoned justification for this decision, that is rigorous and clear. Thus, the emphasis is on concepts and how to use them to reach a decision, not on description.

Finally, this book is designed to provide tools for analyses and decisions about corporate strategy that are based on **research**. This means that the concepts, heuristics, ideas, and frameworks that together make up these tools are either directly or indirectly based on ideas and evidence that have passed the test of academic peer review. The linkage in some cases will be very proximate and we will give references to relevant research where this is the case.

At the same time, we also recognize the limits to exclusive reliance on the existing research base. We therefore also include ideas in this book whose connection to the research (and to rigorously validated ideas and evidence) is less proximate. While we strive to make these ideas always internally consistent, the evidence base may not always exist yet. The reader is warned to recognize these ideas by the absence of direct references (and is advised to exercise appropriate caution in adopting them).

The reasons we rely on the research base (even when we do so indirectly) in developing this material can be traced to our experiences teaching corporate strategy concepts to thousands of MBA, EMBA, and MSc students as well as senior managers and CEOs for over a decade at INSEAD, London Business School, and University College London. Through these experiences, we have come to realize two things. First, corporate strategy is an extremely complex topic. As we will explain, a lot of the complexity comes from the difficulty of separating out the components of a decision. Second, it is precisely in such situations of complexity that

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abstraction is valuable. In particular, our experience suggests that the abstractions and simplifications that researchers typically employ to study the complexities of corporate strategy can in fact be useful to practitioners, too. We believe that it should not be any more difficult for practicing managers to explain and defend decisions based on research, as it is to do so based on judgment and received wisdom. Of course, this book does not aim to be a comprehensive summary of the academic literature in corporate strategy; we are quite selective in picking what we need and know best (which, unsurprisingly, is often our own research) for the particular decisions we are interested in.

A final caveat to note is that the corporate strategy tools and frameworks we present, like all strategy frameworks, try to provide internally consistent representations that abstract from detail, assume some structure even for ill-defined problems, and simplify ambiguity into uncertainty, while still aspiring to be useful. We are keenly aware of the trade-offs on each of these dimensions.[1] An analogy may be useful here: a map, to be of any use at all, cannot possibly be of a scale of 1:1! It necessarily ignores, reduces, and simplifies and that's what makes it useful, both on individual journeys as well as in team efforts where all must agree and understand how to get to a destination. However, no one should or would make the mistake of confusing the map with the real thing. In much the same way, the frameworks and models we present are simplifications, which aim to be useful. They do not pretend to be "real." They offer a way to comprehend reality, and a basis for discussion. Thus the reader is forewarned that the ideas in this book must be complemented with a healthy dose of industry and company specific knowledge, and perhaps even skepticism about the ideas themselves, to be used in a creative and insightful manner.

In particular, we believe that the frameworks we propose can anchor useful debates around important decisions. A good way in which to use the frameworks in this book to make decisions is to

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have competing teams perform analyses to justify different alternatives. For instance, one group may perform the analysis about a diversification decision with the goal of minimizing the chance of an error of commission (i.e., the mistake of diversifying when one should not have) whereas another group may do so to minimize the chance of an error of omission (i.e., the mistake of missing a good diversification opportunity). As long as both teams use the same structured approach, such as that we describe in this book, the resulting debate will involve real communication and be enormously insightful, even when the teams reach opposing conclusions. We believe such an approach can be useful for almost any major corporate strategy decision – e.g., partner selection, valuation, and post-merger integration (PMI) in mergers and acquisitions (M&As).

How this book is organized: key decisions in corporate strategy

To make this book as useful as possible to corporate strategists, we have organized the material in terms of the critical decisions they face, and these make up the bulk of the book. Before we tackle these decisions, Part I (*Foundations*) of the book (Chapters 1, 2, and 3) introduce three theoretical pillars for the analysis of corporate strategy: corporate advantage, synergies, and governance costs.

Part I: Foundations

Chapter 1 (*Corporate advantage*) introduces and defines the concept of corporate advantage, and explains how it is different from competitive advantage, the key concept in business strategy. The chapter also explains why synergies are critical to sustaining corporate advantage when investors can easily replicate the same portfolio of investments as a corporation, albeit without the decision rights that the managers of a corporation enjoy.

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Chapter 2 (*Synergies: benefits to collaboration*) develops a novel approach to analyze synergies between any two businesses at the level of their underlying value chain segments. If synergies are the potential gains from collaboration across different businesses, governance costs are the "tax" that eats into these potential benefits.

Chapter 3 (*Governance costs: impediments to collaboration*) introduces heuristic frameworks to assess the conditions under which these costs are likely to be significant impediments to the realization of synergy. A key insight for corporate strategists is that these costs can be controlled through the appropriate choice of a governance structure (e.g., contract, equity–alliance, joint venture, or full ownership). The optimal governance structure is thus one that takes into account the benefits of as well as the impediments to collaboration.

The frameworks in these three chapters lie at the heart of all the corporate strategy decisions that we discuss in the rest of the book, including diversification, divestiture, valuation, PMI, selection of strategic alliance partners, re-organizing the structure of the corporation, outsourcing, and offshoring. They are thus essential reading for getting the most out of any part of the rest of the book.

Parts II and III: Decisions about portfolio composition

In this part of the book, we examine decisions that pertain to which businesses should be in the portfolio of the corporate strategist, and how to assemble such a portfolio. The implicit assumption is that once these businesses are brought into the portfolio, synergies across businesses can be realized through administrative control. Chapters 4, 5, and 6 look at increasing the scope of the organization. Chapters 7 and 8 consider decreasing the scope of the organization.

Part II: Increasing the scope of the organization Chapter 4 (*Diversification*) introduces a basic test to consider when and where diversification, the entry into a new business, is useful. This brings

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together ideas about corporate advantage (why should *you* diversify rather than your shareholders), synergies (which business should you diversify into), and governance costs (what is the best governance structure to exploit synergies). We discuss vertical integration as a special case of diversification.

Chapter 5 (*Ally or acquire?*) covers the choice between strategic alliance and acquisition, two of the fundamental mechanisms of inorganic growth. A key distinction is that in an alliance the partners remain independent, whereas in an M&A one party gives up control. Because the associated benefits and costs differ, we discuss when an alliance is to be preferred over an acquisition, and vice versa.

Chapter 6 (*Organic or inorganic growth?*) considers whether to enter a new business organically (do it on your own) or inorganically (through alliances or acquisitions). We discuss the factors that favor organic growth and those that favor inorganic growth.

Part III: Decreasing the scope of the organization Chapter 7 (*Divestiture: stay or exit*) covers the divestiture decision, in particular the choice between different modes of exit from a business. Divestiture can be seen as a horizontal scope decision, in which the organization reduces the number of businesses it is active in. We focus on divestiture through sell-off or spin-off.

Chapter 8 (*Outsourcing: make or buy*) covers vertical scope decisions where there is a reduction in the number of value chain segments the corporation is active in while the number of businesses remains constant. We consider the conditions under which outsourcing is appropriate, and when to consider offshoring.

Part IV: Decisions about portfolio organization

In this last part of the book, we take the portfolio composition as given. The focus is on managing the portfolio to extract synergies across the businesses through administrative control.

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Chapter 9 (*Designing the multi-business corporation*) covers organizational structure decisions. We analyze when pure, hybrid, and matrix structures are appropriate, and contrast the legal and organizational structure of multi-business corporations. We also discuss when it is time to re-organize.

Chapter 10 (*Designing the corporate HQ*) covers "corporate parenting" decisions: how to select the appropriate role for the headquarters (HQ) in a multi-business firm. We highlight three key dimensions: standalone vs. linkage based approaches to synergy across businesses, directive vs. non-directive approaches to managing each business, and resource allocation across businesses to balance growth and profits while exploiting synergies.

Chapter 11 (*Managing the M&A process*) examines the key choices when conducting an M&A. Given that a decision to undertake an M&A has been made, several steps need to be taken to successfully conduct it. We focus on the critical aspects: valuation, negotiations, and post-merger integration.

Chapter 12 (*Managing the alliance process*) analyzes the key choices when structuring an alliance. In an alliance, the goal is for the partners to collaborate but without either side gaining full control over the other. We discuss how partner selection, valuation, negotiation, and integration can help you to succeed with an alliance.

While Parts II and III separate the decisions around which businesses belong in the portfolio from how they are managed once the portfolio decision is made, this is an analytical convenience and in practice both aspects must be considered simultaneously. Therefore, the structure of the book is such that it allows the reader to selectively combine a set of chapters to get what she is after efficiently.

For instance, those interested only in M&A should read Chapters 1, 2, and 3 (as these provide the foundations), and then go on to Chapters 5 and 11. To consider the design of the corporate HQ, Chapters 1, 2, 3, and 10 would suffice. Table 0.1 illustrates how the

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TABLE 0.1 *How the chapters build on each other*

Part		Chapter		Builds on Chapter 1	2	3	4	5	6	7	8	9	10	11	12
I	**Foundations**	1	Corporate advantage												
		2	Synergies: benefits to collaboration	1											
		3	Governance costs: impediments to collaboration	1	2										
II	**Portfolio composition:**	4	Diversification	1	2	3									
	increasing scope	5	Ally or acquire?	1	2	3	4								
		6	Organic or inorganic growth?	1	2	3	4	5							
III	**Portfolio composition:**	7	Divestiture: stay or exit	1	2	3									
	reducing scope	8	Outsourcing: make or buy	1	2	3				7					
IV	**Portfolio organization**	9	Designing the multi-business corporation	1	2	3									
		10	Designing the corporate HQ	1	2	3									
		11	Managing the M&A process	1	2	3		5							
		12	Managing the alliance process	1	2	3		5							

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chapters are related. We do not have a separate chapter on international business because we view international aspects as increasingly being quite inter-mingled with corporate strategy decisions. For instance, foreign market entry is an instance of diversification, and a cross-border merger or joint venture is, first and foremost, an acquisition or an alliance, respectively. Where relevant, we mention how decisions may differ between a national and an international context.

Each chapter ends with a list of Frequently asked questions (FAQs) on aspects of corporate strategy, and some Further reading around the topic of the chapter.

Note

1. See for instance the insightful discussion on these issues in Levinthal, D. A. (2011). A behavioral approach to strategy – what's the alternative? *Strategic Management Journal*, *32*(13), 1517–1523.

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