From competitive advantage to corporate strategy

Michael E. Porter

Corporate strategy, the overall plan for a diversified company, is both the darling and the stepchild of contemporary management practice – the darling because CEOs have been obsessed with diversification since the early 1960s, the stepchild because almost no consensus exists about what corporate strategy is, much less about how a company should formulate it.

The track record of corporate strategies has been dismal.

A diversified company has two levels of strategy: business unit (or competitive) strategy and corporate (or companywide) strategy. Competitive strategy concerns how to create competitive advantage in each of the businesses in which a company competes. Corporate strategy concerns two different questions: what businesses the corporation should be in and how the corporate office should manage the array of business units.

Corporate strategy is what makes the corporate whole add up to more than the sum of its business unit parts.

The track record of corporate strategies has been dismal. I studied the diversification records of 33 large, prestigious U.S. companies over the 1950-1986 period and found that most of them had divested many more acquisitions than they had kept. The corporate strategies of most companies have dissipated instead of created shareholder value.

The need to rethink corporate strategy could hardly be more urgent. By taking over companies and breaking them up, corporate raiders thrive on failed corporate strategy. Fueled by junk bond financing and growing acceptability, raiders can expose any company to takeover, no matter how large or blue chip.

Recognizing past diversification mistakes, some companies have initiated large-scale restructuring programs. Others have done nothing at all. Whatever the response, the strategic questions persist. Those who have restructured must decide what to do next to avoid repeating the past; those who have done nothing must awake to their vulnerability. To survive, companies must understand what good corporate strategy is.

A sober picture

While there is disquiet about the success of corporate strategies, none of the available evidence satisfactorily indicates the success or failure of corporate strategy. Most studies have approached the question by measuring the stock market valuation of

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Exhibit I **Diversification profiles of 33 leading U.S. companies**

Company	Number total entries	All entries into new industries	Percent acquisitions	Percent joint ventures	Percent start-ups
ALCO Standard	221	185	99 %	0 %	1 %
Allied Corp.	77	49	67	10	22
Beatrice	382	204	97	1	2
Borden	170	96	77	4	19
CBS	148	81	67	16	17
Continental Group	75	47	77	6	17
Cummins Engine	30	24	54	17	29
Du Pont	60	39	33	16	51
Exxon	79	56	54	5	61
General Electric	160	108	47	20	33
General Foods	92	53	91	4	6
General Mills	110	102	84	7	9
W.R.Grace	275	202	83	7	10
Gulf & Western	178	140	91	4	6
IBM	46	38	18	19	63
IC Industries	67	41	85	3	12
ITT	246	179	89	2	9
Johnson & Johnson	88	77	77	0	23
Mobil	41	32	53	16	31
Procter & Gamble	28	23	61	0	39
Raytheon	70	58	86	9	5
RCA	53	46	35	15	50
Rockwell	101	75	73	24	3
Sara Lee	197	141	96	1	4
Scovill	52	36	97	0	3
Signal	53	45	67	4	29
Tenneco	85	82	81	6	13
3M	144	125	54	2	45
TRW	119	82	77	10	13
United Technologies	62	49	57	18	24
Westinghouse	129	73	63	11	26
Wickes	71	47	83	0	17
Xerox	69	50	66	6	28
Total	**3,788**	**2,644**			
Average	**114.8**	**80.1**	**70.3 %**	**7.9 %**	**21.8 %**

Note:
Beatrice, Continental Group, General Foods, RCA, Scovill, and Signal were taken over as the study was being completed. Their data cover the period up through takeover but not subsequent divestments.

Entries into new industries that represented entirely new fields	Percent acquisitions	Percent joint ventures	Percent start-ups
58	100%	0%	0%
17	65	6	29
61	97	0	3
32	75	3	22
28	65	21	14
19	79	11	11
13	46	23	31
19	37	0	63
17	29	6	65
29	48	14	38
22	86	5	9
27	74	7	19
68	74	5	21
46	88	2	10
16	19	0	81
17	88	6	6
50	92	0	8
18	56	0	44
15	60	7	33
14	79	0	21
16	81	19	6
19	37	21	42
27	74	22	4
41	96	2	2
12	92	0	8
20	75	0	25
26	73	8	19
34	71	3	56
29	64	11	25
17	23	17	39
36	61	3	36
22	68	0	32
18	50	11	39
906			
27.4	67.8%	7.0%	25.9%

mergers, captured in the movement of the stock prices of acquiring companies immediately before and after mergers are announced.

These studies show that the market values mergers as neutral or slightly negative, hardly cause for serious concern.[1] Yet the short-term market reaction is a highly imperfect measure of the long-term success of diversification, and no self-respecting executive would judge a corporate strategy this way.

Studying the diversification programs of a company over a long period of time is a much more telling way to determine whether a corporate strategy has succeeded or failed. My study of 33 companies, many of which have reputations for good management, is a unique look at the track record of major corporations. (For an explanation of the research, see the insert "Where the Data Come From.") Each company entered an average of 80 new industries and 27 new fields. Just over 70% of the new entries were acquisitions, 22% were start-ups, and 8% were joint ventures. IBM, Exxon, Du Pont, and 3M, for example, focused on start-ups, while ALCO Standard, Beatrice, and Sara Lee diversified almost solely through acquisitions (*Exhibit I* has a complete rundown).

My data paint a sobering picture of the success ratio of these moves (see *Exhibit II*). I found that on average corporations divested more than half their acquisitions in new industries and more than 60% of their acquisitions in entirely new fields. Fourteen companies left more than 70% of all the acquisitions they had made in new fields. The track record in unrelated acquisitions is even worse—the average divestment rate is a startling 74% (see *Exhibit III*). Even a highly respected company like General Electric divested a very high percentage of its acquisitions, particularly those in new fields. Companies near the top of the list in *Exhibit II* achieved a remarkably low rate of divestment. Some bear witness to the success of well-thought-out corporate strategies. Others, however, enjoy a lower rate simply because they have not faced up to their problem units and divested them.

I calculated total shareholder returns (stock price appreciation plus dividends) over the period of the study for each company so that I could compare them with its divestment rate. While companies near the top of the list have above-average shareholder returns, returns are not a reliable measure of diversification success. Shareholder return often depends heavily on the inherent attractiveness of companies' base industries. Companies like CBS and General Mills had extremely profitable base businesses that subsidized poor diversification track records.

I would like to make one comment on the use of shareholder value to judge performance. Linking shareholder value quantitatively to diversification performance only works if you compare the

shareholder value that is with the shareholder value that might have been without diversification. Because such a comparison is virtually impossible to make, my own measure of diversification success – the number of units retained by the company – seems to be as good an indicator as any of the contribution of diversification to corporate performance.

My data give a stark indication of the failure of corporate strategies.[2] Of the 33 companies, 6 had been taken over as my study was being completed (see the note on *Exhibit II*). Only the lawyers, investment bankers, and original sellers have prospered in most of these acquisitions, not the shareholders.

Premises of corporate strategy

Any successful corporate strategy builds on a number of premises. These are facts of life about diversification. They cannot be altered, and when ignored, they explain in part why so many corporate strategies fail.

Competition occurs at the business unit level. Diversified companies do not compete; only their business units do. Unless a corporate strategy places primary attention on nurturing the success of each unit, the strategy will fail, no matter how elegantly constructed. Successful corporate strategy must grow out of and reinforce competitive strategy.

Diversification inevitably adds costs and constraints to business units. Obvious costs such as the corporate overhead allocated to a unit may not be as important or subtle as the hidden costs and constraints. A business unit must explain its decisions to top management, spend time complying with planning and other corporate systems, live with parent company guidelines and personnel policies, and forgo the opportunity to motivate employees with direct equity ownership. These costs and constraints can be reduced but not entirely eliminated.

Shareholders can readily diversify themselves. Shareholders can diversify their own portfolios of stocks by selecting those that best match their preferences and risk profiles.[3] Shareholders can often diversify more cheaply than a corporation because they can buy shares at the market price and avoid hefty acquisition premiums.

These premises mean that corporate strategy cannot succeed unless it truly adds value – to business units by providing tangible benefits that offset the inherent costs of lost independence and to shareholders by diversifying in a way they could not replicate.

Passing the essential tests

To understand how to formulate corporate strategy, it is necessary to specify the conditions under which diversification will truly create shareholder value. These conditions can be summarized in three essential tests:

1 **The attractiveness test.** The industries chosen for diversification must be structurally attractive or capable of being made attractive.

2 **The cost-of-entry test.** The cost of entry must not capitalize all the future profits.

3 **The better-off test.** Either the new unit must gain competitive advantage from its link with the corporation or vice versa.

Of course, most companies will make certain that their proposed strategies pass some of these tests. But my study clearly shows that when companies ignored one or two of them, the strategic results were disastrous.

How attractive is the industry?

In the long run, the rate of return available from competing in an industry is a function of its underlying structure, which I have described in another HBR article.[4] An attractive industry with a high average return on investment will be difficult to enter because entry barriers are high, suppliers and buyers have only modest bargaining power, substitute products or services are few, and the rivalry among competitors is stable. An unattractive industry like steel will have structural flaws, including a plethora of substitute materials, powerful and price-sensitive buyers, and excessive rivalry caused by high fixed costs and a large group of competitors, many of whom are state supported.

Diversification cannot create shareholder value unless new industries have favorable structures that support returns exceeding the cost of capital. If the industry doesn't have such returns, the company must be able to restructure the industry or gain a sustainable competitive advantage that leads to returns well above the industry average. An industry need not be attractive before diversification. In fact, a

Where the data come from

We studied the 1950-1986 diversification histories of 33 large diversified U.S. companies. They were chosen at random from many broad sectors of the economy.

To eliminate distortions caused by World War II, we chose 1950 as the base year and then identified each business the company was in. We tracked every acquisition, joint venture, and start-up made over this period—3,788 in all. We classified each as an entry into an entirely new sector or field (financial services, for example), a new industry within a field the company was already in (insurance, for example), or a geographic extension of an existing product or service. We also classified each new field as related or unrelated to existing units. Then we tracked whether and when each entry was divested or shut down and the number of years each remained part of the corporation.

Our sources included annual reports, 10K forms, the F&S Index, and Moody's, supplemented by our judgment and general knowledge of the industries involved. In a few cases, we asked the companies specific questions.

It is difficult to determine the success of an entry without knowing the full purchase or start-up price, the profit history, the amount and timing of ongoing investments made in the unit, whether any write-offs or write-downs were taken, and the selling price and terms of sale. Instead, we employed a relatively simple way to gauge success: *whether the entry was divested or shut down.* The underlying assumption is that a company will generally not divest or close down a successful business except in a comparatively few special cases. Companies divested many of the entries in our sample within five years, a reflection of disappointment with performance. Of the comparatively few divestments where the company disclosed a loss or a gain, the divestment resulted in a reported loss in more than half the cases.

The data in *Exhibit I* cover the entire 1950-1986 period. However, the divestment ratios in *Exhibit II* and *Exhibit III* do not compare entries and divestments over the entire period because doing so would overstate the success of diversification. Companies usually do not shut down or divest new entries immediately but hold them for some time to give them an opportunity to succeed. Our data show that the average holding period is five to slightly more than ten years, though many divestments occur within five years. To accurately gauge the success of diversification, we calculated the percentage of entries made by 1975 and by 1980 that were divested or closed down as of January 1987. If we had included more recent entries, we would have biased upward our assessment of how successful these entries had been.

As compiled, these data probably understate the rate of failure. Companies tend to announce acquisitions and other forms of new entry with a flourish but divestments and shutdowns with a whimper, if at all. We have done our best to root out every such transaction, but we have undoubtedly missed some. There may also be new entries that we did not uncover, but our best impression is that the number is not large.

company might benefit from entering before the industry shows its full potential. The diversification can then transform the industry's structure.

In my research, I often found companies had suspended the attractiveness test because they had a vague belief that the industry "fit" very closely with their own businesses. In the hope that the corporate "comfort" they felt would lead to a happy outcome, the companies ignored fundamentally poor industry structures. Unless the close fit allows substantial competitive advantage, however, such comfort will turn into pain when diversification results in poor returns. Royal Dutch Shell and other leading oil companies have had this unhappy experience in a number of chemicals businesses, where poor industry structures overcame the benefits of vertical integration and skills in process technology.

Another common reason for ignoring the attractiveness test is a low entry cost. Sometimes the buyer has an inside track or the owner is anxious to sell. Even if the price is actually low, however, a one-shot gain will not offset a perpetually poor business. Almost always, the company finds it must reinvest in the newly acquired unit, if only to replace fixed assets and fund working capital.

Diversifying companies are also prone to use rapid growth or other simple indicators as a proxy for a target industry's attractiveness. Many that rushed into fast-growing industries (personal computers, video games, and robotics, for example) were burned because they mistook early growth for long-term profit potential. Industries are profitable not because they are sexy or high tech; they are profitable only if their structures are attractive.

What is the cost of entry?

Diversification cannot build shareholder value if the cost of entry into a new business eats up its expected returns. Strong market forces,

Exhibit II **Acquisition track records of leading U.S. diversifiers ranked by percent divested**

Company	All acquisitions in new industries	Percent made by 1980 and then divested	Percent made by 1975 and then divested	Acquisitions in new industries that represented entirely new fields	Percent made by 1980 and then divested	Percent made by 1975 and then divested
Johnson & Johnson	59	17 %	12 %	10	33 %	14 %
Procter & Gamble	14	17	17	11	17	17
Raytheon	50	17	26	13	28	33
United Technologies	28	25	13	10	17	0
3M	67	26	27	24	42	45
TRW	63	27	31	18	40	38
IBM	7	33	0*	3	33	0*
Du Pont	13	38	43	7	60	75
Mobil	17	38	57	9	50	50
Borden	74	39	40	24	45	50
IC Industries	35	42	50	15	46	44
Tenneco	50	43	47	19	27	33
Beatrice	198	46	45	69	52	51
ITT	159	52	52	48	61	61
Rockwell	35	56	57	20	71	71
Allied Corp	34	57	45	11	40	80
Exxon	19	62	20*	5	80	50*
Sara Lee	145	62	65	39	80	76
General Foods	48	63	62	19	93	93
Scovill	35	64	77	11	64	70
Signal	30	65	63	15	70	67
ALCO Standard	164	65	70	56	72	76
W.R. Grace	167	65	70	49	71	70
General Electric	51	65	78	14	100	100
Wickes	38	67	72	15	73	70
Westinghouse	48	68	69	22	61	59
Xerox	33	71	79	9	100	100
Continental Group	36	71	72	15	60	60
General Mills	86	75	73	20	65	60
Gulf & Western	127	79	78	42	75	72
Cummins Engine	13	80	80	6	83	83
RCA	16	80	92	7	86	100
CBS	54	87	89	18	88	88
Total	**2,021**			**661**		
Average per company†	**61.2**	**53.4 %**	**56.5 %**	**20.0**	**60.0 %**	**61.5 %**

*Companies with three or fewer acquisitions by the cutoff year.

†Companies with three or fewer acquisitions by the cutoff year are excluded from the average to minimize statistical distortions.

Note: Beatrice, Continental Group, General Foods, RCA, Scovill, and Signal were taken over as the study was being completed. Their data cover the period up through takeover but not subsequent divestments.

however, are working to do just that. A company can enter new industries by acquisition or start-up. Acquisitions expose it to an increasingly efficient merger market. An acquirer beats the market if it pays a price not fully reflecting the prospects of the new unit. Yet multiple bidders are commonplace, information flows rapidly, and investment bankers and other intermediaries work aggressively to make the market as efficient as possible. In recent years, new financial instruments such as junk bonds have brought new buyers into the market and made even large companies vulnerable to takeover. Acquisition premiums are high and reflect the acquired company's future prospects – sometimes too well. Philip Morris paid more than four times book value for Seven-Up Company, for example. Simple arithmetic meant that profits had to more than quadruple to sustain the preacquisition ROI. Since there proved to be little Philip Morris could add in marketing prowess to the sophisticated marketing wars in the soft-drink industry, the result was the unsatisfactory financial performance of Seven-Up and ultimately the decision to divest.

In a start-up, the company must overcome entry barriers. It's a real catch-22 situation, however, since attractive industries are attractive because their entry barriers are high. Bearing the full cost of the entry barriers might well dissipate any potential profits. Otherwise, other entrants to the industry would have already eroded its profitability.

In the excitement of finding an appealing new business, companies sometimes forget to apply the cost-of-entry test. The more attractive a new industry, the more expensive it is to get into.

Will the business be better off?

A corporation must bring some significant competitive advantage to the new unit, or the new unit must offer potential for significant advantage to the corporation. Sometimes, the benefits to the new unit accrue only once, near the time of entry, when the parent instigates a major overhaul of its strategy or installs a first-rate management team. Other diversification yields ongoing competitive advantage if the new unit can market its product, through the well-developed distribution system of its sister units, for instance. This is one of the important underpinnings of the merger of Baxter Travenol and American Hospital Supply.

When the benefit to the new unit comes only once, the parent company has no rationale for holding the new unit in its portfolio over the long term. Once the results of the one-time improvement are clear, the diversified company no longer adds value to offset the inevitable costs imposed on the unit. It is best to sell the unit and free up corporate resources.

The better-off test does not imply that diversifying corporate risk creates shareholder value in and of itself. Doing something for shareholders that they can do themselves is not a basis for corporate strategy. (Only in the case of a privately held company, in which the company's and the shareholder's risk are the same, is diversification to reduce risk valuable for its own sake.) Diversification of risk should only be a by-product of corporate strategy, not a prime motivator.

Executives ignore the better-off test most of all or deal with it through arm waving or trumped-up logic rather than hard strategic analysis. One reason is that they confuse company size with shareholder value. In the drive to run a bigger company, they lose sight of their real job. They may justify the suspension of the better-off test by pointing to the way they manage diversity. By cutting corporate staff to the bone and giving business units nearly complete autonomy, they believe they avoid the pitfalls. Such thinking misses the whole point of diversification, which is to create shareholder value rather than to avoid destroying it.

Concepts of corporate strategy

The three tests for successful diversification set the standards that any corporate strategy must meet; meeting them is so difficult that most diversification fails. Many companies lack a clear concept of corporate strategy to guide their diversification or pursue a concept that does not address the tests. Others fail because they implement a strategy poorly.

My study has helped me identify four concepts of corporate strategy that have been put into practice – portfolio management, restructuring, transferring skills, and sharing activities. While the concepts are not always mutually exclusive, each rests on a different mechanism by which the corporation creates shareholder value and each requires the diversified company to manage and organize itself in a different way. The first two require no connections among business units; the second two depend on them. (See *Exhibit IV*.) While all four concepts of strategy have succeeded under the right circumstances, today some make more sense than others. Ignoring any of the concepts is perhaps the quickest road to failure.

Portfolio management

The concept of corporate strategy most in use is portfolio management, which is based primar-

Exhibit III **Diversification performance in joint ventures, start-ups, and unrelated acquisitions**
Companies in same order as in Exhibit II

Company	Joint ventures as a percent of new entries	Percent made by 1980 and then divested	Percent made by 1975 and then divested	Start-ups as a percent of new entries	Percent made by 1980 and then divested
Johnson & Johnson	0 %	†	†	23 %	14 %
Procter & Gamble	0	†	†	39	0
Raytheon	5	50 %	50 %	5	50
United Technologies	18	50	50	24	11
3M	2	100*	100*	45	2
TRW	10	20	25	13	83
IBM	16	100*	†	63	20
Du Pont	15	100*	†	51	61
Mobil	16	33	33	31	50
Borden	4	33	33	19	17
IC Industries	3	100*	100*	13	80
Tenneco	6	67	67	13	67
Beatrice	1	†	†	2	0
ITT	2	0*	†	6	38
Rockwell	34	38	42	3	0
Allied Corp.	10	100	75	22	38
Exxon	5	0	0	61	27
Sara Lee	1	†	†	4	75
General Foods	4	†	†	6	67
Scovill	0	†	†	3	100
Signal	4	†	†	29	20
ALCO Standard	0	†	†	1	†
W.R. Grace	7	33	38	10	71
General Electric	20	20	33	33	33
Wickes	0	†	†	17	83
Westinghouse	11	0*	0*	26	44
Xerox	5	100*	100*	29	50
Continental Group	8	67	67	17	14
General Mills	7	71	71	9	89
Gulf & Western	4	75	50	6	100
Cummins Engine	17	50	50	29	0
RCA	18	67	67	50	99
CBS	16	71	71	17	86
Average per company‡	**7.9 %**	**50.3 %**	**46.9 %**	**21.5 %**	**44.0 %**

*Companies with two or fewer entries.

†No entries in this category.

‡Average excludes companies with two or fewer entries to minimize statistical distortions.

Note:
Beatrice, Continental Group, General Foods, RCA, Scovill, and Signal were taken over as the study was being completed. Their data cover the period up through takeover but not subsequent divestments.

Percent made by 1975 and then divested	Unrelated acquisitions as a percent of total acquisitions	Percent made by 1980 and then divested	Percent made by 1975 and then divested
20 %	0 %	1	1
0	0	1	1
50	46	40 %	40 %
20	40	0*	0*
3	33	75	86
71	38	71	71
22	33	100*	100*
61	43	0*	0*
56	67	60	100
13	21	60	60
30	33	50	50
60	42	33	40
0	63	53	53
57	61	67	64
0	35	100	100
29	45	50	0
19	100	60	50*
100*	41	73	73
50	42	86	83
100*	45	80	100
11	67	50	50
1	63	79	81
71	39	65	66
44	36	100	100
57	60	50	75
44	36	57	67
56	22	100	100
0	40	63	100
80	66	77	67
100	74	77	74
0	67	100	100
56	36	100	100
60	39	100	100
40.9 %	46.1 %	74.0 %	74.4 %

ily on diversification through acquisition. The corporation acquires sound, attractive companies with competent managers who agree to stay on. While acquired units do not have to be in the same industries as existing units, the best portfolio managers generally limit their range of businesses in some way, in part to limit the specific expertise needed by top management.

The acquired units are autonomous, and the teams that run them are compensated according to unit results. The corporation supplies capital and works with each to infuse it with professional management techniques. At the same time, top management provides objective and dispassionate review of business unit results. Portfolio managers categorize units by potential and regularly transfer resources from units that generate cash to those with high potential and cash needs.

In a portfolio strategy, the corporation seeks to create shareholder value in a number of ways. It uses its expertise and analytical resources to spot attractive acquisition candidates that the individual shareholder could not. The company provides capital on favorable terms that reflect corporatewide fundraising ability. It introduces professional management skills and discipline. Finally, it provides high-quality review and coaching, unencumbered by conventional wisdom or emotional attachments to the business.

The logic of the portfolio management concept rests on a number of vital assumptions. If a company's diversification plan is to meet the attractiveness and cost-of-entry tests, it must find good but undervalued companies. Acquired companies must be truly undervalued because the parent does little for the new unit once it is acquired. To meet the better-off test, the benefits the corporation provides must yield a significant competitive advantage to acquired units. The style of operating through highly autonomous business units must both develop sound business strategies and motivate managers.

In most countries, the days when portfolio management was a valid concept of corporate strategy are past. In the face of increasingly well-developed capital markets, attractive companies with good managements show up on everyone's computer screen and attract top dollar in terms of acquisition premium. Simply contributing capital isn't contributing much. A sound strategy can easily be funded; small to medium-size companies don't need a munificent parent.

Other benefits have also eroded. Large companies no longer corner the market for professional management skills; in fact, more and more observers believe managers cannot necessarily run anything in the absence of industry-specific knowledge and experience. Another supposed advantage of the portfolio management concept—dispassionate review—rests on similarly shaky ground since the added value of review alone is questionable in a portfolio of sound companies.

The benefit of giving business units complete autonomy is also questionable. Increasingly, a company's business units are interrelated, drawn together by new technology, broadening distribution channels, and changing regulations. Setting strategies of units independently may well undermine unit performance. The companies in my sample that have succeeded in diversification have recognized the value of interrelationships and understood that a strong sense of corporate identity is as important as slavish adherence to parochial business unit financial results.

But it is the sheer complexity of the management task that has ultimately defeated even the best portfolio managers. As the size of the company grows, portfolio managers need to find more and more deals just to maintain growth. Supervising dozens or even hundreds of disparate units and under chain-letter pressures to add more, management begins to make mistakes. At the same time, the inevitable costs of being part of a diversified company take their toll and unit performance slides while the whole company's ROI turns downward. Eventually, a new management team is installed that initiates wholesale divestments and pares down the company to its core businesses. The experiences of Gulf & Western, Consolidated Foods (now Sara Lee), and ITT are just a few comparatively recent examples. Reflecting these realities, the U.S. capital markets today reward companies that follow the portfolio management model with a "conglomerate discount"; they value the whole less than the sum of the parts.

In developing countries, where large companies are few, capital markets are undeveloped, and professional management is scarce, portfolio management still works. But it is no longer a valid model for corporate strategy in advanced economies. Nevertheless, the technique is in the limelight today in the United Kingdom, where it is supported so far by a newly energized stock market eager for excitement. But this enthusiasm will wane – as well it should. Portfolio management is no way to conduct corporate strategy.

Restructuring

Unlike its passive role as a portfolio manager, when it serves as banker and reviewer, a company that bases its strategy on restructuring becomes an active restructurer of business units. The new businesses are not necessarily related to existing units. All that is necessary is unrealized potential.

The restructuring strategy seeks out undeveloped, sick, or threatened organizations or industries on the threshold of significant change. The parent intervenes, frequently changing the unit management team, shifting strategy, or infusing the company with new technology. Then it may make follow-up acquisitions to build a critical mass and sell off unneeded or unconnected parts and thereby reduce the effective acquisition cost. The result is a strengthened company or a transformed industry. As a coda, the parent sells off the stronger unit once results are clear because the parent is no longer adding value and top management decides that its attention should be directed elsewhere. (See the insert "An Uncanny British Restructurer" for an example of restructuring.)

A strong sense of corporate identity is as important as slavish adherence to business unit financial results.

When well implemented, the restructuring concept is sound, for it passes the three tests of successful diversification. The restructurer meets the cost-of-entry test through the types of company it acquires. It limits acquisition premiums by buying companies with problems and lackluster images or by buying into industries with as yet unforeseen potential. Intervention by the corporation clearly meets the better-off test. Provided that the target industries are structurally attractive, the restructuring model can create enormous shareholder value. Some restructuring companies are Loew's, BTR, and General Cinema. Ironically, many of today's restructurers are profiting from yesterday's portfolio management strategies.

To work, the restructuring strategy requires a corporate management team with the insight to spot undervalued companies or positions in industries ripe for transformation. The same insight is necessary to actually turn the units around even though they are in new and unfamiliar businesses.

These requirements expose the restructurer to considerable risk and usually limit the time in which the company can succeed at the strategy. The most skillful proponents understand this problem, recognize their mistakes, and move decisively to dispose of them. The best companies realize they are not just acquiring companies but restructuring an industry. Unless they can integrate the acquisitions to create a whole new strategic position, they are just portfolio managers in disguise. Another important difficulty surfaces if so many other companies join the action that they deplete the pool of suitable candidates and bid their prices up.

Perhaps the greatest pitfall, however, is that companies find it very hard to dispose of business units once they are restructured and performing well.

Exhibit IV Concepts of corporate strategy

	Portfolio management	Restructuring	Transferring skills	Sharing activities
Strategic prerequisites	Superior insight into identifying and acquiring undervalued companies Willingness to sell off losers quickly or to opportunistically divest good performers when buyers are willing to pay large premiums Broad guidelines for and constraints on the types of units in the portfolio so that senior management can play the review role effectively A private company or undeveloped capital markets Ability to shift away from portfolio management as the capital markets get more efficient or the company gets unwieldy	Superior insight into identifying restructuring opportunities Willingness and capability to intervene to transform acquired units Broad similarities among the units in the portfolio Willingness to cut losses by selling off units where restructuring proves unfeasible Willingness to sell units when restructuring is complete, the results are clear, and market conditions are favorable	Proprietary skills in activities important to competitive advantage in target industries Ability to accomplish the transfer of skills among units on an ongoing basis Acquisitions of beachhead positions in new industries as a base	Activities in existing units that can be shared with new business units to gain competitive advantage Benefits of sharing that outweigh the costs Both start-ups and acquisitions as entry vehicles Ability to overcome organizational resistance to business unit collaboration
Organizational prerequisites	Autonomous business units A very small, low-cost, corporate staff Incentives based largely on business unit results	Autonomous business units A corporate organization with the talent and resources to oversee the turnarounds and strategic repositionings of acquired units Incentives based largely on acquired units' results	Largely autonomous but collaborative business units High-level corporate staff members who see their role primarily as integrators Cross-business-unit committees, task forces, and other forums to serve as focal points for capturing and transferring skills Objectives of line managers that include skills transfer Incentives based in part on corporate results	Strategic business units that are encouraged to share activities An active strategic planning role at group, sector, and corporate levels High-level corporate staff members who see their roles primarily as integrators Incentives based heavily on group and corporate results
Common pitfalls	Pursuing portfolio management in countries with efficient capital marketing and a developed pool of professional management talent Ignoring the fact that industry structure is not attractive	Mistaking rapid growth or a "hot" industry as sufficient evidence of a restructuring opportunity Lacking the resolve or resources to take on troubled situations and to intervene in management Ignoring the fact that industry structure is not attractive Paying lip service to restructuring but actually practicing passive portfolio management	Mistaking similarity or comfort with new businesses as sufficient basis for diversification Providing no practical ways for skills transfer to occur Ignoring the fact that industry structure is not attractive	Sharing for its own sake rather than because it leads to competitive advantage Assuming sharing will occur naturally without senior management playing an active role Ignoring the fact that industry structure is not attractive

Human nature fights economic rationale. Size supplants shareholder value as the corporate goal. The company does not sell a unit even though the company no longer adds value to the unit. While the transformed units would be better off in another company that had related businesses, the restructuring company instead retains them. Gradually, it becomes a portfolio manager. The parent company's ROI declines as the need for reinvestment in the units and normal business risks eventually offset restructuring's one-shot gain. The perceived need to keep growing intensifies the pace of acquisition; errors result and standards fall. The restructuring company turns into a conglomerate with returns that only equal the average of all industries at best.

Transferring skills

The purpose of the first two concepts of corporate strategy is to create value through a company's relationship with each autonomous unit. The corporation's role is to be a selector, a banker, and an intervenor.

The last two concepts exploit the interrelationships between businesses. In articulating them, however, one comes face-to-face with the often ill-defined concept of synergy. If you believe the text of the countless corporate annual reports, just about anything is related to just about anything else! But imagined synergy is much more common than real synergy. GM's purchase of Hughes Aircraft simply because cars were going electronic and Hughes was an electronics concern demonstrates the folly of paper synergy. Such corporate relatedness is an ex post facto rationalization of a diversification undertaken for other reasons.

Portfolio management is no way to conduct corporate strategy.

Even synergy that is clearly defined often fails to materialize. Instead of cooperating, business units often compete. A company that can define the synergies it is pursuing still faces significant organizational impediments in achieving them.

But the need to capture the benefits of relationships between businesses has never been more important. Technological and competitive developments already link many businesses and are creating new possibilities for competitive advantage. In such sectors as financial services, computing, office equipment, entertainment, and health care, interrelationships among previously distinct businesses are perhaps the central concern of strategy.

To understand the role of relatedness in corporate strategy, we must give new meaning to this often ill-defined idea. I have identified a good way to start – the value chain.[5] Every business unit is a collection of discrete activities ranging from sales to accounting that allow it to compete. I call them value activities. It is at this level, not in the company as a whole, that the unit achieves competitive advantage.

I group these activities in nine categories. *Primary* activities create the product or service, deliver and market it, and provide after-sale support. The categories of primary activities are inbound logistics, operations, outbound logistics, marketing and sales, and service. *Support* activities provide the input and infrastructure that allow the primary activities to take place. The categories are company infrastructure, human resource management, technology development, and procurement.

The value chain defines the two types of interrelationships that may create synergy. The first is a company's ability to transfer skills or expertise among similar value chains. The second is the ability to share activities. Two business units, for example, can share the same sales force or logistics network.

The value chain helps expose the last two (and most important) concepts of corporate strategy. The transfer of skills among business units in the diversified company is the basis for one concept. While each business unit has a separate value chain, knowledge about how to perform activities is transferred among the units. For example, a toiletries business unit, expert in the marketing of convenience products, transmits ideas on new positioning concepts, promotional techniques, and packaging possibilities to a newly acquired unit that sells cough syrup. Newly entered industries can benefit from the expertise of existing units and vice versa.

These opportunities arise when business units have similar buyers or channels, similar value activities like government relations or procurement, similarities in the broad configuration of the value chain (for example, managing a multisite service organization), or the same strategic concept (for example, low cost). Even though the units operate separately, such similarities allow the sharing of knowledge.

Of course, some similarities are common; one can imagine them at some level between almost any pair of businesses. Countless companies have fallen into the trap of diversifying too readily because of similarities; mere similarity is not enough.

Transferring skills leads to competitive advantage only if the similarities among businesses meet three conditions:

1 The activities involved in the businesses are similar enough that sharing expertise is meaningful. Broad similarities (marketing intensiveness, for example, or a common core process technology such as bending metal) are not a sufficient basis for diversification. The resulting ability to transfer skills is likely to have little impact on competitive advantage.

2 The transfer of skills involves activities important to competitive advantage. Transferring skills in peripheral activities such as government relations or real estate in consumer goods units may be beneficial but is not a basis for diversification.

3 The skills transferred represent a significant source of competitive advantage for the receiving unit. The expertise or skills to be transferred are both advanced and proprietary enough to be beyond the capabilities of competitors.

The transfer of skills is an active process that significantly changes the strategy or operations of the receiving unit. The prospect for change must be specific and identifiable. Almost guaranteeing that no shareholder value will be created, too many companies

An uncanny British restructurer

Hanson Trust, on its way to becoming Britain's largest company, is one of several skillful followers of the restructuring concept. A conglomerate with units in many industries, Hanson might seem on the surface a portfolio manager. In fact, Hanson and one or two other conglomerates have a much more effective corporate strategy. Hanson has acquired companies such as London Brick, Ever Ready Batteries, and SCM, which the city of London rather disdainfully calls "low tech."

Although a mature company suffering from low growth, the typical Hanson target is not just in any industry; it has an attractive structure. Its customer and supplier power is low and rivalry with competitors moderate. The target is a market leader, rich in assets but formerly poor in management. Hanson pays little of the present value of future cash flow out in an acquisition premium and reduces purchase price even further by aggressively selling off businesses that it cannot improve. In this way, it recoups just over a third of the cost of a typical acquisition during the first six months of ownership. Imperial Group's plush properties in London lasted barely two months under Hanson ownership, while Hanson's recent sale of Courage Breweries to Elders recouped £1.4 billion of the original £2.1 billion acquisition price of Imperial Group.

Like the best restructurers, Hanson approaches each unit with a modus operandi that it has perfected through repetition.

Hanson emphasizes low costs and tight financial controls. It has cut an average of 25% of labor costs out of acquired companies, slashed fixed overheads, and tightened capital expenditures. To reinforce its strategy of keeping costs low, Hanson carves out detailed one-year financial budgets with divisional managers and (through generous use of performance-related bonuses and share option schemes) gives them incentive to deliver the goods.

It's too early to tell whether Hanson will adhere to the last tenet of restructuring—selling turned-around units once the results are clear. If it succumbs to the allure of bigness, Hanson may take the course of the failed U.S. conglomerates.

are satisfied with vague prospects or faint hopes that skills will transfer. The transfer of skills does not happen by accident or by osmosis. The company will have to reassign critical personnel, even on a permanent basis, and the participation and support of high-level management in skills transfer is essential. Many companies have been defeated at skills transfer because they have not provided their business units with any incentives to participate.

Transferring skills meets the tests of diversification if the company truly mobilizes proprietary expertise across units. This makes certain the company can offset the acquisition premium or lower the cost of overcoming entry barriers.

The industries the company chooses for diversification must pass the attractiveness test. Even a close fit that reflects opportunities to transfer skills may not overcome poor industry structure. Opportunities to transfer skills, however, may help the company transform the structures of newly entered industries and send them in favorable directions.

The transfer of skills can be one-time or ongoing. If the company exhausts opportunities to infuse new expertise into a unit after the initial post-acquisition period, the unit should ultimately be sold. The corporation is no longer creating shareholder value. Few companies have grasped this point, however, and many gradually suffer mediocre returns. Yet a company diversified into well-chosen businesses can transfer skills eventually in many directions. If corporate management conceives of its role in this way and creates appropriate organizational mechanisms to facilitate cross-unit interchange, the opportunities to share expertise will be meaningful.

By using both acquisitions and internal development, companies can build a transfer-of-skills strategy. The presence of a strong base of skills sometimes creates the possibility for internal entry instead of the acquisition of a going concern. Successful diversifiers that employ the concept of skills transfer may, however, often acquire a company in the target industry as a beachhead and then build on it with their internal expertise. By doing so, they can reduce some of the risks of internal entry and speed up the process. Two companies that have diversified using the transfer-of-skills concept are 3M and Pepsico.

Sharing activities

The fourth concept of corporate strategy is based on sharing activities in the value chains among business units. Procter & Gamble, for example, employs a common physical distribution system and sales force in both paper towels and disposable diapers. McKesson, a leading distribution company, will handle such diverse lines as pharmaceuticals and liquor through superwarehouses.

The ability to share activities is a potent basis for corporate strategy because sharing often enhances competitive advantage by lowering cost or raising differentiation. But not all sharing leads to competitive advantage, and companies can encounter deep organizational resistance to even beneficial sharing possibilities. These hard truths have led many companies to reject synergy prematurely and retreat to the false simplicity of portfolio management.

A cost-benefit analysis of prospective sharing opportunities can determine whether synergy is possible. Sharing can lower costs if it achieves economies of scale, boosts the efficiency of utilization, or helps a company move more rapidly down the learning curve. The costs of General Electric's advertising, sales, and after-sales service activities in major appliances are low because they are spread over a wide range of appliance products. Sharing can also enhance the potential for differentiation. A shared order-processing system, for instance, may allow new features and services that a buyer will value. Sharing can also reduce the cost of differentiation. A shared service network, for example, may make more advanced, remote servicing technology economically feasible. Often, sharing will allow an activity to be wholly reconfigured in ways that can dramatically raise competitive advantage.

Sharing must involve activities that are significant to competitive advantage, not just any activity. P&G's distribution system is such an instance in the diaper and paper towel business, where products are bulky and costly to ship. Conversely, diversification based on the opportunities to share only corporate overhead is rarely, if ever, appropriate.

Sharing activities inevitably involves costs that the benefits must outweigh. One cost is the greater coordination required to manage a shared activity. More important is the need to compromise the design or performance of an activity so that it can be shared. A salesperson handling the products of two business units, for example, must operate in a way that is usually not what either unit would choose were it independent. And if compromise greatly erodes the unit's effectiveness, then sharing may reduce rather than enhance competitive advantage.

Many companies have only superficially identified their potential for sharing. Companies also merge activities without consideration of whether they are sensitive to economies of scale. When they are not, the coordination costs kill the benefits. Companies compound such errors by not identifying costs of sharing in advance, when steps can be taken to minimize them. Costs of compromise can frequently be mitigated by redesigning the activity for sharing. The shared salesperson, for example, can be provided with a remote computer terminal to boost productivity and provide more customer information. Jamming business units together without such thinking exacerbates the costs of sharing.

Despite such pitfalls, opportunities to gain advantage from sharing activities have proliferated because of momentous developments in technology, deregulation, and competition. The infusion of electronics and information systems into many industries creates new opportunities to link businesses. The corporate strategy of sharing can involve both acquisition and internal development. Internal development is often possible because the corporation can bring to bear clear resources in launching a new unit. Start-ups are less difficult to integrate than acquisitions. Companies using the shared-activities concept can also make acquisitions as beachhead landings into a new industry and then integrate the units through sharing with oth-

Adding value with hospitality

Marriott began in the restaurant business in Washington, D.C. Because its customers often ordered takeouts on the way to the national airport, Marriott eventually entered airline catering. From there, it jumped into food service management for institutions. Marriott then began broadening its base of family restaurants and entered the hotel industry. More recently, it has moved into restaurants, snack bars, and merchandise shops in airport terminals and into gourmet restaurants. In addition, Marriott has branched out from its hotel business into cruise ships, theme parks, wholesale travel agencies, budget motels, and retirement centers.

Marriott's diversification has exploited well-developed skills in food service and hospitality. Marriott's kitchens prepare food according to more than 6,000 standardized recipe cards; hotel procedures are also standardized and painstakingly documented in elaborate manuals. Marriott shares a number of important activities across units. A shared procurement and distribution system for food serves all Marriott units through nine regional procurement centers. As a result, Marriott earns 50% higher margins on food service than any other hotel company. Marriott also has a fully integrated real estate unit that brings corporatewide power to bear on site acquisitions as well as on the designing and building of all Marriott locations.

Marriott's diversification strategy balances acquisitions and start-ups. Start-ups or small acquisitions are used for initial entry, depending on how close the opportunities for sharing are. To expand its geographic base, Marriott acquires companies and then disposes of the parts that do not fit.

Apart from this success, it is important to note that Marriott has divested 36% of both its acquisitions and its start-ups. While this is an above-average record, Marriott's mistakes are quite illuminating. Marriott has largely failed in diversifying into gourmet restaurants, theme parks, cruise ships, and wholesale travel agencies. In the first three businesses, Marriott discovered it could not transfer skills despite apparent similarities. Standardized menus did not work well in gourmet restaurants. Running cruise ships and theme parks was based more on entertainment and pizzazz than the carefully disciplined management of hotels and mid-price restaurants. The wholesale travel agencies were ill fated from the start because Marriott had to compete with an important customer for its hotels and had no proprietary skills or opportunities to share with which to add value.

er units. Prime examples of companies that have diversified via using shared activities include P&G, Du Pont, and IBM. The fields into which each has diversified are a cluster of tightly related units. Marriott illustrates both successes and failures in sharing activities over time. (See the insert "Adding Value with Hospitality.")

Following the shared-activities model requires an organizational context in which business unit collaboration is encouraged and reinforced. Highly autonomous business units are inimical to such collaboration. The company must put into place a variety of what I call horizontal mechanisms – a strong sense of corporate identity, a clear corporate mission statement that emphasizes the importance of integrating business unit strategies, an incentive system that rewards more than just business unit results, cross-business-unit task forces, and other methods of integrating.

A corporate strategy based on shared activities clearly meets the better-off test because business units gain ongoing tangible advantages from others within the corporation. It also meets the cost-of-entry test by reducing the expense of surmounting the barriers to internal entry. Other bids for acquisitions that do not share opportunities will have lower reservation prices. Even widespread opportunities for sharing activities do not allow a company to suspend the attractiveness test, however. Many diversifiers have made the critical mistake of equating the close fit of a target industry with attractive diversification. Target industries must pass the strict requirement test of having an attractive structure as well as a close fit in opportunities if diversification is to ultimately succeed.

Choosing a corporate strategy

Each concept of corporate strategy allows the diversified company to create shareholder value in a different way. Companies can succeed with any of the concepts if they clearly define the corporation's role and objectives, have the skills necessary for meeting the concept's prerequisites, organize themselves to manage diversity in a way that fits the strategy, and find themselves in an appropriate capital market environment. The caveat is that portfolio management is only sensible in limited circumstances.

A company's choice of corporate strategy is partly a legacy of its past. If its business units are in unattractive industries, the company must start from scratch. If the company has few truly proprietary skills or activities it can share in related diversification, then its initial diversification must rely on other concepts. Yet corporate strategy should not be a once-and-for-all choice but a vision that can evolve. A company should choose its long-term preferred concept and then proceed pragmatically toward it from its initial starting point.

Both the strategic logic and the experience of the companies I studied over the last decade suggest that a company will create shareholder value through diversification to a greater and greater extent as its strategy moves from portfolio management toward sharing activities. Because they do not rely on superior insight or other questionable assumptions about the company's capabilities, sharing activities and transferring skills offer the best avenues for value creation.

Sharing allows activities to change completely in ways that increase competitive advantage.

Each concept of corporate strategy is not mutually exclusive of those that come before, a potent advantage of the third and fourth concepts. A company can employ a restructuring strategy at the same time it transfers skills or shares activities. A strategy based on shared activities becomes more powerful if business units can also exchange skills. As the Marriott case illustrates, a company can often pursue the two strategies together and even incorporate some of the principles of restructuring with them. When it chooses industries in which to transfer skills or share activities, the company can also investigate the possibility of transforming the industry structure. When a company bases its strategy on interrelationships, it has a broader basis on which to create shareholder value than if it rests its entire strategy on transforming companies in unfamiliar industries.

My study supports the soundness of basing a corporate strategy on the transfer of skills or shared activities. The data on the sample companies' diversification programs illustrate some important characteristics of successful diversifiers. They have made a disproportionately low percentage of unrelated acquisitions, *unrelated* being defined as having no clear opportunity to transfer skills or share important activities (see *Exhibit III*). Even successful diversifiers such as 3M, IBM, and TRW have terrible records when they have strayed into unrelated acquisitions. Successful acquirers diversify into fields, each of which is related to many others. Procter & Gamble and IBM, for example, operate in 18 and 19 interrelated fields respectively and so enjoy numerous opportunities to transfer skills and share activities.

Companies with the best acquisition records tend to make heavier-than-average use of start-ups and joint ventures. Most companies shy away from modes of entry besides acquisition. My results cast doubt on the conventional wisdom regarding start-ups. *Exhibit III* demonstrates that while joint ventures are about as risky as acquisitions, start-ups are not. Moreover, successful companies often have very good records with start-up units, as 3M, P&G, Johnson & Johnson, IBM, and United Technologies illustrate. When a company has the internal strength to start up a unit, it can be safer and less costly to launch a company than to rely solely on an acquisition and then have to deal with the problem of integration. Japanese diversification histories support the soundness of start-up as an entry alternative.

My data also illustrate that none of the concepts of corporate strategy works when industry structure is poor or implementation is bad, no matter how related the industries are. Xerox acquired companies in related industries, but the businesses had poor structures and its skills were insufficient to provide enough competitive advantage to offset implementation problems.

An action program

To translate the principles of corporate strategy into successful diversification, a company must first take an objective look at its existing businesses and the value added by the corporation. Only through such an assessment can an understanding of good corporate strategy grow. That understanding should guide future diversification as well as the development of skills and activities with which to select further new businesses. The following action program provides a concrete approach to conducting such a review. A company can choose a corporate strategy by:

1 **Identifying the interrelationships among already existing business units.**

A company should begin to develop a corporate strategy by identifying all the opportunities it has to share activities or transfer skills in its existing portfolio of business units. The company will not only find ways to enhance the competitive advantage of existing units but also come upon several possible diversification avenues. The lack of meaningful interrelationships in the portfolio is an equally important finding, suggesting the need to justify the value added by the corporation or, alternately, a fundamental restructuring.

2 **Selecting the core businesses that will be the foundation of the corporate strategy.**

Successful diversification starts with an understanding of the core businesses that will serve as the basis for corporate strategy. Core businesses are those that are in an attractive industry, have the potential to achieve sustainable competitive advantage, have important interrelationships with other business units, and provide skills or activities that represent a base from which to diversify.

The company must first make certain its core businesses are on sound footing by upgrading management, internationalizing strategy, or improving technology. My study shows that geographic extensions of existing units, whether by acquisition, joint venture, or start-up, had a substantially lower divestment rate than diversification.

The company must then patiently dispose of the units that are not core businesses. Selling them will free resources that could be better deployed elsewhere. In some cases disposal implies immediate liquidation, while in others the company should dress up the units and wait for a propitious market or a particularly eager buyer.

3 **Creating horizontal organizational mechanisms to facilitate interrelationships among the core businesses and lay the groundwork for future related diversification.**

Top management can facilitate interrelationships by emphasizing cross-unit collaboration, grouping units organizationally and modifying incentives, and taking steps to build a strong sense of corporate identity.

4 **Pursuing diversification opportunities that allow shared activities.**

This concept of corporate strategy is the most compelling, provided a company's strategy passes all three tests. A company should inventory activities in existing business units that represent the strongest foundation for sharing, such as strong distribution channels or world-class technical facilities. These will in turn lead to potential new business areas. A company can use acquisitions as a beachhead or employ start-ups to exploit internal capabilities and minimize integrating problems.

5 **Pursuing diversification through the transfer of skills if opportunities for sharing activities are limited or exhausted.**

Companies can pursue this strategy through acquisition, although they may be able to use start-ups if their existing units have important skills they can readily transfer.

Such diversification is often riskier because of the tough conditions necessary for it to work. Given the uncertainties, a company should avoid diversifying on the basis of skills transfer alone. Rather

it should also be viewed as a stepping-stone to subsequent diversification using shared activities. New industries should be chosen that will lead naturally to other businesses. The goal is to build a cluster of related and mutually reinforcing business units. The strategy's logic implies that the company should not set the rate of return standards for the initial foray into a new sector too high.

6 **Pursuing a strategy of restructuring if this fits the skills of management or no good opportunities exist for forging corporate interrelationships.**

When a company uncovers undermanaged companies and can deploy adequate management talent and resources to the acquired units, then it can use a restructuring strategy. The more developed the capital markets and the more active the market for companies, the more restructuring will require a patient search for that special opportunity rather than a headlong race to acquire as many bad apples as possible. Restructuring can be a permanent strategy, as it is with Loew's, or a way to build a group of businesses that supports a shift to another corporate strategy.

7 **Paying dividends so that the shareholders can be the portfolio managers.**

Paying dividends is better than destroying shareholder value through diversification based on shaky underpinnings. Tax considerations, which some companies cite to avoid dividends, are hardly legitimate reason to diversify if a company cannot demonstrate the capacity to do it profitably.

Creating a corporate theme

Defining a corporate theme is a good way to ensure that the corporation will create shareholder value. Having the right theme helps unite the efforts of business units and reinforces the ways they interrelate as well as guides the choice of new businesses to enter. NEC Corporation, with its "C&C" theme, provides a good example. NEC integrates its computer, semiconductor, telecommunications, and consumer electronics businesses by merging computers and communication.

It is all too easy to create a shallow corporate theme. CBS wanted to be an "entertainment company," for example, and built a group of businesses related to leisure time. It entered such industries as toys, crafts, musical instruments, sports teams, and hi-fi retailing. While this corporate theme sounded good, close listening revealed its hollow ring. None of these businesses had any significant opportunity to share activities or transfer skills among themselves or with CBS's traditional broadcasting and record businesses. They were all sold, often at significant losses, except for a few of CBS's publishing-related units. Saddled with the worst acquisition record in my study, CBS has eroded the shareholder value created through its strong performance in broadcasting and records.

Moving from competitive strategy to corporate strategy is the business equivalent of passing through the Bermuda Triangle. The failure of corporate strategy reflects the fact that most diversified companies have failed to think in terms of how they really add value. A corporate strategy that truly enhances the competitive advantage of each business unit is the best defense against the corporate raider. With a sharper focus on the tests of diversification and the explicit choice of a clear concept of corporate strategy, companies' diversification track records from now on can look a lot different.

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