# Transforming the business portfolio: how multinationals reinvent themselves

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## Introduction

The strategic restructuring of a firm's business portfolio is a common method for a firm to recreate itself and achieve a competitive advantage. It has been used in the 1960s and 1980s when firms started to diversify their business portfolios and often, subsequently, reversed diversification and refocused on their core business (Nippa *et al.*, 2011). It is still at the heart of corporate strategy and more present on corporate agendas than ever before – especially driven by the increasingly competitive and rapidly changing environment that forces firms to regularly prepare for new challenges ahead.

Business portfolio restructuring not only involves single acquisitions and divestitures but also sequences of strategically intended acquisitions and divestitures to implement a diversification, refocusing or repositioning strategy. We consider a portfolio restructuring to be a business portfolio transformation if it involves a purposeful, significant change of the business mix that alters the appearance of the company. Such transformations typically, but not necessarily, occur over multiple years.

A recent example of such a business portfolio transformation is the refocusing efforts by the Linde Group, a world-leading gas and engineering company. Linde underwent a major transformation between 2004 and 2007 when it first sold its refrigeration division, then acquired its UK-based gas competitor BOC Group and sold its former materials handling division to purely focus on gas[1]. A more drastic example of a repositioning transformation is the French conglomerate Vivendi which transformed itself from a construction and environmental services company back in the late 1990s to a media conglomerate completely focusing on music, television and video games from the mid-2000s onward[2]. Recently, the German steel producer ThyssenKrupp announced its upcoming portfolio transformation to drastically reduce its dependency on steel production and to become a modern technology conglomerate, focusing on business activities such as elevators, refineries, ships, machinery and parts for the automotive industry[3].

Given its importance in the corporate world, research in the field of business portfolio restructuring has emerged from the more general research on corporate restructuring in strategic management (Bowman and Singh, 1993; Liao, 2005). It has primarily focused on cross-sectional studies to investigate antecedents and outcomes of portfolio restructuring. Consequently, portfolio restructuring has so far been portrayed as a response to factors such as poor performance and over-diversification, while its outcomes were mainly described in terms of changes in post-restructuring performance and diversification levels (Johnson, 1996; Brauer, 2006).

However, the strategic process of business portfolio restructuring "as a sequence of events that describe how things change over time" (Van de Ven, 1992, p. 169) appears to be

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strongly under-researched today. The present paper addresses this research gap by investigating the portfolio development of a sample of the largest 100 European and 100 North American firms over the period of 1998-2010. We will answer the question whether portfolio transformations are rare corporate events or more regular instruments of corporate strategy for large multibusiness firms, and investigate the extent to which the identified transformations have been motivated by over-diversification or poor performance (as postulated by prior research) and how successful the transformations have been in addressing these shortcomings. We also analyze the characteristics and patterns of the underlying transformation processes to answer the following questions:

- What is the typical magnitude of a business portfolio transformation?
- How long does a transformation typically take?
- How do firms transform their business portfolios – in several small steps and continuously, in one major step or in a few significant steps every couple of years?
- Are transformations typically based on organic or inorganic changes to the portfolio?

In this way, we will derive practical advice for managers who consider a major restructuring of their corporate portfolios.

### *Identification of business portfolio transformations*

The sample investigated comprised the largest 100 European and the largest 100 North American publicly listed companies based on sales revenues generated in 2010 (taken from the Thomson Reuters DataStream Advanced Database). From this initial sample, the following were eliminated:

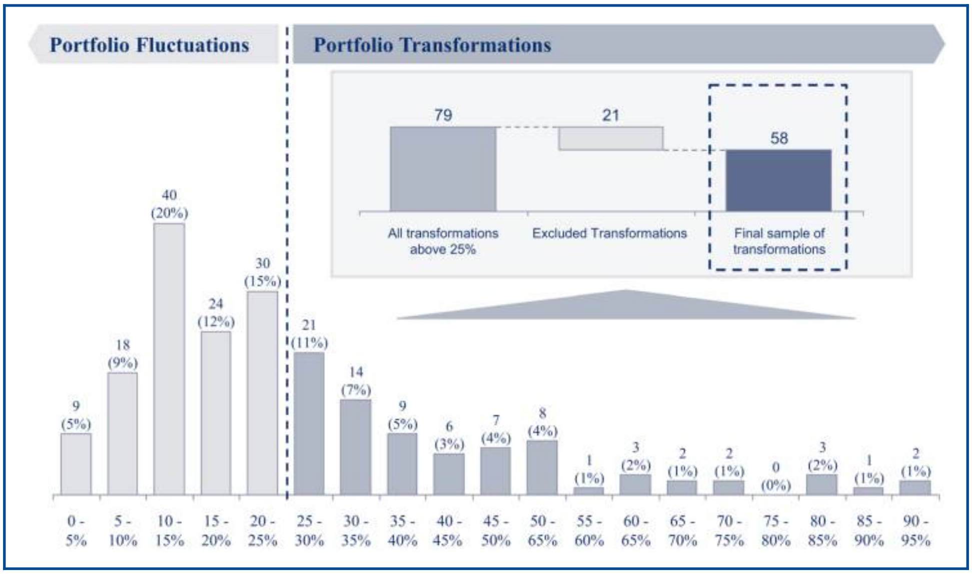
- financial services firms because they have distinct business models and follow different reporting standards;
- firms with fewer than two reportable segments because changes in portfolio composition cannot be traced for them; and
- firms where segmental data could not be traced for at least nine consecutive years between 1998 and 2010 (our period of investigation).

The sample was supplemented with the next largest firms.

To identify firms within our sample that conducted a business portfolio transformation and to quantify these transformations, a three-step approach was followed. First, we quantified how strongly companies actually change the composition of their business portfolios. To this end, we measured the magnitude of each firm’s changes within the business portfolio over the period of 1998-2010. Second, for each company, the respective period in which the relatively strongest portfolio changes took place was determined. Third, we defined a cutoff criterion to identify those firms within our sample that underwent a business portfolio transformation. Details on the methodology will be provided by the authors upon request.

The transformation of a firm’s portfolio ranges from 0 (when the composition of the portfolio is not changed at all) to 100 per cent (when the whole business portfolio was replaced by new businesses during the measurement period). The distribution of the maximum transformation magnitudes for all 200 sample firms over the period of 1998-2010 is illustrated in Figure 1. Almost three-quarters of all firms (72 per cent) have

**Figure 1** Distribution of maximum transformation magnitude for all 200 companies during 1998-2010




changed their portfolio of businesses by <30 per cent, while only 12 per cent of all firms replaced more than half of their portfolio during the sample period and thus became a different kind of firm.

We define business portfolio transformations as purposeful, significant changes of the business mix that alter the appearance of the company. By analyzing the distribution of changes in the portfolio composition in our sample, we defined a cutoff (shoulder) criterion of 25 per cent to qualify as portfolio transformation. Applying this cutoff criterion leads to a subsample of 79 firms. Based on additional cross-checks with publicly available information from press articles and annual reports, we excluded 21 of these 79 firms because they only achieved their transformation by adding up minor changes over a long period. This left us with a final sample of 58 firms that conducted a business portfolio transformation during the period of 1998-2010, with 33 firms originating from Europe and 25 from North America (Table I).

### *Motivation and success of portfolio transformations*

Before investigating the processes of these 58 business portfolio transformations, we wanted to better understand their underlying motivation, direction and success. To this end, the transformations were first classified into three restructuring types (refocusing, diversifying and repositioning) and analyzed for their distinct characteristics. We then investigated to which extent the identified transformations had been motivated by over-diversification or poor performance, as postulated by prior research, and how successful the transformations had been in addressing these shortcomings.

### *Restructuring types*

Prior research distinguishes three types of portfolio restructuring:

1. a firm can choose to diversify its business portfolio, e.g. through a set of acquisitions (Hoskisson and Hitt, 1990; Liao, 2005);
2. to refocus on its core business, e.g. through a set of divestitures of businesses unrelated to this core (Markides, 1993); and
3. fully reposition itself by moving from one core business to another.

**Table I** Top 58 transformations in Europe and North America during the period of 1998-2010

| Rank | Company | *Transformation magnitude (period)* | Rank | Company | *Transformation magnitude (period)* | Rank | Company | *Transformation magnitude (period)* |
|---|---|---|---|---|---|---|---|---|
| 1 | Vivendi SA | 87 per cent (1999-2001) | 21 | Enel SPA | 41 per cent (2006-2010) | 41 | TUI AG | 28 per cent (2007-2008) |
| 2 | Groupe Safran | 84 per cent (2004-2008) | 22 | Koninklijke Ahold NV | 41 per cent (2006-2008) | 42 | Henkel AG & Co. KG | 28 per cent (2001-2002) |
| 3 | Altria Group Inc. | 82 per cent (2006-2008) | 23 | PPR SA | 41 per cent (2002-2005) | 43 | Xerox Co. | 28 per cent (2009-2010) |
| 4 | E.ON AG | 81 per cent (2000-2003) | 24 | Apple Inc | 41 per cent (2008-2010) | 44 | Husky Energy Inc. | 28 per cent (2006-2010) |
| 5 | Time Warner, Inc. | 78 per cent (2000-2001) | 25 | Continental AG | 41 per cent (2006-2008) | 45 | ACS | 27 per cent (2002-2007) |
| 6 | RWE AG | 72 per cent (2000-2005) | 26 | BAE Systems Plc. | 38 per cent (2004-2008) | 46 | Akzo Nobel N.V. | 27 per cent (2006-2007) |
| 7 | Xstrata Plc. | 71 per cent (2001-2004) | 27 | Anglo American Plc. | 36 per cent (2005-2007) | 47 | Amazon.com Inc. | 27 per cent (2005-2010) |
| 8 | Freeport-McMoran Inc. | 70 per cent (2006-2008) | 28 | CVS Caremark Co. | 35 per cent (2006-2007) | 48 | Alstom SA | 27 per cent (2000-2002) |
| 9 | Tyson Foods, Inc | 63 per cent (2000-2002) | 29 | Linde AG | 35 per cent (2006-2007) | 49 | ConocoPhillips | 27 per cent (2000-2002) |
| 10 | Sears Holdings Co. | 61 per cent (2004-2005) | 30 | E.I. Du Pont de N. & Co. | 35 per cent (2000-2005) | 50 | Rio Tinto Plc. | 27 per cent (2006-2008) |
| 11 | Halliburton Co. | 61 per cent (2004-2007) | 31 | Pepsico Inc. | 34 per cent (1998-2000) | 51 | Faurecia | 26 per cent (2000-2001) |
| 12 | Tyco International Ltd. | 55 per cent (2006-2007) | 32 | Imperial Tobacco Plc. | 34 per cent (2007-2009) | 52 | Danone | 26 per cent (2006-2009) |
| 13 | Ferrobvial SA | 49 per cent (2002-2007) | 33 | Deutsche Telekom AG | 33 per cent (1999-2005) | 53 | L-3 Comm. Inc. | 27 per cent (2001-2004) |
| 14 | Deutsche Post AG | 49 per cent (1998-2000) | 34 | General Dynamics Co. | 32 per cent (1998-1999) | 54 | International Paper Co. | 26 per cent (2003-2008) |
| 15 | Aktiebolaget Volvo | 47 per cent (1998-1999) | 35 | Daimler AG | 32 per cent (2006-2007) | 55 | Bombardier Inc. | 26 per cent (2001-2004) |
| 16 | JC Penney Inc. | 46 per cent (2003-2004) | 36 | Finmeccanica SPA | 32 per cent (2003-2005) | 56 | Supervalu Inc. | 26 per cent (2004-2008) |
| 17 | Iberdrola SA | 46 per cent (2006-2009) | 37 | ArcelorMittal | 31 per cent (2003-2004) | 57 | Mol Magyar | 26 per cent (2003-2007) |
| 18 | MAN SE | 45 per cent (2003-2008) | 38 | Fiat SPA | 31 per cent (2009-2010) | 58 | Johnson Controls Inc. | 25 per cent (2005-2009) |
| 19 | KOC Holding AS | 44 per cent (2005-2008) | 39 | Schlumberger Ltd. | 29 per cent (2003-2004) | | | |
| 20 | Comcast Co. | 42 per cent (2001-2003) | 40 | Northrop Grumman Co. | 29 per cent (2000-2002) | | | |

> **"The German steel producer ThyssenKrupp announced its upcoming portfolio transformation to drastically reduce its dependency on steel production and to become a modern technology conglomerate."**

While looking at the 58 firms that had been identified as business portfolio transformations, all three restructuring types were found. We identified the refocusing firms by a decrease in their total diversification degree and diversifying firms by an increase in their total diversification degree during the transformation. Repositioning strategies were identified based on the following criteria:

- First, they had to change the two-digit standard industrial classification (SIC) code of their largest segment.
- Second, the share of the previous largest segment had to decrease by at least 15 percentage points to <33 per cent at the end of the transformation.
- Third, the share of the new largest segment had to increase by at least 15 percentage points from <33 per cent at the beginning of the transformation.

In this way, we identified 26 refocusing, 15 diversifying and 11 repositioning transformations. Six firms could not be allocated to one of the restructuring types.

The 26 refocusing firms transformed their portfolios on average by 36 per cent, with only two firms changing their portfolios by >50 per cent. Interestingly, they increased their total assets on average by 34 per cent and their sales by 9 per cent during the refocusing and only reduced the headcount by 9 per cent. This points to a streamlining of operations rather than a shrinking of the overall company. An example of such an expanding refocusing firm is the Spanish utility Enel which acquired Endesa in 2007 to strengthen its core business.

As expected, an even stronger expansion was observed among the 15 diversifying firms, which, on average, increased their total assets by 149 per cent, their sales by 110 per cent and their headcount by 45 per cent during the transformation period. The average change in portfolio composition for these firms amounted to only 35 per cent with none of the firms changing their portfolio by >50 per cent. A typical example of such a diversifying transformation is the German postal service company Deutsche Post AG which acquired the financial services provider Postbank and also the logistics company Danza and thus significantly increased its size and degree of diversification[4].

By far, the strongest transformations were observed for repositioning firms with an average change of 63 per cent to portfolio composition. Almost three-quarters of these firms substituted more than half of their portfolio by targeting new markets and replacing major parts of their old business portfolio, including their former core business, through a series of acquisitions and divestitures. During the transformation, on average, repositioning firms increased their total assets by 111 per cent and their sales by 91 per cent, while reducing their headcount by 2 per cent. An example of such a repositioning transformation is the case of Vivendi mentioned previously.

### *Poor performance as motivation for portfolio transformation*

Poor performance is frequently cited as the main motive for conducting portfolio restructuring, be it single divestitures or refocusing strategies (Markides, 1993; Bergh, 1998). Consistently, the effect of portfolio restructuring on post-restructuring performance is generally expected to be positive (Markides, 1993; Liao, 2005).

To test the predictions of the literature on our sample, we operationalized firm performance with three different performance metrics:

1. return on assets (ROA) as an accounting-based performance;
2. relative total shareholder return (RTSR) as a market-based performance; and
3. sales growth rate as a growth-based performance.

Accounting-based performance was measured using the average ROA (relative to the industry average) for the two years prior to the start of a transformation for pre-transformation performance, and average ROA for the two years after a transformation for post-transformation performance. Market-based performance was calculated as RTSR (relative to the respective country market index), taking the two-year average before the start of the transformation as the pre-transformation performance, and the cumulated RTSR over the transformation period as the post-transformation performance. Pre-transformation sales growth rate was calculated as the compound annual growth rate (CAGR) for the two years preceding the transformation, and post-transformation sales growth rate were calculated as CAGR for the two years after the transformation.

We compared the starting and ending performance of our sample of 58 transforming companies with the remaining 142 firms that were not classified as business portfolio transformations. Table II shows the percentage point differences in performance of the transformed firms to the average of all non-transformed firms for ROA, RTSR and sales growth.

Regarding firms that implemented a *refocusing strategy*, our results revealed that, while they started with a clearly below-average performance in terms of ROA, RTSR and sales growth, their refocusing strategy seemingly paid off: they managed to increase their ROA over the transformation period by 1.9 percentage points and were rewarded with a positive cumulated RTSR of 1.7 per cent. Interestingly, by refocusing on their core business, these firms also improved their growth trajectory by 7.1 percentage points. The refocusing firms in our sample thus fully confirmed scholarly predictions regarding the economic benefits of refocusing on their core business.

The picture was quite different for *diversifying firms*. They started from a position of strength with an above-average ROA and a strong RTSR track record of +7.2 per cent in comparison to their non-transforming peers. They only lagged in growth, which may have been their main motivation for embarking on a diversifying transformation. In this sense, their transformation was generally successful because they managed to increase their growth rate by 4.1 percentage points to a value above their non-transforming peers. However, diversifying firms paid for this higher growth rate with a reduction of ROA by 2.8 percentage points and suffered from a negative cumulated RTSR of −5.0 per cent over the transformation period.

*Repositioning strategies* seemed to be the most difficult to implement. Repositioning firms, on average, started from weak fundamental and market performance, with ROA and RTSR values similar to those of refocusing firms, although their pre-transformation sales growth

**Table II** Delta of performance at transformation start and end year (ROA, RTSR and sales growth), and over transformation period (cumulated RTSR) between transformed firms and non-transformed sample

| | | *ROA*[a] | | *RTSR*[b] | | *Sales growth*[c] | |
|---|---|---|---|---|---|---|---|
| | | *Start*[d] | *End*[d] | *Start*[d] | *Cumulated*[e] | *Start*[d] | *End*[d] |
| Restructuring types | Refocusing firms | −2.1 | −0.2 | −3.5 | +1.7 | −1.8 | +5.3 |
| | Diversifying firms | +0.7 | −2.1 | +7.2 | −5.0 | −2.2 | +1.9 |
| | Repositioning firms | −1.7 | −6.1 | −2.9 | −9.6 | +7.4 | −4.8 |

**Notes:** [a]Industry-adjusted ROA; [b]Relative total shareholder return (compared to country indices); [c]Growth rate of sales; [d]Displayed value as percentage point differences to average of all non-transformed firms for respective restructuring type; [e]RTSR measured as cumulated RTSR over the transformation period; displayed value as percentage point difference of cumulated RTSR over each transformed firm's transformation period, matched with the cumulated RTSR over the same period of all non-transformed firms for respective restructuring type rate was surprisingly high. However, the average repositioning firm in our sample lost 4.4 percentage points in ROA and 12.2 percentage points in growth rate to its non-transforming peers in the course of the transformation. This was also reflected in a negative cumulated RTSR of −9.6 per cent over the transformation period. It should be noted that these are average values. There are also examples of successful repositioning strategies such as the transformation of E. ON AG which managed to increase its ROA by 2.7 percentage points and had a cumulative RTSR of 13 per cent over the transformation period.

### *Over-diversification as motivation for portfolio transformation*

An alternative motivation for business portfolio restructuring that is frequently cited in the literature is over-diversification. It occurs when a firm's degree of diversification exceeds a firm-specific limit, where the costs of diversification outweigh its benefits, leading to negative synergies and inefficiencies (Markides, 1993; Nippa *et al.*, 2011; Palich *et al.*, 2000). Although over-diversification can be considered a root cause of and an early-warning indicator for poor performance, there are also findings that a high degree of diversification does not automatically induce below-average profitability (Graham, 2012).

To test the role of over-diversification on our sample, we measured the degree of diversification before and after a transformation using the entropy index of diversification (Palepu, 1985). It allows differentiation between the following three diversifications:

1. Related diversification (DR) refers to the share of sales from different four-digit SIC segments within the same two-digit industry groups.
2. Unrelated diversification (DU) refers to the share of sales from different two-digit SIC industry groups.
3. Total diversification (DT) is the sum of DR and DU.

We compared the degrees of diversification for our sample of 58 transforming companies at the start and at the end of the transformations with the remaining 142 sample firms that were not classified as business portfolio transformations. Table III shows the absolute differences in the diversification degree of the transformed firms to the average of all non-transformed firms for DT, DR and DU.

The results for the *refocusing firms* showed that, on average, they started from a very high level of diversification ($\Delta$DT = +0.31 at the start of the transformation), with both related and unrelated diversifications clearly being above that of their non-transforming peers. This supports the assumption that over-diversification is an important trigger for refocusing strategies. These strategies turn out to be successful for our sample firms: they strongly reduced both their related and unrelated diversifications during the transformation to a degree of total diversification below their non-transforming peers ($\Delta$DT = −0.05 at the end of the transformation).

**Table III** Delta of diversification degrees (entropy measure) at transformation start and end year between transformed firms and non-transformed sample

| | | *DT*[a] | | *DR*[b] | | *DU*[c] | |
|---|---|---|---|---|---|---|---|
| | | *Start* | *End* | *Start* | *End* | *Start* | *End* |
| Restructuring types | Refocusing firms | +0.31 | −0.05 | +0.18 | +0.02 | +0.13 | −0.07 |
| | Diversifying firms | +0.08 | +0.37 | +0.08 | +0.18 | ±0.00 | +0.18 |
| | Repositioning firms | +0.37 | +0.20 | −0.04 | +0.10 | +0.41 | +0.10 |

**Notes:** [a]DT = Total diversification; displayed value as percentage point differences to average DT of all non-transformed firms for respective restructuring type; [b]DR = Related diversification; displayed value as percentage point differences to average DR of all non-transformed firms for respective restructuring type; [c]DU = Unrelated diversification; displayed value as percentage point differences to average DU of all non-transformed firms for respective restructuring type

> **“We then investigated to which extent the identified transformations had been motivated by over-diversification or poor performance.”**

*Repositioning firms* also started from a high level of diversification ($\Delta$DT = +0.37 at the start of the transformation), but, in their case, it was mainly driven by unrelated diversification. This unrelatedness facilitated the implementation of a repositioning strategy because there were few synergies to be destroyed when businesses were replaced. On average, the repositioning firms in our sample strongly reduced their unrelated diversification during the transformation, but only to increase their related diversification. In this way, total diversification was only slightly reduced to a level still above their non-transforming peers ($\Delta$DT = +0.20 at the end of the transformation).

In contrast, *diversifying firms* started from a level of diversification that was close to – but not below – the average of the non-transforming companies ($\Delta$DT = +0.08 at the start of the transformation). Seemingly, it was not under-diversification that encouraged them to embark on a diversifying transformation, but rather the lack of growth as already mentioned in the previous section. As expected, they strongly increased their degree of diversification during the transformation ($\Delta$DT = +0.37 at the end of the transformation). Yet, while the related diversification only increased slightly, the unrelated part increased strongly, indicating that diversifying firms tend to transform their portfolios by acquiring unrelated businesses.



### *Transformation process characteristics*

Independently of the initial motive for embarking on a business portfolio transformation, the top management is confronted with important decisions regarding strategy implementation, i.e. the process of the transformation, such as:

- *Transformation speed.* How long should the transformation take?
- *Transformation shape.* Should the transformation start with some major portfolio moves followed by smaller adjustments or rather first test the water with some smaller moves and undertake big acquisitions or divestitures later?
- *Acquisition and divestiture intensity.* Should the corporation transform the portfolio mainly through organic investments rather than through big acquisitions and corresponding divestitures?
- *Transformation announcement.* Should the objectives of the transformation and the target portfolio be disclosed at the beginning of the transformation or should they be kept confidential?

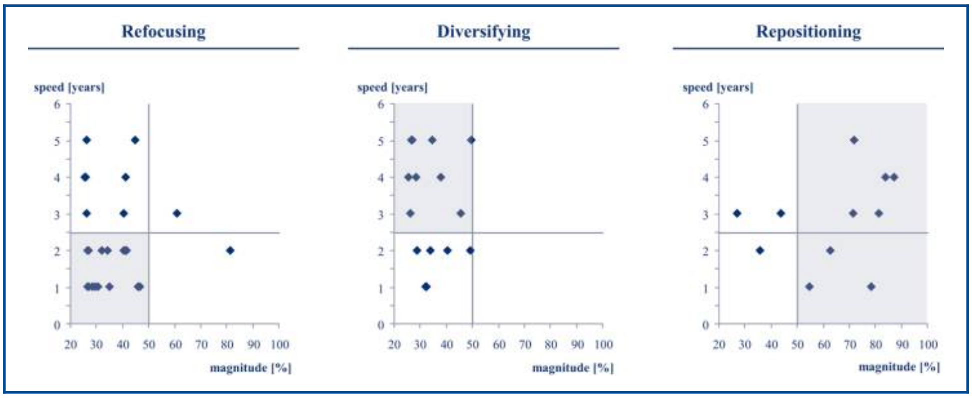
In the following sections, we will shed some light on these strategic questions based on the experience of the 58 transforming companies of our sample.

### *Transformation speed*

While the average transformation period in our sample is 2.6 years, we observe that transformations range from one year to a maximum of six years. There are two main drivers that determine the transformation speed: the magnitude of a transformation and the transformation type.

In Figure 2, we illustrate how the transformation speed depends on the transformation magnitude for the three restructuring types. Following Lamont *et al.* (1994), we define transformations that are implemented within one to two years as fast transformations and transformations that are implemented more gradually over three to six years as slow

**Figure 2** Distribution of magnitude–speed interactions of different restructuring types




transformations. In addition, transformations are classified as moderate, if the company substitutes between 25 and 50 per cent of its portfolio, and as radical if more than half of the portfolio is changed.

Figure 2 shows that most refocusing transformations in our sample are moderate and fast. They have the shortest average transformation period of only 2.2 years. Companies can achieve refocusing of their portfolios by quickly selling peripheral businesses without having to more radically change the overall composition of the portfolios.

In contrast, most diversifying transformations are moderate but slow. This reflects the fact that it takes time, resources and managerial attention to integrate newly acquired businesses. Consequently, diversifying firms have the longest average transformation period of 3.2 years.

Most repositionings are radical transformations because a change in the core business requires a more fundamental modification of the portfolio. Consistently, most repositioning strategies are slow, although the average transformation period of 2.8 years is still lower than that for the diversifying transformations.

### *Transformation shape*

When it comes to the shape of a transformation, companies can choose between three general approaches:

1. they can "front-load" the transformation (which we define as at least 60 per cent of the transformation being implemented at the mid-point of the transformation period);
2. they can "back-load" the transformation (which we define as at least 60 per cent of the transformation being implemented after the mid-point); or
2. they can choose a "steady" approach, where the progress of the transformation is distributed more evenly over the total transformation period.

We observed all three approaches in our sample of 58 transformations. Groupe Safran is an example of a "front-loaded" transformation. It started in 2004 with the acquisition of the French aerospace components company Snecma by Sagem, a French company active in telecommunications and electronics for defense and security. Between 2005 and 2008, this major acquisition was followed by a series of minor adjustments to the portfolio, such as the sale of the "Sage Communications" division in 2007[5]. The transformation of E. ON AG from a utilities conglomerate to a company focusing on core energy services is an example of a "back-loaded" transformation. It started slowly in 2000 and 2001 with minor divestitures (e.g. silicon wafer, aluminum and telecommunication businesses), followed by a series of major acquisitions (e.g. Powergen/LG, Ruhrgas AG) and divestitures (e.g. oil, chemicals and real estate divisions) in 2002 and 2003[6]. Finally, International Paper is an example of

“By far, the strongest transformations were observed for repositioning firms with an average change of 63 per cent to portfolio composition.”

a company that transformed itself steadily over the period of 2003-2008. It started its transformation by selling 50.5 per cent interest in Carter Holt, followed by a step-by-step divestiture program, which included selling forest land, coated paper, beverage packaging and chemical businesses as well as gas-drilling rights[7].

Looking at our full sample of 58 transformations (excluding those transformations that only took one or two years), we found that the three transformation shapes were almost evenly distributed: 28 per cent were “front-loaded”, 36 per cent were “back-loaded” and 36 per cent of firms followed a steady approach. However, none of the refocusing firms used a “front-loaded” approach; they clearly preferred to start slowly and test the water (50 per cent) or to steadily transform their portfolios (50 per cent). In contrast, most of the repositioning firms (57 per cent) “front-loaded” their transformations, starting with a “big bang” to create momentum for a more radical transformation.

### *Acquisition and divestiture intensity*

When a firm seeks to transform its business portfolio, it can choose between a more organic approach that builds on internal development of new businesses or an inorganic strategy that heavily relies on acquisitions and/or divestitures. Previous research hypothesized that organic growth is preferable for diversification into related markets, while unrelated diversification needs to be built on acquisitions (Hennart and Park, 1993).

To test the role of acquisitions and divestitures in our sample of 58 transformations, we measured acquisition and divestiture intensity as the percentage of sales acquired and divested during a transformation. We only found one example of a truly organic transformation which is the prominent case of Apple’s transformation from a computer producer to a consumer electronics and media company with the introduction of the iPod in 2002, the iPhone in 2007 and the iPad in 2010[8]. All other companies in our sample strongly relied on acquisitions and divestitures to implement their transformation strategies.

As expected, *refocusing firms* showed an overall higher divestiture intensity, while *diversifying firms* intensified their acquisition efforts. *Repositioning firms* had, on average, both a high acquisition and divestiture intensity, as their strategy required a more significant change to the business portfolio that can only be achieved by a concurrent management of acquisitions and divestitures. An example of such an inorganic repositioning is the transformation of the German utility company RWE over the period of 2001-2006. RWE sold its chemical business (Condea), petroleum business (DEA downstream), printing machines (Heidelberger Druck) and construction business (Hochtief), while, at the same time, acquiring gas (Transgas), water (Thames Water, American Water Works) and energy businesses abroad (e.g. Innogy Holdings plc., UK)[9].

### *Announcement*

Referring to the classical debate about whether corporate strategy is better characterized as the purposeful execution of a deliberate strategic plan developed at the upper echelons (Ansoff, 1991) or the result of concurrent and perhaps even opportunistic decisions that result in an emerging strategy (Mintzberg, 1990), we were interested in the number of publicly announced business portfolio transformations within our sample. Of course, we are aware that corporate management may, for varying reasons, refrain from publicly announcing its strategy in advance while still explicitly pursuing plans to embark on a portfolio transformation.

In the literature, the effect of an announcement of firm strategy has mainly been analyzed by event studies that search for and quantify possible abnormal returns around the announcement date. Overall, most empirical results indicate that stock market reactions are positive for all types of portfolio restructuring announcements (Berger and Ofek, 1999; Nixon *et al*., 2004). Several factors that influence market reactions were identified: relatedness levels, price disclosures, mode of transaction and strategy behind the restructuring. While pure divestiture announcements, in general, receive positive returns, combined announcements of divestitures and downsizing efforts (i.e. employee layoffs) were found to receive negative returns.

To find out how many of the sample firms announced their strategy when they started the transformation, we comprehensively analyzed annual reports and investor communication in the years prior to the start of the transformation. We excluded transformations that only took one or two years because they typically only comprised one major acquisition or divestiture that was kept confidential and was not announced in advance.

We were surprised to find that half of the firms with longer transformation periods actually gave a public outline of their strategies beforehand. Unfortunately, it is unknown if the remaining companies did not have a clear strategy in mind when they started the transformation or if they just kept this strategy confidential.

What can be the rationale for an early announcement of a transformation? On the one hand, a clear internal and external communication of a planned transformation can have substantial benefits. It can build trust among stakeholders and help to reduce anxiety and potential resistance among employees, who may be intimidated by the expected change. This seems to be of particular relevance for those restructuring strategies that involve divestitures. Consistently, we found that 63 per cent of the refocusing and 57 per cent of the repositioning transformations in our sample had been announced beforehand. On the other hand, one may assume that the top management of those firms showing poor performance, especially relatively to their industry peers, was under particular pressure from their stakeholders and had to justify their decisions publicly (Nippa and Petzold, 2005).

### *Summary and conclusions*

Our explorative study addresses a research gap in the field of business portfolio restructuring by using a longitudinal research design to analyze strategic processes of business portfolio restructuring "as a sequence of events that describe how things change over time" (Van de Ven, 1992, p. 169). We investigated the portfolio development of a sample of the largest 100 European and largest 100 North American corporations over the period of 1998-2010. We identified 58 business portfolio transformations that can be described as purposefully executed, significant changes of the portfolio composition that alter the competitive positioning of the corporation.

Analyzing these 58 portfolio transformations confirms and expands prior literature that postulates that poor performance and over-diversification are key motives for portfolio restructuring. This holds particularly for companies with refocusing transformations that showed, on average, higher diversification levels and weaker performance than their non-transforming peers and successfully managed to strongly reduce their diversification and improve performance in the course of their transformations. In contrast, firms with diversifying transformations were found to start from average diversification levels and above-average returns, but below-average growth rates that seemed to motivate the

> **"*Repositioning strategies* seemed to be the most difficult to implement."**

> **"Should the transformation start with some major portfolio moves followed by smaller adjustments or rather first test the water with some smaller moves and undertake big acquisitions or divestitures later?"**

transformation. They succeeded in improving their growth trajectory by increasing their degree of diversification, but only at the expense of lower returns and weaker capital market performance. Companies with repositioning transformations were found, on average, to start from a very high level of unrelated diversification that was reduced and partly transformed into related diversification. However, repositioning transformations were found to be the most difficult to implement: On average, they started with a significantly weaker performance than their non-transforming peers, but their performance could not be improved, and they further deteriorated in the course of the transformation.

These findings should caution managers not to be too optimistic when they consider a major business portfolio restructuring, in particular when pursuing a diversifying or repositioning transformation. However, our study of the process of portfolio transformations also offers more specific advice with regard to key strategic decisions to increase the odds of a successful restructuring:

- *Transformation speed.* The average transformation period in our sample was 2.6 years, but we observed transformations ranging from one year to a maximum of six years. While refocusing transformations can be moderate and fast, diversifying transformations may take much longer even if they only involve a moderate change of portfolio composition. Repositioning strategies typically require a more radical transformation that will also take more time.
- *Transformation shape.* The three transformation shapes we distinguished ("front-load", "back-load" and "steady") were almost evenly distributed in the sample. However, none of the refocusing firms used a "front-loaded" approach, while most of the repositioning firms (57 per cent) preferred to start with big acquisitions and/or divestitures, most likely to create momentum for a more radical transformation.
- *Acquisition and divestiture intensity.* While Apple was the only company within the sample that pursued a truly organic transformation, all other companies relied on acquisitions and divestitures for implementing their different transformation strategies. This was particularly true for repositioning strategies that require a more significant change of portfolio that can only be achieved by the concurrent management of acquisitions and divestitures.
- *Transformation announcement.* About half of the companies in our sample executing a transformation that lasted more than two years publicly announced their strategies in advance. Such a clear internal and external communication can be a valuable instrument to build trust among stakeholders and reduce fears and potential resistance, in particular, in the case of refocusing and repositioning transformations that also involve divestitures.

*Keywords:*
Diversification,
Longitudinal,
Acquisition,
Corporate restructuring,
Business portfolio restructuring,
Divestiture,
Portfolio transformation,
Refocusing,
Repositioning,
Strategy process

## Notes

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