Department of Business and Management

A CHANGE OF CORE BUSINESS: STRATEGICAL ISSUES AND EMPIRICAL EVIDENCES

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ABSTRACT

A change of core business: the transition of Royal Philips to the Healthcare industry is a case study that analyses the strategy of Philips, a global leader in the Healthcare Industry. Philips operated in too many industries with a severe impact on efficiency in the 1990´s, which resulted in a sharp decrease in income in 1996. Consequently, Philips started to restructure and sold parts of the business which were underperforming or did not fit in the strategic portfolio. It increased its focus on the Healthcare division through acquisitions as it was a very promising industry. Philips successfully changed its core business which was vital for the survival of the company.

Keywords: Core Business, Strategy, Change, Conglomerate, Electronics Industry

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1. Introduction

Globalization

The globalization of industries created many opportunities for firms to expand. Nevertheless, it also created several threats for the core business of a company. The growing globalization of industries has increased the competition between firms due to several reasons. Firstly, there is a decrease in trade barriers which includes tariffs and non-tariff barriers to trade. A tariff is a tax on imports and exports which increases the price of traded products and services. Consumers suffer from this as they have to pay a higher price, they have a limited choice of goods, and they are offered less quality. Those in favor of tariffs argue that the government needs to protect national companies which operate in the manufacturing industry, which was also the case of the 'Tariff 1789' in the United States (Hill, 1893). It was implemented as they expected more benefits from a focus on domestic resources rather than foreign trade. Economists criticized these protective measures as it decreased the efficiency of national companies. As a result, several free trade areas were implemented in order to increase the competition and efficiency of companies such as the European Union (EU), North American Free Trade Agreement and the South Asia Free Trade Agreement. In Europe there are no trade barriers with regard to goods and services as there is a free movement of it. Moreover, it also has a competition policy with which it stimulates competition through various laws in order to increase innovation, productivity, and the position in global markets (EU Competition Policy, 2013). These policies include antitrust, merger control and the control of state aid (EU Competition Policy, 2013). The free trade unions decreased the trade barriers and increased competition between firms.

Reduction in transport costs

Competition also increased through a reduction in transport costs. A study of Hummels (1999) shows that there is a decrease in costs with regard to long distance transporting and air shipping. Technology has played a significant role in

the decline of transportation costs. Navigational aid has helped ships to decrease accidents which will decrease the costs of an insurance in the future (Hummels, 1999). Furthermore, technology improved the speed of transporting by air and sea, which decreased inventory costs. This resulted in the possibility to trade new products which was not possible before due to a lack of speed. For example, perishable foods were not tradable for a long time but this kind of trade improved as the speed of transportation increased. The decline in transport costs resulted in an increase in trade between countries which increased the global competition between firms (Hummels, 1999).

Integration of global capital markets

There is an increase in the integration of global capital markets (Sachs and Warner, 1995). The economic integration increased during the 1980's and the 1990's, and especially in 1989 due to the fall of communism. There are also several organizations which support the convergence of global capital markets such as the World Trade Organization (WTO) and the International Monetary Fund (IMF). The WTO supervises and promotes the trade of goods between more than 150 member countries and the IMF also assists with international trade. Poor countries benefit from trade liberalization as they can import new technologies and exchange ideas which results in economic convergence (Sachs and Warner, 1995). Closed economies do not benefit from the economic convergence and therefore they implemented several trade liberalization programs. A study of Sachs and Warner (1995) shows that many countries 'recently' opened their economies through trade liberalization programs such as Argentina: 1991, Brazil: 1991, Colombia: 1986, Hungary: 1990, India: 1994, Mexico: 1986, New Zealand: 1986, Philippines: 1986, Poland: 1990 and South Africa: 1991. Global competition increased as these new open countries also compete on the global product and services market.

Impact of globalization on the firms strategy

The globalization resulted in an increase in competition at a global, regional and a national level (Wiersema and Bowen, 2008). The foreign competition is either through imports of foreign goods and services or through foreign companies which produce in the firm's domestic market. The competition changes the conditions of domestic markets as there is a more uncertain and dynamic competitive environment, a higher amount of technological developments, more efficient firms in the market, and lower profit margins in the industry (Wiersema and Bowen, 2008).

Globalization forced companies to reevaluate their core business and consider international diversification. As a result, a growing amount of firms focus more on operating and competing in a global market, rather than a specific domestic market. Companies had to change their strategy to a more international strategy in order to survive the fierce competition. Some companies also adjusted their core business due to the increased globalization and competitive rivalry. Nevertheless, many companies went bankrupt or were acquired as they responded too late to the external events (Zook, 2007). The product lifecycle is shorter and this decreased the expected lifetime of a company (Dervitsiotis, 2011).

Beyond the core business

These external events show the importance of thinking beyond the core business (Zook, 2007). Nevertheless, a study of Wiersema and Bowen (2008) shows that product diversification has a negative impact on the firm's ability to enlarge its international presence. Moreover, a company will perform less when they pursue both geographical diversification and product diversification (Wiersema and Bowen, 2008). This shows that a company needs to carefully take product diversification into consideration as it may have a negative impact on geographical diversification. On the other hand, a company should not only focus on geographical diversification as there are fast technological developments and

lower profits in certain industries. In this report the focus is on product and industry diversification, which may result in a change of core business.

Purpose of the project

The purpose of this project is to show that it is important to reevaluate the core business continually in order to survive as a company. Furthermore, it also shows which measures can be taken when a business is underperforming. This case can be used for companies which experience significant difficulties in their core business and want to invest beyond the core. This case is also designed for courses such as corporate strategy, competitive strategy, and leadership and change management. It helps students to learn about the impact of a changing business environment on the company's strategy. Moreover, it should allow students to realize the importance of thinking beyond the core business which is vital for the survival of a company. It should also change the perception about when to think beyond the core business, showing that a company should not only think beyond the core business when a firm is making losses. A profitable and well known company should also think beyond its core business.

1.1 Research Questions

A case study about Philips is used in order to analyze a change of core business. Philips went through two transformations. First it shifted from Lighting to Consumer Lifestyle. Secondly, it moved to Consumer Lifestyle to Healthcare. Healthcare is now the most important business unit of Philips. This was different in 1996, when Consumer Lifestyle was the main business unit. In this report the focus is on the transition of Philips from Consumer Lifestyle to Healthcare.

The research questions for the Philips case are:

1. Why did they change their core business?
2. How did they change their core business?
3. What were successful decisions and mistakes?
4. Discuss the importance of changing a core business nowadays, and give an example of a company in the electronics industry

1.2 Following Chapters

Chapter 2: Literature Review

In the second chapter there is a literature review about the concerned topic. The first part of the literature review is about conglomerate companies in the electronics industry and the second part is about changing a core business. There is a focus on conglomerates as Philips was a conglomerate as well between 1960 and 1996. Moreover, most of the large electronic firms were conglomerates at that time. Conglomerates started to change its strategy in the 1980’s and the 1990’s. The literature review focuses on key success factors and common mistakes when the conglomerates changed its strategy and core business.

Chapter 3 and 4: Methodology and Case Study about Philips

The company Philips is analyzed in more depth. Chapter three shows the methodology which is used to analyze the firm. In chapter four is the case study about Philips. Philips started a restructuring program in 1996. It sold parts of the business which did not fit the core business and expanded in the Healthcare industry as it was a promising and high growth market. The case is analyzed until 2012, and some significant changes can be observed. The research questions are answered in this chapter. Furthermore, the relationship between literature and the case study is also analyzed.

Chapter 5: Conclusion

In the last chapter is the conclusion. There is a conclusion about the case study and literature review. In this chapter it is also stressed out on what future research should focus with regard to this topic.

2. Literature Review

The focus is on conglomerates in the electronics industry, as Philips was also a conglomerate in the 1970’s. They had 400.000 employees and operated in the music, healthcare, consumer electronics, lighting and several other industries (Veen, Yerkes and Achterberg, 2012). Conglomerates experienced high growth in the 1960’s, but reported less growth in the 1970’s and 1980’s. Moreover, the amount of conglomerates decreased in the 1980’s. As a result, many conglomerates, including Philips, started to restructure their business activities. The restructuring resulted in a focus on a limited number of business units. The management of conglomerates realized through this focus that some business units were more successful than others. Conglomerate focused on a few business units which were in a high growth industry. These promising business units could become the new core business. For example, a small undervalued business division could become the new core business of a conglomerate, which was also the case with Philips. There are several common mistakes and key success factors related to a change of core business which is analyzed in the second part of the literature review.

2.1 Conglomerates in the Consumer Electronics Industry

A company is a conglomerate when it has unrelated businesses, or operates in a mix of related and unrelated industries. Cyriac, Koller and Thomsen (2012) gave a more narrow definition of a conglomerate: “A company with three or more business units that do not have common customers, distribution systems, technologies, or manufacturing facilities”. There were many conglomerates in the 1970’s and 1980’s. They dominated the industry and played a significant role in the economy. The conglomerate strategy was highly favored and only 25 percent of the largest companies were firms who operated only in one industry in the 1980’s (Davis, Diekmann and Tinsley, 1994). However, this changed as

conglomerates were inefficient which had a significant impact on companies in the electronics industry as most of these companies were large conglomerates.

2.1.1 History of Conglomerates

There were three kind of merger waves since the 1900's (Davis, Diekmann and Tinsley, 1994). The first one was the horizontal merger in which companies acquired their competitors. The second wave of vertical growth started in the 1920's in which firms acquired suppliers which could benefit the core business. The third wave of diversification started in the 1960's, companies acquired firms in related and unrelated industries. A study of Benzing (1993) shows that high economic growth results in an increase of mergers. There was high economic growth in the 1960's and this increased the amount of acquisitions and mergers. The expansion was not only vertical and horizontal, but also in unrelated industries. This resulted in a significant increase in the number of conglomerates in the 1960's. These new large conglomerates grew through acquisitions very rapidly due to several reasons: they acquired companies that had low P/E ratios compared to the conglomerate, the conglomerates could borrow money with a low interest, and there were favorable accounting policies which resulted in a direct earnings increase in the annual report (McDonald and Eastlack, 1971). This shows that acquisitions improved the performance of the conglomerate immediately. The CEO was rewarded based on the short term performance and therefore they were highly in favor of acquiring companies in related and unrelated industries.

Growth of conglomerates

The main reasons for unrelated activities were diversification, synergism, and profitability (Smith and Schreiner, 1969). A major argument was that unrelated businesses reduce the overall risk and therefore firms should diversify in related and unrelated industries. Unrelated diversification was recommended as it reduced

the overall risks more than related diversification. Firms were also recommended to focus on synergism and economies of scale through related and unrelated diversification. This also known as the “two plus two equals five” effect (Smith and Schreiner, 1969). Regarding profitability, a study of Boyle (1970) which focused on large manufacturing and mining company mergers in the United States shows that conglomerate mergers resulted in higher returns for shareholders than vertical and horizontal mergers in related industries. A broader study of Weston and Mansinghka (1971) also showed that conglomerate corporations performed much better than other firms. A key success factor of conglomerate firms was to invest into any business as long as the investment return was higher than the cost of capital. However, over time it appeared that the conglomerates were not that efficient as expected which is described in the next section.

2.1.2 Criticism on Conglomerates

Difficulties with the allocation of resources

Berg (1965) wrote an article about strategic planning in conglomerate firms in which he focused on several difficulties with regard to the allocation of resources. The conglomerate company had several options to increase the expansion of divisions. Nevertheless, the resources were limited as they only had funds to support a few divisions and not all of them. The headquarters had to decide if either the business units or the headquarters itself could allocate the resources. The advantage of the bottom up approach was that the division managers knew in detail the business activities while the headquarters had limited knowledge. On the other hand, the headquarters had a general knowledge about all divisions while managers of the business units had limited knowledge about other divisions. Thus, the headquarters preferred a top-down approach while the managers of the business units favored a bottom-up strategy (Berg, 1965).

Different interests between business units and headquarters

The two underlying main issues of conglomerates regarding the allocation of resources were different interests between the divisions and the headquarters, and it was complicated to understand all the activities of the company (Berg, 1965). The difference in interests were caused by the everyday environment, compensation and promotion (Berg, 1965). The headquarters and the business units operated in a different environment, as the business units dealt with the products and the issues of the clients and the headquarters was mostly focused on the earnings per share. There was also a different rewarding system, as the divisions were rewarded based on the performance of their own unit and not on the performance of other units, while the headquarters was rewarded based on the overall performance of the company. The main focus of the business units was to maintain the current profits in order to satisfy the headquarters. Consequently, large and risky expenditures for the future were indirectly discouraged as it decreased current profits (Berg, 1965). Business unit managers only accepted low risk investments in order minimize the amount of losses and to avoid a lower profit. The disadvantage of this strategy was that low risk expenditures were related to low growth in profits as well. The single company invested all their resources in the main core business and had less difficulties with the allocation of funds.

Headquarters had difficulties to understand business activities

The second main issue was that the headquarters of a conglomerate company had difficulties to understand all the industries and technologies in which they operated (Berg, 1965). The single company only had to understand one industry and was more concerned about the sales and profits. This shows that the headquarters of a single company understood the different business units more as they operated in one industry. Moreover, the business units also understood each other’s activities more which was not the case with conglomerates. Thus, different

interests and a lack of understanding about all activities resulted in difficulties for the conglomerate with regard to the allocation of resources.

Impact of economic crisis on conglomerates

The criticism on conglomerates increased at the end of the 1960's as more weaknesses were exposed. In 1968, there was an economic crisis and this resulted in a decrease of the shares prices. The shares of conglomerates decreased more than less diversified companies. This contradicted the theory of Boyle (1970) that conglomerates have higher economic returns for the firm and shareholders. Reid (1971) criticized the studies which are in favor of the conglomerate firms. He disapproved the study of Weston and Mansinghka (1971) because it was based on a sample of companies in the period of 1960-1968. These companies show a remarkable high growth due to high economic growth and therefore it was a particular case. The share price of conglomerates decreased more than those of the other firms at the end of 1968 due to the less favorable business conditions. Consequently, a study of the period 1960 to 1970 regarding shareholders return showed different results than a study about the period from 1960 to 1968 (Reid, 1971). This raised the question if the conglomerates were more efficient than single companies.

An increase in criticism on conglomerates

There were several studies in the 1970's which criticized the conglomerate strategy and the return for the firm and shareholders (Attiyeh, 1970; Freemann and Hannan, 1975; Mason and Goudzwaard, 1976; McDonald and Eastlack, 1971; Melicher, Rush, 1974; Nader and Green, 1979). There was criticism on the CEOs of conglomerates. A study of McDonald and Eastlack (1971) showed that conglomerate CEOs were almost not involved in new product development. They believed that most of the growth would come from mergers, acquisitions and new products. Nevertheless, conglomerate CEOs withdrew from new product

development and focused on more on acquisitions, which was different for non conglomerate CEOs. They were involved in both new product development and in acquisition activities. Conglomerate CEOs were very dependent on acquisitions. This was a disadvantage of conglomerates as acquisitions were very risky.

Another disadvantage was that conglomerate CEOs were more concerned with the size of the firm and not shareholders value (McDonald and Eastlack, 1971). Managers thought that an increase in the size of the company always resulted in an increase in the stock price. This kind of reasoning could also be seen from an article of Nader and Green (1979), in which they asked managers about the size of firms and the government. Managers of conglomerates reasoned that it was always good when a firm gets bigger, but they reasoned that this was not always the case for the government due to less efficiency. These two views were contradicting, but conglomerate managers still believed that a larger size was always better and therefore they acquired more firms. A study of Melicher and Rush (1974) showed that firms purchased by conglomerates were not more profitable than those which were bought by non-conglomerates. Nader and Green (1979) criticized these mergers and acquisitions as it resulted in monopoly power and this decreased competition, which had a negative impact on factors such as jobs, innovation and the community. The large number of acquisitions decreased the efficiency of conglomerates which had a negative impact on the economy.

There were several reasons for the inefficiency of conglomerates. Freemann and Hannan (1975) pointed out that there was an increase in administrative work when there was an increase in size and differentiation. This effect should be decreased by economies of scale but often this was not the case as the negative effects were stronger than the positive effects. The main issue was that the administrative expenses increased when the size of the company increased, but when the size decreased, the reduction in administrative expenses was limited. This implied that conglomerate firms lacked the flexibility and the benefits of economies of scale were limited

The conglomerates were inefficient and struggled to deal with the unproductive business units. Attiyeh (1970) pointed out that after the success of

the 1960's, conglomerates were forced to focus on an effective use of internal assets rather than acquisitions due to internal and external constraints in the 1970's. Diversified companies had to make use of divestments and should focus more on internal growth opportunities. A negative aspect of conglomerates was that they kept underperforming activities in their portfolio (Attiyeh, 1970). Secondly, conglomerates did not give enough attention to growth opportunities within the company as the underperforming activities absorbed financial resources (Attiyeh, 1970). Thirdly, managers of conglomerates were mostly focused on underperforming activities, rather than on business opportunities (Attiyeh, 1970). Managers had difficulties to determine how much time they should spend on projects in each division. Thus, the weaknesses of conglomerates were a lack of focus, time and resources for those activities which had the greatest prospects for growth.

Conglomerates in the 1970's

The 1970's were different than the 1960's as there were two oil shocks and several wars which resulted in low economic growth. Only efficient and strong firms could outperform the market in the 1970's. Companies with a conglomerate strategy reported less growth in the 1970's. The weaknesses of the conglomerates resulted in a lower return for the firm and shareholders. A study of Mason and Goudzwaard (1976) showed that conglomerates did not offer higher earnings to the corporation or to the investors. A portfolio of random companies resulted in more benefits than investing in a conglomerate (Mason and Goudzwaard, 1976). As a result, conglomerates reported less growth in the 1970's and the amount of conglomerates started to decrease in the 1980's which is described in the next sections.

2.1.3 Decrease in growth of the conglomerates

The share price of some conglomerates decreased with more than 80 percent in 1968 (McDonald and Eastlack, 1971). The P/E ratio of conglomerates declined significantly and were lower than single firms. The main strategy of conglomerates in the 1960's was to acquire companies with a lower P/E ratio. After 1968, this was difficult as single firms had a higher P/E ratio which made acquisitions more expensive. This limited the growth prospects of conglomerates as they were highly dependent on acquisitions. Furthermore, in 1968 there was an increase in interest rates which made it more costly to borrow money for acquisitions (McDonald and Eastlack, 1971). Additionally, an acquisition had less effect on the earnings per share due to new accounting rules (McDonald and Eastlack, 1971). There were also several other reasons why the conglomerates struggled with growth such as: intensified competition, shorter product life cycles, rising costs and new technology (McDonald and Eastlack, 1971). Conglomerates were less efficient and therefore its products were highly vulnerable to new competitors. Nevertheless, the conglomerates were one of the largest and strongest firms at the end of the 1970's. This started to change in the 1980's.

Conglomerate discount

Several studies showed that conglomerates were valued less on the market when comparing them to their single firms (Khorana, Shivdasani, Stendevad and Sanzhar, 2011; Lebaron and Speidell, 1987; Maksimovic and Phillips, 2002). The conglomerate strategy implied that "two plus two is five", but conglomerates on the stock market were valued as "two plus two is three". The study of Lebaron and Speidell (1987) showed that separate parts of the conglomerate had more value separately than all the activities together. This was the other way around in the 1960's as synergism resulted in "the two plus to two is five effect". The conglomerates were discounted on the stock market because investors were more skeptical towards companies which operated in unrelated industries due to the disappointing results (Lebaron and Speidell, 1987). Moreover, inflation decreased

the value of assets which were acquired in the 1960's. Therefore the value of acquisitions was overvalued in the books as it is was worth less in the open market (Lebaron and Speidell, 1987). Another reason for the conglomerate discount was a lower productivity (Maksimovic and Phillips, 2002). The difference in productivity was connected to smaller segments of the conglomerate when comparing it to single firms. Shareholders preferred a company with less divisions as it had a higher productivity and it was easier to manage the activities of a single company. Shareholders experienced agency issues with conglomerates as they found it difficult to manage these large companies. Moreover, it was difficult to understand all activities of conglomerates. As a result, stockholders invested in single companies as they were less diversified, more productive, smaller and easier to supervise. This resulted in a lower value of conglomerates on the stock market.

Porter (1986) gave more insight in the conglomerate discount as he criticized the diversification strategy as it had three major disadvantages. The first disadvantage is that business units of different firms compete with each other and not conglomerates (Porter, 1986). A company is only successful when it gives attention to each separate division. Highly diversified companies had difficulties to pay attention to each business unit. The second disadvantage is that diversification increased the difficulties for business units (Porter, 1986). There were difficulties because all business units had to communicate with the parent company which was difficult due to a lack of time and resources. The third point was that shareholders could invest in a diversified portfolio of different stocks rather than a conglomerate, which shows that they had the possibility to diversify by themselves (Porter, 1986). Moreover, investors with a small amount of money could also diversify by themselves by making use of mutual funds. A mutual fund has several advantages for small investors such as convenience, professional traders in charge of the funds and lower transaction costs. This means that conglomerates did not need to diversify as investors had the opportunity to do this by themselves. This also benefitted conglomerate as it does not need to pay the expensive take-over premiums for the acquisitions as the P/E ratio of pure play firms were high in the 1970's. Thus, if small and large investors diversify, it

benefits both shareholders and companies. Therefore large investors diversified by themselves and small investors such as households invested in mutual funds. The three points of Porter (1986) showed that diversification in unrelated industries resulted in more disadvantages than advantages. As a result, conglomerates had a discount on the stock market as they were less efficient.

A decrease in the number of conglomerates

In the 1980's, conglomerates were taken over by less diversified firms at a high rate due to the conglomerate discount (Davis, Diekmann and Tinsley, 1994). The less diversified firms kept related high performing activities, and it sold those activities which were underperforming (Davis, Diekmann and Tinsley, 1994). Less diversified companies adopted a different strategy and were more successful than conglomerates. Consequently, a majority of the companies abandoned the conglomerate strategy and adopted different strategies. A study of Bishara (1981) compared multinationals with conglomerates, which showed that a CEO can expect more benefits if it made acquisitions towards becoming a multinational company rather than a conglomerate. This resulted in an increase of related acquisitions and mergers and a decrease in unrelated acquisitions. Companies had to change its strategy in order to protect themselves from a take-over. Firms simplified its business so that investors were more willing to invest in the company. A simplification of the business resulted in a higher P/E ratio which decreased the chance of being acquired. Companies simplified their business through divestures, which resulted in an increase in the share price and it limited the chance of being acquired by another company.

New Strategies of Conglomerates

The new strategies were also based on theories of Porter (1987). In his study he recommended companies to choose in which specific business area it want to operate and need to describe in detail how it want to manage it. The main

objective was to increase the overall company value, so that it had more value than the sum of all the separate divisions together. There were four points important regarding the new corporate strategy: portfolio management, restructure, transmit skills and share behaviors (Porter, 1987). The first two points focused on increasing the value of the company through a stronger connection between the headquarters and business divisions. The last two points focused on the interaction of divisions between each other in order to increase the total value of the company. This shows that there was a shift from a focus on the size of the company to creating value, which means that companies should not only diversify to increase the size of the company. The most important is that diversification should add value to the company, which is a different approach than the conglomerate strategy in the 1960's.

The new corporate strategy of companies also had an impact on the acquisition strategies of firms (Kusewitt, 1985). Conglomerates made acquisitions which resulted in enormous failures but also in significant successes. The variation in performance is related to the synergy and strategic fit between the acquired company and the conglomerate (Kusewitt, 1985). In many cases there was no synergy and strategic fit which resulted in limited value creation. Kusewitt (1985) recommended conglomerates and single firms to acquire companies in related industries in order to increase synergy and efficiency. He also pointed out that there needs to be some compatibility between management of both companies as this ensures a more efficient integration. Furthermore, companies should acquire firms which have high growth, high margins and a low P/E ratio (Kusewitt, 1985). In case a company acquires a large company, it should reduce the amount of acquisitions and focus more on the integration of the large acquired company. It should also not pay too much for a company and avoid a bidding war as this limits created value. Thus, all points focus on creating value and not on increasing the size of the company (Kusewitt, 1985; Porter, 1987). The acquisition of conglomerates and the change of strategy resulted in considerably less conglomerates in the 1990's. There was a shift to vertical integration rather than unrelated diversification (Porter, 1987).

2.1.4 Conglomerates nowadays

Conglomerates in the USA

There are only a few conglomerates left in the developed world. For example, there were only 22 conglomerates in the United States in 2011 (Cyriac, Koller and Thomsen, 2012). A very low amount of firms apply the conglomerate strategy as it is difficult to grow as a large company who operates in unrelated industries. From 2002 to 2010, conglomerates grew by 6.3 percent a year while pure play companies grew by 9.2 percent (Cyriac, Koller and Thomsen, 2012). Successful conglomerates which outperform the market have three characteristics: restructure portfolio continuously by buying undervalued businesses and improving the performance, strong focus on capital management, and a clear separation of the corporate center and the management of the business units (Cyriac, Koller and Thomsen, 2012). This shows that a conglomerate can only be successful when new business units add value to the company.

Conglomerates in Asia

The market conditions are the other way around in Asia. For example, in South Korea 80 percent of the largest companies are conglomerates while this is 40 percent in China (Hirt, Smit and Yoo, 2013). The conglomerates in Asia are very large and are still growing. In the last ten years, the revenues of the largest conglomerates in India and China increased their revenues by more than 20 percent a year (Hirt, Smit and Yoo, 2013). Even more interesting, more than half of the managers of these companies preferred business activities that are unrelated to their core business (Hirt, Smit and Yoo, 2013). The focus of conglomerates is more on size than on shareholders' value. The reason for this is that the size of a company in emerging countries is more important as resources and relationships are needed to be successful. Resources are important for infrastructure, and relationships with the government are needed in order to get permission for

specific business decisions and to operate fast (Cyriac, Koller and Thomsen, 2012).

Nevertheless, this strategy might change if companies adopt the strategy model of Europe and the United States which emphasizes more on creating value. This might take some time as there is high growth in Asia in almost every industry which is similar as the situation in the United States from 1960 to 1968.

2.1.5 Conglomerates in the Electronics Industry

Large conglomerates in the Electronics Industry

The twelve world's most admired companies in the Electronics industry are GE, Samsung, Sony, Panasonic, Emerson Electric, Siemens, Philips, Toshiba, LG, Schneider, Sharp and Mitsubishi Electric (MoneyCNN, 2013). There was a large decline in the number of conglomerates but most of the large companies in the electronics industry are still conglomerates and are stronger than before. They restructured all business units in order to be more efficient and to focus on a few industries. The twelve world's most admired companies in the Electronics industry were heavily impacted by several factors in the past which is described in the next section.

Conglomerates in South-Korea

In South-Korea, the large conglomerates in the electronics industry are Samsung and LG. Samsung and LG are also called 'Chaebols', which is a group of companies in South-Korea which operate in unrelated industries and are owned by influential families (Ferris, Kim and Kitsabunnarat, 2003). The businesses are controlled by owners who have a relatively small amount of shares of the company. South-Korea is still divided in those who support Chaebols and those who are against it. Those in favor argue that LG and other Chaebols would not

have survived if the government did not give special favors to the company, such as protectionist measures and loans (Taniuara, 1993). On the other hand, those who oppose the Chaebols point out weaknesses such as inefficiencies, irregularities and poor management (Moskalev and Park, 2010). Another disadvantage is that minority shareholders were often neglected. This was widely accepted in South-Korea until weaknesses were exposed during the crisis of 1997. Consequently, the government implemented legal reforms which limited the power of controlling shareholders, an evident example of a legal reform is the requirement of a high amount of independent outside directors in the board (Moskalev and Park, 2010). This resulted in a shift in ownership control. Moreover, there is also a shift in the way Chaebols operate, as the government recommended Chaebols to have two or three business units and to focus on specialization rather than the conglomerate strategy (Taniuara, 1993). This shows that the government had a significant impact on the Chaebols in the electronics industry in Korea, which already started with industrial programs in the 1960's.

History of Chaebols in South-Korea

In 1961, the government made a five year economic plan with a focus on exports in order to stimulate the industrial industry (Powers, 2010). The government selected several industries and allowed only a few firms to work out this economic plan. They offered financial incentives in order to stimulate firms. These companies also had the privilege to make use of foreign loans as the government controlled foreign investment of capital. Companies which received these special favors from the government were called 'Chaebols'. They experienced a rapid growth due to high exports, government favors and foreign loans (Powers, 2010). There was little risk for these companies as the government helped them in times of difficulties. The government transferred unprofitable branches to other Chaebols in order to increase profitability (Powers, 2010). Chaebols had a very low risk and therefore they entered many countries and diversified through related and unrelated products and services. Consequently, they dominated the market in the 1980's. This strategy resulted in large amounts

of debt as these companies needed loans to fund its investments. The Korean government noticed the weaknesses such as subsidizing the weaker members in the group, not enough money for high performing industries, over-investments in low performing industries, and a focus on profit stability rather than profit maximization, which resulted in a loss of value relative to companies which were not part of the group of Chaebols (Ferris, Kim and Kitsabunnarat, 2003). Furthermore, there was an increasing gap between smaller businesses and the Chaebol which revealed the economic injustice (Lee, 2008). Chaebols also experienced less growth as their investment decisions did not have a major impact on the economic growth of the firm and shareholders return (Kim, Lyn, Park and Zychowicz, 2005).

Asian financial crisis

The government recommended Chaebols to have two or the businesses as its core business and to focus on specialization rather than the conglomerate strategy (Taniuara, 1993). These recommendations did not make a significant impact as major weaknesses of the Chaebols were revealed during Asian financial crisis. A major disadvantage was that they had large amount of debts, as it had a debt-to-equity ratio of around four and it increased to almost five in 1997, while other listed companies had a ratio of around two (Ham and Mishkin, 2000). Furthermore, smaller Chaebols showed either a negative or a very low return on assets compared to single companies in the 1990's (Ham and Mishkin, 2000). Financial liberalization and a limited amount of regulations for financial institutions resulted in a high growth of bad loans. The government was involved in the credit market and allowed these bad loans. Consequently, the market thought that these Chaebols were too big to fail due to the support of the government. In 1996/1997, there was a large decrease in trade and this caused difficulties for the Chaebols as their profits were already very low. This resulted in the bankruptcy of Hanbo, which was part of the 15 largest Chaebols of South-Korea (Ham and Mishkin, 2000). This bankruptcy showed that Chaebols were not too big to fail and this led to a high uncertainty about the financial situation of the

country. Furthermore, the interest rate increased and this made it difficult for Chaebols to borrow money because they were highly indebted. After the bankruptcy of Hanbo, a few other Chaebols went bankrupt. Investors did not believe in the inefficient system anymore and sold their shares which led to a large decrease in the stock market. The crisis had a major impact on the wealth of the population as it decreased the GNP per capita by 33 percent (Hayo and Shin, 2002).

Intervention by the IMF in the Korean Economic Crisis

The Korean Government realized the severe economic difficulties and agreed for a bailout by the IMF. The IMF bailed out South Korea with the largest loan ever (Hayo and Shin, 2002). This tremendous bailout required a restructuring of all major industries in the Korean economy. The IMF imposed several conditions and tried to match it with the preferences of the Korean government. The requirements and conditions of the IMF changed frequently as for example the budget deficit condition was first a surplus of two percent, which was changed to a fiscal deficit of five percent after several letters (Hayo and Shin, 2002).

The IMF gave several recommendations to Korean politicians in order to recover. The Chaebols were one of the major causes of the crisis and therefore many reforms were targeted on the efficiency of them such as: encourage firms to focus on a limited amount of core businesses, divest unrelated activities, develop a stable financial situation for the company, make Chaebol leaders more accountable and decrease financial transactions between Chaebol members (Powers, 2010). All these measures were based on the Western model as nontransparent procedures, trade barriers and monopolies were discouraged, and efficiency of the financial system was encouraged (Kim, 2000). A year after the crisis, there were less Chaebols but those who survived were more powerful than before. The Chaebols reduced the overlapping of business activities between them and this led to a consolidation in the market (Kim, 2000).

Overall, the IMF had a positive role in the Korean crisis as the government urgently needed money (Hayo and Shin, 2002). The debt of the IMF provided to Korea resulted in a quick recovery of the economy. As a result, the majority of the public is positive about the intervention of the IMF (Hayo and Shin, 2002). The Koreans blame their own failing system and not the IMF for the economic difficulties in the past.

Restructuring the Chaebols

The restructuring policies had a major impact on Samsung and LG. The government dealt more urgently with the five largest Chaebols: Hyundai, Samgung, LG, Daewoo, and SK. These companies had to agree with several reform measures. First, they had to decrease the amount of production facilities in order to increase the efficiency of the firm (Kim, 2000). The second point was to decrease their debt-to-equity ratio from almost five to only two (Kim, 2000). Thirdly, they had to sell activities which did not belong to the core business and were inefficient. Moreover, they had to attract more foreign investors (Kim, 2000). The government recommended the last two points to increase the amount of capital and to reduce the debt of Chaebols in order to stabilize the macroeconomic environment of South Korea.

The restructuring program of the government had an impact on several industries in South Korea. In 1999, the government made Samsung and Hyundai merge their petrochemical divisions in order to cut marketing and administration costs, to reduce debt and to create other synergies (Mollett and Young, 1998). Furthermore, the government also proposed several other mergers between petrochemical companies. This also happened in the automotive industry and the electronics industry (Gadacz, 1998). Hyundai Motors acquired the bankrupt Kiamotors. Moreover, the government suggested Hyundai Motors to acquire Samsung Motors, and Samsung could acquire Daewoo Electronics (Gadacz, 1998). Finally, Samsung sold Samsung Motors to Renault due to corporate differences with Hyundai Motors. The main objective of the restructuring was to

have only two companies for an important export industry (Nolan, 2001). Samsung and LG had to be the only two firms in the consumer electronics group. The government tried to force other Chaebols to sell their electronics divisions to Siemens and LG, and Siemens and LG had to sell those activities which were not related to the electronics industry. The government was actively involved in restructuring the Chaebols and it was clear that the government was not in favor of unrelated diversification.

Conglomerates in Japan

In Japan the situation was similar as in South Korea. In Japan the conglomerates in the electronics industry are Sony, Toshiba and Mitsubishi Electric. A “Keiretsu” in Japan has the shape of a conglomerate as it is a group of companies who have a long term relationship (Goto, 1982). The group of companies help each other in case of internal organization or market difficulties. Keiretsus dominated the Japanese economy in the second half of the 20th century. A main advantage is that these Keiretsus had market power which benefitted members of the group. A Keiretsu seems to be a cartel and therefore analysts tried to find other advantages of Keiretsu besides market power, as a cartel implicates a negative effect on competition and economic democracy. For example, Goto (1982) argued that transactions between the group of companies are more efficient than those in the open market. Another argument which analysts point out was the advantage of an information flow within the group of companies, as they have meetings on a regularly basis (Williamson, 1985). This benefits the group as they can exchange ideas, difficulties and market information.

Horizontal Keiretsu

There are two kinds of Keiretsu, horizontal and vertical. The horizontal Keiretsu is a bank which has a relationship with diverse companies in different industries. Nevertheless, some horizontal Keiretsus also have vertical

relationships. These relationships are complex as the horizontal Keiretsus have a long history. The horizontal Keiretsu started with the 'Zaibatsu' which is a holding company with several businesses which played a significant role in the economy of Japan since the 19th century. A study of Okazaki (2001) showed that Zaibatsu firms outperformed those not affiliated with it. The main reason for success was strong monitoring as holdings controlled the budget, financial data and important decisions. The Zaibatsus disappeared because of the anti-monopoly law which banned holding companies in 1947 (Ozaki, 2001). This resulted in the horizontal Keiretsu which is a group of companies which is closely connected to each other (Aoki and Lennerfors, 2013). It has more flexible relationships and is held together through a large bank in combination with several cross-shareholdings (Aoki and Lennerfors, 2013). The main benefit of horizontal membership of a Keiretsu is risk reduction due to easy access to finance, monitoring, and exchange of information (Dow, McGuire and Yoshikawa, 2009). Keiretsus act as an insurance provider and protect firms from acquisitions, give financial help during economic difficulties, and provide special financial purchase facilities (Dow, McGuire and Yoshikawa, 2009). As a result, members of the group recover faster than independent firms. Another advantage is the reputation of the Keiretsu which benefits all members of the group. The reputation helps members to have better market recognition than independent firms, attract more easily talents and to negotiate better deals with customers, suppliers and the government (Isobe, Makino and Goerzen, 2006). However, they pay a price for horizontal membership as early studies already point out a negative relationship between profit and horizontal group affiliation (Caves and Uekusa, 1976). Furthermore, the profitability of membership firms is lower compared to those who are independent (Isobe, Makino and Goerzen, 2006; Lincoln, Gerlach and Ahmadjian, 1996). Nevertheless, this is different for weak and strong companies. Weak companies benefit from Keiretsus as it recovers faster due to the financial help while strong firms recover less fast, as weak companies receive help from the Keiretsu while strong companies need to take care of those who perform less. Average performers participate less in the Keiretsu as they contribute less and also receive a smaller amount of contribution from the Keiretsu.

Another disadvantage is the high coordination costs, as most of the companies operate in different industries. Therefore they have different demands and cope with dissimilar difficulties (Isobe, Makino and Goerzen, 2006). Furthermore, companies mostly make transactions within the group of companies, which limits the opportunities to trade outside Keiretsu. Another drawback is that social relationships are mostly within this group of companies which limits the exchange of expertise, learning and efficiency (Isobe, Makino and Goerzen, 2006).

Sony and the horizontal Mitsui Group

Keiretsus still play a role in the economy of South Korea. Sony and Toshiba are linked to the horizontal Mitsui Group and Mitsubishi Electric is part of the horizontal Mitsubishi group of companies. Sony was the first company who had the opportunity to issue stocks on the American securities market (Sony Direct Financing, 2013). There were many troubles such as a payment of dividends, theft, currency exchange risks and a difference between business practices (Sony Direct Financing, 2013). Furthermore, in that time they still had to send the stock certificates overseas which was very time consuming. In order to overcome the difficulties the officials from the American banks and agencies often visited Japan in order to open up the securities investment market. Fifteen other companies, including Toshiba and Mitsubishi Corp also passed the strict screening test by the Ministry of Finance and were able to issue stocks on the American market. The main reason for the issue of stocks in the US was to enlarge the financial resources as R&D and other capital equipment investments were very expensive. The high economic growth after WW2 led to a shortage of funds on the open market in Japan. Sony worked only with the Mitsui Bank who was a new and small financial institution. They could not provide enough funds for Sony and they gave priority to members from before the war. Additionally, the Mitsui Bank together with some other partners only had 8 percent of shares of Sony, which was a very low amount at that time (Sony Direct Financing, 2013). As a result, they started to look for alternative ways of financing due to a lack of interest and trust in each other. Sony stopped indirect financing and switched to direct financing

through financial markets abroad. Many other Japanese corporations followed as it was a great success. This shows that the horizontal relationship has become weaker due to financial resources from abroad. Nevertheless, there are still ties between Sony and the Mitsui Group but the company is not a member of it (Nakamoto, 2012).

Toshiba and the horizontal Mitsui Group

The second electronics company is Toshiba which is still a member of the Mitsui Group. Sony is maybe not a member because each horizontal keiretsu has only one company from each industry (Morck and Nakamura, 2005). Toshiba participates in activities of Mitsui and the members of the group. Toshiba benefits from this membership as Mitsui has a worldwide network of 151 offices in 67 countries (Mitsui Corporate Profile, 2013). Moreover, they are involved in a large amount of industries such banking, steel, infrastructure, transportation, chemicals, energy, food and consumer services. For example, several members of the group, Mitsui Chemicals, Mitsui & Shipbuilding Co, Mitsui Engineering & Co., Toagosei Co, Toshiba and Toray Industries planned to build the largest solar and wind hybrid power plant in Japan (Reuters, 2011). Thus, despite several disadvantages of the group which Sony experienced, there are also advantages such as large projects and the members of the group can benefit from this.

Mitsubishi Electric and the horizontal Mitsubishi Group

The third large electronics company in Japan is Mitsubishi Electric. It is connected to a different network, the Mitsubishi Group. This Group was a zaibatsu and became significantly smaller after 1947 due the anti-monopoly law as many of their firms split into smaller independent companies. Nevertheless, Mitsubishi Group still has many core members and also a significant amount of members. This shows the Group transformed into a horizontal Keiretsu. Mitsubishi Electric is a subsidiary of the Group and participates in the horizontal

network. In 1999, Mitsubishi Electric, Chemicals and Materials reported huge losses, which threatened the company with a break down as these poor performing companies dragged down the company (BloombergBusinessweek, 2009). Mitsubishi Electric was too much dependent on the other member companies and was not prepared for global competition when American firms entered Japan. Analysts criticized that there was too much diversification and the focus was on sales rather than on profits which is not sustainable (Bremner, Thornton and Kunni, 1998). The main issues were related to inefficiency, poor investments and indecisiveness, which conglomerates outside Japan experience as well.

Vertical Keiretsu

The second type of Keiretsu is the vertical network. This network consists of manufacturers which have a deep relationship with various suppliers (Dow, McGuire and Yoshikawa, 2009). Honda, Toyota and Nissan are part of a vertical Keiretsu. The main benefits of vertical membership are lower production costs, decrease in transaction costs, ability to monitor supplier's performance, a reduction of information asymmetries, customer knowledge and an exchange of information (Dow, McGuire and Yoshikawa, 2009). For these reasons, both suppliers and manufacturers benefit from the relationship. Nevertheless, there are also some disadvantages such as a strong core firm, limited innovation and limited scope of customers (Dow, McGuire and Yoshikawa, 2009). A strong core firm can benefit on behalf of the suppliers, and this can make the relationship not beneficial for both parties. Furthermore, suppliers in a vertical network can depend on product orders from the core firm, which limits the focus on innovation and on new customers. These disadvantages show that a vertical network is not always beneficial for suppliers.

Decrease in the number of Keiretsus

The domination of Keiretsus decreased in the 1990's, which was caused by three changes (Dow, McGuire and Yoshikawa, 2009). The first was a change in the capital market (Dow, McGuire and Yoshikawa, 2009). The amount of foreign investors increased due to the globalization of the capital markets. There was a conflict between foreign investors and stakeholders, as new investors preferred investments return rather than long-term relationships. This resulted in divestures and downsizing, which was also very common in the American economy (Ahmadjian and Robbins, 2005). Consequently, the American investor capitalism system had a significant impact on stock listed Japanese companies due to foreign investors and the globalization of capital markets, which had an impact on both horizontal and vertical Keiretsus. The second major change was the decrease in importance of banks in Japan (Dow, McGuire and Yoshikawa, 2009). The globalization of capital markets and financial deregulation increased the availability of less expensive foreign loans (Dow, McGuire and Yoshikawa, 2009). Consequently, the Japanese firms were less dependent on national banks for financial services. This decreased the importance of banks in horizontal Keiretsus, as the firms made use of foreign financial services. Both vertical and horizontal Keiretsu benefited because of less expensive foreign loans, and it impacted the horizontal membership negatively as this one was centered around a bank. The third change was an increase in the amount of foreign competitors and an increase in market pressure (Dow, McGuire and Yoshikawa, 2009). There were more low cost suppliers which worked in a flexible, fast and efficient way which resulted in a decrease of vertical keiretsu networks (Ahmadjian and Lincoln, 2001). Nevertheless, this resulted in an increase of vertical integration as companies preferred to perform supplier activities by themselves, or they produced the critical parts themselves and purchased less critical parts from suppliers. The power of suppliers decreased as they were not certain anymore of a secure group of clients, which had a negative impact on the vertical membership. These changes show that regulatory reform, globalization of capital markets, globalization of product markets and increased competition had a negative effect on the stability of Keiretsus in the 1990's.

A study of Dow, McGuire and Yoshikawa (2009) showed that the market impacted the vertical Keiretsu more than the horizontal network. The relationships of the vertical firms weakened while the horizontal companies strengthened their ties, which shows that the capital market network is stronger than the supplier network. The main problem of the supplier network is that suppliers are more prone to switching and give less importance to the network (Banerji and Sambharya, 2004). On the other hand, a recent study of Aoki and Lennerfors (2013) shows that vertical Keiretsus survive despite the globalization of capital markets and increased competition as the Japanese business culture has a more market oriented focus than before. Firms adjusted to the market and became more efficient which is also the only way to survive in the dynamic global market. Although the ties of horizontal firms seem to be stronger, some companies are highly unprofitable which makes the future of horizontal relationships uncertain as well (Dow, McGuire and Yoshikawa, 2011).

The history of the Zaibatsu and the Keiretsu networks had an significant impact on how conglomerates operate in the Japanese electronics industry nowadays. Keiretsu networks have several advantages, but analyst give more weight to disadvantages. Nevertheless, the networks became more flexible and it adjusted to market conditions. Moreover, the crisis sorted out weaker Keiretsus and the strong groups had been successful in exploiting new business opportunities. Some firms focus a lot on these new business opportunities and started to restructure its business activities. It sold business units which did not fit the new core business and invested the money in new business opportunities. This resulted in a change of core business which is described in the next section.

2.2 The push for a change of core business

Changing business environment

Early studies already point out that the business environment is rapidly changing (Cooper and Schendel, 1976; Ferguson and Morris, 1993; Haveman, 1992; Mitchell and Singh, 1995).

"The issue is not whether a company's technology will be supplanted but by whom. Companies that resist internal cannibalization will die at the hands of outsiders" (Ferguson and Morris, 1993).

The business environment is changing fast and becomes more competitive. A study was conducted on the 500 Fortune companies in 1994. In 2004, ten years later, 30 percent of these companies went bankrupt or were acquired, while 26 percent changed their core business (Zook, 2004). This means that more than half of the companies experienced a threat with respect to the independence of the company. A company needs to respond to a threat by organizational change in order to improve the short term financial performance and to increase the long term survival chances of the company (Haveman, 1992). A company needs to innovate and adapt to the market environment or it will not survive (Edwards, 2012).

Difficult for a firm to adapt to changes

It is difficult to innovate, adapt and change as many large companies have a bureaucratic structure. There is a focus on the application of rules in order to successfully manage the daily business activities. This makes employees very resistant to innovation. Consequently, it limits the ability of the company to respond to a shift in the market. This can also be seen from a study of Cooper and Schendel (1976) which shows that new entrants introduce more technological breakthroughs than the traditional industry. This is remarkable as the traditional industry has strong relationships with clients. This shows that traditional companies cannot limit the impact of change. As a result, the traditional industry has only two choices regarding change, either they do not participate in innovation and limit the chance of surviving, or they participate in the process of expansion and have the opportunity to grow and improve financial performance (Mitchell

and Singh, 1995). In the next sections it is explained what a core business is, when and how to change it, and it is analyzed what the common success factors and failures are.

2.2.1 What is a core business?

There are several definitions of a core business. The most basic one is that the core business of a company is the firm's most important business unit, which generates most of the revenues and profits. Edwards (2012) defines the core business as clients which the company has in specific markets, together with existing technologies and capabilities. The core business can also be seen as a combination of the core customers, core differentiation, core capabilities and the culture and organization (Zook, 2007).

Most companies are successful in their core business as they have business experience in this industry (Edwards, 2012). The reason that a company still exists is because they learned several valuable lessons from the core industry. The core business is an 'easy' playfield as the company knows their customers and the clients are aware of the company. Companies such as Pepsi, Fiat and DHL have a core business which is well known by the market. For other companies such as Siemens, Philips and the Mitsubishi Group it is difficult to define what the core business is as they have invested in unrelated diversification.

A firm has a strategy for each core business in order to protect their current competitive advantage, such as cost leadership or differentiation (Porter, 1985). Beyond the core business it is more difficult as there are new customers in different markets (Edwards, 2012). Moreover, it requires different technologies and capabilities as well. It is complicated to find new customers and it takes some time to obtain customer knowledge from new clients. These new clients can be reached through new technologies. However, new technology costs money and it is not sure if the company has the expertise to develop this which creates uncertainty. Some firms are very uncertain and therefore they always stick to their

core business. This is very risky as the market changes which can have a negative impact on the industry in which the firm operates. It is important for a company to be flexible and to adapt to the market environment. In the next paragraph it is explained when companies need to change its core business.

2.2.2 When to change the core business?

Consequences of low growth

The business environment is rapidly changing, "as today's leaders can be tomorrow's laggards" (Edwards, 2012). Moreover, it is difficult to maintain a high growth rate for a long period. Even the conglomerates which had a large amount of resources could not sustain its growth. A low growth results in a lower market share, a decrease in revenues and lower profits. Managers face a problem when the core business cannot satisfy the growth expectations, which happens when the industry in which the company operates is in an unfavorable stage (Edwards, 2012).

Industry lifecycles

An industry has a lifecycle of five stages: the development stage, introduction, growth, maturity and decline. It takes sometimes several years before an industry is in the maturity stage due to new innovations. Furthermore, an industry can move from the maturity stage back to the growth stage due to technological breakthroughs. In the growth stage companies expand their production and revenues. However, in the maturity stage there is a overcapacity which results in a slower growth. Companies start a price war in order to obtain more capacity, which occurs in the maturity and decline stage (Proctor, 2000). Companies cut costs in order to improve margins but sometimes this does not happen due to shrinking profits in the industry (Gilbert, Eyring and Foster, 2012). Furthermore, it is difficult to find new products in the decline and maturity stage and this forces

R&D to change its focus. Many companies consider to exit the industry in the decline stage because there are too many competitors in the industry. The company has three other options in the decline stage which are to invest, hold or milk (Proctor, 2000). The company needs to exit the industry when it has a weak position in the market and the business environment is unfavorable (Proctor, 2000).

Decline stage

Many industries are getting into the decline stage, which can be seen from recent trends. There is a decrease in the expected lifetime of a company from 40-45 years in 1990 to only 18 years in 2008 (Dervitsiotis, 2011). Products and industries have a shorter life cycle than before. Therefore a company should not always stick to its core business. Many traditional firms still make investments in the old technology while there is a decline in the market due to new technologies (Cooper and Schendel, 1976). This shows that it is difficult to allocate resources to new technologies. The first response of the traditional company was to point out the weaknesses of the new technology (Cooper and Schendel, 1976). However, nowadays this doesn't work anymore. For example, Kodak focused too long on its old business and was too late with the transition to digital imaging.

On the other hand, companies should also not invest in every new product and forget their core business (Zook, 2007). The three main reasons why companies experience less growth is that companies with premium brands ignore new lost cost competitors, focus on existing products rather than new products, and they abandon their core business while it is still in the growth stage (Olson, Bever and Verry, 2008). Managers think that their business is in the maturity stage because they do not see business opportunities and underestimate their own capabilities. For example, the company RCA was one of the major players in the computer and electronics industry in the 1960's (Olson, Bever and Verry, 2008). The managers of RCA thought that this market was in the maturity stage and invested in unrelated industries such as food and car rental. They became an inefficient

conglomerate and this led to an acquisition by GE. They made a mistake by judging the industry as mature and invested in industries for which they did not have skills, as these markets had different products and customers. This shows that companies should not abandon their core business too rapidly as the industry can be revitalized through new markets, products and applications (Proctor, 2000).

Beyond the core business

In the case of Kodak, the best option is to exit the industry and to enter a new profitable related industry. However, firms experience difficulties to find a new profitable industry. Moreover, companies realize too late that they need to change the industry. Corporate managers start to think about new business opportunities when their company is in the middle of a crisis. They are too much focused on carrying out the daily business activities which are related to a certain business model. They forget that business models do not sustain forever (Govindarajan and Trimble, 2006). Edwards (2012) points out that at one point of time the growth of the core business will not be enough. Managers realize that they need to think beyond the core business. Nevertheless, investing beyond the core is very risky and therefore risk-averse managers do not consider it. It is important for managers to look with an objective view to the company. Zook (2007) made a table with five questions which help companies to understand the current situation of the company. These questions are related to the current condition of customers, differentiation, profitability of the industry, capabilities, and culture and organization (Appendix 1). Companies need to reconsider their core business when more than one of these topics is negative. This requires communication between the headquarters, employees, customers and suppliers.

Trap of complacency

However, many large successful firms do not take into consideration a different opinion when they outperform competitors and present decent financial

results as the focus is on the efficiency of organizational operations. This results in a company who does not want to change, which can also be seen as the trap of complacency (Hemp and Stewart, 2004). A company which is content does not take into consideration the opinion of customers, the market and employees. This results in major difficulties when there is a shift in the market.

Thus, a company should always be open for a change of core business. Many companies only consider this when they are in the maturity and decline stage. In fact, most companies in the growth do not think about a change of core business at all. Nevertheless, it is important to continuously analyze the core business and its prospects as those firms who enter a new industry have more chance to survive than those who do not think beyond the core business (Mitchell and Singh, 1995).

2.2.3 How to change the core business?

Beyond the core business there are new markets, customers, technology and capabilities (Edwards, 2012). A company can find these opportunities through internal changes, research and development, acquisitions, joint-ventures, partnerships, and several other possibilities. This shows that a change of core business can start within the company or outside the company.

Top-down approach

A company can apply the bottom-up or the top-down approach to create opportunities. It is difficult for a company to change if it only applies the top-down approach. The disadvantage is that a top-down approach limits innovation, speed and flexibility, and therefore the former CEO of IBM prefers a bottom-up approach (Hemp and Stewart, 2004). Moreover, a study of Beer, Eisenstat and Spector (1990) shows that change programs do not result in change, which implies that the top-down is less successful regarding change. One of the main issues is that change from the top does not reach the lower levels of the firm (Paton and

Boddy, 2007). Another disadvantage is that the headquarters has limited knowledge about the condition of the products and the industry (Golovina and Nilsson, 2011). Many large successful firms do not take into consideration a different opinion and therefore they have difficulties when there is a shift in the market. For example, managers of Blockbusters failed to listen to their employees and therefore the company went bankrupt. The company was a movie rental company and had 3500 stores and more than $4 billion of revenues in 1994 (Woolbridge, Matulich and Riddick Jr., 2007). Employees of Blockbusters had a dialogue with the customers every day. The workers already realized that their clients started to get more interested in downloading movies on the Internet. Blockbusters was losing market share as the online rental company Netflix was more successful. The headquarters of Blockbusters responded by putting late fees to an end. Nevertheless, this was not enough as they did not listen to their employees and did not understand their customers. As a result, the company went bankrupt and was acquired by another company. This shows that change is difficult if there is no relationship between the customers, employees and managers. Despite the criticism on the top-bottom approach, the top of the company plays a significant role in the revitalization process in the bottom-up approach.

Bottom-up strategy

The bottom-up strategy has several advantages such as employee involvement, a focus on local issues, and a higher flexibility (Paton and Boddy, 2007). There is more collaboration between headquarters and employees. A study of Beer, Eisenstat and Spector (1990) shows that successful change starts in a business unit far away from the headquarters. The study also shows that successful companies create a climate for change and put less focus on renewal from the top (Beer, Eisenstat and Spector, 1990). On the other hand, corporate managers play a significant role as they need to create a business culture of change and need to motivate employees by being involved in innovation (Paton and Boddy, 2007).

Mix between top-down and bottom-up approach

A mix between the top-down and bottom-up approach is to have a close link between customers, employees, managers and corporate managers. This means that local problems and local solutions should be identified by the business units (Paton and Boddy, 2007). Subsequently, the headquarters needs to facilitate these local solutions by adjusting relevant structures, processes and policies. A mix between the top-down and bottom-up approach helps to create business opportunities, as all the parties are involved which creates value. This shows the growing importance of relationships within the company.

Relationship-centered company

A successful firm is one which has the characteristics of a relationship-centered company (Gulati and Kletter, 2005). For example, a corporate value of IBM was the 'the pursuit of excellence' (Hemp and Stewart, 2004). However, this value turned into arrogance as IBM stopped listening to the market, clients and employees. Companies should not trust on the successes of the past which is a major challenge for large companies. Many large companies have pride which IBM had as well. This resulted in major difficulties when there was a shift in the market as arrogant companies are not flexible. Therefore successful firms focus on customers, suppliers, alliances and business units in order to remain flexible (Gulati and Kletter, 2005). Many companies see customers as someone who buys products and services. Nevertheless, the focus should be on solving problems of customers. For example, the clients of Blockbusters wasted a lot of time by going to the store to rent a video, and internet could help to solve this issue. Nevertheless, Blockbusters focused more on sales, rather than focusing on solving the issues of clients. Blockbusters was not successful due to a lack of strong relationships with their clients and customers. A study of Gulati and Kletter (2005) shows that successful firms have good relationships with their customers through information sharing. Secondly, suppliers are becoming more important as

consumers are more demanding and the markets become more dynamic (Gulati and Kletter, 2005). Successful firms work closely together with suppliers through an improved computer network which increases the efficiency. The third point for a relationship-centered company is to have alliances, as they can help the firm to perform those activities in which they lack the resources and knowledge (Gulati and Kletter, 2005). Fourthly, it is important to focus on business units and to let them work together, as this collaboration results in significant benefits (Gulati and Kletter, 2005). Weak companies have separate units and no collaboration, which limits the sharing of intellectual capital. Thus, the network of relationships with customers, suppliers, alliances and business units creates new business opportunities. Companies which do not invest in relationships limit the chance of new opportunities. Moreover, a company can find a new core business by investing in relational capital. For example, Palmisano became the new CEO of IBM in 2002 and wanted to implement new corporate values as the current values were not matching with the company's business practices (Hemp and Stewart, 2004). The objective was to stimulate and energize employees by these new values. The CEO asked senior executives and employees about their opinion and discussed it with them. Consequently, some changes were made due to the new corporate values. This helped IBM to provide more value for the client. This example shows that a companies provide more value if they listen to employees, the market and customers. Moreover, it increases the chance of finding undiscovered consumer knowledge. This gives the opportunity to change the core business if the clients prefer a different service or product.

Research and development

Business opportunities can also be discovered through R&D. Regarding the electronics industry, R&D is vital as there is an increasing amount of technological breakthroughs which results in a rapid introduction of new products and services. For example, Apple introduced the Mac, iPad, iPod, iPhone and the Apple TV the last few years. These products replace and substitute other products. Edwards (2012) points out that: "a company needs to innovate or dies". R&D

results in new innovations and firms can apply for a patent in order to protect the technology for several years. In these years the corporation has the opportunity to make profits in order to cover the R&D costs. Innovation is increasingly becoming more important for new business opportunities. Companies need to be prepared to compete on the basis of R&D and innovation, which often results in a change of core business as well. For example, Kodak and Blockbusters failed to invest in relationships, but also in R&D and innovation. Kodak failed to make the transition to digital photography and Blockbusters was not successful in the change to online video rental. This shows that R&D and innovation are important for new business opportunities.

Acquisitions

A change of core business can also start outside the company through acquisitions, joint-ventures, mergers and partnerships. Acquisitions are very risky as 65 percent have devastated more value than they create due to paying a premium which is too high, acquiring the wrong firm and unsuccessful integration (Laurie, Doz and Sheer, 2006). It is difficult to create value when a firm pays a high premium. Companies pay a higher price than the market value as they have to reward shareholders with a premium. The company can still benefit from the acquisition through synergies. Desperate firms do not benefit from the synergies as they pay too much for the firm, as the premium is too high (Ji-Yub, Jerayr and Finkelstein, 2011). Companies are desperate if they have an organic growth which is lower than its competitors (Ji-Yub, Jerayr and Finkelstein, 2011). Moreover, a company is also desperate if they are dependent on acquisitions for growth more than competitors (Ji-Yub, Jerayr and Finkelstein, 2011). Similarly, firms which have high organic growth and which are not dependent on acquisitions pay a smaller premium for acquisitions. The firm’s desperation can be limited by an external advisor which has experience with acquisitions and premiums. The issue of desperate firms is also relevant for conglomerates, as they were highly dependent on acquisitions and faced low organic growth. Desperate conglomerates overpaid for acquisitions and therefore the value creation was

limited. The overpayment resulted in difficulties as the costs of acquisitions are higher than the benefits such as synergies. Nevertheless, companies have the opportunity to create business opportunities through acquisitions, which also helps to find a new profitable core business.

Joint-ventures

A company can also change its core business through joint-ventures, which are risky as well. Grondelle (2013), Head of Joint Ventures KPMG, estimates that more than 80 percent of them fail to deliver the expected benefits. The main disadvantages of joint ventures are coordination costs and competitive costs, while the advantages are economies of scale, access to know-how, improved competitive position and quality improvement. The know-how is important for a firm to create new business opportunities. For example, a joint-venture can be started up in order to invest together in a new technology. The company can exploit the business opportunity if the experiment is successful.

Partnerships

Partnerships also help to create new business opportunities, which are less risky than acquisitions and joint-ventures. A new core business requires new technology and capabilities. However, in many cases the company does not have these within the firm. Edwards (2012) points out to look for partners who have a common interest in order to fill the capability gaps when moving beyond the core business. These partnerships can also help to enter new markets. A firm can make a partnership with universities, governmental institutions or other companies. Nevertheless, the partnerships often fail to deliver the expected benefits. A study of Kale and Singh (2006) points out that a company should look for committed, compatible and complementary partners in order to be successful. Moreover, firms with more than one partnership should put an effort in developing talent and processes in order to support the partnership management, which results in more

benefits (Kale and Singh, 2006). Thus, internal changes, R&D, acquisitions, joint-ventures and partnerships help to create new business opportunities and to change the core business. There are several success factors and common failures when companies invest beyond the core which is described in the next section.

2.2.4 Success Factors and Common Failures

Business opportunities within the company

A company needs to look within the company in the same or a related industry for a change of core business as acquisitions and joint-ventures have a high risk. Zook (2007) points out that a change of core business can start within the company by finding: an undervalued business division, undiscovered consumer knowledge or underestimated capabilities. These options have low risks and low costs, although the company has to spend time and effort in defining these areas. It is important to consider partnerships with universities, governmental institutions and other companies, if firms lack the capabilities and expertise in a new industry or market (Edwards, 2012).

Business opportunities outside the company

Companies should consider acquisitions and joint-ventures in case no business opportunities are found within the company. It is recommended to first focus on the same industry and related industries, rather than investing in unrelated industries. As could be seen from the inefficient conglomerates, it is difficult to be successful in unrelated industries. The success of diversifying away from the core business depends on the connection between the new activities and the current competences. There is a negative impact on the financial performance of the company if the current and new activities are not related (Haveman, 1992). Moreover, a study of Zook (2007) about companies that have successfully restructured their core shows that the most secure route is to in invest in a business

close to home rather than to enter an unfamiliar market. Many companies already have some expertise in house which can be used to expand in the same industry. This is also confirmed by a study of Edwards (2012), which shows that innovation becomes more risky when the company goes beyond the core, as a firm is not successful if they are many steps away from the core. Furthermore, a company should improve its performance in the industry where it is rather than entering a new market, as in every industry the return is around the same (Hirsh and Rangan, 2013). There are some high growth industries but most of the time this high growth is not sustainable and slows down over time (Hirsh and Rangan, 2013). One the other hand, in some industries there is high growth for a longer period, and therefore Porter (1987) makes a distinction between attractive and not attractive industries. As a result, companies should also pay attention to related industries with high growth.

Independent growth platform

Companies need to make a list of assumptions before entering a related or unrelated industry (Govindarajan, 2010). A company should not invest in an idea if there are too many negative assumptions. If almost all the assumptions are positive, the company needs to invest in the idea by separating the former and the new core business and let them work separately as independent divisions, while they still have the opportunity to exchange resources with each other as this increases the success for a change of core business (Gilbert, Eyring and Foster, 2012). Laurie, Doz and Sheer (2006) suggested to create an independent growth platform which focuses on new core business opportunities. Nevertheless, no separation is needed when both business units have value creating process for the customer is similar (Govindarajan, 2010). The two business units should only be separated when both units have a different business model.

Both units play a different role in the firm when they are separated, and therefore managers should not treat the two business units equally. The core business remains important and should not be undervalued as it provides cash

flows for the company, innovation, and it pays the salaries of the employees (Edwards, 2012; Gilbert, Eyring and Foster, 2012). The new core business requires extra attention through corporate resources (Gilbert, Eyring and Foster, 2012). Nevertheless, a common failure is to over-invest in start-ups and new business opportunities as managers see them as a competitive advantage of the parent company (Clayton, Gambill and Harned, 1999). The best way is to apply the golden rule: "spend a little, learn a lot" (Govindarajan and Euchner, 2010). After spending a little, there is the experimental stage of a few months in which the assumptions are tested. The company discovers if the market assumptions were right or not. Even more important, the managers can also see if the company has the capabilities to be successful with the new business unit. Moreover, the experimental stage provides consumer insight (Edwards, 2012). Managers should not judge the short-term financial performance of a new start-up as if it was part of the core business. This has negative consequences as entrepreneurs leave the company and new ideas do not have any chance of succeeding (Clayton, Gambill and Harned, 1999). Many start ups are not successful the first time during the experimentation phase, but it gives the opportunity to gain customer knowledge which helps the firm to be successful next time.

Important employees involved in a transition

There are two persons who play a significant role in the transformation of the company: the CEO and the manager of the separated business unit. The initiatives of companies can be classified in three points: improve daily business activities, discontinue underperforming activities, and develop a business model which is sustainable for the future (Govindarajan and Trimble, 2011). A CEO should give equal weight to each initiative. Unfortunately, most of the CEO's duties are linked to initiatives aimed at the daily activities of the corporation. This means that CEO's are focused on the preservation of the company rather than creating new value for the future, which shows that many firms are process-driven as they spend most of their time and resources on continuous improvement of the core activities (Govindarajan and Trimble, 2011). Therefore managers of new growth

platform play a significant role (Laurie, Doz and Sheer, 2006). An important characteristic of this manager is to have a deep interest in opportunities beyond the core business of the company as the business unit is not about the core business but about new business opportunities. This requires specific characteristics such as a high credibility, organizational skills, involved in start-ups and entrepreneurial (Laurie, Doz and Sheer, 2006). The CEO also needs to play an active role in the new core business, which includes to participate in meetings, give insight, and use his or her network to help the new business unit (Laurie, Doz and Sheer, 2006).

Leadership position in the market

If the new business unit is successful, firms should focus on a leadership position in the market, as in many industries more than 70 percent of the profit pool is gained by the No. 1 and 2 of the market (Zook, 2007). Companies should divest those activities in which they do not have any leadership position, and invest it in those divisions which they have some market share. The money of the divestures can be used for strengthening the leadership position of the new core business.

3. Methodology

A case study about Philips is used in order to gain more knowledge about a change of core business. The annual reports of Philips (1998-2012), literature, and news articles are used to analyze the firm. The research questions for the Philips case are:

1. Why did they change their core business?
2. How did they change their core business?
3. What were successful decisions and mistakes?
4. Discuss the importance of changing a core business nowadays, and give an example of a company in the electronics industry

Characteristics of Royal Philips Electronics

The foundation of the Royal Philips Electronics company was laid in 1891 in Eindhoven, the Netherlands (Philips History, 2013). They focused on Lighting when the company was founded for which they are still known today. In the 20th century it focused more on consumer lifestyle products which became its new core business. In 2010, Healthcare became the new core business. Philips made an impressive transition from a conglomerate to a smaller company which has a focus on Lighting, Consumer Lifestyle and a stronger focus on Healthcare.

Today Philips is a diversified health company which focuses on improving the life's of their customers. They have global leadership positions in each division: Lighting, Consumer Lifestyle and Healthcare. In 2012, they had more than 110.000 employees, in more than 100 countries and sales of almost eur 25 billion (Philips History, 2013).

4. Royal Philips Electronics Case

In this chapter the company Philips is analyzed with regard to a change of core business. Philips is mainly known for Lighting and Consumer Lifestyle but changed significantly.

4.1 Change of core business

Philips went through two transitions: Lighting to Consumer Lifestyle, and Consumer Lifestyle to Healthcare.

Philips Lighting and the increased focus on Consumer Lifestyle: 1891-1995

The foundation of Philips was laid in 1891 in Eindhoven, the Netherlands (Philips History, 2013). Gerard Philips started a company to manufacture lamps and other electrical products and around nine years later it became a large lamp manufacturer in Europe. The company experienced a rapid growth and Philips was the largest employer in the Netherlands at the beginning of the 1900's (Philips History, 2013). In 1914, Philips set up a research laboratory and protected its innovations by patents. The start of research led to new products.

Diversification

In 1918, it started with diversification and presented the medical X-ray (Philips History, 2013). The following years Philips was involved in the radio, television and electric razors. Between 1945 and 1990 there were several technological breakthroughs which resulted in the introduction of the compact audio cassette, compact disc and the DVD. Philips focused on consumer electronics, as there were high profit margins and growth opportunities as these products were at the beginning of their life cycle. Philips applied the pioneer strategy and introduced many new product which resulted in a first mover advantage (Nadeau and Casselman, 2008). This approach includes measures such

as applying for a patent, dominating the market, and producing better quality than imitators. Philips participated in all new trends through acquisitions, in-house R&D, partnerships, and joint-ventures.

Philips was a conglomerate

Philips became a conglomerate company as they operated in the music, healthcare, consumer electronics, lighting and several other industries and reached a peak of 400.000 employees around 1975 (Veen, Yerkes and Achterberg, 2012). A company is a conglomerate when it has unrelated businesses, or operates in a mix of related and unrelated industries. Cyriac, Koller and Thomsen (2012) gave a more narrow definition of a conglomerate: "A company with three or more business units that do not have common customers, distribution systems, technologies, or manufacturing facilities". The conglomerate strategy also had disadvantages which is described in the next section.

SWOT Analysis shows the difficulties of Philips: 1996

Exhibit 3 shows the SWOT analysis of Philips in 1996. The strengths of Philips were a number one position in the Global Lighting Market, a number three position in Consumer Electronics Market, strong brand name, high quality products, and R&D capabilities. A weakness was that Philips focused on a large amount of industries which resulted in less efficiency. Furthermore, the pioneer strategy also resulted in some first mover disadvantages such as a shift in technology, free-rider issues and different customer needs (Lieberman and Montgomery, 1987). A major disadvantage for Philips was the rapid shift in technology and low-cost competitors from Asia. Nevertheless, during these difficult times there were also opportunities such as home care medical technology and a high demand from emerging countries. The major threats were declining profit margins for the Consumer Lifestyle division, shorter product life cycles, intensified competition, and substitute products.

Disappointing results: 1996

There was a sharp decrease in income in 1996. The managers implemented a restructuring program in order to make the company more flexible (Philips,1998:36). This helped the company to respond quicker to market changes which was necessary as Philips operated in a competitive environment. The restructuring program was aimed at focusing on the core business and selling parts of the business which were underperforming or did not fit in the strategic portfolio. In addition, Philips wanted to focus on those activities in which they had the opportunity to become a major player worldwide.

Divestments: 1996-1999

In 1998 it sold already 25 operations which did not fit to the core business or were underperforming (Philips, 1998:4). One of these companies was Polygram, which operated in the music and film industry. Polygram had a very different nature of business and therefore it was sold. Philips acquired several companies in order to strengthen their global position in three industries: Consumer Lifestyle, Lighting and Healthcare. They acquired the company ATL Ultrasound, which was a major player in diagnostic medical imaging. The reason for the acquisition was a growing market and high profit margins. Philips was the No.3 in diagnostic imaging and wanted to become the No. 1 (Philips, 1998:28).

In 1999, the divestment plan of Philips continued and it divested over 40 businesses (Philips, 1999:4). Philips kept on monitoring the performance of all divisions in order to see whether improvement was needed and if activities belonged to the core business. In 1999, the core business was Consumer Products as it presented 39.5 percent of the total revenues and 24 percent of the total EBITDA. Nevertheless, Lighting was also important as it accounted for 14.5 percent of the total revenues and 22 percent of the total EBITDA (Philips, 1999:49). Healthcare accounted for 8 percent of the total revenues and 6 percent

of the total EBITDA. The healthcare industry was a growing market due to the aging population and the increase in demand for medical products from emerging countries. As a result, Phillips wanted to expand in this market and this started in 2000 which is described in the next section.

A focus on Philips Medical Healthcare through acquisitions: 2000-2003

In 2000, Philips divested several activities which resulted in a gain of eur 3.6 billion and invested for eur 3.2 billion (Philips, 2000:2). The divesting plan of 1996 was accomplished and Philips implemented a new strategy for a high growth future which consisted of three steps (Philips, 2000:3). The first was to have several leadership positions in the market which should result in a positive cash flow. The second step was to have a portfolio with high growth products and services. Consequently, Philips invested more than usd 4 billion in the Healthcare division in order to increase the variety of products and to explore new high growth products (Philips, 2000:4). The third step of the strategy plan was to be an industry shaper which was possible through high investments in R&D. As a result, Philips built several research centers in China and India and a high tech campus in the Netherlands. This resulted in an increase of patents with 35 percent in 2000 when comparing it to previous year (Philips, 2000:43).

Philips reported losses: 2001

The year 2001 was a difficult year for Philips as they reported a loss of almost eur 3 billion due to the recession (Philips, 2001:41). The divisions Semiconductors, Components and Consumer Electronics reported significant losses, while the division Lighting reported a lower profit than previous year. Nevertheless, the division Healthcare reported a profit record. Cor Boonstra, President of Philips, left in April 2001 the company and was replaced by Gerard Kleisterlee. The new president had more than 25 years of experience at Philips and had worked as a manager for several divisions such as Healthcare, Consumer Electronics and Components (Teather, 2010). The new CEO wrote in the annual

report of 2001 a paragraph about ‘facing the facts’ (Philips, 2001:6). The new CEO admitted that not all the problems can be blamed on the current crisis and that a lot of work had to be done as Philips had too many low growth products in combination with low profit margins. Consumer Electronics accounted for a third of the total sales, and it had been underperforming for several years. As a response, Philips improved the profitability of Consumer Electronics through joint-ventures and outsourcing. Furthermore, Healthcare acquired two large American companies in order to strengthen the division (Philips, 2001:8). In a period of three years, Philips invested more than USD 5 billion in the Healthcare division. These acquisitions resulted in a No. 2 position in the medical digital imaging equipment compared to a No. 3 position in 2000 (Philips, 2001:53).

Division components dissolved: 2002

In 2002, the cash flow from operating activities improved but sales remained flat (Philips, 2002:4). Exhibit 2 shows that the stock dropped from nearly eur 45 in 2001 to eur 15 in 2002. The division components and semiconductors reported significant losses. As a result, the CEO Gerard Kleisterlee took the initiative to dissolve the Components division. Furthermore, he launched the program “Transforming into one Philips” in order to work more closely together as a company and to reduce the costs (Philips, 2002:11). Healthcare focused on the integration of the acquired companies from the previous years in order to benefit from synergies. Furthermore, Philips started partnerships with several important universities in order to implement medical discoveries into new medical systems. Exhibit 4 shows that in 2002 some clear changes can be observed with regard to Healthcare when comparing it to five years ago. In 1998, only 5 percent of the company worked for Healthcare, the division accounted for 6.4 percent of the total sales and 9.4 percent of the total net operating capital. In 2002, 18.2 percent of the employees worked for Healthcare, the division accounted for 21.5 percent of the total sales and 44.6 percent of the total net operating capital. This shows that Healthcare became significantly more important for the operating liquidity of Philips.

Integration of Healthcare acquisitions: 2003

In 2003, Philips benefited from increased performance at Semiconductors, Consumer Electronics and Healthcare (Philips, 2003:4). The integration process at Healthcare resulted in synergy benefits of eur 350 million and income from operations increased by almost 40 percent (Philips, 2003:6). Furthermore, a new alliance with Epic Systems Corporation was introduced in order to improve several processes of the Healthcare division. Between 2000 and 2003, Philips invested around eur 5 billion in acquisitions and doubled the size of the Healthcare business unit (Philips Healthcare, 2013).

Expanding Healthcare in the Chinese market: 2004

Exhibit 5 shows that Healthcare became more important in terms of sales between 2004 and 2012 due to acquisitions, partnerships and innovation. In 2004, Medical Systems invested in a R&D centre and a manufacturing fabric in China through a venture with Neusoft Group in order to expand in the Chinese market (Philips, 2004:10). Innovation in the healthcare industry was very important as 40 percent of the sales were from products younger than 2 years in 2002, while this increased to 60 percent in 2004 (Philips, 2004:30).

Reducing earnings volatility: 2005

In 2005, the focus was to increase the healthcare division as a percentage of the total portfolio, to reduce the presence in product markets which were very volatile, and to invest in innovation (Philips, 2005:10). Philips acquired the company Stentor which is based in the USA and strengthened the position in the IT Healthcare. Nevertheless, this did not have a major impact on the Healthcare division, as the business unit accounted for 20.05 percent of the total sales in 2004 and this increased slightly to 20.87 percent in 2005 (Philips 2005:71). Philips was more successful in reducing the earnings volatility and to invest in innovation.

The division Consumer Electronics and Semiconductors were both operating in a very volatile industry. Philips decided to transfer several activities of Consumer Electronics to TPV in Taiwan in order to reduce earnings volatility. Furthermore, they created a separate legal structure for Semiconductors so that it was possible to sell this volatile business unit which accounted for 15.20 percent of the total sales (Philips 2005:71). Philips was also more successful with their focus on innovation as 49 percent of Philips sales came from business activities launched in the last three years, while this was only 39 percent in 2004 (Philips, 2005:11).

Philips sold Semiconductors for eur 8.3 billion: 2006

In 2006, Philips divested the Semiconductors division and received eur 8.3 billion (Philips, 2006:9). The reason for this was to have a more 'simple' Philips and to focus more on those sectors which have higher profit margins to reduce the earnings volatility. As a result, Philips acquired Intermagnetics and Witt Biomedical in order to become the leader in the market for clinical reporting and MRI components. The market recognized the successful transformation of Philips and the CEO Gerard Kleisterlee was European Business Man of the Year in 2006 (Schwartz, 2007). The Fortune Magazine admired the CEO for transforming the inflexible company with average margins into a market driven firm with high profit margins.

Largest acquisitions in the history of Philips: 2007-2008

The years 2007 and 2008 were very important years for Philips as the largest acquisitions in its history were made. Philips acquired Respironic for eur 3.6 billion which was a market leader in sleep therapy solutions in the USA (Philips, 2007:10). The Light division acquired Genlyte for eur 1.8 billion in the USA, which was a market leader in lighting applications (Philips 2007:56). Philips also divested several activities such as the Mobile Phone activities which were not part of the core business (Philips, 2007:57). Philips had a clear vision as they followed

their strategy of 2005, which was to sell volatile and noncore businesses and to invest in promising products and markets.

Healthcare reported strong results during the crisis: 2009

In 2009 the crisis hit Philips and sales decreased 11 percent (Philips, 2009:7). The largest impact was on the Consumer Electronics division, which had a significant decrease in sales. Healthcare reported strong results and the results of Lighting improved during the year. Philips invested around eur 4.5 billion in the home healthcare activities since 2006. The acquisitions of Agilent, Respironics, Raytel Cardiac Services and Health Watch Holdings were all aimed at strengthening the home healthcare division, in which they compete with firms such as GE and Intel.

Gerard Kleisterlee stepped down as CEO of Philips: 2010

In 2010 Philips continued the trend as they acquired six companies in the Healthcare industry, mainly in upcoming economies. Furthermore, Lighting acquired four companies and Consumer Lifestyle one. Gerard Kleisterlee received recognition for his work at Philips, and in 2010 he won the Outstanding Leadership in Sustainable Practices due to his visionary leadership and as being an important business leader in Europe (European Business Leaders, 2010). In the same year he also stepped down as the CEO of Philips. Gerard Kleisterlee was in charge for ten years and played an important role in the transformation of the company. On the other hand, Exhibit 2 shows that the value of the stock is around eur 23 in April 2011 while it was around 24 Euros when the new CEO entered the company in April 2001. This shows that shareholders did not benefit from the transition of the company. Philips underperformed when comparing it to their competitors such as Siemens AG (Noordhuis, 2011). Furthermore, after almost ten years of restructuring the amount of employees decreased from 189,000 people to

116,000 people, and the revenues decreased from eur 32 to eur 23 billion (Teather, 2010).

Reshaping the Consumer Lifestyle division: 2011

Frans van Houten started as the new CEO of Philips in April 2011. The main challenge was to fix the TV unit as Gerard Kleisterlee left it unfinished behind. Consequently, the television activities were put in a joint venture with TPV in which Philips had 30 percent (Philips, 2011:7). The television activities could perform better under the joint venture and Philips wanted to focus on those activities in which it could increase their leadership position. Consequently, Philips acquired three companies in the healthcare industry, two in the Consumer Lifestyle and one in the Lighting. In 2012, the main focus was on reshaping consumer lifestyle in order to make it more profitable. Therefore, also the audio, video and multimedia were transferred to Funai, for which Philips receives brand license income (Philips, 2012:7).

Impact of previous strategies on Philips: 2012

The strategies of 1996, 2000, 2005 and 2006 were very similar as Philips focused on the core business and sold parts of the business which did not fit in the strategic portfolio. The restructuring program in 1996 was a vital strategy as Philips was an inefficient conglomerate. In 2000, the divesting plan was accomplished and Philips implemented a new strategy for a high growth future which consisted of three steps; leadership positions in the market, portfolio with high growth products and services, and a focus on innovation (Philips, 2000:3). Philips focused on Healthcare and this was a good strategy as this business unit was operating in a high growth and high profit margin industry. In 2005, the strategy was to increase the healthcare division as a percentage of the total portfolio, to reduce the presence in product markets which were very volatile, and to invest in innovation. The strategy of 1996 and 2005 were very similar as they focused on the core business and sold parts of the business which did not fit in the

strategic portfolio. In 2006 the strategy was to have a more ‘simple’ Philips which was similar as the restructuring plan in 1996. The restructuring strategy of Philips resulted in an increased focus on Healthcare.

Importance of the Healthcare division: 2012

Exhibit 6 shows that Healthcare is now the most important business unit for Philips. Healthcare and Lighting show an increase in revenues while Consumer Lifestyle division shows a sharp decrease over the years. Healthcare is both a growing and a profitable part of the company. Healthcare reported sales of eur 10 billion in 2012, Lighting eur 8.4 billion, and Consumer Lifestyle eur 6 billion (Exhibit 5). Regarding EBITA, Healthcare has an EBITA of eur 1.3 billion, Consumer Lifestyle eur 663 million and Lighting 188 eur million (Exhibit 5). The Healthcare division became very important, as it accounts for 41 percent of the revenues and 60 percent of the EBITA (Exhibit 6). Exhibit 7 shows that Healthcare receives 44 percent of the R&D investments. Thus, Philips gives special attention to the Healthcare division. As a result, Philips is now a global leader in the healthcare industry. “They are the largest home healthcare company, being number one in: Monitoring systems, Automated External Defibrillators, Cardiac Ultrasound, Cardiovascular X-ray” (Philips Company Profile, 2013).

Porter’s five forces analysis: 2013

Exhibit 9 shows Porter’s five forces analysis for Philips Healthcare in 2013. The main competitors of Philips in the Healthcare Industry are now GE and Siemens, while Samsung, Sony, Intel and Canon are increasing their focus on the Healthcare Industry. The competitive rivalry within the industry is high as more Electronic companies focus on the Healthcare industry and Asian competitors invest heavily in R&D. Nevertheless, a factor that decreases the threat is that there are relatively few competitors. The threat of new entrants is moderate as more electronic companies and Asian competitors enter the Healthcare industry. On the other hand, factors that decrease the threat are high initial costs, the need to invest

heavily in R&D capabilities, sophisticated technology, high innovation costs, strong brands, and patents. The bargaining power of customers is low as there are a large number of customers and a low concentration of customers. The bargaining power of suppliers is also low as there a large number of suppliers, low concentration of suppliers and low switching costs. The threat of substitute products is low as Philips has high quality and sophisticated products. Philips is less dependent on the volatile Consumer Lifestyle and Lighting industries and is more dependent on the Healthcare industry, which is an industry of high growth, high profit margins and less volatile. As a result, the situation significantly improved compared to the circumstances of 1996. This shows that Gerard Kleisterlee made the right decision by investing extensively in Healthcare more than ten years ago, as the transition created a platform for profitable growth.

Boston Consulting Group (BCG) growth-share matrix: 2013

Philips made an impressive transition from a conglomerate to a smaller company which has a focus on Lighting, Consumer Lifestyle and a stronger focus on Healthcare. Exhibit 10 shows the BCG growth-share matrix and the position of the three divisions of Philips. The revenues of Philips Lighting increased from eur 4 billion in 1996 to around eur 8 billion in 2012 (Exhibit 5). It is expected that the world demand for lighting increases more than 12 percent annually (Freedonia Group, 2013). Philips has a No. 1 position in Lamps, Consumer Luminaires, Professional Luminaires, Lighting Electronics, Automotive and Overall Lighting (Newstreet Research, 2010). Only in LED components it is not the No. 1. As a result, the division Lighting a the star of Philips as there is a high market growth rate and a high relative market share.

The revenues of Philips Consumer Lifestyle decreased from eur 10 billion in 1996 to around eur 6 billion in 2012, which shows that there is a low market growth rate (Exhibit 5). There is a fierce competition with Asian competitors in this industry and therefore it is difficult to increase the revenues as there is a pressure on prices and profit margins. Philips is still considered as a global leader in the electronics industry but it is losing market share due to selling activities and

an increase in competition. As a result, Consumer Lifestyle is a cash cow as there is a low market growth rate and a high/medium market share.

The division Healthcare is a star because the market is growing and Philips has a relatively high market share. The revenues of Healthcare increased from around eur 2 billion to eur 10 billion in 2012 (Exhibit 5). Philips has a high market share in the healthcare industry: "They are the largest home healthcare company, being number one in: Monitoring systems, Automated External Defibrillators, Cardiac Ultrasound, Cardiovascular X-ray" (Philips History, 2013). The Healthcare industry has a high market growth as there are growing and aging populations (Philips, 2012:11). On the other hand, growth in America's healthcare spending decreased to around 4 percent per year in 2013, which is the lowest rate since 1969 (MoneyCNN, 2013). Nevertheless, it is expected that this will increase to more than 7 percent annually when the economy recovers (MoneyCNN, 2013).

4.2 Characteristics found in the change of core business

In this section the research questions are answered based on the Philips case:

1. Why did they change their core business?
2. How did they change their core business?
3. What were successful decisions and mistakes?
4. Discuss the importance of changing a core business nowadays, and give an example of a company in the electronics industry

4.2.1 Why did they change their core business?

Philips focused on Consumer Lifestyle in the 20th century as these products were in the introduction and growth stage of the product life cycle, and therefore it was a very profitable market. Moreover, there were only a few competitors and the market was enormous as everyone wanted a television and a radio. Moreover,

an advantage was that they had the capabilities and technologies to operate successfully in the electronics industry. Nevertheless, there was an increase of Asian competitors and the profit margins in the industry decreased in the 1990's. As result, they focused on Healthcare as it was a more profitable industry and there was a higher growth (Philips, 1998:26). Healthcare became the new core business while Lighting remained important for Philips as well. Consumer Lifestyle became less important as it had been underperforming for years. As a response, the audio, video and multimedia were transferred to Funai, for which Philips receives brand license income (Philips, 2012:7).

4.2.2 How did they change their core business?

Research and Development

The first transition from Lighting to Consumer Lifestyle started with a research laboratory in 1914. They focused on Lighting but also discovered technologies with which they developed other electrical products. Consequently, they also invested in other products such as the television, radio and compact disc. In the following years Philips participated in all new electronic trends through R&D, acquisitions, joint-ventures and partnerships. Thus, the first transition started with research and development.

Restructuring program

The second transition started with a restructuring program and acquisitions in order to make the company more flexible, as Philips was active in too many industries (Philips,1998:36). They sold parts of the business which were underperforming or did not fit in the strategic portfolio of Philips. As a result, they divested over 40 businesses between 1996 and 2000. In the 21st century Philips divested also some divisions such as components in 2001, semiconductors in 2006, and the mobile phone activities in 2007.

Acquisitions

After the restructuring program, it decided to focus on a portfolio with high growth products and to be an industry shaper. They focused on Healthcare and acquired Adac Laboratories and Agilent in 2000, Marconi in 2001, Stentor in 2005, Intermagnetics in 2006, VMI-Sistemas Medicos, XIMIS, Emergin and Respironic in 2007, VISICU and TOMCAT Systems in 2008, and several other medium and small firms (Philips Acquisitions, 2013). Between 2000 and 2003, they invested around eur 5 billion in Healthcare which was the start of the transition to Healthcare (Philips, 2001:53). The largest acquisition was Respironic for eur 3.6 billion in 2008, which was a market leader in sleep therapy solutions in the USA (Philips, 2007:10). Philips also invested heavily in research centers in emerging markets in order to be an industry shaper. Moreover, Philips made several alliances in order to improve the processes of Healthcare, for example with Epic Systems (Philips, 2003:6). Furthermore, Philips started partnerships with several important universities, such as the Washington University in the USA, in order to implement medical discoveries into new innovative medical systems (Philips, 2002:31). Thus, the second transition started with a restructuring program and acquisitions which was supported by research centers, alliances and partnerships.

4.2.3 What were successful decisions and mistakes?

Mistake: Unrelated Diversification

Philips was successful in the electronics industry as they had a first mover advantage. Nevertheless, they entered too many unrelated industries which made them inefficient. For example, Polygram operated in the music and film industry, which was different than Philips' core industries. Polygram was owned by Philips and Siemens due to a merger in the 1970's. Siemens sold their 50 percent to Philips as Polygram was unprofitable and made enormous losses. Therefore it was not sure if Polygram could be successful in the music and film industry

(Polygram, 1991). Moreover, Philips had Superclub and Videoland which operated in the video chain industry. Phillips experienced difficulties in the entertainment industry as its video chains made significant losses. The video chains were part of vertical integration, as it sold CD's of Polygram and other Philips products in the two stores and they promoted their own products. It was not very successful as customers preferred to go to other stores. As a result, Philips closed the two video chains in 1996 and 1997. Moreover, it also sold Polygram as it was not part of the core business. The entertainment effort of Philips required investments and time. Consequently, there was less focus on business activities related to the core business. Siemens did a better job as they exited this industry already in 1987 (Polygram, 1991). Thus, the music, film, and video chain industry were unrelated to Philips core business, which limited the success and resulted in less focus on high growth industries such as Lighting and Healthcare.

Successful in: Restructuring strategies

Phillips is a more stable company as it sold a large number of firms which did not fit to the core business. It is impressive that Philips sold over 40 firms between 1996 and 2000. Moreover, it also dissolved the division components in 2002 as it was not profitable. It sold Semiconductors in 2006 as it was a volatile business, it did not fit to the core business and the plan was to have a more 'simple' Philips. As a result, several activities of Consumer Lifestyle were transferred to TPV in Taiwan in order to reduce the earnings volatility. The reduction in the earnings volatility will help Philips to survive a crisis. This is important as for example the Japanese electric manufacturer Sharp is almost bankrupt due to falling demand for TVs which shows that they are dependent on a volatile business (Yasu, 2012). This example shows that Philips was successful with its restructuring strategy. On the other hand, there were already many critical papers about the conglomerate strategy in the 1970's, 1980's and 1990's, while Philips started its restructuring program in 1996, which can be considered as late.

Successful in: Finding business opportunities within the company

Philips found an undervalued business division within the firm. This required time and it limited the amount of risk and costs. Philips already had the X-ray in 1918. This shows that they had many years of experience in the Healthcare industry but they did never focus on it as a new core business.

Successful in: A focus on Healthcare

Philips made the right decision by implementing a restructuring program in 1996. This helped them to focus on their core business. Moreover, they received money for divestures which was used to strengthen their core business. Healthcare was a small part of the company in the 1990's. The restructuring program allowed them to invest and expand in the healthcare industry. This was necessary as there were low profit margins in the Consumer Lifestyle industry. The new CEO was important as he increased the focus on Healthcare. He was the right man for the job as he had more than 25 years of experience at Philips and held several executive positions at Healthcare, Consumer Electronics, Components and worked in a number of countries. Consequently, the Healthcare division grew significantly as Philips made large acquisitions and they were successful in making several partnerships and alliances. Philips also focused on the integration of acquisitions which resulted in synergies. This was important as acquisitions should create synergies and provide value for the company. Moreover, they focused on leadership positions within the market in which they were successful.

Successful in: Cooperation between business units

Another important aspect was that the three divisions worked closely together through the program "Transforming into one Philips" in 2002. This increased the information flow within the company and created a better platform for responding to the market and implementing new ideas more quickly. Moreover, Philips operated in related industries after the restructuring program, and therefore the

business units learned from each other as they had several things in common. The cooperation between business units also increased as Philips focused on making the company more ‘simple’ in 2006. The simplification helped business units to understand the overall picture of the company and therefore they could also learn more from other divisions.

Successful in: Research and Development

The focus on R&D also made Philips successful, as they spend around 7 percent of their sales on R&D as they wanted to be an industry shaper. Nevertheless, this percentage is the same as the electronics industry average (Jusko, 2008). The efforts in R&D resulted in many new products. In 2004, 60 percent of the sales were due to products younger than 2 years, which shows how fast the market changes and how important R&D centers are for Philips. Another positive aspect is that the R&D centers give special attention to Healthcare, as it received 44 percent of the R&D investments in 2012 (Exhibit 7).

4.2.4 Discuss the importance of changing a core business nowadays and give an example of a company in the electronics industry

The push for a change of core business is not only an issue that Philips had to face. There are several other electronic companies which also experience a shrinking profit pool (Zook, 2007). For example, TomTom sells Personal Navigation Devices (PND) for the car. Tomtom and Philips sell different products but they both operated in an industry characterized by low growth and low profit margins due to increasing competition from Asian competitors. Nevertheless, the situation of TomTom is much worse than the one of Philips. The shares of TomTom decreased from eur 50 in 2007 to only eur 3.30 in April 2013. Moreover, they are targeting a shifting and a shrinking profit pool, while Philips only experienced a shrinking profit pool (Zook, 2007). Automotive companies

install the PND in the car and therefore the consumer doesn't need a PND from TomTom, while consumers still needed Lighting and Consumer Lifestyle products from Philips. Moreover, customers use their mobile phone software for navigation. This resulted in a loss of eur 2 million and a decrease of 13 percent in revenues in the first quarter of 2013 (TomTom Third Quarter Results, 2013). Even worse, TomTom expects the PND revenues to decline by around 18 percent year by year (TomTom, 2012:9). Nevertheless, the current CEO is making an effort to change the core business:

"Our strategy is to restore revenue growth. This will be achieved through greater growth from non- PND product sales while limiting revenue decline in the PND category. We have been working on establishing the foundations for our non-PND related business since 2007. During 2012 we reached an important milestone in this regard: over 50 percent of group revenue was derived from non-PND sales. The new revenue structure does not compensate for the declining demand for PNDs, but we are getting closer to that point" (TomTom, 2012: 2).

As a result, the Consumer division becomes less important. TomTom has four business units: Consumer, Automotive, Licensing and Business Solutions. The consumer business unit accounted for 76 percent of the revenues in 2010, which decreased to 60 percent in 2012 as there was a significant decrease in the revenues from 2010 to 2012 (TomTom, 2012:5). Automotive and Licensing also reported a decrease in revenues in 2012 due to lower car sales in Europe and less income from mobile customers. Only Business Solutions reported a double digit growth as this industry has high growth and high profit margins, and therefore it should continue to focus on this business unit.

4.3 Links with literature

Disadvantages of a conglomerate

Philips had 400.000 employees and operated in the music, healthcare, consumer electronics, lighting and several other industries in the 1970's (Veen,

Yerkes and Achterberg, 2012). Philips was a conglomerate as they were “a company with three or more business units that did not have common customers, distribution systems, technologies, or manufacturing facilities” (Cyriac, Koller and Thomsen, 2012). Philips became a conglomerate due to a high amount of acquisitions in the 1960’s and the 1970’s (Philips Acquisitions, 2013). This was possible as they acquired companies that had low P/E ratios, they borrowed money with a low interest, and there were favorable accounting policies which resulted in a direct increase in earnings in the books (McDonald and Eastlack, 1971). Philips invested in several industries as it created diversification, synergism, and profitability (Smith and Schreiner, 1969). A disadvantage was that the headquarters of Philips had difficulties to understand all the industries and technologies in which they operated (Berg, 1965). There were also several other disadvantages such as focusing on the size of the company and not focusing on creating value (McDonald and Eastlack, 1971), ineffective acquisitions (Nader and Green, 1979), inefficiency (Freeman and Hannan, 1975; Maksimovic and Phillips, 2002) and they did not sufficiently deal with unproductive business units (Attiyeh, 1970). Philips struggled with growth due to intensified competition, shorter product life cycles, rising costs, high interest rates and new technology (McDonald and Eastlack, 1971). Porter (1987) shows that diversification in unrelated industries results in more disadvantages than advantages which was also the case for Philips.

A study of Attiyeh (1970) about disadvantages of conglomerates helps to understand why Philips experienced difficulties in 1996. First, Philips kept underperforming activities in their portfolio for a long time (Attiyeh, 1970). Secondly, Philips did not give enough attention to growth opportunities within the company as the underperforming activities absorbed financial resources (Attiyeh, 1970). Thirdly, the managers of Philips were mostly focused on underperforming activities and not on business opportunities (Attiyeh, 1970). Consequently, Attiyeh (1970) advised conglomerates to focus on an effective use of internal assets rather than acquisitions. This is why Philips started the restructuring program in 1996, in which they aimed at selling underperforming activities, paying attention to growth opportunities, and focusing on internal assets. The

restructuring program was also very similar to the recommendations of Porter (1987), in which he recommended firms to focus on portfolio management, reorganizing the firm, transmitting skills and sharing behaviors in order to create value. The divestments of Philips were a good decision as it decreased the conglomerate discount, increased the efficiency of remaining activities and it improved the focus of the company (Dittmar and Shivdasani, 2003).

Focus on three or less three industries

The divestments also resulted in a focus on Lighting, Consumer Lifestyle and Healthcare. The South Korean government recommended Chaebols to have two or three businesses as its core business and to focus on specialization rather than on the conglomerate strategy as this would be more successful (Taniuara, 1993). This is what Philips did as it decided to focus on three business units. Nevertheless, both Chaebols and Philips implemented this strategy too late as major weaknesses of them were revealed during the Asian financial crisis. Consequently, the IMF gave several recommendations to Korean politicians, such as encouraging firms to focus on a limited amount of core businesses, divesting unrelated activities and developing a stable financial situation for the company (Powers, 2010). Therefore Philips and Chaebols continued its divestures after the Asian financial crisis in order to become more efficient.

A focus on a high growth industry, leadership and innovation

The divesting was accomplished in the year 2000, and Philips implemented a new strategy for a high growth future which consisted of three steps: high growth products, leadership, and an industry shaper (Philips, 2000:3). Philips invested in Healthcare in order to increase the variety of products and to explore new high growth products. Philips had a high chance of success as they already had some expertise in the Healthcare industry which is important for being successful (Edwards, 2012, Kusewitt, 1985; Zook, 2007;). Philips focused more on

Healthcare and less on Lighting and Consumer Lifestyle. This was a good decision as there were shrinking profits in Consumer Lifestyle industry (Zook, 2007). The focus on healthcare was very important as business analysts still did not really knew who the company Philips was and what it did (Schwartz, 2007). Conglomerates had the same issue as they operated in several industries (Dekker, 1986). Exhibit 8 shows that confusion among analysts and investors result in a discount valuation of the share which is negative as there is a lower shareholders return. Consequently, the new CEO focused on acquisitions in the Healthcare industry which provided synergies and therefore a premium valuation of the stock. The second step was to have a leadership position which is important as in many industries more than 75 percent of the profit pool is gained by the No. 1 and 2 of the market (Zook, 2007). The third step of the strategy plan was to be an industry shaper which was possible through high investments in R&D. Philips built new research centers in emerging countries such as China and Singapore. A study of Dervitsiotis (2011) shows that the desired target level for revenue can only be reached through existing products, market expansion and through investments in innovation. This shows that the target level cannot be reached without investments in innovation, and therefore investments in R&D is necessary. Furthermore, innovation is highly important to survive as a company in the market (Drucker, 1985). The new strategy of Philips in 2000 was good as each point was supported by literature.

Finding an undervalued business unit, undiscovered consumer knowledge or underestimated capabilities

Philips changed its core business by finding an undervalued business division and invested in it through many acquisitions. Zook (2007) points out that a change of core business can start within the company by finding: an undervalued business division, undiscovered consumer knowledge or underestimated capabilities. Healthcare played a very small role for Philips in the 20th century. In 1999, the core business was Consumer Products as it presented 39.5 percent of the total revenues and 24 percent of the total EBITDA (Philips, 1999:49). Healthcare only

accounted for 8 percent of the total revenues and 6 percent of the total EBITDA. Philips realized the enormous potential in the Healthcare Industry and considered the division as an undervalued business unit. Consequently, it decided to focus and to invest in it by acquisitions. Nevertheless, acquisitions are very risky as 65 percent have devastated more value than they create due to paying a premium which is too high, acquiring the wrong firm and unsuccessful integration (Laurie, Doz and Sheer, 2006). Philips knew exactly what kind of companies it wanted to acquire and therefore it acquired the right companies. For example, it invested around eur 4.5 billion in the home healthcare activities between 2006 and 2009 as they wanted to be a market leader in this industry. Moreover, they also focused on the integration of these companies. As a result, the acquisitions contributed value to the company due to synergies. The acquisitions of Philips were also successful as they invested in a business close to home (Zook, 2007), the current and new activities were related (Haveman, 1992), and it was an attractive industry (Porter, 1985), which decreased the risk of the acquisitions (Edwards, 2012).

Relationship-centered company

The acquisitions were also successful as Philips invested in its business units and partnerships. A successful firm is one which has the characteristics of a relationship-centered company (Gulati and Kletter, 2005). Therefore successful firms focus on customers, suppliers, alliances and business units in order to remain flexible. Philips focused on partnerships and its business units in order to create value. Philips started partnerships with several important universities in order to strengthen the Healthcare division. A study of Edwards (2012) confirms the importance of partnerships as it is vital to look for partners who have a common interest in order to fill the capability gaps when moving beyond the core business. These partnerships helped Philips to be more innovative and successful. Philips also started the program, “Transforming into one Philips”, which was aimed at cooperation between business units. This was a good initiative as a study of Gilbert, Eyring and Foster (2012) confirms that this concept is vital for resilience, as a successful transformation of the company requires an exchange of

resources between the new and the former core business, while not interfering with each other's operations. Therefore this program was good for the Healthcare division as the business units share intellectual capital. Moreover, Philips also focused on the integration of the business units of the acquired companies, which was good as a study Kusewitt (1985) recommends firms to reduce the amount of acquisitions and focus more on the integration after large acquisitions.

Role of a CEO in a transition

The CEO played a very important role in the transition of the company. The initiatives of companies can be classified in three points: improve daily business activities, discontinue underperforming activities, and develop a business model which is sustainable for the future (Govindarajan and Trimble 2011). A CEO should give equal weight to each initiative. Unfortunately, most of the CEO's duties are linked to initiatives aimed at the daily activities of the corporation. Nevertheless, the CEO of Philips gave attention to each point. The most important was that he developed a business model which is sustainable for the future. Philips would not have been that successful as it is today if the CEO only focused on the daily business activities. In that case the core business would be still Consumer Lifestyle which is less profitable than Healthcare. The Healthcare division became very important as it accounts for 41 percent of the revenues and 60 percent of the EBITA in 2012 (Exhibit 6). This shows that a CEO should not spend all his or her time on daily activities. Philips is still focusing on Healthcare division, as Exhibit 7 shows that Healthcare received 44 percent of the R&D investments in 2012. This means that Philips gives special attention to the Healthcare division, which is also suggested by a study as it recommends managers to not treat divisions equally in case of a transition (Gilbert, Eyring and Foster, 2012).

5. Conclusions

Philips faced several difficulties such as inefficiency and a lack of focus. It operated in too many industries which made it difficult for the headquarters to understand all business activities in detail. Another disadvantage was that Philips was highly dependent on the Consumer Lifestyle industry which had low growth and low profit margins due to intensified competition. Moreover, this industry had an increase in substitute products and shorter product life cycles.

5.1 Conclusions regarding the case study

The value of Philips on the stock market decreased, and therefore Philips had a 'conglomerate discount' in 1996. Conglomerates had a discount on the stock market as they were less efficient and did not sufficiently deal with unproductive business units. The conglomerate discount forced Philips to restructure and simplify its business activities in order to become efficient and to increase the share price. The managers implemented a restructuring program in order to make the company more flexible in 1996. This helped the company to respond quicker to market changes which was necessary as Philips operated in a competitive environment. The restructuring program was aimed at focusing on the core business and selling parts of the business which were underperforming or did not fit in the strategic portfolio. In addition, Philips wanted to focus on those activities in which they had the opportunity to become a major player worldwide. Between 1996 and 2000, Philips divested over 40 businesses. In 1999, Healthcare accounted for 8 percent of the total revenues and 6 percent of total EBITDA. The healthcare industry was a growing market due to the aging population and the increase in demand for medical products from emerging countries. As a result, Philips decided to focus on this industry.

Between 2000 and 2003, Philips invested around eur 5 billion in acquisitions and doubled the size of the Healthcare business unit. In 2006, Philips divested the Semiconductors division and received eur 8.3 billion. The reason for this was to

have a more ‘simple’ Philips and to focus more on those sectors which have higher profit margins to reduce the earnings volatility. In 2007, the largest acquisition in its history was made. Philips acquired Respironic for eur 3.6 billion which was a market leader in sleep therapy solutions in the USA. In 2012, the main focus was on reshaping consumer lifestyle in order to make it more profitable. The strategies between 1996 and 2012 were very similar as Philips focused on the core business and sold parts of the business which did not fit in the strategic portfolio.

The Healthcare division became very important, as it accounts for 41 percent of the total revenues and 60 percent of the total EBITA in 2012 (Exhibit 6). Healthcare receives 44 percent of the R&D investments in 2012 (Exhibit 7). This shows that Philips gives special attention to the Healthcare division. As a result, Philips is now a global leader in the healthcare industry. Philips made an impressive transition from a conglomerate to a smaller company which has a focus on Lighting, Consumer Electronics and a stronger focus on Healthcare.

The case study shows that Philips focused on Healthcare and not on Consumer Lifestyle as it was a more profitable industry and there was a higher growth. Philips changed its core business by research and development, several restructuring programs and acquisitions. The case study also shows that Philips made one major mistake and several successful decisions. Unrelated diversification was a major mistake of Philips as it made the firm inefficient. Nevertheless, they solved this with several restructuring programs. It is impressive that Philips sold over 40 firms between 1996 and 2000. Philips was successful in finding and recognizing the undervalued business unit Healthcare. This only required time and therefore there were limited risks and costs involved. Philips is successful with its focus on Healthcare as it is an industry of high growth with high profit margins. The key success factors of its investments in the Healthcare industry were: a focus on the integration of acquisitions, hiring a new CEO with experience, aiming at leadership positions in the market and investing in innovation. Philips was also successful with its acquisition as it is a relationship-

centered company and this makes the firm very flexible. This is important as the market is constantly changing.

There are some relevant points about how it possible to successfully change a company's core business. The first learning point is that a company needs to look within the company in the same or a related industry for a change of core business as acquisitions and joint-ventures have a high risk. Zook (2007) points out that a change of core business can start within the company by finding: an undervalued business division, undiscovered consumer knowledge or underestimated capabilities. These options have low risks and low costs, although the company has to spend time and effort in defining these areas. It is important to consider partnerships with universities, governmental institutions and other companies, if firms lack the capabilities and expertise in a new industry or market (Edwards, 2012).

The second point is that companies should consider acquisitions and joint-ventures in case no business opportunities are found within the company. It is recommended to first focus on the same industry and related industries, rather than investing in an unrelated industry as it is difficult to be successful in an unrelated industry. The success of diversifying away from the core business depends on the connection between the new activities and the current competences. There is a negative impact on the financial performance of the company if the current and new activities are not related (Haveman, 1992).

The third point is that is that firms should focus on a leadership position in the new industry, as in many industries only the two largest companies in the industry gain all the profits in the industry (Zook, 2007). Companies should divest those activities in which they do not have any leadership position, and invest in industries in which the firm has a high market share. The money of the divestures can be used for strengthening the leadership position of the new core business.

5.2 Future Research

Literature review and the case study about Philips show that it is important for conglomerates to focus on a maximum of three industries, which also the Korean government and the IMF recommended to the Chaebols. Nevertheless, it is difficult to determine what a firm should do when it has two stars and a cash cow. Should it sell one star and one cash cow and focus only on one star? Should it only sell the cash cow and focus on the two stars? Future research should focus on conglomerates which have a combination of cash cows and stars.

I. Appendices

Exhibit 1: Evaluate your core business by five questions from Zook (2007)

1. What is the state of our core customers?
   - Measures of Customer Loyalty and Advocacy
   - Retention Rate
   - Market Share
   - Profitability

2. What is the state of our core differentiation?
   - Increasing or Decreasing Differentiation
   - Business Models of Emerging Competitors
   - Relative Cost Position
   - Definition and Metrics of Differentiation

3. What is the state of our industry profit's pools?
   - High Cost and Prices
   - Shifts and Projections
   - Boundaries
   - Share of Profit Pools Captured
   - Size, Growth, and Stability

4. What is the state of our core capabilities?
   - Relative importance
   - Inventory of Key Capabilities

5. What is the state of our culture and organization?
   - Bottlenecks to growth
   - Energy and Motivation
   - Alignment and agreement with objectives
   - Capacity and Stress Points
   - Loyalty and Undesired Attrition

Source: Zook, Chris. 2007. "Finding your next core business", Harvard Business Review, p66-75.

Exhibit 2: Philips share value from 1995 to 2013 in Euros

Source: Markets.ft.com

Exhibit 3: SWOT analysis of Philips in 1996

Strengths:

- No. 1 in the Global Lighting Market
- No. 3 in Consumer Electronics Market
- Brand name
- High quality products
- R&D Capabilities

Weaknesses:

- Operating in several different industries
- Incapability of the Headquarters to understand all the business activities
- Highly dependent on Consumer Lifestyle: low profit margins
- Reluctant to change
- Largely dependent on Europe
- A focus on increasing the size and not on creating value
- Not sufficiently dealing with unproductive business units
- Not paying enough attention to growth opportunities

Opportunities:

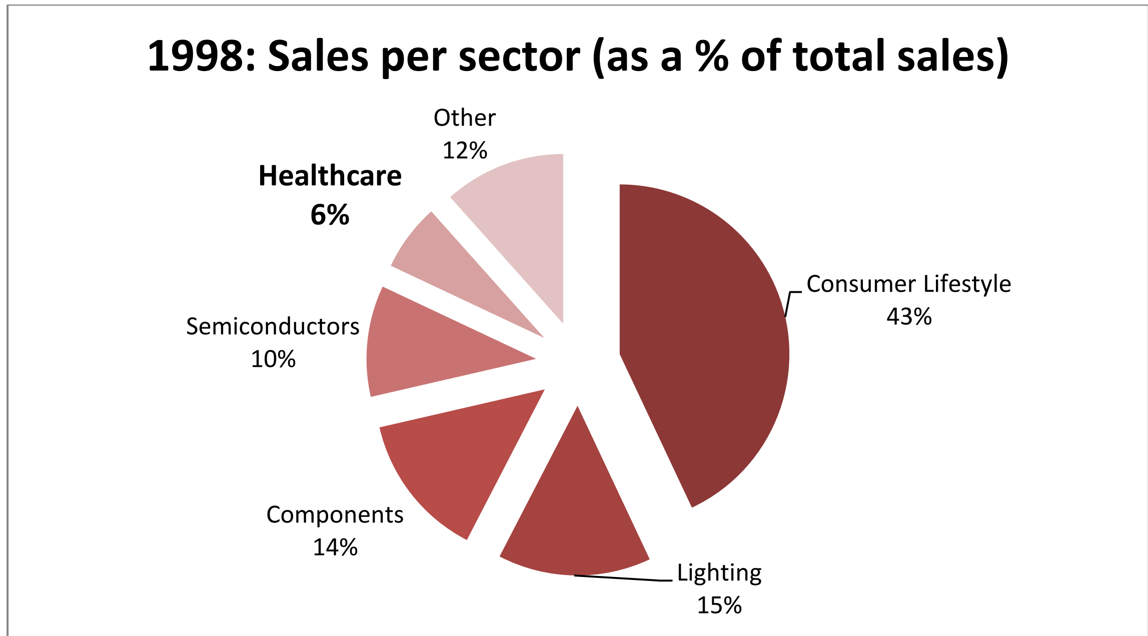
- Ultrasound, fastest growing sector of the medical imaging industry

- Home care medical technology
- High demand from emerging countries

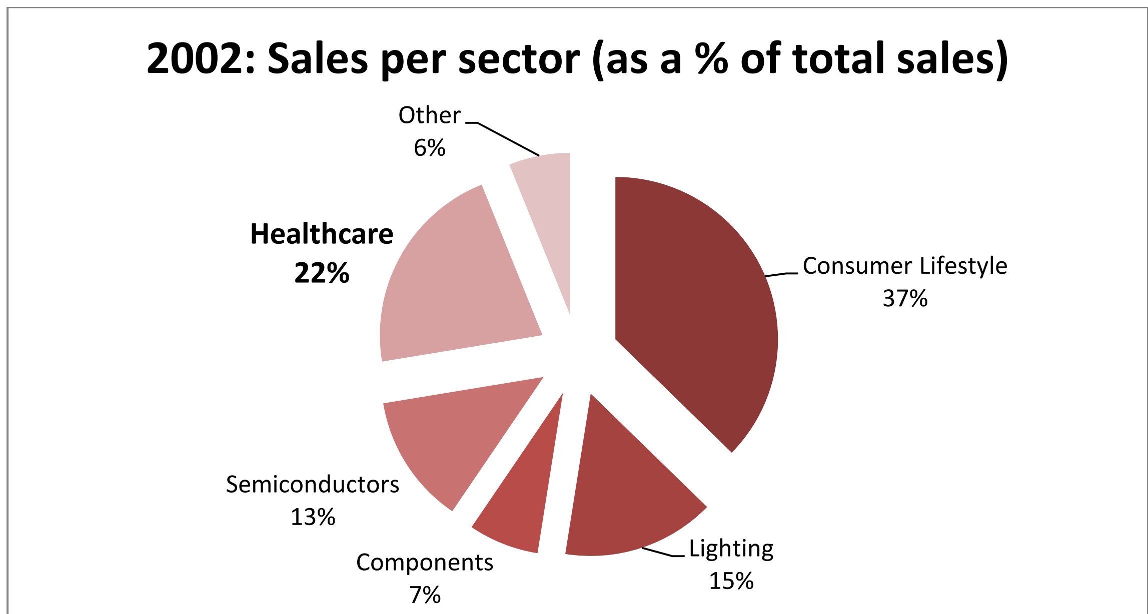
Threats:

- Declining profit margins for the Consumer Lifestyle division
- Shorter Product Life Cycles
- Bad Economic Conditions and intensified competition
- Substitute Products

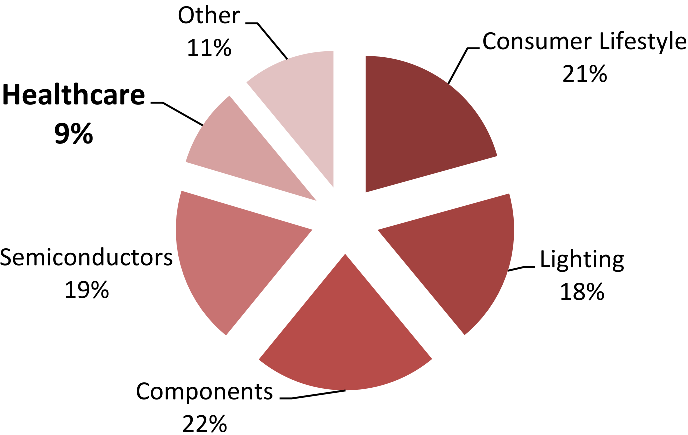
Exhibit 4. Comparison between 1998 and 2002



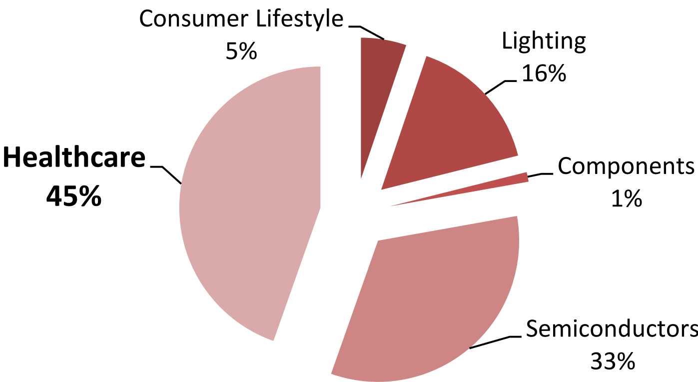
Source: Philips Annual report 2002



Source: Philips Annual report 2002

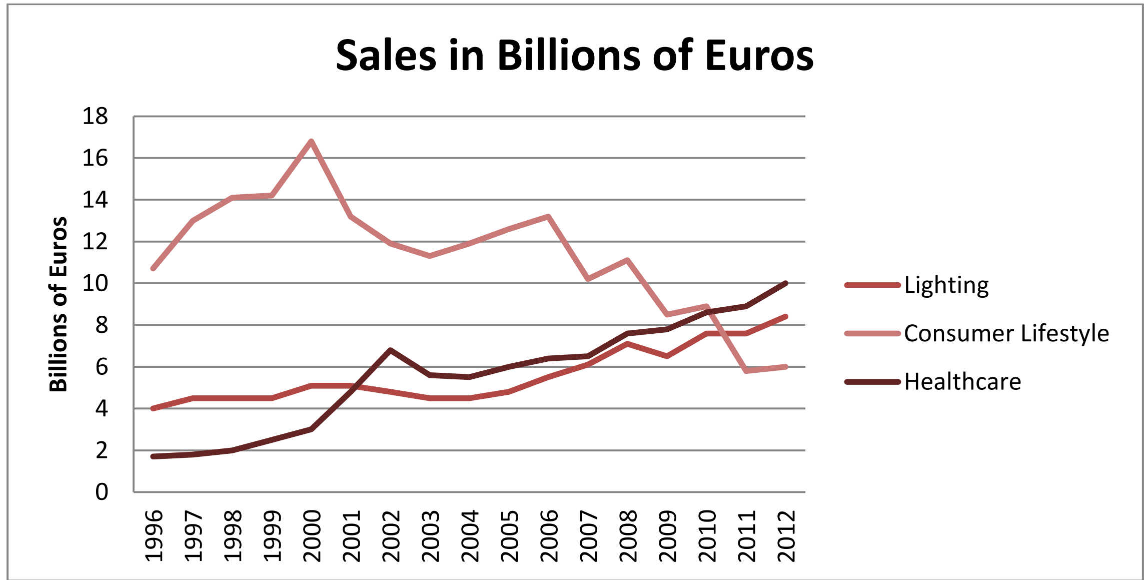


Source: Philips Annual report 2002

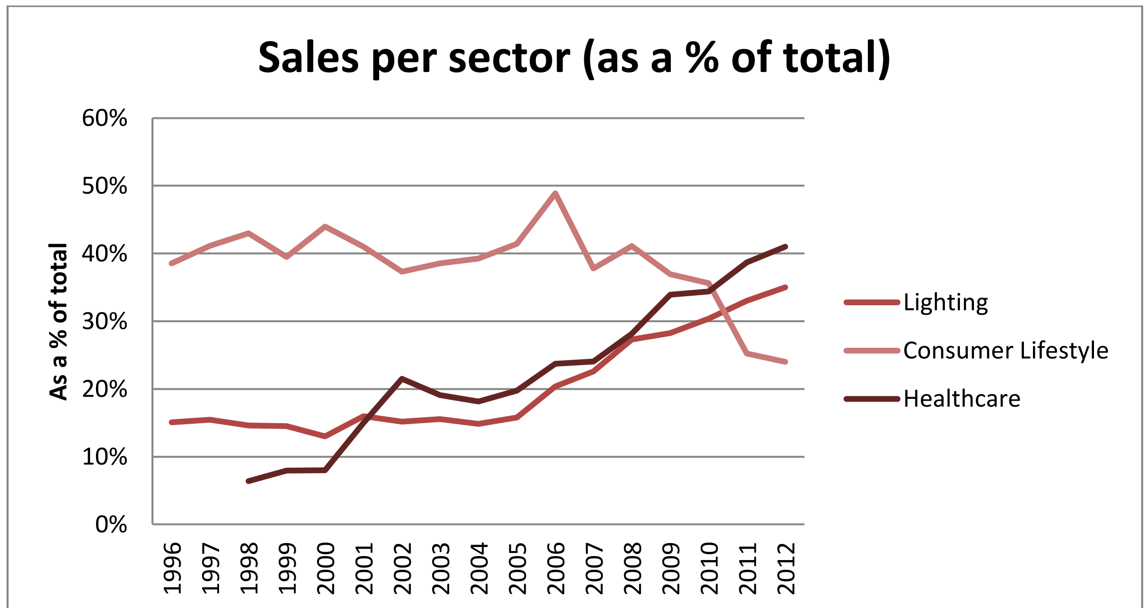


Source: Philips Annual report 2002

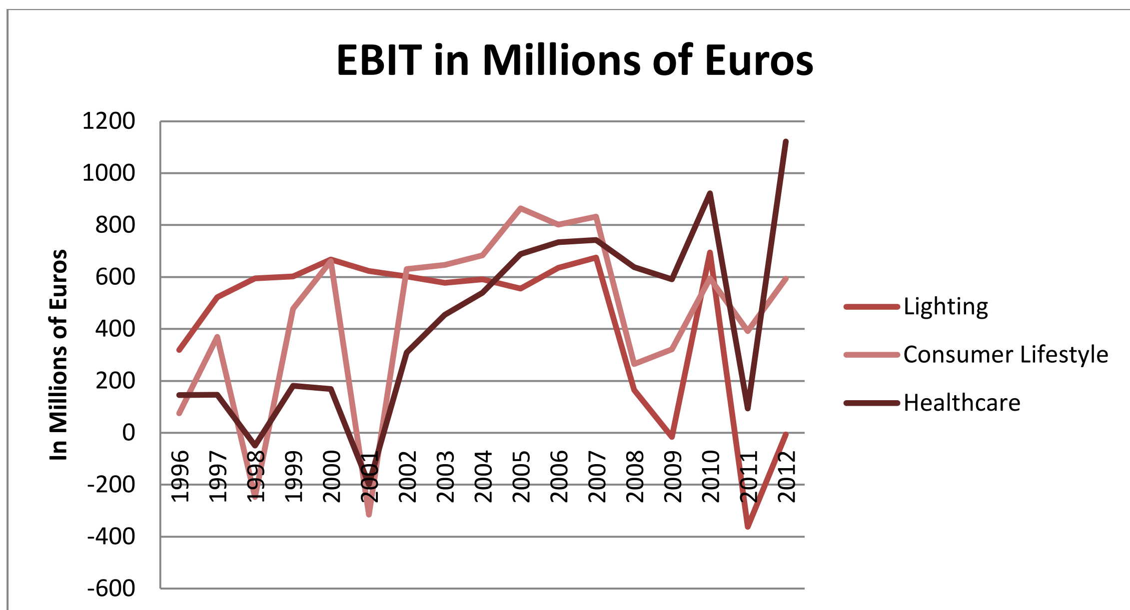
Exhibit 5. Sales and EBIT of Philips.



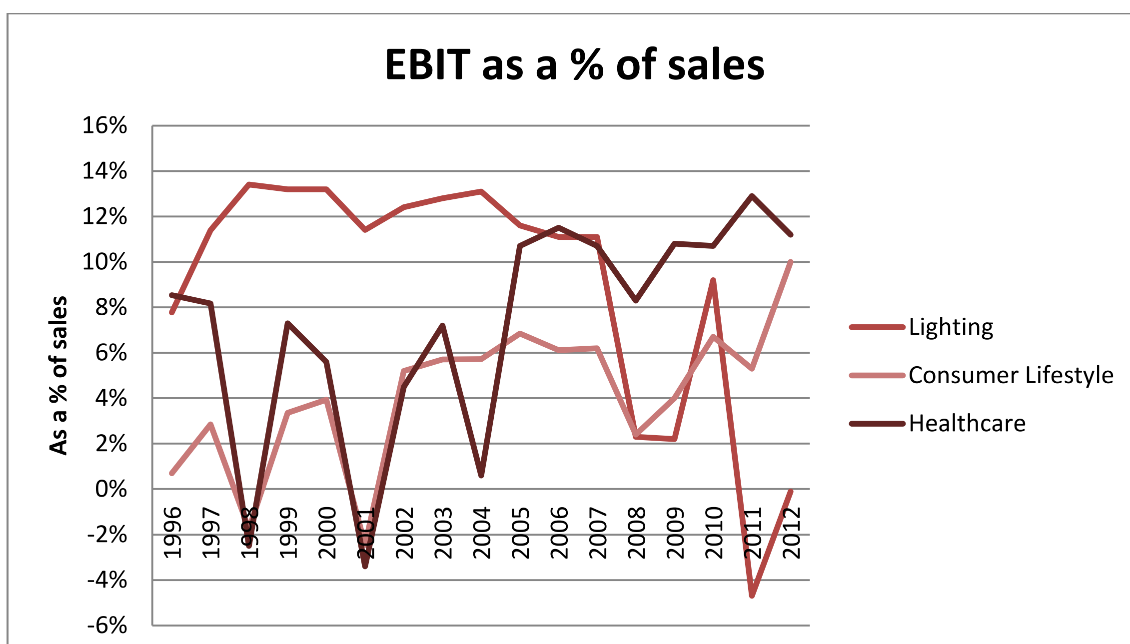
Source: Philips Annual Reports 1998-2012



Source: Philips Annual Reports 1998-2012

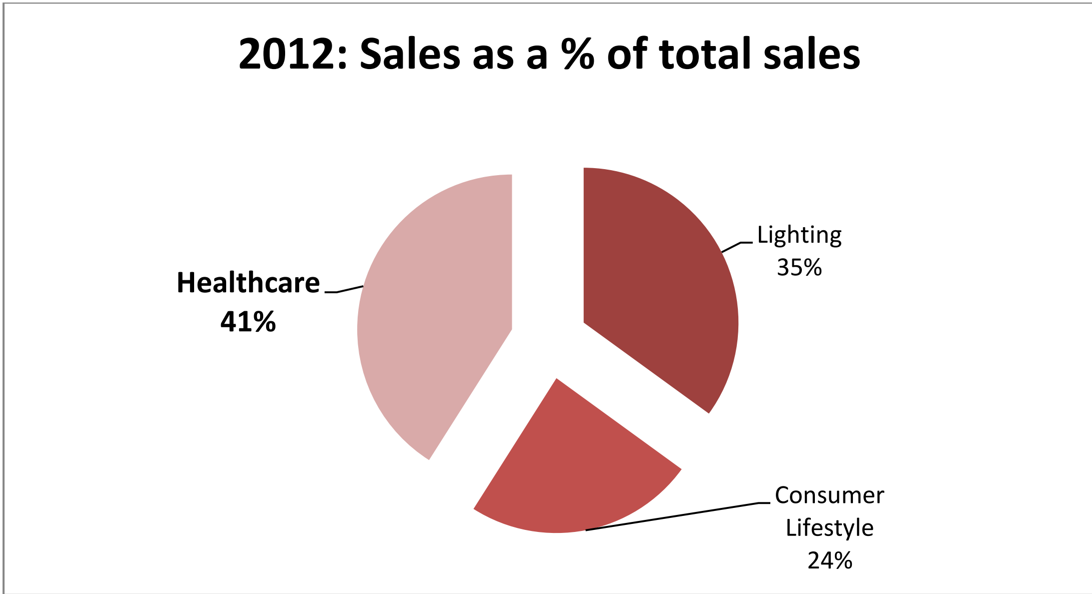


Source: Philips Annual Reports 1998-2012

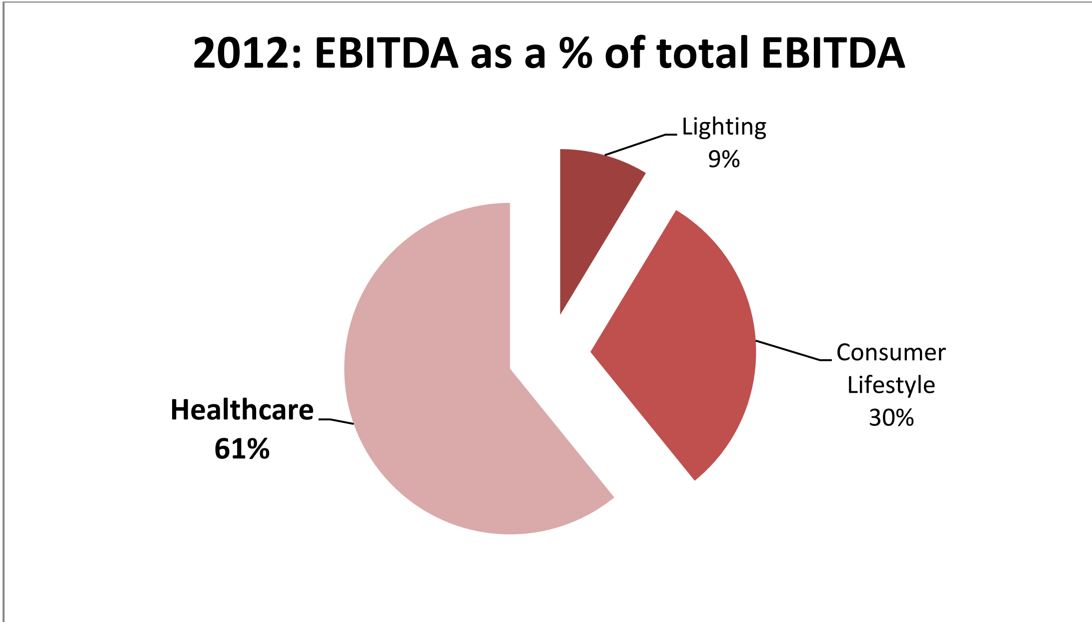


Source: Philips Annual Reports 1998-2012

Exhibit 6. The importance of the Healthcare Division in 2012

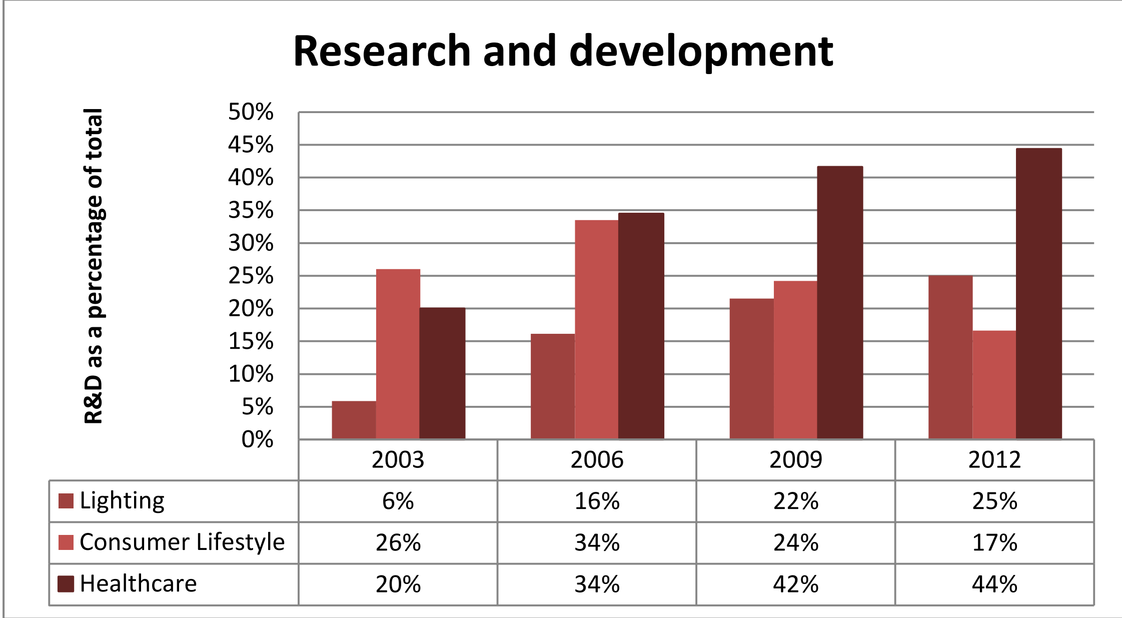


Source: Philips Annual Report 2012



Source: Philips Annual Report 2012

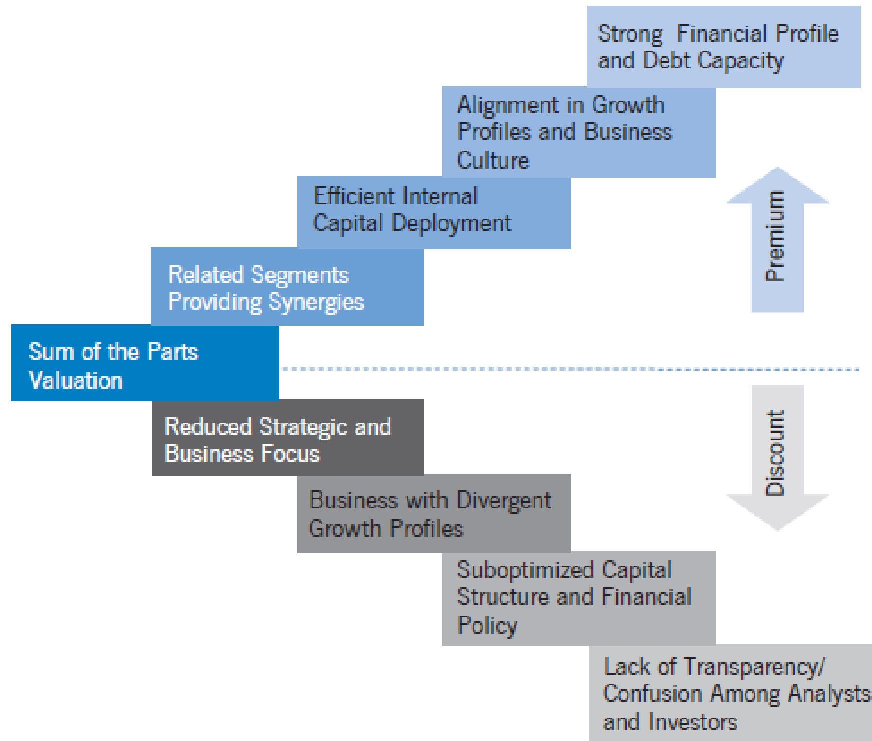
Exhibit 7: Research and Development



	2003	2006	2009	2012
Lighting	6%	16%	22%	25%
Consumer Lifestyle	26%	34%	24%	17%
Healthcare	20%	34%	42%	44%

Source: Philips Annual Report 2003, 2006, 2009, 2012

Exhibit 8: Premium and Discount Valuation in Conglomerates



Source: Journal of Applied Corporate Finance, V.23, Nr. 4, Fall 2011

Exhibit 9: Porter's 5 five forces analysis for Philips Healthcare in 2013

1. **Competitive rivalry within the industry: High**

Factors that increase the threat:

- More Electronic companies focus on the Healthcare industry
- Asian competitors invest heavily in R&D
- Low switching costs

Factors that decrease the threat:

- Relatively few competitors

2. **Threat of new entrants: Moderate**

Factors that increase the threat:

- More Electronic companies enter the Healthcare industry
- Asian competitors enter the Healthcare industry

Factors that decrease the threat:

- High initial costs
- The need to invest heavily in R&D capabilities
- Sophisticated technology
- High innovation costs
- Strong brands
- Patents

3. **Bargaining power of customers: Low**

Factors that decrease the threat:

- Large number of customers
- Low concentration of customers

4. **Bargaining power of suppliers: Low**

Factors that decrease the threat:

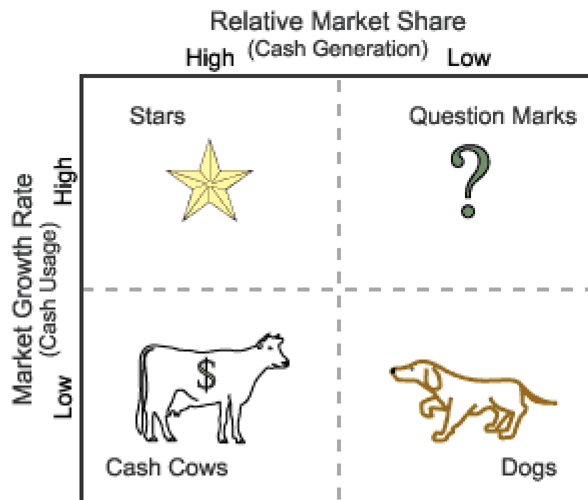
- Large number of suppliers
- Low concentration of suppliers
- Low switching costs

5. **Threat of substitute products: Low**

Factors that decrease the threat:

- High quality products
- Sophisticated products

Exhibit 10: Boston Consulting Group growth-share matrix



Source: http://www.bcg.com/about_bcg/history/history_1968.aspx

Growth-share matrix analysis for Philips:

Philips Healthcare:

Star:	High Market Growth Rate:	Around 10% worldwide
	High Market Share:	No. 1 with several products

Philips Lighting:

Star:	High Market Growth Rate:	12%
	High Market Share:	No. 1

Philips Consumer Lifestyle:

Cash Cow/Dog:	Low Market Growth Rate:	Depends on the product
	Medium Market Share:	Losing market share

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