

Corporate Strategy and Parenting Theory

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THIS PAPER PROVIDES A BRIEF summary of what we at the Ashridge Strategic Management Centre believe we have learned about corporate strategy over the last ten years. It lays out the basis for our ideas about corporate parenting and the implications of parenting theory for management decisions. It is structured around nine propositions, each of which attempts to convey both what we have learned and why it matters. The paper concludes with our views about where future research priorities should lie.

Justifying the Parent

What We Have Learned

In multibusiness companies, the existence of a corporate parent, by which we mean all those levels of management that are not part of customer-facing, profit-responsible business units, entails costs. These costs, which include not only corporate overheads but also knock-on costs of corporate reporting in the businesses, are not balanced by any direct revenues, since the corporate parent has no external customers for its services. Furthermore, the business units often feel that they could be independently viable and, indeed, could do better without a corporate parent. This belief is given credence by the success of so many management buy-outs and spin-off companies.

The parent can therefore only justify itself if its influence leads to better performance by the businesses than they would otherwise achieve as independent, stand-alone entities. It must either carry out functions that the businesses would be unable to perform as cost-effectively for themselves or it must influence the businesses to make better decisions than they would have made on their own. In other words, the parent must add more value than cost to the busi-

In November 1987, the Ashridge Strategic Management Centre was established, with the mission of carrying out research focused on corporate-level strategy and the management of multi-business companies. In November 1997, we ran a major conference to review what we had learned during the last decade. Since Brief Case has reported piecemeal on a variety of the research initiatives that we have carried out during this time, we felt that it would be appropriate to publish the background paper that we prepared for the conference, which gives a brief overview of the main propositions that we believe we have established. We would very much welcome comments on these propositions: Which do you agree or disagree with? Which are most or least important? What areas merit further research and investigation? © 1998 Elsevier Science Ltd. All rights reserved

nesses in the portfolio. The logic of the need to add value is now becoming more widely accepted.

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However, there are still relatively few companies whose corporate strategies are based on powerful and convincing sources of value creation.

Why it Matters

The challenge to corporate parents to justify themselves is important because it concentrates attention on whether and how the activities of the parent do add value. Rather than assuming the existence of a corporate parent, and then asking what the businesses can do for it, it places the onus in precisely the opposite direction. Now the key question is what the parent can do for the businesses, and whether it can positively demonstrate that its undoubted costs are more than offset by tangible benefits for the businesses. For many corporate parents, this has been a new perspective, and has led to the elimination of worthless, bureaucratic routines and a sharper concentration on those things that genuinely add value.

PROPOSITION: Many of the business units in multibusiness companies could be viable as stand-alone entities: To justify its existence, the corporate parent must influence the businesses collectively to perform better than they would as stand-alone entities.

Parenting Advantage

What We Have Learned

Since corporate parents exist in a competitive world, in which ownership of businesses is transferable, adding some value is not a sufficient justification for the corporate parent. Ideally, the parent must add more value than other rival parents would: otherwise all stakeholders could be made better off through a change in ownership of the businesses to a superior parent.

The force of this objective is evident when companies face the possibility of a hostile acquisition. But, even if there is no imminent threat of a take-over, the aspiration to add as much value as possible to all the businesses in the portfolio should remain the ultimate goal. Businesses whose competitors have parents that add more value are at a disadvantage, which will eventually be reflected in their results.

Why it Matters

The objective of adding more value than other rival parents, which we refer to as achieving "parenting advantage", is important because it provides a sound and powerful guiding objective for corporate strategy. All too often other objectives, such as achieving a faster rate of growth, balancing the portfolio between sectors or geographies, spreading risk, or simply survival, take precedence over parenting advantage, and lead to poor decisions. These other objectives are not in themselves wrong, but can lead corporate parents

to forget that parenting advantage should be in centre stage and, hence, to take decisions that have nothing to do with added value. Parenting advantage should be the guiding criterion for corporate-level strategy, rather as competitive advantage is for business level strategy.

PROPOSITION: Parent companies compete with each other for the ownership of businesses: The objective of corporate strategy should be to add more value to the businesses in the portfolio than other rival parent organisations would.

Value Destruction

What We Have Learned

Corporate hierarchies inevitably destroy some value. Apart from the obvious issue of corporate overheads, the main problems relate to ill-judged influence from senior managers and to information filters.

Since senior corporate managers must divide their time between a number of businesses in the portfolio, they will always be less close to the affairs of each business than its own management team. Inevitably, there is a danger that their influence will be less soundly-based than the views of the managers running the businesses.

Corporate hierarchies encourage business managers to compete with each other for investment funds and for personal promotion. Business managers therefore tend to filter the information they provide to divisional and corporate management, in order to present their businesses in the most favourable light. The information on which corporate managers must base their influence and decisions tends to be systematically biased.

The corporate centre also tends to be insulated from the sort of critical examination of cost effectiveness that other parts of a company routinely receive. Processes to assess net corporate value added are seldom well-developed, and power relationships in the corporate hierarchy mean that it is hard for the businesses to express their views openly. Central costs have a tendency to creep upwards and unproductive central interference goes unchecked.

Extra costs and negative influence are therefore pervasive features in all multibusiness organisational hierarchies and can only be offset by substantial value creation in targeted areas (see proposition 5). Research with a wide cross-section of companies in the US, Europe and Asia-Pacific has provided many specific examples of the phenomenon.

Why it Matters

This observation is important because it should lead corporate parents to be more disciplined. They should avoid intervening in businesses unless they have

specific reasons for believing that their influence will be positive. They should avoid extending their portfolios into new businesses unless they have good grounds for believing that they will be able to add value to them. They should seriously consider demerging or spinning off businesses that do not fit well with their skills. And they should be willing to downsize or eliminate corporate functions unless they have a clear added-value role.

This perspective provides a counterweight to ill-focused and over-ambitious corporate strategies. Previously, it was too easy for corporate parents to feel that simply going through the budget or capital expenditure review process “must be good for the businesses” or that diversifying into more glamorous or more rapidly growing sectors “must be good for investors”. Now we know better, since we can see that good corporate strategy is as much about avoiding value destruction as it is about maximising value creation.

PROPOSITION: *All multibusiness organisations have inherent and pervasive tendencies to destroy value; Corporate strategies should recognise these tendencies and be designed to minimise value destruction as much as to maximise value creation.*

Lateral Synergies

What We Have Learned

Since Ansoff’s pioneering work on synergy, most businessmen and management thinkers have justified multibusiness companies because of the existence or potential for lateral linkages between their businesses. Managers at the centre have believed that their main role is the creation of synergy.

Our research, in contrast, has shown that parent managers are often pursuing mirages rather than real synergy opportunities, and that their interventions in the lateral relationships between businesses are often net negative rather than net positive. Furthermore, most “synergies” are available between independent businesses. A common parent is not necessary for two or more businesses to trade with each other, form alliances or joint ventures, licence technology, share benchmarks and best practice, pool negotiating power, share services, coordinate strategies or combine to create new businesses. Only a few synergies require a common parent to be effectively implemented. We have also observed that, for many multibusiness companies, the main source of added value stems from the relationship between the centre and each business as a stand-alone entity. We have, therefore, concluded that the value potential of synergies has been systematically over-rated by managers, academics and consultants.

Why it Matters

This observation is important because it should change the mindset of corporate centre managers.

Instead of “desperately seeking synergies”, centre managers should be focusing their efforts only on those synergies that need central intervention. Instead of actively fostering a “one enterprise” or “one family” philosophy, centre managers should usually be encouraging “market place” relationships between business units. Instead of supporting “corporate centre creep”, in which activities graduate to the centre in the name of synergy, centre managers should be vigilant in avoiding interventions unless they are clearly beneficial. This change in mindset will focus central management time on those synergies where the parent has a real role to play. It may also free time for value creating influence on businesses as stand-alone entities.

The change in mindset will also reduce the amount of value destroyed from “contamination”. Contamination occurs when two businesses with different critical success factors are encouraged to work closely together in the name of synergy, and pollute each other’s thinking and strategies. The loss of focus and muddled thinking that results can end up hurting both businesses.

PROPOSITION: *The importance of lateral synergies in creating value in multibusiness companies has been systematically overrated; Corporate parents should pay relatively more attention to other sources of value creation, in particular their ability to improve performance in each individual business as a stand-alone entity.*

Value Creation

What We Have Learned

Value creation only occurs under three conditions:

- the parent sees an opportunity for a business to improve performance and a role for the parent in helping to grasp the opportunity
- the parent has the skills, resources and other characteristics needed to fulfil the required role
- the parent has sufficient understanding of the business and sufficient discipline to avoid other value-destroying interventions.

The most successful parents concentrate their attention on a few large areas of opportunity rather than attempting to intervene more broadly: in this way they can both develop distinctive skills that are specially suitable for the opportunities they are targeting and avoid dissipating their energies on issues where their contribution will have low or negative value.

Although competitive pressures should weed out businesses that persistently underperform, oppor-

tunities for a corporate parent to add value are not uncommon. They arise when

- weaknesses in business managers are causing underperformance
- the business managers face opportunities that even a competent management team will find difficult to seize without help from the parent
- the parent possesses some special resources that open up new opportunities for the businesses.

Our emphasis is on the skills or competences of the parent and the extent to which they fit with the opportunities in the businesses. It is parenting competences or resources, what the parent can do to make a difference, that explain successful corporate strategies. The broader notion of core competences, though useful, fails to highlight the role to be played by the parent.

Why it Matters

The conditions for value creation are important, because they force corporate parents to think through what major opportunities for added value lie behind the corporate strategy. If no such opportunities have been identified, the strategy is bound to be fatally flawed.

They also help corporate parents to focus their activities. By giving prominence to a few major opportunities, corporate priorities can be clarified, irrelevant or value destroying activities can be eliminated, and time and attention can be devoted to building up the competences that the parent needs most. By not trying to do everything, the parent can become specially good at doing the things that really matter.

The objective of building parenting competences that fit well with particular opportunities also gives a sharper and more practical basis for competence development at the parent level. The often fruitless quest for nebulous core competences can be replaced with a much more targeted agenda for the skills, resources and processes that the corporate parent needs most.

Lastly, an emphasis on the distinctive insights and skills possessed by the parent is valuable because it underlines how much the success of any corporate strategy depends on the experience, capabilities and attitudes of the CEO and his team. The personal views and qualities of the CEO need to be a primary criterion in selecting the corporate strategy.

PROPOSITION: Value creation seldom occurs unless the corporate parent perceives a few large opportunities for business performance enhancement, and develops distinctive skills, resources and influencing processes that address these opportunities: Corporate parents should focus their efforts on building special competences that fit the particular opportunities they are targeting.

Corporate Centres and Management Processes

What We Have Learned

The desire to follow 'best practice' in corporate processes (such as planning, capital sanctioning, performance targeting and monitoring, etc.) has resulted in several popular but ephemeral trends. Similarly, a focus on the appropriate size of the corporate centre has, at different stages, encouraged managers to increase centralisation and the staffing of functions such as corporate planning and corporate HR, or, more recently, to reduce dramatically the numbers employed in such functions.

But managers adopting the general trends and supposed best practice of the day have frequently been disappointed by the results. Furthermore, parents who appear to be successful in adding value to their businesses have processes and corporate staffing levels that are both widely different from each other and, in many cases, that are out of tune with accepted best practice at the time.

These observations have taught us that personal skills and cultural fit are the key issues; that the skills of the individuals involved and the organisational heritage in which they operate can make essentially the 'same' process either effective or ineffective. We have also learned that the opportunities to add value with a given process or level of centralisation differ depending on the specific needs of the businesses in question. A 'one size fits all' approach to designing the nature and composition of the parent is inappropriate.

Why it Matters

The importance of the size, staffing and design of the corporate office is not in question, and managers devote considerable attention to it. But if corporate functions and processes are not developed as an integral part of the overall value adding corporate strategy, they may be in line with general good practice, but lead to little or no improvement in performance. Equally, it is far more important for parent managers to possess idiosyncratic skills that are suitable for the parenting opportunities they are targeting than for them to be abreast of all the currently fashionable general management trends. Worse still, changing from existing arrangements to make them fit better with general good practice may undermine value creation that is currently being achieved due to the special circumstances of the portfolio and the managers running it. Without a clear focus on selected parenting opportunities, simply going through the motions, however professionally, is as likely to destroy value as create it.

PROPOSITION: Corporate centres, functions, and processes designed to achieve general best practice

lack sufficient focus to achieve outstanding results: They should be designed more idiosyncratically to fit with the specific opportunities targeted by the corporate-level strategy.

Diversity

What We Have Learned

For many years, it has been felt that highly diverse multibusiness companies must be more difficult to manage than less diverse companies. An extensive stream of academic research has sought to examine the comparative performance of “related” and “unrelated” diversification strategies, where “relatedness” was measured in terms of technologies, markets and customers.

Yet the evidence has not provided conclusive support for the intuitively appealing idea that related corporate strategies should outperform unrelated ones. And the performance of companies such as Hanson, BTR and KKR in the 1980s and of Virgin and GE in the 1990s provide specific counter-examples. “Relatedness” seems to be neither a necessary nor a sufficient condition of a successful multibusiness strategy.

During the 1980s, a new approach to measuring diversity began to emerge. Prahalad and Bettis suggested that the mindsets and skills of the corporate team provided the constraint on how much diversity was manageable. There was a “dominant logic” that tended to be applied across the whole portfolio, irrespective of the strategic characteristics of each business. The Ashridge Strategic Management Centre notion of “management styles” also suggested that each corporate team had a well-defined approach that it brought to bear on all the businesses in the portfolio.

More recently, we have pushed these ideas further, arguing that diversity is best measured in terms of the differences in parenting needs and opportunities between businesses in the portfolio. Businesses with different critical success factors require parenting that is sympathetic to these differences, and businesses with different opportunities for parental value creation require different parenting skills and resources that are suitable for realising the opportunities in question. Our research has shown that successful corporate parents have portfolios of businesses that are relatively homogenous in terms of parenting needs and opportunities, and that many corporate strategy disasters can be explained in terms of straying into businesses that turned out not to be responsive to the dominant parenting approach of the company.

These findings show why conventional measures of relatedness have proved imperfect predictors of corporate performance, since they do not focus on the fit between the businesses and the parent. The successes of the Hansons, the KKR and the Virgins

are easy to appreciate in terms of parenting opportunities and fit, but incomprehensible in terms of relatedness as conventionally defined.

Why it Matters

A valid means of measuring diversity provides vital guidance to corporate parents who may have been impressed by the current vogue for “focusing on core businesses”, but are unsure how to determine which businesses should be included in the core. Now we can see that corporate parents should aim to focus their portfolios around businesses with similar parenting needs and opportunities, for which the parent either has or can build suitable parenting skills and resources. These are the businesses in which the parent is likely to be able to add the most value; we refer to them as “heartland” businesses. To avoid excessive diversity, corporate parents should focus their portfolios on heartland businesses.

PROPOSITION: Past measures of diversity based on conventional concepts of relatedness have proved unsatisfactory: To avoid excessive diversity, corporate parents should build their portfolios around businesses with similarities in terms of parenting needs and opportunities.

Stretch and Fit

What We Have Learned

Some critics regard Ashridge Strategic Management Centre’s approach to corporate strategy as too cautious. Our emphasis on the pervasiveness of value destruction, the need for a close fit between parenting capabilities and business needs, and the dangers of excessive diversification, they claim, prevents companies from seeing the potential of radical new strategies with stretching goals. And, without stretching ambitions, companies become slow moving, flabby and lacking in motivation.

We accept the need for “stretch” as well as “fit”. Our research supports the desirability of a continuous search for new opportunities and a commitment to refining and extending parenting skills. We recognise both the excitement of fresh challenges that cannot easily be met and the stultifying effects of an unwillingness to alter the *status quo*.

But we are also realists. We have observed how frequently corporate strategies fail because parents are overoptimistic about their ability to build new skills and understand new types of businesses. We have researched numerous diversification attempts in which there were gross underestimates of how much time and attention it would take for the parent to get to grips with the new business. As a result, we believe that much of the advice that companies receive about rejuvenation, growth ambitions, and long term survival causes managers to launch initiatives that are

foolhardy rather than bold. **At the least, stretch should be tempered with realism when corporate strategies are being developed**, and a balance should be maintained between stretch for new opportunities and fit with the parent's existing skills.

Why it Matters

A recognition that stretch should be balanced by realism is valuable. It should **prevent complacency and encourage innovative ideas**, while at the same time helping to eliminate many of the more extreme disasters of excessive corporate ambition (Sony in Hollywood, Exxon in office equipment, Daimler-Benz in white goods, Saatchi and Saatchi in management consulting, ...).

A company with low growth or declining core businesses faces three options. It can aggressively seek a new "heartland" with "platform" initiatives (investments in new or different businesses designed to speed the learning of new parenting skills). **It can experiment with "edge of heartland" investments**, in the hope of evolving towards a broader heartland which offers more potential. **Or it can decide to focus on its mature core and be the best in a limited field.** Whereas many advisers and managers rule out the last option as defeatist, we believe it is often a reasonable choice. In a dynamic economy, new rising organisations will always be balanced with others that decline. Helping some businesses decline gracefully, without too many development attempts, may be as important as helping other businesses to broaden their portfolios and set ambitions for the next century.

Moreover, companies that do push forward into new businesses will prosper more if they choose those that are compatible with parenting skills that they have or can develop. Many parent organisations are "stretching" their skills too far in pursuit of new opportunities, when they would do better to choose a narrower range of businesses where greater "fit" can be created.

PROPOSITION: Many corporate parents are over-ambitious about the speed with which they can build new skills and understand new types of businesses; Good corporate strategies should maintain a balance between "stretch" for new opportunities and "fit" with the parent's existing skills.

Business Unit Definition and Corporate Structure

What We Have Learned

Business units represent the basic building blocks in any multibusiness company. The boundaries around the business units

- establish what groups of activities will receive the focused attention of a single management team, and

will be aggregated together for performance measurement and reporting purposes

- determine what entities will report to the corporate parent and, conversely, what entities the corporate parent will need to add value to
- establish the scope for lateral synergies by determining what activities fall within each unit, and hence what the opportunities are for units to link with each other.

Business unit definitions can either protect activities from the corporate parent's attention or expose them to it—thereby inhibiting or opening up the possibilities for the parent either to create or destroy value.

Business unit definitions have a profound impact on the behaviour and aims of business managers and on the size and nature of parenting opportunities.

Inappropriate business definitions lead to compromised business strategies and missed opportunities for parental value creation.

In companies with intermediate parenting levels, such as divisions, the grouping of businesses into divisions is also important. Lack of clarity on the added value role of different levels, groups and individuals within the parent leads to redundant cost, confusion, and reductions in net value creation. Where the parenting tasks are shared between different individuals, their respective responsibilities also need to be clearly defined and complementary. Getting the unit definitions and corporate structure right is an important precondition for a successful corporate strategy.

Why it Matters

No-one doubts that business unit definition and corporate structure are important topics. Typically, they are high on chief executives' agendas. But a perspective on these issues that stresses value creation and the role of the parent is much less common; history, personal ambition and corporate politics often seem to be the major considerations. Instead, careful analysis of the advantages of breadth versus focus in business definition and of the impact of different structures on corporate value creation should underpin these organisational choices.

PROPOSITION: Business unit boundaries and corporate reporting structures have a profound impact on both the value creation opportunities and the value destruction risks for the corporate parent; Decisions on unit definitions and corporate structures should be determined by careful analysis of their likely impact on net value creation, not by history, ambition and politics.

Future Research Challenges

We see four priority areas for future research:

1. **How companies can build the parenting skills that enable them to grow into new businesses.**

- ❑ By what means have corporate parents that have presided successfully over radical changes in their portfolios learnt new competencies?
 - ❑ How much time, investment and change (e.g. people change) is needed to develop a portfolio into new business areas?
 - ❑ Is it possible to distinguish in advance those new business growth ambitions that will be achievable from those that will be a bridge too far?
 - ❑ What are the chances of success with new business initiatives, and how can the odds be improved? Is it possible to identify those companies that would be better off trimming their development ambitions, breaking up or focusing more tightly?
 - ❑ Which development paths are most successful? Are there lessons to be learned from successful developers?
- 2. How to manage the internal and external boundaries of the corporation to create value, and in particular how to create value without full ownership.**
- ❑ How can the boundaries between business units, and between the company and third party organisations, be managed most effectively?
 - ❑ What effect do different ways of defining business units have on corporate value creation?
 - ❑ What is the impact of ownership versus joint venture versus alliance versus relational long-term contracts?
- 3. Better understanding of the organisation structures and capabilities needed to implement corporate strategies successfully.**
- ❑ What are the best ways to divide up tasks between different levels, groups and individuals in complex parent organisations?
 - ❑ How should corporate headquarters be designed to support the corporate strategy and to avoid being driven by empire-building or bureaucratic expansion?
 - ❑ How can the skills needed to implement a given corporate strategy be defined as fully and clearly as possible? What is the best way to develop these skills?
 - ❑ What career paths best prepare a manager for a role as corporate parent? From what pools of managers should parent managers be selected and how can the quality of these pools be enhanced?
- 4. More precise means of measuring the net value added by the corporate parent.**
- ❑ What techniques are being used or can be developed to identify and quantify more precisely the ways in which the parent adds and subtracts value?
 - ❑ What are the best measures of value to use?