Strategic refocusing of large firms on core businesses – A *process* approach[1]

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The aim of this paper is to expound my Ph.D. topic, which deals with strategic refocusing of large firms on core businesses.

In its main features, corporate refocusing usually relates (1) the – no yet settled – debate about the preeminence of a form of diversification and (2) the causal relationship between corporate refocusing and performance. With respect to most published works, related diversifiers outperform their competitors. However, with respect to American restructuring during the 1980s, M. A. Hitt and R. H. Hoskisson (1994) reported that unrelated diversifiers, in spite of frequent divestments, continued to diversify in an unrelated manner. On the contrary, related-linked diversifiers (amalgam of related and unrelated businesses) improved the connections between businesses.

On the one hand, there is an historical explanation to the double focusing of the research agenda. The trend towards corporate refocusing dates back to the 1980s. It occurred to disavow a number of 1970s perilous options of diversification; those later had been based upon the only statistical control of the portfolio risk. Actually, top managers used to apply an ephemeral and essentially financial logic of resources allocation instead of achieving synergies (M. Porter, 1985). On the other hand, corporate refocusing obviously appears to be the opposite of diversification. For instance, C. Markides (1995) found that refocused firms have diversified beyond the optimal level. Thus one needs only to invert the diversification evidences and arguments so as to explain corporate refocusing (B. Paulré, 2000).

1 – Refocusing in the growth trajectory of the firm – a *process* approach.

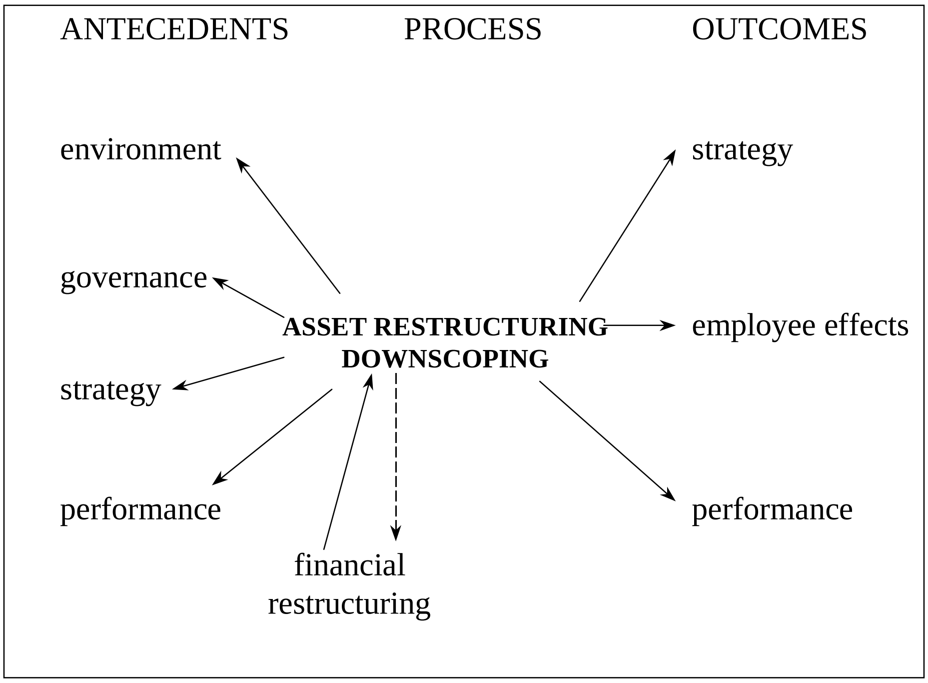
Hence, researchers are used to addressing corporate refocusing in a performance perspective. They compare the portfolio of domains before and after the refocusing, looking for a causal relationship between “antecedents and outcomes of corporate refocusing” (R.A. Johnson, 1996) as pointed out in *figure 1*.

[1] The French foundation for teaching in management (FNEGE), through the CEFAG programme, made it possible to prepare this paper. This later is in keeping with a research stay at the Copenhagen Business School.

However, we are often provided with a static approach of strategic refocusing; that is to say one snapshot of the portfolio before and one after the refocusing program. Even though corporate refocusing is a *process* of divestment from (sometimes-lucrative) non-core domains and “reinforcement” of core businesses, the strategic refocusing *process* is not investigated between the two snaps.

Thus, my Ph.D. topic consists in understanding corporate refocusing in the growth trajectory of the firm. It does not consist in providing neither the evidence of a relationship between refocusing program and performance, nor in concluding that one kind of diversification (related, unrelated) is superior to another. Those two above mentioned topics are very well addressed by other contributors. In a large outlook, my research project points out how top managers proceeds to refocus the firm on core businesses.

Figure 1. Summary model of the antecedents
and outcomes of corporate refocusing



Source: R. A. Johnson, 1996, p. 441

2 – From contraction vs. expansion to expansion through contraction.

Occidental schemas of thought are especially centered on oppositions and rifts although researchers have been interested in paradoxes and trade-offs for a few years. Thus, R. A. Johnson, in the introduction to his 1996 exhaustive synthesis, submitted two opposed forms of restructuring: expansion and contraction. With respect to the refocusing theme, researchers working in this area rarely address the second edge of the program. Corporate refocusing “relates to the process of reducing diversified scope through sell-offs, spin-offs, or split-ups” (R. A. Johnson, 1996, p. 440). Corporate refocusing is often reduced to contraction through divestiture. It is an end in itself.

That is easily understandable. Financial researchers have particularly well investigated the corporate refocusing topic. They aim at providing the evidence that corporate refocusing increases the profitability rate and the market value of the firm. Thus the expansion side of the refocusing strategy is less consistent with their aim. In particular, event studies are used in order to demonstrate that the market positively values divestiture, sell-off, … Nevertheless, event studies carry some limitations from a strategic insight: long-term impact, strategic meaning, are not taken into accoun[2]t.

By contrast, the Chinese "yin yang" philosophy points out that opposed concepts have to be joined together so as to explain and feed each other. "Contraction is the main condition of the future deployment. Even more exactly, who is not able to contract won't be able to deploy" (F. Jullien, 1989 [1996], p. 26). Corporate refocusing may thus encompasses contraction and expansion even though it is very difficult to accept that the growth of the firm proceeds from divestitures or spin-offs (G. Koenig, 1997). By selling off non-core businesses to counterparts or competitors, refocused firm obtains means to emphasize their core businesses. Hence, the outlook is usually focused on the "contraction" side of refocusing programs and I would like to account for the expansion side.

Here is the main topic of my research project. Reducing corporate refocusing to the divestment from lines of businesses consists in a static and no strategic approach. Indeed, competition between actors – incidentally strategy – takes place in a situation of continuous disequilibrium that questions endlessly achieved rent (N. J. Foss, V. Mahnke, 1999). Therefore, "it is of no use" to refocus the firm on a few core businesses, if firm doesn't explore ways of redefining, renewing, reorganizing, … them. If the firm is satisfied with the only exploitation of core businesses, competitors may overthrow the competitive advantage by changing the rules of the game (schumpeterian perspective). Thus, empirically, the firm have to find other means to reach efficiency. Theoretically, a "static efficiency" approach doesn't allow us to explain the situation of continuous disequilibrium in which actions of corporate refocusing – strategy in general – takes place.

Before addressing the process of expansion on core businesses involved in the refocusing programme, it's fitting to dwell upon what is a core business.

3 – What is a core business?

It is a tautology that core businesses are the businesses that firms (re)focus on and, paraphrasing O. E. Williamson (1999) about core competencies, that a core business is a business which is core. In other words, core businesses come from the refocusing strategy as much as they manage it. Actually, the term "core business" has been left to intuitive interpretation (I. Snehota, 1990)[3].

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[2] According to Zhao and colleagues (p. 6-7), (1) event studies are not able to measure the long-term impact of refocusing on firm performance, which is, after all, the main concern of strategic management. (2) Refocusing programmes take a long time to implement in so far as performance outcomes may fall far behind announcements. (3) Markets returns do not inexorably constitute comprehensive measures of performance.

[3] "Core business" is the most faithful English language translation of the French concept of "métier" that exists. In French language, "métier" is a metaphor from the person to the firm, in the same meaning as Selznick´s (1957) "distinctive competence" describes the firm character. There is

External vs. internal and objective vs. subjective

Business has commonly been defined with respect to customers functions, products and competitors that are interdependent (Abell, 1980). The core business is thus addressed from the outside of the firm in so far as it is an "objective" reality.

As a matter of fact, two associated "trade-offs" have to be reached in order to fix the limits of the concept:

1. between an environment-driven definition and an internal description of businesses;

2. between managerial perceptions of what domains firm is in and "objective" definition of core businesses.

The E. T. Penrose point of view (1959 [1995], pp. 41-42) is here useful. According to her, firms' behavior cannot be accounted for only from the study of external circumstances. Therefore, the "objective" productive opportunity of a firm is determined by what this firm is able to do, but its "subjective" potential depends on what it believes to be able to do. Thus, the environment is not independent of firm's own activities but, in the end, firm perceptions of productive potential have to be confronted with environment reply. Environment accepts or rejects the pertinence of the opportunities estimating.

Firm managers cannot picture to themselves what their businesses are without taking account of the interplay with environment. This reality, neither "objective" nor "subjective", but co-constructed, provides in part the firm core businesses uniqueness.

To summarize, the concept of core business is related to the unique cognitive way a firm perceives its own businesses. That means that managers also have to find the balance between a precise (but possibly too narrow) and a broad (but possibly too vague) definition of what are core businesses. The part of the environment (market, customers and competitors…) is to check the congruity to the reality.

Relationships between core business and RBV[4] concepts.

The concept of core business appears to be consistent with resource-based concepts. With respect to "the theory of the firm", it seems that RBV give an interpretation of many matters:

- the collection of resources possessed by the firm inside its boundaries;

- the competencies and capabilities so as to combine and coordinate those resources;

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one word to define, on the one hand, the "craft" or the "trade" (person) and, on the other hand, the "core business" (firm). However, the French literature copes with the same "no definition" problem.

[4] By convenience, RBV also encompasses « capabilities-based », « knowledge-based » and « competence-based ».

- the services of resources that firms source outside their boundaries (outsourcing…) or shares with their counterparts and competitors (cooperative agreements…).

But the RBV appears to be "short of" a theoretical concept that encompasses the system of resources and capabilities mobilized inside and outside boundaries of the firm.

A first attempt of definition may be the following. A core business consists in a resources and competencies system, coordinated and embedded into firm's history, identity and experiences, guided by managers's vision, in order to supply to a set of demands. But how this definition is different from the definition of a usual business?

Is the core business simply the firm's traditional business?

Following C. Markides (1995), a firm that refocuses on core businesses may have diversified beyond the optimal level: it suggests then that the firm should "get back to its roots" (traditional core businesses) in order to cancel the bad outcomes of diversification. Nevertheless, it implies implicitly (1) that strategic actions and choices are reversible and (2) that "intertemporal" comparison is feasible. However, in the course of time, contents and boundaries of core businesses are not necessarily stable and a refocused firm doesn't cope continually with the same constraints. Thus core businesses also have to be viewed in a dynamic perspective (B. Paulré, 2000).

Moreover, Zhao and colleagues (1999) reported that "there is no significant difference in the performance of firms that refocus on traditional core businesses versus firms that refocus on new core businesses" (p. 17). And everyday we are showed the empirical evidence of firms, which refocus on core businesses stem from diversification movements. Consequently, history doesn't really matter; traditional core businesses don't fundamentally build a kind of strategic "path dependency". To be more precise, the age of a core business is rather irrelevant to the corporate refocusing analysis and to the definition o the concept. Actually, R. G. McGrath (1995) seems to be the closest to a definition as she characterizes core businesses "as those which represent a significant portion of the firm's sales or profits".

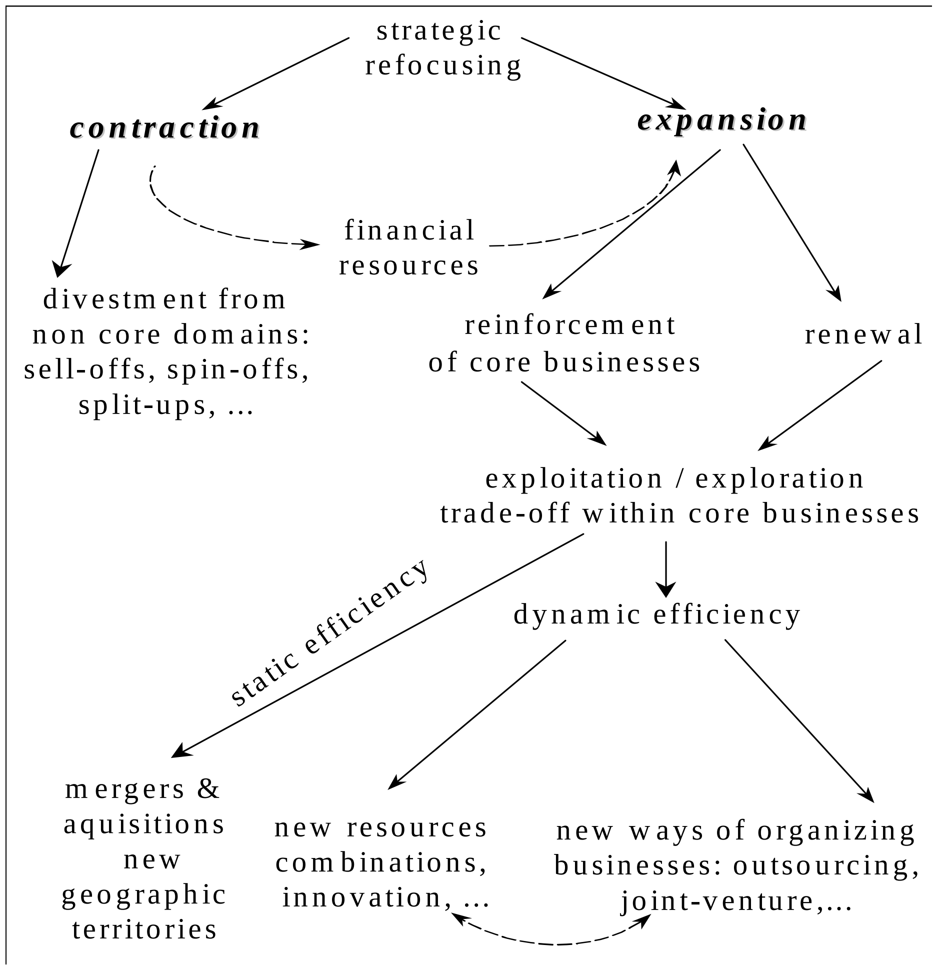
4 – Exploitation / exploration trade-off within core businesses.

How to renew core businesses?

We above mentioned (1) that corporate refocusing is outlined as a process of expansion through contraction and (2) that the expansion edge of refocusing is rarely addressed in the literature as so far as it suggests a static and no strategic approach. Our perspective is represented in *figure 2*.

The expanding side of refocusing consists in finding the balance between the exploitation of core businesses (static efficiency) and the exploration within core businesses (dynamic efficiency) because both of them, independently conducted, are perilous.

Figure 2. A process approach of strategic refocusing



In short, the exploitation "guarantees" the firm a rent in reinvesting in – i.e. reinforcing - the existing core businesses. It consists in improving the profitability rate, the more often by external growth (mergers and acquisitions). The firm takes advantage of experiences, obtains the same or higher gains but at lower costs, enhances its profit rate and sales, often in extending the geographic areas served by the firm. By this way, the firm may obtain a greater market power in a monopolistic end. Strategic refocusing becomes a matter of drawing out maximum monopoly rents.

It is adapted when a firm needs to reach a critical size in a context of markets geographic globalization. In that case, firm may refocus on core businesses in order to concentrate all the financial means on the aim of globalization.

Nevertheless, this strategy is irrelevant or insufficient in unstable environments, fast technological changes and time-based competition circumstances. Competitors may overthrow the competitive advantage by changing the rules of the game and "bringing down" the entry barriers. Indeed, those conditions tend to spread all around the markets. Thus, empirically, the firm have to find other means to reach efficiency or, theoretically, a static efficiency approach is not consistent with explaining the situations of continuous disequilibrium in which strategic refocusing takes place.

Dynamic efficiency: exploration within core businesses

Transforming the existing core to keep pace with changing circumstances requires some exploration (R. G. Mc Grath, 1995, p. 5). To restrict the risks of the insufficient exploitation, refocused company may try to redefine, transform and renew its core businesses.

S. Ghoshal and P. Moran (1999) suggest two means to achieve value creation: combination (rather within the firm) and exchange (which encompasses hybrid forms)[5]. Therefore, the exploration within core businesses may be directed at two linked ways: modifying the organizational form(s) and recombining resources within core businesses.

- Various ways of organizing core businesses:

First, there are some aspects (strategic or not) of a company's core businesses, which can and should be outsourced, given back to market… "By recombining the set of resources that are within one's reach, exchange changes and reprioritizes the services that are possible and/or motivated for each party, and it stimulates the perception of new combinations". "In essence, exchange allows to better exploit existing knowledge as it induces the continual migration to better-known uses" (S. Ghoshal, P. Moran, p. 395 & 396). Thus, the firm ability to "take up" resources through exchange or hybrid arrangements consists in developing some kind of strategic options that will allow the firm to diversify in more products markets (Sanchez, 1995).

Even though one suggests that firms should ever disaggregate, diffusing market principles inside the firm also constitutes a – new, maybe less expensive, painful and risky – way of organizing core businesses externally (N. J. Foss, 2000). As T. Elrfing and Ch. Baden-Fuller (2000) pointed out, markets, firms and networks are all loci of entrepreneurship which can participate to the renewal of core businesses.

- New resources combinations within core businesses:

Secondly, the core business is the locus of new resources combinations and arrangements. That straightly refers to seminal Schumpeter´s and Penrose´s thoughts.

[5] Of course, combinations may be achieved through the market and market incentive mechanisms are present inside firms. But, by theoretical convenience, combination and exchange are separated.

1. “Exactly the same resource when used for different purposes or in different ways and in combination with different types or amounts of other resources provides a different service or set of services” (E. T. Penrose, 1959, p. 25). “Unused productive services are, for the enterprising firm, at the same time a challenge to innovate, an incentive to expand, and a source of competitive advantage. They facilitate the introduction of *new combinations of resources* – innovation – within the firm” (p. 85)

2. New combinations constitute the source of all endogenous changes that distinguish the process of economic development (J. Schumpeter, 1934).

The both exploration opportunities mentioned in short may contribute to broaden the scope of core businesses and/or to create new core businesses: in one word to “related-diversify” the firm. More particularly, this exploration process may play a crucial part in shifting incrementally the strategic direction of the firm. Besides, it is interesting to notice that the strategic refocusing may exists, in itself, as a strategic re-orientation and/or a radical change, when firms through refocusing shift their center of gravity. For instance, Danone Group, which will be the subject of a case study, through the 1996-2000 refocusing programme, changed its center de gravity from the glass making business (“inborn” core business) to food businesses stem from diversification actions.

Conclusion

This research project aims at addressing the expansion edge, rather rarely investigated, of corporate refocusing. More particularly, it submits that strategic refocusing is a process of expansion through contraction. Therefore, as the refocused company – through divestments, sell-offs… - obtains financial means to develop, the interest is focused on the ways of renewing, transforming and shifting core businesses.

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