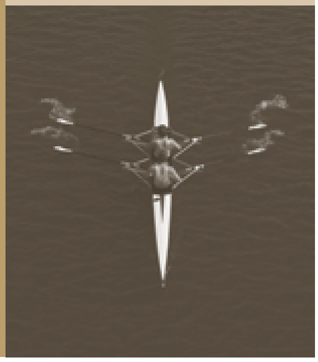
16

Managing the Multibusiness Corporation



Some have argued that single-product businesses have a focus that gives them an advantage over multibusiness companies like our own – and perhaps they would have, but only if we neglect our own overriding advantage: the ability to share the ideas that are the result of wide and rich input from a multitude of global sources.

GE businesses share technology, design, compensation and personnel evaluation systems, manufacturing practices, and customer and country knowledge. Gas Turbines shares manufacturing technology with Aircraft Engines; Motors and Transportation Systems work together on new propulsion systems; Lighting and Medical Systems collaborate to improve x-ray tube processes; and GE Capital provides innovative financing packages that help all our businesses around the globe. Supporting all this is a management system that fosters and rewards this sharing and teamwork, and, increasingly, a culture that makes it reflexive and natural at every level and corner of our Company.

—JACK WELCH, CHAIRMAN, GENERAL ELECTRIC COMPANY, 1981–2001

OUTLINE

Introduction and Objectives

In the last chapter, we concluded that the case for diversification rests ultimately on the ability of the diversified corporation to exploit sources of value from operating across multiple businesses more effectively than can specialized firms linked by markets. Chapters 13 and 14 arrived at the same conclusion in relation to vertical integration and multinational operations. Hence, multibusiness companies[1] – whether vertically integrated, multinational, or diversified across multiple products – face two critical issues. First, can value be created through the relationships between businesses that span different activities or different markets? Second, how should a company be structured and managed to exploit these sources of value? Chapters 13, 14, and 15 addressed the first question in relation to vertical, multinational, and multiproduct scope. This chapter addresses the second question.

To manage multiple activities in multiple markets, multibusiness corporations typically use *multidivisional structures* comprising several divisions or subsidiaries, coordinated by a corporate headquarters. We shall examine the structures, management systems, and leadership styles through which these – typically large, complex – corporations formulated and implement their strategies. As we will see, corporate strategy is not simply a matter of answering the question: "What businesses should we be in?" Some of the most difficult issues of corporate strategy concern the roles and activities of the corporate head office and the relationships between the businesses and the corporate center. These issues include: managing the business portfolio; resource allocation; strategic planning; controlling business unit performance; and coordinating across businesses.

By the time you have completed this chapter you will be able to:

- Recognize the principal organizational feature of the multibusiness corporation.
- Apply the techniques of portfolio analysis to corporate strategy decisions.
- Analyze the potential for value creation through restructuring a multibusiness corporation.
- Understand how corporate headquarters manages its individual businesses through strategic planning and financial control and by managing linkages across businesses.
- Analyze the fit between a firm's corporate strategy organization structure, management systems, and leadership style.

The Structure of the Multibusiness Company

Chapter 1 introduced the distinction between business strategy and corporate strategy and observed that, within the multibusiness company, corporate management takes primary responsibility for corporate strategy, and divisional management takes primary responsibility for business strategy. This corporate/divisional distinction is the basis feature of the multibusiness corporation. Whether we are referring to a multiproduct company (such as Viacom), a multinational company (such as SABMiller), or a vertically integrated corporation (such as Alcoa), almost all multibusiness companies are organized as multidivisional structures where business decisions are located at the business level and the corporate center exercises overall coordination and control. As we noted in Chapter 6, the emergence of the multidivisional structure during the early 20th century was one of the key innovations in the history of management since it facilitated the development of the large diversified, multinational corporations.

The allocation of decision making between corporate and divisional levels has shifted over time. The initial rationale for the multidivisional firm was the separation of strategic and operational decision making. During recent decades, more strategic decision making has been devolved to the divisional and business unit levels, while corporate headquarters have taken responsibility for corporate strategy and the management of overall corporate performance. Our primary focus is to analyze and understand the role of the corporate center in managing the multibusiness company.

The Theory of the M-form

Once Alfred Chandler had documented the origin and diffusion of the multidivisional form, it was left to Oliver Williamson to theorize about its rationale.[2] Williamson identified four key efficiency advantages of the divisionalized firm (or, in his terminology, the *M-form*):

1. *Adaptation to "bounded rationality."* If managers are limited in their cognitive, information-processing, and decision-making capabilities, the top management team cannot be responsible for all coordination and decision making within a complex organization. The M-form permits decision making to be dispersed.
2. *Allocation of decision making*. Decision-making responsibilities should be separated according to the frequency with which different types of decisions are made. The M-form allows high frequency decisions (e.g., operating decisions) to be made at divisional level and decisions that are made infrequently (e.g., strategic decisions) to be made at corporate level.
3. *Minimizing coordination costs*. In the functional organization, decisions concerning a particular product or business area must pass up to the top of the company where all the relevant information and expertise can be brought to bear. In the divisionalized firm, so long as close coordination between different business areas is not necessary, most decisions concerning a particular business can be made at the divisional level. This eases the information and decision-making burden on top management.
4. *Avoiding goal conflict*. In functional organizations, department heads emphasize functional goals over those of the organization as a whole. In multidivisional companies, divisional heads, as general managers, are more likely to pursue profit goals that are consistent with the goals of the company as a whole.

As a result, the multidivisional firm can help solve two key problems of large, managerially controlled corporations:

- *Allocation of resources*. Resource allocation within any administrative structure is a political process in which power, status, and influence can triumph over purely commercial considerations.[3] To the extent that the multidivisional company can create a competitive internal capital market in which capital is allocated according to financial and strategic criteria, it can avoid much of the politicization inherent in purely hierarchical systems. The multidivisional company can achieve this through operating an internal capital market where budgets are linked to past and projected divisional profitability, and individual projects are subject to a standardized appraisal and approval process.
- *Resolution of agency problems*. A related shortcoming of the modern corporation is that owners (shareholders) wish to maximize the value of the firm, while their agents (top managers) are more interested in salaries, security, and power. Given the limited power of shareholders to discipline and replace managers, and the tendency for top management to dominate the board of directors, the multidivisional form may act as a partial remedy to the agency problem. The rationale is as follows: by acting as an interface between the stockholders and the divisional managers, corporate management can enforce adherence to profit goals. With divisions designated as profit centers, financial performance can readily be monitored by the head office, and

divisional managers can be held responsible for performance failures. So long as corporate management is focused on shareholder goals, the multidivisional structure can support a system for enforcing profit maximization at the divisional level. General Electric, Emerson Electric, and BP are prime examples of multidivisional companies where the corporate headquarters has been highly effective in creating profit-oriented systems and cultures.

Oliver Williamson explains these merits of the multidivisional corporation as follows:

> *The M-form conglomerate can be thought of as substituting an administrative interface between an operating division and the stockholders where a market interface had existed previously. Subject to the condition that the conglomerate does not diversify to excess, in the sense that it cannot competently evaluate and allocate funds among the diverse activities in which it is engaged, the substitution of internal organization can have beneficial effects in goal pursuit, monitoring, staffing, and resource allocation respects. The goal-pursuit advantage is that which accrues to M-form organizations in general: since the general management of an M-form conglomerate is disengaged from operating matters, a presumption that the general office favors profits over functional goals is warranted. Relatedly, the general office can be regarded as an agent of the stockholders whose purpose is to monitor the operations of the constituent parts. Monitoring benefits are realized in the degree to which internal monitors enjoy advantages over external monitors in access to information – which they arguably do. The differential ease with which the general office can change managers and reassign duties where performance failures or distortions are detected is responsible for the staffing advantage. Resource allocation benefits are realized because cash flows no longer return automatically to their origins but instead revert to the center, thereafter to be allocated among competing uses in accordance with prospective yields.*[4]

Can the corporate general office really be relied upon to act as an "agent of the stockholders"? Despite evidence that multidivisional structures are, in general, more effective for diversified firms than alternative structural forms,[5] some of the most notorious examples of chief executives operating their companies as personal fiefdoms are found among diversified, divisionalized corporations. Armand Hammer at Occidental Petroleum, Howard Hughes at Hughes Corporation, Ken Lay at Enron, Dennis Kozlowski at Tyco, and Jean-Marie Messier at Vivendi Universal all pursued empire building at the expense of shareholder return.[6] Corporate executives of diversified companies may be less emotionally committed to particular businesses, but this does not necessarily mean that they are more predisposed to shareholder return than to Napoleonic personal grandeur.

Problems of Divisionalized Firms

In principle, the divisionalized corporation reconciles the benefits of decentralization with those of coordination. As Henry Mintzberg points out, in practice, the multi-divisional structure suffers from two important rigidities that limit decentralization and adaptability:[7]

- *Constraints on decentralization*. Although operational authority in the M-form firm is dispersed to the divisional level, the individual divisions often feature highly centralized power that is partly a reflection of the divisional president's personal accountability to the head office. In addition, the operational freedom of the divisional management exists only so long as the corporate head office is satisfied with divisional performance. Monthly financial reviews typically mean that variances in divisional performance precipitate speedy corporate intervention.

- *Standardization of divisional management*. In principle, the divisional form permits divisional management to be differentiated by their business needs. In practice, there are powerful forces for standardizing control systems and management styles which may inhibit individual divisions from achieving their potential. The imposition by Exxon of its standard financial control systems and hierarchical culture on its entrepreneurial IT subsidiary, Exxon Office Systems, was a key factor in the venture's eventual failure. The difficulties that many large, mature corporations experience with new business development often result from applying to new businesses the same management systems designed for existing businesses.[8]

The Role of Corporate Management

How does the corporate headquarters create value within the multibusiness corporation? If the multibusiness corporation is to be viable, then the additional profits generated by bringing several businesses under common ownership and control must exceed the costs of the corporate headquarters. To explore the potential for corporate management to add value, we must consider the role and functions of corporate managers.

So far we have identified corporate headquarters primarily with corporate strategy: determining the scope of the firm and allocating resources between its different parts. In fact, the responsibilities of corporate management also include administrative and leadership roles with regard to implementing corporate strategy, participating in divisional strategy formulation, coordinating the different divisions, and fostering overall cohesion, identity, and direction within the company. These functions extend beyond what is normally thought of as "corporate strategy." For this reason, Goold, Campbell, and Alexander refer to the role of the corporate headquarters in the multibusiness company as "corporate parenting."[9]

There are three main activities through which corporate management adds value to the multibusiness company:

- Managing the corporate portfolio, including acquisitions, divestments, and resource allocation.
- Exercising guidance and control over individual businesses, including influencing business strategy formulation and managing financial performance.
- Managing linkages among businesses by sharing and transferring resources and capabilities.

Let us consider each of these corporate management activities and establish the conditions under which they can create value.

Managing the Corporate Portfolio

The basic question of corporate strategy is: "What business are we in?" Hence, corporate strategy is concerned with the composition and balance of a company's portfolio of businesses. The key issues are extensions of the portfolio (acquisitions, mergers, new ventures, and market entries), deletions from the portfolio (divestments), and changes in the balance of the portfolio through the allocation and reallocation of capital and other resources. While additions to and deletions from the corporate portfolio are typically major but infrequent strategic decisions, resource allocation among businesses is an ongoing strategic responsibility of corporate management. *Portfolio planning models* are useful techniques for appraising a firm's overall business portfolio and for formulating strategies for the individual businesses.

GE and the Development of Strategic Planning

Portfolio planning techniques were one outcome of the pioneering work in corporate strategy initiated by General Electric at the end of the 1960s.[10] Indeed, General Electric has been a leading source of corporate strategy concepts and innovations for more than half a century. GE has been among the top five members of *Fortune* magazine's "America's Most Admired Corporations" since the listings began.

At the end of the 1960s, GE comprised 46 divisions and over 190 businesses. To manage this sprawling industrial empire more effectively, GE launched a series of initiatives together with the Boston Consulting Group, McKinsey & Co., Arthur D. Little, and the Harvard Business School. The result was three innovations that would transform corporate strategy formulation in multibusiness companies:

- *Portfolio planning models* – two-dimensional, matrix-based frameworks to evaluate business unit performance, formulate business unit strategies, and assess the overall balance of the corporate portfolio.
- *The strategic business unit (SBU)* – the basic organizational unit for which it is meaningful to formulate a separate competitive strategy. Typically, an SBU is a business consisting of a number of closely related products and for which most costs are not shared with other businesses. McKinsey recommended the reorganization of GE into SBUs for formulating and monitoring business strategies.
- *The PIMS database* – an internal database that comprises strategic, market, and performance data on each of GE's businesses for assisting strategy formulation by providing analysis of the impact of market structure and strategy variables on profitability.[11]

Portfolio Planning: The GE/McKinsey Matrix

The best-known products of GE's corporate planning initiatives of 1969–72 are the portfolio planning models developed by McKinsey, BCG, and A. D. Little. The basic idea was to represent the businesses of the diversified company within a simple graphical framework that could be used to guide strategy analysis in four areas:

1. *Allocating resources*. Portfolio analysis examines the position of a business unit in relation to the two primary sources of profitability: industry attractiveness and the competitive advantage of the firm. These indicate the attractiveness of the business for future investment.

2 *Formulating business unit strategy*. The current positioning of the business in relation to industry attractiveness and potential competitive advantage indicates the strategic approach that should be taken with regard to capital investment and can point to opportunities for repositioning the business.
3 *Analyzing portfolio balance*. The primary usefulness of a single diagrammatic representation of the company's different businesses is the ability of corporate management to take an overall view of the company. This permits planning the overall balance of:
   - *cash flows*: by balancing cash-generating businesses against cash-absorbing businesses, the diversified company can achieve independence from external capital markets;
   - *growth*: by balancing a mix of businesses in different stages of their life cycles, the diversified company can stabilize its growth rate and achieve continuity over time.
4 *Setting performance targets*. To the extent that positioning with regard to industry attractiveness and competitive position determine profit potential, portfolio-planning matrices can assist in setting performance targets for individual businesses.

The two axes of the GE/McKinsey matrix (see Figure 16.1) are the familiar sources of superior profitability for a firm: *industry attractiveness* and *competitive advantage*. Industry attractiveness combines the following factors: market size and growth rate; industry profitability (return on sales over three years); cyclicality; inflation recovery (ability to cover cost increases by higher productivity and increased prices); and importance of overseas markets (ratio of international to US sales). Business unit competitive advantage is computed on the basis of the following variables: market share; competitive position with regard to quality, technology, manufacturing, distribution, marketing, and cost; and return on sales relative to that of leading competitors.

Strategy recommendations are shown by three regions of Figure 16.1:

- Business units that rank high on both dimensions have excellent profit potential and should be *grown*.
- Those that rank low on both dimensions have poor prospects and should be *harvested* (managed to maximize cash flow with little new investment).
- In-between businesses are candidates for a *hold* strategy.

FIGURE 16.1 The GE/McKinsey portfolio planning matrix

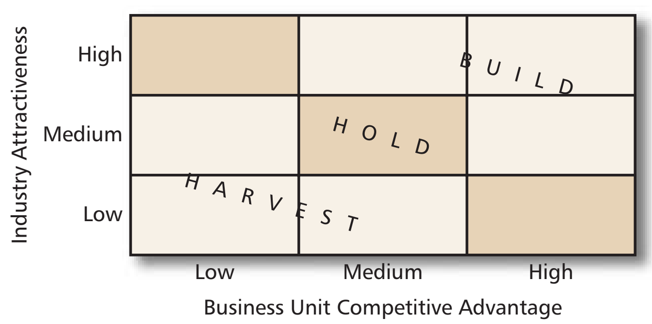
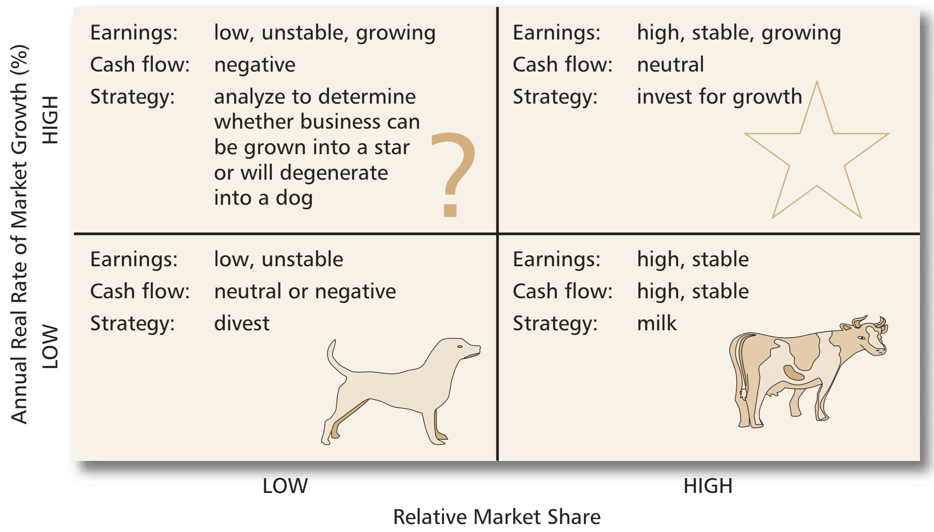


FIGURE 16.2 The BCG growth–share matrix



Portfolio Planning: BCG's Growth–Share Matrix

The Boston Consulting Group's matrix is similar: it also uses industry attractiveness and competitive position to compare the strategic positions of different businesses. However, unlike the McKinsey matrix, it uses single variables for each axis: industry attractiveness is measured by *rate of market growth*, competitive advantage by *relative market share* (the business unit's market share relative to that of its largest competitor).

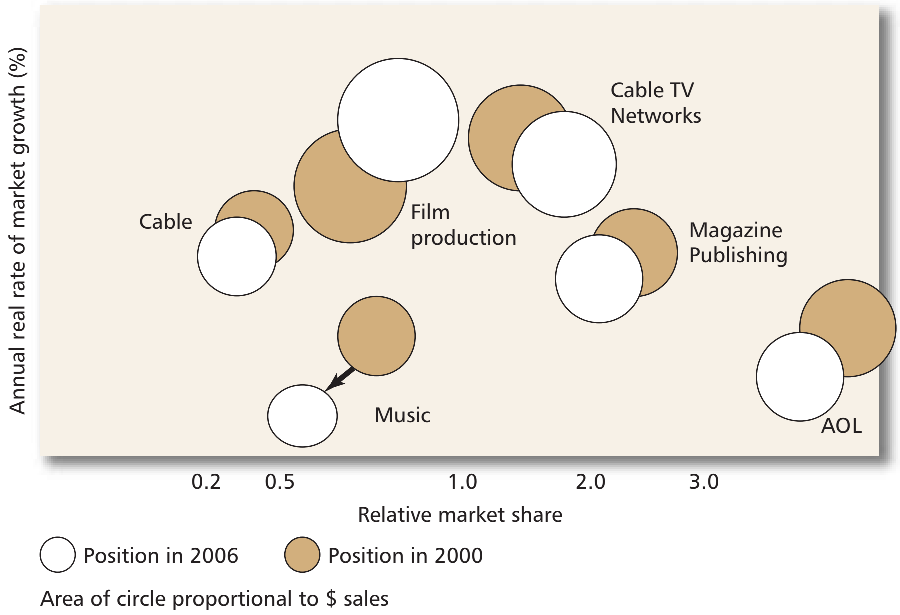
The four quadrants of the BCG matrix predict patterns of profits and cash flow and offer strategy recommendations as to appropriate strategies. These are summarized in Figure 16.2.

The BCG growth–share matrix is even more elementary than the McKinsey matrix, yet, in providing a first-cut analysis, this simplicity is also a virtue:

- Because information on only two variables is required, the analysis can be prepared easily and quickly.
- It assists senior managers in cutting through the vast quantities of detailed information on individual businesses to reveal some key differences in their positioning.
- The analysis is versatile – it can be applied not only to business units, but also to analyzing the positioning and performance potential of different products, brands, distribution channels, and customers.
- It provides a useful point of departure for more detailed analysis and discussion of the competitive positions and strategies of individual business units.

The value of combining several elements of strategically useful information in a single graphical display is illustrated by the application of the BCG matrix to Time Warner (see Figure 16.3). This shows each business's positioning with regard to market growth and market share; it also indicates the relative size of each business and movements in its strategic position over time.

FIGURE 16.3 Applying the BCG matrix to Time Warner Inc.



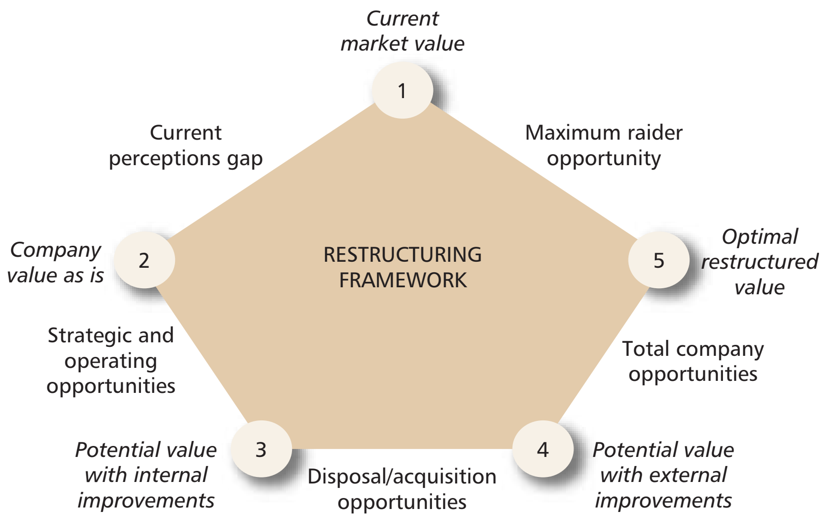
Since the 1980s, portfolio planning matrices (including those of BCG and McKinsey) have lost their popularity as analytic tools. Among their weaknesses are the following:

- Both are gross oversimplifications of the factors that determine industry attractiveness and competitive advantage. This is especially true of the BCG matrix, which uses just two variables: market share is a crude indicator of competitive advantage; market growth is a poor proxy for profit potential.
- The positioning of businesses within the matrix is highly susceptible to measurement choices. For example, relative market share in the BCG matrix depends critically on how markets are defined. Is BMW's North American auto business a "dog" because it holds about 2% of the total auto market, or a cash cow because BMW is market leader in the luxury car segment? Booz Allen Hamilton suggest that "dog" business may, in fact, offer attractive development opportunities.[12]
- The approach assumes that every business is completely independent. Where linkages exist between business units, viewing each as a standalone business inevitably leads to suboptimal strategy choices. As a standalone business, Disney's theatrical productions (such as *Lion King*) looks like a dog. This ignores the fact that Disney's theatrical productions profitably exploit themes and characters developed for other media.

Value Creation Through Corporate Restructuring

During the past two decades, the major theme of corporate strategy has been refocusing and divestment. As a result, the key issue for portfolio analysis is whether the market value of the company is greater *with* a particular business or *without* it (i.e., selling it to another owner or spinning it off as a separate entity).

FIGURE 16.4 The McKinsey restructuring pentagon



SOURCE: T. E. COPELAND, T. KOLLER, AND J. MURRIN, *VALUATION* (NEW YORK: WILEY, 1990).

Applying the techniques of shareholder value analysis outlined in Chapter 2, McKinsey & Co. has proposed a systematic framework for increasing the market value of multibusiness companies through corporate restructuring.[13] McKinsey's *Pentagon Framework* consists of a five-stage process, illustrated in Figure 16.4. The five stages of the analysis are:

1 *The current market value of the company*. The starting point of the analysis is the current market value of the company, which comprises the value of equity plus the value of debt. (As we know from Chapter 2, this equals the net present value of the anticipated cash flow to the company.)

2 *The value of the company as is*. Even without any changes to strategy or operations, it may be possible to value simply by managing external perceptions of a company's future prospects. Over the past ten years, companies have devoted increasing attention to managing investor expectations by increasing the flow of information to shareholders and investment analysts and establishing departments of investor relations.

3 *The potential value of the company with internal improvements*. As we shall see in the next section, the corporate head office of a company has opportunities for increasing the overall value of the company by making strategic and operational improvements to individual businesses that increase their cash flows. Strategic opportunities include exploring growth opportunities such as investing in global expansion, repositioning a business in relation to customers and competitors, or strategic outsourcing. Operating improvements would include cost-cutting opportunities and taking advantage of the potential to raise prices.

4 *The potential value of the company with external improvements*. Once top management has determined the value of its constituent businesses and of the company as a whole, it is in a position to determine whether changes in the business portfolio will increase overall company value. The key issue is whether an individual business, even after strategic and operating

improvements have been made, could be sold for a price that is greater than its potential value to the company.

5 *The optimum restructured value of the company*. This is the maximum value of a company once all the potential gains from changing investor perceptions, making internal improvements, and taking advantage of external opportunities have been exploited. The difference between the maximum restructured value and the current market value represents the profit potential available to a corporate raider from taking advantage of the restructuring opportunities.

This type of analysis has been traditionally associated with leveraged buyout specialists and other corporate raiders. However, faced with the increasing threat of acquisitions, such analysis is increasingly being undertaken by corporate senior managers themselves. The restructuring measures undertaken by the oil majors during 1986–92 exemplify this process: increasing the value of existing businesses through cost cutting, while taking advantage of external opportunities for trading assets and selling businesses.[14]

Managing Individual Businesses

Despite the emphasis given to economies of scope and other types of linkage among the businesses within the multibusiness firm, some of the most important opportunities for corporate headquarters to create value arise from what Goold, Campbell, and Alexander call "standalone influence." This relates to the corporate parent's ability to:

> *. . . appoint the general manager of each business and influence management development and succession planning within the businesses. It can approve or reject budgets, strategic plans, and capital expenditure proposals and it can influence the shape and implementation of these plans and proposals. It can provide advice and policy guidance to the businesses. The parent also influences the businesses by the hints and pressures passed on through both formal and informal line management meetings and contacts, and, more indirectly, through the corporate culture.*[15]

There are two primary means by which the corporate headquarters can exert control over the different businesses of the corporation. It can control decisions, through requiring that particular categories of decision – typically those involving significant resource commitments – are referred upward for corporate approval. Thus, a company may require that all capital expenditure decisions involving a commitment of funds of over $20 million are approved by the executive committee. Alternatively, corporate headquarters may seek to control businesses through controlling performance targets, backed by incentives and penalties to motivate the attainment of these targets. The distinction is between *input* and *output* controls: the company can control the inputs into the process (i.e., the decisions) or it can control the outputs (the performance). Although most companies use a combination of input and output controls, there is an unavoidable tradeoff between the two: more of one implies less of the other. If a company exerts tight control over divisional decisions, it must accept the performance outcomes that arise from those decisions. If the company exerts rigorous controls relating to performance in terms of annual profit targets, it must give divisional managers the freedom to make the decisions necessary to achieve these targets. Corporate influence over business strategy formulation is primarily a form of "input control"; corporate financial control – especially the setting of performance targets – is a form of "output control."

The Strategic Planning System

In Chapter 1, I identified corporate strategy as being set at the corporate level and business strategy as set at the business level. In reality, business strategies are formulated jointly by corporate and divisional managers. In most diversified, divisionalized companies, business strategies are initiated by divisional managers and the role of corporate managers is to probe, appraise, amend, and approve divisional strategy proposals. The critical issue for corporate management is to create a strategy-making process that reconciles the decentralized decision making essential to fostering flexibility, responsiveness, and a sense of ownership at the business level, with the ability of the corporate level to bring to bear its knowledge, perspective, and responsibility for the shareholder interest. Achieving an optimal blend of business-level initiative and corporate-level guidance and discipline is a difficult challenge for the multibusiness corporation. Common to the success of General Electric, Exxon Mobil, Samsung, and Unilever is a system of strategic management that has managed this difficult tradeoff between business initiative and corporate control. Strategy Capsule 16.1 describes key elements of the strategic planning process at Exxon.

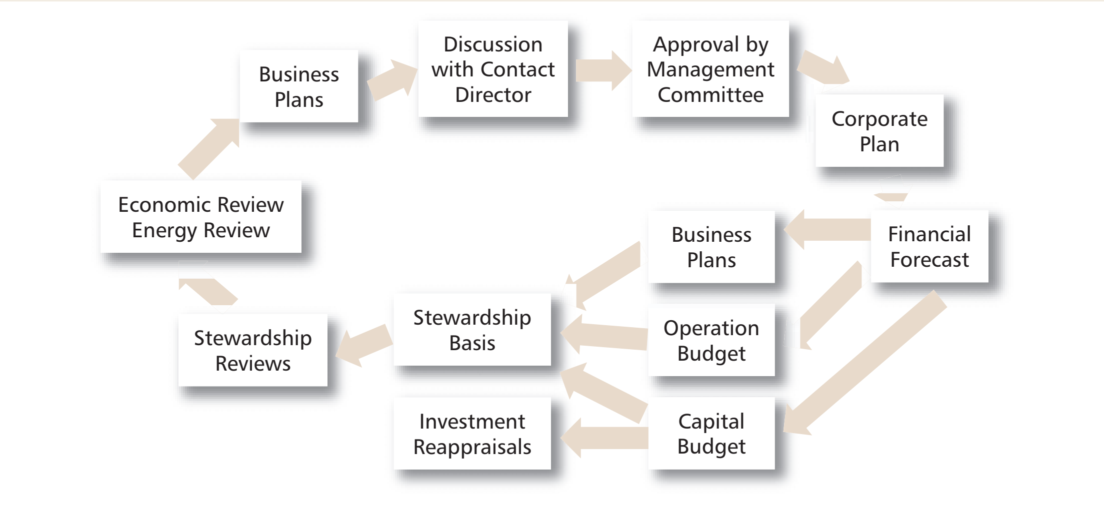
Rethinking the Strategic Planning System For the past 25 years the strategic planning systems of large firms have been bombarded by criticism from academics and consultants. Two features of corporate strategic planning systems have attracted particular scorn:

- *Strategic planning systems don't make strategy*. Ever since Henry Mintzberg attacked the "rational design" school of strategy (see Chapter 1), strategic planning systems have been castigated as ineffective for formulating strategy. In particular, formalized strategic planning has been viewed as the enemy of flexibility, creativity, and entrepreneurship. Marakon consultants Mankins and Steele have observed that "strategic planning doesn't really influence most companies' strategy."[16] The principal reasons are its rigid annual cycle and its preoccupation with business unit plans – as a result "senior executives . . . make the decisions that really shape their companies' strategies . . . outside the planning process typically in an ad hoc fashion without rigorous analysis or productive debate." The approach they identify at companies such as Microsoft, Boeing, and Textron is what they call "continuous, decision-oriented planning" where the emphasis is, first, on analyzing the critical issues that face the company and, second, on decision making. The central feature of the process is that the top management team – the executive committee – becomes the key drivers of the strategy-making process.
- *Weak strategy execution*. A major theme of recent years has been the need for more effective strategy execution by large companies. This means a more effective linkage between strategic planning and operational management. Larry Bossidy and Ram Charan point to the key role of *milestones* that can ". . . bring reality to a strategic plan."[17] Thus, to keep Honeywell's strategy for cost cutting in its automotive business on track, managers developed short- and medium-term milestones for shifting production overseas. As was

STRATEGY CAPSULE 16.1

Strategic Planning at Exxon

Exxon (now Exxon Mobil) is the world's biggest company (in terms of revenue and market value) and is the most financially successful oil and gas major. Exxon's strategic planning system has successfully reconciled long-term strategic planning with rigorous, short-term financial control; and strong centralized direction with flexible, responsive, business-level decision making. Exxon's strategic planning process follows an annual cycle that is similar to the "generic" strategic planning process outlined in Chapter 6 (see Figure 6.6).



The principal stages of the planning cycle are as follows:

1. *Economic Review and Energy Review* are forecasts of the economy and energy markets prepared in spring by the Corporate Planning Department to provide a basis for strategic planning.
2. *Business Plans* are developed during the spring and summer by individual businesses and are aggregated and refined at the divisional level. Their time horizon is ten years for upstream, five years for downstream and chemicals. Prior to discussion, negotiation, and approval by the Management Committee, the plans are discussed with each division's Contact Director and evaluated by Corporate Planning Department (during October).
3. *The Corporate Plan* results from the aggregation of individual business plans. The approved business and corporate plans then provide the basis for the financial and performance plans (formulated during November).
4. *The Financial Forecast* comprises forecasts of revenues, operating costs, capital expenditures, interest and other expenses, income, and cash flow for divisions and for the company as a whole over a two-year period.

5. *The Operating and Capital Budgets* are set for the upcoming year (the first year of the plans).
6. *The Stewardship Basis* comprises annual targets against which the next year's performance by each division will be judged. They include financial objectives, operating targets, safety and environmental objectives, and strategy mileposts.
7. *Stewardship Reviews*. In February of each year, each division's performance for the previous year is evaluated against its stewardship objectives. These reviews involve presentations by the divisional top management to the Management Committee.
8. *Investment Reappraisals* occur in August and September and involve the divisions reporting back on the outcomes of specific investment projects.

In addition to this annual strategic planning cycle, *Strategic Studies* are ad hoc projects by the Corporate Planning Department that address specific issues such as country and product studies and responses to major market, technological, and political changes.

Exxon's strategic management system features clearly defined corporate, divisional, and business unit responsibilities (with matching accountability). At the same time there is close communication and coordination between these levels. This takes place formally through the strategic planning and financial control system, and informally through ongoing communication between the Management Committee (composed of Exxon's executive board members) and the Divisional Presidents and their management teams. Each member of the Management Committee is "Contact Director" for two or three divisions. The dialog between the Divisional Presidents and the Contact Directors is a mechanism for knowledge sharing and initiating strategic changes that adds flexibility to the formal strategic planning process. The result is a system of strategy formulation and performance management that is simultaneously top–down and bottom–up.

Fundamental to Exxon's close integration of financial management with strategic planning is Exxon's emphasis on *stewardship* – a doctrine of managerial responsibility and accountability that makes each executive personally responsible to the corporation and its shareholders.

noted in Chapter 2, the *balanced scorecard* is another technique for translating strategy into specific functional and operational targets. Building on their balanced scorecard approach, Kaplan and Norton argue that *strategy maps* are used to plot the relationships between strategic actions and overall goals.[18] To ensure a close linkage between strategic planning and strategy implementation they recommend that companies establish an *office of strategy management*.[19] How does this differ from the familiar corporate planning department? The key, according to Kaplan and Norton, is that the office of strategy management is responsible not just for managing the annual strategic planning cycle but also for overseeing the execution of strategic plans, including: "communicating corporate strategy, ensuring that enterprise-level plans are translated into the plans of the various units and departments, executing strategic initiatives to deliver in the grand plan, and aligning employees' competency development plans and their personal goals and incentives with strategic objectives."[20]

Performance Control and the Budgeting Process

Most multidivisional companies operate a dual planning process: strategic planning concentrates on the medium and long term, financial planning controls short-term performance. Typically, the first year of the strategic plan includes the performance plan for the upcoming year in terms of an operating budget, a capital expenditure budget, and strategy targets relating to market share, output and employment levels, and specific strategic milestones. Annual performance plans are agreed between senior business-level and corporate-level managers. They are monitored on a monthly or quarterly basis, and are reviewed more extensively in meetings between business and corporate management after the end of each financial year.

The corporate head office is responsible for setting and monitoring performance targets for the individual divisions. Performance targets may be financial (return on invested capital, gross margin, growth of sales revenue), strategic (market share, rate of new product introduction, market penetration, quality), or operational (output, productivity). Performance targets are primarily annual, with less detailed performance targets set for up to five years ahead. Corporate emphasis is on annual targets which are monitored on a monthy and quarterly basis to detect deviations.

Performance targets are supported by incentives include financial returns (bonuses, enhanced authority, recognition) and sanctions. Some companies have combined demanding performance goals and powerful incentives to create an intensely motivating environment for divisional managers. At ITT, Geneen's obsession with highly detailed performance monitoring, ruthless interrogation of divisional executives, and generous rewards for success developed a highly motivated, strongly capable group of young, senior executives who were willing to work unremittingly long hours. They demanded as high a standard of performance from their subordinates as Geneen did of them.[21] Creating an intense, performance-driven culture requires unremitting focus on a few quantitative performance targets that can be monitored on a short-term basis. PepsiCo's obsession with monthly market share nourishes an intense, marketing-oriented culture. As CEO Indra Nooyi noted, "We are a very objective-driven company. We spend a lot of time up front setting objectives and our guys rise to the challenge of meeting those objectives. When they don't meet the objectives, we don't have to flog them because they do it themselves."[22] One executive put it more bluntly: "The place is full of guys with sparks coming out of their asses."[23] Even in businesses where interdependence is high and investment gestation periods are long, as in oil and gas, short- or medium-term performance targets can be highly effective. The key feature of BP's performance-oriented culture is a system of performance contracts in which each business unit general manager agrees a set of financial, strategic, and operational targets with the CEO.[24]

Linking individual incentives to company performance goals has proved to be more difficult than most advocates of performance management envisaged. Over time, top management compensation has become increasingly closely tied to company performance through performance-related bonuses the stock options. Moreover, performance bonuses and options packages have been extended down corporate hierarchies to increasing numbers of employees. In the UK, salary comprised 54% of total executive compensation as compared with bonuses 24%, and options and long-term incentive plans 22%.[25] However, financial incentives for executives seem to be poorly aligned with the goals of shareholders. The ability of top managers to design their own compensation schemes has resulted in massive growth in top management pay and in the manipulation of these schemes to the benefit of executives.[26] The stock market boom of the late 1990s created perverse incentives for executives to maximize short-term financial performance and even to manipulate financial statements.[27]

Balancing Strategic Planning and Financial Control

One implication of the tradeoff between *input control* (controlling decisions) and *output control* (controlling performance) is that companies must choose how far to emphasize strategic planning relative to financial planning as their primary control system. A study of British multibusiness companies by Michael Goold and Andrew Campbell found that their corporate management systems emphasized either strategic planning or financial control.[28] *Strategic planning* emphasized the longer term development of the businesses and was associated with substantial involvement by corporate headquarters in business-level planning. *Financial control* implied limited involvement by corporate management in business strategy formulation, which was the responsibility of divisional and business unit managers. The primary influence of headquarters was through short-term budgetary control and the establishment of ambitious financial targets that were rigorously monitored by headquarters. Table 16.1 summarizes key features of the two styles.

TABLE 16.1 Characteristics of Different Strategic Management Styles

	Strategic planning	Financial control
Business Strategy Formulation	Businesses and corporate HQ jointly formulate strategy. HQ coordinates strategies of businesses.	Strategy formulated at business unit level. Corporate HQ largely reactive, offering little coordination.
Controlling Performance	Primarily strategic goals with medium- to long-term horizon.	Financial budgets set annual targets for ROI and other financial variables with monthly and quarterly monitoring.
Advantages	Effective in managing (a) linkages among businesses, (b) innovation, (c) long-term competitive positioning.	Business unit autonomy encourages initiative responsiveness, and the development of business leaders.
Disadvantages	Loss of divisional autonomy and initiative. Conducive to unitary strategic view. Resistance to abandoning failed strategy.	Short-term focus discourages innovation and long-term development Limited sharing of resources and skills among businesses.
Style suited to:		
UK Examples	Companies with a small number of closely related businesses. In sectors where technology and competition are important and projects are large and long term.	Companies with many businesses across a wide range of industries, and with limited linkages between them. Approach works best in mature, technologically stable sectors where investment projects are relatively small and short term.
	BP, BOC, Cadbury-Schweppes, Lex Group, STC, United Biscuits.	Hanson, BTR, General Electric Company, Ferranti, Tarmac

SOURCE: BASED ON M. GOOLD AND A. CAMPBELL, *STRATEGIES AND STYLES* (OXFORD: BLACKWELL, 1987).

Since Goold and Campbell's original study, it appears that financial control has become increasingly important – even in companies, such as BP, that fell into the strategic planning category. Thus, among the oil and gas majors, it was observed that strategic planning has become less concerned with strategic decision making and more focused on managing financial performance.[29]

Using PIMS in Strategy Formulation and Performance Appraisal

Some of the most sophisticated techniques for strategy development and performance appraisal have been those based on the PIMS (Profit Impact of Market Strategies) database. PIMS grew out of General Electric's internal database and was developed by the Strategic Planning Institute. It comprises information on over 5,000 business units that is used to estimate the impact of strategy and market structure on business-level profitability. Table 16.2 shows an estimated PIMS equation.

PIMS is used by multibusiness companies to assist in three areas of corporate management:

- *Setting performance targets for business units*. Using the regression coefficients in the PIMS profitability equations, it is possible to plug into the PIMS regression the actual levels of the strategic and industry variables for a particular business and thereby calculate its "Par ROI" – the level of ROI that would be expected for the business given its profile of strategic and industry characteristics if its performance were typical of the sample as a whole. "Par ROI" represents a benchmark that can be used to set profitability targets or to evaluate actual profitability.
- *Formulating business unit strategy*. Because the PIMS regression equations show the impact of different strategy variables on ROI, these estimates can indicate how a business can adjust its strategy to increase its profit performance.
- *Allocating investment funds between businesses*. Past profitability of business units is a poor indicator of the return on new investment. PIMS' "Strategic Attractiveness Scan" indicates investment attractiveness based on (a) estimated future real growth rate of the market, and (b) the "Par ROI" of the business. The analysis offers predictions as to the "strategic attractiveness" of investment in the business, and the cash flow that can be expected from it.

Managing Internal Linkages

As we saw in the previous chapter, the main opportunities for creating value in the multibusiness company arise from sharing resources and transferring capabilities among the different businesses within the company. This sharing occurs both through the centralization of common services at the corporate level and through direct linkages between the businesses.

Common Corporate Services

The simplest form of resource sharing in the multidivisional company is the centralized provision of common services and functions. These include corporate management

TABLE 16.2 The PIMS Multiple Regression Equations: The Impact of Industry and Strategy on Profitability

Profit Influences	Impact on:	
	ROI	*ROS*
Real market growth rate	0.18	0.04
Rate of price inflation	0.22	0.08
Purchase concentration	0.02	N.S.
Unionization (%)	−0.07	−0.03
Low purchase amount:		
low importance	6.06	1.63
high importance	5.42	2.10
High purchase amount:		
low importance	−6.96	−2.58
high importance	−3.84	−1.11
Exports–Imports (%)	0.06	0.05
Customized products	−2.44	−1.77
Market share	0.34	0.14
Relative quality	0.11	0.05
New products (%)	−0.12	−0.15
Marketing, percentage of sales	−0.52	−0.32
R&D, percentage of sales	−0.36	−0.22
Inventory, percentage of sales	−0.49	−0.09
Fixed capital intensity	−0.55	−0.10
Plant newness	0.07	0.05
Capital utilization	0.31	0.10
Employee productivity	0.13	0.06
Vertical integration	0.26	0.18
FIFO inventory valuation	1.30	0.62
R^2	0.39	0.31
F	58.3	45.1
Number of cases	2,314	2,314

Note: For example, if Real Market Growth Rate of a business was to increase by one percentage point, the equation predicts that its ROI (return on investment) would rise by 0.18% and ROS (return on sales) by 0.04%.

SOURCE: ROBERT D. BUZZELL AND BRADLEY T. GALE, *THE PIMS PRINCIPLES: LINKING STRATEGY TO PERFORMANCE* (NEW YORK: FREE PRESS, 1987): 274.

functions such as strategic planning, financial control, cash and risk management, internal audit, taxation, government relations, and shareholder relations. They also include services that are more efficiently provided on a centralized basis, such as research, engineering, human resources management, legal services, management development, purchasing, and any other administrative services subject to economies of scale or learning. By 2000, shared corporate services accounted for 43% of headquarters staff among large UK corporations.[30]

In practice, the benefits of centralized provision of common services tend to be smaller than many corporate managers anticipate. Centralized provision can avoid costs of duplication, but there is little incentive among headquarters staff and specialized corporate units to meet the needs of their business-level customers. The experience of many companies is that corporate staffs tend to grow under their own momentum with few obvious economies from central provision and few benefits of superior services.

As a result, many companies separated their corporate headquarters into two groups: a *corporate management unit* responsible for supporting the corporate management team in core support activities such as strategic planning, finance, and legal, and a *shared services organization* responsible for supplying common services such as research, engineering, training, and information technology to the businesses. Market incentives have been created for these shared service organizations by requiring them to supply services on an arm's-length basis to internal operating units, sometimes in competition with independent suppliers. For example:

- Amoco split its head office between a Corporate Roles group – comprising the Controller, Treasurer, Financial Operations, Corporate Planning, Corporate Secretary, and Quality Management – and a Shared Services Organization, including Human Resources, IT, Government Relations, Public and Government Affairs, Purchasing, Facilities and Services, Business Processing, Analytical Services, Environment-Health-Safety, Supply, Engineering and Construction, Tax, Auditing, and Legal Services. These 14 service groups initially had a three-year "monopoly" on supplying services to the business groups, after which the businesses were free to obtain services from inside or outside the Amoco group.
- Alcoa's Global Business Services was created in 2003. It offers financial accounting services; procurement; environment, health and safety services; people services; global credit; and information services. Its 1,900 employees are based in Pittsburgh, Monterrey (Mexico), Quebec (Canada) Szekesfehervar (Hungary), Booragoon (Australia), Sao Paulo (Brazil), and Bangalore (India). Its vision is to "deliver valuable services to Alcoa's business and resource units at a cost and quality better than competitive alternatives."[31]

Business Linkages and Porter's Corporate Strategy Types

Exploiting economies of scope doesn't necessarily mean centralizing resources at the corporate level. Resources and capabilities can also be shared between the businesses. Michael Porter has argued that the way in which a company manages these linkages determines its potential to create value for shareholders.[32] He identifies four corporate strategy types.

- *Portfolio management*. The most limited form of resource sharing is where the parent company simply acquires a portfolio of attractive, soundly managed companies, allows them to operate autonomously, and links them through an efficient internal capital market. The typical organizational structure for portfolio management is the *holding company* – a parent company that owns controlling stakes in a number of (typically unrelated) subsidiaries, but, beyond appointing the boards of the subsidiary companies, does not exert significant management control. Investor AB of Sweden (controlled by the

Wallenberg family), Koor Industries of Israel, and Berkshire Hathaway of the US (headed by legendary investor Warren Buffett) are leading examples. Value is created by acquiring companies at favorable prices, closely monitoring their financial performance, and operating an effective internal capital market.

- *Restructuring*. Conglomerates such as Tomkins, Tyco, and Textron create value by restructuring: acquiring poorly managed companies, then intervening to appoint new management, dispose of underperforming businesses, restructure liabilities, and cut costs. Recently, private equity groups such as Carlyle, KKR, Blackstone, and Texas Pacific in the US and Alchemy and Candover in the UK are performing the same restructuring role.[33]
- *Transferring skills*. Organizational capabilities can be transferred between business units. LVMH transfers brand management and distribution capabilities among its different luxury-brand businesses. Sharp transfers its optoelectronics and miniaturization capabilities across a number of consumer, electronic, and office equipment products. Creating value by sharing skills requires that the same capabilities are applicable to the different businesses, and also that mechanisms are established to transfer these skills through personnel exchange and best practice transfer.
- *Sharing activities*. Porter argues that the most important source of value arises from exploiting economies of scope in common resources and activities. For these economies to be realized, corporate management must play a key coordinating role, including involvement in formulating business unit strategies and intervention in operational matters to ensure that opportunities for sharing R&D, advertising, distribution systems, and service networks are fully exploited. Such sharing is facilitated by:
  – a strong sense of corporate identity;
  – a corporate mission that emphasizes the integration of business-level strategies;
  – an incentive for cooperation among businesses;
  – interbusiness task forces and other vehicles for cross-business cooperation.

The Corporate Role in Managing Linkages

The closer the linkages among businesses, the greater the opportunities for creating value from sharing resources and transferring capabilities, and the greater the need for corporate headquarters to coordinate across businesses. We noted earlier that the "financial control" style of management occurs mainly in conglomerate where the independence of each business limits the coordinating role of the head office to managing the budgetary process and establishing "framework conditions" for divisional planning.

In more closely related companies such as the vertically integrated oil companies, or companies with close market or technological links (such as IBM, Procter & Gamble, American Express, and Alcoa), corporate management uses a "strategic planning" style, which is likely to involve not only coordination of strategies but also operational coordination to exploit the economies of scope and transferable skills discussed in Chapter 15. Corporate involvement in interdivisional affairs has implications for the size of the corporate headquarters. Berkshire Hathaway, which has almost no linkages among its businesses, has a corporate staff of about 50. Hewlett-Packard, with about the same sales but much closer linkages between its divisions, has close to 3,000 employees at its Palo Alto head office. Goold and Campbell note that the companies that are closely involved with their businesses through "*value-added corporate parenting*" tend to have significant numbers of headquarters staff involved in developing key technical and functional capabilities. Thus, Pfizer and Corning have strong corporate R&D groups; Dow has a strong corporate manufacturing function; and Virgin's corporate team plays a key role in managing the Virgin brand.[34]

Opportunities for sharing and transferring resources and capabilities may require ad hoc organizational arrangements such as *cross-divisional task forces*. Such task forces might be formed for the introduction and dissemination of total quality management, to reengineer financial management practices, to promote fast-cycle new product development, to coordinate business development in China, and so on.

CEOs can use their authority to launch corporate-wide initiatives to encourage divisional managers to exploit interbusiness linkages and to take account of companywide issues in their strategies and operating decisions. These initiatives provide a key mechanism for disseminating strategic changes, best practices, and management innovations.[35] At General Electric, Jack Welch was an especially effective exponent of corporate initiatives as a means of driving organizational change. These were built around communicable and compelling slogans such as "GE's growth engine," "boundarylessness," "six-sigma quality," and "destroy-your-business-dot-com."

Exploiting linkages between businesses requires careful management, and this imposes costs. Though Porter may be right that the *potential* for value creation increases as a company moves from a loose, "portfolio management" strategy toward the more integrated, "shared activity" strategy, it is not apparent that this potential is always realized. For example, most attempts at exploiting the potential for cross-selling across different businesses have yielded disappointing results, especially in financial services.[36] Lorsch and Allen shed light on the management implications of close linkages between businesses. They compared three conglomerates with three vertically integrated paper companies.[37] The coordination requirements of the paper companies resulted in greater involvement of head office staff in divisional operations, larger head office staffs, more complex planning and control devices, and lower responsiveness to change in the external environment. By contrast, the conglomerates made little attempt to exploit linkages even if they were present:

> *The conglomerate firms we had studied seemed to be achieving appreciable degrees of financial and managerial synergy but little or no operating synergy. Some of the firms saw little immediate payoff in this operating synergy; others met with little success in attempting to achieve it.*[38]

The success with which the corporate headquarters manages linkages between businesses depends on top management's understanding of the commonalities among its different businesses. As we noted in the last chapter, the underlying rationale of the diversified company has been called *dominant logic* by C. K. Prahalad and Richard Bettis.[39] They define *dominant logic* as "the way in which managers conceptualize the business and make critical resource allocation decisions." For a diversified business to be successful, they argue, there must be sufficient strategic similarity among the different businesses so that top management can administer the corporation with a single dominant logic.

Leading Change in the Multibusiness Corporation

Our conception of the role of management in the multibusiness corporation has shifted substantially in recent years. Two decades ago it was about the administration of large business empires. Today the focus is on value creation in an intensely competitive, fast-changing world. Corporate headquarters are concerned less with the problem of control and more with the problem of identifying and implementing the means for creating value within and between their individual businesses. The use of the term "parenting" to describe the corporate role, as opposed to the notion of "systems of corporate control," reflects this shift in thinking.

Changes in the management of multibusiness corporations have included decentralization of decision making from corporate to divisional levels, a shift from formal to informal coordination, and a more multidimensional role for the corporate headquarters. From being simply a control center, the corporate HQ acts as a service center, a guide to the future, and a knowledge hub.

Managing transition has been a key role for chief executives. The most celebrated of these "change masters" was Jack Welch, Chairman and CEO of General Electric from 1981 to 2001. Welch's style and the system he created has become a model for other large, multibusiness corporations – not just in North America, but in Europe and Asia too. Strategy Capsule 16.2 outlines Welch's style and methods.

As Welch has shown, managing large-scale organizational change is not simply about top–down decision making. A key component is fostering change processes at lower level of the organization – GE's "work-out" is a prime example. A critical feature of organizational design is building structures and systems that permit adaptation.

STRATEGY CAPSULE 16.2

General Electric: Welch's Reinvention of Corporate Management

Jack Welch's 20 years as Chairman and CEO of General Electric began with an intensive period of restructuring, which transformed the composition of GE's business portfolio through acquisitions and disposals and extended the conglomerate's global reach. Toward the mid-1980s, Welch's attention shifted from the business portfolio to the structure, systems, and style of GE. Among the changes he initiated were the following.

1 *Delayering*. Welch's fundamental criticism of GE's management was that it was slow and unresponsive. Welch eliminated GE's sector level of organization so that business heads reported directly to him. He pressured them to flatten their management pyramids. Overall, GE's layers of hierarchy were cut from nine or ten to four or five.

2 *Changing the Strategic Planning System*. During the 1970s, GE had developed a systematic and formalized approach to strategy formulation and appraisal. Welch believed that not only was the system slow and inefficient, it also stifled innovation and opportunism. Welch replaced the

staff-led, document-driven process with more personal, less formal, but very intensive face-to-face discussions. Instead of data-heavy documents, each business head was asked to produce a slim "play-book" that summarized key strategic issues and actions. Concise answers were required to questions about market dynamics, competitive activity, risks, and proposed GE business responses. These documents became the basis for a half-day review session where business heads and key executives met with the Office of the CEO in an open dialog on strategy and performance.[1]

3 *Redefining the Role of Headquarters*. The changes in the strategic planning system reflected broader changes in the role of the corporate headquarters. Welch viewed headquarters as interfering too much, generating too much paper, and failing to add value. His objective was to "turn their role 180 degrees from checker, inquisitor, and authority figure to faciliator, helper, and supporter" so that decisions could move more quickly:

> *What we do here at headquarters . . . is to multiply the resources we have, the human resources, the financial resources, and the best practices . . . Our job is to help, it's to assist, it's to make these businesses stronger, to help them grow and be more powerful.*[2]

4 *The Coordinating Role of Corporate*. A key role of corporate was facilitating coordination across GE's businesses. The Corporate Executive Council was reconstituted to include the leaders of GE's 13 businesses and several key corporate executives. It met two days each quarter to discuss common problems and issues. The Council became an important vehicle for identifying and exploiting synergies. In 1990, Welch launched his concept of the "boundaryless company." This involved blurring internal divisions so that people could work together across functional and business boundaries. Welch aimed at "integrated diversity" – the ability to transfer the best ideas, most developed knowledge, and most valuable people freely and easily between businesses.

> *Boundaryless behavior is the soul of today's GE . . . Simply put, people seem compelled to build layers and walls between themselves and others, and that human tendency tends to be magnified in large, old institutions like ours. These walls cramp people, inhibit creativity, waste time, restrict vision, smother dreams and, above all, slow things down . . . Boundaryless behavior shows up in the actions of a woman from our Appliances business in Hong Kong helping NBC with contacts needed to develop satellite television service in Asia . . . And finally, boundaryless behavior means exploiting one of the unmatchable advantages a multibusiness GE has over almost any other company in the world. Boundaryless behavior combines 12 huge global businesses – each number one or number two in its markets – into a vast laboratory whose principal product is new ideas, coupled with a common commitment to spread them throughout the Company.*[3]

Notes:

1 *General Electric: Jack Welch's Second Wave (A)*, Case No. 9-391-248 (Boston: Harvard Business School, 1991).

2 Jack Welch, "GE Growth Engine," speech to employees (1988).

3 "Letter to Share Owners," General Electric Company 1993 Annual Report (Fairfield, CT, 1994): 2.

While CEOs cannot be the primary initiators of change, they need to be alert and responsive to signals. Intel's former CEO, Andy Grove emphasizes the importance of CEOs identifying *strategic inflection points* – instances where seismic shifts in a firm's competitive environment require a fundamental redirection of strategy.[40] At Intel, such inflection points included the transition from DRAM chips to microprocessors, the decision to focus on its x86 series of microprocessors in favor of RISC architecture, and the decision to replace its faulty Pentium chips.[41]

Above all, CEOs need to be adept at managing contradiction and dilemma. For example:

- Companies must strive for efficiency, which requires rigorous financial controls; they must also be innovative and entrepreneurial, which requires autonomy and loose, flexible controls.
- Maximizing current performance requires strategies that exploiting existing resources and capabilities across different markets; success for the future is dependent on the creation of new resources and capabilities and their deployment in new markets.
- Innovation, efficiency, and responsiveness require autonomy for business-level managers; yet the competitive advantage of the multibusiness corporation ultimately depends on integrating resources and capabilities across businesses. Is it possible for companies like Microsoft, Siemens, or Samsung to mesh the resource advantages of the giant corporation with the responsiveness and creativity of small enterprises?

Resolving these dilemmas requires that organizations operate in multiple modes simultaneously. In particular, they need to combine both decentralized flexibility and initiative *and* centralized purpose and integration. The transformation of IBM under Lou Gerstner offers some guidance has to how this can be achieved. Resisting Wall Street pressure to break up IBM, Gerstner was able to combine aggressive cuts in costs and jobs, entrepreneurship and flexibility through decentralized decision making, and integration of technology and know-how by breaking down barriers both within IBM and between IBM and other companies.[42]

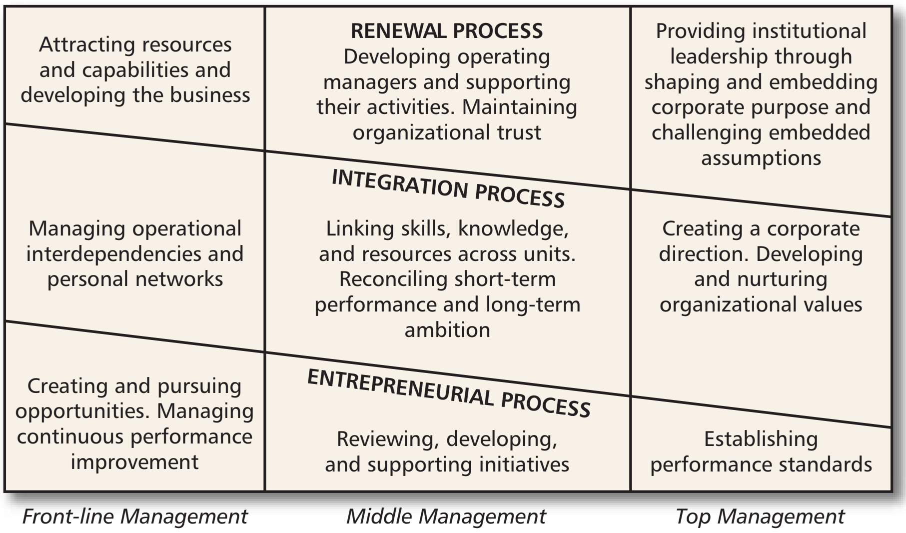
Flexible integration – whether it is sharing capabilities, harmonizing market initiatives in different countries, or collaborating to develop the new products and technologies requires – cannot be hierarchically decreed: headquarters does not posses the necessary knowledge to be in the driver's seat. It must happen through horizontal collaboration among the businesses units. This requires that business-level general mangers identify not only with their particular businesses, but also with the corporation as a whole. Fostering the necessary identity and direction within the multibusiness corporation is probably the most important task that the CEO must perform.

Creating this sense of identity is much more challenging for a company that spans several businesses than for one whose identity is determined by the products it offers (McDonald's or De Beers). Its goes beyond "strategic relatedness" and "dominant logic" and embraces notions of vision and mission – concepts which were identified in Chapter 1 as lying at the foundations of companies' strategy formulation. Thus, LVMH, supplier of Moët & Chandon champagne, Hennessy cognac, Dior and Givenchy perfumes, and Louis Vuitton luggage, has established an identity that not only established its strategic logic but also the "cultural glue" that holds its disparate businesses together:

The common cultural trunk is based on the permanent search for quality of the products and the management, human relations based on responsibility and initiative, and rewarding competences and services.[43]

Reconciliation and pursuit of multiple – often conflicting – performance goals requires differentiation and integration across the different levels of management. Bartlett and Ghoshal point to the need to redistribute management roles within the company.[44] They identify three central management processes: the *entrepreneurial process* (decisions about the opportunities to exploit and the allocation of resources), the *integration process* (how organizational capabilities are built and deployed), and the *renewal process* (the shaping of organizational purpose and the initiation of change). Conventionally, all three processes have been concentrated within the corporate HQ. Bartlett and Ghoshal propose a distribution of these functions between three levels of the firm: corporate ("top management"), the business and geographical sector coordinators ("middle management"), and the business units ("front-line management"). The critical feature of the relationships between these management levels and between the individual organizational members form a social structure based on cooperation and learning. Figure 16.5 illustrates their framework.

FIGURE 16.5 Management processes and levels of management



SOURCE: C. A. BARTLETT AND S. GHOSHAL, "BEYOND THE M-FORM: TOWARD A MANAGERIAL THEORY OF THE FIRM," *STRATEGIC MANAGEMENT JOURNAL* 14, WINTER SPECIAL ISSUE (1993): 38.

Summary

Formulating and implementating corporate strategy in the multibusiness company presents issues of almost impenetrable complexity. We can classify firms in different strategic types but, ultimately, it is impossible to offer generic recommendations for how a multibusiness company should implement its corporate strategy: each firm possesses a unique portfolio of products and markets; each owns a unique set of resources and capabilities; each has developed a distinct administrative structure, management style, and corporate culture. Given these factors, it is hardly surprising that empirical research offers little clear guidance as to the correlates of superior performance – close relationships between businesses may or may not lead to higher profitability; sharing resources and capabilities offers economies but also imposes management costs; and there are no consistent relationships between a company's performance and the characteristics of its structure, control system, or leadership style.

Designing the appropriate organizational structure, management systems, and leadership style of a multibusiness corporation depends critically on *fit* with the corporate strategy of the company. Fundamental to this fit is the *rationale* for the firm. Diversification – both across product markets and across geographical markets – can create value in different ways. Each source of gain from diversification is likely to imply a quite different approach to managing the firm. For a conglomerate firm, value can be created through the strategic judgment of the CEO with regard to business prospects and company valuation, and the ability to operate a highly efficient internal capital market. Hence, organization and management systems should be oriented toward a clear separation of business levels on corporate decisions and a highly effective system for budgetary control and project evaluation. For a technology-based diversified corporation, value is created through the transfer and integration of knowledge, ideas, and expertise. The company must be organized in order to facilitate the transfer and application of knowledge. Two sets of issues are critical:

- The characteristics of the resources and capabilities that are being exploited within the multibusiness corporation.
- The characteristics of the businesses.

Ultimately, the structure, systems, and management style must fit with the identity of the company. The conglomerates of the 1970s failed either because they did not establish a clear identity or because their identity was so closely linked with a single person (e.g., Geneen at ITT). In other cases, the rationale on which the identity was based was found to be flawed (e.g., Allegis Corp.). Conversely, multibusiness companies that sustain success over time establish clarity of identity and vision that is reflected in their strategy, structure, management systems, and leadership style. Moreover, they periodically revisit that identity and vision as their world changes.

Self-Study Questions

1 Williamson's "M-form" concept argues that the efficiency of the multidivisional firm is the result of (a) the separation of responsibilities between divisional and corporate management and (b) overcoming the "agency problem" of managers pursuing their own interests rather than those of shareholders. How effective are most multibusiness companies in achieving these advantages? Are there other performance advantages associated with multibusiness companies?

2 If you were VP of Strategic Planning for a large, multibusiness company, would you use portfolio planning techniques in your work? If so, for what purposes? If not, why not? Would your preference be to use the GE/McKinsey matrix or the BCG matrix?

3 Identify a poorly performing multibusiness company (examples might include Sony, Time Warner, Bombardier, Pearson, Matsushita, Fiat Group, or Tyco). Using the McKinsey pentagon framework, in which stage do you perceive the greatest opportunities for value creation through restructuring? (Use the company's website or Hoovers.com to access information on the company.)

4 For technology-based companies, building linkages across different business is critical to sustaining competitive advantage. Select a technology-based company that you are familiar with (possibilities might include Microsoft, HP, Apple Computer, Canon, Nortel Networks, or Finmeccanica), then identify how linkages between businesses are currently being exploited and identify opportunities for additional exploitation of cross-business linkages.

Notes

1 I use the term *multibusiness company* to refer to a company that comprises multiple business units. These may comprise different vertical activities, different geographical units, or different product sectors.
2 O. E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (New York: Free Press, 1975); and O. E. Williamson, "The Modern Corporation: Origins, Evolution, Attributes," *Journal of Economic Literature* 19 (1981): 1537–68.
3 J. L. Bower, *Managing the Resource Allocation Process* (Boston: Harvard Business School Press, 1986).
4 Williamson, "The Modern Corporation," op. cit.
5 See, for example, P. Steer and J. Cable, "Internal Organization and Profit: An Empirical Analysis of Large UK Companies," *Journal of Industrial Economics* 21 (September 1978): 13–30; H. Armour and D. Teece, "Organizational Structure and Economic Performance: A Test of the Multidivisional Hypothesis," *Bell Journal of Economics* 9 (1978): 106–22; D. Teece, "Internal Organization and Economic Performance," *Journal of Industrial Economics* 30 (1981): 173–99.
6 E. J. Epstein, *Dossier: The Secret History of Armand Hammer* (New York: Carroll & Graf, 1999); B. Burrough, *Barbarians at the Gate: The Fall of RJR Nabisco* (New York: Harper & Row, 1990); J. Johnson and M. Orange, The Man Who Tried to Buy the World (Pengain, 2004).
7 H. Mintzberg, *Structure in Fives: Designing Effective Organizations* (Englewood Cliffs, NJ: Prentice Hall, 1983): Chapter 11.
8 J. Birkinshaw and A. Campbell, "Know the Limits of Corporate Venturing," FT Summer School, *Financial Times* (August 10, 2004).
9 M. Goold, A. Campbell, and M. Alexander, *Corporate-Level Strategy: Creating Value in the Multibusiness Company* (New York: Wiley, 1994).
10 *General Electric: Strategic Position – 1981*, Case No. 381–174 (Boston: Harvard Business School, 1981): 1.
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