Edited by

MICHAEL GOOLD

& KATHLEEN SOMMERS LUCHS

Managing the **Multibusiness** Company

STRATEGIC ISSUES FOR DIVERSIFIED GROUPS

ROUTLEDGE

Managing the Multibusiness Company

Strategic Issues for Diversified Groups

Edited by Michael Goold and
Kathleen Sommers Luchs

ROUTLEDGE
London and New York

First published 1996
by Routledge
11 New Fetter Lane, London EC4P 4EE

Simultaneously published in the USA and Canada
by Routledge
29 West 35th Street, New York, NY 10001

Typeset in Garamond by Datix International Limited, Bungay, Suffolk

Printed and bound in Great Britain by T J Press (Padstow) Ltd, Padstow, Cornwall

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
A catalogue record for this book has been requested

ISBN 0–415–13268–1 (hbk)
ISBN 0–415–13269-X (pbk)

Managing the Multibusiness Company

All multibusiness companies need to be able to justify the ownership of the businesses in the group. The corporate-level strategy must therefore show how and why the corporate parent adds value to the businesses. Classic strategic issues, which are addressed in this book, include the allocation of resources between businesses, the creation of synergy through linkages amongst the businesses and the choices faced when creating a corporate portfolio.

This selection of readings, which includes writings by leading business authorities, has been organized around the major issues outlined above. In Part I the readings concern the basic justification for the existence of multibusiness companies. Parts II and III concentrate much more on advice for the managers of these companies about how to handle the difficult strategic issues they face. Part IV offers empirical evidence on how diversified companies have performed, which leads to the penultimate part's selection of readings examining the nature of the influence that corporate parents actually exercise over their businesses, for good or ill. Part VI looks at the process for developing an effective corporate-level strategy.

Although the strategic issues that multibusiness companies confront will remain challenging and difficult, this book provides up-to-date thinking about how to approach them, and reveals that a robust framework for dealing with them is beginning to emerge.

Michael Goold is a director of the Ashridge Strategic Management Centre. Previously he was a Senior Fellow at the London Business School and a Vice President of the Boston Consulting Group. He has an MBA from Stanford Business School. **Kathleen Sommers Luchs** is an Associate at Ashridge Strategic Management Centre. She has an MBA from the London Business School and a PhD from Yale University.

Notes on sources

Chapter 1 Williamson, Oliver E. (1975) *Markets and Hierarchies*, New York: Free Press, pp. 8–10; 39–40; 132; 137–8; 141–51; 156–62; and references. Reprinted with the permission of the Free Press, a Division of Simon & Schuster Inc. from *Markets and Hierarchies: Analysis and antitrust implications* by Oliver E. Williamson. Copyright © 1975, 1983 by The Free Press.

Chapter 2 Teece, David J. (1982) 'Towards an Economic Theory of the Multiproduct Firm'. Reprinted from *Journal of Economic Behaviour and Organization*, 3, pp. 39–63, 1982, with kind permission from Elsevier Science B.V., Amsterdam, The Netherlands.

Chapter 3 Peteraf, Margaret A. (1993) 'The Cornerstones of Competitive Advantage: A Resource Based View', *Strategic Management Journal*, (14): 179–91. Reprinted by permission of John Wiley & Sons Ltd.

Chapter 4 Grant, Robert (1991) *Contemporary Strategy Analysis*, Oxford: Blackwell. pp. 340–4 + diagram p. 345.

Chapter 5 Reimann, Bernard C. (1988) "Managing for the Shareholders: An Overview of Value-Based Planning", *Planning Review*, 16(1): 10–22, January/February. This article is reprinted from *Planning Review*, 1988, with permission from The Planning Forum, The International Society for Strategic Management and Planning.

Chapter 6 Collis, David J. 'What is a "Related" Corporate Strategy?' unpublished paper, 1995.

Chapter 7 Haspeslagh, Philippe C. and Jemison, David B. (1991) *Managing Acquisitions: Creating Value Through Corporate Renewal*, New York: The Free Press, pp. 18–37. Reprinted with the permission of the Free Press, a Division of Simon & Schuster Inc. Copyright © 1991 by The Free Press.

Chapter 8 Porter, Michael (1985) *Competitive Advantage*, New York: Free Press. pp. 317–19; 323–63; and References. Reprinted with the permission of The Free Press, a Division of Simon & Schuster Inc. Copyright © 1985 by Michael E. Porter.

Chapter 9 Prahalad, C. K. and Hamel, Gary (1990) 'The Core Competence of the Corporation', *Harvard Business Review*, pp. 79–91, May–June.

Chapter 10 Kanter, Rosabeth Moss (1989) *When Giants Learn to Dance*, London: Simon & Schuster, pp. 100–16 and notes. Reprinted with the permission of Simon and Schuster.

Chapter 11 Ramanujam, Vasudevan and Varadarajan, P. Rajan (1989) 'Research on Corporate Diversification: A Synthesis', *Strategic Management Journal* 10 (6), 523–51, November–December. pp. 525; 526 (Figure only); 531–4; 535; 537–43; 545–51 (selected references). Reprinted by permission of John Wiley & Sons Ltd.

Chapter 12 Porter, Michael. E. (1987) 'From competitive advantage to corporate strategy', *Harvard Business Review* 65 (3): 43–59.
Chapter 13 Jensen, Michael C. (1989) 'Eclipse of the public corporation', *Harvard Business Review*, pp. 61–74, September–October.
Chapter 14 Chandler, Alfred D., Jr (1991) 'The Functions of the HQ Unit in the Multibusiness Firm', *Strategic Management Journal* 12: 31–50. Reprinted by permission of John Wiley & Sons Ltd.
Chapter 15 Campbell, Andrew, Goold, Michael and Alexander, Marcus (1995) 'The Value of the Parent Company', *California Management Review*, 38 (1), Fall.
Chapter 16 Prahalad, C. K. and Bettis, Richard A. (1986) 'The dominant logic: a new linkage between diversity and performance', *Strategic Management Journal*, 7: 485–501. Reprinted by permission of John Wiley & Sons Ltd.
Chapter 17 Goold, Michael., Campbell, Andrew and Alexander, Marcus (1994) *Corporate-Level Strategy: Creating Value in the Multibusiness Company*, New York: John Wiley & Sons, Inc. pp. 291–318. Copyright © 1994 M. Goold, A. Campbell and M. Alexander. Reprinted by permission of John Wiley & Sons Ltd.

Contents

Figures, tables and exhibits

FIGURES

TABLES

EXHIBITS

Introduction

During the last forty years, an important shift has taken place in corporate strategies. Until the 1950s, the vast majority of companies were functionally organized and focused their activities around a single dominant business. Today, divisional structures are far more common, and most medium and large sized companies operate in a number of separate businesses. The emergence of companies that own and manage several different businesses, multibusiness companies, has been a striking feature in all developed industrial economies.

Multibusiness companies include not only the classic conglomerates, such as Hanson or ITT. The term also applies to the much larger number of companies which certainly do not see themselves as conglomerates, but whose operations nevertheless extend over more than one distinct business. Such companies include Dupont and ICI, Exxon and Shell, Procter & Gamble and Unilever, Banc One and Barclays, as well as a whole host of smaller companies organized around separate divisions or profit centres. These companies are all multibusiness companies, and, as such, face distinctive strategic issues.

All multibusiness companies need to be able to justify their ownership of their multiple businesses. They need to be able to show that the influence they exercise on their businesses as corporate parents is beneficial, and that the businesses perform better as part of the corporate portfolio than they would as separate, independent entities. This is the basic challenge for multibusiness companies; a corporate-level strategy that is no more than the aggregation of a collection of individual business strategies is seriously inadequate. The corporate-level strategy must show how and why the corporate parent adds value to its businesses, and must address issues such as the allocation of resources between the businesses, the creation of synergy through linkages amongst the businesses, and choices concerning the businesses that should make up the corporate portfolio. These are the classic strategic issues for multibusiness companies that are addressed in this book.

THE DEVELOPMENT OF MULTIBUSINESS COMPANIES

Alfred Chandler, the eminent business historian, has shown how the divisionalized, multibusiness company first emerged in the years before and during the Second World War.[1] In Chandler's view, companies like General Motors, Dupont, and Standard Oil were forced to adopt a divisional structure because they had grown too large and complex to be managed with their previous functional organizations. These companies had been drawn into a wider and wider range of products and markets to exploit the opportunities arising from their base businesses and competences, and found that the only way to avoid overload at the centre was by decentralization. Divisional structures were therefore introduced, which separated day-to-day management responsibilities for the businesses from corporate strategy and resource allocation. These divisional structures recognized, for the first time, a distinction between business-level decisions, which were now the primary responsibility of management within the division, and corporate-level strategy, which was the responsibility of the corporate centre.

The success of companies such as GM led to increased popularity for divisional structures. Richard Rumelt's *Strategy, Structure and Economic Performance* estimates that the percentage of divisionalized companies in the Fortune 500 rose from 24 per cent in 1949 to 51 per cent by 1959 and to 80 per cent by 1969.[2] In many cases, divisionalization was coupled with, or led on to, moves into new businesses to supplement the original, core business. The logic for these diversifications was that they could spread the company's risks, utilize its management skills, and, with new businesses that were related to the base businesses, provide opportunities for synergy.

By spreading risks across a variety of different businesses and countries, corporate managements believed they could reduce the volatility of their companies' performance and their dependence on individual markets or technologies. Although financial theorists now argue that investors should not value corporate diversification as a means of risk spreading, since they can diversify their risks more efficiently by selecting a portfolio of different investments,[3] many corporate managers have continued to be attracted by diversifications that reduce their exposure to a single, dominant business.

The ability to utilize management skills and competences more fully is a second, long established argument in favour of entering new businesses. From the 1950s onwards, writers like Peter Drucker were beginning to put forward the proposition that good managers needed to master certain general principles of management that were applicable in any business setting.[4] Given a belief in general management skills, it was not a great leap to conclude that 'professional managers' might be able to use their skills in a variety of different business areas.[5] At one extreme, conglomerates such as Litton, ITT, and Textron sought growth by entering a wide range of different businesses. The top managers of these conglomerates believed that they possessed distinctive general management skills, and that, by applying them to a large number of different businesses, they could grow profitably. But many other, more traditional industrial companies also diversified during the 1960s and 1970s. In particular, where the companies' base businesses were maturing, corporate managers looked for growth opportunities in new areas. Diversification was attractive to such companies as a means of leveraging corporate competences and resources, and thereby meeting corporate growth objectives. Typically, the diversifications were not in 'unrelated' areas, as with the true conglomerates, but were in 'related' businesses, which had some links with the base business.

Diversifications into related businesses could be justified both by the fuller utilization of management skills or competences and by a belief in synergy. Igor Ansoff, for example, advised firms to analyse their capabilities in areas such as manufacturing, marketing and general management, and to identify new product-markets where these capabilities could be exploited to achieve synergies.[6] Rumelt's research on diversification suggests that, by 1969, 44 per cent of the Fortune 500 companies had diversified into related businesses, while only 12 per cent had diversified into unrelated areas.[7]

For all these reasons, the growth and popularity of diversified, multibusiness companies continued unabated through the 1970s. By the 1980s, however, many diversified, multibusiness companies were encountering performance problems, and widespread scepticism about the ability of companies to manage and add value to multibusiness portfolios gained ground. Raiders such as Carl Icahn, T. Boone Pickens, Kohlberg Kravis and Roberts, and Hanson demonstrated that they could acquire even the largest companies, break them up, and realize huge profits. The takeover activity of the 1980s prompted a rethinking both of the role of the corporate centre and of the kinds of strategies which were appropriate in multibusiness companies. Moreover, consultants and academics, such as Tom Peters, Robert Hayes and Michael Porter, were less and less favourable towards diversification, with several studies showing that diversifications and acquisitions had generally performed poorly, and advocating a renewed focus on selected core businesses.[8] During the 1980s, corporate restructuring in the USA began to reverse the trend of the previous three decades, and the percentage of diversified firms declined among the Fortune 500.[9]

In the 1990s, many multibusiness companies therefore face an increasing need to improve their performance and sharpen their strategies.

Though multibusiness companies continue to account for a high proportion of economic activity in the developed economies, they are under increasing pressure to show that their corporate strategies create value, and that they should not be broken up into their constituent parts.

STRATEGIC ISSUES FOR MULTIBUSINESS COMPANIES

Although many corporate managers recognize the need to re-evaluate their corporate strategies, they confront contradictory advice on how this should be achieved. Multibusiness companies are advised to 'stick to the knitting' and focus on one or a few closely related core businesses, but are also told to exploit their strengths in new businesses to ensure corporate renewal and growth. They are told to downsize and delayer, but also exhorted to search for synergies and build the corporation's core competences. Some advisors portray portfolio changes such as demergers or acquisitions as opportunities to increase shareholder value, while others criticize such moves as accounting tricks. Sorting through such conflicting approaches, and distinguishing between passing fads and more enduringly valuable thinking about corporate strategy, is not an easy task.

This book of readings is designed to help managers and students of corporate strategy to identify concepts and frameworks that can help them to deal with the distinctive strategic issues faced by multibusiness companies. The purpose of the book is to highlight and make more accessible the main themes and ideas that writers and researchers on corporate-level strategy have put forward, and to provide the reader with an overview of current thinking. In selecting the readings, we have aimed to identify theoretical, empirical and practical approaches to corporate-level strategy that together provide a sound basis for addressing the major issues in this field.

The readings have been organized around six major issues faced by all multibusiness companies:

- What is the basic economic justification and rationale for bringing different businesses together under the common ownership of a single corporate entity?
- How should resources be allocated among the businesses in the corporate portfolio, what businesses are suitable for inclusion within the corporate portfolio, and what criteria should guide acquisitions and divestments?
- How should linkages and synergy between businesses be analysed and facilitated?
- How well have diversified, multibusiness companies performed, and

what are current trends in diversification?
- How do corporate parents in fact influence their businesses, and under what circumstances do they create or destroy value through their influence?
- What process should be adopted for developing a convincing and powerful corporate-level strategy for a multibusiness company?

Figure Intro.1 provides an overview of the topics covered and the readings included in the book.

The first set of readings, in Part I, concerns the basic justification for the existence of multibusiness companies. These readings are more concerned with economic theory than with practical managerial issues, but they attempt to provide a fundamental underpinning for the multibusiness organizational form. The transaction cost thinking developed by Oliver Williamson, the theory of specialized resources and market failures stressed by David Teece, and the whole resource-based theory of the firm summarized by Margaret Peteraf each give basic insights into why and how multibusiness firms can, in some circumstances, be more economically efficient than single business firms. These readings contain some hints for corporate strategists concerned with the management of multibusiness companies, but their main focus is on theory building, not practical advice.

The next two parts, by contrast, concentrate much more on advice for multibusiness company managers about how to handle difficult strategic issues that they face. In Part II, questions of resource allocation and portfolio development are addressed. What businesses should the company be in, and how should it allocate resources amongst them? In Part III, the topic is the search for synergy. How can the businesses be made to collaborate in ways that mean that 2 and 2 will add up to more than 4?

Resource allocation across a variety of different businesses has always been both a vital and a difficult role for multibusiness companies. Robert Grant summarizes the portfolio planning techniques which became so widely used for this purpose during the 1970s, and Bernard Reimann explains the techniques of value-based planning that have gained popularity more recently. Though both these approaches to resource allocation have shortcomings, their use in multibusiness companies has been widespread. David Collis concentrates more on portfolio development and Philippe Haspeslagh and David Jemison on acquisitions. Both these readings draw explicitly on the resource-based theory of the firm, and attempt to show its practical implications for multibusiness company managers.

The readings in Part III concern synergy, which many writers, including David Teece, believe should be the main rationale for multibusiness companies. Michael Porter, who supports this view of the importance of

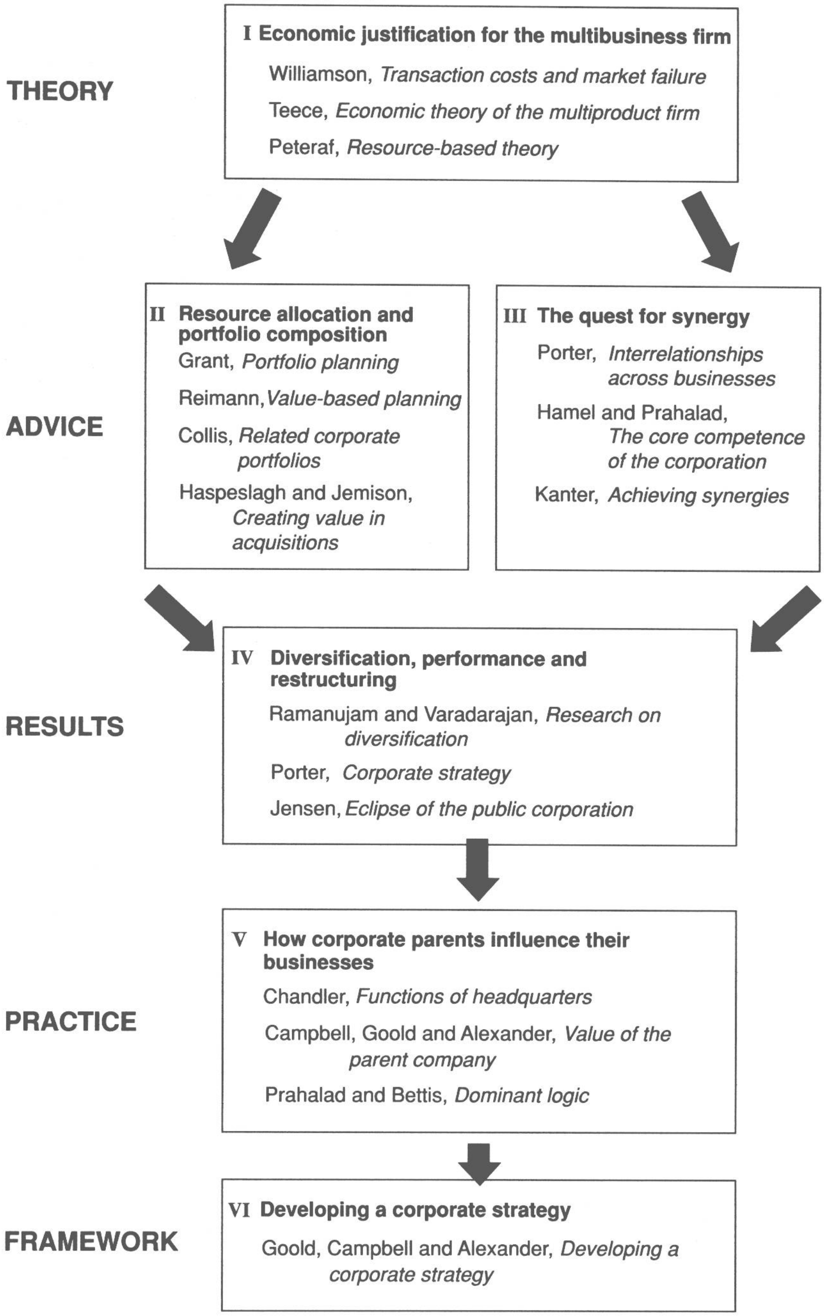

Figure Intro. 1 Overview of the book