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The concepts of "selection and concentration," "core and non-core," and "returning to the core business" have been introduced as guiding principles for corporate reorganization. In general, these concepts have been applied with a view to shedding operations that do not make money and retaining those that are profitable. Although this approach could hardly be called mistaken, it does not provide sufficient criteria for determining the scope of a firm's operations.

For many years, the criteria for deciding the scope of a company's operations have been derived from the idea of synergies (beneficial mutual interactions) between different types of operations. As an opposite concept, the new idea of *anergy* has emerged. This concept focuses on the negative effects of the mutual interactions between the activities of different business divisions under the same management.

Anergy considers the mutual effect between (1) verticality, which is the length of the value chain of development, manufacturing, and sales, and (2) laterality, which is the breadth of the scope of different businesses. As a result of the development of a market, a wide scope of business operations does not necessarily produce the desirable synergies. In contrast, the ill-advised integration of resources within the company has led to increased anergy and the negative effects arising therefrom.

A pure company is one that squarely faces up to anergy and then defines the scope of its operations. In most cases, a company will reduce the scope of its operations by focusing on anergy.

One aspect of the application of the pure company concept is corporate modularization. Along with the trend towards outsourcing to replace in-company procurement, the number of companies that rely exclusively on outsourcing has been increasing.

As pure company reform gains ground, enterprises that are encumbered by the weight of anergy (i.e., highly diversified but nebulous corporations) will be weeded out while others will be forced to break up and adopt pure company structures—in other words, well-defined corporate strategies that eliminate anergy.

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I Impetus Towards Pure Company Reforms

1 European and American Companies Are Ahead

American industry in the 1980s was uniquely characterized by audacious company acquisitions and sell-offs. It was joked at the time that Japanese and German firms sold products while American companies sold businesses. While Europe had been as hesitant as Japan with respect to such bold restructuring, it soon followed the American lead and gained a head start on Japan with sweeping changes in corporate laws and regulations and an overhaul of the tax system. Subsequently, radical reform began to make sense even for companies with a hundred-years history. Statistics show that during the 1990s there was a tenfold increase in restructuring resulting from the devolution of corporations into entities more closely matching the pure company model.

For example, the prestigious German corporation Siemens spun off its stagnating semiconductor operations in 1999 and floated a public offering to set up Infineon Technologies. The company subsequently achieved greater success and went on to claim its place as a leading global enterprise, leaving Japanese companies behind. Or consider the cases of two well-known chemical giants, Rhone-Poulenc of France and Hoechst of Germany. After each had spun off all its chemical operations except pharmaceuticals, they merged to form Aventis, a new pharmaceuticals company. The chemical division of Rhone-Poulenc became the new company Rhodia, while the chemical operations of Hoechst were acquired by DuPont of America and others (see Figure 1).

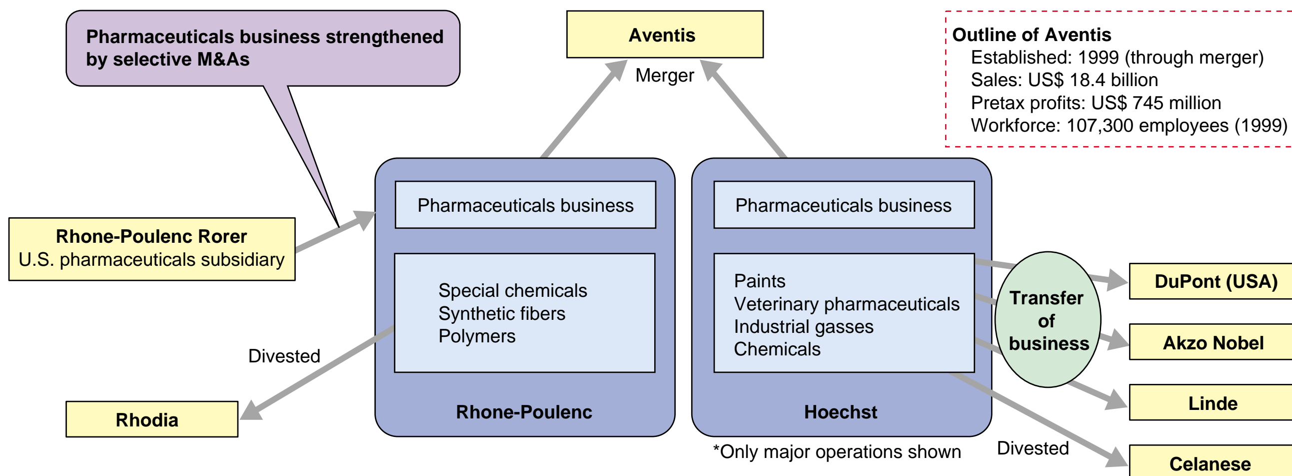
The factor motivating pure company reforms has been increased competition in the market for products. To regain strength, highly diversified corporations that had lost their competitive edge were forced to become involved in pure company reforms. A typical case is Westinghouse, the giant American electrical corporation. Despite repeated acquisitions and divestitures, its business performance failed to improve and only the CBS TV network ultimately remained. Westinghouse took its final bow by adopting the CBS name and the closing the curtain of history on a prestigious American company name.

In Europe there are similar examples. ICI was a chemicals corporation based in Great Britain. Although the name remains, the nature of its business has completely changed. As a result of repeated acquisitions and divestitures, the business of the original ICI has all but disappeared. Its operations are now centered on special chemicals for the food industry, a business that it acquired from the Anglo-Dutch food company Unilever.

2 Segmentation of Lines of Business and Unbundling of Functions

Successful pure companies have focused clearly on competitiveness when deciding their scope of operations. The European companies mentioned above, which reformed their horizontal operations in chemicals, pharmaceuticals, and similar products, comprise one such group. When the vertical value chain of development, manufacturing and sales is segmented, a pure company reform is a natural consequence. In the history of electrical appliance sales in Japan, for example, sales networks used to be established and managed by manufacturers. General merchandisers later came into the picture, and hyper stores that specialize in home electrical appliances generate the bulk of sales today. The appearance of pure companies specializing in the large-scale retailing of appliances has affected both appliance makers and general merchandisers.

Figure 1. Establishment of Aventis



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EMS enterprises have appeared in the upstream manufacturing sector through receiving component production orders from multiple set makers. EMS companies buy plants and equipment from existing manufacturers and achieve growth as pure companies by focusing on the volume supply of parts and production management. Among automakers, GM and Ford Motors have both turned away from the internal supply of parts and spun off Delphi Automotive Systems and Visteon Corporation as independent parts manufacturing enterprises. Even further upstream in the research and development territory, huge companies have been created in the pharmaceuticals sector such as Amgene, which was set up to specialize in the development of new medicines.

Moreover, companies that until recently had developed and run their own company information management systems have increasingly been divesting captive information processing divisions. As a consequence, pure companies solely in the business of running information technology services have been growing.

Furthermore, in the financial sector in Japan, all the major companies have set up call centers. In the American mutual fund industry, however, there is a single company specializing solely in the operation of call centers. This company, DST, runs large-scale call center facilities that deal with the customers of rival financial companies. The integrated services that DST offers extend even into the logistics of processing the checks and vouchers for client transactions. DST's share of this market segment now exceeds 50 percent.

3 Criteria for Optimal Scope of Business

In order to understand these aspects behind pure company reforms, the principles of selection and concentration, core and non-core, and returning to the core business may help. The ideas of selection and concentration and core and non-core are applied in the context of reducing the size of a business that has overextended its reach. The underlying motivation, however, is nearly always to withdraw from businesses that do not generate a profit and retain only those operations that make money. Although this approach is not invalid as a decision-making criterion, its effectiveness is limited. It does not help when deciding the best size for a company with the ability to compete.

Let us consider the example of a highly profitable home electrical appliance manufacturer and a highly profitable company in the forest-products industry. Would there be any advantage in the two companies getting together in a merger? Such a move would have been seen as advantageous in America back in the 1960s, when conglomerates were blue chip stocks. They moved into growth industries through effective management of their business portfolios, with their stock-holding companies producing synergistic effects by strategic fund raising and business management.

This type of strategy is now completely out of favor with the stock market. Buyers in the market for electrical appliance manufacturers would see the papermaking component as superfluous, while those interested in the paper company would be unwilling to support the cash flow demands of the electrical appliance division of the corporation. Rather than being priced at the aggregate value of each element in the corporation, the stock of a holding company with combined interests in disparate businesses would be discounted. It is like buying a computer and a printer as a set at a discount, as no one wants to buy any kind of package deal that costs more than the sum of the parts sold individually.

If the electrical appliance manufacturer's stock is valued at 100 and the paper company's is also at 100, on the market you could only sell the stock of a corporation with combined interests at 180. This type of conglomerate discount means that a large-scale company with two sources of cash flow won't sell unless its value is discounted. Conglomerate discounting has been pointed out as a factor in pure company reform, but it fails to give a complete picture because it is only concerned with market valuation. This argument presupposes that after the merger, both the electrical appliance division and the papermaking division would each generate cash flow equal to 100.

The pure company concept, which focuses on optimizing the scope of company operations in the interest of competitiveness, goes further. Pure company reforms presuppose that any improper combination of businesses will adversely affect the results of each business division of a company. Combining an electrical appliance business with a papermaking business would drag down the results of both businesses. Some would say that the original value of 100 for each would be reduced to 80 and 70, respectively. The combined value would then be 150. The effect responsible for this 50-point reduction is known as anergy.

II Anergy: The Negative Effect of Mutual Interactions

1 Anergy Dispels the Myth of Synergy

In broadly integrated diversified corporations that have widespread interests, the head office is often called the "strategic headquarters"—a term that sounds grand and admirable. Functions are divided into daily decision-making for each division and overall strategies for the entire enterprise, and the headquarters is authorized to evaluate performance and control personnel and corporate finance. Its purpose is to optimize the entire organization and realize synergies from among the

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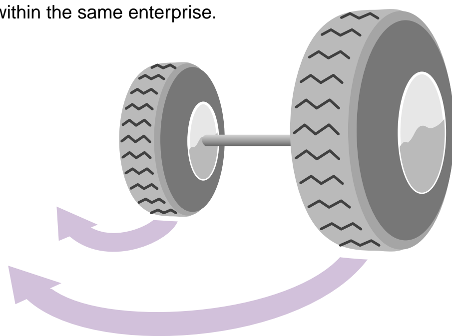
Figure 2. Anergy

Anergy refers to the negative mutual effects of an ill-considered combination of different business operations within the same enterprise.



different operations. The image is that of a well-run capital of a prosperous business empire.

Pure company reforms have taken place amidst disillusionment over the failure of strategic headquarters to live up to the objectives of realizing synergies. By contrast, the key concept of anergy refers to the negative mutual effects caused by the interaction between different business operations within the same enterprise (see Figure 2).

When there are diverse operations within the same business, the mutual interaction among these various operations generates the positive effects of synergy and the negative effects of anergy at the same time. Whereas advocates of large, broadly integrated corporations revolving around the strategic headquarters point out that broad-based enterprises have many opportunities for the realization of synergies, the anergy concept presents an opposing view. Anergy inevitably occurs in single enterprises that have incorporated differing lines of business. In other words, the achievement of synergy tends to be the exception.

2 Internal Optimization Will Not Guarantee External Optimization

Let us consider the anergy that is generated by broadly integrated corporations with strategic headquarters. First of all, the action policy of the strategic headquarters is to optimize the overall structure of the entire business operation. Rather than prioritizing the ability of each business division to compete in the market, such a philosophy is not conducive to optimizing the whole as it allocates corporate resources within the company. Overall fitness is sacrificed to internal optimization. This is not the way to optimize a company's market readiness.

Regardless of how large the enterprise is, its internal resources are limited compared to the quantity and quality available in the entire market. As long as rival firms competing in the same market are also preoccupied with internal optimization, there will be no apparent problem. With the emergence of pure companies committed to optimizing their readiness purely for market competition, however, operations shackled by the anergies imposed by the internal optimization policies of strategic headquarters will find it tough to compete. This is because pure companies have devoted themselves to creating and retaining tangible and intangible assets that cannot be acquired in the market, and to combining these with the finest resources that the market can provide.

If the market for raw materials, parts, capital and labor is still undeveloped, there is a large potential for creating synergies by extending the limits of the company. If the procurement of rolled steel becomes a bottleneck for auto manufacturers, for example, they could go as far as to integrate a steel maker to create a source of synergy—just as Ford did in its early days. By the same token, if the market for autoparts is undeveloped, it is essential for auto manufacturers to start producing parts for themselves in order to remain competitive. On the other hand, once parts makers have established their presence, there is a greater opportunity to procure parts on the open market and a loss of the synergies that had benefited general auto manufacturers with an array of parts divisions. Furthermore, because they cannot easily sell to competitors, the parts divisions of automakers are faced with considerable difficulty in trying to increase their share of the expanding market for autoparts.

3 The Myth of Selective Intervention

Next, let us consider the idea of the strategic headquarters as an active investor. This notion is based on the premise that daily decision-making for each division and major strategic corporate planning can be separated, but that the corporate headquarters may still be able to selectively intervene in important strategic decision-making by each business division as appropriate. In a pure company that pays attention to anergy, this kind of approach is totally unrealistic. The fact is that the strategic headquarters often fail to intervene when appropriate but do intervene when it is not appropriate. When companies increase their scope of business, it becomes impossible to understand the situation at each of the individual divisions because the only basis for judgment is sheer numbers and other ordinary indices. Moreover, decision-making is further obstructed when the strategic headquarters get involved, even though the final responsibility for decisions is not clearly identified there.

Not only do the business divisions of broadly integrated corporations have to contend with rivals in the market, they also have to convince their strategic headquarters. The redeeming feature is that poor performance in the market may be compensated for with company reserve funds if success can be achieved in persuading the head office. A secondary effect is that

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those who are effective at persuading the head office are most likely to advance in what can easily become a bureaucratic company organization.

In a corporation that combines quite different business divisions, there will be minimal anergies if all that the head office does is merely to prepare financial statements. In reality, however, every head office also draws up business plans, approves budgets, and evaluates business performance since funds from the company pool must be properly allocated. It is also natural for the head office to introduce common formats to enable comparisons of the performance of different business divisions, as well as common criteria and indicators such as growth rates and rates of return, the proportion of new products, or the balance of new orders.

When the same criteria are used to evaluate different businesses it causes discontent at the divisions that feel it is unfair. Changing the criteria would only lead to discontent at a different division. Going back to the earlier example of a business combining electrical appliance and paper manufacturing divisions or, say, the personal computer and nuclear power generation business of a general electrical company, it becomes extremely hard to find ways of evaluating performance that satisfy everyone. One way or another, the performance of each division is not solely evaluated by efforts in the market, but by the criteria set by the head office. Much time and energy will then be spent in working on the head office in an attempt to induce favorable criteria, and anergistic effects are generated whenever each business division acts to meet internal evaluation criteria.

Such divisional resistance may lead to undesirable compromises. For instance, although more companies have become concerned about capital costs differences in evaluating the lines of business, disputes over the charged cost of capital among business divisions increase as capital cost becomes an important factor in the division performance review system. Most corporations end up compromising and apply uniform capital cost.

If the corporation ventures to set different criteria according to business divisions just to appease dissatisfied divisions with operations that incur high capital costs, the weight given to the return on investment in the overall assessment of performance is considerably reduced. In enterprises which combine different types of business that incur greatly differing capital costs, performance management based on capital costs produces substantial anergies.

4 Deliverance from Anergy

Much energy is expended on these symptoms of anergy by the strategic headquarters of broadly integrated corporations, and these problems frequently cause confusion among their business divisions.

By contrast, the pure company approach is based on the premise that the business model for each type of business is different and mutual understanding is hard to achieve, and that it is a waste of energy even to try to integrate highly diversified business operations. In other words, it does not deal with such a difficult problem from the outset. By establishing the mutual independence of differing businesses, the vexing effects of anergy are eliminated.

In the core versus non-core approach, the head office determines the important and unimportant businesses. As a result, the bigger divisions become the core in almost all cases, absorbing relatively small-scale businesses with increasing earnings. Operations that are not profitable are classified as non-core. Reorganization is carried out on the basis of current earnings. In a corporation combining mixed business interests, the whole process is like going through a toy box and discarding the damaged toys. In the end, the situation in the toy box remains the same.

Pure companies attack the problems by focusing on the anergies caused by the combination of differing businesses and analyzing the situation from the standpoint of each business. From the vantage point of the smaller business divisions within the enterprise, the other large divisions are considered non-core. It is not a case of crossing out the operations that are to be discarded; rather, the structural principles are based on reorganizing so that the resulting structure is more competitive (see Figure 3).

Figure 3. Pure Company Versus Broadly Integrated Corporation with Strategic Headquarters

Pure company	Broadly integrated company
• Emphasis on business strategy • Seeks optimization of market readiness • Company values and evaluation criteria can be harmonized • Elimination of anergies	• Separation of business operations and strategic planning • Aims for overall organizational optimization by headquarters • Unified management and evaluation criteria established by headquarters judgment • Realization of synergies

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III Accelerating the Momentum of Pure Company Reforms

1 Well-Developed Markets Decrease the Opportunities for Synergy

Contingency theory explains changes in the scope of business and organizational structures in the following way. Contingency itself refers to a situational dependency, as we cannot assume that any enterprise always finds itself with the optimal scope of business operations and management organization. As long as competition is not intense, companies may live with inefficient business organizations; it is only when competition intensifies that there will be an incentive to change to more efficient ways of doing business.

After the Second World War, when the tide of enterprise conglomeration was ebbing in the US, the symptoms of inefficiency were not initially apparent in Europe. Progress was sluggish towards implementing internal control of the business organization based on corporate division systems. Companies with inefficient business organizations could survive because the European market was divided by numerous national boundaries and subject to governmental intervention in each country. As a result, enterprises had little to fear from cross-border competition. According to contingency theory, as competition gradually increased, the format of European companies changed in response. This is especially pertinent with respect to the reorganization of European companies before and after the introduction of the euro.

Japan provides another example of a situation in which soft competition has allowed loosely managed companies to survive. For example, the domestic market is still highly regionalized with transportation, domestic gas services, and other geographically based local business networks. This situation has also allowed these local businesses to branch out into the hotel and retail trade, thus promoting the formation of regional business conglomerates.

Typically, the largest enterprises that cover a wide range of business sectors are electrical companies. The biggest of these is Hitachi, Ltd., which has expanded business across a broad front in competition with General Electric in its main business lines, and with IBM in computers, Lucent Technologies in telecommunications, and with various other competitors in other fields. The development of Hitachi has taken place in the context of government industrial policies and anti-recession measures involving NTT and nine regional power companies, which provided a huge market and a competitive environment that was extremely docile by any definition.

Pressure to restructure into a more efficient organization has come with the reductions in market size following changes in the procurement policies of NTT and those of the regional electric power companies. Under these circumstances, competition with overseas companies became inevitable for Hitachi. Whereas the CEO of IBM can focus on working out a global strategy for its IT business, the management of Hitachi is distracted by the need to consider both nuclear power generation and communications devices simultaneously. This is a serious handicap when it comes to competing in the global market. Like local conglomerates, Hitachi must cope with bigger handicaps as the barriers that long separated regional business markets have gradually disappeared.

With the increasing development of the market, the synergies produced by having a wide range of business interests are reduced. Highly developed capital and labor markets curtail the value of the synergies created by business diversification in helping to boost fund raising capabilities and stabilizing employment by alleviating the risk of fluctuating earnings. This is because a market that can evaluate and absorb risks will no longer require any single company to disperse risks internally—a capability that used to be considered highly valuable.

The synergy of being able to guarantee stable employment and thus attract more competent personnel has also been lessened with the appearance of companies specializing in R&D that provide returns to match the risks involved. Moreover, the development of stock markets and venture capital schemes provides businesses with the potential for high returns with greater opportunity to procure capital even without guaranteed stability. Anergies have emerged as these kinds of synergies decrease.

2 Modularization of Corporate Activities

As uniform standards are applied to physical products and parts and other aspects of business such as planning and design, production methods, information processing systems, more and more corporations have adopted a modular system where specific corporate activities are separated and combined as necessary. An increasing number of module-based products and services have been introduced into the market, and pure companies specializing in particular modules have appeared. Microsoft and Intel are giant pure companies that have achieved success in this area.

Modularization of corporate activities has promoted outsourcing, such as contracted use of factory capacity and information systems as well as of call center services. The spread of pure company reforms reflects the trends toward the modularization of broad corporate activities. The question today is the optimal boundaries of a firm beyond the optimal business portfolio.

In contrast, Japanese corporations have adopted the idea of integration rather than modularization. It is said

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that they have the ability to create advanced product by coordinating and integrating diverse technologies and parts, which goes beyond simple combinations. The value of such integration to achieve technical and product breakthroughs has not been diminished by the development of modularization. Even within modules, the interaction of diverse technologies gives much potential for significant breakthroughs. The same is also true for the development of new modules. However, those breakthroughs and innovations do not emerge naturally from the simple maintenance of broad business interests and functions.

The pure company concept does not mean breaking down businesses into operational units that are as small as possible. Only a level of integration that competitors cannot achieve gives a company an extra competitive edge. Applying the concept of anergy clearly reveals the business range that creates true added value. In so doing, it is useful to carry out an organizational comparison with competitors that have successfully implemented this approach, focusing on the anergies that may burden each type of operation.

Finally, it is important to note that the introduction of the pure company concept will not obviate the possibilities of developing innovative businesses. By analyzing the anergies involved, companies should work for the best form of operations without regard to past circumstances.

IV Prospects and Issues for Japanese Companies

During the past few years, Japanese companies have been increasingly concerned about corporate organizational structures. Laws regulating holding companies and spin-offs have been revised and the range of business activities and other choices for companies have been broadened as a result. For the first time in the history of Japanese business, there have been attempts to expand the concept of the company. These efforts include introducing new formats such as clustered organizations that bundle up the diverse operating divisions that proliferated under internal company systems, reforming the board of directors and other head office functions, reorganizing subsidiaries (some of which may be withdrawn from stock exchanges), creating joint ventures with rival companies as business divisions are spun off into independent entities, and pursuing mergers with rivals through holding companies.

In examining these changes in the light of the pure company reforms that are sweeping the globe, however, we can see that insufficient attention is being paid to anergy as a criterion for determining the scope of company operations even while discussions of the core or non-core issue still prevail. For example, the potential sources of anergy are clearly not eliminated when a joint venture is established with a rival company and the two parent firms retain the right to make final decisions for their respective business divisions and the new joint venture.

In Japanese companies, incentives through promotions are deeply embedded in the corporate ladder. Any enterprise with a long history holds not only diverse business divisions but also many functional subsidiaries, such as distribution companies, leasing companies, travel companies, engineering companies, and data processing companies—all of which depend on orders from within the corporate group. Good use is made of the key posts in those affiliated companies to ensure that personnel affairs go smoothly. This system is very similar to the one involving special public corporations in Japan that have been set up to secure posts for retiring government employees.

Carrying out a pure company reform of a broadly integrated corporation will cause some hardship for some senior management people by reducing what are considered reemployment opportunities after retirement. To date, this major consideration still prevents all but a very few companies from carrying out any radical re-sizing of the scope of the corporate business activities until their business performance becomes extremely poor.

Accordingly, pure company reforms will advance along a road of corporate dissolutions, because enterprises that carry heavy burdens of anergies resulting from unfocused diversification strategies will be weeded out and diversified. Pure companies are rising to prominence in emerging markets, which are characterized by modularization. Becoming a major player in this growing field will not be possible by clinging to the old strategic headquarters model. It is essential to work out a clear strategy that tackles the problem of anergy.

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