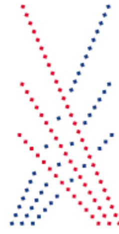

BRITISH ACADEMY OF MANAGEMENT

BAM CONFERENCE

3RD-5TH SEPTEMBER

ASTON UNIVERSITY BIRMINGHAM UNITED KINGDOM

This paper is from the BAM2019 Conference Proceedings

About BAM

The British Academy of Management (BAM) is the leading authority on the academic field of management in the UK, supporting and representing the community of scholars and engaging with international peers.

http://www.bam.ac.uk/

MAKING THE MOST OF WHAT YOU SELL: FROM INTRAFIRM TO INTERFIRM RELATIONSHIPS IN DIVESTITURES

Oleksandra Kochura
Toulouse School of Management / Toulouse Business School
Oleksandra.Kochura@tsm-education.fr

Abstract

A corporate divestiture is a unique form of transactions because while pursuing a strategic change with the detachment of some activities from the corporate portfolio, it enables their simultaneous retention to ensure that the divestiture implementation process will lead to the desired outcomes. However, up to date, there exists no investigation of the divested businesses embeddedness and associated with its formation of new inter-organizational relationships. The objective of this conceptual paper is 1) to explain value creation from divestiture process by relying on the role of embeddedness and business relatedness, but also 2) to explore the phenomenon of formation of inter-firm cooperative arrangement in the framework of businesses' separation process. Taking into consideration that disappearance of the access to valuable resources may result in disturbance of the existing linkages and relationships among businesses in a firm, this paper is aimed at identifying the best scenarios for the divestiture process design in the relation to the embeddedness of businesses to-be-divested.

CORPORATE DIVESTITURE PROCESS

Nowadays, multi-business firms are concerned with various methods of corporate portfolio restructuring, be it mergers and acquisitions (M&A), corporate divestitures or other reorganization techniques. These pathways enable firms to accomplish a corporate shift in face of changing market conditions and firms' strategic orientations, but encounter also major difficulties during their implementation, such as a decrease in financial performance (Bergh, 1995), subsequent lack of innovation (Hitt et al., 1996), or even further liquidation. If extensive research has been conducted over the past decades on implementation challenges of M&A, surprisingly little attention has been paid to analyzing factors driving to divestiture outcomes (Lee & Madhavan, 2010). This is principally rooted in the consideration that divestitures are a simple "mirror image" of M&As (Brauer, 2006). However, important differences exist among these two portfolio restructuring methods (Kochura, 2018), requiring research on divestitures as an independent object of study.

There is the increasing relevance of divestitures to business practice (80% of companies plan divestitures in 2019 against 43% in 2016, Deloitte report) and the general lack of research and theoretical insights on what shapes their implementation and outcomes.

Extant literature on divestitures focused primarily on divestiture antecedents, but previous characteristics are not an exclusive factor for further growth or failure (Brauer, 2006). The main rationale behind divestiture decision is a response to internal and external issues which firms face and an intention to value maximization (Feldman & McGrath, 2016; Villalonga & McGahan, 2005; Hurry, 1993). The essential motives for divestiture choice are scaling down diversification level (Moschieri & Mair, 2012), focusing on core activities eliminating negative synergies (Brauer, 2006b; Bergh et al., 2008), raising cash for investment or liquidity concerns (Moschieri & Mair, 2012) or responding to legal or regulatory changes (Moschieri, 2011; Montgomery et al., 1984).

Divestitures have implications for economic, strategic and organizational characteristics on a macro- and industry-level, firm- or unit-level and individual-level effects (Zschoche, 2016; Kaprielyan, 2016; Lee & Madnavan, 2010; Bergh & Lim, 2008; Mulherin & Boone, 2000; Montgomery et al., 1984). On the macro- and industry-levels, divestitures can influence price, market shares, collaborative and competitive structure of industry (Brauer, 2006b). On a firm- and unit-level they generally have a positive effect on performance (Feldman & McGrath, 2016; Lee & Madhavan, 2010; Montgomery et al., 1984). Intended outcomes for divestiture include better efficiency (Johnson, 1996), transformation of organizational success, cost reduction, productivity enhancement (Moschieri & Mair, 2008; Sewing, 2010; Lee & Madhavan, 2010), quality improvement, competitive advantage reinforcement, creation of new strategic orientation and culture and potential synergy between the businesses (Hoskisson and Hitt, 1994; Moschieri & Mair, 2008). Despite favorable implications, consequences for a firm may also be devastating (Thywissen et al., 2017a, b; Moschieri, 2011). Possible unintended outcomes may arise, such as turnover of employees, neglect of their commitment and loyalty, managerial risk aversion, short-term goals preference, resistance to change, lack of innovation (Hoskisson and Hitt, 1994; Moschieri & Mair, 2008) and important financial losses (Duhaime & Grant, 1984). Moreover, outcomes can include extensive uncertainty, ambiguity, and confusion about further decisions (Moschieri, 2011).

Generally, researches on antecedents and outcomes are two research streams dominating across scientific publications (Feldman & McGrath, 2016; Sewing, 2010). Only a few scholars study the process of divestitures (Karim and Capron, 2016) and there is a pressing need for developing a sound understanding of the role of distinct management processes that shape the

way businesses are divested (Moschieri, 2011; Lee & Madhavan, 2010). The role of time and speed (Thywissen et al., 2018), post-deal access and control (Moschieri, 2011), experience (Brauer et al., 2017; Bergh and Lim, 2008) were found to influence post-divestiture performance. Further, the sale of valuable resources may result in disruption of existing interdependencies between remaining operations or units of divesting firms (Damaraju et al., 2015) and unique forms of intra- and inter-organizational relationships may be formed to support strategic change and lead to variance in outcomes.

We consider two important attributes of the divestiture process, the interplay of which help to seize social and economic perspectives simultaneously, and to shape future outcomes for divestors: embeddedness and relatedness.

EMBEDDEDNESS AND RELATEDNESS FOR VALUE CREATION

The notion of embeddedness implies the multiplexity, as businesses have multiple types of interactions (Kessler, 2013, p. 744). Granovetter (1985) proposed that social relationships and arising networks have an influence on the behaviour and further outcomes for firms. It comprises various firm of ties that firms form, be it direct ties (relational embeddedness) or indirect ones (structural embeddedness). The role of these ties was largely investigated in terms of different interfirm relationships (Gulati and Wang, 2003), but remains underexplored in terms of the shift from intra- to inter-organizational ones. However, we propose that the presence of ties cannot fully explain the variance in economic consequences.

Business relatedness has been widely recognized in the literature on diversification, strategy, and M&As to account for dyad attributed between firms and businesses in one firm. In divestiture studies, the role of the relatedness, as that found to impact considerably the outcomes, was studied exclusively for over-diversified firms and measured based on similar industry codes. Despite this taken-for-granted assumption, in the meta-analysis of divestiture and firm performance, Lee and Madhavan (2010) did not find any moderation relationship between the level of the relatedness and post-divestiture performance. However, the businesses in divesting firm may belong to the same industry but to have no coherent ties between them or vice versa. Asset relatedness features of the main businesses of the firm, which enable to enhance interrelationships between them and contribute to the development of the competitive advantage in the most cases (Bergh et al., 2008). The management can evaluate the value of these interactions, in contrary, they cannot be perceived in the same extent from outside, thus it creates information asymmetries. Therefore, more complex investigation of the relatedness

is needed: share of the same patents among the businesses, customer base, supply chain components.

The network embeddedness and business relatedness may inform the divestiture process that is leading to more beneficial outcomes. The development and the interlock of different intra- and inter-organizational relationships exist in the corporate divestiture process at different stages: in the pre-divestiture period, during separation of businesses and in post-operation timeline.

Firstly, sell-offs are considered multilateral activities, which include at least two parties – a seller and buyers (Hurry, 1993), therefore the process and the outcomes of these dyadic and portfolio relationships may be dependent on the level of the firms' network embeddedness (Granovetter, 1985) and the prior existing ties between parties.

Secondly, another emergent phenomenon happens when firms, in order to assist the progress of sell-off completion, are forming partnerships and alliances during the divestiture process. These forms of inter-organizational relationships enable to reduce the level of partner opportunism, facilitate the exchange of information, enhance the learning mechanisms (Gulati and Wang, 2003), but also to enable smooth disentanglement reducing the level of stress, fear and uncertainty among employees (Sewing, 2010) in reaction to restructuring. These may affect the employees' motivation; thus, the sense of continuity and legitimacy should be delivered to employees (Moschieri, 2011). The partnerships and alliances between sellers and buyers are often terminated when the unit is successfully separated from the parent divesting firm.

Thirdly, many firms, that are selling business units from their corporate portfolios, tend to maintain parent-unit relationships in the post-divestiture period (Moschieri, 2011). Even though, divestitures often concern the businesses that are unrelated, especially in the resource profiles, to the core activities of the selling firm (Duhaime & Grant, 1984; Damaraju et al., 2015), the legacy businesses, as those which historically be the first businesses the companies operated at the time of the creation. In this setting, the parent strives to maintain the parent-unit relationships in order to access the information and innovations, or further to have an option to further reacquire the unit.

INTERDEPENDENCIES BETWEEN DIVESTED AND REMAINING ACTIVITIES

Feldman (2013) researched the divestitures of legacy businesses, as those which historically be the first businesses the companies operated at the time of the creation. The legacy businesses comprise the set of key organizational routines, that are created in a path-dependent manner, therefore should involve the considerable interdependencies with the other firm's

businesses (Feldman, 2013). Leonard-Barton (1992) studied the core capabilities in terms of new product development. He defined core capabilities as "part of an organization's taken for granted reality, which is an accretion of decisions made over time and events in corporate history". As the firms tend to pursue the path-dependent development, they apply the tacit knowledge and organizational routines from a firm's established businesses to the other business units: this application of the knowledge is thus resulting in the generation of significant interdependencies (Leonard-Barton, 1992). Therefore, the divestiture of highly embedded and taken for granted business may cause the disruption of the functioning in the remaining parent firm operations. The higher the complexity of the separation of highly embedded businesses requires more time and managerial attention.

More importantly, the role of time and speed was found as having a significant effect on the outcome of portfolio restructuring mechanisms. In M&A research, timing is addressed regarding the speed of integration. Angwin (2004) summarized that shorter integration support value enhancing results while providing a faster return on investment, displacing uncertainty, increasing stability, decreasing the costs of readjustments and limiting the time for competitors to react. But Bijlsma-Frankema (2001) promotes the idea that slow integration's relevance means better integrity among employees, knowledge transfer and trust building. The contradicting statements were stressed by Bauer et al. (2016) with cultural integration that should be accelerated, whereas task integration should be slowed down to realize operational synergies. In divestiture research, Thywissen et al. (2017) argued that divestiture on time, which resulted in the less time spent on the decision-making process illustrated positive results. However, there is no evidence that faster implementation of the divestiture procedure will facilitate divestiture success.

Proposition 1.1. If the business relatedness between divested unit and remaining operations is high, there is more likelihood of creation of inter-organizational relationships between divestors and acquirers.

Proposition 1.2. There is a relationship between creation of inter-organizational relationships and the speed of divestiture.

Proposition 1.3. There is a relationship between creation of inter-organizational relationships and performance.

THE EMERGENCE OF INTER-FIRM COOPERATIVE ARRANGEMENTS

Although the differences in the post-divestiture performance may be moderated by the presence of networks or alliances of the firms, these inter-organizational relationships were studied in research on mergers & acquisitions, but remain unexplored in divestiture literature (Brauer, 2006; Lee & Madhavan, 2010).

Structuring and implementation of the divestitures encompass several sub-processes like due diligence, separation, and design of parent-unit relationship. Regardless of the crucial need for techniques for the design and implementation of divestitures for managers, there exists scarce empirical investigation of this process. Moschieri and Mair (2012) showed several reasons for the retaining of parent-unit relationship in a post-divestiture period, be it control, moral, value creation or hedging reasons. They argued that the maintenance of relationship can be attained through outsourcing contracts, commercial agreements or occupying a board seat in a new entity. The preservation of linkages includes an option to pursue the reacquisition in the future. In general, the maintenance of the parent-unit relationship found to be a moderator for achieving more successful outcomes: enable to take advantage of the innovation produced in divestment unit (Moschieri and Mair, 2011), attain the sense of continuity and legitimacy among the employees (Moschieri, 2011), easier to reacquire sold business, especially in the period of market uncertainty (Damaraju et al., 2015). However, the relationships which are taken into the consideration consider those realized in a post-divestiture period. The interest lies into the incorporation of other forms of possible ties, their detailed design, and change during the pre-divestiture, divestiture and post-divestiture period.

Proposition 2.1. The presence of collaboration prior to the divestiture deal reduces information asymmetry between divestor and acquirer.

Proposition 2.2. The presence of collaboration between divestor and acquirer prior to the divestiture deal is positively associated with dyadic resource exchange and combination.

Proposition 2.3. There is a relationship between the presence of collaboration prior to the divestiture deal and the speed of divestiture.

Proposition 3. If there is a high frequency of inter-organizational relationship in a post-divestiture period, then there is more likelihood of re-acquisition of divested business.

These inter-organizational links provide a competitive advantage for acquirers and divestors by pooling specific assets, knowledge-sharing, complementary resources and

capabilities and effective governance (Dyer and Singh, 1998), and by simultaneously ensuring the steady divestiture's separation process. As a result, this type of transactions is unique forms of pursuing a strategic change, whereas the detachment of some activities, but their simultaneous retention ensure that the divestiture implementation process will lead to the desired outcomes.

REFERENCES

Angwin, D. (2004). Speed in M&A Integration: The First 100 Days. *European management journal*, *22*(4), 418-430.

Bauer, F., Matzler, K., & Wolf, S. (2016). M&A and innovation: The role of integration and cultural differences—A central European targets perspective. *International Business Review*, *25*(1), 76-86.

Bergh, D. D. (1995). Size and relatedness of units sold: An agency theory and resource-based perspective. *Strategic Management Journal*, *16*(3), 221-239.

Bergh, D. D., & Lim, E. N. K. (2008). Learning how to restructure: absorptive capacity and improvisational views of restructuring actions and performance. *Strategic Management Journal*, *29*(6), 593-616.

Bergh, D. D., Johnson, R. A., & Dewitt, R. L. (2008). Restructuring through spin-off or sell-off: transforming information asymmetries into financial gain. *Strategic Management Journal*, *29*(2), 133-148.

Bijlsma-Frankema, K. (2001). On managing cultural integration and cultural change processes in mergers and acquisitions. *Journal of European Industrial Training*, *25*(2/3/4), 192-207.

Brauer, M. (2006). What have we acquired and what should we acquire in divestiture research? A review and research agenda. *Journal of Management*, *32*(6), 751-785.

Damaraju, N. L., Barney, J. B., & Makhija, A. K. (2015). Real options in divestment alternatives. *Strategic Management Journal*, *36*(5), 728-744.

Deloitte report. (2018). The state of the deal: M&A trends 2019.

Duhaime, I. M., & Grant, J. H. (1984). Factors influencing divestment decision-making: Evidence from a field study. *Strategic Management Journal*, *5*(4), 301-318.

Dyer, J. H., & Singh, H. (1998). The relational view: Cooperative strategy and sources of interorganizational competitive advantage. *Academy of management review*, *23*(4), 660-679.

Feldman, E. R. (2013). Legacy divestitures: motives and implications. *Organization Science*, *25*(3), 815-832.

Feldman, E.R., & McGrath, P.J. (2016). Divestitures. *Journal of Organization Design, 5* (2), 1-16.

Granovetter, M. (1985). Economic action and social structure: The problem of embeddedness. *American journal of sociology*, *91*(3), 481-510.

Gulati, R., & Olivia Wang, L. (2003). Size of the pie and share of the pie: Implications of network embeddedness and business relatedness for value creation and value appropriation in joint ventures. In *The governance of relations in markets and organizations* (pp. 209-242). Emerald Group Publishing Limited.

Hitt, M. A., Hoskisson, R. E., Johnson, R. A., & Moesel, D. D. (1996). The market for corporate control and firm innovation. *Academy of management journal*, *39*(5), 1084-1119.

Hoskisson, R. E., & Hitt, M. A. (1994). *Downscoping: How to tame the diversified firm*. Oxford University Press on Demand.

Hurry, D. (1993). Restructuring in the global economy: The consequences of strategic linkages between Japanese and US firms. *Strategic Management Journal*, *14*(S1), 69-82.

Johnson, R. A. (1996). Antecedents and outcomes of corporate refocusing. *Journal of management, 22*(3), 439-483.

Kaprielyan, M. (2016). Valuation consequences of the decision to divest in the globalized world. *Journal of Multinational Financial Management, 36*, 16-29.

Karim, S., & Capron, L. (2016). Reconfiguration: Adding, redeploying, recombining and divesting resources and business units. *Strategic Management Journal*, *37*(13).

Kessler, E. H., 2013, *Encyclopedia of management theory*. Sage Publications.

Kochura, O. (2018). Corporate divestiture and M&A - just a simple mirror image? European Academy of Management, Reykjavik, Iceland

Lee, D., & Madhavan, R. (2010). Divestiture and firm performance: A meta-analysis. *Journal of Management*, *36*(6), 1345-1371.

Leonard-Barton, D. (1992). Core capabilities and core rigidities: A paradox in managing new product development. *Strategic management journal*, *13*(S1), 111-125.

Montgomery, C. A., Thomas, A. R., & Kamath, R. (1984). Divestiture, market valuation, and strategy. *Academy of Management Journal*, *27*(4), 830-840.

Moschieri, C. (2011). The implementation and structuring of divestitures: the unit's perspective. *Strategic Management Journal*, *32*(4), 368-401.

Moschieri, C., & Mair, J. (2011). Adapting for innovation: Including divestitures in the debate. *Long Range Planning*, *44*(1), 4-25.

Moschieri, C., & Mair, J. (2012). Managing divestitures through time—expanding current knowledge. *Academy of Management Perspectives*, *26*(4), 35-50.

Mulherin, J. H., & Boone, A. L. (2000). Comparing acquisitions and divestitures. *Journal of corporate finance, 6*(2), 117-139.

Sewing, J. H. (2010). *Prescriptive design of divestiture decision-making.* In Corporate Divestiture Management (pp. 53-110). Gabler.

Thywissen, C., Pidun, U., & zu Knyphausen-Aufseß, D. (2017). Divesting on time: How decision-making processes influence divestiture outcomes.

Villalonga, B., & McGahan, A. M. (2005). The choice among acquisitions, alliances, and divestitures. *Strategic management journal, 26*(13), 1183-1208.

Zschoche, M. (2016). Performance Effects of Divesting Foreign Production Affiliates: A Network Perspective. *Long Range Planning*, *49*(2), 196-206.