MAKING CORPORATE STRATEGY WORK –

FOCUSED CORPORATE PARENTING AS A CORE COMPETENCE

Timothy Galpin, Ph.D.
Senior Lecturer in Strategy and Innovation
Saïd Business School, Park End Street, Oxford OX1 1HP
Email: timothy.galpin@sbs.ox.ac.uk

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ABSTRACT

The gap between management theory and practice has been much criticized. To help bridge the divide, a synthesis of empirical, theoretical, and practice literature is offered, along with an application of the widely used VRIO framework, to contend that developing a focused corporate parenting approach as a core competence serves as a source of competitive advantage for diversified companies. The synthesis of empirical, theoretical, and practice literature presented provides a foundation for future research into the impact of focused corporate parenting on diversified firm performance. The application of the resource-based view (RBV) and core competency theories to corporate parenting provides managers with the rationale for and methodology to focus their corporate parenting activities. A prescription for how diversified firms can implement a focused corporate parenting approach is also included.

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The fundamental differences between business and corporate strategy lie in the level of organizational focus and in the primary questions management must answer. Business strategy resides at the business unit level and requires managers to answer the question *how do we compete*?, whether for example, through low cost, better and/or more varied products, or high levels of customer service and responsiveness. Corporate strategy resides at the multi-business unit level and answers two key questions. Firstly, managers must decide *which businesses should we be in*?, requiring them to analyze and select the markets and/or industries in which to operate. Once the decision has been made to diversify, managers must then determine *how will the corporate office manage the array of businesses*?, requiring them to make decisions about their "corporate parenting" approach – answering this question is the focus of this discussion.

The gap between management theory and practice has been much criticized (Bennis and O'Toole, 2005; Brownlie et al., 2008). To help bridge this divide, a synthesis of empirical, theoretical, and practice literature is presented to contend that – *developing a focused corporate parenting approach as a core competence serves as a source of competitive advantage for diversified companies*.

The growth gap

Sustaining growth is hard to do. Known as the growth gap (Laurie, Doz, and Sheer, 2006), there is a large difference between the growth markets expect of firms based on their past performance and the growth they actually deliver (see Figure 1). Based on an analysis of the growth of 93 firms before and after entering the Fortune 50 between 1955 and 2006, firms enter the Fortune 50 by growing quickly, with average annual growth rates for each of the five years prior to entering the Fortune 50 ranging from 9% to 20%. They continue to grow for the first year after entering the Fortune 50 at an astounding 28.6%. Then, the firms' performance falls off drastically one year after entry into the Fortune 50, with average annual growth rates for years two through fifteen after entering the Fortune 50 ranging from a high of 5.1% to a low of -3.9%. (Laurie et al., 2006).

INSERT FIGURE 1 ABOUT HERE

Closing the growth gap

In order to close the growth gap, Ansoff (1957) offers four basic growth alternatives available to firms based on their selection of market and product offering. When faced with a growth gap, firms typically follow a logical progression through the areas of Ansoff's Matrix (see Figure 2), from market penetration, then to related diversification, and finally to conglomerate diversification (Johnson Whittington, Scholes, Angwin and Regner, 2017).

INSERT FIGURE 2 ABOUT HERE

A market penetration strategy is characterized by a firm's attempt to grow using its existing products and services, in existing markets. Market penetration involves increasing market share within existing markets. This can be achieved by selling more products or services to established customers or by finding new customers within existing markets. The company pursues increased sales for its existing products in its current markets by lowering prices, increased promotion and distribution support, market consolidation through the acquisition of rivals in the same market, and/or modest product refinements. Examples of a market penetration growth strategy include heavy promotion campaigns by Coca Cola (Oakley, 2015).

Related diversification occurs when a business attempts to grow by offering the same product to new markets, or offering new products to existing markets. Tesla's expansion globally with the same products it sells in the US market (Models S and X) is an example of same product, new market growth. Likewise, an example of the new product, same market growth strategy is Tesla's introduction of the lower-priced Model 3 in the US market.

Finally, unrelated conglomerate diversification happens when a firm moves into offering new products in new markets. GE (example businesses include: consumer electronics, aviation, real estate, financial services, energy, water, and lighting), The Tune Group (example business units include: aviation, sports, education, lodging, insurance, telecommunications, and entertainment), and Tata (example businesses include: manufacturing, realty, aerospace, retail, financial services, hotels, and aviation) are all examples of conglomerate diversification.

Diversification and performance

While corporate diversification is commonplace (Nippa, Pidun, and Rubner, 2011), there has been ample evidence demonstrating that diversified firms encounter significant performance issues (Palich, Cardinal, and Miller, 2000). Figure 3 illustrates how firms perform along a spectrum of diversification. The curvilinear relationship, or inverted U, between diversification and performance illustrates those firms that pursue related diversification outperform undiversified firms. But, performance falls off significantly for conglomerates consisting of unrelated businesses. The poor performance of highly diversified firms has been attributed to a variety of problems including the high cost of a corporate infrastructure, added bureaucratic complexity, obscured financial performance of weak portfolio companies, and a lack of discipline (i.e. unfocused corporate parenting) in managing a diversified portfolio of businesses (Johnson et al, 2017).

INSERT FIGURE 3 ABOUT HERE

Core competencies provide competitive advantage

The resource-based view of the firm proposes that management should look inside the firm to find the sources of competitive advantage. According to the resource-based view theory, internal resources are given the major role in helping companies to achieve higher organizational performance (Wernerfelt, 1984). Two fundamental types of resources exist: tangible and intangible. Tangible assets are physical things, such as land, buildings, machinery, equipment, and capital. Physical resources can easily be bought in the market so they present little advantage to the companies in the long run because rivals can soon acquire identical assets. Intangible assets are everything else that has no physical presence but can still be owned by the company. For example, brand reputation, trademarks, intellectual property, and business processes are all intangible assets. Unlike physical resources, many intangible assets are built over a long time and are something that other companies cannot buy from the market. Resource-based view theory argues that intangible resources usually stay within a company and are often the main source of sustainable competitive advantage (Wernerfelt, 1984).

Building upon the resource-based view theory, Prahalad and Hamel (1990) describe the concept of core competencies, proposing that firms can differentiate themselves from their competition by developing an integrated set of unique and valuable capabilities (i.e. a combination of tangible and/or intangible assets) that are difficult for other firms to imitate.

Besides being a differentiator, how a firm organizes around a unified set of capabilities provides a source of strategic competitive advantage. Separately, each capability is valuable. But, the principal competitive advantage is found in the integrated combination of capabilities a firm employs in a particular area, making them hard to separate and difficult for other firms to duplicate (Porter, 1996). How then does a firm know if a particular core competence provides competitive advantage?

Since its introduction by Barney (1995), the VRIO (Valuable, Rare, Inimitable, Organizational) framework has become a standard test of how well a particular core competence does or does not provide competitive advantage to a firm (Knott, 2015). The VRIO framework consists of four key criteria about a resource or capability to determine its competitive potential:

1. **Value**: Does the resource/capability enable the firm to improve its efficiency or effectiveness?
2. **Rarity**: Is control of the resource/capability in the hands of a relative few?
3. **Imitability**: Is it difficult to imitate, and will there be significant cost disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?
4. **Organization**: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?

The competencies that answer yes to all four questions are sources of sustained competitive advantage. Figure 4 illustrates the resource-based view as core competencies, which fulfill the VRIO criteria, leading to competitive advantage.

INSERT FIGURE 4 ABOUT HERE

Focused corporate parenting as a core competence

The value-adding effect of the corporate head office on individual business units comprising the firm's portfolio is termed the "parenting advantage" (Campbell Goold, and Alexander, 1995). Corporate parents can add or destroy value in their portfolio companies in numerous ways (Johnson et al., 2017). Value-destroying activities include, for example, increasing costs, adding bureaucratic complexity, or obscuring poor business unit performance. While value-adding activities involve, among others, coaching business unit management, facilitating synergies between business units, providing efficient and effective central administrative services, and helping manage external relations (Campbell et al., 1995). Johnson et al. (2017) identify three fundamental types of corporate parenting – *portfolio manager, synergy manager, and capability developer*.

Portfolio managers act as strategic investors, and are not concerned with the relatedness of the business units in their portfolio or interfering in the management decisions of the business units. Instead, portfolio mangers perform the role of knowledgeable investors, informed board members, and an in-house bank, funding investments in various business units (Vermeulen, 2013). Berkshire Hathaway is a clear example of a corporate parent that has focused on a portfolio management parenting approach (Thorndike, 2012). The integrated bundle of capabilities forming the core competency of portfolio management includes: financial analysis, capital budgeting, fiscal management, acquisition and divestiture transaction experience, and strategic investment savvy.

The synergy manager seeks to share business practices across business units. Synergy managers do not strive to bring business practices into various units from the corporate center. Rather, they establish mechanisms for sharing processes, people, and systems across business units, with the aim of improving efficiency and effectiveness among the units (Porter, 1987). General Electric, under former CEO Jack Welch who persistently advocated the "shameless stealing of good ideas" between business units, implemented a corporate parenting approach focused on facilitating cross unit synergies such as management training, HR practices, and business process improvements (Knoll, 2008; Slater, 1999). The cohesive set of capabilities forming the core competency of synergy management includes cross-business unit: core knowledge identification and capture, business process analysis, meeting facilitation, communication, technology-based learning systems implementation, and training design and delivery.

The capability developer applies its own central capabilities to add value to its businesses. Capability developers are not concerned with pursuing collaboration across business units or transferring capabilities between business units, as is the case for synergy managers. Rather, capability developers focus on the resources or capabilities they as corporate parents can transfer downwards to improve the performance of business units (Johnson et al., 2017). Unilever has been highlighted as a corporate parent that focuses on capability development within their business units, such as imparting fiscal management expertise, HR management management processes, and marketing practices (Caligiuri, 2012; Campbell et al. 1995). The cohesive set of capabilities forming the core competency of capability development includes corporate to business unit: communication, talent identification, specific business process expertise such as marketing or global supply chain management, and training design and delivery.

Although future empirical research needs to be done, from the descriptive evidence that exists in the practice literature, unfocused corporate parenting is common while focused corporate parenting is rare. Both academic and practice literature also suggest that focusing on one of the three principal corporate parenting approaches provides several benefits. First, discipline on the part of the corporate parent prevents its drifting into inappropriate activities or taking on unnecessary costs (Johnson et al., 2017). Second, the ability to adopt and maintain a strong strategic focus is necessary to realize the potential of the core competence approach (Clark, 2000). Third, each of the three firms identified above as examples of focused corporate parenting (GE, Unilever, and Berkshire Hathaway) experienced stock prices that significantly outperformed the S&P 500 index for the 20-year period between 1988 and 2008.

Just as individual firms "cannot succeed by trying to be all things to all people" (Treacy and Wiersema, 1995, pp. xii), it would follow that corporate parents also cannot succeed by trying to be all things to their business units. Because of the specialized bundled of capabilities involved in each parenting role, it is virtually impossible for a corporate office to be competent at two or all three roles at the same time. Likewise, a corporate parent attempting to fulfill each role concurrently will only serve to confuse business unit management.

As diversification is commonplace (Nippa et al., 2011), simply diversifying without a focused corporate parenting approach does not fulfill the VRIO criteria for competitive advantage. Whereas, firms that are able to implement a focused corporate parenting approach, do realize each of the VRIO criteria (see Figure 5). Therefore, simply diversifying does not provide firms with competitive advantage, diversifying combined with a focused corporate parenting approach, does.

INSERT FIGURE 5 ABOUT HERE

Building a focused corporate parenting core competence

Building a focused corporate parenting approach includes seven key steps (see Figure 6). The process begins by conducting a corporate parenting performance review, in order to establish an understanding of the firm's current parenting approach. This review involves identifying what works well and what could be done better regarding the firm's current corporate parenting activities; determining how focused or unfocused the firm's current parenting activities are; identifying and cataloging the firm's current corporate parenting practices, talent, and tools; and recording key learnings to apply to the firm's future corporate parenting activities.

Based on the parenting performance review, management must then decide which corporate parenting approach to focus on in the future - *portfolio manager, synergy manager, or capability developer*. Once management decides upon their desired parenting approach, the next step is to identify the corporate parenting practices, talent, and tools required to build the chosen parenting approach into a core competence. Examples of the integrated bundle of capabilities forming the core competency of each parenting approach were identified above. Then, the gaps between the firm's current and future corporate parenting practices, talent, and tools should be identified.

To begin closing the identified gaps between the firm's current and desired future parenting needs, the next step is to implement training which includes developing training content for the desired parenting approach, identifying training participants based on the corporate parenting talent inventory above (i.e. those who will be responsible for implementing the desired parenting approach), and scheduling and conducting training sessions for the identified participants. In addition to the training sessions, as part of the firm's knowledge capture efforts, a corporate parenting knowledge repository should be established. The repository can be housed on the firm's intranet, and should contain tools, templates, and best-practice information for the chosen parenting approach. As the selected parenting approach is implemented, the final step is maintenance. Maintenance efforts include conducting regular reviews of the firm's corporate parenting performance, practices, talent, and tools, and updating the firm's corporate parenting repository as needed.

INSERT FIGURE 6 ABOUT HERE

Implications for research

The application of the resource-based view and core competency theories to corporate parenting discussed here creates several implications for research. In order to test the premise that – *firms that apply a focused corporate parenting approach perform better than those that do not*, research should be conducted to:

- Determine the ratio of diversified firms using a focused versus unfocused corporate parenting approach.
- Determine the ratio of diversified firms who use a focused parenting approach which are: portfolio managers, synergy managers, and capability developers.
- Compare the performance of diversified firms that use focused corporate parenting to those that use unfocused corporate parenting.
- Compare the performance among diversified firms that focus on each of the three types of corporate parenting (portfolio managers, synergy managers, and capability developers).

- Compare the pre- and post-competency development performance of diversified firms that shift from unfocused corporate parenting, to focused corporate parenting.

Summary

Since diversification is a preferred growth strategy for many firms (Nippa et al., 2011), simply diversifying, but having an unfocused corporate parenting approach is not enough to create a competitive advantage. Instead, building a core competence by embedding integrated capabilities within the corporate organization to employ a focused corporate parenting approach will provide a valuable, rare, and inimitable advantage for a diversified company.

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Figure 1: The growth gap

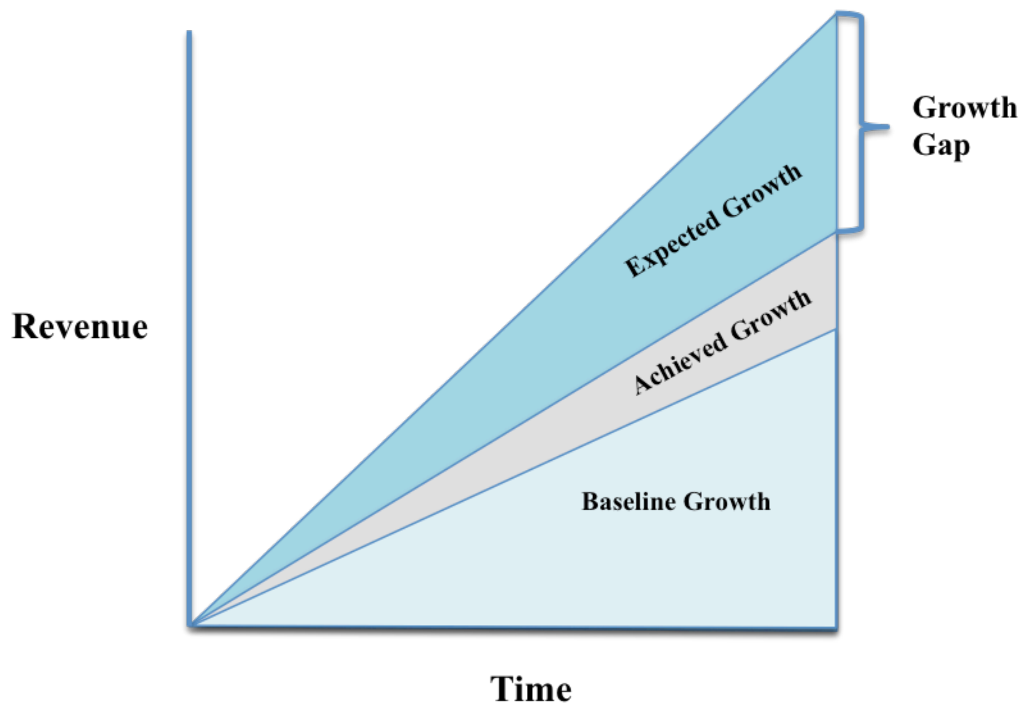


Figure 2: Progression through Ansoff's Matrix

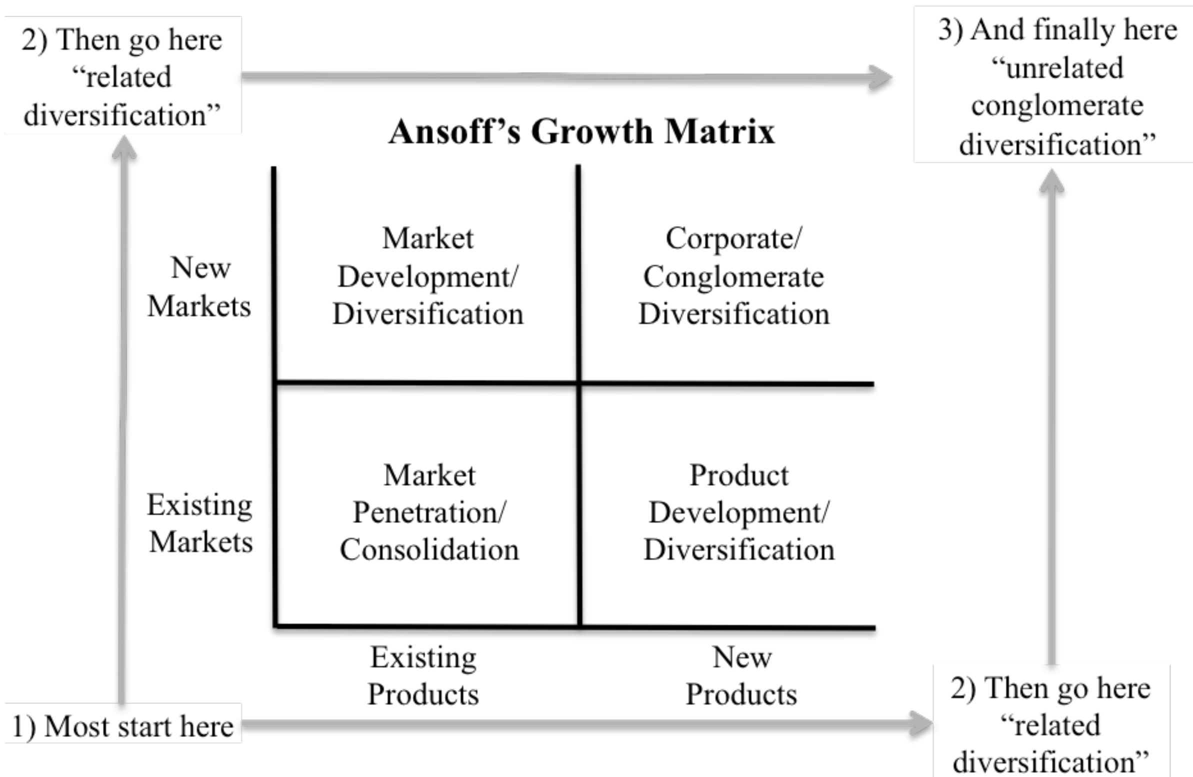
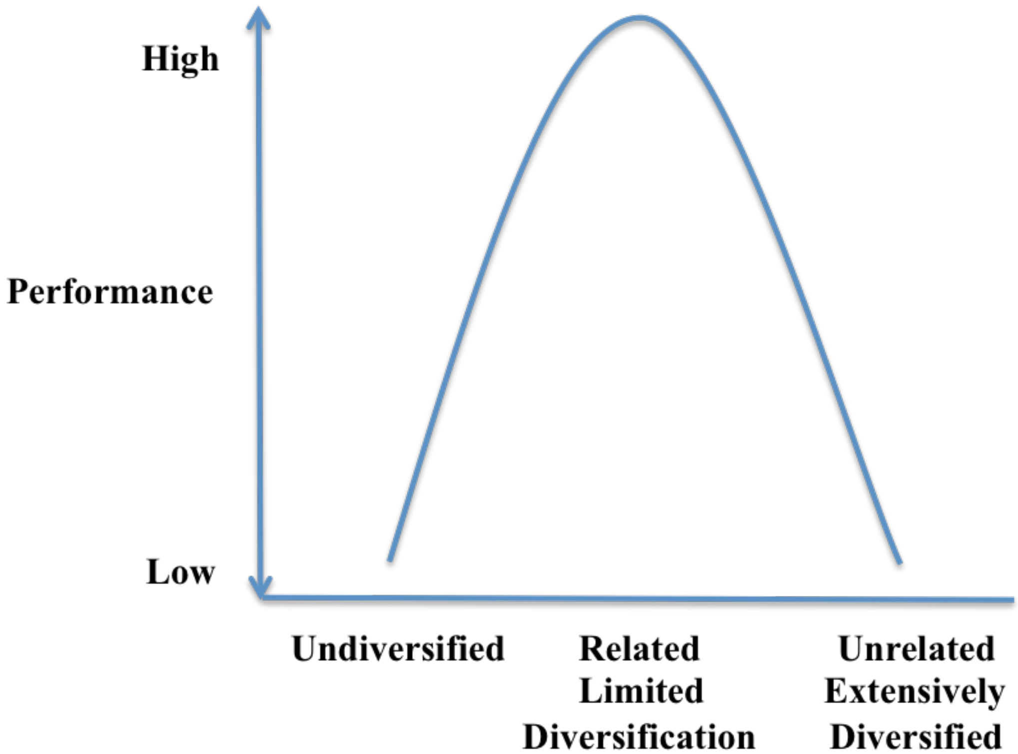


Figure 3: Research findings – Diversification and performance1



[1] Johnson, G., Whittington, R., Scholes, K., Angwin, D.N., and Regner, P. (2017). *Exploring Strategy*, 11th edition, Pearson: Harlow, UK, pp. 252.

Figure 4: Resource-based view of core competencies that provide competitive advantage

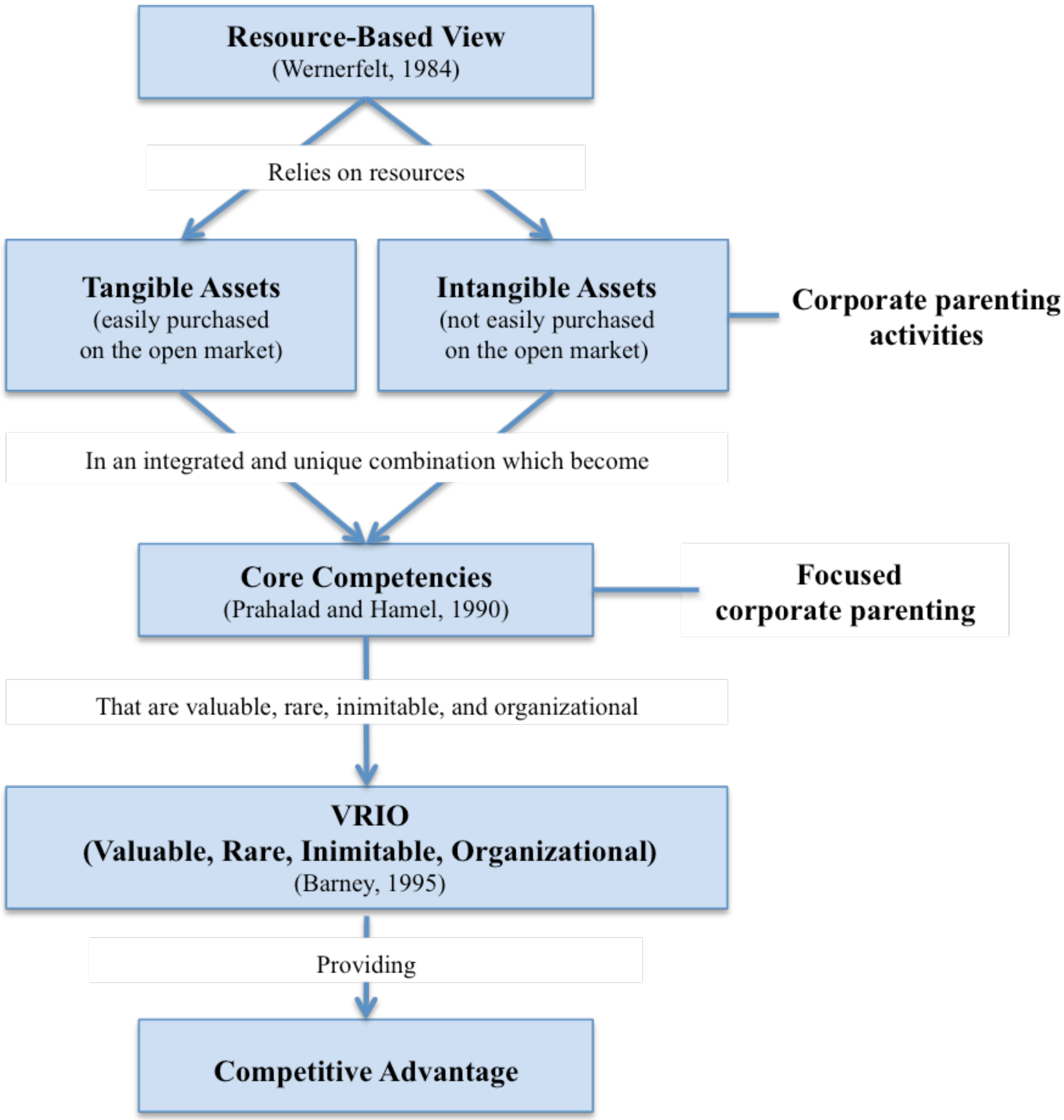


Figure 5: VRIO – Unfocused corporate parenting versus focused corporate parenting

Unfocused corporate parenting		
VRIO Criteria	**Fulfills VRIO?**	**Rationale**
Value: Does the resource/capability enable the firm to improve its efficiency or effectiveness?	**NO**	• Unfocused corporate parenting creates confusion, unnecessary costs and inefficiencies, destroying value.
Rarity: Is control of the resource/capability in the hands of a relative few?	**NO**	• Unfocused corporate parenting is common among diversified firms.
Inimitability: Is it difficult to imitate, and will there be significant cost and/or time disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?	**NO**	• It is easy for many firms to become unfocused in their corporate parenting approach, trying to be all things to all business units.
Organization: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?	**NO**	• Many firms are not organized to effectively implement a focused corporate parenting approach once new businesses are added or established.
Focused corporate parenting		
VRIO Criteria	**Fulfills VRIO?**	**Rationale**
Value: Does the resource/capability enable the firm to improve its efficiency or effectiveness?	**YES**	• A focused corporate parenting approach creates value through the implementation of proven value creating activities.
Rarity: Is control of the resource/capability in the hands of a relative few?	**YES**	• Focused corporate parenting uncommon among diversified firms.
Inimitability: Is it difficult to imitate, and will there be significant cost and/or time disadvantage to a firm trying to obtain, develop, or duplicate the resource/capability?	**YES**	• An integrated focused corporate parenting competency is hard to duplicate because of the effort, time, and cost involved.
Organization: Is the firm organized in such a way that it is ready and able to exploit the resource/capability?	**YES**	• A focused corporate parenting approach requires a firm to organize around an integrated bundle of capabilities, applying all the relevant skills, knowledge, tools, and talent required for value creation.

Figure 6: Building a focused corporate parenting core competence

Component	Key Activities
1. Conduct a current corporate parenting performance review	• Identify what works well and what could be done better regarding the firm's current corporate parenting activities. • Determine how focused or unfocused the firm's current parenting activities are. • Identify and catalog the firm's current corporate parenting practices, talent, and tools. • Record key learnings to apply to the firm's future corporate parenting activities.
2. Decide which parenting approach to focus on	• Based on the current parenting performance review, decide which corporate parenting approach to focus on in the future: – Portfolio manager – Synergy manager – Capability developer
3. Identify needed corporate parenting practices, talent, and tools	• Identify corporate-level practices required for the chosen parenting approach. • Identify key corporate-level talent and skills necessary for the chosen parenting approach. • Identify corporate-level tools and templates necessary for the chosen parenting approach.
4. Identify gaps	• Identify gaps between the firm's current and future corporate parenting practices, talent, and tools.
5. Conduct corporate parenting training	• Develop training content for the desired parenting approach. • Identify training participants based on the corporate parenting talent inventory above. • Schedule and conduct corporate parenting training.
6. Establish a corporate parenting knowledge repository	• Establish a corporate parenting knowledge repository, housed on the firm's intranet, for the chosen parenting approach. • Populate the repository with firm-specific tools, templates, and best-practice information for the chosen parenting approach.
7. Conduct regular maintenance	• Conduct regular reviews of the firm's corporate parenting performance, practices, talent, and tools. • Update practices, talent, and tools in the firm's corporate parenting repository as needed.