INTERVIEW

BORROW STRATEGIES AS ALTERNATIVE TO MERGERS & ACQUISITIONS

Laurence Capron , author *Build, Borrow or Buy*

Could you briefly tell us the difference between build, borrow and buy in the context of your book?

Build, Borrow, and Buy refers to three specific paths firms can take to acquire new resources and grow: 1) Developing resources on its own (Build); 2) Using an external partner to obtain the needed resources through a contract or an alliance (Borrow); or 3) Acquiring another company (Buy). The challenge for firms is to know when to pick a specific path over another and having the optimal mix of building, borrowing and buying. Too much building leads to inertia and rigidity – most firms renew themselves through external influences. Too much buying leads to chaos and fragmentation – with the firm running out of integration skills. Too much borrowing leads to overreliance on external partners and risk of capability leakage.

In our research on 150 telecom firms from Europe, US and Asia, my co-author, Professor Will Mitchell and I find that firms that use multiple models of growth had 46 per cent higher chance of survival over a five-year period compared to those that focus only on alliances; 26 per cent more likely than those using M&A and 12 per cent more likely than companies using only internal development.

To illustrate your theory from the first question, can you give us for each of the strategies a good and a bad example of a company who applied the respective strategy to build, to borrow or to buy?

Some firms are indeed good at executing specific types of strategy. For instance, 3M has built a reputation for fostering internal innovation and corporate venturing. Cisco has developed a strong reputation in the M&A domain – with strong learning processes within Cisco to capitalize on its M&A experience. Firms like Corning and Unisys have developed strong capabilities in managing their alliance portfolio.

Again, even for firms that are strong in a specific mode of corporate development, whether it is Build, Borrow or Buy, the trap to avoid is to become a one-trick pony. The firms mentioned above have been disciplined in their approach and have often developed a well-rounded build-borrow-buy capability, which complements their strengths in one specific mode. For instance, although Cisco is known for its M&A capabilities, it has also developed strong skills in managing alliances and fostering corporate venturing.

As you also mention in your book, most growth strategies are based on internal development and/or merger & acquisition. Why do many companies forget or avoid a borrow strategy to grow?

Many business leaders have an overly negative view of re¬source borrowing. Fully 80 per cent of the surveyed executives shared concerns of exclusivity, control and resource protec-tion in alliances. One leader called them a “flawed approach that would lead to 'shopping corecompetences' rather than sharing knowledge." While it is true that short-term contracts and alliances can be complex and difficult to manage, when implemented correctly, they also represent a potentially cheaper, more flexible, and less traumatic growth strategy than the riskier alternative of M&A.

Which are the different borrow strategies? Could you briefly describe these and show how they are different?
There are two main types of borrow strategies: 1) the basic contract (e.g. in-licensing) and 2) the alliance. In-licensing and other types of purchase contracts offer the simplest means of obtaining new resources from external sources. For instance, pharmaceutical firms commonly license the rights to register and market another company's drug in particular geographic markets. Purchase contracts like that only work, however, when you can negotiate transparent agreements to govern the exchange. They will fail when the parties involved don't reach a shared

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understanding of the value of the contract. For instance, Bosch considered using a simple purchase contract to obtain automotive air conditioning technology from the Japanese firm Denso, but decided not to follow through on the negotiation because it realized that Denso knew far more about the value of the resources than it did.

When the value of the new resources is too difficult to determine, therefore, firms must move on to consider whether or not to engage in some kind of partnership or alliance with an external provider of resources. Alliances can take many forms, ranging from R&D and marketing partnerships to free-standing joint ventures, among many other options.

Alliances are most effective as a means of obtaining new resources when the resource exchange between the partners involves relatively limited depth and scope – that is, when relatively few people and organisational units from each party need to work together to coordinate the joint activities. The Astra Merck venture required only a moderate number of people from each firm. As another example, General Electric's aerospace business and the French firm SNECMA have maintained a long term aircraft engine venture, CFM, which largely rests on independent activities by the two partners, with limited points of contact needed to coordinate technical activities and marketing efforts in different geographic markets.

M&As are often not as successful as the requiring company had hoped for when deciding for the strategy? Why do you think this is? What's the single best piece of advice you could give a company that is looking for an M&A?

At many firms, M&A becomes the strategy instead of remaining a tool for strategy implementation. Acquisitions need to be the final choice in the decision sequence, so that the firm can preserve the scarce financial and managerial resources they need to successfully scale up their capabilities. What's more, over-reliance on acquisitions adds to the firm's overall risk, making that next acquisition that bit more dangerous. It may also stretch the firm's M&A integration capabilities too thinly. Finally, firms using M&A regularly must be disciplined about selling off resources that they do not need, otherwise they will become overloaded with unnecessary baggage. Both J&J and Philips regularly divest businesses when they have extracted the resources that they want. General Electric, similarly, has divested just as often as it has purchased, after absorbing the resources that it wants from its corporate acquisitions.

Do you think there's any reason to believe that successful growth strategies (build, borrow or buy) are different for b2b versus b2c companies? Could you illustrate with an example of both?

I don't see differences. Both types of firms need to be able to find effective ways of acquiring new resources and growing. For B2C, marketing and branding skills might be an important component of the resource search process. For B2C, you also have a mini-case on Danone in Chapter 6 (p171-173).

Cisco In the telecom industry, Cisco, the world's largest maker of networking equipment, has grown from two employees in 1984 to more than 70,000 people, 200 worldwide offices, and revenues of $43 billion in 2011. Although Cisco's well-earned reputation is that of a best-in-class acquirer of innovative high-tech companies, it is also adept at complementing acquisitions with strong internal development and alliances. Its balanced approach is rounded out by corporate support activities — in-house venture expertise, strategic use of flexible incentives, an expansive resource-scanning horizon, and robust execution skills — that keep it well supplied with new resources and customer-oriented solutions. The base strength of Cisco's corporate development is its ability to carefully evaluate sourcing options and engage adaptively and creatively with internal and external innovators. In the way it blends all of the modes, Cisco demonstrates the value of top-level leadership for what should be seen as an enterprise discipline: strategically coordinated Building, Borrowing, and Buying.

Johnson & Johnson In the pharmaceutical industry, Johnson & Johnson (J&J) is also a strong example of how firms can blend effectively internal innovation

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with acquisitions. J&J is widely regarded as one of the world's most innovative and reliably successful companies. It generates high profits year after year, offering a dynamic mix of consumer products, professional medical products, and pharmaceuticals. J&J has built a sophisticated sourcing discipline that allows it to adapt continuously to changes across its product segments and geographies. This discipline adroitly mixes internal development and acquisitions, combined with active post-acquisition integration and ongoing reshuffling of its resource portfolio.

In your book, 'resources' is the main determining factor to decide for a build, borrow or buy strategy? What is, according to you, the role of branding in any growth strategy?

Branding is key in any growth strategy but the challenges are different. For a Build strategy, the firm has the full control over the development of its brand – yet development of new brands in consumer markets is difficult. For a borrow strategy, brand management is challenging since each partner might have a different brand positioning and one partner can suffer if the 'alliance product' is not aligned with its brand image. For a Buy strategy, the challenge is to know when to preserve or absorb the brand or co-create a common new brand.

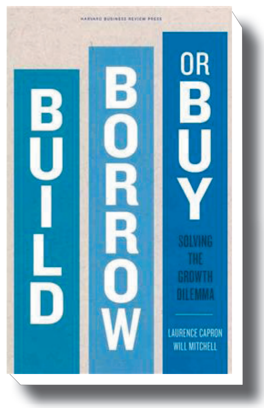
What is the role of marketing in each of the three strategies?

In build strategy, marketing is key and the firm needs to make sure it has strong in-house skills to nurture the branding skills. For borrow strategy, it is more an issue of coordination and interest alignment between partners – with potential cost of compromise to bear. Marketing people might then become frustrated. A buy strategy might entail redundancies among the marketing skills and overhead, as well as differences in the way the marketing function operates and is viewed across the merging firms.

What's the best single piece of advice you could give companies when deciding on the right growth strategy?

Do not become a one-trick pony and experiment new ways of growing. Match your methods to your opportunities

… and if the methods simply won't match, look for other opportunities rather than forcing yourself down a pathway that, in your heart of hearts, you know will not work.



BUILD, BORROW, or BUY Solving The Growth Dilemma