CHAPTER 16

Lessons from twenty years of consulting experience

We have found that the three logics described in this book have been invaluable in guiding our clients about which businesses to expand, shrink, launch, buy or sell. The Added Value logic, in addition, guides decisions about corporate structures, headquarters functions and management processes that are needed to make the group of businesses successful. In the last twenty years, we have encountered very few senior managers who disagree at an intellectual level with these ideas.

Yet we have also encountered a large number of companies where the senior team does not follow this approach in its day-to-day work. Portfolio decisions fail to take account of one or more of the three logics. Headquarters managers take actions that are not primarily guided by added-value principles. The corporate strategy is not clearly articulated and communicated, or else seems to be at odds with our principles. We have been puzzled and concerned by this failure to convert intellectual acceptance into practical application.

The main issue is with the thinking linked to Added Value logic. Managers often acknowledge that corporate headquarters should add value, but they do not invest enough time in clarifying and sizing the main sources of value; they do not build them prominently enough into their portfolio decisions; and they do not drive their headquarters managers to focus on them. Typically, they spend more effort looking for attractive businesses than for businesses to which they can add value. They also tolerate too many central initiatives, projects and functions, and do not think through the costs and subtracted value that can accompany these well-intentioned initiatives.

In this closing chapter, we reflect on the reasons for shortcomings in what managers do and on what might rectify the situation. Our observations are based on our consulting experience since we published Corporate Level Strategy in 1994. Over this period, our clients have been grappling with corporate strategy issues and have been, to a greater or lesser degree, attempting to follow our principles.

We divide the chapter into three sections:

- Thoughts that get in the way of our approach to corporate strategy: watch out for these.
- Tricky situations where it is tempting to do the wrong thing: beware the temptations.
- Simple tips to help to bring the right thinking to the fore: try them.

THOUGHTS THAT GET IN THE WAY

There are several common ways of thinking about corporate strategy which seem superficially attractive, but can conflict with our approach.

Corporate Strategy is About Investing in Attractive Businesses

Summaries of a company's corporate strategy, of the sort found in the Chairman's Statement in the Annual Report, are very often phrased in terms of an aspiration to shift the portfolio into businesses with higher margins and/or higher returns, and with faster growth prospects. This laudable and widely-held objective is expected to appeal to investors and is, of course, fully consistent with Business Logic, as we have described it in this book.

But Business Logic should not be the only driver of corporate strategy. It is also important to ask whether the parent is able to add any value to the more attractive businesses into which the company wishes to move (Added Value Logic) and whether it expects to be able to buy into or develop these businesses at a discount to their true value (Capital Markets Logic). If the new, more attractive businesses are not in the company's current heartland, there is a serious danger of subtracted value, and if the new businesses are widely seen as attractive, the price of entry to them may well be too high to justify the move. Business Logic alone can lead to corporate strategy moves that end up destroying value.

Our antidote: make sure you get all three logics onto the table and do not overemphasise Business Logic to the exclusion of Added Value Logic and Capital Markets Logic.

Portfolio Balance is Critical

Many executives believe that corporate portfolios need to be 'balanced'. They need to include a mix of fast growth and slow growth businesses, of cash-generating and cash-using businesses, of businesses with a presence in different regions of the world, of businesses from cyclical and less cyclical sectors. Portfolios of this sort will be more robust, more insulated from problems that may arise in particular sectors or geographies, more self-sustaining, and more consistent in the returns they deliver. We recognise that this line of thinking is appealing.

However, while there is some value in all of these ideas, the thinking is usually muddled. Investors are perfectly capable of diversifying and balancing their own portfolios if they wish to do so. It is rarely the job of corporate managers, except in special circumstances such as closely-held family companies, to perform this function. Hence, initiatives to balance the portfolio are rarely justified, unless they are also supported by one or more of the three logics, which they very often are not. Often, attempts to balance the portfolio have more to do with the preservation of management jobs and careers than with sound corporate strategy.

Our antidote: Be alert when anyone uses the word balance. It is seductive and can cover up sloppy thinking.

'Best Practices' Should Drive the Design of Headquarters

We have often been asked to advise companies on how to ensure that their planning process or HR function or process for post merger integration is "World Class" or "Best Practice". Managers understandably want to know that their activities are not out of date or at a significant disadvantage. Yet, this thought shows a misunderstanding of the challenge of leading a good corporate headquarters.

Each company's headquarters needs to be designed to support its own specific strategy and sources of added value. Because companies differ greatly in the sources of added value on which they focus, their headquarters are likely to differ in size, composition, skills and processes. There is no best way to do things, no template of best practices to follow. In fact, for most headquarters activities, best practice is a positively dangerous thought. It motivates companies to establish departments and processes by reference to what successful but very different companies do and without regard to whether these practices will add any value to the businesses in this particular group. It is a thought that leads to an administrative mind set, which is more concerned with sophistication and comprehensiveness than with the needs of the businesses.

This is not to say that best practice thinking has no place. There are some governance activities common to most companies, such as producing the annual report. Here benchmarking can be helpful. But only for activities that exist mainly for governance reasons.

Also, rival parent analysis is an important part of good strategic thinking. Leaders need to know how their rivals are adding value to check whether their own company has parenting advantage. Rival parent analysis can also show a company new ways of adding value. Bu even here, leaders should be cautious. They need to understand whether the activities of one of their rivals can be copied or whether they rely on cultural or historical factors that cannot be replicated.

Our antidote: Be vigilant in focusing on Added Value Logic rather than best practice thinking. Avoid 'corporate excellence' programmes and prefer 'fit for purpose' programmes. Look out for headquarters managers who justify initiatives with reference to what other companies do.

Lean is Best

Many efforts to redesign a headquarters are, explicitly or implicitly, driven by a cost. The CEO decides that he or she wants to cut overheads and launches a programme to do so, even if it is announced under the more neutral banner of 'redesigning' the headquarters.

It is certainly true that corporate function heads, driven by the quest for best practices or simply by an enthusiasm to do more, often expand the size, cost and powers of their functions beyond what is needed. So periodic projects to cut corporate costs are needed. But an emphasis on cost or an implication that a lean headquarters is better can distract managers from the real purposes of headquarters, to add value. The best corporate strategies are not founded on the leanest headquarters. Rather the headquarters should be right-sized to deliver the added value and governance tasks that are needed. A focus on cost reduction risks throwing the added value baby out with the bureaucratic bath water.

Our antidote: Regularly use a challenge process, such as the three tests (page xx), to make sure that all initiatives and activities have an added value or governance rationale that can be justified. Use the opinions of managers in business divisions to root out inefficiencies and bureaucracy. Even, have regular cost cutting initiatives. Just make sure that the focus is on added value and not cost.

'What Can They Do For Us?'

There is a whole way of thinking about the relationship between the corporate parent and the businesses that begins with the question: 'What can they (the businesses) do for us (the parent)?' Because the parent owns the businesses, it feels justified in expecting things of them, whether it is growth, cash flow, profitability or whatever. The parent's performance is then a reflection of how well the businesses have been doing.

Although an understandable perspective, it is exactly the wrong way to think about corporate strategy. The fundamental question is the reverse: 'What can we (the parent) do for them (the businesses)?' Unless the parent has some added value contribution to make, it will be difficult to justify owning the businesses. Unless the parent is doing something that helps the businesses, the corporate strategy is no more than the aggregation of the business strategies. The group might as well be broken up into its constituent parts without the overhead burden of a shared headquarters.

Our antidote: Echo JFK. Stop asking what the businesses can do for you. Ask what you can do for the businesses. Think of them as customers and encourage your colleagues to do the same. Also, give more voice to the businesses. Create opportunities for them to say what they want and do not want. Do a regular survey of their opinion of the usefulness of each corporate function.

TRICKY SITUATIONS

There are some situations where the application of our approach leads to difficult or unpalatable conclusions. Managers are then tempted to compromise on the principles of corporate strategy by looking for other logics that do not require them to face up the challenge.

Mature or Declining Heartland

All managers know that the businesses they are in today will mature and may eventually decline. The businesses that represent the heartland today may not provide long-term growth and prosperity. If this situation is imminent, the corporate management team faces some difficult decisions. Should managers accept the decline and use share buy-backs to enhance returns for shareholders? Or should the company launch out into new business areas that have better growth prospects?

Inevitably the growth option appears much preferable, especially for managers who are concerned about their own careers. Typically it leads to speculative investments in new growth areas irrespective of Business Logic, Value Added Logic or Capital Markets Logic. Often companies overpay or over invest. Frequently, the new activities are well away from the current heartland, and there is little prospect of the company developing the new parenting skills that are needed. Not surprisingly the failure rate is high.

While the search for new growth is an essential corporate activity, it needs to be overseen by people with a commitment to the three logics. The harsh reality is that most companies, and most corporate strategies, do not survive for 50 or 100 years, and it is unrealistic to expect them to do so. The three logics can lead to the conclusion that a company should shrink rather than grow. They can even guide a company to break itself up or to sell itself to another owner. Managers need to be willing to face these realities when the analysis is pointing in that direction.

Bad Parents of Attractive Businesses

In chapter 6, we discussed situations when the three logics lead to different conclusions. A particular problem arises when a company owns an attractive business, but is not a good parent for it. The business is probably worth more to another owner. But, by retaining the business, managers are more easily able to deliver growth and margin targets. The plan to sell the business, give the cash back to shareholders and reset the targets seems much less attractive than the plan to hold on.

In these circumstances, it is easy for managers to fool themselves about their ability to be a good parent or to assume that subtracted value is minimal. Clearly it takes brave and disciplined managers to see their own skills clearly and to listen to the often muted thoughts of managers lower down. But, if the business will be more successful with a different owner, both sets of managers gain from making the change.

Multilevel Parents

In large companies, there is often more than one organisation level above the operating units. There may be Groups, Divisions or Regions sitting between headquarters and the operating units. The parenting role and the task of adding value to the operating units is then shared between these levels. Clarifying the role of each layer and what to centralise and decentralise can represent a particularly tricky challenge.

In our experience, clarity is rare. Often, headquarters treats the intermediate parent levels as big businesses and does not recognise that they are in fact playing a parenting role. And the intermediate levels assume that they should discharge all the important parent responsibilities, leaving nothing for the corporate parent to do except duplicate what has already been done by lower levels. Ambiguity about who is doing what is common, and typically results in redundant reviews at multiple levels.

It may well be necessary and desirable to have multilevel parents. But, when they occur, too few companies do the careful analysis needed to lay out the added value, the risks of subtracted value and the complementary roles for each level.

Parents that Do Not Add Major Value

We have worked with many corporate leaders who wanted to add more value. Typically they were concerned that their headquarters was not adding enough value. They were sensitive to the need to add value, and aware of the costs of headquarters. Many even understood the ever-present potential for subtracted value. So they asked for help in finding new and major sources of added value.

Our experience is that this quest for major new sources of added value is often fruitless. The desire to find new ways to add value is laudable, but is dependent on the skills of headquarters managers. Some are able to change their skills. Some are willing to bring in new talent. But, more normally, the same team tries to graft on new behaviours, without the insights, experience and drive needed for success. If the "cupboard is bare", it is usually because there are not many opportunities-to-add-value or because this particular headquarters team does not have appropriate skills or both.

Such a conclusion is not an easy one for managers to accept. It implies that they should break up or sell the company, or resign from their jobs. As a result, the tendency is to plump for dubious or minor sources of added value as the basis for the corporate strategy. Our observation is that this "sticking plaster" solution rarely solves the problem for long. A hostile takeover, a mutiny from below or a restless board normally puts the management team out of its misery. Far better, in our opinion, to take the medicine and be seen to do the right thing.

SIMPLE TIPS

This book has provided many frameworks and tools already – enough to satisfy the appetite of most corporate strategists. But we end with a few simple tips that will help managers to put into practice the ideas we have put forward.

Set Up a Corporate-level Strategy Process

In too many companies, there is no distinctive and separate corporate-level process. Instead, the businesses go through an extensive planning process and the corporate level aggregates the plans of the businesses, with some challenge to business strategies and some attempt to stretch objectives or identify gaps between corporate aspirations and what the businesses think they can deliver. This is not a satisfactory way to develop corporate-level strategy.

The whole thrust of this book has been to argue that corporate-level strategy needs to be seen as a separate topic from business strategy. It needs distinctive analyses and thought processes, and leads to distinctively corporate conclusions about the make-up of the portfolio and the way in which the businesses are parented. As such, it is essential that companies should establish a corporate-level process, which provides a periodic focus on corporate-level strategy, and which builds on but is distinct from the business strategy process. The lack of this separate process is one reason why corporate strategies are often inadequate.

Make Corporate Functions Develop Strategic Plans

Corporate functions are both the handmaidens of the chief executive in helping to add value and the dragons of bureaucracy and subtracted value. For many managers in business divisions, the dragons are more visible than the handmaidens, and often the subtracted value is greater than the added value.

One way of helping to correct the balance is to treat corporate functions in the same way that businesses are treated. They need a strategy. They need a budget. They need performance reviews. They need structured challenge. So ask corporate functions to produce strategies just as businesses are asked to do. These can then be reviewed and challenged by the businesses as well as by the chief executive. Often the planning diary is already too crowded with reviews of business strategies, so functional strategies can be addressed at a different time of year.

Agree the Strategic Logic Before Doing the Cash Flows.

Corporate strategy moves are normally justified by a business case, which includes detailed cash flow projections. A proposed acquisition is pursued because a business case with a 22% IRR has been put together. A reorganisation from independent country businesses into global product lines is justified on a mix of cost reductions and sales increases. But all too often the business case is weak: the detailed numbers have been manufactured to support what key executives want to do anyway. The subsequent performance falls well short of planned projections.

Of course, there is a need for cash flow projections to support corporate strategy initiatives. But the driver of corporate strategy initiatives should be the strategic logic not the financial logic. If the move does not fit with one of the three logics, it should be rejected, irrespective of the cash flow analysis. The cash flows and the detailed business case should only come into play once the underlying logic has been agreed. Their function is to make sure that detailed plans to implement the strategy in a profitable way can be drawn up, not as the primary justification of the move.

Do Rival Parent Analysis

It is now almost a truism to suggest that business managers give too little attention to their competitors when developing their strategies. We have found that this truism is equally if not more valid for corporate strategies.

Analysis of actual or potential rival parent companies – possible alternative owners of your businesses – is necessary to test the corporate strategy you are considering and is often a source of new ideas and learning about how strategies can be improved. If you have a strategy that adds value, but your rivals have strategies that will add much more value, you need to think again. Your strategy will not achieve ‘parenting advantage’, and, at least in principle, everyone would be better off if the rival parents took ownership of your businesses.

More constructively, you may be able to pick up ideas about how to add more value by studying and understanding how your rivals go about it. What do they do that we do not do? Could we add more value by emulating them? What would it take for us to do so, in terms of skills, people, processes and resources? In what respects are we different from rivals, and how can we exploit these differences to add more value? As with best practice analysis, we need to be very careful not to assume that the same approaches will work for us as for others. However, an understanding of what close rivals are doing can lead to new insights.

Be More Willing to Sell Businesses

We have found that corporate managers are usually reluctant to sell businesses. They prefer to believe that they can turn around failing businesses, add more value to businesses outside the current heartland, and achieve a higher NPV by holding on than selling. They also dislike the idea of shrinking the company. So the sale option is often dismissed too readily, even for poorly performing businesses that do not fit in the company's corporate strategy. The result is that they sell only in a crisis or under threat of a hostile takeover, often at a time when they will get less for the business than they should.

In our experience, good corporate strategists see a decision to sell a business as a positive move. First, they can expect to get a premium because the business is likely to be worth more to rival parents. Second, they can often take advantage of capital market conditions that favour sellers over buyers. Third, they are able to get rid of a distraction, which may be preventing them from adding value to other businesses in the portfolio. Fourth, the disposal typically makes it easier to communicate the corporate strategy both to investors and employees. Selling businesses may go against the grain, but is very often a wise step in clarifying and improving the corporate strategy.

Be More Willing to Change People

Corporate strategy work is often done in the context of the existing corporate team. The question being addressed is really "what strategy should this team pursue?" It is harder, but in our experience more rewarding, to step to one side and ask "what is the best strategy for this company?"

The ability to separate the company from the existing team is particularly important for corporate-level strategy. Corporate headquarters is usually a fairly small entity, in which only a handful of people are capable of moving the needle. It also creates value mainly by influencing others rather than by making products or developing technologies. People and their skills are vital. And we know that developing new skills is hard for senior managers at a relatively late stage in their careers. Hence, any new corporate strategy will likely require new people in the corporate centre and the departure of some existing managers. If the new strategy is implemented by the existing team, the chances of success are low: you will be trying to play tennis with a team of golfers.

Following acquisition or some other crisis that brings in new management, companies are suddenly able to transform in ways that were not possible with previous managers. So a willingness to make some difficult people decisions is probably a precondition of meaningful corporate strategy change.

SUMMARY

It is easy to be distracted from the principles of corporate strategy that we have advocated. Other ideas can get in their way and temptations can arise that lead down a different path. Our approach is simple and logical, so should provide an antidote to these distractions. But it needs commitment and discipline to avoid being blown off course.

Corporate processes that ensure the three logics are kept in centre stage are helpful. But, the key is a willingness to follow through on the implications for both businesses and people. Our experience suggests that this is easier said than done. Many highly capable leaders have been distracted or found it difficult to face up to the implications of the analysis. Those who remain steadfast, therefore, are more likely to emerge as the ultimate winners.