Business Book Summaries®
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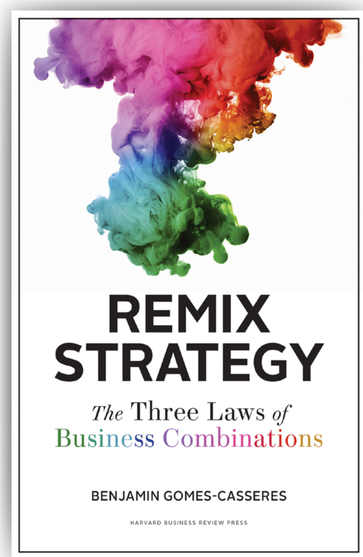
Remix Strategy

The Three Laws of Business Combinations

Benjamin Gomes-Casseres



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Key Concepts

- *Joint business relationships often fail because the firms involved have not followed the three key principles behind successful business combinations.* These principles include identifying potential joint value, governing the collaboration, and sharing the value that is created.
- *Successful resource combinations produce value that is more than the sum of the parts.* Mergers, joint ventures, alliances, and partnerships should only be undertaken when the benefits resulting from them are greater than what either party could produce independently. Additionally, the greater the joint value, the more likely the venture will be successful.
- *Business combinations must be structured to continually support joint value.* It is not enough to simply establish a broad, top-level relationship; rather, every effort within the relationship must be targeted toward identifying and leveraging the connection points that maximize that joint value.
- *The joint value of a business combination must be mutually acceptable and motivating.* If one party benefits from the relationship more than the other, or the benefits are not significant for either party, participants will lose interest and pull back on their contributions, and the relationship will fail.
- *The three laws of business combinations are equally important and work in concert.* Each of the three laws makes a unique contribution to the joint venture process. The three laws work together to yield the maximum benefit from the venture. Throughout the process, participants must pay close attention to making sure each law is being applied for maximum benefit.
- *Business combinations will change over time.* Often resource combinations are made to meet a specific business objective. As objectives are achieved and the business environment changes, these relationships must be reevaluated to determine if they are still producing joint value.

Summary

Introduction

In today's highly competitive business environment, companies must be able to quickly acquire and effectively apply new assets and capabilities that enable them to innovate and excel against the competition. Increasingly, companies are achieving these resource remixes through relationships of various kinds, including simple contracts, alliances, and mergers. In **Remix Strategy**, author and business relationship expert Benjamin Gomes-Casseres provides a framework upon which businesses can successfully combine resources to achieve mutual benefits and create new opportunities. By following the three laws of business combinations, organizations can ensure their relationships will add significant value for all parties and deliver mutually acceptable and sustainable joint value over time.

Part One: Creating Value by Combining Resources

The Three Laws of Business Combinations

Today's business leaders are not strangers to mergers, acquisitions, partnerships, and other means of combining business resources. However, while they may be adept at implementing various business combinations, many business leaders have been much less successful at reaping the value expected as a result of these relationships.

The demise of many promising business ventures that are based on combining resources is often attributable to their failure to pay attention to three laws of business combinations:

1. The value created from a joint venture must exceed the value the businesses could achieve on their own.
2. The relationship must be specifically designed and managed to produce joint value.
3. All partners must receive enough value from the relationship to justify their participation.

Acquisitions, mergers, joint ventures, alliances, partnerships, and other business combinations are bringing in resources from outside the firm. And they are no longer exceptions in most businesses—they have become central to gaining competitive advantage.

The three laws work in concert and influence one another. No one law is more important than the other.

Assessing Your Portfolio of Relationships

Businesses work together in all sorts of ways. Some of these methods are *transactional* (such as making material purchases for the supply chain), others are *relationship based* (such as formal partnerships), and some are *permanent integrations* (such as mergers and acquisitions). Therefore, business relationships can be viewed on a spectrum that ranges from simple transactions to deeper and more complex structures. While not all of the methods are considered a combination of resources, they can all add value in some way. True resource combinations occur when assets that were once managed separately are now managed together to create joint value.

The first step an organization must take in applying the three laws model is to assess all the relationships and resources currently available that could provide an opportunity for creating synergy. This assessment can be achieved by developing a relational footprint that maps the connections between the organization and other firms. The following steps can help a firm hone in on the best relationship opportunities available prior to making any decisions regarding specific business resource combinations:

1. Define the organization's key goals and success factors within its competitive domain, and identify any advantage gaps that could be filled by combining resources.

2. Map the current and potential network of partners that addresses the organization's strategic goals, assessing combination potential and pinpointing weak spots.
3. Compare competitors' relationship footprints to the organization's relationship footprint, looking for competitive advantages and possible threats.

With this new, deeper understanding of the interplay between strategic objectives and resource combination opportunities, the next step in applying the three laws is to identify the best opportunities for creating joint value with and through other entities.

Part Two: Using the Three Laws to Shape Combinations

First Law: Identify Potential Joint Value

Joint value must be identified before pursuing any relationship. This requires a two-step process. The first step in identifying joint value is for a company to look outside itself for businesses that have complementary features that, when combined with its own, would create greater value than either companies offer alone. Complementary businesses are those that:

- Are similar in nature and share the same market.
- Are different from one another but sell to one another, creating a chain.
- Sell components that contribute to a common stack that becomes an overall solution.

There are four sources of joint value:

1. *Economies of scale*, through which costs are reduced. This can be accomplished by expanding production resources, leveraging marketing and management capabilities, and/or combining customer bases.
2. *Economies of scope*, through which similar and complementary products are added to the product mix.
3. *Management coordination improvements*, in which companies merge and leverage processes and assets.
4. *Expanded future options*, which involve the ability to see trends, predict upcoming opportunities, and combine resources to take advantage of these trends and opportunities.

*. . . to be successful, a business combination must have the potential to create an amount of **joint value** in the market that exceeds the total value that would be generated by the same resources without the combination.*

The most logical place to search for joint value is within a company's industry segment. This can be done by identifying related businesses that may have complementary assets or strategies.

The second step is to look back inside each company to identify the connection points that will create this joint value. To make joint value a reality, firms must construct synergies between themselves. The building blocks for this process are typically each company's activities, resources, or capabilities.

The *value stack* is a graphical representation of how a single company's assets and capabilities work together (or stack up) to produce its own outputs. By evaluating theirs and other companies' value stacks, relationship managers can identify areas in which one company is strong and another is weak, thus revealing opportunities to combine resources and create more value.

Second Law: Govern the Collaboration

The *governance model* for a business combination must first and foremost support the joint value. Poor governance can undo even the most promising relationship. The definition and pursuit of the prescribed joint value is what shapes the governance model, not the other way around. The governance model should be closely aligned with strategy and designed to fulfill strategic objectives.

There are three primary relationship models through which companies combine resources:

1. *Trade*, which involves the exchange of outputs or resources by contract between completely independent parties.
2. *Ally*, which involves a more interdependent mingling of outputs and resources using an incomplete contract that is managed consciously and sustained by the value of the relationship.
3. *Merge*, which involves the unified management of formerly independent entities.

Governance decisions should be customized, adaptable, and targeted to help create joint value.

While each of these relationships suggests a specific governance structure, resource combinations should be viewed as occurring along a spectrum. The depth of a combination along the spectrum is a product of the length of the combination and the extent of joint decision making by the parties. Therefore, rather than created as absolute mandates, governance decisions should be customized to the situation based on whether the relationship is viewed as a trade, an alliance, or a merger. Every situation is different, so every governance model will be different. Governance models should also be adaptable, allowing for change over time.

Governance design is also influenced by the following resource combination characteristics:

- *Scope*: The number of participants and how many aspects of the business need to be linked.
- *Depth*: The number of building blocks up and down the value stack that are involved and whether or not there will be investment in specific assets.
- *Activities*: How tailored the activities that create joint value are.
- *Predictability*: The variability of conditions for achieving the joint value.

Among the three general relationship models, alliances require some special considerations. This is in large part because they are not as easily defined as trade transactions or as mergers. Alliances are by nature incomplete contracts. Relationship managers should follow these guidelines to help ensure successful alliances:

- Do not base alliances solely on interpersonal relationships, though these are important for success.
- Use contracts whenever and wherever possible, but realize that they are often incomplete. That is, they contain gaps that will require future joint decisions.
- Govern the gaps through good communication, established and agreed upon decision-making protocols, and strong leadership.
- Keep the focus on the strategy and future potential of the alliance, and make adjustments when the strategy changes.

Third Law: Share the Value Created

There are multiple channels through which joint value is returned. The actual sharing of that joint value—in other words, who receives what percentage of the value when it becomes tangible as profits or other rewards—can be a sensitive issue. All parties will want to maximize their portion of the returns on investment. If sharing joint value is not planned well, the parties will withdraw from the relationship and no joint value will be created for anyone.

Value shares are typically determined based on the following factors:

- The way the resource combination is formally structured.
- The relative bargaining power of each of the participating parties.
- The degree to which each party is contributing to the joint venture.

Value shares can also change over time, so it is important to structure a deal to allow for adjustments.

Adding to the complexity of value sharing is that companies that combine resources to realize joint value also sometimes compete with one another, at least in some part of their businesses. *Co-opetition* is the popular business term that describes collaboration between competing entities. Relationship managers can proactively address potential issues related to co-opetition by:

- Taking a realistic approach and bringing any potential competitive conflicts to the forefront early on in the planning process.
- Avoiding co-opetition if possible, especially if the relationship is highly competitive.
- Preempting co-opetition by considering a merger rather than an alliance.
- Structuring the deal so as to minimize the competitive aspect.
- Pursuing deals despite the competitive aspect if the benefits substantially outweigh the drawbacks.

The key to managing joint value in today's competitive environment is finding a balance between competition and cooperation. Finding this balance begins by mapping where competition occurs, both within the potential resource combination and between the combination and external rivals. Bargaining power within the business combination is shaped by the importance of each party's contribution to the joint effort, and the internal and external alternatives of that party.

At the root of sharing value in combinations lies the dilemma of how the parties compete for a piece of the pie while also collaborating to create that pie.

Part Three: How Remix Strategy Changes the Way You Compete

The Three Laws in Multipartner Groups

Today it is increasingly common for there to be resource combinations that involve multiple firms. Grouped together, these firms can be viewed as *constellations*—multipartner groupings that leverage one another's assets, activities, and capabilities in a networked way to add joint value.

Not all of the firms within a constellation are directly linked to one another, but together they form a grouping. Alliance managers and other leaders will need to be well-versed in how to navigate a multipartner group environment if they are to be successful at creating ongoing joint value.

Essentially, the three laws of business combinations apply to multipartner groups in the same way they apply to less complex relationships. Identifying compelling joint value, creating a governance structure that brings forth joint value, and ensuring every participant receives enough joint value to stay invested in the relationship are universal principles, regardless of the number of participants. Making sure all of these factors are properly addressed does become more complicated within a multipartner or constellation environment.

Constellations exist on a spectrum that ranges from loosely managed networks to tightly managed ones. The more stable a constellation seeks to be and the greater the collective decision making required, the more tightly controlled the constellation will need to be.

Constellations produce joint value through *group-based advantages*, such as scale, marketing, and technical capabilities. The share earned by each member depends on their *member-based advantages* within the group. Competition within the constellation can increase a member's bargaining power (when that member offers the greatest benefits to the group) and erode it at the same time (when members directly compete with one another). Value sharing in constellations can be represented as a ratio of value added versus internal rivalry generated.

Rethinking Strategy

Combining resources inside and outside the firm is a new way of thinking that impacts every business aspect. Steve Jobs remixed existing capabilities and nurtured critical alliances to transform Apple into one of the most successful companies in history. Similarly, any firm can apply the three laws of business combinations to existing internal and external resources to create additional value that exceeds the sum of the parts.

A remix mind-set that focuses more on resources and less on the firm itself will enable better decisions regarding how a firm develops strategy, creates competitive advantage, determines governance, manages change, drives innovation, and maximizes return on investment, as follows:

- *Strategy*: Rather than viewing competition as company against company, leaders should understand that it is now combinations of resources that compete against one another. Instead of seeking out strategic alliances for the sake of a "deal," firms should develop an alliance strategy that seeks out the best combination of resources to meet a strategic objective, understanding that alliances will evolve over time.
- *Competitive advantage*: It is no longer necessary to own resources and activities that provide a competitive advantage. With a remix strategy, both owned and unowned resources can be combined to create unique advantages. Additionally, in a remix model, relationship management itself becomes a competitive advantage.
- *Governance*: Good governance is what ensures joint value is realized for all parties. Combining resources outside the firm extends the boundaries of traditional corporate governance and requires a more holistic view of governance, in which planning rather than a specific plan is what matters most.
- *Change and innovation*: Remixing enables the flexibility and nimbleness that today's ever-changing business environment requires. Organizations that are skilled at combining and recombining resources are much more able to access and leverage the resources they need when they need them. Companies can be entirely transformed by creating new resource combinations.
- *Return on investment*: Remixing provides value to the combination itself and to the individual participants. While the returns from a resource combination might sometimes be less than the returns from the participants' core businesses, resource combination can add value that is not otherwise available.

Features of the Book

Estimated Reading Time: 5–6 hours, 304 pages

In **Remix Strategy**, Benjamin Gomes-Casseres offers a framework and roadmap for ensuring business combinations of all kinds produce beneficial results for all participants. The book is intended for anyone who is involved in the process of combining businesses—from decision makers to those who execute strategy on a day-to-day basis. **Remix Strategy** should be read cover to cover, as each chapter builds on the ideas presented in previous chapters. Numerous case studies and real-life examples of the principles presented are included, as well as a section presenting a Complete Collection of Remix Strategy Tools and another with suggestions for Further Reading.

Contents

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About the Author

Benjamin Gomes-Casseres has been studying, teaching, and consulting on the strategy of business combinations for 30 years. His work has focused on alliances and multipartner constellations, with special attention to innovation strategy. He has studied business combinations in a range of industries, from information technology and pharmaceuticals to automobiles, airlines, and energy.

Gomes-Casseres is a professor at the International Business School, Brandeis University, and previously was a professor at Harvard Business School. Before that, he was an economist at the World Bank. He has published his research in three books (*Remix Strategy*, *The Alliance Revolution,* and *Mastering Alliance Strategy)*, and in articles, handbook chapters, blogs, and videos. He speaks for and consults widely with companies seeking to create value from external resources and to improve the way they manage business partnerships. He earned a doctorate in international business from Harvard University, a master's degree in economic development from Princeton University, and a bachelor's degree in history and economics from Brandeis University.

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