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The Corporate Growth Dilemma: Build, Borrow or Buy?

M&A is one tool in the corporate growth toolbox.

There is something broken in the way many businesses obtain the resources necessary for growth. Most companies are very good at identifying what those new resources are, and nearly all of them take that challenge seriously. Yet, we have seen company after company– even highly regarded ones — get into trouble as they grow because they pay much less attention to choosing the right way to obtain resources than to the task of identifying them.

They have underestimated the importance of making a well-considered decision in choosing the right pathway to growth: whether to build, borrow or buy new resources.

So how do you grow a firm? Do you let the firm grow organically? Do you obtain needed resources through a licensing agreement or partnership? Or do you buy them through an acquisition? These are some of the toughest questions executives face and their decision can make or break the company.

Through my research with Prof. Will Mitchell of Duke University, I've found that firms which can diversify their growth strategies are actually 46% more likely to be in business five years later compared to those who only focus on alliances. They're 26% more likely to survive that time period compared to firms that only use M&A, and 12% more likely to survive compared to firms that only rely on internal development.

The problem is that it is human nature to repeat what has worked in the past. If a company has historically used acquisitions to obtain needed resources, they are more likely to continue with that path. You can see this with Cisco, which in the 1990s made more than 70 acquisitions, but later needed to rebalance its mix of organic and acquisitive growth in the early 2000s. Companies that make too many acquisitions within a short period often become fragmented because they simply run out of integration skills; it then becomes a struggle to absorb any organic growth that happens.

It's also common to see pharmaceutical companies following certain patterns for growth. They often specialize in a certain role, generating a lot of organic growth. However, they eventually become rigid and inert, finding themselves in need of breaking up the cycle so they make sourcing agreements with an external partner to attempt to rebalance the growth paths. In the past few years, big pharma firms like Merck or Sanofi-Aventis have embarked on aggressive external sourcing to complement their internal R&D efforts.

It's important to consider all of the options when a company is in need of additional resources. A firm needs to ask if they have existing resources to develop their targeted resources. If yes, then perhaps it should build those resources internally. If not, then the firm needs to consider looking at outside options.

The next step is to consider the type of relationship it wants to pursue with an external party. Does it want a simple collaboration? How many people does it want involved? What is the scope and depth of the relationship and how much should the external party be involved?

Depending on the answers, a focused licensing contract might make sense or perhaps the firm should consider a broader alliance. But if the firm wants a broad and deep relationship with the resource provider, then it should consider an acquisition. But keep in mind that M&As are complex, costly and disruptive and should only be used when the ends justify the investment of time, money and human resources.

The bottom line is that firms need to consider all of the options rather than just doing what is familiar. Over time, they need to develop a diverse portfolio of paths for growth. Otherwise, they may not be around in five years.

This *post originally appeared on **mitsloanexperts.com**.*

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