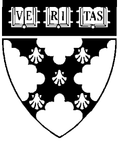

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Corporate Strategy: A Conceptual Framework

Corporate strategy, which is typically understood to be "the overall plan for a diversified company,"[1] is a vitally important area of management. The *Fortune 500* companies which account for nearly 40% of U.S. GNP are each active, on average, in over 10 discrete lines of business. The choice and implementation of these companies' corporate strategies affects not only their financial performance but also the fate of workers and managers in all the businesses they own and control. For smaller firms, similar decisions concerning scope and range of activities can affect their very survival.

Unfortunately, corporate strategy—in contrast to competitive strategy at the business unit level—is a poorly understood activity, as the track record of the last 30 years illustrates. Porter, for example, calculated that over 50% of all acquisitions made by 33 large corporations before 1975 had been divested by 1985.[2] Between 1980 and 1985, 17% of the *Fortune 500* simply ceased trading as public companies, (i.e., were acquired, declared bankruptcy, or went private). Indeed, 20% of all corporate assets changed hands between 1980 and 1987.

Moreover, the public corporation has itself been challenged as the dominant organizational form for economic activity in the United States. LBO partnerships and MBOs are now believed to account for 6% of GNP, and franchises, which are responsible for 35% of retail sales, account for another 7% of GNP. Joint ventures, alliances, and other contractual forms of relationship between firms also make up a substantial part of economic activity in the United States. The traditional corporate hierarchy has, therefore, been supplemented, if not yet replaced, by novel forms of governance designed to overcome some of the flaws of large bureaucratic institutions.

There is, therefore, a need for an approach to corporate strategy which will allow management to justify a corporation's role both in the product markets in which it chooses to compete, and in the market for corporate control. Previous perspectives on corporate strategy have clearly not been adequate to the task.

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[1]M.E. Porter, "From Competitive Advantage to Corporate Strategy" *Harvard Business Review*, vol. 65, no. 3 (May/June 1987): 43-59.

[2]Ibid. Analysis of larger samples suggest a divestiture of about 33%. D.J. Ravenscraft and Scherer, "Mergers, Sell-offs and Economic Efficiency" (Washington D.C.: The Brookings Institution, 1987).

Professors David Collis and Cynthia Montgomery prepared this conceptual note as the basis for class discussion.

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I. Previous Approaches to Corporate Strategy

Earlier perspectives on corporate strategy can be traced back to the original writings on corporate strategy by Professor Andrews in the 1960s.[3] These ideas were taught at HBS for nearly 20 years in the Business Policy course[4] (now replaced by C&S and MPP). In Professor Andrew's view, corporate strategy was concerned with building a "distinctive competence" that would provide the corporation with a competitive advantage in its various businesses. Distinctive competence, which was viewed as "more than what (the organization) can do; it is what it can do particularly well,"[5] could be identified through internal analysis of the corporation's capabilities. It could then be matched with the market opportunities identified by analysis of the external competitive environment in order to derive the optimal strategy. When initially advanced, this view suffered from an inability to distinguish between strategy at the corporate and the business unit level. It also lacked a specificity and grounding in economic analysis that prevented it from being applied in a truly rigorous fashion. As a consequence, while immensely valuable and influential, the approach became more applied to business unit strategy where it was summarized in the SWOT (strengths, weaknesses, opportunities, threats) analysis popularized by McKinsey.

At the same time as the Business Policy faculty at Harvard were developing their ideas on strategy formulation, Professor Alfred Chandler was addressing the issue of organization structure inside the corporation.[6] He first documented the broadening scope of corporate activity and noted the consequent increase in the complexity of the management task. He then described how corporations solved this complexity by reorganizing from a functional to a divisional organization structure. The M-form of multidivisional corporate structure was therefore seen as allowing companies to manage an extensive array of separate businesses. Ensuing research, much of it again conducted at HBS, demonstrated both the increasing prevalence of the M-form corporation, and that this organizational form led to superior financial performance. Consulting firms, McKinsey in particular, used this model during the 1960s and 1970s to reorganize many of the corporations in the United States and Western Europe into multidivisional structures.

However, the multidivisional organization structure introduced a basic dilemma for corporate management: should the relationship between the corporate office and the divisions be centralized or decentralized? For years the debate raged without resolution, and Chandler's work, like Professor Andrew's, was therefore interpreted mainly at the business unit level as a recommendation to ensure a "fit" between organization structure and strategy, so that "structure follows strategy."

Neither Chandler's work, nor the original Business Policy perspective was specific about which businesses a corporation should participate in. This issue became particularly salient during the conglomerate boom of the late 1960s. To address it, a doctoral student at HBS, Richard Rumelt, studied the performance of corporations as a function of the degree of relatedness among their various businesses.[7] He found that closely related corporate strategies outperformed highly diversified corporate strategies. This finding was widely accepted and, although challenged in later research, remains intuitively appealing because it can be explained by the "synergy" that can be exploited among related businesses. Indeed, "synergy" became the buzz word of the 1970s, and was used to justify the diversification of many previously single or limited business corporations. Unfortunately, the ill-defined nature of "synergy" enabled it to be used to justify almost any

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[3]K.R. Andrews, *A Concept of Corporate Strategy* (Homewood, Ill: Richard D. Irwin 1960).

[4]These are summarized in the old course books, *Business Policy: Text and Cases*, various editions, multiple authors.

[5]K.R. Andrews (1960).

[6]A. Chandler, *Strategy and Structure* (Cambridge, MA: MIT Press, 1960).

[7]R.P. Rumelt, *Strategy, Structure and Economic Performance* (Boston MA: Harvard Business School Press, 1974).

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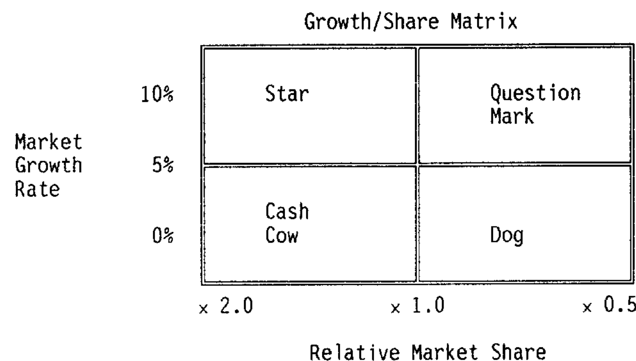
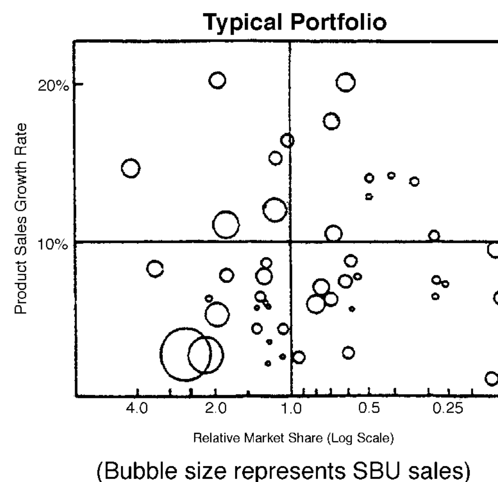
diversification. General Mills, for example, believed synergy was based on "understanding the needs and wants of the homemaker" and so misguidedly pursued a corporate strategy of diversification into toys, fashion clothing, restaurants, and specialty retailing.

By the mid-1970s, therefore, most large corporations had diversified, primarily through acquisition. Corporate managements were now responsible for a range of businesses they often knew little about, and which were generally run as autonomous divisions. As the first oil crisis hit in 1973, bringing the expansion of the 1960s to an end and introducing an era of inflation, corporate management was faced with deteriorating performance and with little advice on how to act. Into this vacuum came the Boston Consulting Group and portfolio management. In the now famous growth/share matrix, corporate management was finally given a tool with which to reassert control of its many divisions.





(Bubble size represents SBU sales)

This intrinsically simple matrix allowed managers to classify each division (now renamed a strategic business unit or SBU) into a quadrant, and implement the recommended strategy for that quadrant. SBUs with a leading market share in a slow growing market were cash cows. These were to be sustained as generators of cash for the corporation. Dogs with poor market position in low growth industries would be cash neutral and should receive no investment capital, but be harvested or divested. The cash thrown off by the cash cows should either be invested in question marks (to make them stars) or, preferably, in increasing the market share of the stars until their industry growth slowed and they become the next generation of cash cows. Such simple prescriptions gave corporate management both a sense of what their strategy should accomplish—building a balanced portfolio—and a way to control their divisions. Regardless of the ROI on a capital expenditure proposal from a "dog" division (which corporate managers would be unable to disprove because they knew little about the business) the request could be justifiably turned down.

Through the mid-1980s portfolio management dominated corporate strategy.[8] This was accompanied by an emphasis on strategy formulation at the SBU level facilitated by the introduction of tools such as BCG's experience curve, the PIMS analysis, and then by Porter's competitive strategy framework. Many corporations, like G.E., therefore, built large corporate departments to control strategic planning throughout the organization. Strategy at both the corporate and the business unit level had seemingly achieved a legitimacy and a rigor that it had previously lacked. This comfortable state of affairs was rudely interrupted by developments in the capital market in the 1980s.

The growth/share matrix was predicated on the assumption that corporations had to be self-sufficient in capital. This implied both that they should find a use for all internally generated cash inside the corporation rather than pay out free cash flow to shareholders, and that they could not raise additional funds from the capital market (otherwise any number of stars and question marks could be funded without a single cash cow to support them). In an efficient capital market neither of these assumptions was correct. The capital market's valuation of oil companies reinvesting their free cash flow in diversification, such as Mobil's acquisition of Montgomery Ward, illustrated the inappropriateness of the first assumption. The abundance of venture capital in the eighties meanwhile demonstrated the fallacy of the second implicit assumption of portfolio management.

At the same time, the enormous corporate infrastructure assembled by many large, diversified corporations to manage and support their divisions[9] (to say nothing of the excesses of corporate perks at some companies like RJR Nabisco) raised the fundamental question of what value that overhead contributed to autonomous SBUs. Easy access to debt financing through the junk bond market encouraged divisional managements and investment bankers to find the answer. Not surprisingly, these buyouts demonstrated that, in many cases, corporate overhead contributed little economic value. Indeed, because of the agency problems that arose when a division manager's interests were not aligned with those of the corporate management (let alone those of the ultimate principal—the shareholder) corporations were often destroying value by owning many of their divisions.

The resulting focus on the market for corporate control led to the last major perspective on corporate strategy—value based strategy, and to its emphasis on optimizing shareholder value. This perspective was almost the logical evolution of portfolio management, as it treated each SBU as a discrete entity valued according to its own cash flow profile. If the stock market valued the corporation at less than the sum of individual SBU valuations, the prescription was to sell off those divisions which were implicitly being undervalued.

By the late 1980s, therefore, large multibusiness corporations were struggling to justify their existence, and answer the three fundamental issues that corporate strategy must address:

- How is economic value created through multimarket activity?
- How must the corporation be structured and coordinated to realize the benefits of its multimarket activity?
- Why should those activities be undertaken inside the corporation rather than through contracts, joint ventures, or other institutional arrangements?

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[8]P. Haspeslagh found that nearly half of the large corporations he surveyed were using portfolio management in 1982. P. Haspeslagh, "Portfolio Planning: Uses and Limits," *Harvard Business Review*, vol. 60, no. 1 (1982).

[9]The average headquarters cost for 22 of the largest 25 U.S. industrial corporations in 1986 was 1.0% of total corporate sales or 1.3% of the market value of their assets. By comparison, mutual funds usually charge a fee of 0.5% of the assets under management. See T. Copeland, T. Koller, and J. Murrin, *Valuation* (New York: John Wiley & Sons, 1990).

Given a groundswell of belief that there must be a rationale for corporations, academics and consultants looked to develop typologies of corporate strategy that answered the first of these questions and described how to add value to multiple businesses. Michael Porter advanced a typology of four corporate strategies—portfolio, restructure, transfer skills, and sharing assets—in 1987.[10] McKinsey produced a list of nine in 1989.[11] The goal of corporate strategy as they saw it was to build a "corporate advantage," analogous to a competitive advantage in a business unit, and so earn above normal returns. To achieve this it was recognized that a corporation had to do the following:[12]

- generate value from the membership of each business unit
- create more value than the cost of corporate overhead
- add more value than any other corporation

The first test is based on the premise that profits are only realized in product market competition so that corporate advantage must translate into competitive advantage in a business if it is to be of economic value. It is not a requirement that each business must benefit from corporate membership, because the performance of some business units may be suboptimized for the corporation to achieve its optimal performance. However, membership of each business unit must on balance create value somewhere in the corporation. The second test recognizes that the costs incurred by corporations can on occasion outweigh the economic benefits that the corporation provides its business units. The numbers quoted earlier (in footnote 9) on corporate overhead costs suggest that this is not a trivial test. The third test recognizes that merely creating some value is insufficient given the modern market for corporate control. The value added must be greater than any other corporation or institutional arrangement (such as an MBO) can contribute, or else there will be capital market pressure to change ownership.

In practice this last test, which can be thought of as requiring all corporations to truly possess a competitively superior "distinctive competence," since only this will result in adding more value than any other corporation, is not as demanding as it may seem. The market for corporate control is a blunt instrument with which to discipline corporations. The acquisition premium necessary to dislodge an incumbent owner (which is of the order of 20%) and transactions costs (notably investment bank and legal fees) associated with changes in ownership (at least 2% of value) allows a substantial margin of error for incumbent owners. A corporation can be creating only 78% of the value that could be generated from a particular business unit and yet still be immune to the threat of a change in corporate control. This explains why corporate portfolios exhibit an enormous inertia even when the corporation is not pursuing an effective corporate strategy, or only possesses a competence, not a "distinctive competence."

As with our understanding of competitive strategy, the real breakthrough in the attempt to understand the sources of corporate advantage came from intellectually rigorous notions derived from economics. These are represented in what is now called "the resource-based view of the firm." Although this term covers several different approaches,[13] they have in common a view of the corporation as an idiosyncratic bundle of inimitable tangible and intangible assets which collectively form its "distinctive competence". These assets can be shown to be the source of economic profit in multiple markets and so to justify corporate activity. It is this perspective which forms the basis of the framework for corporate strategy proposed in the next section of this note.

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[10]M.E. Porter, "From Competitive Advantage to Corporate Strategy," *Harvard Business Review*, vol. 65, no. 3 (May/June 1987).

[11]Of the nine corporate strategies identified only three—controller, coach, and orchestrator—were found to be most relevant. McKinsey & Company, "What is the Right Role for a Corporate Parent?" (1989).

[12]Goold and Campbell, "Parenting Advantage," Ashridge Strategic Management Centre (1982).

[13]See the references in the course syllabus.

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II. A Framework for Corporate Strategy

Every framework must begin with a definition of terms. Many definitions of what constitutes a corporate strategy exist. Here corporate strategy is defined as the way a corporation seeks to create value through the configuration and coordination of its multimarket activities. This definition captures a number of important features of corporate strategy. First, it places the emphasis on value creation as the justification for the existence of the corporation. Second, it differentiates corporate from business unit strategy by its focus on multimarket activity. Third, it recognizes that corporate strategy must be concerned both with the set of businesses in which the corporation chooses to compete (configuration), and how it manages those various businesses (coordination).

In the basic conceptual framework of the course, a corporate strategy then consists of a set of five elements:

As a corporation, unlike a business unit, is a distinct and bounded entity, it is vital that it possess a *vision*. An overall conception of what the company is striving to become both provides an inspiration and a challenge to the organization. An effective vision usually contains two distinct components—a statement of values and ethics, and a definition of the corporate domain. These are vital both in providing motivation and meaning to employees and in guiding the direction of the corporation.

A vision is not a specific commitment, but a subjective, impressionistic idea of what lies on the horizon. It neither lays out a clear path nor specifies a detailed endpoint, but rather provides an overarching sense of purpose and mission. As such the vision should be articulated in general terms that convey some sense of what the company wants to achieve in the future and how that will contribute to society.

A corporate strategy should also include a set of *goals and objectives* that are more immediate and concrete than the vision. These targets represent the shorter term milestones which the corporation seeks to achieve in the implementation of its strategy. Goals are not quantifiable, but represent desirable ends which the company wishes to reach. Providing customer satisfaction and quality throughout the organization would be examples of goals. Objectives, in contrast, are measurable closed end targets that the corporation sets itself. They can be either general or specific. An example of the former would be to earn a 20% ROE over a business cycle. An example of the latter would be to acquire a company that is a leader in a particular technology within the next five years. Both goals and objectives set targets for the corporation which directly motivate behavior.

Central to every corporate strategy must be an understanding of the corporate advantage the company will build and exploit. Any company can set itself a vision and goals and objectives; the corporate advantage is the means by which those ends will be realized. It defines what it is that the corporation does better or differently than everyone else. At the core of corporate advantage and, therefore, at the core of corporate strategy lie the idiosyncratic *resources* of the corporation. The conceptual note "Resources: The Essence of Corporate Advantage" defines resources in more detail. For the purposes of this note, they can be thought of as the set of tangible and intangible assets accumulated over time by the corporation which cannot readily be imitated or acquired on traded

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factor markets, and which therefore make each corporation unique. When these resources are competitively superior, and when they contribute to competitive advantage in multiple product markets, they become the source of "corporate advantage." Such resources include physical assets, like machinery or a salesforce; intangible assets, like a brand name or knowledge of a specific technology; and organizational capabilities, such as rapid product development or manufacturing skills.

A distinction between one-time and ongoing value creation has to be made when considering corporate resources. Many resources lead to only a one-time injection of value. Restructuring a business unit occurs only once, and continuing corporate membership provides no additional value. Ongoing value, in contrast, would come from the continued use of a corporate brand name, or the sharing of a manufacturing facility between business units. Distinguishing which type of value a corporate strategy generates is critical because one-time injections of value require the corporation to sell off or otherwise dispose of business units after the value creation phase is over. Retaining ownership of a business unit without adding ongoing value is possible (because of the incumbent's margin of error), but it is not optimal.

If it is unique resources which are the ultimate source of value for a corporation, they must still be mobilized if their inherent value in multiple markets is to be realized. This does not imply that all resources reside directly at the corporate level. Many resources, such as a company's tacit collective knowledge of a technology, are embedded in the business units. Nevertheless, the corporate center must in some way act to mobilize those resources and effect their transfer or coordination among divisions, or else there is no justification for corporate ownership.

This challenge, and the need of the corporate office to control decentralized decision making in the divisions, defines the two critical tasks the corporate office must perform—deploying the corporate resources into the businesses, and establishing the context for decentralized decision making. These tasks are in addition to performing the routine "public company" functions, such as public and investor relations, legal, financial, and tax reporting, etc., which are required of any corporate entity, and providing a few "scaleable overhead functions" as services to the businesses. The conceptual note, "Managing the Multibusiness Corporation" describes these headquarters tasks in detail. What is important is that choices about the way the corporation fulfills these tasks determine the details of its organization design.

The set of these *structure*, *systems*, and *processes* used by the corporation to control and coordinate its multibusiness activities are also described in more detail in the conceptual note "Managing the Multibusiness Corporation." Here it is necessary to point out that there are multiple elements involved, ranging from the formal organization structure, capital budgeting, and strategic planning processes to the informal style of corporate management and the history of their symbolic actions. For successful implementation of a corporate strategy these elements of organization design need first to be internally consistent so that, for example, the incentive scheme is not rewarding behavior which is being denigrated by corporate executives. But more than that, these is a need, as Chandler observed, for "structure to follow strategy." Thus, the corporate structure, systems, and processes must be derived from, and aligned with, the resources that underpin the corporate advantage the corporation is pursuing and the appropriately chosen headquarters tasks.[14] The degree of interrelationships between business units, the extent of corporate intervention in business unit activities, the role of central staff functions, the corporate reporting systems, etc., all must be consistent with the chosen source of advantage. As a simple example, Hanson Trust's measurement and incentive system for divisions will look very different from the Walt Disney Company because each achieves a corporate advantage by leveraging a different resource in a different manner.

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[14]This argument is derived from contingency theory. See Lawrence, P. and Lorsch, J., "Organisation and Environment" Boston, MA: Harvard Business School 1967.

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The last element of a corporate strategy is the *industries* the corporation chooses to compete in, and the competitive *strategies* adopted by its business units in those industries. This has been traditionally thought of as the main function of corporate strategy. While important, choosing which businesses to compete in is not the only element of corporate strategy. Moreover, viewing this element as being determined solely by product market relatedness is also incorrect. The framework articulated here recognizes that businesses can be related in ways other than product market similarity.[15]

LBO firms, for example, usually participate only in mature technology, low growth industries as the market leader or as a dominant competitor in a niche. These criteria are necessary because the use of simple incentives schemes and the absence of any industry operating experience prohibit LBO partners from dealing with complex situations or much uncertainty.[16] Emerson Electric, in contrast, leverages unique skills in "best cost manufacturing," and competes in industries, including nonelectrical ones, where it believes it can succeed as the low-cost competitor. Effective corporate strategy that exploits a particular resource, therefore, limits the corporation to compete in particular industries and strategies. These may on occasion exhibit product market similarities, but will more often be related by other features of the corporate strategy itself.

A coherent corporate strategy can then best be thought of as how, in pursuit of a vision, the corporation aligns its goals and objectives, organizational structure, systems, and processes, and choice of industries and strategies to build and leverage the unique resources to give it a corporate advantage. It is through these actions that the corporations will create value and so justify its existence as a multibusiness entity.

III. Evaluating Corporate Strategy

This framework suggest that there is no one right corporate strategy. Instead, a corporate strategy is any internally consistent set of the five elements that create a "corporate advantage." At this stage of research, it has not been possible to identify a complete list of viable corporate strategies, or even articulate the extent of such feasible strategies.

In evaluating a corporate strategy, therefore, there are five tests that can be applied—vision, internal consistency, external fit, corporate advantage, and feasibility. An effective corporate strategy that creates value will pass all five tests.

A corporation should first possess an appropriate vision. This should be predicated on the likely evolution of the environment and should stretch and challenge the organization. However, it is vital that the vision also suggest a sense of the value the corporation is contributing to society. Part of its purpose is to provide employees a sense of belonging and commitment to the company. To achieve this the vision must articulate something more than just a return to shareholders. It must convey how in an ethical fashion the company will in some small way change the world for the better.

The five elements of the corporate strategy must also be internally consistent. As in competitive strategy, all elements of the strategy need to be aligned if the system as a whole is to move in one direction and not be pulled apart by internal dissonance. The corporate advantage must contribute to competitive advantage in the businesses in which the company chooses to compete. The structure, systems, and procedures of the corporation must fit with the tasks the headquarters performs. The goals and objectives must be leading towards fulfillment of the vision. Each element

[15]This has been called a "dominant logic." See C.K. Prahalad and R.A. Bettis, "The Dominant Logic: A New Linkage Between Diversity and Performance," *Strategic Management Journal*, vol. 7 (1986): 485-501.

[16]Extensive debt financing also prohibits LBO partnerships from competing in cyclical industries or pursuing cash-negative strategies.

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of a good corporate strategy depends on and supports the other elements. Thus, the elements must be internally aligned if the strategy is to have a chance of successful implementation.

The strategy should also fit with the external competitive environment. Corporations do not act in isolation, but against competitors in various markets. Thus, the strategy must stand up to competitive challenges, and be robust to predicted changes in the environment. An under-standing of technology changes and evolving consumer needs as well as the relative position of competitors and their likely strategic moves is therefore necessary to the evaluation of any corporate strategy.

The fourth and most important test of a corporate strategy is whether it truly builds and exploits a corporate advantage. In turn, this test can be thought of as having four parts. The first is whether the strategic is based on unique and valuable resources. As it is these which underpin corporate advantage, the strategy must be able to concisely *identify* and articulate exactly what resources are the source of value creation in this company. The strategy must then develop programs to *invest* in those resources. The third part of the test is whether the strategy maximizes the *leverage* of these resources. Many corporations possess resources that are underutilized. An effective strategy will expand the scope of the firm to fully employ these resources and so maximize the return to the corporation. A change in corporate control often results when a strategy fails this part of the test. The fourth part of the test is whether the strategy is creating, renewing, and *upgrading* vital corporate resources. The activities the corporation performs, whether in the businesses or at headquarters, both use and create resources. A good corporate strategy ensures that those resources critical to corporate advantage are not being depreciated but rather are being invested in and expanded. Indeed, for those corporations that do not currently possess a corporate advantage, a clear articulation of how to acquire or build the resources that will in the future provide the advantage is the single most important part of the corporate strategy.

The final test is whether the strategy is feasible. This does not involve the competitive test described earlier under external fit, but rather evaluates whether the corporation's growth path is achievable and of acceptable risk. Any strategy involves change and the question is whether the corporation possesses the capability to change as fast as, and in the direction that the strategy specifies. Is the organization simply being asked to do too much? Will the capital market provide the financial resources needed? Are there too many uncertainties which must resolve themselves favorably for the strategy to succeed? Striking the right balance between setting a challenging strategy and overextending the organization is a difficult task, but the evaluation of a strategy must involve a judgement that the planned development of the company is indeed attainable.

Ultimately, a good corporate strategy, like a good competitive strategy, should be able to be described in one or two sentences. Its essence—how to create economic value through multimarket activity—is not difficult to understand. Its practice, as recent history demonstrates and the detail of the framework suggests, is more complex.

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