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RETROSPECTIVE ON CORPORATE RENEWAL

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Abstract

An historical review of managers' corporate renewal decisions reveals an evolution has occurred away from using operating turnarounds in favor of making changes in corporate scope via transactions. One explanation for this progression is that financial valuation considerations supplanted other inputs to strategic logic in seeking value creation—a reflection of the rising institutional influence of financial institutions. The market for corporate control has brought financial owners into the arena of corporate renewal activities. They have embraced the earlier emphasis upon fixing underperforming resources to accomplish corporate renewal. This evolution was supported by the rising importance of private equity firms as suitors to acquire distressed assets. As underperforming resources have been passed from firm to firm until finding an owner willing to confront their operating challenges, specialized financial owners have risen in importance in corporate renewal while the importance of strategic owners in performing operational turnarounds to renew their corporations has eroded.

RETROSPECTIVE ON CORPORATE RENEWAL

Corporate strategy involves making resource allocation decisions—including deployment of cash flows, technology, and people. Included among these fundamental scope decisions are those to enter or exit lines of business, expand or contract productive capacity within extant businesses, and change the encouraged relationships among firms' lines of business and/ or third parties within their ecosystems. The corporate office frequently provided the needed resources to effect these changes in corporate scope.

Over time, the processes of corporate renewal have evolved in response to exogenous changes in the performance expectations of publicly-traded firms. Society values technological progress; accordingly, business managers adapted to the ever-mutating pressures to correct their firms' underperformance expediently. The method by which corporate strategy was adjusted to adapt to the inevitable competitive dynamics most industries face has evolved to include frequent scope changes. This was necessary as Schumpeterian advantage has been more commonplace than Ricardian advantage (Nelson, 1994), and a succession of formerly-attractive industries have lost their respective attractiveness as the next wave of technology makes seeming-sound diversification choices appear obsolete soon thereafter. The greater speed with which resource allocations require scope changes has skewed the nature of corporate renewal activities toward transactions and away from processes.

Corporate Renewal Alternatives

When financial and competitive performance declined, managers were charged with taking appropriate actions to renew their firms' corporate viability. As lines of business became less attractive, renewal activities became necessary to adjust how firms' resources were employed. The focus of their renewal actions could be targeted across the geographically diverse venues where firms' lines of business operated or reflect modifications of firms' respective technological capabilities. Sometimes managerial responses to underperformance involved reallocating resources among business units to reflect firms' changing commitments to served markets; managers may have redeployed business units' resources to achieve new corporate purposes and liquidated their past positions as commitment waned. A spectrum of corporate renewal alternatives was possible.

In response to exogenous threats to revenue growth, corporate managers could work to revitalize their firms' ongoing operations, redeploy their corporation's sunk resources to other uses, monetize corporate assets via business exit in order to use cash for better opportunities, or spend on innovation to improve products or business processes. Strategic triage involved supporting innovation within promising businesses while downsizing others to use their resources elsewhere. managers closed excess plants, furloughed redundant workers, de-integrated businesses that no longer should have been linked, and dissolved non-remunerative internal relationships among their firms' business units. But such leaders were in the minority as most managers did not find operational approaches to corporate renewal.

Revitalization of operations typically called for turnaround processes that encompassed innovations in how customers might be best served, as well as improvements to the content of firms' internal control systems, performance measures and incentives, and other appropriate arrangements that could be used to foster relationships between sister business units. Internal triage among lines of business was needed during such a revitalization process to realize potential operating synergies while dismantling internal linkages where negative synergies were being generated instead of positive ones. The complexity of rethinking an interlinked corporate structure was daunting (Chandler, 1994).

Resource redeployments undertaken to cope with underperformance have included downsizings of asset commitments as well as outright business exits. Restructurings have revisited the optimality of members within the corporate family in order to prune away lines of business that were no longer core or ancillary to firms' corporate strategy—whether monetization was accomplished via outright divestiture or incrementally via spin-offs. These diverse modes of exit determined whether the corporation shared in potential performance improvements that might be released by selling off partial equity shares instead of outright sale of the troubled units (Corredor and Mahoney, 2019; Feldman, 2016; Feldman, Gilson, and Villalonga, 2014.). Partial exits did not fully address the fundamental problem of underperformance, but they sometimes freed resources for use elsewhere.

The proceeds obtained from divestitures were the second aspect of managers' changing approaches to corporate scope decisions. By rearranging the pieces comprising their corporate family members, managers have may have temporarily deluded themselves into believing their firms could acquire their ways out of difficulty—regardless of the transaction costs that must be paid out (and earned back) in order to change their business mixes materially to regain prosperity (Sirower, 1997). Frequently firms' diversification campaigns to find growth were accompanied by the excessive financial leverage made possible by advances in corporate finance.

Although they could have maintained their firms' extant scope by paying down debt and turning around internal elements of their firms' operations incrementally, managers more frequently added to (or subtracted from) those lines of businesses that comprised their firms' corporate family in order to create their unique vision of corporate advantage for owners. Thus, because of pressures for rapid improvement in performance, resource renewal more frequently involved changes in firm scope using transactions instead of organic evolutions.

It was not always so. Managers' corporate renewal campaigns were once focused more heavily upon organic growth through fine-tuning operations and less heavily upon discrete financially-oriented transactions. Although less-studied among corporate strategy alternatives, organic corporate-renewal activities that involved turning around distressed operations, downsizing or refocusing corporate priorities by moving resources from firms' less promising businesses, and monetizing underperforming assets in order to innovate internally were once worthy topics to master since the majority of firms operating within post-industrial economies faced daily corporate renewal challenges that were addressed incrementally. In steady state businesses, managers strived to load their firms' facilities more efficiently and utilize their corporate resources—including their corporate levels of debt capacity—most effectively. Over time, however, the increasing institutional influence of financially-oriented restructurings touted a strategic logic for value creation that was difficult to ignore. It was based primarily upon financial market timing considerations and less upon operational fundamentals. It was the beginning of an erosion of deep knowledge in firms' domains.

Historical Challenges Within Post-Industrial Economies

Post-war theories of corporate strategy from the 1950s and 1960s emphasized growth topics, such as how to push the firm's frontiers or scope outward incrementally by offering related products (or services) to existing customers, as well as how to serve new and related customers via diversification (Ansoff, 1957). For firms domiciled within post-industrial economies, this era reflected easy implementation of their strategic initiatives since competition from non-traditional firms was weak. It was an era of relative complacency. By the 1970s, however, resistance was palpable and errors in overexpansion required correction. OPEC was formed and the world economic order was changing as the basis for advantage was overturned.

Table 1 about here

As Table 1 indicates the Strategic Management Society was created in 1981—after a formative meeting in 1977—just in time for its members to ponder the effects of unraveling firms' excessive financial exuberance from the Reagan merger wave (some of which was financed by leveraged buyouts). By the 1980s market share leaders within post-industrial economies, were forced to confront the associated problems of underperforming assets, inappropriate corporate scope, and the need to revitalize those business lines that remained within their corporate families due to the ascendency of formidable new competitors that had developed (or re-developed) their own distinctive sources of competitive advantage. The "Big Four" U.S. automobile companies became the "Big Three" and Chrysler filed for the first of several court-supervised financial restructurings. In the years that followed, strategists were torn between the lure of chasing dot-com related growth—as epitomized by the surprising IPO of Netscape—and managing what was already growing in their corporate gardens. Too frequently managers concluded that they were fostering weeds and that the grass grew greener elsewhere.

Since the time of Harrigan's (1980b) seminal study of the strategy alternatives that firms used to cope with declining demand, managers have found that turnarounds and re-deployment of resources have increasingly been required in order to thrive. Competitive advantage is not forever sustainable within environments that are challenged by lower-cost competitors, technological obsolescence, demographic shifts, regulatory changes, and other exogenous forces (D'Aveni, Dagnino, and Smith, 2010). Indeed, firms that operated assets within post-industrial economies were forced to shut down hundreds of their underutilized facilities during the 1980s and 1990s as more effective competitors captured their existing customers' patronage, cultivated demand for new types of customers elsewhere, and moved the nexus of industrial productivity offshore to create lower-cost business models. While extant firms maintained their relationships with ultimate customers, the location of their productive activities should have been of lesser concern, but many firms were slow to recognize that they could sell their accumulated knowledge (as embodied in value-adding services) as complements to their tangible products.

Much knowledge was destroyed when they left competitive arenas without recovering the value of their resources.

Although a few astute firms prospered in the face of such adversity, many competitors could not cope with making required changes and merged with acquiring firms to preserve some remaining value for their owners. Other firms downsized the scope of their operations to emphasize more-promising, remaining business opportunities. As technological innovation forced formerly-separate industries to converge, the need for financial restructurings became urgent. Thus firms operating within post-industrial economies became especially challenged by the need to manage corporate renewal effectively while they also pondered their business mixes and confronted questions of appropriate portfolio rationalization (Harrigan, 1980c).

The Lure of the Transactional Bandwagon

Advances in financial engineering and media-fed investor excitement about the prospects of entering new, technologically-enabled products and services have obscured the fact that most managers struggled daily just to retain their firms' extant customers. Most firms were not engaged in glamorous pursuits, such as executing roll-ups to consolidate their respective industry structures or using financial transactions to change their business mixes. But excitement garnered by headlines trumpeting some firms' consummation of mergers, acquisitions, alliances and even divestitures made investors hungry for accretive growth and left them unimpressed by organic growth (Williamson, 1994). Managers faced shareholder pressures for corporate renewal at a faster pace than operating turnarounds typically required. This was an unfortunate trend that ignored a track record of worthy managerial efforts. It also presaged the elevation of an investment banker's mentality in the corporate suite—a reflection of how corporate renewal was regarded during an era when firms were built to flip.

Divesting managers diversified their firms away from familiar lines of business that were perceived to be problematic—often paying high acquisition premiums to gain access to different lines of business that they considered to be failsafe. Although corporate renewal via mergers and acquisitions seemed to be a relatively fast and risk-reducing restructuring alternative (albeit overpriced), it was also a false panacea since new types of performance problems remained for firms that could not integrate new businesses with ongoing one effectively. As they stockpiled rising-star business comets, corporate managers became further divorced from understanding their firms' new business models—which limited their judgement of performance issues to financial evidence only since they had fewer operating insights.

When financial and competitive performance next declined, corporate managers were again charged with taking appropriate actions to renew their firms' corporate viability, but their assessments focused on valuation topics rather than fundamentals. In a vicious cycle of revolving ownership, problem businesses that were difficult to blend with ongoing activities were frequently divested at fire sale prices from one owner to another until they found the type of owner who worked to salvage their remaining resource value.

Shareholder Activists Accelerate Renewal

The evolution emphasizing risk and valuation criteria over accumulated industry expertise in renewal did not come easily. Implementation of transactions-oriented corporate renewal processes required managers to overcome many types of internal resistance to making such changes (Ansoff, 1965). Barriers to business exit and organizational change were myriad and had to be overcome to achieve these transitions. Objective changes were particularly difficult to implement where business units had been strategically linked (Caves and Porter, 1977; 1978; Harrigan, 1980a) or had been the basis for a firm's rise to prominence (Feldman, 2014). Managers within overextended firms, like General Electric, had to unravel the roles of their corporate offices and end internal arrangements that no longer added value over and above that created by business units themselves (Harrigan, 2018; Karim, Carroll, and Long, 2016).

The value of maintaining internal markets came into doubt as managers had to foster new sources of operating synergy, dismantle old relationships, move resources to new uses, and redesign their firms' organization structures, systems and corporate functions to accommodate their newly-oriented corporate renewal activities (Agarwal, and Helfat, 2009). The role of the corporate office and their activities in creating shareholder value became highly scrutinized in order to eliminate those longer-term bets that investors no longer had an appetite to subsidize (Collis, Young, and Goold, 2007; 2012; Menz, Kunisch, and Collis, 2015).

Shareholder activists rose to prominence as a force by advocating accelerated strategic renewal activity (Chen and Feldman, 2018; Clifford, 2008). Many such activists were, in fact, backed by financial owners and institutional shareholders who were seeking to increase their equity's value after becoming disenchanted with extant managerial ineptitude. Equity analysts further exacerbated the pressures to cull underperforming assets and refocus the corporation's mix of businesses (Feldman, Gilson, and Villalonga, 2014; Feldman, 2016). The rise of shareholder activists as an asset class further institutionalized the mechanism for pressing managers to improve operating outlooks and results through financial transactions if they could not improve performance organically. Meanwhile consultancies, like Bain, which faced different types of performance criteria since they did not have shareholders, acquired equity in the clients that they were turning around—reflecting the evolving boundary between the ownership of corporate assets and management thereof.

The Rise of Financial versus Strategic Owners

The specialized management skills that became crucial for coping with adverse competitive environments during the 1980s were inculcated within consulting firms developed at that time to specialize in advising turnarounds and corporate restructurings. As traditional corporate managers developed financially-oriented, deal-making skills to apply in corporate renewal, Consultancies and private equity firms refined the specialized functional skills that traditional corporate managers once excelled in. For example, AlixPartners, a consulting firm chiefly known for turnarounds, was founded in 1981—the same year as the creation of the Strategic Management Society. Two other leading turnaround consultants, FTI Consulting and Alvarez & Marsal, were founded in 1982 and 1983, respectively. By the 2010s, specialist consultants vied for change management engagements in competition with traditional strategic management firms like McKinsey & Company, Boston Consulting Group, and Bain & Company to perform operating turnarounds on distressed firms and rejuvenate them.

These were not the first turnaround firms to become prominent at corporate renewal; indeed investors during the 1970s had lauded Victor Palmieri and Sanford Sigoloff for their slash-and-burn efforts to recover value within distressed firms. However the rise of consulting firms, such as Berkeley Research Group, that had developed or acquired specialized talent to specialize in turnarounds and restructurings, reflected a pattern whereby institutional and financial owners of corporate equities increasingly used consultants to intervene in managerial decisions and remedy underperformance.

Repeated failures by corporate managers to improve distressed firms' performance created an entrée for private equity investors and hedge funds to acquire such troubled firms outright with the intention of restructuring, then monetizing such investments. To support their desire to find value in distressed firms, private equity owners, like Cerberus Capital Management and Blackstone Group, employed their own cadre of turnaround specialists to assist their portfolio companies on the path back to prosperity.

The rise of interventionist financial owners escalated corporate managers' concerns about preserving their autonomy in making timely turnarounds or restructurings. By the 2010s the corporate managers who might have invested in incremental resource redeployments to revitalize their troubled companies were assailed for flagging performance by shareholder activists who were seeking accelerated responses to business failure. Over time, equity analysts, business journalists, and institutional investors all trumpeted their outrage when corporate resources appeared to be wasted by poor utilization within publicly-traded firms. As stakeholders pressed for rapid performance improvements on many fronts, corporate managers quickly lost both their autonomy to make unwarranted investments and their ability to use generated slack to subsidize their underperforming businesses.

The inevitable outcome of this contestable market for corporate control was the rise of private equity firms as financial owners who were frequently more skilled at fixing troubled companies than were the managers of publicly traded firms who had allowed owners' assets to become underperforming (Baker and Wruck, 1989; Cuny and Talmor, 2007; Manne, 1965). Noteworthy mismanaged firms were acquired by financial owners to be rehabilitated by them instead. With time, the institutional owners of mediocre companies became ever more interventionist in their support of shareholder activism and invited financial owners to bid for the opportunities to renew corporations—albeit with different motives and objectives for turning around the underperforming and underdog firms that they acquired (Harrigan and Wing, 2021; Klier, Welge, and Harrigan, 2009; Zong, 2005).

Implications for Research

Although Table 1 suggests that declines in gross national product coincided with the development of innovative financial approaches to value creation, relatively little is known about how corporate managers might best innovate to retain their respective justification to act as stewards of firms' resources. Initiatives are needed as pressures for cumulative performance improvements have intensified. Because little is known about the internal managerial processes within the financial owners who purchased and revitalized productive resources, a substantial opportunity was lost to understand alternative models for successful management of multi-business enterprises and how their approaches to resource renewal differed. What insights has strategic management research to offer them, and vice versa? Were financial owners ever the audience of strategic management research, and will they be so in the future?

The trade-offs within the implementation of rival types of business models (and how they are best organized) should be of interest to strategy scholars. Although their pivotal knowledge proves to be rediscovered content from a more placid era when managers were given the luxury of adequate time to fix troubled assets, it would appear that many forms of financial owners that have been sheltered from the dysfunctional regulation of publicly-traded firms enjoyed advantages both in purchasing productive assets inexpensively and benefitting from their subsequent rehabilitation. Rival types of organizations vie for the same investor funding; if technological progress is society's goal, a productivity comparison of rival business models should be of interest to consider how best to harness the creativity that is generated by renewing the viability of businesses and their assets under each respective form of enterprise. What are the trade-offs of embracing each model and what does this allocation portend for future renewal activity?

Recognition of how stewardship roles have been reversed over time should sound a warning alarm for corporate managers who must address the challenges of resource renewal before financial owners supplant them (Jensen, 1986). Scholars of corporate governance will benefit from investigations concerning whether corporate boards who insisted upon restructurings served stakeholders better than did corporate managers that facilitated operating turnarounds internally. When share repurchases became an indicator that managers fostered no promising internal projects, it would have been useful to understand the content of renewal strategies pursued by firms that were effectively decapitalized when they downsized in order to contrast their activities with firms that performed internal triages yet continued to enthrall investors when returning to the capital markets. At a minimum, it would be useful for scholars to document the penalty imposed upon publicly-traded firms for failing to grow their revenues and profits during periods of adversity.

The familiar complaint that fund managers can better optimize investments by buying and selling their shares instead of the actual assets of firms can be refuted by considering how best to utilize the corporate office (Hill, 1994). Greater investigation of how the corporate suite of multi-business enterprises might best function is warranted. Does emphasis upon compliance to satisfy investors suggest that Chief Financial Officers will exercise greater power over scope decisions within the corporate office than has heretofore been acknowledged? Will strategies to foster operating synergies be downplayed as unwarranted cross-subsidizations? Will operating managers and entrepreneurs who can guide their start-ups to acquisition emerge as the unsung heroes within publicly-traded firms?

More scholarly investigation is warranted of firms that have avoided the embrace of vulture capitalists to date and rehabilitated their firms by redeploying resources internally. Table 1 ends with the challenges of the COVID-19 pandemic that halted operations within so many enterprises. The turnaround community was still waiting for a flood of clients seeking help at the end of 2020. These troubled firms had not yet arrived on their doorsteps as the new year began. Strategy scholars will want to discover how mundane operations coped with the adversity of severe work stoppages and survived during this era. How did managers revitalize operations?

Harrigan (1980b) found that well-managed operations within maturing and declining demand settings could generate substantial amounts of cash to fund their continual upgrading and renewal of operations. Their customers were relatively price-insensitive when availability of desired products and services was important to them. Results suggested that some problem businesses were instead opportunities that thrived for leaders possessing the appropriate skills and aptitudes to renew business viability.

The market favors pure plays and eschews confusing diversification. Its dominance over strategy making suggests that managers must rediscover the simple skills of running less complicated companies—albeit for a shorter horizon than strategy research has assumed to be desirable. If the death of competition means there can be no long-term strategy horizons, then strategy research should be focusing upon where corporate managers can best invest in competitions that they can win and leave research concerning specialist activities to a new breed of financial researchers who have developed the tools to evaluate corporate renewal in its current incarnation if strategy scholars are not disposed to do so.

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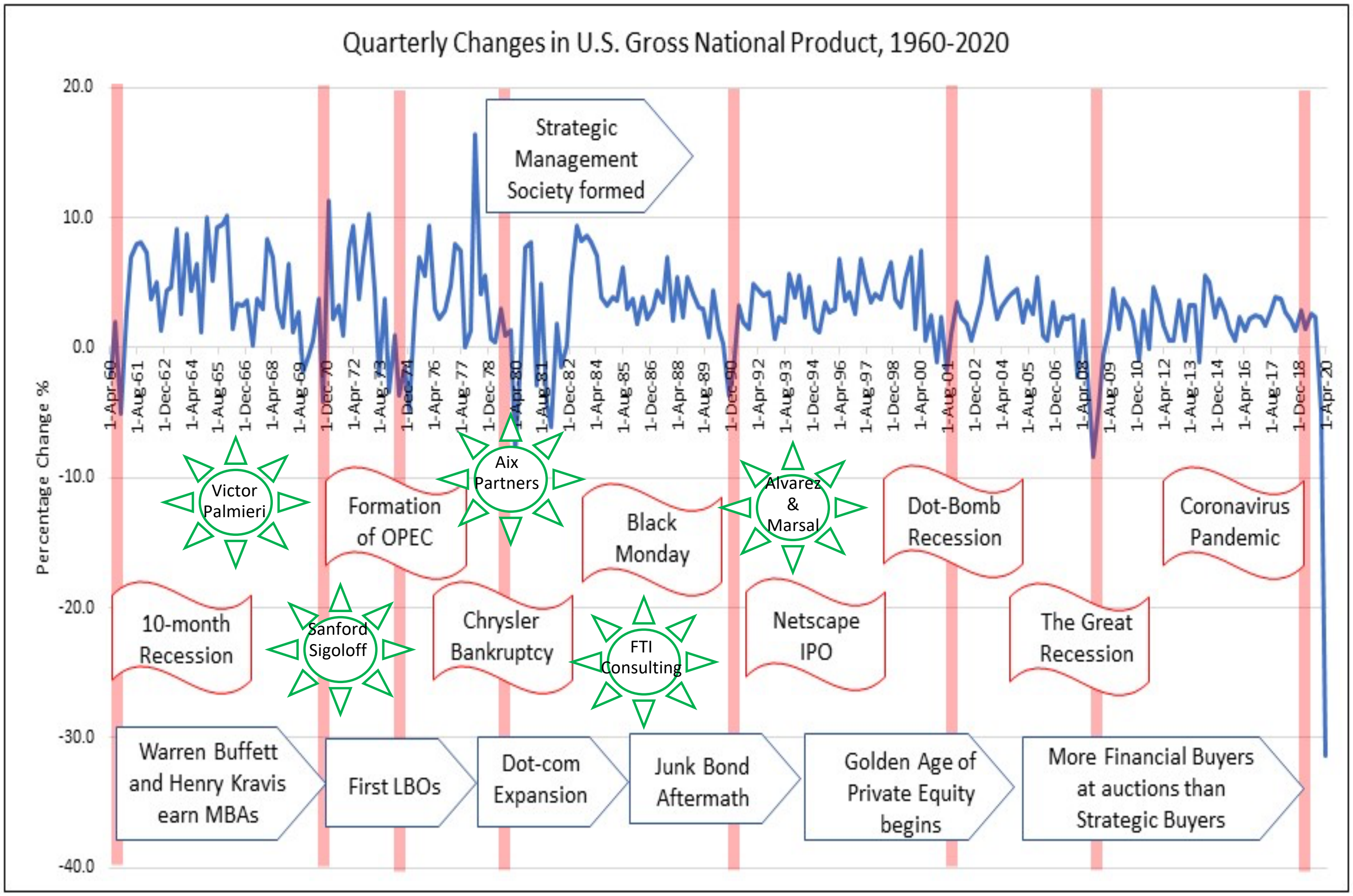
Table 1 – Key U.S. Economic Events Affecting Corporate Strategy



Source: Capital IQ and Federal Reserve