



What Corporate Strategists Need to Know About Synergies

Understanding the distinctive “footprints” of four different types of synergy can help improve the way you value and implement corporate strategies

It’s generally acknowledged that the chief advantage of multi-business firms resides in the internal linkages they’re able to create. Otherwise, there would be no essential difference between the decision-making process of a C-suite exec and that of a mutual fund manager.

My years of teaching corporate strategy to senior managers and CEOs, however, have shown me just how little we as academics have offered them in terms of how to tackle this problem rigorously. Beyond the exhortation to “pursue synergies”, we have done relatively little to prevent this becoming a meaningless slogan.

The “four Cs” of synergy

With this in mind Bart Vanneste, Associate Professor in Strategy & Entrepreneurship at the UCL School of Management, and I developed an approach to thinking about synergies that we call the “Algebra of Value Chains”.

The premise for our analysis is simple: operational synergies require changing the relationships between the resources underlying the value chains of different businesses. This may involve exploiting similarity or dissimilarity across them, and the extent of modification to resources may be minimal or extensive. Combing these ideas gives us, we

believe, the first mutually exclusive and collectively exhaustive categorisation of four types of operational synergies.

These are:

- **Consolidation** – perhaps the most intuitive of the four. It involves creating value across highly similar resources by eliminating redundancies. Because the gains here come from elimination, the resources at one or both sides need to be trimmed and possibly adjusted. Examples might be: merging departments to reduce the total headcount, or merging resources of the separate business units to form less expensive, shared resources.
- **Combination** – essentially, the “strength in numbers” approach. It involves pooling highly similar resources to gain bargaining power. Unlike with consolidation, no resources are eliminated in the realisation of the synergy. Two examples might be combining purchasing to obtain volume discounts, or acquiring a competitor and then raising prices for customers. This is the type of synergy most likely to ping a regulator’s radar. Acquisitions might be blocked on anti-trust grounds if the market power increases significantly.
- **Customisation** – partnership based on marrying two entities’ idiosyncratic value chains.

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For instance, a mobile phone operator and a software company collaborate to develop handset hardware and operating system software that are highly compatible with one another. The outcome of the customisation should be that the final product works better and/or costs less than before. Intangible assets such as best practice, knowledge, or IP from one company can be customised by another to generate value.

· **Connection** – in essence, the bundling effect. Here, dissimilar value chains link up to expand their market reach. Seeking new market share by co-branding, bundling, or cross-selling would be one example. In each case, the underlying resources are hardly changed, just linked.

This should not be a mere classification exercise. As noted in our book ***Corporate Strategy: Tools for Analysis and Decision-Making***, leaders should be able to use this tool to identify which type(s) of synergy they're seeking with each new deal and to discover new opportunities for synergy within existing partnerships or proposals, e.g. by ascertaining whether a business has in its value chain resources similar (for consolidation and combination opportunities) or dissimilar (for customisation and connection) to theirs.

In addition, applying the “four Cs” provides a set of general forecasting principles. It can be helpful to know that, for example, consolidation and customisation synergies cost more initially because they entail greater resource modification.

Finally, and perhaps most importantly, these categories make it easy to explain the sources of value to investors, managers, and customers.

Valuation

The “four Cs” are merely where strategic analysis begins. Finally, of course, the decision will weigh the dollars and cents. Our book ***Corporate Strategy*** presents a series of pragmatic frameworks—many of which have never been published before—for extracting and quantifying synergistic value through strategic decision-making. The book's primary purpose is to expand the strategic repertoire of senior leaders who might be called upon to make such decisions, present their reasoning to peers and superiors, and evaluate the arguments of their professional advisors (like bankers and consultants). It is designed to provide a wide-angle, holistic view of corporate strategy that nonetheless allows you to analyse any given decision within an Excel spreadsheet.

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