Market exit: Divestment or redeployment?

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Multi-business firms have flexibility advantages over single-business rivals because they have the option to redeploy resources across businesses. This flexibility, it has been assumed without empirical evidence, is purported to inspire quicker exits from markets.

A 2017 survey revealed that 70 percent of corporate executives expected to make at least one divestment in the subsequent two years, with the primary motive being strategic realignment of portfolios as non-core assets are shed. A large number of academic studies have established that parent firms tend to use the external market to sell businesses that are unrelated to their core business. However, this seemingly ignores the fact that there is an important alternative to divestment—the internal reallocation of business resources elsewhere within the corporation.

A new study published in the *Strategic Management Journal* examines how the relatedness of businesses and market efficiency might inspire exit through resource redeployment versus divestment. The researchers, Timo Sohl, Univ. Pompeu Fabra (UPF) Barcelona, Spain and Timothy B. Folta, University of Connecticut, examined 3,082 retail chains across 106 countries.

"The influence of business relatedness on exit decisions has been of great interest to strategy research," write the authors. "However, little is known about how business relatedness might influence exit through internal redeployment versus divestment.

"On the one hand, business relatedness makes resource redeployment less costly and hence, it should increase the probability of exit. On the other hand, business relatedness might also decrease the likelihood of exit through divestment because it increases the chances that the same resources enable intra-temporal economies of scope, commonly referred to as synergy."

The research objective was to provide more clarity around this puzzle and also to provide a template to help distinguish between the two exit modes when they are not directly observable.

"To examine how the potential for resource redeployment affects exit, we focused on potential redeployments of highly location-bound resources (i.e., physical stores) to sibling businesses within country divisions," write the authors. "This allowed us to produce a set of patterns that, as a whole, provide the first large-scale empirical evidence supportive of the view that market exit is taking place through internal redeployment."

"In particular, we find that greater potential for resource redeployment—which is when there is a larger number of more-related sibling businesses—has a significant and sizable effect on market exit, especially when there are higher external transaction costs and businesses perform poorly relative to their business siblings."

The focus of this research on fixed assets complements an earlier study on the redeployment of human capital. Future research could combine the role of fixed asset redeployment with labor redeployment, and Sohl's and Folta's research framework could be used to focus on other types of fixed assets, such as manufacturing plants, power plants, or heavy tools and machinery.

"We also encourage future research to examine additional boundary conditions such as sales price (i.e., inducements in the external market), ownership structure, and/or organizational structure," the researchers write. "Moreover, to the extent that some corporate chains are at least partially owned by franchisees, this may hinder the ability to redeploy. We attempted to rule out this explanation in our analysis of retail subsegments that might be more or less inclined to have franchise-owned stores, but future analysis could more thoroughly explore this issue with data on the number of franchise-owned stores across chain-country-years."

"We assume that corporate decisions are made with the intent of maximizing the efficiency of resources in a country, but we acknowledge there may be alternative objectives, some of which may be driven by incentives or brand hierarchy."

More information: Timo Sohl et al, Market exit and the potential for resource redeployment: Evidence from the global retail sector, *Strategic Management Journal* (2021). DOI: 10.1002/smj.3285

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