CORPORATE PARENTING

Which businesses belong in a parent's portfolio?

Corporate Strategy: The Ques

As they craft corporate-level strategy, most chief executives today fail to address two crucial questions: What businesses should this company, rather than rival companies, own and why? And what organizational structure, management processes, and philosophy will foster superior performance from its businesses?

We are not saying that chief executives intentionally avoid or ignore those questions. They simply lack the tools and processes for the job. Most planning processes focus on developing business-level, rather than corporate-level, strategies. Even more important, the planning frameworks that corporate-level strategists have commonly used have proven inappropriate or impractical.

The growth/share matrix, introduced in the 1970s and adopted by two-thirds of all U.S. corporations within a decade, encouraged companies to balance their business portfolios with a mix of stars, cash cows, and question marks. But the poor performance of companies using the portfolio-management technique, and disillusionment with diversification, have discouraged all but a handful of companies from using it today.

For the past five to ten years, increasing numbers of companies have been trying to stick to their knitting, as Tom Peters and Bob Waterman first advised in their book *In Search of Excellence* in 1982. Companies have been shedding the businesses they acquired as diversifications in order to focus instead on core businesses, relying for guidance on the core competence concept. In introducing the concept ("The Core Competence of the Corporation," HBR May-June 1990), C.K. Hamel and Gary Prahalad proposed that companies should build portfolios of businesses around shared technical or operating competencies and should develop structures and processes to enhance their core competencies.

Despite its powerful appeal, the core competence concept has not provided practical guidelines for developing corporate-level strategy. Many companies have tried to define their core competencies, but, lacking reliable analytical tools, few have achieved the clarity they sought. Furthermore, the core competence model does not account for the

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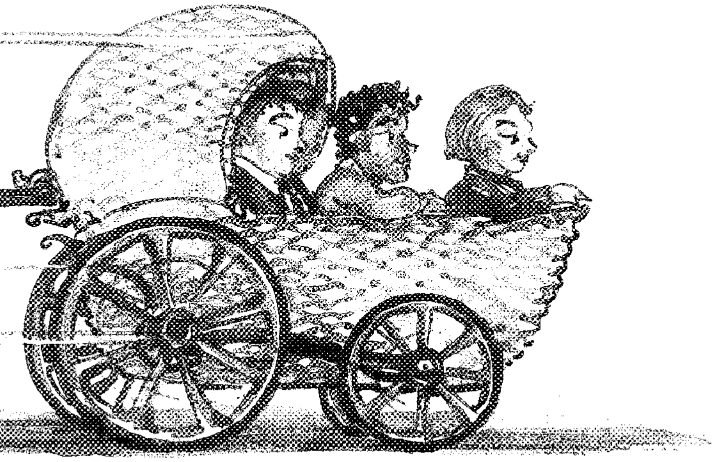
DRAWINGS BY MARK STEELE

or Parenting Advantage



by Andrew Campbell, Michael Goold, and Marcus Alexander

success of companies such as ABB Asea Brown Boveri, BTR, Emerson Electric, General Electric, Hanson, and Kohlberg Kravis Roberts, whose businesses have limited technical or operating overlap.

The framework we propose – the parenting framework – fills in the deficiencies of the core competence concept. It provides a rigorous conceptual model as well as the tools needed for an effective corporate-level planning process.

Based on research with some of the world's most successful diversified companies, the parenting framework is grounded in the economics of competitive strategy. Multibusiness companies bring together under a parent organization businesses that could potentially be independent. Such parent companies can justify themselves economically only if their influence creates value. For example, the parent organization can improve the businesses' plans and budgets, promote better linkages among them, provide especially competent central functions, or make wise choices in its own acquisitions, divestments, and new ventures.

Multibusiness companies create value by influencing – or parenting – the businesses they own. The best parent companies create more value than any of their rivals would if they owned the same businesses. Those companies have what we call *parenting advantage.*

Previous strategic frameworks have focused on the businesses in the portfolio and searched for a logic by examining how they relate to one another. The underlying assumption has been that portfolios of related businesses perform better than portfolios of unrelated ones. The growth/share matrix implies that businesses are related if their cash, profit, and growth performance create a balance within the portfolio. The core competence concept says that businesses are related if they have common technical or operating know-how. The parenting framework, in contrast, focuses on the competencies of the parent organization and on the value

The best parent companies create more value in their businesses than rivals would.

created from the relationship between the parent and its businesses.

The parent organization is an intermediary between investors and businesses. It competes not only with other parent organizations but also with other intermediaries, such as investment trusts and mutual funds. Corporate-level strategies, therefore, make sense to the extent that the parent creates sufficient value to compete with other intermediaries. That occurs when the parent's skills and resources fit well with the needs and opportunities of the businesses. If there is a fit, the parent is likely to create value. If there is not a fit, the parent is likely to destroy value. The parent, we have found, is highly influential, and its impact is rarely neutral.

Fit between a parent and its businesses is a two-edged sword: a good fit can create value; a bad one can destroy it.

Demerger decisions, such as the one facing Imperial Chemical Industries (ICI) in 1992, dramatically illustrate the importance of fit between the parent and its businesses. To split a large and venerable organization that had been built up over decades demanded a powerful rationale. (See "Why ICI Chose to Demerge.")

Divestment decisions, such as the exit of oil companies from the minerals business, also illustrate the logic of the fit. Companies such as British Petroleum (BP), Exxon, and Shell entered minerals in order to diversify. They believed they had the appropriate skills for that business because, like oil, it involved exploration, extraction, government relations, and large, technically complex projects. Minerals and oil seemed to share competencies.

However, after more than ten years of experience, oil companies are getting out of the minerals business. BP sold its minerals businesses to the RTZ Corporation in 1989, and Shell recently sold its operations to Gencor in South Africa. Why? Because their minerals businesses have consistently underperformed those of minerals specialists. The minerals businesses of Atlantic Richfield, BP, Exxon, Shell, and Standard Oil had an average pretax return on sales of –17% during the mid-1980s, while independent metal companies achieved a 10% return. One reason for the disparity is the influence that managers in oil-company parents exercised over decisions made in their metals businesses. As a manager in BP's minerals businesses explains, "The problem was that the BP managing directors could not really come to grips with the minerals business or feel they understood it. There was always that vestige of suspicion that led to a temptation to say no to proposals from the business or, alternatively, if they said yes, to say yes for the wrong reasons." In other words, the influence of the parent managers on the minerals business was faulty because of insufficient understanding – an insufficient fit – between the parent and the business.

The oil companies' diversification into minerals failed because, despite similarities, some success factors in minerals are different from those in oil. Exploration, for instance, is not as critical. Finding new mineral deposits is not necessarily a passport to profit. More important is access to low-cost deposits because only those deposits make profits in cyclical downturns. For minerals businesses, forming joint ventures with companies that already have low-cost mines can be more profitable than searching for new deposits. Pressure from oil-company managers to spend more on exploration was therefore counter-productive. RTZ, the new parent of BP's minerals businesses, has not had that problem, however. "It has been easy to add value," Robert Adams, RTZ's planning director, explains, "because we have some specialist expertise in mine planning and operations and a natural affinity for the investment and exploration decisions and trade-offs that you face in cyclical minerals businesses."

Whether a parent and its businesses fit is a tough question that few managers address.

The oil-company examples show that fit between parent and businesses is a two-edged sword. A good fit can create additional value; a bad one can destroy value. Bad parenting causes business-unit managers to make worse decisions than they would otherwise. In one company, the managers in the minerals business had taken bad advice about exploration techniques from their oil-company bosses. When asked why, they replied, "They had acquired us so we thought they must know something we didn't."

Our framework for developing corporate-level strategy is based on assessing the nature of the fit between the corporate parent and its businesses. Is there a match that will create value, or a mismatch that will destroy value? By answering that question, corporate strategists can consider which changes – either to the portfolio of businesses or to the parenting approach – will improve fit.

Assessing Fit

Few corporate-level managers find it easy to assess the fit between the corporate parent and its businesses. The reason, in part, is that they seldom openly address the question. But even if they do, it is a tough question to answer. It is like asking whether a particular manager fits a particular job. One must understand a great deal about the manager and the job to judge well.

To aid those judgments, we have developed a structured analytical approach. It begins with an assessment of the businesses. First, we examine the critical success factors of each business. We need to understand those factors in order to judge where the parent's influence is positive and where it is negative. Second, we document areas in the businesses in which performance can be improved. Those are areas in which the parent can add value. They represent the upside potential.

Armed with those analyses, we then review the characteristics of the parent, grouped in a number of categories. That analysis ensures that managers will consider all the main characteristics of the parent when they judge whether its influence is likely to fit the business's opportunities and needs. The final step is to test the judgments against the results that the businesses achieve under the influence of the parent.

Critical Success Factors: Understanding the Businesses. The concept of critical success factors is familiar to most managers. In every business, certain activities or issues are critical to performance and to the creation of competitive advantage. However, success factors differ among and even within industries. For example, those in bulk chemicals are not the same as those in specialty chemicals.

Most business-level plans define the critical success factors as part of the rationale for the actions proposed. A special analysis of critical success factors is not, therefore, usually necessary to develop corporate-level strategy. However, it is a good idea to summarize critical success factors, confirm their importance with business-level managers, and check whether circumstances in the business have changed – for example, whether its costs have risen. (See the table "Critical Success Factors for a Diversified Food Company.")

Critical Success Factors for a Diversified Food Company

Success Factors	Food products	Property	Restaurant A	Restaurant B	Retail	Hotels
Product branding	★					★
Selling	★					★
Product mix management	★					
Scale and capacity utilization	★					
Business development skills		★				
Formula branding			★	★	★	
Positioning to match locality		★	★	☆	★	
Site selection		★	☆	★	★	★
Property development costs		★	☆	★		★
Value engineering			★	★		☆
Detailed operating controls			★	★	★	★
Management selection and training			★	★	★	★
Supply chain logistics	★		★	★	★	★
Low overheads	★	★	★	★	★	★

Critical-success-factor analysis is an important base for assessing fit. It is useful in judging whether friction is likely to develop between the business and the parent. A parent that does not understand the critical success factors in a business is likely to destroy value. It is also useful for judging how similar the parenting needs of different businesses are. In the food-company example, the restaurant and retail businesses are more similar than the hotel, property, and food-products businesses. Finally, critical-success-factor analysis is a prerequisite for a parenting-opportunity analysis.

Parenting Opportunities: Gauging the Upside. To add value, a parent must improve its businesses. For that to be possible, there must be room for improvement. We call the potential for improvement within a business a *parenting opportunity.*

Many kinds of parenting opportunities may present themselves. For example, a business may have excessive overhead costs that its managers are unaware of. For the right parent, the high overhead is an opportunity. Or two businesses might be able to gain economies of scale by combining their sales forces. The businesses' managers may find such consolidation difficult because of personal animosities or loyalties, or concerns about control. The combining of sales forces is, therefore, an opportunity for the right parent. In another example, a business may have good, but not world-class, manufacturing and logistics management skills. A parent company that has world-class expertise in those areas can help that business. (See the insert "Ten Places to Look for Parenting Opportunities" for a checklist of circumstances in which parenting opportunities can arise.)

Most businesses have parenting opportunities and could improve their performance if they had a parent organization with exactly the right skills and experience. The purpose of a parenting-opportunity analysis is to document those opportunities and estimate their significance. The analysis can be a major challenge, though, because the parent often needs a depth of expertise in the business to identify the opportunities. For example, a parent that is not expert in manufacturing might not know that a business lacked world-class manufacturing skills. Or a parent without detailed knowledge of a business's market may not be aware of the opportunity to combine sales forces.

Three types of analyses can help strategists identify parenting opportunities. First, strategists list the major challenges facing a business, which are normally recorded in the business plan. Then they examine each challenge to see whether it contains a parenting opportunity. For example, one business faced two major challenges: to expand capacity in order to meet the demands of a growing segment and to lower costs by improving purchasing. The first challenge did not contain a parenting opportunity, because the business-unit managers had already successfully expanded capacity many times and would likely be able to do so again without parenting influence. However, the second challenge did contain a parenting opportunity: the business-unit managers had weak purchasing skills and had never recruited a top-ranking purchasing manager. A parent with suitable skills would be able to coach the business managers, helping them avoid pitfalls, such as offering a salary too low to attract someone with the expertise they need.

In the second type of analysis, strategists document the most important influences the parent has on the business and then judge whether those influences are addressing parenting opportunities that were not identified in the first analysis. For example, at one parent company, the central engineering function develops the technical procedures and standards for all its chemical businesses. Con-

Understanding the Parent

To understand the parent organization, we recommend a systematic review of its characteristics in five categories:

☐ The parent's *mental maps* are the values, aspirations, rules of thumb, biases, and success formulas that guide parent managers as they deal with the businesses. Mental maps shape the parent's perception of opportunities to improve business performance. They embody its understanding of different types of businesses. They underlie the knee-jerk reactions and intuitive assumptions of the parent. Usually, they reflect deeply held attitudes and beliefs and are based on managers' personal experiences. A manager with 20 years of experience in commodity chemicals will have very different maps from one who has spent 20 years in fashion retailing.

☐ The parenting *structures, systems,* and *processes* are the mechanisms through which the parent creates value. The number of layers in the hierarchy, the existence of a matrix, the appointment processes, human resource systems, budgeting and planning processes, capital-approval systems, decision-making structures, transfer-pricing systems, and other coordination or linkage mechanisms are all important aspects of parenting. The design of structures and processes is important, but more particular to each company is how managers interact within the structure or process.

☐ Corporate *staff departments* and *central resources* should support line management's efforts to create value. Some parents have large central functions, some as few as possible. Resources, such as patents held by the parent, the corporate brand, special government relationships, or access to scarce property or financial assets, can also be important characteristics. The potential for central staffs and resources to create value depends on the circumstances in each business: a large manufacturing-services staff may be helpful for one business but completely unnecessary or damaging for another.

☐ Parents often create value because they have *people* with unique *skills.* The parent's mental maps will likely overlap with the expertise in functions and serversations with business-unit and central-engineering managers confirmed that having a central department develop standards addressed a parenting opportunity. The business-unit managers lacked the skills and time to become expert in technical and engineering standards. Moreover, the businesses were sufficiently similar so that technical lessons learned in one situation could be applied to others. Central engineering was able to create value by helping the businesses raise technical standards.

A third kind of analysis looks at the influence different parent companies have on similar businesses to see whether they have discovered still other parenting opportunities. This step requires that managers learn about rival parent companies through public documents, individuals in those companies, or consultants and industry observers. Frequently, rivals share information about their parenting activities, believing it to be of low commercial value.

Characteristics of the Parent: Assessing Fit. The next step in developing a corporate-level strategy is to decide how closely the parent organization fits with the businesses in the portfolio. That involves documenting the characteristics of the parent organization, then comparing them with the critical success factors and parenting opportunities in each of the businesses.

Parenting characteristics fall into five categories:
☐ the mental maps that guide parent managers;
☐ the corporate structure, management systems, and processes;
☐ the central functions, services, and resources;
☐ the nature, experience, and skills of managers in the parent organization; and
☐ the extent to which companies have decentralized by delegating responsibilities and authority to business-unit managers.

The five categories are lenses through which one can view the influences of the parent. Although the categories have obvious links and overlaps, analyzing each one separately ensures a comprehensive understanding of the parent. (See the insert "Understanding the Parent" for a fuller description of the categories.)

With a good grasp of a parent's characteristics and hence of the influence it exercises, strategists can then ask two key questions:
☐ Does the parent have characteristics – that is, the skills, resources, management processes, and so forth – that fit the parenting opportunities in the business? Can the parent exploit the upside potential of the relationship?
☐ Is there a misfit between the parent's characteristics and the business's critical success factors? What is the potential downside of the relationship?

The 1989 acquisition of Champion International Corporation, the spark-plug company, by Texas-based manufacturer Cooper Industries illustrates the importance of the two questions. Cooper uses a distinctive parenting approach designed to help its businesses raise their manufacturing performance. New acquisitions are "Cooperized" – Cooper audits their manufacturing operations; improves their cost accounting systems; makes their planning, budgeting, and human resource systems conform with its systems; and centralizes union negotiations. One business manager observes, "When you are acquired by Cooper, one of the first things that happens is a truckload of policy manuals arrives at your door." Such hands-on parenting has been effective in transforming the cost and quality of certain kinds of manufacturing businesses.

The issue facing Cooper was whether Champion would fit with that parenting approach. For example, would Cooper's manufacturing-services department be able to add value to Champion? Manufacturing at Champion fell short of best practice, offering a major opportunity for Cooper's parenting skills. But there were some worries. Spark plugs involve ceramic manufacturing, an area about which Cooper's manufacturing-services department knew little. Moreover, Champion's factories produced millions of spark plugs annually in high-volume processes, while Cooper's manufacturing staff was

vices. Yet neither of those characteristics sufficiently emphasizes the importance of key individuals in parent companies. Some corporate parents are dominated by managers, such as Jack Welch at General Electric or Allen Sheppard at Grand Metropolitan, whose personalities and skills make a critical difference. But a skilled division head or technical director can also be the parent's greatest source of value, provided his or her style, beliefs, and skills address parenting opportunities in the portfolio.

☐ The *decentralization contract* between parent and business defines which issues the parent normally influences and which it delegates to business managers. It contains the authorization limits, job descriptions, and formal statements of due process. However, it is typically embedded in the culture of the company rather than fully explicit. The decentralization contract should direct the parent's attention toward those business issues to which it has something to contribute and away from those for which its influence is likely to be damaging.

Ten Places to Look for Parenting Opportunities

Size and Age. Old, large, successful businesses often accumulate bureaucracies and overheads that are hard to eliminate from the inside. Small, young businesses may have insufficient functional skills, managerial-succession problems, and insufficient financial resources to ride out a recession. Are those factors relevant to the business?

Management. Does the business employ top-quality managers compared with its competitors? Are its managers focused on the right objectives? Is the business dependent on attracting and retaining people with hard-to-find skills?

Business Definition. The managers in the business may have an erroneous concept of what the business should be and may consequently target a market that is too narrow or broad, or they may employ too much or too little vertical integration. The trend of outsourcing and alliances is changing the definitions of many businesses, thus creating new parenting opportunities. Is each business in the portfolio defined to maximize its competitive advantage?

Predictable Errors. Does the nature of a business and its situation lead managers to make predictable mistakes? For example, attachment to previous decisions may prevent openness to new alternatives; business maturity often leads to excessive diversification; long product cycles can encourage excessive reliance on old products; and cyclical markets can lead to overinvestment during the upswing.

Linkages. Could the business link more effectively with other businesses to improve efficiency or market position? Are linkages among units complex or difficult to establish without parental help?

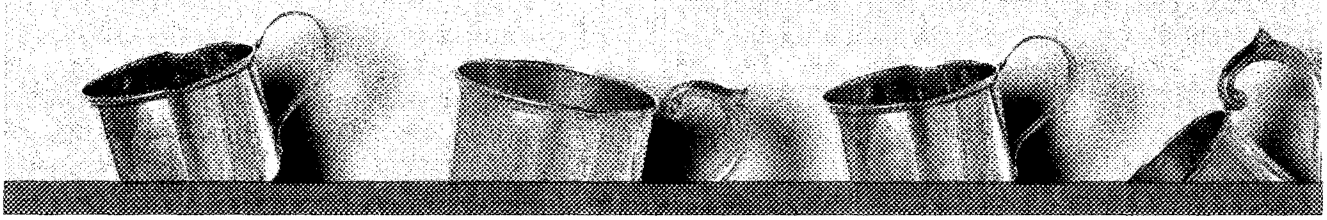
Common Capabilities. Does the business have capabilities that could be shared among businesses?

Special Expertise. Could the business benefit from specialized or rare expertise that the parent possesses?

External Relations. Does the business have external stakeholders, such as shareholders, government, unions, and suppliers, that the parent company could manage better than it does?

Major Decisions. Does the business face difficult decisions in areas in which it lacks expertise–for example, entering China, making a big acquisition, or dramatically extending capacity? Would the business experience difficulty getting funding for major investments from external capital providers?

Major Changes. Does the business need to make major changes in areas with which its management has little experience?



most knowledgeable about slower, cell-based or batch-process operations. In addition, Champion had a number of operations outside the United States, while Cooper had less experience working in foreign countries.

To judge Champion's fit, Robert Cizik, Cooper's CEO, had to examine his company's parenting characteristics and assess the potential and risks for each one. What would be the impact of centralizing union negotiations, imposing Cooper's cost accounting processes, and so on? Cizik had to judge the net effect of all those influences.

In addition, he had to consider whether Cooper's parenting influence would be better for Champion than that of rivals. Dana Corporation, another manufacturing-oriented parent company, also spotted the opportunity at Champion. Would Cooper's impact on Champion be greater than Dana's and hence justify the premium Cooper had to pay to acquire the business in direct competition with Dana?

Impact on Results: Validating the Judgments. One can test a company's judgments about how well its parenting characteristics fit with its businesses by examining the company's track record with different sorts of businesses. A technique we call *success and failure analysis* is a useful way of summarizing a parent's track record. The analysis involves listing important decisions and classifying each as a success, a failure, or neutral. It is often useful to group decisions by type: for example, key appointments, major capital investments, new product launches, or acquisitions. By identifying the influences of the parent and by searching for patterns of success and failure, one can identify types of situations in which the parent's influence is positive or negative. (See the graph "Success and Failure Analysis.")

Performance analysis is yet another way of validating managers' judgments about fit. It involves reviewing the performance of each business in

PHOTOS BY BRUCE T. MARTIN

comparison with its competitors. Businesses with comparatively poor results are probably not benefiting from, and may be hobbled by, the parent's influence. However, strategists must exercise care in reaching such conclusions. A business may be performing well or poorly without the parent having any significant influence on it. One must be sure that the performance is due to the parent's influence before using such evidence to assess fit. The real question is whether the business is performing better or worse than it would as a stand-alone, independent company. One way to make that judgment is to compare the performance of different businesses in a company's portfolio with their par return on investment, as predicted by the Profit Impact of Market Strategies (PIMS) methodology. PIMS is a research database of detailed information on thousands of business units, submitted by participating companies. One of the uses of the database is to provide par performance statistics for a business, based on responses to a questionnaire about its structural and strategic characteristics.

Profitability that is much higher or lower than par levels is a strong indication that the parent has had an impact. However, even then, strategists must understand to what extent the unusual performance is due to the influence of the parent.

The Fit Assessment at BTR

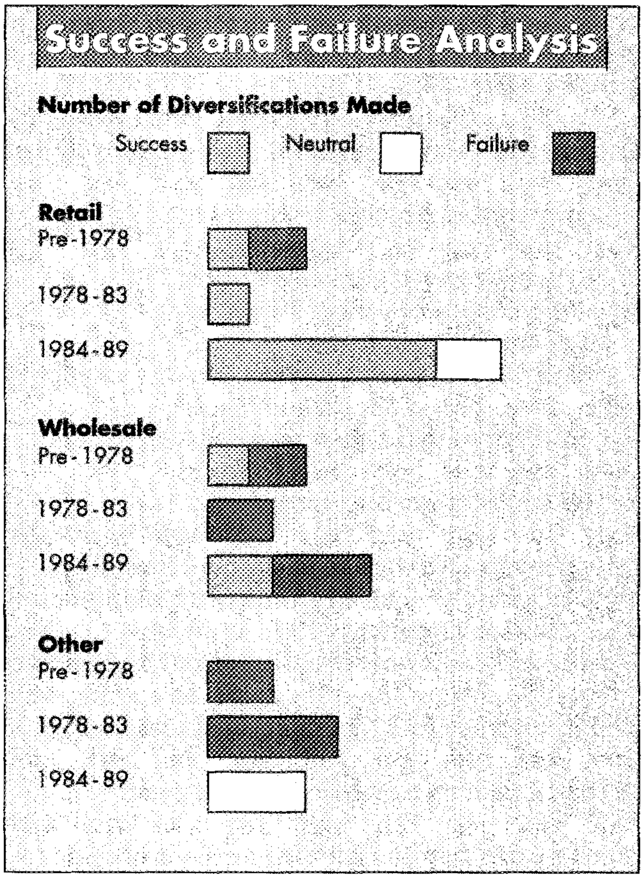
BTR, one of Great Britain's most successful companies, illustrates the importance of the fit between a parent and its businesses. In the industrial manufacturing businesses that make up the bulk of BTR's portfolio, the company's characteristics fit well both with the parenting opportunities that the company is targeting and with its businesses' critical success factors. BTR has gone from strength to strength, often achieving margins on sales in the 15% to 20% range, while competitors settle for 5% to 10%.

Sir Owen Green, managing director of BTR from 1967 to 1987, identified certain parenting opportunities in industrial manufacturing businesses. Particularly in mature niche areas, he found that businesses often underperform. Their financial information on product profitability may not tell them where they are making money and where they need to improve productivity. Their fear of losing customers may cause them to underprice, especially with larger customers. They may adopt a fill-the-factory mentality and pursue marginal sales, particularly in a recession. In an attempt to move away from mature product areas, they often diversify in a way that is wasteful.

Green learned from experience that BTR could improve those businesses' performance dramatically. For instance, by imposing a more rigorous budgeting and financial-reporting system, he encouraged business managers to pinpoint their richest profit sources, cut unnecessary costs, and achieve higher productivity. By pushing for price increases in line with or ahead of inflation, he showed managers how they could get higher prices from good customers. By focusing managers' attention on margins rather than sales, he helped managers shed the fill-the-factory mentality. By insisting on a tight business definition focused around the skills of the factory, he dissuaded managers from diversifying wastefully.

Over the years, BTR has developed parenting characteristics that fit its businesses, as described in the insert "Understanding the Parent." Green's insights, his commitment to giving managers responsibility for meeting profit targets, and his understanding of the critical success factors in industrial manufacturing businesses are now written into the *mental maps* that guide BTR's parenting.

BTR's *structure* comprises a large number of small, tightly defined, autonomous profit centers, each with its own management team. The company's renowned profit-planning *process,* which de-



mands detailed cost and profit information for every product line in every business, shapes its management systems. The process permits parent managers to challenge and stretch the profit targets of the businesses, to press for price increases and margin improvements, and to raise the standards of financial management throughout the company. The profit-planning process has become a powerful tool in the hands of the BTR parent managers, who have accumulated vast experience in interpreting the plans and comparing the performance of many similar profit centers.

BTR does not believe in large *central staffs* or *functional resources.* As Alan Jackson, BTR's current CEO, explains, "It is very important to remember that each business remains separate. We certainly do not have any nonsense like central marketing or group marketing directors. We do not blunt the edges of clear business-unit focus. That would be criminal." Corporate headquarters is small and concentrates mainly on financial control, with only 60 employees in London and similarly small groups in the corporate offices in the United States and Australia. The headquarters building is modest, and its furnishings seem to have changed little since it was built in the 1960s. The inscription on the boardroom clock epitomizes the company's culture: "Think of rest and work on."

The primary *skills* of the people in the parent organization involve motivating and controlling profit center managers and using the profit-planning process to improve their performance. Nearly all the BTR senior managers have long personal experience with industrial manufacturing businesses.

Finally, the *decentralization contract* gives profit center managers the freedom to make their own decisions, as long as their profit-planning ratios and bottom line are satisfactory. The parent interferes in running its businesses only when it sees ways to enhance performance.

"Our game is really in industrial manufacturing," Jackson comments. "We know how to set up a plant. We know how to get productivity improvements. We know how to downsize and squeeze when volumes fall." In such businesses, BTR is good both at seeing the parenting opportunities and at understanding the critical success factors.

BTR's approach, however, fitted less well with some of the distribution businesses it obtained as part of larger acquisitions. That is not because there are no parenting opportunities to be found in cost reduction, productivity improvement, or pricing, which are BTR's forte. Rather, distribution businesses have some critical success factors that do not fit BTR's approach. "We have found that it is much harder to downsize distribution businesses

> The words on the boardroom clock epitomize BTR's culture: "Think of rest and work on."

when volumes fall," Jackson explains. The BTR approach seeks to maintain margins even when volumes decline, which is often possible in industrial manufacturing because true fixed costs are a small percentage of the total. In some distribution businesses, the approach does not work because of the relatively high fixed costs associated with maintaining a distribution network. "As volumes fall," Jackson says, "we press for cost reductions, and that can be achieved only by closing depots. But closing depots causes further volume losses and weakens the rest of the network."

The financial results also indicate a poor fit between the parent and its businesses. BTR's distribution businesses have not outperformed competitors in the same way that its manufacturing businesses typically do. In manufacturing, BTR's return on

> A structured analysis cannot replace judgment. Managers must be honest about their own strengths and weaknesses.

sales is frequently double that of the average competitor, while margins in distribution are closer to industry norms. "We have been less successful away from industrial manufacturing," Jackson says. "Distribution businesses need a different sort of philosophy." So he decided to divest some of BTR's distribution businesses, such as National Tyre Service in Great Britain and Texas-based Summers Group. The parenting opportunities in distribution businesses were not great enough to warrant a change in BTR's parenting approach.

The BTR example shows that fit assessments require difficult judgments about the parent's positive and negative influences. A structured analytical approach to making those judgments can help by breaking the problem into smaller elements and ensuring that analysts take all relevant aspects of the parent and the businesses into account. But analysis cannot replace judgment. Parent managers must be honest with themselves about their own strengths and weaknesses. Most companies will find they have a good fit with some portfolio businesses and a poor one with others. The challenge for the corporate strategist is to decide which changes in parenting are appropriate.

Making Changes to Improve Fit

To pull the judgments about fit together and rank a company's businesses, it helps to summarize the assessments into a matrix. (See the graph "Parenting-Fit Matrix for a Diversified Food Company.")

The horizontal axis of the matrix records how well the parent's characteristics fit the business's parenting opportunities – the first set of judgments made in the fit assessment. The vertical axis records the extent of any misfit between the parent's characteristics and the business's critical success factors – the second set of judgments made in the fit assessment. A good fit reduces the danger of destroying value in a business.

Each portfolio business can be located on the matrix. The matrix in our illustration plots the businesses of the diversified food company described in the table of critical success factors. Each position on the matrix has implications for the company's corporate strategy.

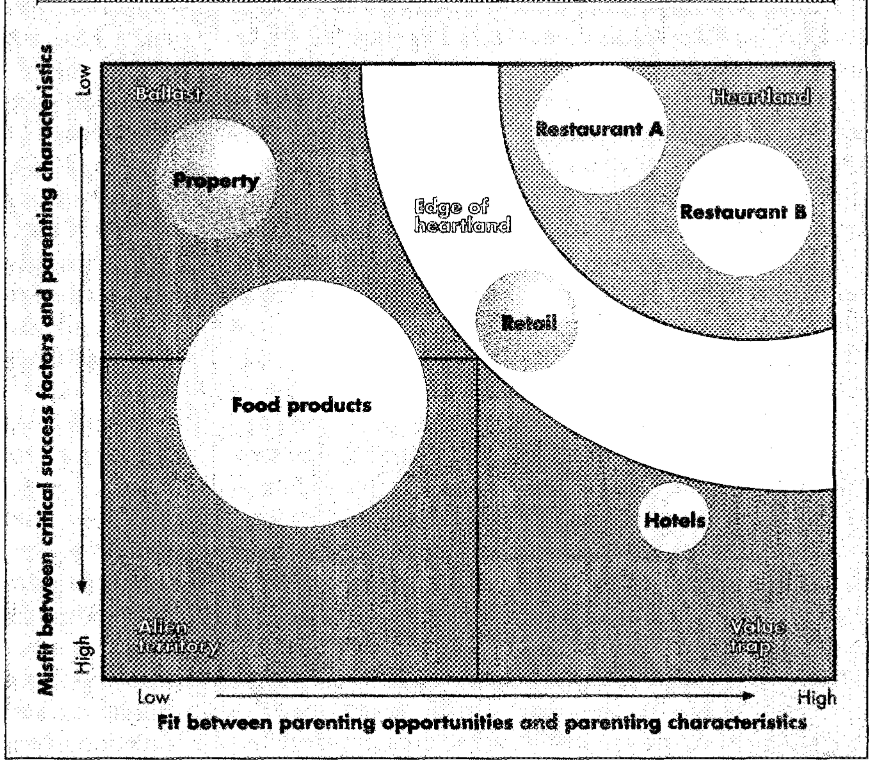
Heartland Businesses. Businesses that fall in the top right corner should be at the heart of the company's future. Heartland businesses have opportunities to improve that the parent knows how to address, and they have critical success factors the parent understands well.

In the case of the two restaurant businesses in the graph, the parent provides high-quality services in property development, food purchasing, menu management, and staff scheduling. The parent also has skills in formula branding, in setting performance targets that generate above-average restaurant margins, and in designing flat structures for chain operations that keep overheads per unit to a minimum. Furthermore, the parent does not have any characteristics that will destroy value; none of its characteristics conflict with the businesses' critical success factors.

Heartland businesses should have priority in the company's portfolio development, and the parenting characteristics that fit its heartland businesses should form the core of the parent organization.

Edge-of-Heartland Businesses. For some businesses, making clear judgments is difficult. Some parenting characteristics fit; others do not. We call those businesses, such as the retail business in the food-company example, *edge of heartland.* The parent's skills in staff scheduling, brand management, and lean organizational structures appear to add value to the business. However, the added value is partly offset by critical success factors that fit less well with the parent. For example, the retail business requires skills in site selection and property development that are different from those required for the restaurants. The parent's influence in those areas is probably negative. With edge-of-heartland businesses, the parent both creates and destroys value. The net contribution is not clear-cut. Such businesses are likely to consume much of the par-

Parenting-Fit Matrix for a Diversified Food Company



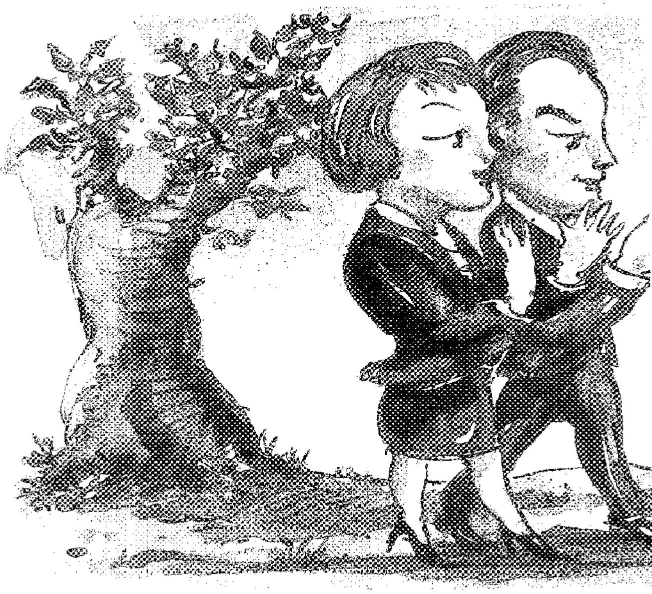
ent's attention, as it tries to clarify its judgments about them and, if possible, transform them into heartland businesses.

Many edge-of-heartland businesses move into the heartland when the parent learns enough about the critical success factors to avoid destroying value. Sometimes that means changing the parent's behavior or the business's strategy, but often the solution is for the parent to learn when not to intervene and when to be sensitive to special pleas from the business.

When Unilever acquired Calvin Klein's perfume business, it adjusted its usual parenting approach to increase the potential for value creation. For instance, Unilever did not impose its famous human resource management processes on Calvin Klein, because it recognized that its managers and Calvin Klein's would not mix easily. Unilever also did not impose its marketing policies, which would have conflicted with Calvin Klein's. Calvin Klein, for instance, does not use market research to launch its upmarket perfumes in the same way Unilever does to launch mass-market products. Unilever treated Calvin Klein as a global business, while its own personal-products businesses are national or regional. To accommodate the differences between Calvin Klein and its other businesses, Unilever changed or neutralized many of its usual parenting influences and channeled most contact between the two companies through a single person.

Ballast Businesses. Most portfolios contain a number of *ballast businesses,* in which the potential for further value creation is low but the business fits comfortably with the parenting approach. That situation often occurs when the parent understands the business extremely well because it has owned it for many years or because some of the parent managers previously worked in it. The parent may have added value in the past but can find no further parenting opportunities. In the food-company example, the property business fits that category. The business owns a large number of sites that are leased to third parties. The company has little potential for adding value to the business operation because it has identified no parenting opportunities. It also has little potential for destroying value because the parent managers are so familiar with the property-business issues.

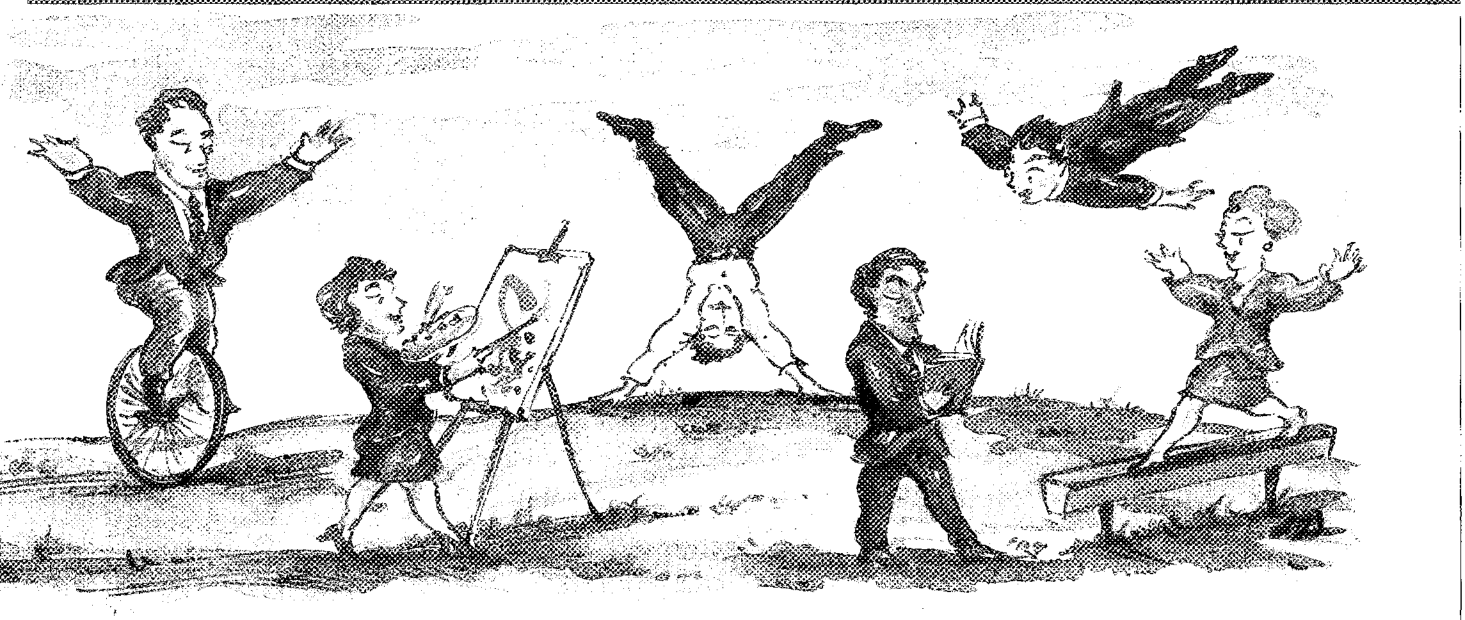
Most managers instinctively choose to hold on to familiar businesses. Sometimes that is the right decision, but it should always be examined. Ballast businesses can be important sources of stability, providing steady cash flow and reliable earnings. But ballast businesses can also be a drag on the company, slowing growth in value creation and distracting parent managers from more productive activities. Moreover, there is a danger that changes in the business environment can turn ballast businesses into what we call *alien territory.*



While good parents are always fine-tuning their parenting, th

Managers should search their ballast businesses for new parenting opportunities that might move them into heartland or edge-of-heartland territory. If that effort fails or if the parenting opportunities that are discovered fit better with a rival's characteristics, companies should divest the ballast business as soon as they can get a price that exceeds the expected value of future cash flows. Not surprisingly, that advice is difficult for most managers to take. Profitable businesses requiring little parent attention seem ideal. However, the risks of holding on to them may be substantial. Companies with too many ballast businesses can easily become targets for a takeover.

Alien-Territory Businesses. Most corporate portfolios contain at least a smattering of businesses in which the parent sees little potential for value creation and some possibility of value destruction. Those businesses are alien territory for that parent. Frequently, they are small and few in a portfolio – the remnants of past experiments with diversifications, pet projects of senior managers, businesses acquired as part of a larger purchase, or attempts to find new growth opportunities. But, in the food-company example, the largest business – food products – fits partly into alien territory, even though it is the company's original core business. The industry has become international, so the national business has become less competitive. The parent's managers have little international experience and have mostly come up through the restaurant side of



ely change in any fundamental ways.

the company. Their influence is more likely to destroy than to create value in the business.

Managers normally concede that alien-territory businesses do not fit with the company's parenting approach and would perform better with another parent. Nevertheless, parent managers often have reasons for not divesting them: the business is currently profitable or in the process of a turnaround; the business has growth potential, and the parent is learning how to improve the fit; there are few ready buyers; the parent has made commitments to the business's managers; the business is a special favorite of the chairman; and so forth. The reality, however, is that the relationship between such businesses and the parent organization is likely to be destroying value. They should be divested sooner rather than later. The company in our example should sell its food-products business to an international food company.

Companies need to be clear about their heartland before they can recognize alien territory. They also need to be clear about their alien territory in order to recognize their heartland. Hence, as companies describe their heartland businesses, they will give as many negative criteria – which are alien-territory criteria – as they do positive ones. For example, here is how managers at Cooper Industries describe their heartland: manufacturing businesses, metal-based manufacturing in particular rather than service or assembly; businesses with proprietary products and strong technology; cell-based manufacturing, not continuous process; businesses whose marketing and distribution costs are less than manufacturing costs; businesses with strong market positions; businesses large enough to support Cooper's overhead; and businesses with no intractable environmental or union problems. The criteria help Cooper strategists sort among heartland, edge-of-heartland, and alien-territory businesses and improve their acquisition and divestment decisions. Cooper has exited a number of businesses that did not fit its criteria. Most recently, it proposed divesting its original business – oil tools.

Value-Trap Businesses. Parent managers make their biggest mistakes with *value-trap businesses.* They are businesses with a fit in parenting opportunities but a misfit in critical success factors. The potential for upside gain often blinds managers to the misfit – that is, downside risks.

Managers make their biggest mistakes with businesses that fit in parenting opportunities but not in critical success factors.

In the food-company example, the hotel business is a value trap. The parent believed its restaurant and retail skills would bring success in the hotel business. Management initially saw it as an edge-of-heartland experiment, with parenting opportunities in food purchasing, property-development costs, and performance benchmarking. But value was destroyed in other vital areas. Hotel businesses require selling skills, referrals from other businesses, and specialized site selection. The parent's influence in those areas proved highly negative, and, five years after its acquisition, the business is probably worth half the capital invested in it.

The logic of core competence can push parent managers into value traps as they strive for growth through diversification. In Europe, many privatized utility companies have created engineering consultancies and construction companies on the basis of their competence in engineering and managing large construction projects. But the parent organizations' bureaucratic policies, planning systems, and decision processes, which are geared to their capital-intensive base businesses, proved to be severe disadvantages for the new businesses. The parents burdened their businesses with unreasonable overheads, restrained them from paying appropriate salaries, encouraged them to overspend on balance-sheet items, and prevented them from grasping market opportunities in a timely manner. What sounded like a synergistic core competence has led the parents into a value trap.

Changing Parenting Characteristics

Faced with a spread of businesses across the parenting-fit matrix, as in the graph, managers might assume that they should change the skills and resources of the parent organization in order to move all their businesses into the top right corner. Our research suggests, however, that parenting characteristics are built on deeply held values and beliefs, making changes hard to implement. Good parents constantly modify and fine-tune their parenting, but fundamental changes in parenting seldom occur, usually only when the chief executive and senior-management team are replaced.

It is also difficult for parent organizations to behave in fundamentally different ways toward different businesses in their portfolios. The interlocking nature of parenting characteristics, pressures for fair and equal treatment of all businesses, and deeply held attitudes all mean that a parent tends to exert similar influences on all its businesses. Alan Jackson's recognition of the difficulties likely to arise from treating BTR's distribution and manufacturing businesses differently persuaded him to sell the distribution businesses rather than compromise the corporate philosophy.

Companies are coming to understand that it is often easier to change the portfolio to fit the parent organization than to change the parent organization to fit the businesses. That realization accounts for the rise in demergers and corporate-level breakups. ICI, for example, chose to divide into two portfolios rather than attempt to be a good parent to businesses with widely different parenting needs.

The process we have described is a structured means of creating corporate-level strategy. Critical-success-factor analysis identifies areas in which the parent's influence is inappropriate. Parenting-opportunity analysis focuses attention on the upside potential. The parenting-fit matrix ranks the businesses, exposing those with lower levels of fit.

The most immediate benefit that companies receive from such analyses is identifying misfits. With that knowledge, they start to reduce the impact of bad parenting techniques and exit alien-territory businesses. Additional value creation comes from focusing on the best parenting opportunities and developing the parenting skills to match. But it is a long-term challenge requiring the parent to learn new skills. Moreover, maintaining fit is a dynamic process. As the needs of the businesses change, the parent organization must continually review its behavior and its portfolio of businesses.

Companies without sound corporate-level strategies gradually lose strength and fall prey to hostile predators or become emaciated from periodic downsizing and cost cutting. Excessive overhead consumes profits, businesses that do not fit lose ground to competitors, and decisions are guided by the wrong criteria. Management fads, cash availability, or business-level performance – rather than parenting fit – influence acquisition decisions. Bureaucratic tidiness, arbitrary cost targets, or organizational politics – rather than value creation – influence changes in the parent.

Companies with sound corporate-level strategies create value from a close fit between the parent's skills and the businesses' needs. The best companies, however, do more. They strive to be the best parents for the businesses they own – to create more value than rivals would. They are on a quest for parenting advantage.

Just as the concept of competitive advantage has been one of the greatest contributors to clearer thinking about business-level strategy, we believe the concept of parenting advantage can achieve the same for corporate-level strategy. Parenting advantage not only drives planning; it also helps executives make decisions. Will an acquisition, divestment, corporate function, coordination committee, reporting relationship, or planning process enhance parenting advantage? If not, it should be reexamined and new ideas generated.

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