



Conglomeration is a good way to maintain control over family businesses, as Reliance, Mahindra, and Tata, among other firms, have demonstrated in India. But conglomerates have rarely maximised long-term shareholder value. PHOTO: REUTERS

Korea, and jitian in China, as well as in much of Europe.

But conglomerates have rarely maximised long-term shareholder value. Too often, whatever synergies they manage to create fail to compensate for the costs associated with the increased complexity. Such conglomerates seek out scope as well as scale, even when they lack expertise in the targeted sectors. In Europe, for example, the now-disbanded Hanson Trust group spanned retail fashion, typewriters, chemicals, gold mining, toys, tobacco, and beyond.

The temptation to devise economies of scope is hard to resist, even when it stretches a conglomerate's capabilities. Five years ago, the world's largest telecom operator, AT&T, acquired the WarnerMedia entertainment group, for example, only to unwind the deal three years later.

Like other industrial concerns, GE operated under the principle that centralised strategic planning and capital allocation was the most efficient way to run separate business units. Yet, during the global financial crisis, its GE Capital financial division faltered and starved the whole enterprise of cash. This helped force the sell-off of its mass media unit NBCUniversal.

Giant corporate conglomerates often hire strategy consultants to help address the challenges posed by their size. Various management fads in the 1980s made way for operational solutions and systems implementation in the 1990s. Under CEO Jack Welch, for example, GE adopted Six Sigma process-improvement methods. But these practices ended up mostly overengineering management structures.

In PE, financial engineering tends to drive investment performance. So, the corporate fixers in financial conglomerates are not management consultants but leveraged finance and turnaround experts, especially in distressed scenarios.

Eventually, the corporate conglomerate came to suffer from a fundamental weakness: The whole was worth less than the sum of its parts, and unrelated divisions were "worth less than if they were stand-alone units", as Michael E Porter writes.

The combination of business and market risks led public investors to assess most conglomerates at a discount relative to their breakup value.

**Risk diversification and return dispersion**  
 Demergers became the most efficient way to extract the true value of the underlying assets and demonstrated that individual corporations did have an optimal structure. Therefore, the main challenge for modern-day private capital firms is

## Private capital: Lessons from the conglomerate era

The main challenge for financial supermarkets is achieving both horizontal cohesion and vertical integration. **By Sebastien Canderle**

GLOBAL private capital firms are charting a well-travelled course. With their sprawling empires, the largest alternative asset managers have adopted strategies that borrow extensively from the octopus-like corporate conglomerate business model.

### The age of private market empires

Many private equity (PE) firms are building product lines that are adjacent if not necessarily complementary to their traditional buyout activities. These product lines all sit under one common umbrella: capital solutions. That is why the moniker "financial conglomerate" now applies.

By aggregating multiple and sometimes loosely related businesses, these modern conglomerates achieve two main purposes: they consolidate market power and diversify away economic risks.

Infrastructure, credit, life insurance, real estate, and venture capital have as much in common today as the General Electric (GE) domestic appliances line had with its aircraft engine production unit, or the General Motors (GM) former subsidiary Frigidaire had with its main automobile manufacturing business. For today's financial conglomerates, as with their corporate predecessors in the last century, asset accumulation and revenue maximisation have taken priority over strategic coherence.

Fifty years ago, buyout pioneers believed cor-

porate conglomerates were overly complex and that corporate carve-outs could create greater value. Yet today, in a bid to shed their reputation as financial engineers, PE fund managers are acting more like industrial owners, holding onto portfolio assets for a decade or longer rather than the conventional three to five years.

They also play a more active role in portfolio management – with operating partners, sector experts, and when needed, turnaround specialists – than they did when they first emerged in the 1970s. Back then, they behaved more like holding companies: They were neither operationally nor strategically involved in the day-to-day running of investee companies. Though established to improve corporate governance and strategic focus, private capital firms now emulate old corporate conglomerates.

But if this is the case, it is worth examining why the practice of vertical and horizontal integration so often led to failure in the past. What went wrong with the corporate conglomerate business model?

### The conglomerate discount

Conglomeration is a good way to maintain control over family businesses, as Reliance, Mahindra, and Tata, among other firms, have demonstrated in India, and can also help governments set industrial policies in strategic sectors, as with some keiretsu in Japan, chaebols in South