2.2 RESTRUCTURING AND DIVESTITURES

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Introduction

Research in corporate strategy fundamentally seeks to address the question "How do managers set and oversee the scope of their firms?" (Feldman, 2020), a key component of which is the issue of which businesses they choose to participate in and which they do not. Managers can pursue a range of strategies to make such decisions, which can generally be grouped into two categories: (1) expansionary strategies, such as mergers and acquisitions, alliances, joint ventures, and corporate venture capital, which allow firms to increase their scope; and (2) contractionary strategies, such as selloffs, spinoffs, carveouts, and asset restructuring, which enable firms to reduce their boundaries.

Despite the fact that expansionary and contractionary corporate strategies are inverses of one another, significantly more academic research has been conducted about the former than the latter. In the last 10 years, for example, the *Strategic Management Journal* published 144 articles about acquisitions, alliances, and joint ventures versus 20 articles about divestitures.[1] This pattern is echoed in practice as well. My analyses show that in 2019, U.S.-based firms undertook nearly three acquisitions for every one divestiture they implemented. Nonetheless, contractionary strategies have a significant potential for value creation, perhaps even more so than expansionary strategies. For instance, my analyses of U.S.-based acquisitions and divestitures over the last 10 years reveal that the shareholder returns to divestiture announcements are more than double the shareholder returns to acquisition announcements, and my review of recent literature indicates that the average abnormal return to divesting firms upon divestiture announcements is +3.0 percent,[2] as compared to a –0.7 percent abnormal return to acquiring firms upon acquisition announcements.[3]

Together, these points suggest that contractionary strategies such as divestitures and restructuring (henceforth, I refer to both as divestitures) are a very fruitful area for investigation. In this chapter, I present an agenda for research into these phenomena by surveying past and current literature about them and laying out some productive directions for future research in this domain.

Past Research

Past research on divestitures largely conceptualized these strategies as reactions to negative occurrences that had previously happened either inside or outside of firms. Some examples of internal problems that have been shown to prompt managers to divest include declining firm or business unit performance (e.g., Duhaime and Grant, 1984; Duhaime and Schwenk, 1985; Jain, 1985; Hoskisson and Turk, 1990; Ravenscraft and Scherer, 1991; Barker and Duhaime, 1997; Desai and Jain, 1999; Schlingemann, Stulz, and Walkling, 2002); unsuccessful mergers and acquisitions (e.g., Kaplan and Weisbach, 1992; Weisbach, 1995); over-diversification, especially when driven by empire building (e.g., Jensen, 1986; Hoskisson and Turk, 1990; Markides 1992, 1995; Hoskisson and Hitt, 1994; Comment and Jarrell, 1995; Daley, Mehrotra, and Sivakumar, 1997); and other manifestations of agency conflicts, including managerial entrenchment or inefficient internal capital markets (e.g., Shleifer and Vishny, 1989; Scharfstein, 1998). Analogously, some external factors that have been shown to induce managers to divest include industry decline (e.g., Harrigan, 1980); information asymmetry vis-à-vis external constituents like securities analysts and investors (e.g., Zuckerman, 1999; Gilson *et al.*, 2001); hostile takeover attempts (e.g., Bhagat, Shleifer, and Vishny, 1990; Berger and Ofek, 1999); and regulatory requirements such as antitrust (Joskow, 2002).

In turn, much of the early literature on divestitures documented that these transactions are beneficial for divesting firms, in terms of operating performance (e.g., Hoskisson and Turk, 1990; John and Ofek, 1995; Daley *et al.*, 1997), short- and long-term stock market performance (e.g., Montgomery, Thomas, and Kamath, 1984; Hoskisson and Turk, 1990; Comment and Jarrell, 1995; John and Ofek, 1995; Desai and Jain, 1999), and analyst coverage and forecast accuracy (e.g., Krishnaswami and Subramaniam, 1999; Zuckerman, 2000; Gilson *et al.*, 2001). These favorable consequences are often portrayed as evidence that divestitures succeed at resolving the problems that prompted managers to undertake these transactions in the first place.

It is interesting to note that a significant portion of the above-described body of research is published in finance journals. This at least in part reflects this literature's use of divestitures as a context in which to measure the existence and magnitude of the diversification discount (a topic of significant debate in the late 1990s and early 2000s), in that the value gains resulting from divestitures could be interpreted as evidence of value destruction within the diversified firms that undertook those transactions (Villalonga, 2003). Having said this, much more of the current research on divestitures is appearing in strategy journals, reflecting a reconceptualization of these strategies as proactive, forward-looking ways for managers to reshape their boundaries rather than as reactive, backward-looking solutions to problems. I discuss this shift in the next section, emphasizing the point that a key way for strategy scholars to differentiate their work from that of finance scholars (even though both sets of researchers often use similar data, measures, and methodological approaches) is to

focus on the proactive, forward-looking aspects of divestitures as part of companies' corporate strategy toolkits.

Current Research

Current strategy research about divestitures can be grouped into four main categories: the drivers of divestiture decision-making, the actors that undertake and influence those decisions, the interdependences between divestitures and other modes of corporate strategy, and the implications of divestitures for divested units. I describe each of these in turn.

First, per the earlier discussion, divestiture decisions were historically thought to be driven largely by economic considerations, such as industry decline or ill-fated expansion strategies. Increasingly, though, strategy scholars have come to realize that a host of totally different, non-economic considerations can and do affect divestiture decisions. For example, such factors as historical connections (Feldman, 2014), organizational inertia (Shimizu and Hitt, 2005), unit interdependency (Duhaime and Grant, 1984; Duhaime and Grant, 1985), behavioral biases (Hayward and Shimizu, 2006; Shimizu, 2007; Vidal and Mitchell, 2015), prior transaction experience (Bergh and Lim, 2008; Villalonga and McGahan, 2005), internal social comparison costs (Feldman, Gartenberg, and Wulf, 2018), and even public stigma against these transactions (Dranikoff, Koller, and Schneider, 2002) all have a significant influence on divestiture decision-making.

Second, and further to the previous point, the identity and characteristics of various organizational actors have also been shown to affect divestiture decisions. The characteristics of managers and directors—such as their age and tenure (Wiersema and Bantel, 1992; Shimizu and Hitt, 2005; Feldman, 2014), share ownership (Bergh, 1995; Hoskisson, Johnson, and Moesel, 1994), and experience and power (Bigley and Wiersema, 2002)—have all been shown to be key drivers of decision-making. More recently, research on divestitures has also begun to attend to the role of various corporate owners, such as activist investors (Chen and Feldman, 2018; Shimizu and Hitt, 2005), other large blockholders (Bethel and Liebeskind, 1993; Bergh, 1995; Bergh and Sharp, 2015; Bergh *et al.*, 2019), and founding families (Feldman, Amit, and Villalonga, 2016).

Third, a rich stream of research, primarily rooted in the resource reconfiguration literature (Karim and Capron, 2016), has emerged about interdependences between divestitures and other modes of corporate strategy. Scholars in this domain are exploring how managers may sequentially use divestitures and other modes of corporate strategy to proactively reshape firm scope (Teece *et al.*, 1994; Chang, 1996; Capron, Mitchell, and Swaminathan, 2001; Helfat and Eisenhardt, 2004; Bennett and Feldman, 2017; Vidal and Mitchell, 2018), and also when and how these modes may be complements to or substitutes for one another (Berry, 2010; Kaul, 2012; Miller and Yang, 2016; Lieberman, Lee, and Folta, 2017; Feldman and Sakhartov, 2021).

Fourth, and finally, while much current strategy research about divestitures has taken the perspective of the divesting firm, scholars have also begun examining the implications of these transactions, especially spinoffs, for the units that are divested. Within this domain, questions about how divested businesses constitute their boards of directors (Semadeni and Cannella, 2011; Feldman, 2016a), structure managerial incentives (Seward and Walsh, 1996; Feldman, 2016b), establish independent identities (Corley and Gioia, 2004; Wiedner and Mantere, 2019), secure relevant analyst coverage (Feldman, Gilson, and Villalonga, 2014), and even experience the divestiture process (Moschieri, 2011) have all become paramount.

Future Research

Having surveyed the landscape of past and current divestiture research, it now becomes possible to articulate my views about the future of research in this domain. In seeking to address the foundational question of how managers set and oversee the scope of their firms, I proposed a framework for corporate strategy in Feldman (2020) that comprises three levels of analysis: intraorganizational, whereby managers must coordinate relationships and resources within the boundaries of their firms; interorganizational, whereby managers must coordinate interactions with other companies across firm boundaries; and extraorganizational, whereby managers must decide which businesses belong within the boundaries of their firms and which ones do not. I structure my discussion of future research on divestitures around these three levels of analysis.

Intraorganizational

Beginning with an intraorganizational perspective, three key facets of how divestitures influence and are influenced by resource allocation within firm boundaries merit further research attention. The first looks at the firm through the lens of stakeholder theory. Stakeholder theory holds that the firm lies at the center of a network of stakeholders (such as customers, employees, suppliers, local communities, shareholders, and other providers of financial capital) that contribute specialized and socially complex assets and resources to the firm (Barney, 2018). The issue that immediately becomes apparent from this perspective is that divestitures are likely to disrupt the ongoing resource contributions of one or more of these stakeholders (especially employees, who may experience the dislocations resulting from divestitures most acutely[4]), with potentially significant consequences for the firm's ongoing operations. Bettinazzi and Feldman (2020) began exploring this very point by conceptualizing divestitures (and different types of divestitures) as arising endogenously in firms where those transactions are less costly to stakeholders than the internal resolution of conflicts among those stakeholders (Klein *et al.*, 2019). Building from this premise,

future research could usefully explore when and how divestitures disrupt the contribution and allocation of resources by various stakeholders, as well as the implications that this has for the anticipation and proactive management of conflicts among stakeholders, and hence, for firm performance and other outcomes.

A second key direction for future research taking an intraorganizational perspective on divestitures is to introduce organization design into the mix. With the exception of only a few prior studies (e.g., Arora, Belenzon, and Rios, 2014), the literatures on organization design and corporate strategy have largely remained separate from one another, despite the obvious parallel that the former explores internal boundary decisions while the latter explores external boundary decisions. As noted in Feldman and McGrath (2016), modularity is one facet of organization design that could interact with divestitures, particularly in terms of the ease with which divesting firms may be able to cleave off divested units. For instance, it may be more straightforward for companies to divest previously acquired rather than internally developed units, to the extent that the former are less integrated with, and hence, more modular, than the latter. Another facet of organization design that could interact with divestitures is the firm's degree of centralization or decentralization. For example, in a recent working paper, Eklund and Feldman (2021) show that the degree of centralization of divesting firms' research and development (R&D) units has significant implications for the manner in which firms apply the resources that are freed up by divestitures (e.g., cash, human resources, physical capital) to future innovation opportunities. Scholars would be well served to continue mining the rich literature on organization design for potentially interesting intersections with research on divestitures.

Third, future research could investigate how divesting firms reconfigure existing resources and processes within their organizations following the completion of divestitures. These transactions can be enormously disruptive events for firms, and existing studies have begun to contemplate how divestitures may impel firms to reorganize internal processes and practices like compensation (Pathak, Hoskisson, and Johnson, 2014; Feldman, 2016b), capital allocation (Feldman, 2016c), and innovation (Eklund and Feldman, 2021). A few papers have also begun to consider how divestitures might disrupt key interdependences within divesting firms (Feldman, 2014; Natividad and Rawley, 2016; de Figueiredo, Feldman, and Rawley, 2019), prompting a reconsideration of where synergistic value is generated within multibusiness firms. Future research could usefully continue to explore these issues in greater depth.

Interorganizational

From an interorganizational perspective, a key direction for future research about divestitures is to study how divesting firms manage their post-divestiture relationships with divested businesses. In particular, it would be very valuable to understand how various resources, processes, capabilities, physical assets, and human capital are divided between divesting firms and divested businesses, especially because

practitioners have articulated that these entities often need to continue sharing such resources following the completion of divestitures (e.g., Alaix, 2014). A few published papers and some work in progress have begun to pursue this approach, for example, by exploring the allocation of board members, management, and other employees (Semadeni and Cannella, 2011; Feldman, 2016a, 2016b; Bodner and Feldman, 2021); the establishment of distinct identities and cultures (Corley and Gioia, 2004; Wiedner and Mantere, 2019); and even the use of transition services agreements to manage the separation process (McGlinch and Feldman, 2021). Having said this, many other aspects of the process of division remain unaddressed, including the allocation of patents and other intellectual property; reputational assets such as brands, logos, and names; plants and machinery; debt, overhead, and other centralized corporate expenses; contracts with suppliers and customers; and even alliance relationships. The literature on post-merger integration may have useful insights into these issues, since this body of research, at its core, considers the inverse question of how to *unite* resources, capabilities, physical assets, human capital, and cultures that originate from distinct organizations (Graebner *et al.*, 2017; Bodner and Capron, 2018).

A second way in which one might approach the interorganizational question of how managers coordinate relationships with other companies across the boundaries of their firms is to consider the role of counterparties to divestiture transactions (i.e., the acquiring entities that buy divested businesses). As noted in Feldman, Amit, and Villalonga (2019), divestitures and acquisitions are bilateral transactions, in that one company buys an asset or a business from another company that is selling that asset or that business. A few recent studies have shown that conceptualizing divestitures in this way has significant performance implications (Capron and Shen, 2007; Laamanen, Brauer, and Junna, 2014; Kaul, Nary, and Singh, 2018; Feldman *et al.*, 2019). As Feldman (2020) points out, one useful extension of these ideas might be to examine corporate strategy transactions—divestitures in particular—trilaterally, in that they involve an acquiring firm, a divesting firm, and the business unit that is changing hands. This approach could be used to generate novel insights into how interorganizational relationships between divesting firms and their counterparties influence divestiture performance. Another important extension to the idea of conceptualizing divestitures bilaterally or trilaterally is to consider the role of private equity firms versus traditional corporations as buyers and sellers in divestitures (and acquisitions). Kaul *et al.* (2018) began to do this in their study of which divested assets are bought by private equity firms versus companies, but many more opportunities remain in this line of inquiry, especially given the recent prevalence of private equity as a major player in the market for corporate transactions. This point could be extended even further into an exploration of which acquirers (private equity vs. companies) buy the assets that are removed by full versus partial divestitures (e.g., Vidal and Mitchell, 2015).

Finally, it would be valuable for scholars to study the role of interorganizational knowledge and learning spillovers within the context of divestitures. While existing research has shown that the repeated execution of transactions like acquisitions and

divestitures leads to the accumulation of valuable capabilities and, in turn, better transaction performance (e.g., Haleblian and Finkelstein, 1999; Bergh and Lim, 2008), it is readily evident that learning and experience may accumulate due to interactions and relationships *between* firms as well. Thus, one might consider, for example, whether firms that have more acquisition experience perform better when they undertake divestitures (and vice versa), as well as when and why this might or might not be the case. Further to this point, one could also explore whether and how interactions with intermediaries like investment bankers, lawyers, and consultants result in the accumulation of divestiture capabilities, as articulated, for example, in McGrath's (2016) dissertation on this topic. These and related ideas raise intriguing questions about how interorganizational relationships between firms and their intermediaries might influence divestiture decision-making and performance.

Extraorganizational

From an extraorganizational perspective, one important direction for future inquiry is for scholars to continue to incorporate the insight into their research that divestitures are a key part of the intertemporal process of resource reconfiguration and scope change. As mentioned previously, the notion of using divestitures sequentially with other corporate strategy transactions is not new, especially in terms of acquisitions preceding divestitures (Kaplan and Weisbach, 1992; Teece *et al.*, 1994; Chang, 1996; Capron *et al.*, 2001; Shimizu and Hitt, 2005; Hayward and Shimizu, 2006; Shimizu, 2007) and divestitures preceding acquisitions (Dranikoff *et al.*, 2002; Bennett and Feldman, 2017; Vidal and Mitchell, 2018).

Having said this, however, many opportunities remain available to explore this issue in greater depth. For example, researchers might examine the different configurations of corporate strategy transactions that exist, incorporating acquisitions, alliances, divestitures, joint ventures, corporate venture capital, and even internal resource redeployment (e.g., Feldman and Sakhartov, 2021) and organic growth (e.g., Tang and Feldman, 2021) into their analyses. To facilitate this, scholars must embrace the notion that corporate strategy is a dynamic and holistic process that unfolds over time and involves series of transactions rather than discrete events (Feldman, 2020), and they must begin to explicitly conceptualize and model longer-term sequences of corporate strategy transactions, as a few scholars have begun to do (e.g., Chang, 1996; Teece *et al.*, 1994; Feldman and Sakhartov, 2021).

Another important research direction from an extraorganizational perspective is to understand how various internal and external constituents might influence the divestiture decision. Much of the existing literature about divestitures has been built around the assumption that managers decide to divest or not to divest particular businesses. Recently, though, some studies have begun to explore how external actors, such as activist investors (Chen and Feldman, 2018) and securities analysts (Feldman *et al.*, 2014; Feldman, 2016d), might influence or equally be influenced by these

decisions. As an extension of these findings, it would be interesting to understand how other external constituents—such as the press, social activists, debtholders, and even other kinds of equity owners—might exert pressure on firms to divest or not to divest certain businesses, with significant implications for the divesting firms.

Extending this idea a step further, one could even consider the role of internal constituents along this dimension as well. For example, Feldman *et al.* (2018) articulate that firms may undertake divestitures in response to high pay inequality and its resulting social comparisons among their employees. Although these authors do not argue that employees *demand* divestitures in response to high pay inequality, there could be situations in which such demands are made in response to some sort of dissatisfaction within the organization. Investigating these kinds of questions could be very interesting, especially in the current business environment where such expressions are becoming increasingly commonplace and where companies are increasingly responsive to them. This could form an important link to the literature on entrepreneurial spin-offs, which explicitly considers the separation of employee-led ventures into freestanding entities (e.g., Klepper and Sleeper, 2005; Agarwal *et al.*, 2004). There are obvious parallels between entrepreneurial spin-offs and corporate divestitures, creating a potentially fascinating opportunity for cross-fertilization across fields of research.

Last but not least, one final area of inquiry taking an extraorganizational perspective could be to consider the interplay between divestitures and industry conditions. A few studies have examined industry divestiture waves, documenting significant industry clustering of divestiture activity as well as performance consequences deriving from the point in an industry divestiture wave at which a focal transaction is situated (Mulherin and Boone, 2000; Brauer and Wiersema, 2012). One could usefully extend some of these ideas by considering macroeconomic and even social trends (per the earlier discussion) as significant drivers of divestiture decisions and divestiture performance. This leads to an additional possibility, which might be to explore the implications of divestitures for competition and industry characteristics. For example, when one company sells a business unit to another firm that is already in that line of business, market concentration increases in the industry in which that business operates (since the acquiring firm now holds a larger share of the market). It would be useful to consider the competitive implications of divestitures for different industries, which would represent an important marriage of the competitive and corporate strategy literatures.

Conclusion

This chapter has reflected on the historical development, current status, and future trajectory of research on divestitures. Against the backdrop of the central question in corporate strategy—how do managers set and oversee the boundaries of their firms?—it is evident that divestitures play as integral a role as the expansionary strategies that

have heretofore received more attention in the academic literature and in managerial practice. Having said this, the tide is beginning to turn, as scholars increasingly see divestitures as interesting and worthy of investigation, and as numerous studies document the significant implications that divestitures have for divesting firms, divested businesses, and the other actors and entities that are involved in or affected by these transactions. This is also reflected in the rich opportunities for future inquiry about divestitures that I have presented in this chapter.

Divestiture activity reached an all-time high between 2014 and 2019, with over $1 trillion of transactions completed annually during this period and close to $1.5 trillion in 2015 alone. This trend is likely to have been driven by a number of factors, including the rise of activist investors demanding that managers proactively reshape their firms' corporate scope as well as major consulting firms actively promoting the use of these transactions.[5] In the wake of the coronavirus pandemic, managers are likely to turn to divestitures to restructure and reconfigure their portfolios of businesses with an eye toward retrenchment and efficiency gains in the face of performance decline,[6] just as they did after the 2007–2009 financial crisis. Among managers, this may prompt some regression to the view that divestitures are merely solutions to problems, intended primarily to be used in times of distress or decline. The forward-thinking executive, however, will continue to look to divestitures as a proactive, strategic tool with which to manage corporate scope in a value-additive manner. Thus, I close this chapter with a call to the academic community, especially scholars in the field of corporate strategy, to continue producing robust knowledge and insights about how and why divestitures can fulfill this function and accomplish these objectives.

Notes

1. I conducted this analysis using Web of Science, with the following keywords (presented with their variants): merg*, acqui*, M&A, ally, alliance*, joint ventur*, divest*, asset sale, spinoff, spin-off, selloff, and sell-off.
2. The following articles were used to generate this figure: John and Ofek (1995), Comment and Jarrell (1995), Daley, Mehrotra, and Sivakumar (1997), Krishnaswami and Subramaniam (1999), Desai and Jain (1999), Bergh, Johnson, and DeWitt (2008), Feldman (2014, 2016d).
3. The following articles were used to generate this figure: Asquith, Bruner, and Mullins (1983), Bradley, Desai, and Kim (1988), Lang, Walkling, and Stulz (1989), Servaes (1991), Kaplan and Weisbach (1992), Mulherin and Boone (2000), and Mitchell and Stafford (2000).
4. "For example, when DowDuPont announced that it would divide the newly-merged company into three independent firms, employees in the divesting firm were angered by the prospect of having to move to the different geographic locations where the divested businesses would be headquartered" (Bettinazzi and Feldman, 2020: 10–11).
5. https://advisory.kpmg.us/content/dam/advisory/en/pdfs/2020/think-like-an-activist.pdf
6. https://www.carpenterwellington.com/post/corporate-divestiture-plans-placed-on-hold-during-pandemic

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