THE CONTINUUM OF EFFECTIVE CORPORATE STRATEGY

Unfortunately, there is no one right corporate strategy – just look at the difference between firms as successful as Silver Lake and Clorox. However, there is a common underlying logic that underpins all effective corporate strategies. This is captured in the alignment of the three elements of a multi-business firm – resources, businesses and organization (the Corporate Strategy Triangle, Figure 1) – to pass the "better-off" and "ownership" tests (such that for every business in the portfolio: value is added, more value than cost imposed, and more value than any other possible owner).

Figure 1 **Effective Corporate Strategy**

ECONOMIC LOGIC:

The common economic logic shared by all effective corporate strategies starts from the important recognition that **corporations themselves do not compete**, nor do they create value in their own right. Rather value creation comes from improving the competitive position of businesses in the corporate portfolio.

All effective corporate strategies, however different their manifestation, therefore **align the three elements** to ensure that each and every business unit benefits from membership in the corporation – is "better off" for being part of the corporation. This requires that every discrete business in the portfolio either experiences an increase in willingness to pay or volume, or a decrease in cost because it is part of the larger entity. As Mickey Mouse greeting guests at breakfast gives Disney a 100% price premium and a 20% occupancy advantage against similar hotels in Orlando, and Simba earns a 300% price premium over other plush lion toys from the same Chinese factory!

"Better-Off": an improvement in competitive advantage - increase in willingness to pay or volume, or decrease in cost - by virtue of membership in the corporation

But that logic is not complete. A company does not need to own a business to capture the value it contributes to that business. Disney licenses for a rich fee a toy company, like Hasbro, the right to make Mickey Mouse dolls rather than owning a manufacturing company itself. In contrast, Disney acquired Pixar rather than renegotiate an existing movie licensing agreement. This shows that there is always a contractual alternative to ownership for the governance of every business relationship or "transaction"[1]. To justify diversifying into a business, vertically integrating, or expanding into a foreign country, there must be a valid reason to own the activity, rather than simply contract for it.

"Ownership": the cost of managing the business within the corporate hierarchy is lower than an arms-length relationship - whether a market exchange, long term contract, or joint venture.

Finally, every business bears some of the direct costs of corporate headquarters, no matter how small the corporate staff. More importantly, corporate ownership inflicts indirect costs on businesses as they are subject to the bureaucratic intervention of headquarters and lose their autonomy and entrepreneurial freedom! Thus an effective corporate strategy delivers a net benefit of membership greater than the cost of the management structure, systems and processes that support value creation.

This logic identifies a company possessing a "**Corporate Advantage"** when the **value added to each business is greater than the cost of being part of a corporate entity** so that every unit in the portfolio can assert that membership in the corporation:[2]

1) **Adds value** by increasing willingness-to-pay or volume, or decreasing cost in the business unit

2) **Adds more value than the ongoing cost of ownership**, including a return above the cost of capital.

3) **Adds more net value (value added – cost of ownership) than any other potential parent**, including being a standalone entity[3].

CONTINUUM:

Can we go further and offer advice about how to align those elements? The answer is yes. Strategy is about consistency and alignment[4], and the **continuum of corporate strategy** provides guidance for how design of the organization and portfolio selection fits with the resources that create value (Figure 2).

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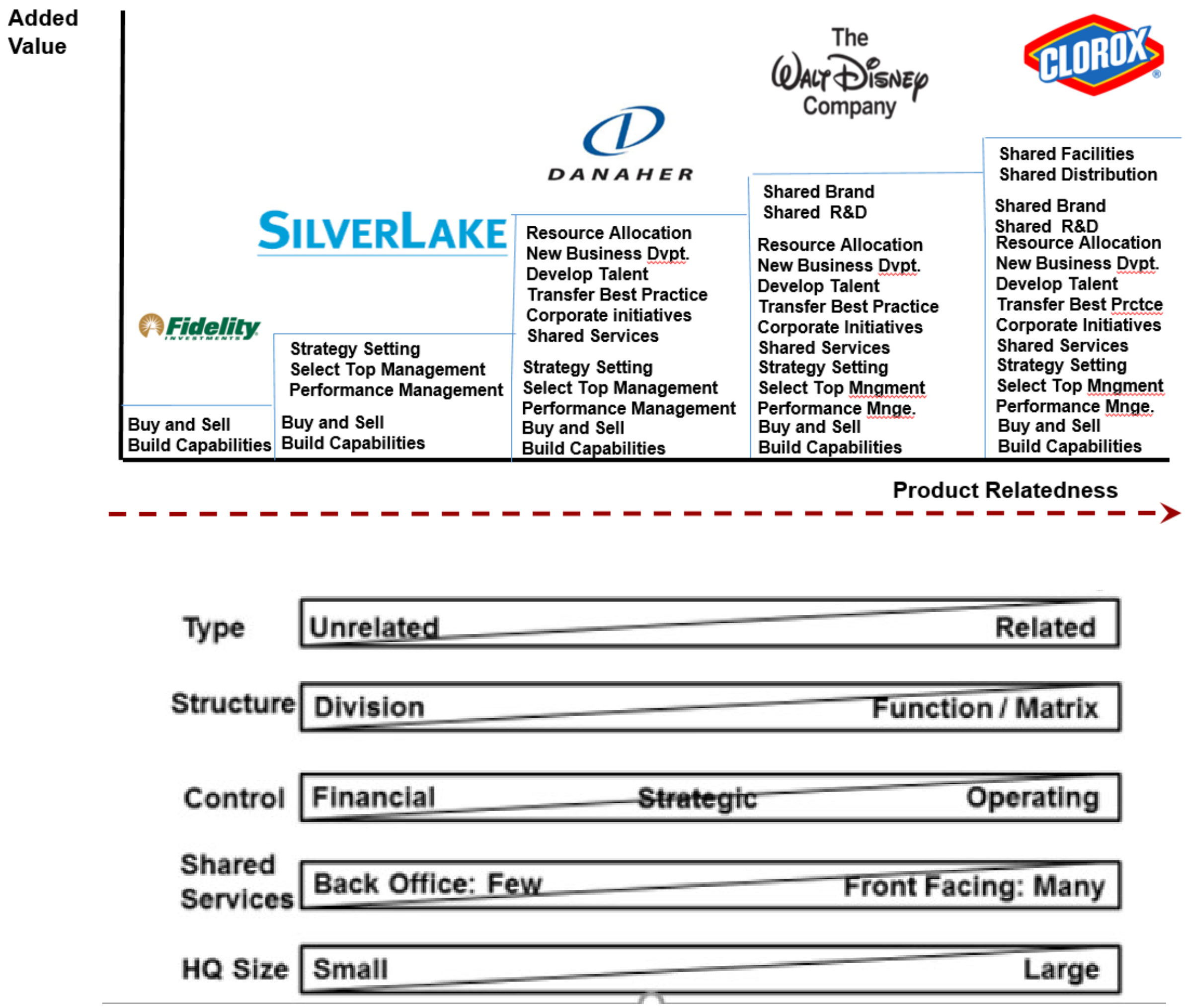
[1] This is the domain of transaction cost economics (Williamson 1976).
[2] Tests articulated by Goold, Campbell and Alexander ("Strategy for the Corporate Level," Jossey-Bass, 2014) as three logics - "value added," "business," and "capital markets", respectively.
[3] The last test is the most difficult to pass since it presumes that there is a "best owner" for every business.
[4] As with business unit strategy, the success of Corporate Strategy depends on the internal alignment of the organisation's activities, systems and processes. See Collis and Montgomery "Corporate Strategy" 2005, and M.Piskorski "Note on Corporate Strategy" 2006

Figure 2 Continuum of Effective Corporate Strategy

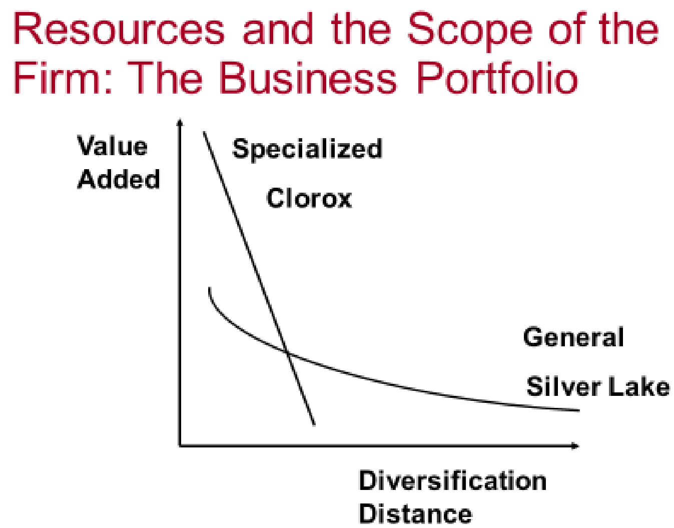


Source: Casewriter

While not definitive, the continuum is arrayed along a dimension that loosely summarises the entire corporate strategy – the degree of product relatedness in the portfolio. At one extreme is a mutual fund that can own any stock, regardless of the inherent nature of the product or service it delivers. At the other extreme would be a single product entity or a vertically integrated manufacturer. In between are corporations arrayed from private equity partnerships, through “conglomerates”, to diversified firms within a broad sector, like Disney in family entertainment, and, at the more related end of the continuum, a company like Clorox that historically only competed in “dominant brands in mid-sized, middle of the grocery store” products.

Along that continuum all three elements are aligned to ensure an appropriate fit as the scope of the firm expands into increasingly less related businesses. Resources vary from the generic – management skills, access to capital of private equity firms - to the very specific – Clorox’s three D’s that narrowly apply to middle of the store brands in traditional channels supported by traditional television advertising campaigns. While the latter can potentially add more value to a business in the portfolio, they are far more restricted in the range of businesses to which they can successfully be applied. The former are potentially valuable in far more businesses, but their value adding potential is limited by the generic nature of their skills (Figure 3).

Figure 3

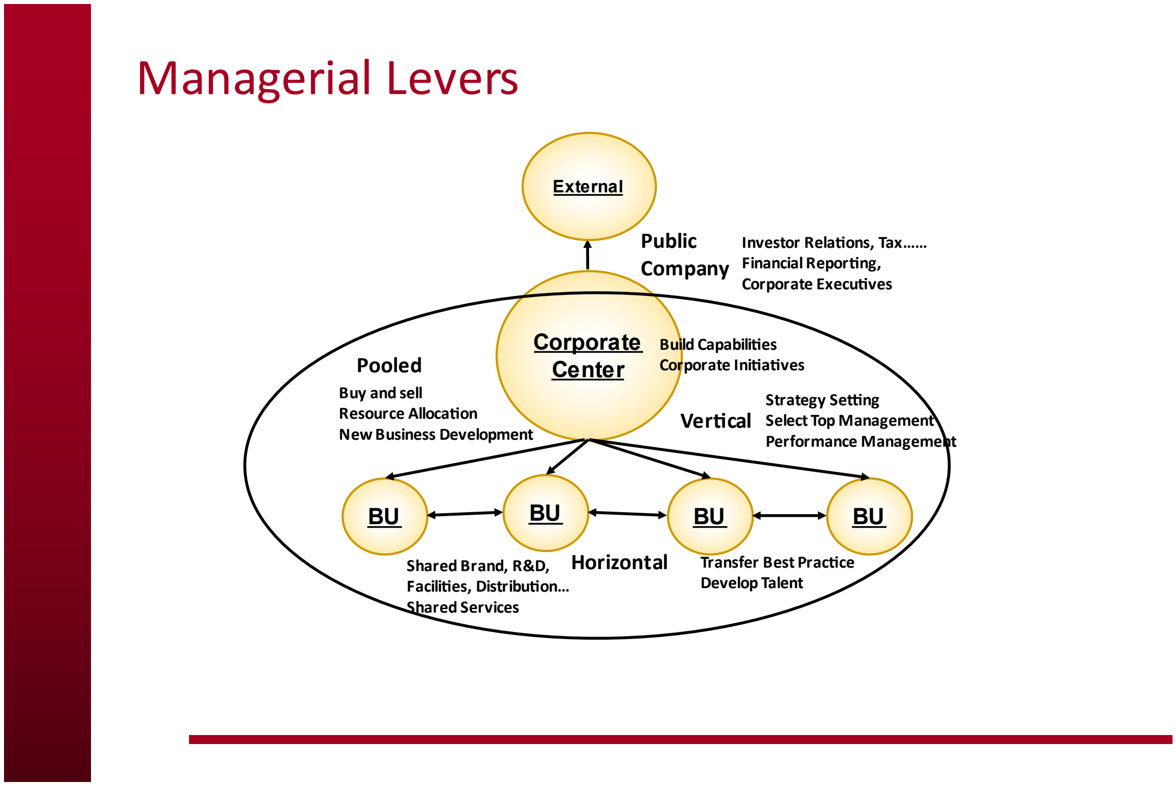


SOURCE: Casewriter

Organisation structure and design of administrative processes necessarily become more complex towards the related end of the continuum as corporations employ more levers to create more value (Figure 4)[5]. All corporations seek to minimize the cost of performing the tasks required of any corporate entity – financial and tax reporting, investor relations etc. Everyone has to continually invest in the capabilities and resources that become their “Mickey Mouse”. All have some form of performance management and monitoring processes to control their portfolio companies (vertical relationship). And many reallocate resources among their businesses over time (pooled). What varies most are the extent of shared activities and transferred skills that are utilised to capitalize on “synergies” across the portfolio (horizontal relationships that require coordination). This is why Clorox has a matrix structure – however unwieldy the design and however hard it is to manage the allocation of decision rights and role clarity – whereas Silver Lake operates with (legally) separate portfolio companies.

[5] The note “Organisation: Managing the Firm” provides more detail.

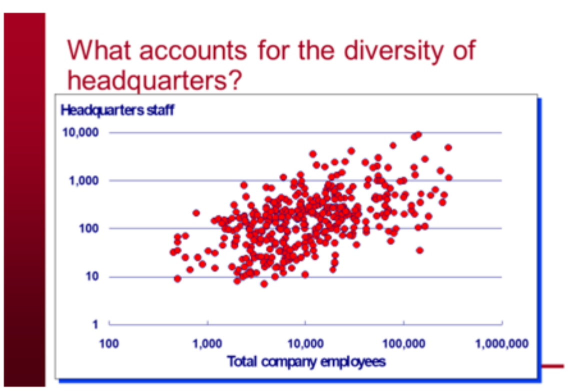
Figure 4



Source: Casewriter

As the set of businesses becomes more related, corporations employ more levers to create more value. As a result, corporate headquarters become larger at the right hand end of the continuum when there are more activities to coordinate. This is why Silver Lake has a total professional staff of 150 in charge of portfolio companies employing 400,000, while Clorox has that same number of corporate functional staff in Bentonville Arkansas supporting Walmart alone (Figure 5).

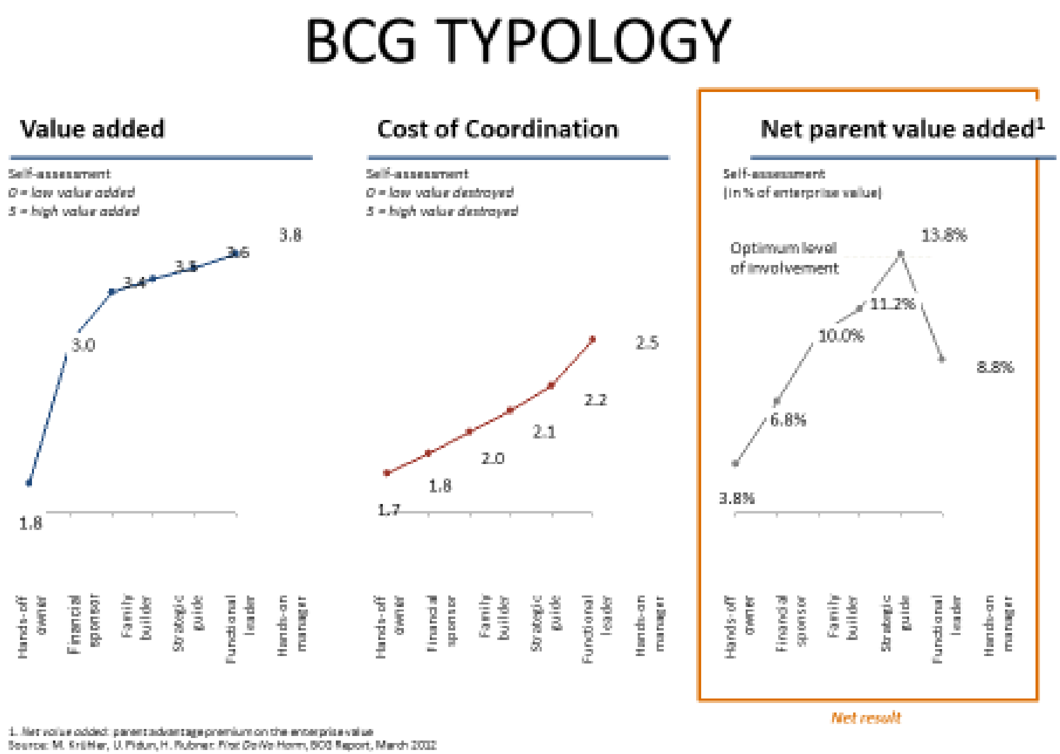
Figure 5



Source: Collis D., Young D. and M. Goold "The Size, Structure, and Performance of Corporate Headquarters" Strategic Management Journal, vol.28, #4, April 2007, pp 383-405

We can identify archetypes of effective corporate strategy along the continuum by examining successful firms at each location. These are not meant to be exact templates for companies to naively copy. Rather they are role models that suggest how to effectively align the three elements of corporate strategy. BCG, for example, has its own typology (Figure 6) – and is keen to point out that no one type dominates in performance. The important strategic take away from application of the continuum is to know where the corporation wants to be located - the objective – and aligning the three elements according to that location.

Figure 6



Corporate Strategy Statement

Corporate strategy is defined as "the way a company seeks to create value through the *configuration* and *coordination* of its multi-market activities" and can be described in a succinct way that follows the format applied to business unit strategy as an **Objective, Scope, and Advantage**.[6]

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[6]Collis D, Rukstad M "Can you say what your strategy is?" *Harvard Business Review* April 2008, vol.86 #4 p82-90

It can be useful to capture the corporate strategy in a concise statement, so that everyone in the organization understands how value is created and how that influences decisions they control (Figure 7). The statement should cover the Objective (typically financial to provide guidance into the margin/growth tradeoff); Domain (a definition of businesses that fit in the portfolio – with an emphasis on identifying what does not fit); and the Advantage which succinctly captures the resources that underpin value creation, and the requisite organization design.

For Corporate Strategy, the Objective – the (ideally single) metric for which management will be held accountable as the best milestone on the path to sustainable shareholder value creation – is typically financial. The Scope defines the limit to the businesses that fit within the corporate portfolio with an emphasis on the boundaries that proscribe markets the corporation will not enter, rather than being explicit about exactly which businesses the corporation actually will compete in. The Advantage captures the other two elements of corporate strategy by identifying the valuable resources the corporation possesses, and summarizing distinctive and critical features of its organization design.

Being clear about these elements of the strategy ensures that management provides direction to the entire organization, particularly with regard to what businesses and activities to perform, and how to structure the administrative context. A full version of the corporate strategy statement includes a more detailed deconstruction of terms, but it is important that companies are able to describe and communicate their corporate strategies in fifty words or less. Examples provide role models in this regard, and should resonate with you as succinct descriptions of the essence of those strategies that would provide useful guidance to their executives in decisions we study in the course, such as M&A, spinoffs, vertical integration, and organizational transformation.

Figure 7

WALT DISNEY COMPANY

OBJECTIVE	To grow eps by 20% pa
SCOPE	Creating and delivering trusted family entertainment in every distribution format and geography
ADVANTAGE	By coordinating the multiplatform management of owned durable entertainment franchises through individual divisions

DANAHER CORPORATION

OBJECTIVE	Deliver 25% per annum total return to shareholders
SCOPE	Acquiring, growing and continuously improving differentiated market leaders in B2B technical businesses
ADVANTAGE	Applying DBS and a pool of process trained managers to platform businesses with a tiny corporate office