Chapter One

Strategy for the Corporate Level: Summary of the Main Messages

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Almost all companies need a strategy at the corporate level that is in addition to the strategies for products or markets or business divisions. So this book is for any manager with responsibilities for multiple business divisions. It is also for any student, adviser or more junior manager who wants to understand the challenges that corporate managers face and how they make decisions. The book will help answer two important questions that can only be addressed at the corporate level:

1. What businesses or markets should a company invest in, including decisions about diversifying into adjacent activities, about selling businesses, about entering new geographies or markets and about how much money to commit to each area of business?
2. How should the group of businesses be managed, including how to structure the organisation into divisions or units or subsidiaries, how to guide each division, how to manage the links and synergies between divisions, what activities to

centralise or decentralise and how to select and guide the managers of these divisions?

We will refer to the first as "business" or "portfolio" strategy and the second as "management" or "parenting" strategy. The combination of these two types of strategy makes up corporate-level strategy.

Terms like business division, corporate headquarters or corporate-level strategy may suggest that this book is only relevant to managers running old-fashioned conglomerates. Far from it. This book is just as relevant for focused companies like Apple or Google. It is also relevant for public sector organisations, although much of the language used is commercial.

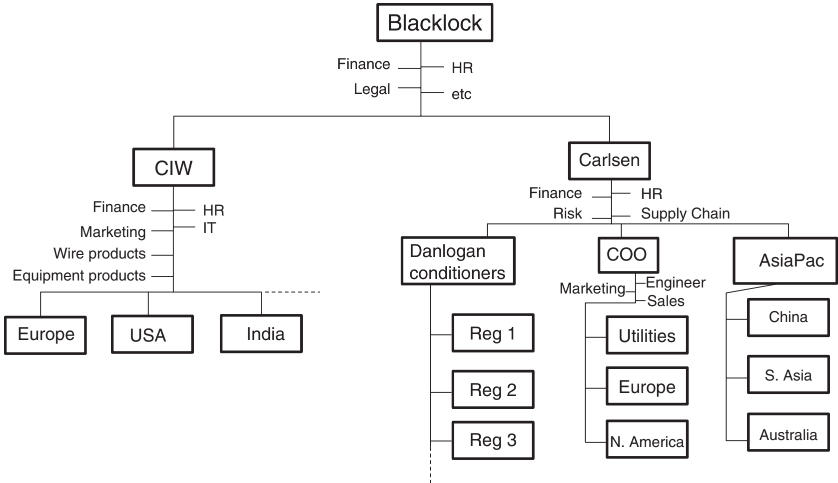
Blacklock[1]

In 2010, Blacklock Inc., a US engineering company, was being threatened with hostile takeover approaches from two companies: Vantex, another US engineering company, and Molsand, a Scandanavian company skilled at turnarounds and business improvement. Blacklock had two business divisions: Carlsen, a company manufacturing pumps, water equipment and air conditioners, and CIW, a company supplying wire, wire equipment and related consumables (see Figure 1.1).

The Carlsen division was itself organised into business divisions. Some of the business divisions were focused on products, such as a type of equipment or conditioner. Some were focused on market segments, such as the utilities sector. Some were focused on regions, such as AsiaPac or Europe. All business divisions contained both manufacturing and sales. Linking the business divisions together were processes for sharing technology, manufacturing and purchasing as well as typical group functions, such as finance, HR and IT.

Some of Carlsen's business divisions also contained business units. For example, Danlogan, a division focused on con-

Figure 1.1: Blacklock organisation structure (simplified)



ditioners and acquired in 2005, was divided into seven geographic regions. Also, the AsiaPac division included business units in Australia, China and South Asia.

CIW (originally Commercial & Industrial Wire) was also organised into business divisions. CIW's business divisions were geographic: Europe, North America, South America, China, India, etc. Each division had its own manufacturing and sales, but technology and product development were centralised at the CIW level, along with group marketing. Also at the CIW level were typical group functions covering finance, HR, IT, Safety and Lean.

At the Blacklock level, there were a handful of managers covering legal and financial issues.

For a company like Blacklock, this book is about the following questions. Should Blacklock own both Carlsen and CIW? What other business divisions should Blacklock seek to develop or acquire, if any? Should Blacklock resist the acquisition approaches by Molsand and Vantex? If not, which company should they seek to align with? What should be the main focus

of the management team at the Blacklock level? Which activities should be centralised at the Blacklock level? How should Blacklock appoint, interact with and guide the management teams running Carlsen and CIW? How much collaboration should Blacklock encourage between Carlsen and CIW?

Blacklock is a parent company and this book is helpful to managers at this level in the organisation. But this book is just as relevant for managers at the Carlsen and CIW levels. The management teams of Carlsen and CIW are both running organisations with multiple business divisions. For Carlsen, this book will help with the following questions. Why does it make sense for Carlsen to own businesses involved in both pumps and conditioners? What other products should Carlsen seek to develop or acquire, if any? Does it make sense for Carlsen to be involved in bespoke equipment for the water industry as well as off-the-shelf equipment for general industrial uses? Is it necessary for Carlsen to have a global footprint? How should Carlsen group its business units into business divisions: by geography, by market sector, by product or by a combination of all of these? How should Carlsen manage the links and overlaps among divisions? Which activities should be centralised at the Carlsen level? How should Carlsen's top managers appoint, interact with and guide the managers running its business divisions?

Even within Carlsen, this book will help the management team running the Danlogan division or the Asia division. Why does it make sense for Danlogan to be a global company rather than focused in just one region? What other countries should Danlogan enter? How should Danlogan control or guide the links among its country-based business units? Which activities should be centralised at the Danlogan level? How should Danlogan appoint, interact with and guide the managers running its business units?

For CIW, this book helps answer similar questions. Should CIW own businesses in India and South America? What other geographies should CIW seek to expand into? Should CIW produce both wire products and wire equipment? What other products, if any, should CIW produce? Which activities should be centralised at the CIW level? Should CIW be organised into regional business units or should it be a global functional structure? How should CIW's top managers select, interact with and guide the management teams running its regional units?

Hence, it is important that readers do not presume that this book is only relevant for management teams at the parent company level of diversified companies. It is equally relevant for, and potentially has more to offer to, management teams trying to integrate closely linked businesses and for management teams running divisions that themselves contain sub-businesses.

Molsand was the winning bidder and acquired Blacklock. A similar set of questions then needed to be asked at the Molsand level. Why will Molsand benefit from paying a significant premium over the quoted market price for the Blacklock businesses? Why did it make sense for Molsand to outbid Vantex? Having acquired Blacklock, should Molsand retain the Blacklock level of management? Should Molsand keep both business divisions or should it sell either Carlsen or CIW or parts of these companies? Should Molsand retain Carlsen and CIW in their current shape or should Carlsen be divided, for example, into two companies each reporting directly to Molsand: conditioners and water equipment? What other companies should Molsand seek to acquire? What should be centralised at the Molsand level? (At the time of writing, Molsand had fewer than 20 people in its corporate centre.) How should Molsand appoint, interact with and guide the managers of Blacklock, Carlsen and CIW once they are under full ownership?

So, this book is for a wide range of managers and covers a wide range of decisions. Even a single hotel can be considered to have multiple businesses or profit centres – accommodation, business conferences, restaurant and spa – and hence needs a corporate-level strategy. Ashridge Business School, a charity, with revenues in 2012 of about £40 million, needs a corporate-level strategy. Ashridge has profit centres for open programmes, tailored programmes, conferences, hotel and facilities, qualification programmes, consulting and research centres. It needs a strategy that explains why these different activities are part of one organisation and how the leadership team is going to manage the organisation. So, this book is about more than diversified conglomerates, it is about the strategic thinking that is required to run any complex organisation.

Portfolio strategy

How should managers make decisions about which businesses, markets or geographies to invest in and which to avoid, harvest or sell? There are three logics that guide these decisions:

1. **Business logic** concerns the sector or market each business competes in and the strength of its competitive position. Is the market attractive or unattractive and does the business have a competitive advantage or competitive disadvantage?
2. **Added value logic** concerns the ability of corporate-level managers to add value to a business. Is this business one that corporate-level managers feel able to improve or create synergy with other businesses, or is it one that corporate-level managers may misjudge and damage?
3. **Capital markets logic** concerns the state of the capital markets. Are prices for businesses of this kind inflated and hence likely to be higher than the net present value of future

cash flows, or depressed and hence likely to sell at less than net present value?

These three logics are each important for making good portfolio decisions. If a business is likely to sell for more than it is worth (capital markets logic), there is little reason to buy and good reason to sell. You would only buy if you felt that the business would perform much better under your ownership (added value logic). If you are already in the business, you might consider selling now or doubling your investment with a view to selling soon (capital markets logic).

If a business is in a low margin industry and has a significant competitive disadvantage (business logic), you are likely to want to sell it or close it, unless you can help the business overcome its disadvantage or improve the margins in its industry (added value logic) or unless you believe that owning the business adds value to your other businesses (added value logic), or unless the price you can sell it for is less than the value of continuing to own it (capital markets logic).

If a business is in a high growth market and is earning high margins (business logic), you are likely to want to invest in it, unless you believe that you are a bad owner of the business (added value logic) or you could sell it for significantly more than it is worth to you (capital markets logic).

If a business is one you are able to significantly improve or one that will add value to your existing businesses (added value logic), you are likely to want to invest in it or acquire it. Even if it is likely to sell at a price that is higher than the value of cash flows it generates (capital markets logic), you are still likely to want to retain the business.

Business logic

Business logic looks at the market the business is competing in and the position the business has in that market. The core

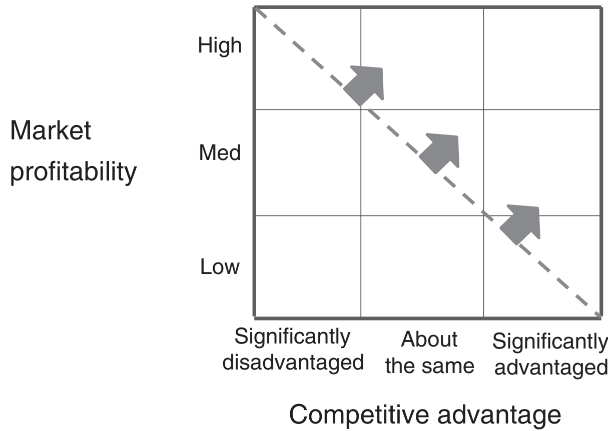
thought is that a company should aim to own businesses in attractive markets and that have significant competitive advantage. These businesses are highly profitable. This analysis – market attractiveness and competitive advantage – is part of the normal work done for business-level strategy. Hence, business logic is the main area of overlap between business-level strategy and corporate-level strategy: it is a tool used by both disciplines.

The attractiveness of a market can be assessed by calculating the average profitability of the competitors in the market. If average profitability is significantly above the cost of capital, the market is attractive. If average profitability is significantly below the cost of capital, the market is unattractive. Michael Porter, the Harvard Business School strategy guru, developed a framework – the 5-Forces framework – that summarises the factors that drive average profitability. He identified competitive rivalry, the power of customers, the threat of substitutes, the power of suppliers and the threat of new entrants as the five forces that influence the average profitability of a sector.

Of course, the attractiveness of a market to a particular company may be influenced by factors other than average profitability. Growth is typically an important factor to most management teams. Size of the market is typically another factor. Individual companies may want to develop their own measures of market attractiveness.

The other dimension, competitive advantage, can be assessed using relative profitability: the profitability of your business versus the average competitor in the market. If your business is more profitable than the average, it is likely to have a competitive advantage. If your business is less profitable than the average, it is likely to have a competitive disadvantage. Competitive advantage may be created by many factors, such as technology or customer relationships or scale economies. Relative profitability captures the result of all these factors.

Figure 1.2: Business Attractiveness matrix



These two measures – the average profitability of the competitors in the market and the relative profitability of your business versus the average – are good surrogates for market attractiveness and competitive position. They can be combined into a matrix – the Business Attractiveness matrix (see Figure 1.2). This matrix is similar to the McKinsey/GE matrix described in most textbooks. Business units that plot in the top right corner of the matrix are most attractive and those in the bottom left are least attractive. In broad terms, companies should look to hold onto or acquire businesses that are to the right of the central diagonal, and exit or restructure businesses that are to the left of the central diagonal.

Business logic steers companies towards investing in attractive businesses: those in markets where most competitors make good profits and where the business has higher profits than the average. **Mexican Foods**[2] owned a portfolio of foods businesses with a bias towards private-label products. These are products that sell under a retailer's brand rather than a manufacturer's brand. The management team predicted that margins on private-label businesses were likely to be squeezed in the

future. The problem was the power of the major retailers, as well as the large number of small low cost competitors. Profitability for the average competitor was already low and would be likely to fall.

Branded products, in contrast, would be likely to provide good margins. There were fewer competitors in the branded sector, and, because the brand communicated directly with consumers, branded companies could resist the power of retailers. Mexican Foods owned one or two strong brands, which were well positioned in their product categories.

As a result of this assessment of the relative attractiveness of the two markets, senior managers decided to focus their investment on their strongest brands and look for bolt-on brands to acquire. Over time they decided to shift their portfolio towards brands and away from private label products.

Added value logic

Added value (or parenting) logic looks at the additional value that is created or destroyed as a result of the relationship between the business and the rest of the company. There are two kinds of added value. Added value can come from the relationship between the business and its parent company – hence the term "parenting". But value is also created or destroyed as a result of the relationship between the sister businesses. The first type we can think of as vertical added value and the second type as horizontal added value. Together they make up added value.

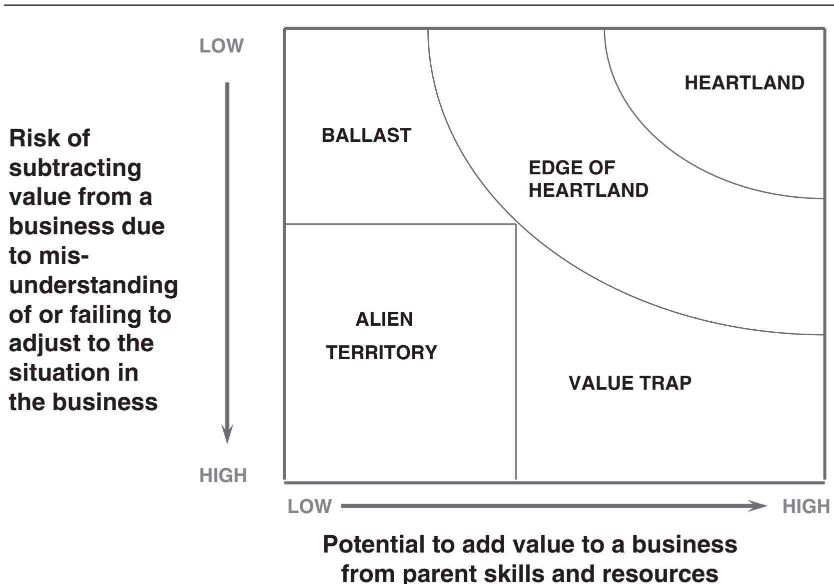
In commercial companies, added value is measured by looking at the impact on future cash flows. If the discounted value of future cash flows increases as a result of some headquarters initiative, value has been added. In public sector organisations or charities, added value is measured by a ratio such as cost per unit of benefit. If a headquarters initiative can lower costs for the same benefits or increase benefits for the same

cost, the ability of the organisation to serve its beneficiaries has been increased: value has been added.

Value can be added or subtracted. Added value can come from wise guidance from headquarters managers or from a broad range of other sources, such as a parent company brand, the technical know-how of a central technology unit, relationships with important stakeholders, financial strength, etc. Subtracted value happens when headquarters provides less wise guidance, such as the setting of inappropriate targets or inappropriate strategies, or from a broad range of other sources, such as time wasting, inefficient central services, delayed decision making, inappropriate standardisation and poor people decisions.

The potential for added value and the risk of subtracted value can be combined to form a matrix – the Heartland matrix (see Figure 1.3). The issue at stake is the balance between the two types of value.

Figure 1.3: The Heartland matrix



Each business unit is plotted on the matrix. Where the potential for the company to add value to the business unit is high and the risk that the company will subtract value from the business is low, it is plotted in the "heartland". In other words there is a good fit between the business and the company.

If the risk of subtracted value is high and the potential for added value is low, the business is in "alien territory". The fit is bad, and the company should almost certainly sell or close this business.

If the risk of subtracted value is low and the potential for added value is low, the business is "ballast". The danger here is that the business will consume the scarce time of headquarters managers without resulting in any extra value. Unless headquarters managers can find ways to add value, these businesses are candidates for selling; but can easily be retained until an opportune moment arrives.

If the risk of subtracted value is high and the potential for added value is high, the business is a "value trap": the subtracted value may well outweigh the added value. It is normally best to exit these businesses unless managers at the group level can find ways to reduce the risks of subtracted value, and hence raise the business into "edge of heartland".

Added value logic steers companies towards investing in businesses that will benefit significantly from being part of the company or that will contribute significantly to the success of other businesses in the company.

Danaher, a diversified US company with a portfolio of businesses that mainly manufacture equipment, is an example of a company driven by added value logic. Danaher delivered over 25% annual share price growth from its founding in 1985 up to the economic crisis in 2008. The largest divisions focused on electronic test equipment, environmental test equipment and medical technologies.

Danaher acquired companies and improved them: more than 50 in the five years before 2008. The driving force was the Danaher Business System, an approach to continuous improvement based on the principles of lean manufacturing. As Larry Culp, CEO from 2001, explained, "The bedrock of our company is the Danaher Business System (DBS). DBS tools give all of our operating executives the means with which to strive for world-class quality, delivery and cost benchmarks, and deliver superior customer satisfaction and profitable growth."[3]

Following acquisition, the new business would feel the influence of Danaher immediately. Within one month, the management team would have an Executive Champion Orientation. This involved getting the top 50 managers in the business to map out the processes in the business and come up with targets for improvement. The improvement targets typically ranged from 20 to 100%.

The next influence came from redoing the business's strategic plan. Particular attention would be given to gains in market share and to understanding why some customers buy from competitors. Typically, the new plan involved doubling the business's organic growth ambitions.

At the same time Danaher would demand a review of people. Most businesses tolerate some managers who are capable at their jobs but not drivers of change and improvement. Danaher would provide replacements from other businesses in the group.

The final influence would come from the Danaher system for ensuring that plans are executed – Policy Deployment. Each manager would be given a set of metrics that linked directly to the plan. The metrics would be pinned to his or her door (or displayed in the work area) and updated monthly. This accelerated the pace of change.

One further source of added value came from bolt-on acquisitions. Danaher liked to acquire businesses that could create

a platform for bolt-on acquisitions. A large portion of the back office costs in these bolt-on acquisitions could be saved. There were also often savings in sales and distribution costs as well as opportunities to consolidate manufacturing sites.

Apple is a more integrated company than Danaher. The added value of corporate headquarters, while Steve Jobs was leading Apple, was considerable. Headquarters led the product development process, controlling the heart of Apple's success. Headquarters looked after the brand. Headquarters also ensured that different products shared sales channels and supporting services, such as the retail stores, and online applications and services, such as the Apps Store.

With this degree of centralisation, Apple needed to have a set of product lines, each of which could benefit from its added value. At the time of writing, Apple was expected to enter a new business – television. Added value logic would require Tim Cook, the new CEO, to ask whether television products would be likely to gain as much advantage as phones and tablets from Apple's product development skills, brand, distribution channels and online services. He would also need to ask whether the business model in television is significantly different from that of phones or computers, and, hence, whether there is a significant risk of subtracted value. Is television heartland, edge of heartland or value trap for Apple?

Apple is a particularly interesting example, which we will come back to in Chapter 12. The involvement of headquarters at Apple was so great that it would be reasonable to think of Apple as a single business rather than as a corporate group. However, we will show how corporate-level strategy analysis is as helpful in a company like Apple as it is in a more divisionalised company like Danaher.

Capital markets logic

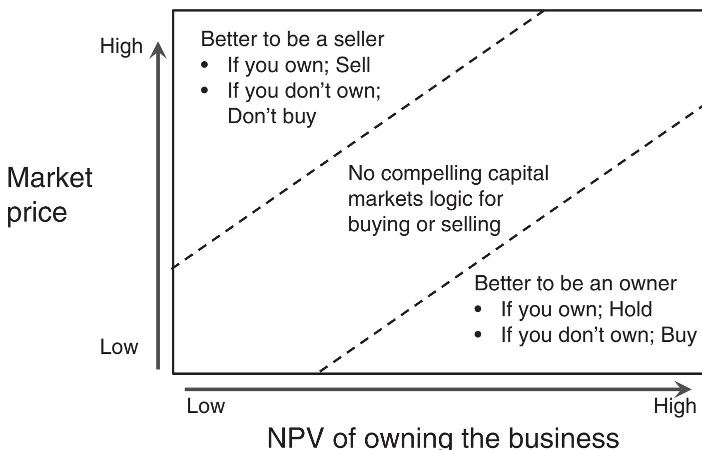
Capital markets logic looks at the market for buying and selling businesses. At certain times, businesses are given low values

by the capital markets: there are few buyers and many sellers. This was true for oil refineries during the 1990s, due to excess capacity, and for regional food brands from the late 1980s, because the major food companies were focusing on international brands. At other times, businesses have high values: there are many buyers and few sellers. This was true for dot.com businesses and for mobile telephone licences in the 1990s.

As a result of these market trends, businesses can have market values that differ from the discounted value of expected future cash flows. A difference between market value and discounted value happens partly because some buyers or sellers are not knowledgeable about likely cash flows or appropriate discount rates, and partly because cash flows are not the only factor influencing decisions to buy or sell. Managers can have "strategic" reasons for buying or selling that cause them to pay a price or accept a price that is above or below the discounted cash flow value (net present value).

Figure 1.4 plots the market value against the net present value (NPV) of owning the business. If the two values diverge outside of a corridor where market value and NPV are approximately equal, there are important consequences for portfolio

Figure 1.4: Fair Value matrix



decisions. When the market value is significantly above the NPV, companies should avoid buying and consider selling. When the market value is significantly below NPV, companies should consider buying and avoid selling.

Capital markets logic steers companies towards buying businesses that are cheap and selling businesses that are expensive. It is probably most influential in affecting the timing of portfolio decisions, rather than in being a prime determinant of the composition of the portfolio. However, **Associated British Foods** (ABF), a UK-based conglomerate, is an example of a company that made a number of significant decisions primarily driven by capital markets logic.

ABF started as a bakery in Canada in the 1890s.[4] It grew first as a worldwide bakery group and then, in the 1960s, diversified more widely. In the financial crisis of the 1970s, the company split into two and the UK arm became ABF. Gary Weston, the CEO and a member of the founding Weston family, then built ABF through a series of well-timed acquisitions and disposals.

He sold Premier Milling in South Africa before the apartheid regime resulted in negative sentiment for South African businesses. He sold Fine Fare, a grocery retailer, before the race between Sainsbury's and Tesco to build out-of-town stores reduced the prices of high street retailers. He bought Beresford, the owner of British Sugar, at a point when its stock price was low. Conglomerates such as Beresford were out of favour and the profits from sugar were temporarily depressed. A few years later, the annual profit from British Sugar, a division of Beresford, was nearly the same as the price he had paid for the whole company. As one manager explained, "The basic logic of this portfolio is that they were businesses that were cheap."

In the last 10 years, ABF has expanded its branded grocery business acquiring brands from companies like Unilever. ABF

spotted that major companies, like Unilever and P&G, were increasingly focusing on their large international brands. This caused them to sell regional brands and smaller international brands. But, there were not many buyers for these brands, enabling ABF to acquire them at attractive prices.

The three logics – business logic, added value logic and capital markets logic – are best used in combination. Mexican Foods, for example, was driven by business logic, when deciding to focus on brands. But managers needed to consider the other logics as well. Using added value logic, managers recognised that branded businesses were a potential value trap because most of the senior managers had cut their teeth on private-label businesses. So they considered what they would need to do at the group level in order to reduce the risk of subtracted value. They also wanted to increase the amount of value they could add to branded businesses, so they decided to strengthen and centralise brand marketing.

Using capital markets logic, managers asked whether now would be a good time to buy branded businesses or sell private-label businesses. They decided not to sell the private-label businesses. Prices were too low: there were very few buyers. For the reverse reason, it proved hard to buy branded businesses at reasonable prices. Other food companies had done similar analyses about the prospects for branded businesses. As a result, the strategy to focus on brands became an organic growth strategy based on existing brands, and on creating new brands using competences from the private-label businesses.

Danaher also used the three logics to guide its acquisition decisions. While managers were interested in acquiring businesses that would respond to the DBS, business logic caused them to look particularly in markets that would allow high margins and for businesses that had strong competitive positions. As Larry Culp explained, Danaher looked to acquire the number one or two in large markets, or to acquire companies with

significant market shares and high margins in fragmented markets. In these situations, their “lean” medicine proved to be particularly effective: they were good at tuning up sound businesses.

Danaher managers also used capital markets logic to guide their decisions. They avoided sectors such as communications equipment, because they were considered hot opportunities by other acquirers. They also made more acquisitions when stock markets were low, such as 2001–2005, than in the boom markets of 2006 and 2007.

ABF was also influenced by all three logics. While the main strategy was about buying cheap, ABF also focused on business logic. In the early 1980s, Gary Weston sold “any part of the business that was not generating cash”, and kept businesses, like Primark, that appeared to have a significant competitive advantage.

ABF also exploited added value logic. By bringing in new managers to British Sugar and raising performance targets, ABF more than doubled profits. By adding bolt-on brands to its Grocery Division, ABF exploited its international presence and back office platform. The bolt-on brands could be integrated without adding significant overheads.

Management (or parenting) strategy

Once portfolio decisions have been made (which businesses to invest in and how much to invest in each), managers at the corporate level need to decide how to manage the resulting portfolio. They need to decide how to structure the organisation into business divisions, what functions and decisions to centralise at the corporate level, who to appoint to the top jobs in the divisions and what guidance to give these managers in the form of strategic targets and controls.

The main logic that guides all of these decisions is the logic of **added value**. All these decisions should be guided by the

objective of maximising the additional value created from owning multiple business divisions and minimising the negative aspects of creating layers of management above the level of the divisions.

In other words, decisions or activities should be centralised at the corporate level, if centralisation will improve overall performance. Targets should be set for divisions by corporate-level managers, if the targets will help division managers achieve more than they would have achieved without the targets. Decisions delegated to divisions should be influenced by corporate-level managers, if the influence can help improve the decisions or the motivation of the managers in the divisions.

Of course there is also a **governance and compliance** logic that determines the existence of some activities, like financial controls and tax management. These activities must be carried out at the corporate level in any responsible company. Headquarters managers must interact with the owners and with certain stakeholders, such as governments. The corporate level must ensure that financial controls are in place, that there is sufficient money available, that taxes are paid and that employees are acting within the law. Corporate-level managers must develop some business plan and share it with the board. Finally, the CEO and the board must appoint the heads of the businesses under their control.

In some industries, such as financial services, that are highly regulated, these governance and compliance activities can be significant, involving hundreds of central staff. However, in most companies these "required activities" are not the main role of headquarters managers. They are part of the management strategy at the corporate level, but they typically occupy only a small percentage of the managers at headquarters. The remainder of the people have jobs at the corporate level that are about adding value.

Typically, a corporate group will have three to seven **major sources of corporate added value**. This list will then guide all

of the difficult decisions about what to centralise, how to organise, who to appoint and how to design group-level processes.

For example, if the main sources of added value are

- investing in a company-wide brand,
- creating a company-wide commitment to lean manufacturing and
- helping business divisions grow in China,

there are implications for centralisation, organisation and processes.

First, the corporate level is likely to appoint some marketing people to look after the brand. These people will set policies for how the brand can be used and may require that decisions relating to the brand pass through their department. Their department is likely to be a central function so that it can gain authority from proximity to the CEO. But, this is not the only arrangement possible. Virgin's brand is managed by a separate company that licenses it to Virgin's businesses. In some companies, product brands that are used in more than one division are controlled by the lead division.

Second, the company will need a team of experts in lean manufacturing to drive the lean initiative. The lean effort will probably be supported by an information system that records the progress each business is making with its implementation of lean methods. It may also require some attention from headquarters managers in setting targets and encouraging commitment. The lean department is likely to be located in headquarters, but many of those who work on lean projects may come from all around the organisation.

Third, the company will benefit from having some headquarters managers with years of experience in China, and who have good relationships with Chinese companies and dignitaries. To support the China effort, the company may need an

organisation structure that has all businesses in China reporting to one head of China. It may need a reporting process that provides detailed information on the performance of units in China.

Fourth, if these are the only sources of added value, other functions, such as finance and human resources, will probably be decentralised with only small teams at group headquarters, focused mainly on governance and compliance. This is because the contributions of these functions to these three major sources of added value are small.

Danaher's main sources of added value were the DBS, the pool of 2000 internal executives Danaher could draw on and the synergies from bolt-on acquisitions. To deliver this added value, Danaher's headquarters was an unassuming office six blocks from the White House in Washington DC. Danaher's name was not even on the building. Inside, around 50 executives populated functions such as finance, legal, HR, accounting, tax and M&A. While a significant portion of the time of these people was devoted to governance and compliance, they could all be involved in significant acquisitions either in a due diligence role or in helping with integration issues.

Headquarters managers were also all trained in the DBS tools. The DBS office was led by an ex-division president, but all of the DBS staff were located in business divisions rather than in Washington. Following an acquisition or when a business needed help, the DBS office would assemble a team to support the project.

The head of HR was an ex-division president rather than an HR professional. His main role was to help assess people and to maintain records on 2000 internal managers so that he could help fill vacancies with capable managers.

Management or parenting strategy is, therefore, mainly about governance and major sources of added value. However, there are often a large number of other activities where small

gains in performance can be achieved by some limited centralisation or standardisation or other form of central influence. Proposals to centralise payroll, to improve working capital or to help an individual business with its market entry in the USA are typical examples.

These **minor sources of added value** should be included in the management strategy with reluctance. The main focus of the management strategy should be the major sources of added value. Danaher is a good example. With only 50 managers in headquarters there was little opportunity to become distracted with minor sources of added value.

The problem is that activities that distract attention from the major sources can easily generate opportunity costs that are greater than the benefits. Moreover, subtracted value, the negative side of headquarters activity, is an ever-present threat. The more activities that are centralised, the more initiatives that are led by headquarters managers and the more headquarters managers "interfere", the higher the risk of subtracted value. As a result, it is important to challenge all minor sources of added value, and only include them in the management strategy if the risk of value destruction, whether from opportunity costs or other sources, is low.

Headquarters functions are normally looking for additional ways to improve overall corporate performance and to expand the remit of their functions. Despite good intentions, their enthusiasm for additional activity can run ahead of their ability to genuinely add value. Over time, headquarters functions can gradually smother both initiative and efficiency at the business level. There are plenty of examples of business divisions spun out of larger groups that have performed better as independent companies. For these divisions, the net impact of the good intentions of their corporate parents was negative. Released from this "parenting", the business-level managers were able to focus on what was important to the success of their business, instead of considering what their corporate masters wanted.

One way to keep a check on the build-up of bureaucracy at corporate levels is to challenge all new corporate-level initiatives against three hurdles:

1. Is the initiative a necessary part of governance or compliance?
2. If not, is the initiative a necessary part of some major source of corporate added value?
3. If not, does the initiative clearly add some value *and* have low risk of negative side effects?

If the initiative fails all three hurdles, it should be rejected.

So, the management strategy is built from an understanding of the compliance and governance requirements, the major sources of added value and a number of minor sources of added value that have low risk of negatives. These three reasons for activity at headquarters guide decisions about:

- the overall organisation structure (how and whether the business units are grouped into divisions),
- the functions at the corporate level or at the division level,
- the central policies,
- the skills, capabilities and focus of senior corporate managers,
- the design of company-wide processes such as planning and budgeting,
- the degree of centralisation or decentralisation and
- the ways in which managers at the corporate level interact with managers lower down.

Having a management strategy that adds a significant amount of value is a central aim of any company ambitious to own multiple business units. Unfortunately, many companies fail this test. They own business units that are performing less well because of the attentions of their parent company or they create costs at the corporate level that are greater than the value

added. This state of affairs is clearly unsatisfactory and immediate action is needed.

However, being a positive parent is not enough. The management strategy should aim higher. Companies should aim to have a **parenting advantage**: they should aim to add more value than other parent companies can. They should aim to be the best owner of each of the businesses in their portfolio. If they are the best owner, there is no opportunity for a different management team to acquire the whole company and make changes that would improve overall value.

We use the phrase parent company to emphasise the fact that corporations are not only competing with other corporations for the ownership of business units. They are also competing with governments, private equity firms, family holding companies, national wealth funds, investment firms like Berkshire Hathaway, and others for the ownership of businesses.

Of course, companies are rarely the best owners of all of their business units all of the time. Sometimes the portfolio strategy has taken the company into some new sector because of its future growth potential. For a period the company many not be the best owner of this fledgling business. But, over time, it should be ambitious to become a good owner. At other times, an opportunity to expand the portfolio has come unexpectedly due to some imperfection in the capital markets. Again, for a period, the company may not be the best owner of this new business. At other times, managers at the parent level retire and need to be replaced. It is not always possible to find replacements with all the required skills. So, for a period while the new managers learn and develop, the company many not be the best parent of all of its businesses.

Nevertheless, despite many situations where the current parent company is not the best possible owner of a particular business unit, it is important that the management strategy is guided by the medium-term aim of being the "best owner". This

means that management strategy should include an analysis of **rival parents**. Without a good understanding of the management strategies of other companies, it is hard to make judgements against the best owner metric.

Summary

Corporate-level strategy involves making decisions about which businesses to own and invest in (portfolio strategy) and how to manage or parent the businesses (management/parenting strategy). Part II of this book addresses portfolio strategy and Part IV addresses parenting strategy.

Added value logic is a common guiding thought in both portfolio strategy and parenting strategy. Hence, it is a central pillar of corporate-level strategy: companies should aim to be the best parents of the business units they own. As a result, Part III of this book is dedicated to exploring added value in more detail. We describe different sources of added value. We comment on sources of subtracted value. We also provide some tools to help managers identify the best sources of added value in their companies.

Added value is also a driving logic in international strategy. In the Appendix, we look at the links and overlaps between corporate-level strategy and international strategy. Since most companies in multiple businesses are also in multiple countries, it is important to understand how corporate-level strategy and international strategy fit together.

Added value logic is, however, not the only driver of corporate-level strategy. Companies need to consider the attractiveness of the markets they choose to enter and the strength of their competitive position within these markets (business logic). They also need to consider the state of the capital markets for buying and selling businesses (capital

markets logic). Both of these two additional logics can provide reasons to buy or sell or invest or disinvest that are in contradiction to the added value logic.

As a result, good corporate-level strategy work involves balancing the influence of these three logics over time. Sometimes, added value logic will be the primary driver. For example, managers at Danaher between 2000 and 2010 worked hard to improve their ability to add value to their portfolio of engineering businesses and only added business units to the portfolio that were similar to the ones they already had.

At other times, business logic is the driving force. For example, managers at Mexican Foods concluded that they needed to change the balance of their business units, reducing the emphasis on private label and increasing the emphasis on brands. This change involved significant adjustments to both portfolio and parenting.

At still other times, investment logic may be the driving force. For example, ABF expanded in the bakery business at a time when flour milling and bread manufacturing were out of favour and undervalued. ABF was also able to improve these businesses both with stronger management and with economies of scale. But, as the markets changed, ABF sold many of its bakeries earning a premium on the price it had paid.

Corporate-level strategy is therefore a balancing act, where different ideas may be driving activity at different times. The remainder of this book explains in more detail how to be good at developing corporate-level strategy, what analyses are helpful and how to retain a balanced perspective. However, before we dive into the details of corporate-strategy analysis, we should start by looking back at the history of thinking in this field. We need to ground our concepts in the academic literature and the lessons of experience.

Notes

[1] Blacklock is a real company that the authors have advised. It has been disguised at the request of management. Names, dates and locations have been changed.

[2] This is another company where the management team asked us to use a disguise.

[3] Harvard Business School case "Danaher Corporation", Case No. N9-708-445, January 2008.

[4] Harvard Business School case "Associated British Foods", Case No. N9-708-402, November 2011.