

*How can you tell
if your company is really
more than the sum of its parts?*

CREATING CORPORATE ADVANTAGE

BY DAVID J. COLLIS AND CYNTHIA A. MONTGOMERY

MOST MULTIBUSINESS COMPANIES ARE the sum of their parts and nothing more. Although executives have become more sophisticated in their understanding of what it takes to achieve competitive advantage at the level of individual businesses, when it comes to creating *corporate* advantage across multiple businesses, the news is far less encouraging.

True, corporate executives face mounting pressure from their boards and from capital markets to add value. To date, however, that pressure has had the greatest impact on corporate strategy in pathological companies such as ITT, where the *destruction* of value was so great that it had to be stopped.

What has slipped under the radar are those companies—the majority, we would argue—that don't destroy value at the corporate level, but neither do they create it.

That failure is not for lack of trying. Indeed, in many of the 50 companies we studied during a six-year research project, corporate executives were struggling to create viable corporate strategies. Some were working on their core competencies, others were restructuring their corporate portfolios, and still others were building learning organizations. In each case, executives were focusing on individual elements of corporate strategy: resources, businesses, or organization. What was missing was the insight that turns those elements into an integrated whole. That insight is the essence of corporate advantage—the way a company creates value through the configuration and coordination of its multibusiness activities. Ultimately, it is what differentiates truly great corporate strategies from the merely adequate.

Choices Along The Resource Continuum

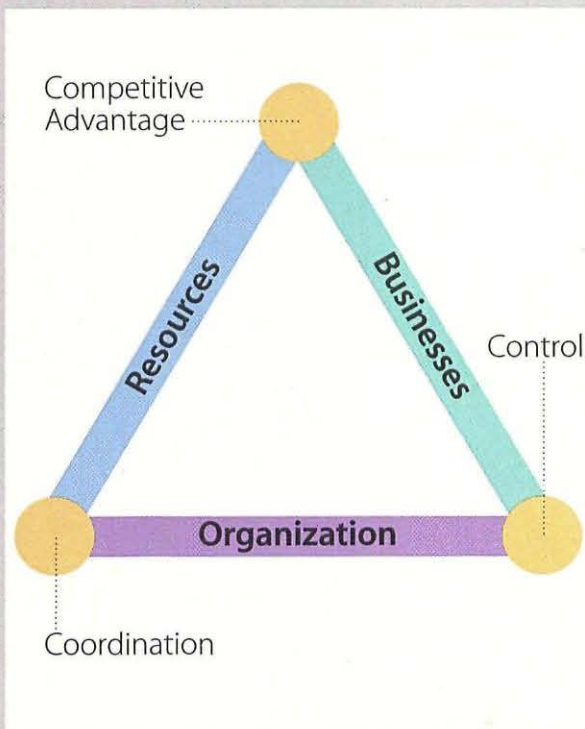
An outstanding corporate strategy is not a random collection of individual building blocks but a carefully constructed system of interdependent parts. More than a powerful idea, it actively directs executives' decisions about the resources the corporation will develop, the businesses the corporation will compete in, and the organization that will make it all come to life.

But there's more to it than that: in a great corporate strategy, all of these elements are aligned with one another. That alignment is driven by the nature of the firm's resources—its special assets, skills, and capabilities. The firm's resources are the unifying thread, the element that ultimately determines the others. (See the exhibit "The Triangle of Corporate Strategy.")

The resources that provide the basis for corporate advantage range along a continuum—from the highly specialized at one end to the very general at the other. Sharp Corporation, the Japanese electronics company, has specialized technological

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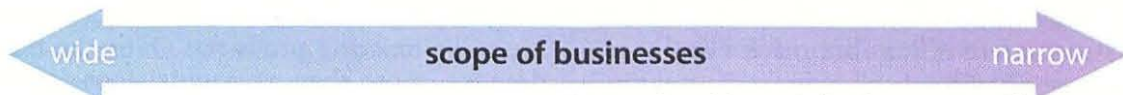
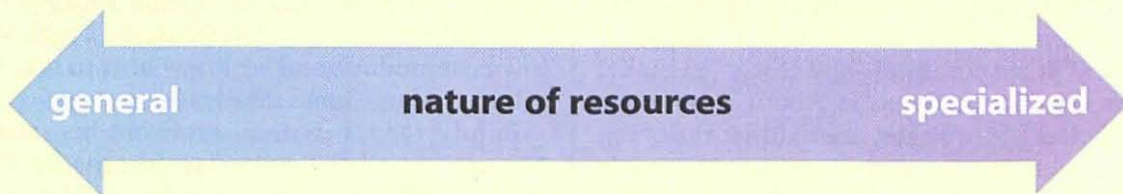
THE TRIANGLE OF CORPORATE STRATEGY



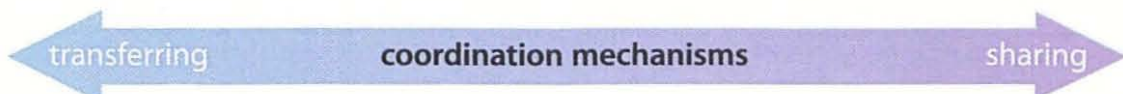
Great corporate strategies come in the first instance from strength in each side of the triangle: high-quality rather than pedestrian resources, strong market positions in attractive industries, and an efficient administrative organization. But true corporate advantage requires a tight fit at each angle as well. When a company's resources are critical to the success of its businesses, the result is competitive advantage. When the organization is configured to leverage those resources into the businesses, synergy can be captured and coordination achieved. Finally, fit between a company's measurement and reward systems and its businesses produces strategic control.

THE RESOURCE CONTINUUM

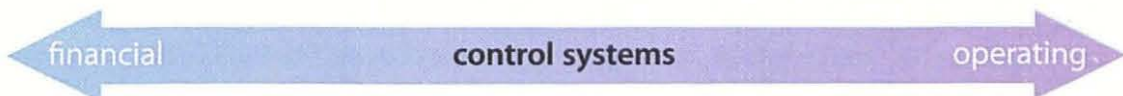
The resources that provide the basis for corporate advantage range along a continuum – from the highly specialized at one end to the very general at the other. A corporation's location on the continuum constrains the set of businesses it should compete in and limits its choices about the design of its organization along the other dimensions below.



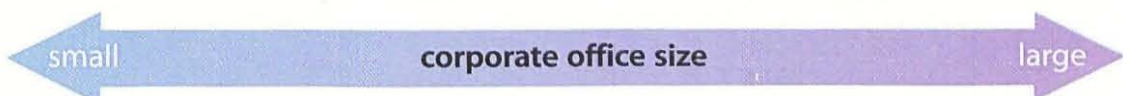
Companies with specialized resources will compete in a narrower range of businesses than companies with more general resources.



The more general the resource, the more likely the company can effectively deploy it through transfer rather than sharing.



As resources become more specialized, the value of moving from financial to operating controls increases.



The more general the resources and the less the need for sharing, the smaller the corporate office should be.

expertise in optoelectronics that gives each of its businesses a competitive advantage. Tyco International, a conglomerate at the opposite end of the continuum, creates value for its businesses through a set of general management skills and a system of corporate governance. (See the exhibit "The Resource Continuum.")

This continuum of strategic resources is important because a corporation's location on the continuum constrains the set of businesses it should compete in and limits its choices about the design of its organization. Our research suggests that most executives think they're getting the alignment of their corporate strategies right, when in fact they are not. They mistakenly enter businesses based on similarities in products rather than similarities in the resources that contribute to competitive advantage in each business. It is a common—and costly—mistake. (See the insert "Relatedness Is About Resources, Not Products.") Moreover, instead of tailoring organizational structures and systems to the needs of a particular strategy, they create plain-vanilla corporate offices and infrastructures as if there were one best practice that every company should follow. The current fashion happens to favor a lean, minimalist corporate office—but, as we shall see, one size does not fit all.

Far from it. One can find great corporate strategies in companies all along the continuum. Some companies may fit the lean mode, while others require richer and deeper infrastructures. Consider

the Newell Company, whose resources are neither exceedingly general nor specific but an attractive mixture of both.

Newell's Corporate Advantage

In 1966, Daniel Ferguson, a Stanford M.B.A., became CEO of Newell, an old-line manufacturer of brass curtain rods. The company had revenues of \$14 million, a limited product line of drapery hardware, and no articulated strategy for the future. Ferguson began to develop a "build on what we do best" philosophy. At the time, Newell was selling extensively to Woolworth's and to Kresge (later Kmart). Ferguson foresaw the trend toward consolidation in the retail business and envisioned a role for Newell: "We realized we knew how to make a high-volume, low-cost product, and we knew how to relate to and sell to the large mass retailer."

In July 1967, Ferguson wrote out his strategy for Newell, identifying its focus as the market for hardware and do-it-yourself products. The company then made its first nondrapery hardware acquisition—Mirra-Cote, a producer of bath hardware—in order to gain access to new discount outlets for Newell's existing products. Over the next three decades, more than 75 acquisitions followed, all guided by Ferguson's carefully articulated strategy of 1967: "Newell defines its basic business as that of manufacturing and distributing volume merchandise lines to the volume merchandisers. A

RELATEDNESS IS ABOUT RESOURCES, NOT PRODUCTS

Mercury Measures—an actual company whose name has been disguised—makes industrial thermostats. Not long ago, growth prospects in its core markets had flattened. But not all was bleak. Mercury's head of marketing was forecasting strong growth in the demand for household thermostats. For Mercury's management team, pursuing such a natural extension of the company's current business was a no-brainer.

Three years and lots of red ink later, Mercury had to write off the business. Why? At first glance, the strategy had made good sense. Mercury would remain a thermostat producer, adding only an additional product line. But a more careful and more rigorous look reveals that the fit between the two businesses was not at all close.

Mercury had all the factors needed for success in industrial thermostats: strong R&D capabilities; expertise in strict tolerance, made-to-order production;

and a technically sophisticated sales force of industrial engineers. Although Mercury was able to leverage some of its technological know-how when it entered the household market, R&D was not critical for success in that market, nor did it constitute a significant portion of the added value.

Moreover, Mercury lacked the resources necessary to be competitive in household thermostats. It had no expertise in design, product appearance, or packaging; it lacked the capabilities for mass production; and it didn't know how to distribute products through industry representatives to mass marketers and contractors.

Like Mercury, companies often err by expanding into market segments that appear to be related to their existing businesses but in fact are quite different. In particular, they tend to make this mistake when they define relatedness according to product characteristics rather than resources.

combination or package of lines going to the large retailers carries more marketing impact than each line separately, and Newell intends to build its growth through performance and marketing leverage of this package."

Although that strategy has been reviewed annually, its basic tenets have remained largely unchanged. Steadily pursuing this vision, Newell had sales of nearly \$3 billion by 1997 and was ranked twenty-second on the *Fortune* 500 in ten-year total return to shareholders. A review of Newell's corporate strategy reveals why.

Resources and Businesses. Today the products Newell makes range from propane torches to hair barrettes to office products. That may appear to be a bizarre collection of unrelated items, yet Newell is far from being a conglomerate. The relatedness across its businesses comes not from similarities in the products themselves but from the common resources they draw on: Newell's relationships with discount retailers, its efficient high-volume manufacturing, and its superior service, including national coverage, on-time delivery, and program merchandising.

How do we know that Newell has the right balance of resources and businesses? Because the firm's corporate capabilities enhance the competitiveness of every business it owns. Many of the companies Newell has acquired were subpar performers. Under its ownership, typical operating margins have increased threefold, from about 5% to 15% or more.

The company's resources define the businesses that make sense for it to own and those that do not. Newell will never compete in high-tech, seasonal, or fashion products because they require skills the company doesn't have. Nor will it enter businesses whose dominant channel of distribution is outside discount retailing. Indeed, Newell sold off Wm. E. Wright, a profitable line of home sewing products, when its distribution shifted to specialty stores. This need for fit between resources and businesses constrains the set of businesses in which a company should operate but increases the likelihood that a multibusiness strategy will actually create value.

Organization. A great corporate strategy begins with a vision of how a company's resources will differentiate it from competitors across multiple businesses. But it must also articulate how to achieve that vision. In particular, what kinds of coordination and control must the company provide in order to effectively deploy its resources?

Most corporate-level executives understand the need to add value to their businesses, yet few put in place the organizational mechanisms to make that possible. Many executives are reluctant to violate the autonomy and accountability of independent business units. Others fear they will end up with large, bureaucratic overhead structures. Companies like Newell, however, achieve the benefits of coordination with modest organizational costs.

Coordination. Newell understands that the outright sharing of resources such as a common sales force is not always the best way to capture synergies. So Newell *transfers* critical resources through-

Most executives create plain-vanilla corporate offices as if there were one best practice that every company should follow.

out the firm without undermining the independence of its business units. (See the insert "Should Corporate Resources Be Shared or Transferred?")

Much of Newell's know-how and experience is embedded in its managers. To leverage that resource, Newell deliberately moves managers across business units and from the business to the corporate level. That practice enables Newell to transfer experience and to build a skilled in-house labor pool. Job openings are publicized widely within the company and usually are filled by in-house candidates. For Newell, the benefits of such transfers can be fully realized because of the commonalities across its businesses—and that is not an accident but a result of forethought.

Other transfers of learning occur when divisional leaders convene six times a year for presidents' meetings and when they meet one another at trade shows. Annual management meetings bring together functional vice presidents for sales and marketing, operations, personnel, control, and customer service from all divisions. Each functional group has its own two-day meeting, featuring presentations and programs aimed at transferring best practices across the divisions.

In contrast to its many resource transfers, the only activity Newell *shares* among its businesses is its advanced data-management system. Meeting the needs of its demanding customers for efficient logistics, billing, and collection is so central to Newell's strategy—and the activity is so scale sensi-

SHOULD CORPORATE RESOURCES BE SHARED OR TRANSFERRED?

Deploying key resources where they are important to the competitive advantage of individual businesses is at the heart of corporate strategy. Sometimes it makes sense for businesses to share a common resource, like a sales force or an MIS system. In other cases, resources can be transferred across businesses with a minimum of coordination. Knowing whether to transfer or share resources—and which mechanisms to use—is largely a question of what kind of resource you are trying to leverage.

A useful distinction can be made between resources that we call *public goods* and those we call *private goods*. By public goods, we mean, for example, brand names or best demonstrated practices—things that can be used in several businesses simultaneously without conflict. By private goods, we mean such things as a common sales force or component-manufacturing facility—resources that are much more difficult to

manage and can lead to competition and conflicts between businesses.

Transferring public goods within a company can usually be done at arm's length with little intervention and coordination by the corporate office. Indeed, it may involve few, if any, explicit organizational mechanisms. For example, simply placing the Nike brand on a new line of sporting goods may convey a substantial competitive advantage to the business with relatively little effort on the part of the corporation. Other transfers can occur through occasional cross-business meetings and limited exchanges of information. When Disney introduces a new animated cartoon character, such as Hercules, the various Disney business units, from consumer products to theme parks, just need to be aware of one another's activities so that they don't conflict. Even the transfer of best practices, such as Newell's skills in inventory man-

manage and can lead to competition and conflicts between businesses.

tive—that the corporate office itself takes responsibility for those tasks and requires the divisions to accept its terms and conditions. All other operational activities, including sales, are the responsibility of Newell's 20 independent divisions. The company explicitly chose not to form one central sales force, fearing the consequences of lost autonomy and accountability at the business level.

Control Systems. The other element of infrastructure that plays an important role in corporate strategy is a firm's control systems. Without the appropriate control systems, the corporate center can quickly lose its ability to determine strategic direction and influence performance in the individual businesses. That is why choices about what to measure and reward are so important. Broadly speaking, corporations have the choice between two types of control systems: operating or financial. Understanding which one fits a company's particular resources and businesses is critical to creating corporate advantage. (See the insert "Financial Versus Operating Control.")

Newell's system of operating controls fits its strategy of leveraging the experience of senior managers. The system focuses on 30 operating variables that management believes are critical to the success of the businesses—and because the businesses have so many similarities, a single carefully tailored system can be applied to all of them.

For example, regardless of how a business unit is organized, Newell believes its SG&A expenses should never exceed 15%. All variances are bracketed, and too many variances lead to a "brackets meeting." Similarly, even if sales are above budget, managers will intervene if the fixed-cost numbers show an unfavorable variance. Senior managers are intimately involved in the oversight and monitoring of the businesses, principally through monthly performance reviews that allow them to add value in discussions with divisional managers.

Compensation systems are always central to control systems. Again, Newell's is aligned with its strategy. To facilitate transfers, compensation is uniform across divisions; base salaries are determined by position and division size. Newell holds individual managers and operating units accountable for performance, and it rewards excellence. Managers who make it over Newell's high hurdle for bonus payouts—by achieving at least a 32.5% return on assets—are handsomely rewarded for their efforts with bonuses of up to 100% of their base compensation.

Corporate Office. A thoughtful observer would understand Newell's corporate strategy by walking around its headquarters and noting who was there and what they were doing—a simple mirror of any strategy. In 1997, there were 375 people on Newell's corporate staff. Beyond a small cadre of highly expe-

agement and program merchandising, can be relatively straightforward. Experienced managers can move to the new division or a project team can act as consultants. Because there is no conflict in their use, and because even autonomous business units will actively seek to capitalize on such truly valuable corporate resources, transferring public goods can be done with relative ease, once the means for doing so are in place.

With public goods, the challenge is often in their development and preservation. Who should be responsible for the resource? How can you ensure that the necessary investments are being made? Should new practices be developed by the corporate office or allowed to flourish in many divisions before the best one is applied everywhere? It is also important to safeguard the use of some public goods, particularly intangible ones such as brand names or sets of relationships, so that one unit does not spoil or devalue the asset.

Private goods require more explicit coordination because the same resource is shared by multiple businesses and therefore its use by one unit can affect its use by another. Consider a corporate unit that buys materials for all divisions in order to exploit economies of scale in purchasing. Should Pepsico's three restaurants, Taco Bell, Pizza Hut, and KFC—recently spun off as Tricon Global Restaurants—jointly purchase toilet paper? If they did, they would save several hundred thousand dollars per year. Believe it or not, this simple decision took more than a year to resolve. One chain wanted one-ply tissue, another wanted two-ply, and the third did not care. This example is powerful precisely because it is so trivial. If it takes a year to reach a compromise agreement on a question like this, imagine how difficult and time consuming it can be to reach consensus on sharing something important, like a sales force.

rienced senior managers who interacted frequently with the business heads, most of those people worked on the company's centralized data-management systems, which were critical to the company's operations.

From the top down, Newell maintains a culture deeply permeated by the expectation that it will be a leader in serving the needs of discount retailers. It is a source of pride that a frequently asked question in the industry is, "Do you ship as well as Newell?" Nearly all of Newell's senior managers maintain high-level relationships with customers, not to sell a particular product but to "sell Newell." As Daniel Ferguson explains, "Like everything else we do in marketing to the mass retailer, the more they see us as an effective partner, the greater the edge we have when a certain product comes up for review."

For all the value Newell adds to its businesses, it levies a corporate charge of only 2% of sales, a number far below the increase in operating margins the divisions gain by being part of Newell. That sort of tangible value has enabled Newell to achieve a ten-year total return to investors of 31% per year, compared with an 18% average for the S&P 500.

The Lessons of Newell

What are the most important lessons of Newell's long-term success?

- First, corporate strategy is guided by a vision of how a firm, as a whole, will create value. When Daniel Ferguson first laid out Newell's strategy, the company's resources were modest at best. Ferguson made the commitment to invest in and build the resources that allowed Newell to compete in a changing market.
- Second, corporate strategy is a system of interdependent parts. Its success depends not only on the quality of the individual elements but also on how the elements reinforce one another.
- Third, corporate strategy must be consistent with, and capitalize on, opportunities outside the company. Newell caught the upswing in discount retailing 30 years ago; more recently, it adjusted its domestic focus to exploit the growth of other "category killers" such as Home Depot and the office products superstores.
- Fourth, the benefits of corporate membership must be greater than the costs. Most corporate advantages are realized in the enhanced performance of the business units. While better performance is often more difficult to measure than in Newell's case, corporations must determine if they are achieving it. If they are not, they are not creating real corporate advantage.

Looking closely at how the elements of Newell's strategy work as a system, we see that its resources are the unifying thread. It is the nature of Newell's

FINANCIAL VERSUS OPERATING CONTROL

There are two fundamentally different methods for monitoring and controlling the performance of subordinates and business units. The first, *financial control*, holds managers accountable for a limited number of objective output measures, such as return on assets or aggregate sales growth. The second, *operating control*, recognizes that all sorts of events outside managers' influence, such as the bankruptcy of a major customer, may affect their performance. Rather than measuring outputs, operating control is concerned with evaluating managers' decisions and actions. Thus after an unexpected recession, financial control would punish managers because profit was below budget, while operating control might reward them for anticipating the downturn and cutting inventories, even though they missed their budget targets.

While most companies use some mix of the two, successful corporate strategies tend to emphasize one or the other. That choice depends primarily on the nature of the businesses in the portfolio and the relative expertise of corporate executives.

Financial control is most appropriate in mature, stable industries and for discrete business units. For such businesses, a few financial variables accurately reflect their strategic positions. In fast-moving industries with high levels of uncertainty, financial control is less suitable. In high-tech businesses, for example, current financial results may not capture the loss of technological leadership. Such measures may also be problematic when results across units are interdependent.

Operating control typically involves both quantitative and qualitative assessments that capture the nuances of a particular business. To use operating control

effectively, corporate managers have to be very familiar with the businesses in the firm's portfolio. Often the managers themselves will have extensive relevant operating experience.

Corporate managers may monitor dozens of line items such as reject rates, delivery lead times, and conversion statistics to assess the health of a business. The trade-offs among the targets may not be fully specified and the evaluation and incentive schemes may resemble more an implicit contract than a simple objective target.

Operating control systems require far more interaction between corporate and business unit managers. Through frequent strategic-planning sessions, operating reviews, and capital-budgeting discussions, corporate management can closely observe managers' performance and act as coaches and sounding boards. Not surprisingly, such systems place more demands on an organization and generally lead to somewhat larger corporate infrastructures.

In contrast, financial control systems are the easiest to implement and place the fewest demands on corporate management. The key is to establish discrete business units, to hold management accountable for outcomes, and to provide strong incentives for managers to meet their numbers. The archetype of such systems is the LBO, in which financial targets not only are agreed to within the firm but also are bound by covenants with external providers of capital.

No control system can be assessed in isolation. Rather, its effectiveness depends on its degree of fit with the company's particular set of resources and businesses.

resources that determines the businesses it should compete in, the design of Newell's organization, and the role the corporate office should play in the coordination and control of its businesses.

Sharing Resources at Sharp

Sharp Corporation, a \$14 billion consumer-electronics giant, sits near the specialized end of the resource continuum. Seen at one time as a second-tier competitor by its Japanese rivals, Sharp's consistent pursuit of a vision of technological creativity has pushed it to the forefront of its industry.

Resources and Businesses. Sharp's valuable resources are a set of specialized optoelectronics technologies that contributes to the competitive advantage of the company's core businesses. Its most

successful technology has been liquid crystal displays (LCDs), which are critical components in nearly all Sharp's products. The competitive advantage this resource confers is illustrated by Sharp's success in video recorders. Its breakthrough Viewcam was the first to incorporate an LCD viewfinder, an innovation that propelled Sharp to capture 20% of the Japanese market within six months of the product's introduction.

Atsushi Asada, a Sharp senior executive, described Sharp's technology strategy: "We invest in the technologies that will be the nucleus of the company in the future. Like a nucleus, such technologies should have an explosive power to multiply themselves across many products." By following this strategy, Sharp can successfully extend its scope into many new businesses, as long as compet-

itive advantage in those businesses depends on one of its core technologies. For example, as an extension of its screen technology, Sharp created the personal electronic organizer with its Wizard product.

Like most companies that operate near the specialized end of the resource spectrum, Sharp's set of businesses is fairly restricted: television and video systems, communications and audio systems, appliances, information systems, and electronic components. Unlike its competitors Sony and Matsushita, Sharp has never considered entering the movie business because it knows it has no competitive advantage outside its technology base.

Organization. Sharp's technological investments share several characteristics: they tend to be expensive, they often have substantial lead times, and the advantages they confer in products may be short-lived because of imitation or brief life cycles. To be successful in such an environment, Sharp must make good investment choices and, to recoup its investment, it must leverage new technologies quickly and broadly throughout the company.

Hence Sharp has a corporate office, not counting corporate R&D, of more than 1,500 people. Judged by today's fashion for lean corporate staff, that number is bound to appear shockingly large. Sharp's strategy, however, depends critically on extensive, intricate coordination of its shared technological activities—thus the logic behind its headquarters staffing.

Coordination. The need to share activities determines Sharp's basic structure. Unlike Newell, Sharp is divided into functional units, not product divisions. As a result, applied research and manufacturing of key components, such as LCDs, occur in a single specialized unit where scale economies can be exploited. In contrast, Honeywell, a typical U.S. company organized by product divisions, at one time had LCD research activity in seven divisions.

To prevent the functional groups from becoming vertical chimneys that obstruct effective product development, Sharp employs product managers who have responsibility—but not authority—for coordinating the entire set of value chain activities. And the company convenes enormous numbers of cross-unit and corporate committees to ensure that shared activities, including the corporate R&D unit and sales forces, are optimally configured and allocated among the different product lines. Sharp invests in such time-intensive coordination to minimize the inevitable conflicts that arise when units share important activities.

Each year, nearly one-third of Sharp's corporate R&D budget is spent on 10 to 15 Gold Badge projects. These are selected at the corporate technical strategy meeting because they involve original technologies that cut across product groups. All project members are vested with the authority of the company president and wear his gold-colored badge so that they can call on people throughout Sharp for assistance.

Control Systems. Because of the blurred accountability that results from its functional structure, Sharp requires a very different control system than a simple divisional P&L. It has to employ an operating control system that focuses more on how people behave than on the short-term financial outcomes they achieve. Promotion, therefore, rather than annual compensation, is the most powerful incentive, and employees are promoted on the basis of seniority and subtle skills exhibited over time, such as teamwork and communication. In a technologically based company with a functional organization structure, this control system is one of the few that will not unduly reward a short-term, self-interested orientation.

Like many Japanese companies, Sharp's culture reinforces the view that the company is a family or community whose members should cooperate for the greater good. In accordance with the policy of lifetime employment, turnover is very low, which encourages employees to accommodate everyone's interests and to pursue what's best for the company overall. That common outlook reduces the inevitable conflict over sharing such important resources as R&D and component manufacturing.

Sharp has to employ an operating control system that focuses more on how people behave than on short-term financial outcomes.

Like Newell, Sharp is successful in leveraging resources throughout its organization but, consistent with the nature of its underlying resources, it does so in very different ways. Newell's resources can be nurtured and transferred without confronting costly trade-offs across businesses. Merchandising practices used in one unit do not alter their use in another unit, and the development or deployment of those practices does not require extensive, coordinated decision making.

In contrast, Sharp's resources put greater demands on the organization. Their greatest benefits are realized when individual units collaborate and pool investments. In such a context, conflicts and trade-offs are inevitable; managing them well is critical to the success of strategies at that end of the resource continuum.

Controls and Incentives at Tyco

Tyco International represents the other end of the continuum from Sharp. Tyco is a \$12 billion conglomerate built around a set of very general resources that it leverages into a wide range of businesses. Contrary to the widely held negative view of conglomerates, Tyco illustrates that a carefully conceived and implemented strategy at the far left of the continuum *can* create substantial amounts of value—even in the United States, and even in the late 1990s. Since 1993, the market capitalization of Tyco has grown from \$1.2 billion to \$25 billion. Return on equity in 1996 was 16%.

Resources and Businesses. "What's special about Tyco," says CEO Dennis Kozlowski, "are its financial controls, good incentive programs, strong manufacturing, and operating managers who are highly motivated by incentives and who enjoy working without a whole lot of group support." Tyco's resources are general, much like those of venture capitalists and private equity groups.

Due to the broad applicability of their resources, companies like Tyco can operate in a wide range of businesses. In 1997, the company was organized around six operating groups: fire protection, flow control, disposable medical products, Simplex Technologies, packaging materials, and specialty

mature, stable, low-tech businesses, which, compared with Sharp's, face less uncertainty and require considerably lower levels of R&D spending. Tyco could not succeed in high-tech businesses where external events can badly distort a year's financial results.

Organization. Rather than reaching for specific synergies *across* its groups, Tyco uses the general resources of the corporation to encourage the division presidents to act like entrepreneurs *within* their groups, and to focus on expanding the scope and profitability of those units. As Kozlowski explained several years ago, "While they have the backing of an old-line, financially secure, capable company, they can act like small entrepreneurs who go out and do what needs to be done without all the encumbrances of the corporation."¹

A Tyco executive once likened the company's structure to a capitalistic system with "very little central planning. We don't tend to set up a lot of rules. We develop incentives for our people, and it works."² Indeed, its highly disciplined financial-control system and steep incentive schemes are at the heart of Tyco's strategy.

Tyco's managers are on the line to perform. The company's unsparing, top-down budgeting process holds divisional presidents accountable for the financial performance of their individual units—and only for that. At the same time, Tyco offers powerful incentives to achieve extraordinary results, of which there have been many. There is no cap on the bonuses for individual performance. In some cases, division heads make more money than Tyco's CEO. When a manager fails to perform, Tyco will look for a replacement with relevant industry expertise outside the organization. Because of the wide scope of its businesses, it cannot draw from an extensive internal labor pool the way Newell can.

Tyco recognizes that if you don't intend to achieve a lot of coordination across your businesses, you shouldn't have much of a corporate staff. That thinking is consistent with Tyco's "no meetings, no memos" philosophy.

In 1997, only 50 of the company's 40,000 employees were on the corporate staff. Its headquarters was in a modest frame building in New Hampshire. Like the rest of the corporate infrastructure, it was unpretentious but more than adequate to get the job done.

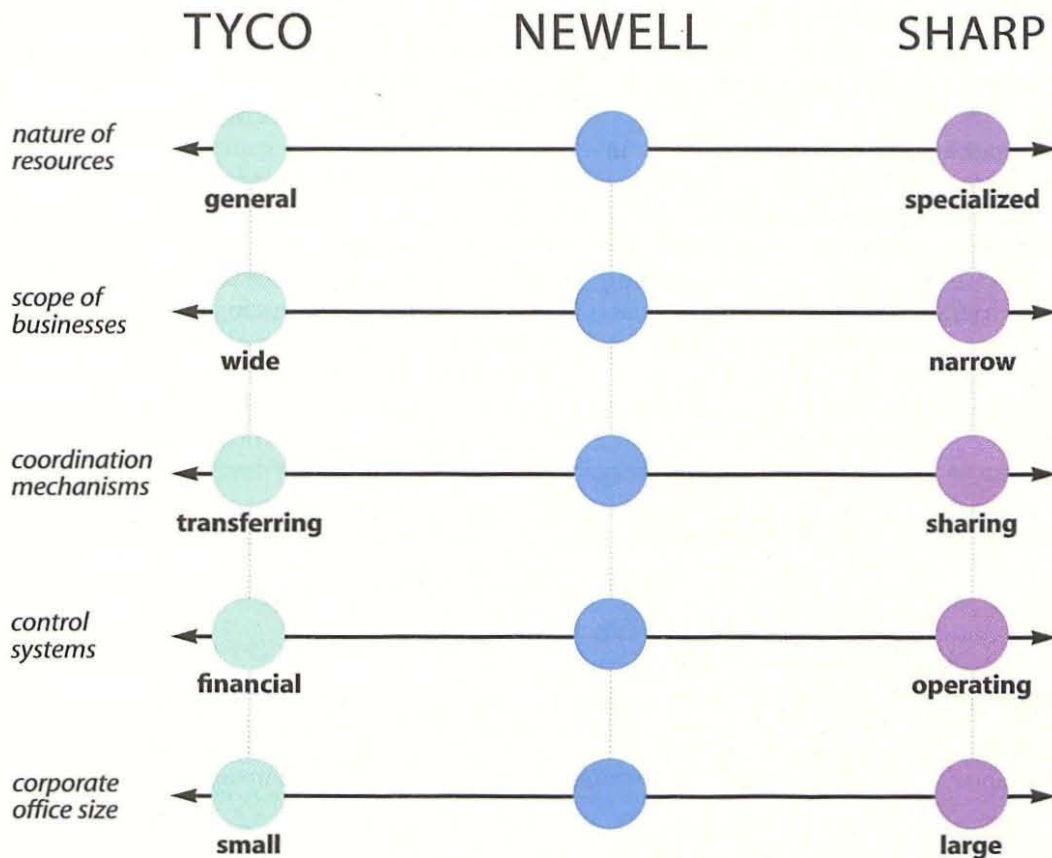
Kozlowski is aware of the criticisms of conglomerates and of the risks and challenges of holding a company together around a very general set of resources. He explains, "At least once a year we bring

Tyco's "no meetings, no memos" philosophy is consistent with the company's corporate strategy.

products. Each of these independent product groups was headed by a president who reported directly to Kozlowski.

While there are few product similarities across Tyco's businesses, its resources—financial controls and governance structure—do set limits on the kinds of businesses it can own. Tyco confines itself to businesses in which division executives can be held strictly accountable for a limited number of financial measures. As a result, Tyco competes in

THREE WELL-ALIGNED STRATEGIES



in someone from the outside who has a lot of incentive to break up the company—someone from a JP Morgan, Merrill Lynch, or Goldman Sachs—and say to them, ‘take a good look at us, break us up, and tell us what we’re going to get per share for it. Then tell us if you think we should break up.’ It’s the only way to get an objective look at it. And they’ve always said that we should stay as we are.” Given Tyco’s impressive record of value creation, it’s not a surprising conclusion.

No One Right Strategy

When we look across the spectrum of resources—from Sharp’s specialized technological expertise to Tyco’s general management disciplines—one thing is clear: as brilliant as any one strategy might be, it won’t necessarily work well for all companies. That’s because every company starts at a different

point, operates in a different context, and has fundamentally different kinds of resources. There is no best prescription for all multibusiness corporations.

What prevails instead is the logic of internally consistent corporate strategies tailored to a firm’s resources and opportunities. When corporate strategy adheres to this logic, a company can create a meaningful corporate advantage. When a strategy departs from it, a company at best will coast to mediocrity. At worst, the lack of consistency could be the iceberg that sinks the corporate ship. Consider the failure of Saatchi and Saatchi—at one time the world’s largest advertising agency and now, renamed Cordiant, a shadow of its former self.

Saatchi and Saatchi rose to fame in the 1970s and early 1980s on its reputation for creative advertising and its championing of global advertisements. Those skills enabled it to build a client base that became its most valuable resource. In 1986, with

the acquisition of Ted Bates, Saatchi became the world's largest advertising agency.

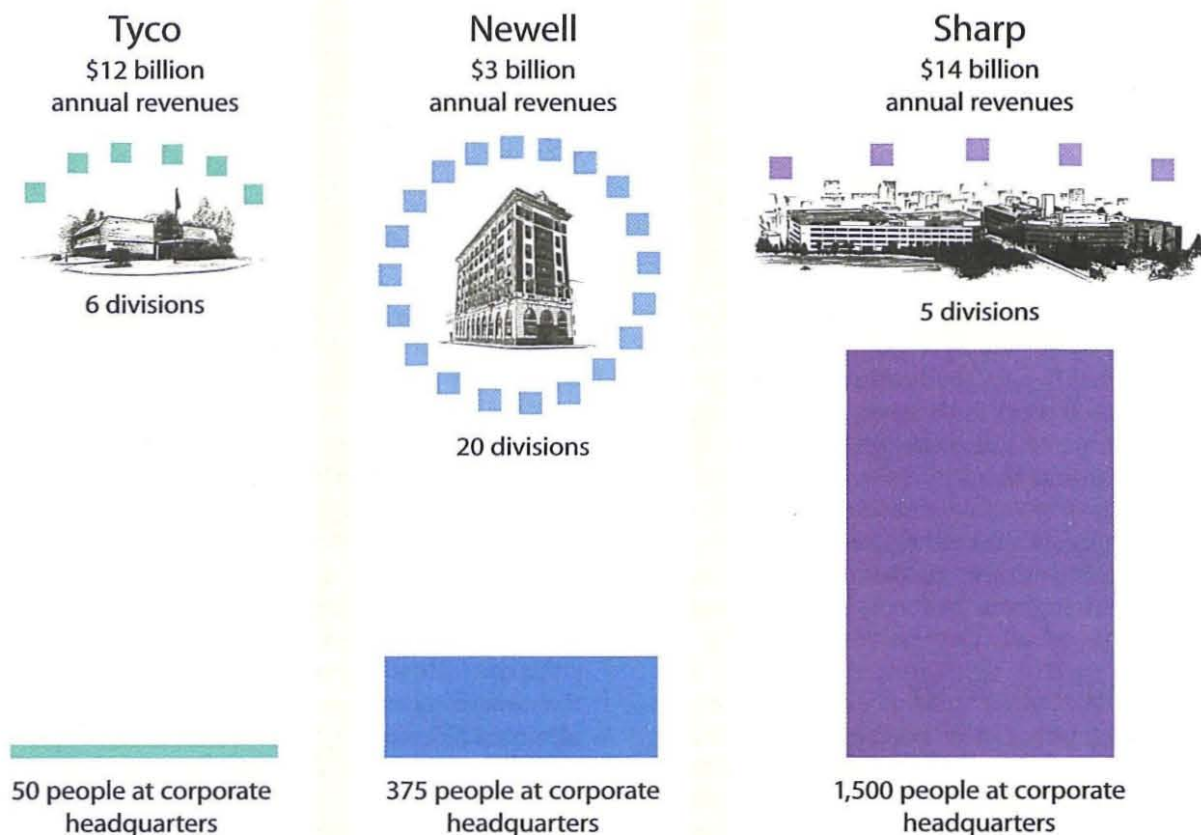
Within six years, the firm was on the verge of bankruptcy. Saatchi and Saatchi made many mistakes, including overpaying for acquisitions and not anticipating the end of the 1980s advertising boom. Its fate, however, was sealed by its failure to craft a coherent corporate strategy. Indeed, the company violated most of the requirements for internal alignment.

The vision for Saatchi was to be number one in its industry. However, unlike Newell or Sharp, Saatchi never established a boundary to its domain. Having reached the limit in advertising (where conflict of interest prevents one agency from becoming too large), Saatchi expanded into a number of businesses in which its relationship with a client's marketing executives provided a potential competitive advantage: marketing services, public relations,

direct marketing, and promotions firms. But when Saatchi acquired consulting firms and then bid for a British merchant bank and a commercial bank, the client relationship was no longer a valuable resource. A marketing vice president is not the buyer of logistics consulting or banking services. Indeed, a corporate reputation for edgy creativity is probably the last thing a company looks for in its choice of commercial banker.

Worse still, even where there was potential synergy, Saatchi never implemented effective processes to capture it. Cross-selling was restricted to informational meetings where each business informed the others about its services, and no financial incentives were provided for referrals. The risk of a sister company souring a relationship inhibited businesses from sharing clients. As a result, Saatchi was never able to leverage its most valuable resource—customer relationships—across businesses.

HOW BIG SHOULD A CORPORATE OFFICE BE? ONE SIZE DOES NOT FIT ALL.



But perhaps the worst failure came on the control side. Saatchi had developed what at the time was an advanced financial-control system for advertising agencies. But when an ex-consultant was placed in charge of both the consulting and the advertising businesses, he imposed the budgeting system from consulting on the advertising agencies. The consulting system starts not with expected client revenues, which are relatively predictable, but with desired numbers of employees. In consulting, where professionals by and large generate their own revenues, this is an adequate system. In the notoriously optimistic advertising business, it was a disaster. Agencies projected rapid growth in employees and acquired long-term leases on the office space to accommodate them. When the dust settled, Saatchi took write-offs of more than £150 million just to cover the excess floor space the company had leased. Saatchi's failure to understand the control requirements of different businesses undercut the enterprise.

Many Ways to Succeed

The fact that there are potentially an unlimited variety of effective corporate strategies does not mean that most corporate strategies are effective. Observation suggests the opposite—that many strategies do not enhance value. If executives benchmarked their corporate strategies as aggressively as they do their operations, most would discover that their strategies are far from world class.

The resource continuum and the range of strategies it encompasses provides a useful starting point for benchmarking the effectiveness of your corporate strategy. Begin by looking for companies with successful strategies built around types of resources that are similar to yours. Those companies can serve as models, while companies further away on the resource continuum can provide instructive contrasts.

The harsh moment of truth for many companies built around specialized resources comes when they discover that, despite the related appearance of their businesses, they are adding little more value to their businesses than a well-run conglomerate would. The performance of these companies, however, suffers from the drag of a larger corporate overhead than that of a conglomerate.

At the other end of the spectrum, conglomerates often find that leveraged buyout firms have even lower-cost operations and more effective means for

financing and controlling sets of unrelated businesses. Alternatively, conglomerates may discover that the businesses they own could be worth more in the hands of a corporation with more specialized resources.

That is the acid test for any corporate strategy: the company's businesses must not be worth more

The acid test for any corporate strategy is this: the company's businesses must not be worth more to another owner.

to another owner. In a dynamic, competitive environment, that threat is always lurking around the corner. To guard against it requires the continual upgrading not only of the resources on which the strategy is based but also of all the elements of the strategy triangle and their fit.

Newell, Sharp, and Tyco have all sustained corporate advantage over many years through just such a process of continual upgrading. Newell, for example, used to be proud of service levels that it would shun today. Tyco has ratcheted up the size of the acquisitions it is capable of making. Sharp has consciously fostered a feeling of crisis in the firm, a sense that the roof is falling in. Today, to respond to increased competition in some of its core markets, Sharp must be able to make another round of technology investments. The race never ends. But no company's strategy can endure without continual pressure to improve.

There are many ways to succeed. Creativity and intuition are hallmarks of great corporate strategies. So too, however, are discipline and rigor. In the companies we studied, brilliant strategies began with new ideas. These were followed by deliberate investments in resources made over many years, the development of a clear understanding of the businesses in which those resources would be valuable, and the painstaking tailoring of organizations to make the strategy a reality. Ultimately, strategies that prevail are well-constructed systems that deliver tangible benefits.

1. Mark McLaughlin, "Flat and Happy at the Top," *New England Business*, March 1990, p. 19.

2. "John Fort: CEO, Tyco Laboratories," *The Business of New Hampshire*, February 1997, p. 38.

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