Parenting Advantage: The Key to Corporate-Level Strategy

Marcus Alexander, Andrew Campbell, and Michael Goold

While business-level strategy has improved dramatically over the past two decades, business-level strategy alone cannot meet the strategic needs of large, multi-business companies. Such companies need strategies for each of their businesses, and they also need something else: a corporate-level strategy. The corporate-level strategy provides a rationale for keeping all these businesses grouped together under common ownership – and at some distance from outside shareholders and investors.

Corporate-Level Strategy

Corporate-level strategy has not been well-served. It has been a poor cousin to business-level strategy and has made far less progress. Many companies have little explicit corporate-level strategy at all. Instead they have a collection of business strategies, some general aspirations about aggregate growth and profitability, and a statement of corporate mission or business scope, often worded to stretch like ding-film over the existing portfolio, while always allowing a bit of extra room for appealing but unidentified acquisitions. Frequently, notions of portfolio management, risk-spreading, and balance still lurk beneath the surface, increasingly supplanted by concepts of regeneration and core competence extension.

Furthermore, while many companies now feel sure that „overdiversification“ is dangerous and destroys value, it is much less clear what the „over“ really involves. Notions of business-relatedness and synergy vie with SIC codes and linguistic labels to determine what is close enough and what is too far away. If you make financial software for personal computers, are you overdiversifying if you go into games software, or financial services, other computer services, computer manufacturing, or other goods sold to your existing customers? How can you tell?

The confusion about corporate-level strategy is not simply of academic interest. We estimate from our research that, far from being worth more than the sum of their parts, well over half the world's multibusiness companies are actually worth less than this. They are value destroyers. The lack of clear corporate-level strategies shows up in the portfolios of unhappy bedfellows, well-intentioned but damaging corporate initiatives, and strings of acquisitions that create more wealth for bankers, lawyers and advisers than for closer stakeholders in the company. The cost of this gap in corporate strategy is the suppression of billions of dollars of value, which is sporadically released by MBOs, unusually powerful shareholders, or the threat of enforced break-up. In contrast, some multibusiness companies create significant value from sound corporate-level strategies.

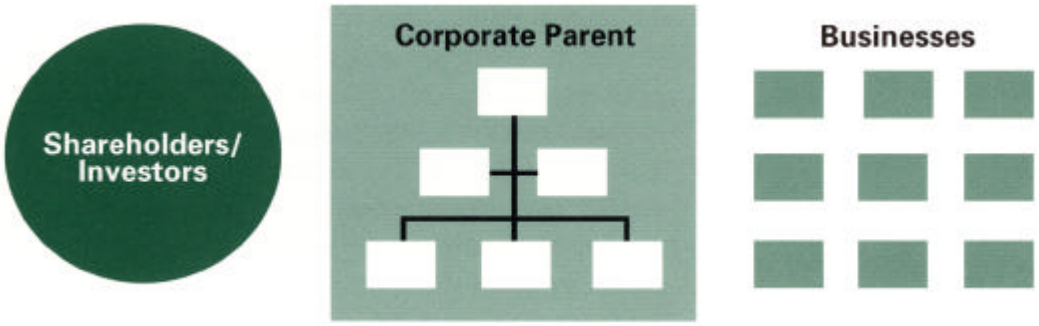
Our approach to corporate-level strategy, based on 10 years of research with multibusiness companies in Europe, North America, and Asia, adopts a bottom-up view of the corporation, emphasizes the danger of value destruction and the necessity of „fit“ between businesses and their parent company, and places at center stage the concept of „parenting advantage.“

A Bottom-Up View

We start with the observation that multibusiness companies comprise two elements: business units, which could theoretically be independent companies, relating directly to the capital markets; and one or more layers of other line and staff managers above or outside the businesses, which we refer to collectively as „the parent“ (Exhibit 1). The businesses are directly involved in value creation: they produce goods and services and attempt to sell them for more than their cost. But the parent is involved much less directly. Its ability to create value depends largely on its influence on the businesses and the way it supports them.

Exhibit 1

The Corporate Parent as Intermediary



The parent acts as an intermediary between the businesses and outside investors. It clearly incurs costs, both direct and indirect. It is therefore justified only if, through its influence, it creates more value than these costs. If it does not, businesses and shareholders would be better off without it. This bottom-up view challenges the very existence of the parent: the parent has no automatic right to exist. To justify its existence, the parent should be able to demonstrate that its businesses perform better in aggregate than they would as a series of individual, stand-alone entities. Sadly, few corporate parents appear to pass this test. Most destroy value, not primarily through bloated departments or excessive pay, but through the damaging influence they inadvertently exert on their businesses.

Destroying Value

Typically, parents destroy value in a number of ways. If they do not have a good feel for a business, they are likely to focus on the wrong issues, appoint unsuitable managers, or press for inappropriate levels and measures of performance. Even if the business is more familiar, capital rationing and political pressures distort the flow of information that reaches the parent, frequently encouraging misperceptions. Attempts to gain economies of scale through central departments all too often lead to unresponsive or compromised services; apparent „synergies“ are sponsored with little appreciation of the opportunity costs involved; business managers are pressed into corporate policies that fail to match their individual circumstances. Underlying such value destruction is some type of misfit between the parent and the business in question.

The Importance of Fit

In order to create value, the parent must do more than simply avoid creating damaging misfits. It must have some skills or resources that are specially helpful to its businesses. It must help its businesses address opportunities to improve their performance that they would fail to realize by themselves. The nature of these opportunities varies from one business to another. In one business, there may be an opportunity to improve performance by applying tighter controls than would exist if the business were independent. In another business, there may be an opportunity to facilitate the sharing of complex know-how that would not occur between stand-alone entities. Such different opportunities can be realized only by applying different parenting skills or characteristics.

The essence of successful parenting is therefore to create a fit between the way the parent operates – the parent’s characteristics – and significant improvement opportunities that exist in its particular businesses. A parent that is well-suited to address certain opportunities may be ill-suited to address others. For example, a parent whose systems and staff are well-suited to squeezing cash out of mature businesses and to resisting unprofitable growth strategies that will destabilize the market will not be well-suited to facilitating complex linkages across emergent high-growth applications of new technology. The parent’s skills are not good or bad in any absolute sense; their value depends on the nature and needs of their businesses. If these elements fit well together, value will be created.

Corporate Strategy Framework

In developing corporate strategy, the first task is therefore to assess the current level of fit between the characteristics of the parent and its businesses (Exhibit 2). What is different and unusual about the parent? How do most senior managers think about their roles? What „mental maps“ do they have regarding business success, appropriate responses to problems, and the nature of unexploited opportunities in the businesses? What systems and processes link the parent with its businesses and how are they used in practice?

Understanding the characteristics of the businesses is equally important. In contrast to traditional portfolio matrix views, our focus is not on the businesses per se (such as whether they are in growth areas or have advantaged positions), but on the influence, positive and negative, that a parent is likely to have on them.

All businesses will have some improvement opportunities, but which of these opportunities could be realized only with the help of a parent? What is the underlying reason why business-level managers need help in addressing a particular opportunity? What is the nature of the help they need?

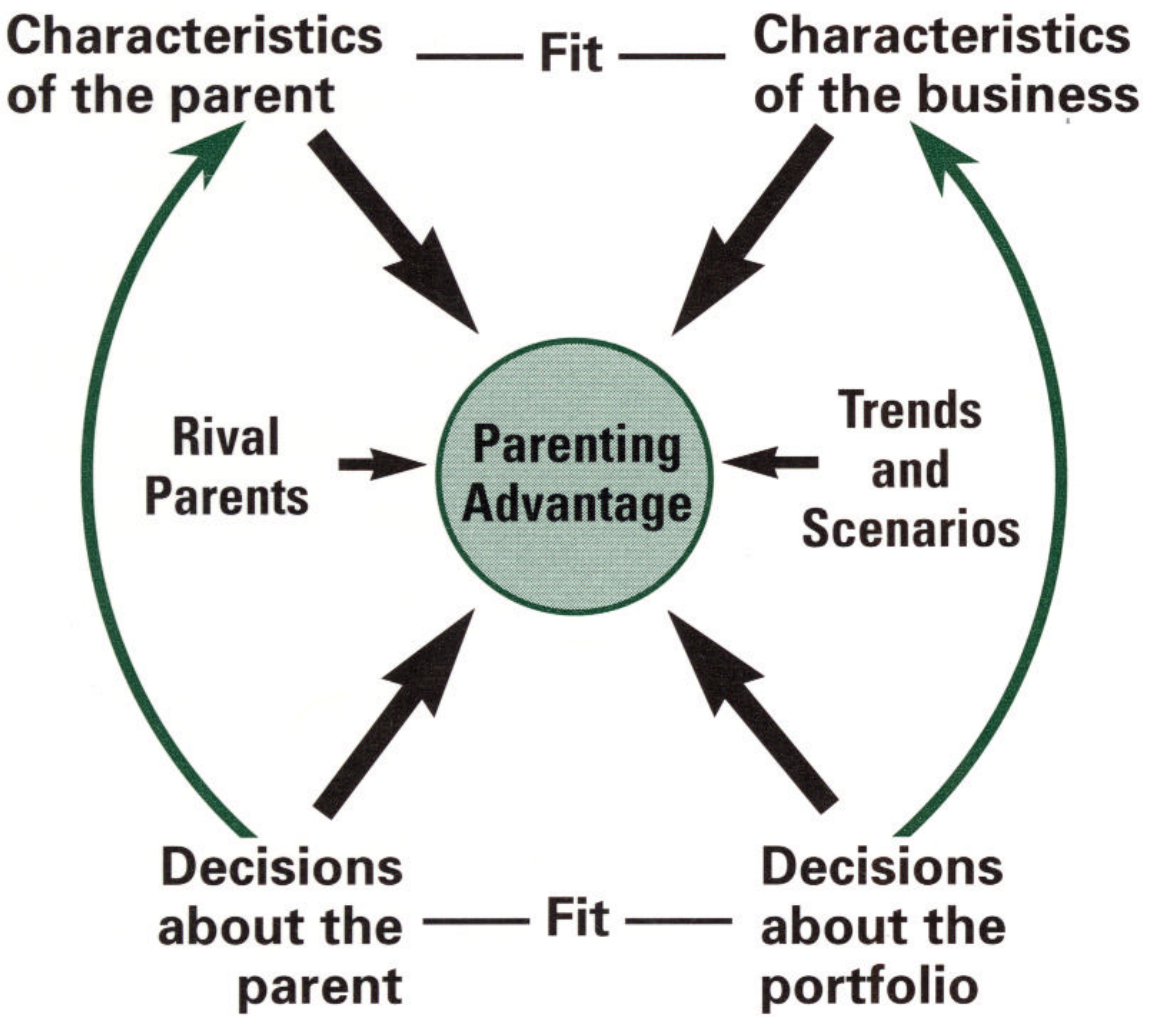
Successful parents have clear insights regarding these questions, but there is no magic formula. Different parents have different insights: the chosen role of the parent at Canon is completely different from that of Hanson or Unilever. However, successful parents all seem to focus on a small and internally consistent set of insights that enable them to become specialists. This contrasts significantly with less successful parents, which are less focused and less clear about their own roles. While they attempt to add some value through budget reviews, an „informed second opinion,“ or the pursuit of general synergies, in reality their intervention is often unhelpful or distracting. Without specific insights about how it can add value, the parent is likely to destroy it.

But simply having insights is not enough. The fit must extend from intention to behavior. BTR, a widely diversified international group, provides an example. While many companies may share BTR’s insights about improving attention to productivity and product profitability in mid-tech, stable businesses, few have the relevant parenting characteristics to deliver against these aspirations. BTR itself has developed skills and tools that make

it unusually capable in this particular role. Its profit-planning system, ratio packages, and review process have been fine-tuned over many years. Of equal importance is its cadre of battle-hardened group chief executives – a resource that is hard for others to replicate. The company's culture is noted on the boardroom clock: „Think of rest and work on."

Exhibit 2

Corporate Strategy Framework



In contrast, on the negative side, it is important to consider what aspects of the business may be most severely damaged by inappropriate parenting. For example, the complex risks and cyclical nature of RTZ's minerals and metals businesses would lead most parents to curtail valuable investment opportunities. Only a special type of parent, such as RTZ, has much chance of avoiding negative influence. Similarly, BTR's powerful characteristics, if applied to businesses in oil exploration or pharmaceutical research, would be as damaging as they are helpful to the current portfolio. Specific frameworks and tools can help define the relevant characteristics of the businesses and assess their fit with particular parenting behavior.

Parenting Advantage

Avoiding misfits and achieving a reasonable degree of positive fit are necessary requirements for a sound corporate-level strategy. But the aspirations of corporate management should be higher. Just as business-level managers should not be content simply to make a profit, corporate-level managers should strive for more than the creation of some net value. The appropriate target, the goal for corporate-level strategy, should recognize the existence of competitors at the parent level, just as the concept of competitive advantage recognizes competitors at the business-unit level.

Parents should strive to be the best possible owners of their businesses – to create more value out of their portfolio than would be achieved by any rival. We call this aspiration the quest for „parenting advantage.“ If another parent would create more value with the businesses in the company, then in theory, at least, the stakeholders of all parties would be better served by a change of ownership. In practice, incumbent management teams may be sheltered, at least for a period of time, and other considerations, such as taxes and transaction costs, may create genuine blocks. But, just like competitive advantage at the business level, the basic concept of parenting advantage is a powerful prompt and provides a central focus for corporate-level strategy.

In assessing the fit between a parent's characteristics and those of its businesses, judgment should be relative as well as absolute. In absolute terms, the parent must create net value, just as a business must exceed its long-run cost of capital. In relative terms, the parent must compare itself with rivals, just as a business must compare itself with competitors. In addition to assessing its own fit with its businesses, the parent should therefore also consider the potential fit of rival parents. What opportunities would they target and realize in the businesses? Would they maintain ownership of the whole portfolio or sell off parts to other parents who could create even greater value with a particular unit? What damaging influences would they have on the businesses? It is only in the context of its competitors that the current parent can be fully judged.

The assessment of absolute fit between a parent and its businesses, and of relative fit in comparison to rivals, provides the basis for an audit of current parenting advantage. But strategy is forward looking and dynamic. A viable framework for corporate-level strategy must therefore include an input that recognizes that the world is not static. This final input involves an assessment of trends and scenarios that will affect rival parents, the existing portfolio, and businesses currently outside the portfolio that might benefit from this particular parent's approach.

Implementing Strategy

A corporate strategy can then be developed that will guide the two outputs: decisions about the portfolio – what should be added, split off, or sold – and decisions about the parent, how it should be designed and how it should relate to its businesses.

Once the corporate-level strategy has been clarified in this way, it is possible to address issues of diversification and relatedness from a different perspective. The businesses can be arrayed on a portfolio matrix that focuses on their relationship with the parent and the influence that the latter will have in creating, or destroying, additional value (Exhibit 3).

„Heartland“ businesses have improvement opportunities that the parent is well-suited to exploit. Furthermore, they are sufficiently well-understood that the parent does not inadvertently destroy value through other areas of misfit or unsuitable influence. Heartland businesses, as their name implies, should be at the heart of the corporate strategy and of acquisition activity. It is these businesses that will benefit most from inclusion in the group, and the parent should focus its attention on them.

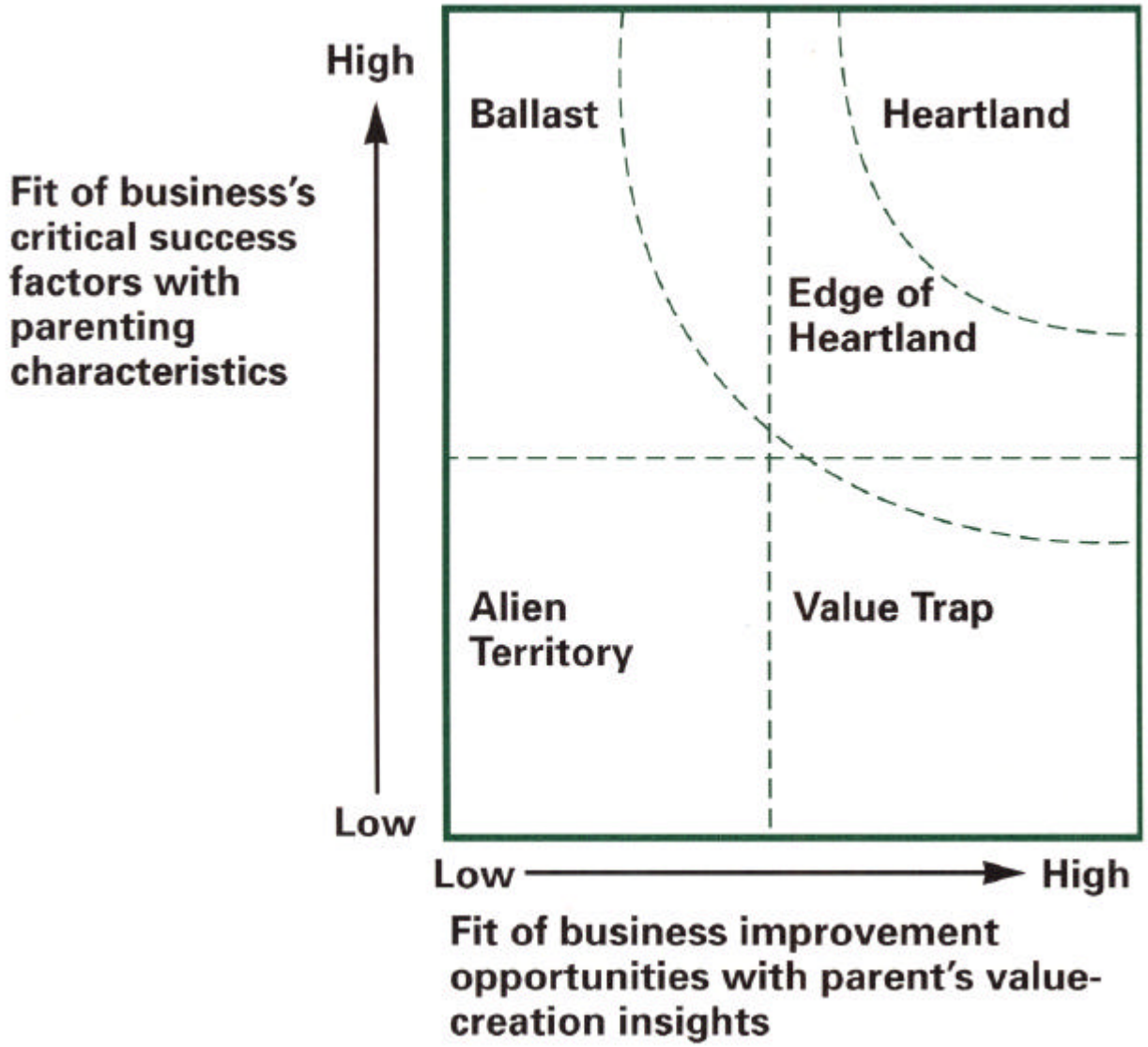
Some businesses appear to be fairly close to this category but have certain characteristics that may cause friction. We call these „edge-of-heartland“ businesses. For example, when Cooper Industries acquired Champion, the sparkplug company, it judged Champion to have many of the characteristics of its traditional heartland and to offer many of the same improvement opportunities. But Champion also involved some ceramics technology that was unfamiliar ground for Cooper, and it had a much more international spread than Cooper's previous acquisitions. It was therefore outside the heartland proper. Parents must work actively to learn about edge-of-heartland businesses and try to bring them into the heartland as soon as possible.

At the opposite extreme, „alien territory“ businesses are not well understood by the parent, have few improvement opportunities that the parent can address, and are likely to be damaged by some misfit with the parent's characteristics. For example, the parent may apply a complex planning process or sophisticated linkage mechanism to a business that is largely independent and too small to bear the overhead burden or to suffer the opportunity cost of losing its managers to head office meetings. Alien territory businesses should clearly be candidates for rapid divestment. Even if they are currently profitable, the influence of the parent will reduce their value over time.

More problematic are „ballast“ businesses, well understood by the parent and not likely to suffer damage from misfit, but where the parent has little insight or ability to add significant value. Many so-called „core businesses“ fall into this category. They may be large, profitable, and historical parts of the portfolio, but the parent has run out of ideas about how to make them perform much better than they would by themselves. Having some ballast is often attractive; it provides stability and weight. But it also slows down the parent's efforts to create additional value. Every hour spent on ballast businesses is an hour less for moving the heartland forward. Typically, managers are deeply resistant to exiting or floating off such businesses until there is clear evidence that they are drifting down into alien territory.

Exhibit 3

Ashridge „Fit“ Matrix



Most difficult of all are „value traps.“ The parent has an insight about how they can be improved, but also has elements of misfit that will lead to value destruction. American Express Company's relationship with its Shearson subsidiary may well have fallen into this category. Unless a parent can find ways to align its own characteristics more clearly with those of its value trap businesses, it is best to divest them. If it does seek to align itself, it must be careful not to dilute the very characteristics that create value in its heartland.

A New Basis for Corporate Strategy

The clear guiding principle of corporate strategy should be to achieve parenting advantage: to create more value in the portfolio of businesses than would be achieved by any rival. This requires detailed alignment and tight fit. To bring this principle to the heart of corporate-level strategy calls for far-reaching changes in the focus and nature of most corporate planning processes. Such changes are required if the value of multibusiness companies is to become positive more often than negative.

Marcus Alexander, Andrew Campbell, and Michael Goold are Directors and Fellows of the Ashridge Strategic Management Centre, a research unit based in London, and are joint authors of the book Corporate-Level Strategy: Creating Value in the Multibusiness Company *(John Wiley, 1994).*