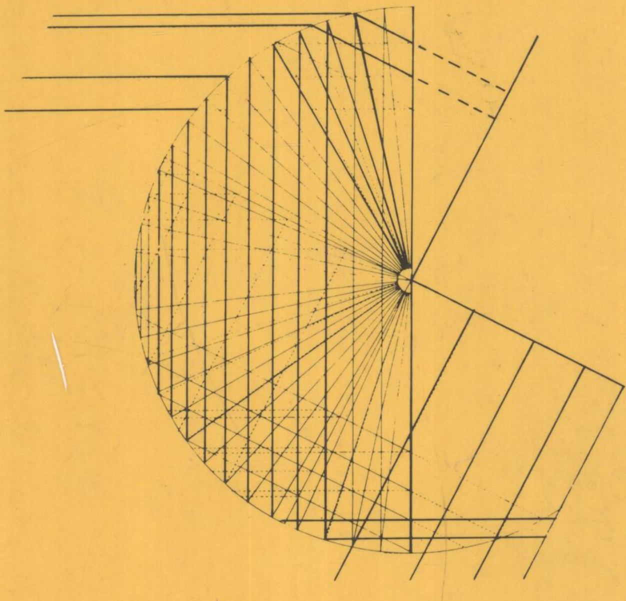
STRATEGIES AND STYLES

The Role of the Centre in Managing Diversified Corporations



MICHAEL GOOLD
and
ANDREW CAMPBELL

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Michael Goold is Director of the Ashridge Strategic Management Centre, a research organization that specializes in issues concerned with the management of multi-business corporations. He was previously a Senior Research Fellow at the London Business School's Centre for Business Strategy. An MBA from Stanford Business School, he helped set up the Boston Consulting Group's London office, and became a Vice-President in 1978. For twelve years he worked on strategy problems for leading UK, US and European companies.

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Cover design by Blackbird Graphics
Printed in Great Britain

ISBN 0-631-16846-X

Basil Blackwell
Oxford and
Cambridge, MA

Strategies and Styles

The London Business School Centre for Business Strategy Series

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and Andrew Campbell

Basil Blackwell

First published 1987
First published in paperback 1989
Reprinted 1989 (twice)

Basil Blackwell Ltd
108 Cowley Road, Oxford OX4 1JF, UK

Basil Blackwell, Inc.
3 Cambridge Center,
Cambridge, Massachusetts 02142, USA

British Library Cataloguing in Publication Data
Goold, Michael
Strategies and styles: the role of the
centre in managing diversified corporations.
1. Conglomerate corporations—Management
I. Title II. Campbell, Andrew
658'.046 HD2756
ISBN 0–631–15829–4
ISBN 0–631–16846–X Pbk

Library of Congress Cataloging in Publication Data
Goold, Michael.
Strategies and styles.
Includes index.
1. Conglomerate corporations. 2. Diversification
in industry. I. Campbell, Andrew. II. Title.
HD2756.G66 1988 658'.046 87–12151
ISBN 0–631–15829–4
ISBN 0–631–16848–X (pbk.)

Typeset in 10 on 11 pt Times
by Cambrian Typesetters, Frimley, Surrey
Printed in Great Britain by
Billing & Sons Ltd, Worcester

For
E. B. G.
and
A. E. C.

Acknowledgements

We have been working directly on this book for the past three years. Indirectly, however, we have been grappling for much longer with the question of the role of the centre in large firms. This means that we have benefited from many influences in developing our thinking. We are grateful to colleagues, past and present, at the London Business School, at The Boston Consulting Group (BCG) and at McKinsey; to numerous clients with whom we have worked on these issues; and to many others with whom we have debated our conclusions.

Although we cannot list all the individuals who have helped us, there are some specific acknowledgements we want to make. At the London Business School we would single out John Stopford, who was Director of the Centre for Business Strategy during most of the work on the book, and who encouraged us to focus on the issue of how the centre adds value to the business units; and John Roberts, Research Fellow in the Centre for Business Strategy, whose own research ran in parallel with ours, and who pressed us constantly to avoid oversimplifying problems. John's influence is most evident in our discussion of the tensions in the corporate role. Ian Mackenzie, another BCG alumnus, worked closely with us in some of the field research, and James Lyle, Hugh Woolhouse, Judith Waters, Matthew Bishop and Bryan Rimmer all provided valuable background analysis at different stages in the work.

We clearly could not have undertaken the work at all without the cooperation and support of the 16 companies. We are grateful to them not only for research access, but also for helping to shape and test our thinking through a series of meetings, seminars and presentations. They have been more than the subjects of the research: they have been true collaborators.

We probably owe our greatest debt, however, to the members of the Council of the Centre for Business Strategy. The whole Council, but particularly Trevor Chinn, Dick Giordano, David Plastow, David Sainsbury and David Walker, helped us gain access to the companies in our sample, criticized and challenged our thinking, and provided a never-ending source of encouragement by their enthusiastic interest.

Lastly we would like to praise Kathryn Duff and Hayley Bell who typed and retyped draft after draft of our manuscript, remaining cheerful and resilient throughout.

Despite our many debts, the responsibility for the views presented in this book remains, of course, our own.

M. G.
A. C.

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1

Introduction

This book is about the management of large, diversified companies. It deals both with conglomerates like Hanson Trust, which operates in several unconnected industries, ranging from bricks to batteries, and with industrial giants such as Cadbury Schweppes, which has remained in essentially two related industries, soft drinks and confectionery, but has many separate businesses within these industries. Since the war diversified giants such as these have come to dominate industry in all the major Western economies.

The importance of diversified companies is evident from their high and rising share of industrial production. In 1950, 75 per cent of the 200 largest companies in the UK derived the bulk of their sales from a single business. The proportions were similar in other developed economies. By the mid 1980s these figures had altered dramatically: now only 35 per cent of large firms concentrate on a single business. This change follows precedent in the United States and is reflected in all the main European countries.[1] It must represent one of the most rapid and profound shifts in industrial structure ever witnessed.

Some experts feel this trend towards diversity has gone too far. In the United States, in particular, pundits are exhorting businessmen to 'stick to the knitting'. Yet the merger boom of the 1980s has simply reinforced the movement towards increasing size and diversity. As a result, it is no exaggeration to argue that the economies of the developed world now depend crucially on the performance of large, multibusiness, diversified companies.

As firms diversify, they move away from being functionally organized towards a divisional structure, in which responsibility is pushed down to business unit and profit centre managers.[2] In large companies there may be as many as five levels of general managers – the profit centre (the lowest level where profit is measured), the business unit (often consisting of two or three profit centres), the division, the group and the corporate headquarters. Strategies are set and implemented at the sharp end, in the profit centres or business units. But there also needs to be a role for the higher levels and, in particular, for the corporate centre.

Given the involvement of several organizational levels and of many different individuals, the strategic decision-making process becomes highly complex and subject to many influences. Our work unravels these influences.

- What is the role of each level of management in the decision-making process, and, in particular, how do corporate and divisional managers influence business unit strategy?
- How does the process blend broad vision, corporate goals, detailed market knowledge, the results of strategy analysis, and the aims and aspirations of the members of the management team?
- What part does 'strategic planning' play? How much planning is done, and is it useful?
- How is commitment generated? What objectives matter most, and how are they established? Do they follow from, or precede, strategy?
- What facilitates good strategies? What gets in their way? Why do some companies get locked into unimaginative or unsuitable strategies, while others go from strength to strength?

In management textbooks the answers to such vital questions may seem straightforward. In practice, the picture is far less clear.[3] We can illustrate the complications and ambiguities with an account of a review meeting that we attended late in 1984.

Strategy in the Making

The meeting concerned the strategy for a smallish subsidiary of a large and diversified company. Around the table sat the subsidiary's managing director and its marketing director, together with the chairman, the finance director and the planning manager from the division of which the subsidiary formed a part. The topic under discussion was the launch of a series of new products.

The subsidiary had recently been acquired for £20 million. It held a 3 per cent share of a market dominated by three industry giants. The strategy being proposed by the subsidiary's marketing director was to become a 'niche innovator' – to bring out new products to slot into niches too small to attract the attention of the giants. In this way the marketing director believed he could increase share to around 5 per cent or beyond. A strategy of this sort had already been operating with some success for the past 6 months.

The marketing director argued that the strategy would build on advantages which the subsidiary possessed: greater experience in launching new products, better ability in managing low volume products, a more innovative marketing team. These advantages, however, were now under attack from the divisional planning manager, and were beginning to look less than convincing. The planning manager referred to the results of a consulting study. The study had concluded that the niche innovator strategy was unlikely to be defensible against the industry leaders. Soon the competitors would strike back, and the subsidiary's success would then evaporate. He also pointed out that even if the marketing director's strategy worked according to plan, the cash flow did not turn positive for another 5 years. He questioned whether the investment of £5 million in machinery, product development and advertising could be justified.

Despite his planning manager's arguments, the divisional chairman seemed to support the strategy. He acknowledged the force of the planning manager's comments and suggested that the subsidiary's managing director review the points that had been raised. But he claimed to see benefits for other parts of the division in going ahead. The mood of the meeting appeared to be in favour of proceeding as planned.

After leaving the room, we discussed the outcome with the subsidiary's marketing director. He seemed confident that the strategy would be continued, despite the criticisms that had been voiced. His observations were candid: 'We're all emotionally committed already. In fact, quite a bit of the new equipment has been purchased. The division chairman needs the growth we can offer, and I know the corporate CEO backs us.'

It emerged that, when the subsidiary was being acquired, both the corporate chief executive officer and the divisional chairman had supported the acquisition because of its potential for growth. The CEO, who believed in providing bold and visionary leadership, had seen the subsidiary as the basis for big new initiatives. The division chairman saw the acquisition as an opportunity to grow, at a time when most of his division's businesses were mature. Together they had pushed the acquisition through a somewhat sceptical board. Ever since, the subsidiary managing director had felt under pressure to live up to the expectations of his superiors.

The consulting study, commissioned immediately after the acquisition, had therefore proved an embarrassment. It had been much less optimistic about the growth prospects, and had suggested a strategy that would focus on raising the profitability of existing products. But by the time the report was received a major new flexible manufacturing line had already been ordered. Furthermore, the first new products were doing well in test market.

Confident in their own assessment of the market opportunity, aware of the sentiments at corporate and divisional level, and bowled along by the momentum of events, the subsidiary's management team had discounted the consultant's report. They had decided to steam ahead at full throttle, modifying their plans only by drawing out somewhat the time scale over which the strategy could be expected to pay off.

When we probed the marketing director further, he admitted some concern with the strategy, but remained convinced that they should go ahead: 'Basically, it comes down to backing your market judgement, and I reckon we know this market about as well as we can. Without the CEO's support, I suppose we might think again. But he's as convinced as we are that this is the right way to go. At least if we're wrong, we're all in it together.'

This example captures the complexity of the influences on managers as they decide on strategy. It also demonstrates the importance of the relationship between the centre and the business. Because the centre signalled that it wanted, even expected, an ambitious growth strategy, the subsidiary managers knew their plan would get a favourable reception. A less aggressive plan would have needed to be extremely well argued to receive approval.

Yet the subsidiary managers also knew that the plan was risky. The division planner's comments and the consultant's report were evidence for this. In many companies the risk would have caused the subsidiary managers to have been cautious: to have talked their bosses' ambitions down to safer levels. They didn't do this because they knew that failure of the plan would not destroy their careers. By recognising that 'we're all in it together', the marketing director was pointing out that the responsibility for the plan was shared further up the hierarchy. For him the plan was ideal. It gave him the opportunity to demonstrate creativity in marketing and product development. If it succeeded, he would be the architect of success. If it failed, the mud would not stick to his reputation.

The centre's influence was, therefore, a result not only of signalling to the subsidiary managers that a growth strategy was needed, but also of communicating that the risk of failure would not be borne by the subsidiary alone. This was vital both in guiding strategic thinking and in structuring expectations about the consequences of success or failure.

In the event the plan worked well for 18 months. The new products were a success, volume and profit grew, and return on capital, though low, was bearable. Then problems occurred. Volume declined, some new products failed, profits fell and return on capital became unacceptable. But both the managing director and the marketing director had by now been promoted into other parts of the company. A new team were faced with pushing through a cost reduction plan.

It could be argued that this was an example of bad decision-making. The logic of the strategy analysis was not confronted, and the management team allowed a sort of 'group think' to guide their judgement. Indeed, the planning meeting appeared to be a sham because the decision had effectively already been taken once the new equipment was ordered. On the other hand, the decision process achieved a high degree of commitment to the strategy. Despite its riskiness, the strategy was enthusiastically implemented and achieved some big successes in the first year and a half. Given that the division was looking for growth, the results were, on balance, satisfactory, and the decision process may not have been inappropriate.

More importantly, this story describes the kind of situation encountered regularly in large companies. It serves to bring out the variety and ambiguity of the influences that shape strategy. Informal understandings work alongside more formal processes and analyses. The headquarters' agenda becomes entwined with the business unit agenda, and both are interpreted in the light of personal interests. The sequence of events from decision to action can often be reversed, so that 'decisions' get made retrospectively to justify actions that have already taken place.

Our task in this book will be to create some order in this apparently chaotic scene. It will be to seek an improved understanding of the reality of corporate decision processes.

The Role of the Centre

Our particular focus will be on the role of the corporate centre. This is because the centre defines the approach a company takes to making decisions. It determines planning procedures, hurdle rates, control processes and organization structures. It steers strategy by influencing managers in the business units, by supporting one investment rather than another, and by making acquisitions or divestments. Most essentially, it establishes the atmosphere, the culture, in which lower level managers propose and implement strategy.

Despite the importance of corporate headquarters, there are few accepted theories or useful prescriptions for how it should operate.[4] There is no clear consensus on the right role for the centre. Moreover, there are doubts about the value the centre creates. When is the centre's influence beneficial, and when is it merely an expensive overhead? What advantages, if any, does membership of a large group confer on the individual businesses within it? Time and again in our interviews these themes recurred. They are vital issues not only for corporate management but also for those working at divisional or business unit levels.

These questions emerge into the public arena at a time of major takeover bids. Over Christmas 1986 and throughout January 1987 the British industrial community debated the advantages and disadvantages of the bid by BTR for Pilkington. Pilkington, a family-led business for more than 100 years, is the world's leading glass-maker. It invented the float glass technology in the 1950s, and is one of the few companies in Britain that can claim to lead the world in both technology and market share. BTR is Britain's most successful conglomerate. Formed in 1934 out of the British arm of an American tyre company, BF Goodrich, it has built its success around a particular management philosophy. By applying the approach to larger and larger acquisitions, BTR has outperformed all but two other quoted UK companies in terms of return to shareholders in the period from 1974 to 1986.

Anthony Pilkington, chairman and chief executive of the glass company, stood for long-term strategies. He argued that investment in plant and technology was the key to business success. He underlined the importance of a global strategy and of the willingness of managers to make investments for strategic reasons, even though financial returns might be uncertain. The centre's role was to promote and reinforce these strategies. Sir Owen Green, BTR's chairman, accused Pilkington of spending too much on research and of following a global strategy that constrained the actions of managers in each country. He believed that Pilkington could substantially increase current profits without losing world position. 'Only a radical change in the culture at Pilkington can restore it to long term profitability,' he claimed. At BTR, the centre sees its role much more in terms of motivating managers to stretch for increased profitability than in terms of guiding long-term strategies.

In the event, Pilkington's share price rose to a point where Sir Owen Green withdrew his bid. This can be seen as a vote from shareholders in favour of the long-term policies of existing management.

In a similar battle a year earlier, shareholders voted the other way. Hanson Trust, another successful conglomerate, was competing with United Biscuits for control of the Imperial Group. Sir Hector Laing, the chairman of UB, claimed that he could turn the combined food companies into a world-beater. He envisaged investing in China, Brazil and Indonesia, to build world food brands that would rival Coca Cola or MacDonalds. Lord Hanson, the chairman of Hanson Trust, rested his case on the simpler claim that Imperial was badly managed. He argued that he could come close to doubling profits from the Imperial companies.

In this case the Imperial shareholders voted for Hanson Trust. They have since seen their company broken up: the head office has been closed, large parts of the business have been sold, and strong controls have been imposed on the remainder of the company. But the financial returns to the Hanson strategy have been excellent.

In both these cases the role of the centre was crucial. Anthony Pilkington, Sir Hector Laing, Sir Owen Green and Lord Hanson all have different philosophies about how large, multibusiness companies should be run. Moreover, these differences have deep roots. They are born out of years of successful practice. Differences of opinion about the right way to run a diversified company therefore become all the more acute; but too often these crucial questions are debated with little real understanding of what the different management approaches entail, and of what other approaches are available. Predictably, the resulting arguments generate more heat than light.

We feel that a fuller account of what different corporate headquarters do, how they work, and what issues they face is needed. Even senior corporate managers know remarkably little about how their counterparts in other organizations function. And they devote too little time to the question of whether their performance would improve if they copied some of the practices of other companies. Outside this circle there is widespread public ignorance concerning the role of the corporate centre. Not surprisingly, this has bred suspicions and misconceptions, which a wider sharing of experiences will help to eliminate.

Research Approach

Our work has involved research with a cross-section of leading British firms. We approached companies that are widely regarded as successful, state-of-the-art organizations, seeking a working relationship that would