ACID TESTS OF CORPORATE ADVANTAGE[1]

The corporate advantage paradigm of Collis & Montgomery (2005) is expanded and operationalized using six acid tests of corporate strategy that facilitate efficacy comparisons across diversified firms. The best corporate strategy is balanced on all dimensions and creates the desirable outcomes of superior competitive advantage for the firm's business units, operating synergies across family members and a robust resource renewal process that provides appropriate resources for the firm's future success.

The test of an effective corporate diversification strategy is called *corporate advantage* (Collis & Montgomery, 1997). It is a multi-dimensional efficacy test appropriate for evaluating multi-business strategy that is analogous to the tests of *competitive advantage* that are used to evaluate the strategy of a single line of business – except that in the context of corporate strategy, the performance of several lines of business are being considered simultaneously within the context of a corporate family and comparison is made with other diversified firms that compete with it for access to capital.

Corporate strategy includes decisions regarding what lines of business to buy (or develop in-house), sell, expand, shrink, or link. It also includes (1) the search for operating synergies among family members and (2) the activities of the firm's corporate headquarters that somehow gives the combination of idiosyncratic businesses within a particular firm greater advantage than would be enjoyed were they not all part of the same corporate family. The desired "family advantage" arises from access to the firm's *corporate resources* which are valuable to family members because these corporate resources help the individual lines of business to compete more effectively than they could do without the use of their parent's resources. The benefit of expenditures made when the corporate parent develops, replenishes, nurtures, and evolves its corporate resources are what a particular acquiring firm "brings to the party" in mergers and acquisitions – the traits that make it a superior parent for fostering certain lines of business, *i.e.,* those businesses that will benefit most from what the acquiring firm has to offer to its family.

How can the managers of a diversified firm ascertain how close it is to reaching this nirvana called *corporate advantage*? We propose three outcome measures that suggest whether a particular firm's corporate strategy is superior to others. Then we suggest six acid tests for determining of how well a multi-business firm's corporate strategy comes to realizing its full potential in attaining these outcomes. Building upon the driving dimensions of the Collis & Montgomery (2005) strategy triangle, our acid tests embellish upon the implementation aspect of corporate strategy by considering the underlying, moderating forces of fit and intervention in operations.

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[1] This note by Professor Kathryn Rudie Harrigan is based on lectures from B7708: Corporate Growth & Organizational Development as well as from Collis & Montgomery (2005), Corporate Strategy: A Resource-Based Approach, Irwin/ McGraw-Hill

Definitions

Corporate strategy pertains to the firm's choices concerning the composition of its corporate family (*line-of-business diversification*), the structures used to coordinate the lines-of-businesses' activities with those of other family members' activities -- or not (*corporate interventions*), and how the firm supports each corporate member's respective efforts to improve their competitive strategies by using the parent firm's special resources (*corporate resources*). The effectiveness of a particular firm's corporate strategy is evaluated relative to that of other diversified (or not so diversified) firms – or any other, competing form of investment that competes for capital, *e.g.*, other listed stocks, bonds, mutual funds, or private equity funds, among others.

Superior corporate strategy is believed to yield superior corporate performance. The diversified firm that has superior corporate performance is believed to enjoy higher market valuation -- if it is publicly-traded -- which arguably will enable the corporate family to have better access to the resources that will be needed for its organizational renewal in order to ensure continuity. For the purposes of this discussion, corporate advantage is treated as a *relative* rather than absolute condition because the efficacy of a particular diversified firm's corporate strategy should be judged relative to the successes enjoyed by other diversified firms during the same time period (since the firm vies against them for capital and access to alternative forms of investment opportunities).[2]

Diversification describes the pattern of relatedness of a firm's corporate family members to each other (Rumelt, 1974). Diversification occurs as the single-product, single-market (or single-customer), single-technology, single-location firm grows by adding products, customers, technologies and geographies to its business activities. Diversification changes a firm's risk profile as its members' profit volatilities offset or parallel each other (due to differing demand traits, price elasticity, and competitive behaviors that exist within each respective line of business).

<u>Horizontal.</u> When a firm re-invests its profits in the same line of business that produced the profits, the resulting family members are *horizontally-related* to each other (because they engage in the same activities) – even if the firm funds expansion in that same line of business within a new geography. A family of *horizontally-related* businesses may be *geographically-diversified* from each other, yet remain undiversified with respect to the nature of the industry they compete within, as in the example of retailing firms like WalMart or Tesco that operate stores on several continents. When financial service firms (like brokerages) open offices in new geographic locations, they too are pursuing horizontal diversification. Horizontally-related businesses have the greatest potential for sharing corporate resources among them because their respective success

[2] Private equity firms that create their own versions of diversified firms for the financial benefit of their subscribers represent a competing investment opportunity, but performance comparisons between diversified firms and private equity firms are difficult due to prohibitions against transferring assets and commingling cash among separate private equity funds managed by the same private equity firm. Therefore strategy comparisons cannot be made easily. (See Klier, Welge & Harrigan, 2009).

requirements are so similar to each other, particularly where the success requirements for serving diverse types of geographies become more similar over time, because they offer the potential to realize scale-economy synergies in operations.

Vertical. When a firm invests its profits by diversifying in lines of business that supply goods or services to the business unit that produced the profits, the resulting involved family members are *vertically-related* to each other because they have a potential supplier-buyer relationship to each other whereby the cash-generating business unit ***A*** (for example, the microcontroller business of Texas Instruments) could be customer to the *upstream*, sister business unit ***B*** (Texas Instruments' microprocessor business) that could be its supplier.[3] If the corporate family members act upon their potential for supplier-buyer transactions, the effects of exposure to each line of business' competitive risks are exacerbated for the firm because vertically-related business units ***A*** and ***B*** rely upon each other for more than sharing business intelligence and other corporate intangibles (as would occur if Aber Mining acquired Harry Winston Diamonds to learn about the pricing of diamond jewelry).

The efficacy of vertical diversifications are analyzed with respect to a particular, core business unit within the corporate family which is presumed to make especially good use of the family's corporate resources in attaining its respective competitive success (Harrigan, 1985; 1986). For example, the vertical diversification of consumer packaged goods firm, Proctor & Gamble, is evaluated vis-à-vis its consumer products businesses since they are the focal activities that create the greatest appropriable, value-creating advantages for the corporation. *Upstream* diversifications (investments in supplying activities) from that focal or core line of business build more heavily on commonalities in technologies shared among corporate family members. *Downstream* diversifications from the focal or core line of business (investments in consuming, distributing or value-adding activities) more heavily exploit commonalities in customer knowledge shared among corporate family members. Access to the benefits of corporate family resources may ameliorate some of the structural risks of intrafirm transactions that are vertical in nature.

The horizontal and vertical diversification relationships between particular corporate family members sometimes coexist with other patterns of relatedness vis-à-vis other groups of businesses within the corporate family. Corporate intervention concerning operating decisions (to facilitate greater coordination of particular activities) may occur more frequently where horizontal or vertical diversification exists to protect the value of shared resources, for example to prevent overexposure of Warner Brothers' movies being shown on HBO, TNT and other Time Warner-owned programming packagers.

[3] *Vertical diversification* can also pertain to a diversifying investment made in a business unit ***A*** that could consume, distribute or add value to goods and services made by its supplying, sister business unit ***B***. For example, in the 1980s, Texas Instruments used its own integrated circuits and semiconductors to make consumer products like computers and speech-enabled educational toys that were sold through Texas Instruments' owned retail stores (Harrigan, 1983). In this example, the respective roles have changed between business ***B*** -- which becomes the potential supplier -- and its sister business unit ***A*** which is the potential *downstream* customer.

Related. Even where corporate family-member business units have no supplier-buyer relationships among them, similarities in the success requirements of competing for customers within their respective marketplaces determine the business units' *relatedness* to each other. Closely-related business units frequently build upon common resources provided by their corporate parent and family members to enhance their own respective competitiveness. Although each respective business unit possesses its own set of unique, competitive resources that create *competitive advantage* in its respective marketplace, access to those special, corporate resources that become available only through membership in a superior corporate family can give the member business unit a more superior *corporate advantage* that competitors from inferior corporate families cannot match, as in the example of the market power of Proctor & Gamble's advertising expenditures (Campbell, Goold & Alexander, 1995). Thus, the corporate family with the most effective corporate strategy (which includes membership as well as support decisions) outperforms similar but less effective corporate families.

In summary, c*orporate advantage* is a construct that measures the optimality of the firm's diversification, corporate structure and corporate strategy. Evaluation of a firm's *geographic* diversification, diversification into industries of varying *relatedness* to each other, and even *unrelated*, conglomerate diversification uses several "acid tests" to determine the corporate family's overall level of corporate advantage. All corporate strategies can be evaluated against these measures of how corporate parents develop and share their corporate resources in ways that make a difference to family members when diversified firms compete for customers as well as capital.

Strict Tests of Corporate Advantage

The corporate advantage model assumes that corporate value is created by the choices that headquarters managers make.[4] The foundations of a firm's strategy are the decisions concerning the corporate family's pattern of diversification (which lines of business are in the family), investments in corporate resources used by corporate family members (which resources the corporate family contributes), and organizational infrastructure created (plus headquarters activities undertaken) to implement the corporate family's strategy (structures and processes used to reap the rewards of diversification). If they are indeed effective influencers of corporate performance, the interactions of these three decisions should create conditions that enable the corporate family to renew its corporate resources (which will further strengthen the corporate family members' relative competitive advantages in their respective lines of business) while realizing potential cost improvements and operating synergies attained when family members share these corporate resources effectively. The critical determinant of how well a corporate

[4] In Collis & Montgomery (1997) the strict test of attaining corporate advantage specifies that it is attained when (1) a multi-business firm's headquarters managers create *corporate value* from the membership of each business unit in the corporation, (2) the benefit such *corporate value* creates exceeds the cost of corporate overhead incurred in doing so (*including the cost of headquarters staff who may coordinate certain intrafirm activities, or not*), (3) the corporate parent under analysis adds more *value* to its corporate family members than any other potential corporate parent could offer (or vice versa), and (4) the *corporate value* that the family of businesses under analysis adds in its particular enterprise form is greater than any alternative corporate form of enterprise could add to its family members.

parent can attain these operating improvements is the nature of intervention by the corporate parent firm in the operations of its family members and whether these headquarters interventions will create appropriate behavioral incentives among the family's managers to induce desired decisions.

Performance outcomes of corporate strategy[5]

If the parameters of the strict test are relaxed to allow for unequal financial performance by the corporation's lines of business over time (i.e., to allow for temporary cross-subsidizations associated with start-ups, roll-outs and other internal, entrepreneurial behaviors), outcome-driven performance measures may be used to evaluate the firm's corporate strategy. As Figure 1 indicates, we propose three outcomes that indicate corporate strategy success: (1) superior competitive advantages for the corporate family's lines of business [attained by using superior corporate resources], (2) operating synergies among lines of business that share corporate resources [attained by prudent incentives that encourage cooperation] and (3) robust renewal of those same corporate resources that improve the future competitive performance of family members [attained by coordination processes between lines of business]. These outcome performance measures are dynamic because as the corporate family's mix of businesses evolves, the effectiveness of certain, shared corporate resources will wane while others grow in importance over time vis-à-vis each member business – especially when the industry success requirements of the corporate family's lines of business converge or evolve.

Figure 1 here

Because firms may grow via acquisition, innovation, alliances, franchising or other enterprise forms, individual approaches to the required organizational development and learning process will differ as management tailors the firm's internal systems to the needs of their corporate strategy. Innovation rises in importance for a corporate family as dependence on growth via acquisition subsides, making coordination processes and intrafirm incentives increasingly important for internal growth. Organic growth makes attainment of operating improvements from integration more critical for successfully capturing the benefits of past strategic investments. Internal growth forces attentions towards long-term targets that are associated with finding future sources of demand growth as well as immediate targets that maximize returns available from past resource investments. Growth via acquisition typically emphasizes enhancement of the performance outcome of improved competitive advantage first and integration-driven performance outcomes later.

[5] Qualitative, performance-outcome measures are more difficult to operationalize for empirical testing than (1) financial and profitability measures, (2) Tobin's q, (3) disturbance and risk measures, or (4) entropy measures like the Hirschman-Herfindahl Index that are typically used to gauge performance.

Improved competitive advantage for family-member businesses

The first performance outcome measure, *superior competitive advantage for the corporation's lines of business,* is a constantly-moving outcome that can be eroded by technological change and competitor imitation that make the corporation's contributed resources lose their effectiveness (Schumpeter, 1934). Briefly, the sustainability of a particular firm's competitive advantage indicates the *speed* with which that business unit's advantages can be eroded by competitive imitation. If similar corporate families can be formed via acquisition, e.g., Palmolive, Unilever and Proctor & Gamble, the distinctiveness of a particular parent's contributions to its family may be eroded – converting them to a "ticket of admission" advantage instead of a uniquely-functioning trait.

In each marketplace, competitors typically chip away at reducing the distinctiveness of other firms' strategies by making investments that will erode customers' willingness to pay a premium for a particular firm's products and services while the affected firms try to retaliate with new bases for competition. Competitors which are members in a strong corporate family can sustain their valuable distinctiveness longer because they have a "sugar daddy" that is providing germane resources that other firms cannot afford. To the extent that a particular corporate parent can continue to provide resources that are particularly appropriate for the success requirements faced by a particular line of business, the duration of competitive advantage that business unit can enjoy (before profit erosion occurs) can be extended to the point of extracting Ricardian rents – provided that the corporate resources provided by its parent are used effectively in the competitive marketplace. For example, in their respective eras, IBM (for computing hardware) and Cisco Systems (for internet-communications hardware) enjoyed very high rents because the purchase of products bearing their corporate brand names suggested failsafe solutions to customers' problems and their corporate halo could be extended to acquired as well as new products. As their growth paths moved them into arenas where their corporate name connoted lesser expertise, the value of the parent's corporate resources for attaining the improved competitive advantage performance outcome waned and family's corporate strategy emphasized other performance measures where corporate resources were still valuable.

Realization of operating synergy benefits

The second performance outcome measure, *cost savings through operating synergies,* is an evolving outcome that can be eroded by designing incentive systems that encourage excessive corporate interventions in activities where synergies should naturally be pursued. The goal of attaining operating synergies is to leverage the activities of sister lines of business in ways that give them a significant cost advantage on germane dimensions that other firms would find difficult to match. For example, the scale economies that the firm's lines of business pursue individually can be realized jointly through the scope economies of sharing the use of key productive assets. Accelerated information flows shared within the corporate family can mitigate the speed of creative destruction that may prevent the lines of business from enjoying their respective *experience curve* economies. Coordination advantages attained from intelligence-sharing up and down the value chain of operations could allow cooperating lines of business to exploit *vertical integration* economies that benefit their corporate family. To the extent that a corporate parent's managerial systems appropriately incentivize orchestration of operating synergies, cost savings from sharing resources can be multiplied over time. Careful integration of acquired companies can enhance operating synergies among related businesses -- but only when circumstances are right and corporate controls are appropriate.

Enhancement and improvement of corporate resources

The third performance outcome measure, *robust renewal of corporate resources,* considers the firm's resistance to a diminishing outcome because corporate resources inevitably lose their distinctiveness or become mis-matched to their family of business units' success requirements over time. Enduring corporate advantage requires robust resource renewal capabilities. Support systems must be developed for nurturing, augmenting, enriching and replacing corporate resources, as needed. Because the value of corporate resources is constantly being eroded by competitive activities, the firm must work to renew their value or develop new corporate resources that are more appropriate for the competitive needs of its changing family members. Elements of the firm's organizational structure, managerial systems and decision-making processes should work positively to nurture the corporate family's current mix of valuable corporate resources and foster activity paths appropriate for creating new corporate resources.

In summary, the efficacy of a firm's corporate strategy is evaluated in terms of the value of a parent firm's contributions to member firms' ability to compete, the value created from shared use of corporate resources by member firms, and the renewability of the firm's ability to make future contributions of value to its corporate family members. Implementation of corporate strategy determines which lines of business are included in the family's corporate portfolio, how the corporation is structured and what activities it uses to reinforce its ability to make positive contributions to corporate advantage.

Six corporate strategy choices

As Figure 2 illustrates, the corporate advantage paradigm builds on the three driving corporate strategy choices [shown as Figure 2a] identified by Collis & Montgomery (1997) – (1) *attractive industries*, (2) *corporate resources* and (3) *organizational structures, systems and processes (OSSP)* – and three moderating corporate choices

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Figure 2 here

[shown as Figure 2b] that determine how the corporation -- uses, controls and coordinates the family's corporate resources to enhance corporate performance – (4) *corpo-*

rate controls, (5) *coordination among lines of business*, and (6) *nature of business units' competitive advantages.*

Effective choices among these six corporate strategy dimensions will produce three desirable corporate **outcomes** (*enhanced operating synergies*, *robust resource renewal* and *sustainable competitive advantages*) that create corporate advantage for a particular firm's diversification strategy. (The desirable outcomes are shown on the triangle's apex in Figure 3 with a starburst appearing above each of them. (The drivers – the original Collis & Montgomery dimensions -- are designated in Figure 3 by arrows.)

Figure 3 here

Each dimension of the proposed corporate shape can be scored between 00 and 100 – with higher scores awarded when driver strategy dimensions interact positively with moderating dimensions to contribute to the desirable outcomes of sustainable competitive advantage, enhanced operating synergy and robust resource renewal. (Negative interactions among drivers and moderators will destroy corporate advantage instead of creating it and may be shown as very low scores along the six axes of Figure 3.)

CORPORATE STRATEGY PARADIGM

Analysis of the advantage of a firm's corporate strategy considers the efficacy of each respective **driver dimension** in its own right (*resources, industries* and *organizational structure, systems and processes*) as well as in light of how that particular driver dimension interacts with the adjacent **moderating dimensions** (*controls, coordination* and *competitive advantage*). Their interactions produce (or damage) the **outcomes** that make a particular corporate family superior to others (*enhanced operating synergies*, *robust resource renewal* and *sustainable competitive advantages*). In order to assess whether a corporate family has attained relative corporate advantage, it is useful to consider how its strategy fares vis-à-vis certain *acid tests* that evaluate the efficacy of each respective corporate strategy dimension. Since the driver strategy dimensions can *interact with each other* as well as with the moderating strategy dimensions, some strategic choices affect both driver and moderating dimensions to foster desired outcomes.

Acid test of attractive industries

The corporate choice of which industries to compete in and nature of linkages between lines of business within the corporate family considers the relatedness pattern of a corporate family's members and the attractiveness of the family of industries that the firm has invested in. Is each line of business competing within an attractive industry (Porter, 1980; 1985)?[6] If each respective industry is deemed attractive, is the firm's re-

[6] The quintessential technique for assessing industry attractiveness relies on the structure-conduct-performance (SCP) framework (Scherer, 1973; Caves, et al, 1980). For example, Porter's 5-Forces paradigm, which synthesizes research findings from industrial organization economics, is used to assess an industry's average profitability

spective business unit within it enjoying market leadership or is it an also-ran that is merely being buoyed up by the high average returns of an inherently attractive industry?

A particular firm's business unit could be enjoying above-normal profits if it pursues an effective competitive strategy (or has a powerful corporate parent), even if the industry is deemed relatively "unattractive" using analyses like the Porter 5-Forces framework (Harrigan, 1980). Evaluating the overall industry attractiveness – not a particular firm's success within that industry – provides a better assessment of industry's effect on corporate strategy and potential for performance improvement. (For example, industry analysis may reveal that certain geographic markets are quite attractive, but the firm under analysis does not yet participate in those particular markets. This revealed deficit suggests how the firm might improve its corporate strategy.) Most of the variance in explaining diversified firms' performance is explained by the industries that they operate within (Schmalensee, 1985; Wernerfelt & Montgomery, 1988), so this is a very important dimension in the corporate strategy paradigm.

Although the structure-conduct-performance paradigm is a good starting point for assessing industry attractiveness, analysis of overall *demand* traits is also important in scoring this dimension. Is demand growing (or saturated) in the markets where the firm's businesses compete and will demand growth encourage new competitors to challenge established vendors? Which exogenous forces are likely to change customers' purchasing requirements (thereby raising the competitive ante)? Which competitive dynamics are likely to harm industry attractiveness? Is there growing demand for complementary products that could revitalize stagnant demand for products? An industry-by-industry assessment of static and dynamic structural and competitive traits is needed to create a weighted-average assessment of the *industries* dimension of the corporate strategy paradigm. Attractive industries are typically characterized as those with double-digit demand growth or those with industry structures that foster high average profitability or those with a favorable regulatory environment or those having other criteria that currently please the providers of capital (or some combination of these and other attractiveness traits).

A robust corporate strategy is built on attractive industry traits within a family of businesses that are related in ways that reinforce the firm's advantages. Evaluation of the *industries* dimension of the corporate strategy paradigm also considers the existence of linkages among the firm's family of businesses (or lack thereof). The effect of closely-related lines of business may be weighted more heavily when calculating a score for the *industries* dimension if their respective success requirements are similar enough to warrant sharing corporate resources among them (or transferring salient knowledge among a cluster of related business units). Assessments of the firm's major lines of business can be weighted by the proportion of total investment that each line of business represents (measured by revenues generated, profits generated, capital deployed, or any salient metric that accurately represents the firm's mix of businesses). It

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potential. See Porter, M.E. 1980. Competitive strategy: Techniques for analyzing industries and competitors. New York: Free Press.

may not be necessary to analyze smaller lines of business if they share no corporate resources with sister business units and contribute revenues and profits that are proportionate to their size. From all of these considerations, a score for the *industries* dimension is created that compares the firm's unique business mix with all other feasible families of industries that the firm may have chosen instead.

Acid test of valuable resources – what the corporate parent provides for family members: In order to justify their diversified structure, corporate-parent firms must possess *resources* that can be made available to appropriate business units to enhance their respective competitive advantages. Valuable corporate-level resources can be competencies, capabilities, knowledge workers or other resources that are distinctive in ways that contribute positively to the competitive advantages of the firm's lines of business (Barney, 1991; Peteraf, 1993; Collis & Montgomery, 1995). Because they are shared, corporate resources are the glue that holds together corporate families and they are likely to be intangible assets that are meaningfully unique from the assets controlled by other corporate parents. Such corporate resources may include patents, brand names, corporate logos and trademarks, distribution systems that can be shared, databases and information system infrastructures, knowhow, expertise or other valuable intangibles. Valuable corporate resources are typically developed over time, like business judgment which is the fruit of making past strategic investments. A corporate parent's valuable resources may have originated with particular business units within its family. Control over the use of such resources was typically elevated to the corporate level as the firm expanded by adding related lines of business to its corporate family. Possession of specific, valuable corporate resources make certain corporate parents better-suited to own particular business units than other firms would be.

If two or more lines of business in the corporate family rely upon the same valuable resources for success in their respective marketplaces, those resources are probably provided by their corporate parent – much in the same way that former GE CEO Jack Welch would assert that his firm owned the resources that it allowed lines of business to use for GE's greater well-being. Most business units within diversified firms also have their own valuable resources that are idiosyncratic to their respective industry success requirements and are not used by other members of their corporate family. It is important to distinguish between these two levels of resources; if the resources that are most important to *competitive* success are owned by a respective lines of business and the use of *corporate* resources adds little incremental advantage to that business unit's strategic posture, then that particular corporate parent adds little of value to that specific member of its family. The valuable corporate resources offered by highly-diversified firms tend to be more generalized in nature than those that help a family of closely-related business units.

Corporate resources can be evaluated using the same tests that are used to evaluate the value of resources owned by a particular line of business (Wernerfeldt, 1984; Peteraf, 1993). Valuable corporate resources increase customers' willingness to pay premiums for the firm's products and services because they are highly desirable. Valuable corporate resources are unique, inimitable, and competitively superior to those of other corporate parents (Barney, 1991; Peteraf, 1993; Wernerfelt, 1984). The corporate parent accrues valuable rents for the corporate family to appropriate (instead of its individual employees) by using its valuable corporate resources to improve the competitive advantage of family members (Collis & Montgomery, 1997).

The score of the *resources* dimension of the corporate advantage paradigm increases when a corporate parent exploits valuable corporate resources by sharing them with its business units. To prevent negativities, headquarters staff oversees how such valuable resources are being used (Collis, Young & Goold, 2007). As long as the value of the firm's corporate resources are enhanced -- not destroyed -- by the way in which lines of business use them, corporate resources can be renewed and corporate advantage is enhanced. The value of corporate resources can even be renewed if interactions among the firm's lines of business that are using them generate positive spillovers in the benefits of using such resources (Harrigan, 1985; 1988; Kogut & Zander, 1993; Shaver, Mitchell & Yeung, 1997).

Acid test of optimal organizational structures, systems and processes (OSSP): The firm implements its corporate strategy through the organizational structure, managerial systems and decision-making processes that it establishes -- its corporate structure and lines of communication, size and role of corporate staff, nature of performance measures and feedback, use of performance incentives, opportunities for managerial training or promotion or rotation among lines of business, uses of symbolism in developing corporate culture, and other dimensions of organizational design. The firm's organizational structure, management systems and decision-making processes should be *appropriate* for the type of corporate strategy that the firm is pursuing (*e.g.,* synergistic conglomerate, passive holding company, organic growth via innovation, collecting rents via franchising, joint venture, corporate venture capital to enhance internal entrepreneurship, or other some other type of relatedness and coordination among the firm's lines of business). Corporate choices concerning which industries to invest in and how closely business units will be related to each other will suggest whether successful performance depends on generalized management skills that can be applied widely and replicated easily rather than specialized management skills that are difficult to transfer and can be applied to a much narrower range of industries.

The firm's organizational structure should be appropriate vis-à-vis divisional autonomy for the corporate strategy that it is pursuing (Chandler, 1962). Corporate parents will provide fewer central services to highly-diversified family members and share fewer valuable corporate resources to them than to closely-related ones. As Figure 4 indicates, greater operating autonomy is enjoyed by the highly-diversified family members that are likely to be structured like holding companies than is enjoyed by closely-related ones (which are more likely to be structured like operating companies because of the greater coordination they require).

Figure 4 here

Where family members are related, corporate parents should facilitate coordination activities in areas where centralization is appropriate. In extreme cases, *e.g.,* where business units are *vertically-related*, the firm's organizational structure, managerial systems and decision-making processes may mandate intrafirm purchases (or sales), oversee transfer prices, or intervene in other managerial decisions to optimize corporate performance. Intrafirm recruiting, training, evaluation, promotion and retention may be centralized (or highly coordinated) among closely-related business units. Corporate policies, such as "promotion from within," are consistent with homogeneous corporate values, frequent functional rotations, cross-divisional transfers, and other practices that depend upon the larger-scale organizational base that is possible when a firm's personnel services are centralized.

When corporate strategy encourages the organization to be boundaryless in its problem-solving outlook, its successful implementation requires several coordinating mechanisms to increase the breadth of multi-level managerial contacts and foster intrafirm relationships among personnel -- job rotations, participation on cross-functional or cross-divisional teams or other experiences intended to expose personnel to diverse functional and business outlooks, face-to-face meetings for training and seminars, and other processes for sharing expertise and solving problems.

Where family members are unrelated to each other and a decentralized organizational structure is appropriate, commonality of experiences and relationships across the organization is a less important criterion for promotion. Outsiders may be hired at all managerial levels. The career paths of top management may emphasize financial expertise rather than experience from running companies. Because communication flows within corporate families within unrelated business units tend to be primarily up and down organizational levels (instead of across the disparate business units), headquarters staff may be smaller and their duties may be limited to *control* activities.

Where the corporate controls used in evaluating business unit performance emphasize *outcomes* (e.g., financial results), the organizational performance measures, measurable targets, managerial incentives, rewards and feedback systems will emphasize accountability using financial measures. Management systems that charge lines of business with attaining budget targets may also allow managers to operate with greater operating autonomy because decision making is typically decentralized. Because unrelated lines of business are not required to make decisions with their sister business units in mind in such systems, the resulting organizational structure may tolerate duplications of facilities and overlapping turf among lines of business that compete for the same customers. The organizational culture in such firms may tolerate opportunism (instead of intrafirm cooperation among business units) because it rewards entrepreneurial behavior and rewards business units' individual competitive successes instead of enhancement of the family's overall performance.

In summary, the implementation of effective corporate strategy depends upon successful operations within highly-attractive industries, provision of valuable corporate resources that enhance the individual business units' respective abilities to compete and using organizational structures, managerial systems and decision-making policies that allocate necessary funds and personnel correctly, facilitate appropriate communication flows and reinforce desirable corporate membership behaviors. The moderating dimensions of the corporate strategy paradigm support these implementation mandates.

MODERATING DIMENSIONS OF CORPORATE STRATEGY

Acid test of competitive advantage: Within any particular line of business, a successful competitive strategy strives to attain *competitive advantage* – which is evaluated relative to the success of other firms' business units that are serving the same customers in the same competitive marketplace. An effective competitive strategy takes offensive -- or defensive -- action against profit-eroding industry forces before competitors can pre-empt the firm from influencing the balance of competitive forces to its advantage Porter, 1980). In brief, the successful competitor makes superior choices concerning how to serve its customers that sustains their willingness to pay for the business unit's unique products over time (Ghemawat, 1986). In Figure 3, the implicit competitive advantage of corporate family members is a moderating dimension in the evaluation of corporate strategy that can be positively affected by the interaction of exposure to the corporation's family of businesses and the use of corporate resources that it provides to those respective lines of business. In a favorable interaction, the business unit's competitive advantage will be even stronger than it would have been were it not a member of any corporate family.

A corporate parent is expected to develop, nurture and replenish its corporate resources for the benefit of its corporate family members and the nature of their valuable corporate resources guides their growth pattern. Although the business units in their family are already configured to perform value-adding activities that create desirable products and services for their customers, the best corporate parent can *further* enhance their respective competitiveness because use of their resources by each family member gives each respective line of business a boost that makes a palpable difference in their perceived distinctiveness in the marketplaces where they participate. If the resources that a particular corporate parent provides are especially valuable to a germane business unit that is using those resources, it may enjoy *sustainable* competitive advantage (which erodes more slowly than Schumpeterian sources of competitive advantage). Parent firms can help some of its business units more effectively than others and those are the business units that will benefit most greatly from access to the resources that its corporate parent can provide (perhaps because the corporate family resources that is has access to are so much more superior than its own resources).

Acid test of appropriate coordination activities: In Figure 3, corporate-level management encourages *coordination* among business units by designing appropriate processes and forums for exchanging knowledge and sharing corporate resources. The corporation may provide advantageous access to capital or talent or other necessary items that the parent can acquire more cheaply than each of its business units can do individually. Corporate staff may orchestrate the cross-fertilization of ideas that could become future corporate resources by fostering an organizational culture that looks across the firm for solutions to competitive challenges or outward to benchmark performance against other firms with extraordinary achievements. Corporate staff may serve as an internal adoption agency for ideas needing sponsorship and leverage the use of valuable corporate resources that must be shared across germane products, markets, technologies, and geographies to protect their long-term value.

Appropriate coordination activities may rely upon managerial transfers across business units, participation in cross-functional or cross-divisional seminars and problem-solving teams, and other cross-organizational activities to create the firm's core knowledge. Coordination exploits the benefits of relatedness among its family of businesses by organizing interactions among experts and problem solvers to disseminate and build upon their knowledge. In doing so, line managers may surrender some decision-making autonomy and control over resources that are deemed to be corporate in nature.

Coordination can facilitate operating synergies -- provided that it is not overdone. If business units are horizontally-related (as is often found in some forms of global strategy), corporate intervention in decision-making may improve coordination among geographically-diverse sites while playing off the differing levels of country risk that particular lines of business face. If the firm's business units are vertically-related to each other, corporate interventions can sometimes enhance the effectiveness of internal purchases between them by improving competitive intelligence and using assets more efficiently by coordinating throughput volumes. If the firm's business units are related to each other with respect to any coherent trait, corporate interventions to transfer knowledge, enhance asset-sharing arrangements or incubate new business initiatives can create greater resource renewal than would be possible if each line of business competed only on the potential of their respective industries (as would be the case in unrelated diversification strategies). Every organizational arrangement, practice, and corporate intervention into the autonomous activities of business units should create greater value for the firm than if business units were allowed to operate independently -- without corporate coordination.

Acid test of controls that reinforce desired behaviors: Depending on the breadth of the firm's diversification, its controls should be designed to reinforce its corporate strategy. The extent of corporate interventions into a particular business unit's decisions depends on the use a corporate parent makes of its control mechanisms. In Figure 3, *controls* is a moderating dimension that tailors the firm's organizational structure, managerial systems and decision-making processes to the industries of its family members and the relatedness among them. Outcome-oriented controls are used in families of unrelated businesses that pursue only financial results. Such controls give the firm's lines of business the greatest operating autonomy because decision making is typically decentralized.

Headquarters interventions occur more frequently and pertain more directly to decision-making when behavioral controls are used. They are appropriate where managerial decisions are multi-dimensional and can contribute to the realization of operating synergies. Depending on the nature of corporate interventions, behavioral controls give the firm's lines of business the least operating autonomy because decision making is typically coordinated with sister business units and many activities are centralized to enjoy economies of scale (or economies of scope which are attained by sharing common platforms to reach scale economies). Behavioral controls are used where lines of business share corporate resources, transact in vertical integration relationships, transfer technologies and cross-fertilize ideas. Accountability is more difficult to assess because individual business units may be sub-optimizing their respective strategic actions for the sake of temporarily cross-subsidizing a sister business unit's launch, start-up costs or competitive warfare expenses. In its capacity as guardian of the parent firm's valuable resources, corporate staff uses controls to prevent value destruction to them due to over-exposure, denigration of image, or other damaging activities. Unfortunately, many firms impose heavy-handed corporate controls in situations where greater competitive autonomy is warranted.

In summary, the implementation of effective corporate strategy depends upon applying valuable corporate resources to enhance the competitive advantage of business units beyond what they could attain alone, creating knowledge and synergies by coordinating interactions among members of the corporate family and protecting the firm's valuable resources by controlling their use. Use of the moderating dimensions of the corporate strategy paradigm are suggested by the relatedness of the business units' industries, the relevance of the firm's corporate resources to the success requirements of the business units' respective industries, and the nature of the organizational structures, managerial systems and decision-making policies used to apply the moderating strategy dimensions.

Summary and Limitations

For whichever of the driver dimensions is under analysis -- (a) corporate resources, (b) leadership, strength and relatedness among the corporate family of industries or (c) organizational structures, managerial systems and decision making processes (OSSP) that implement the firm's corporate strategy – an assessment of the dimension's contribution to corporate advantage is needed. When evaluating driver strategy dimensions, it is useful also to consider whether a particular driver dimension interacts favorably with the moderating drivers to enhance the desirable outcomes that lead to a firm's corporate advantage. For example, an OSSP that enhances use of the firm's corporate resources through effective coordination activities will enhance *robust resource renewal* and the creation of appropriate new corporate resources. Business units backed by valuable corporate resources will enjoy stronger competitive advantages in their respective markets and enhance their *sustainability* over time. An OSSP that creates controls that reward appropriate resource sharing between and rotations of personnel among diverse lines of business can foster positive *operating synergies*. The outcomes influenced by the driver and moderating dimensions create the basis for a firm's corporate advantage over other firms.

The usefulness of the corporate advantage paradigm to evaluate corporate strategy is limited in the case of private equity firms because of restrictions on their ability to realize operating synergies among the members of the firms' portfolios (Klier, Welge & Harrigan, 2009). Each line of business is accountable to the distinct fund that acquired it and resources cannot be commingled to achieve interfirm transfers as we describe them herein. To date, private equity firms can build positions within attractive industries via roll-up acquisitions (or platform and add-ons) that may attain competitive advantage in their respective lines of business, but the valuable corporate resources that private equity parents bring to firms within their private equity families – primarily favorable access to capital and professional management -- tend to be general and fungible in nature that cannot create sustainable advantages for the family members that use them because they are easily imitated by others.

Figure 5 here

If the six scores are posted along the respective scaled lines on the shape in Figure 5 and are connected by lines between each posting to form the planes of a hexagon, a visual evaluation of the firm's corporate strategy is created. Strategies that most closely approach optimal corporate advantage will be depicted as balanced and large (since the scores of many of their driver and moderating dimensions will approach 99). Inferior corporate strategies will be depicted as unbalanced and smaller (since the scores of many of their driver and moderating dimensions will be below average). In Figure 5 the corporate shape of *Firm 1* (depicted by a single line) shows that the firm has a family of businesses in relatively-attractive industries, but it has few germane corporate resources that contribute positive family membership advantages to its lines of business. Furthermore since the corporate family's organizational structure, managerial systems and decision-making processes *(OSSP)* are not optimal for the success requirements of its family of businesses, little coordination of resources, competencies, capabilities, and knowledge workers occurs among the lines of business in ways that would positively enhance the family's corporate resources and build upon the family's strengths. Consequently, the corporation does poorly at renewing the advantages conveyed by its family resources and becomes bustable (i.e., the lines of business become no better off as family members than they would be alone).

By contrast, in Figure 5, the corporate shape of *Firm 2* (depicted by double lines) shows a firm whose lines of business are in slightly less-attractive industries than those of *Firm 1*, but whose corporate resources are very well-matched for making the competitive advantages of its lines of business even stronger and long-lived. Since *Firm 2's* organizational structure, managerial systems and decision-making processes are appropriate for satisfying the success requirements of its family of businesses, headquarters managers encourage positive coordination among the firm's lines of business in ways that enhance and grow the family's corporate resources. The corporation renews and expands the advantages conveyed by its family resources and family members are better off than they would be if alone. The area represented by *Firm 2's* corporate shape is larger than *Firm 1's* corporate shape and its resulting corporate advantage is relatively greater.

As a diagnostic tool, the corporate shape can suggests which dimensions of a firm's corporate strategy should be strengthened to improve implementation of management's strategic vision by adjusting balance interactions among the content and processes of implementing its corporate strategy. Although industry choice exerts the greatest impact on financial performance (Christensen & Montgomery, 1981; Montgomery, 1982, 1985; Montgomery & Singh, 1984), the corporate advantage perspective argues that managerial contributions make a significant difference in outcomes since there are performance differences among firms competing within the same mix of industries.

Figure 1

Performance Outcomes of Corporate Strategy

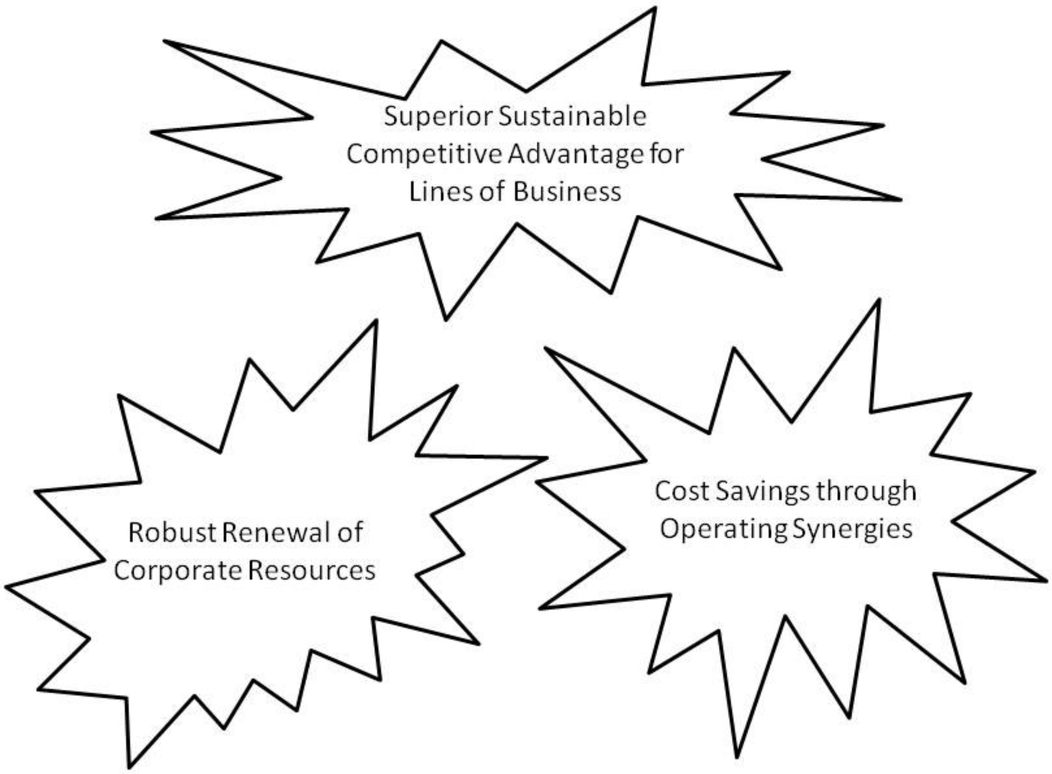
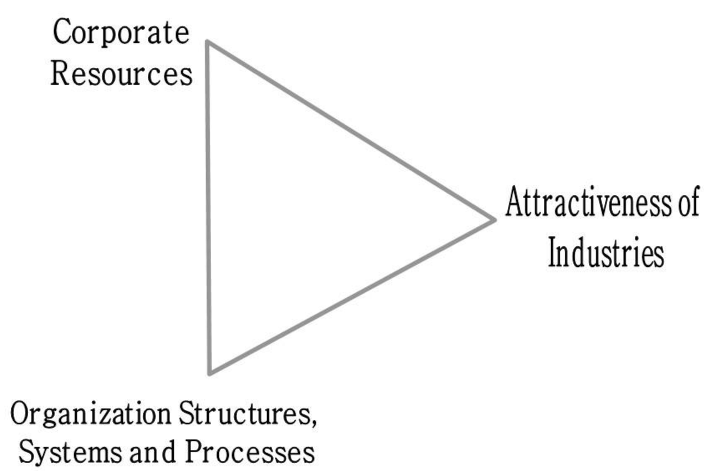
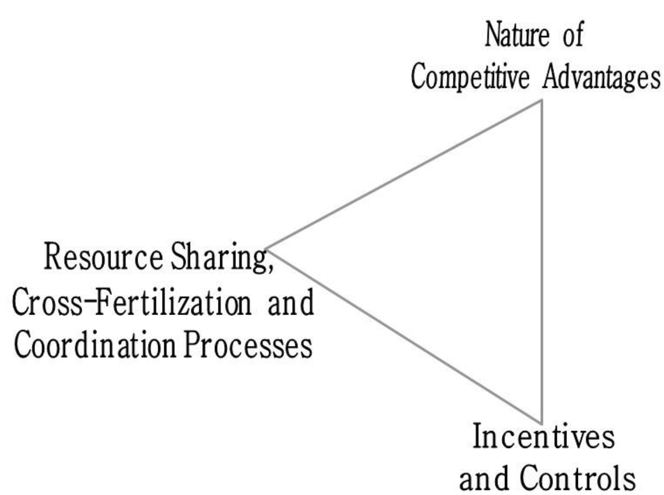


Figure 2
Dimensions influencing corporate advantage

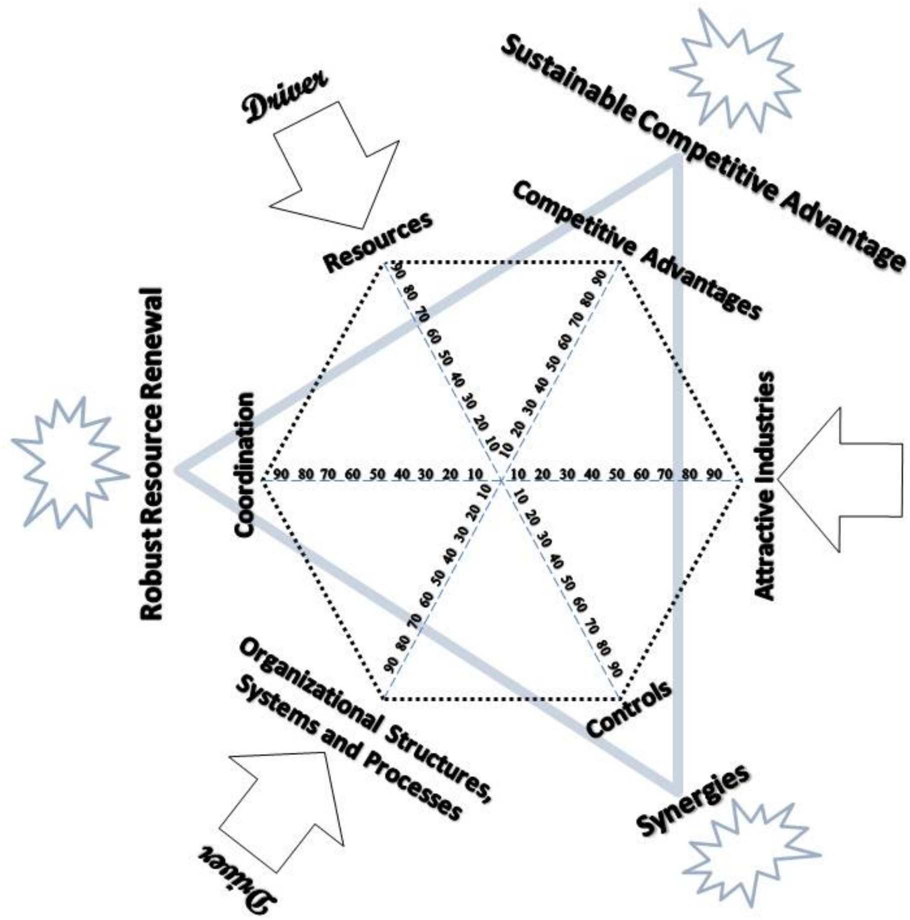


Choice dimensions adapted from Collis & Montgomery (1997)
Figure 2a



Choice dimensions focused on performance outcomes
Figure 2b

Figure 3



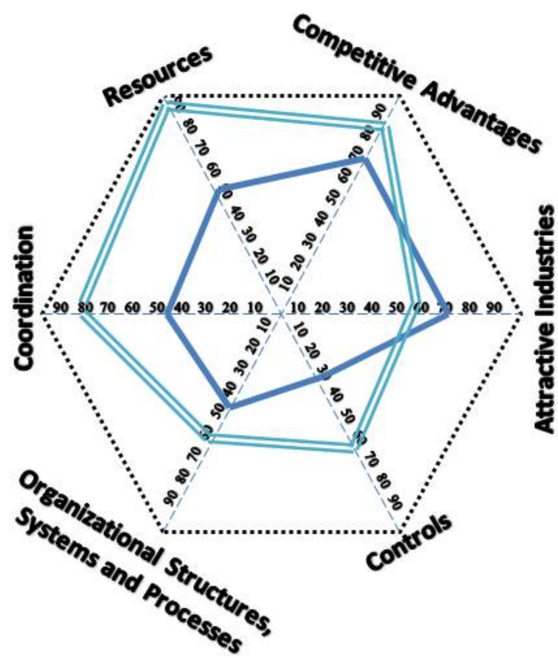
Sustainable Competitive Advantage
Driver
Resources
Competitive Advantages
Robust Resource Renewal
Coordination
Attractive Industries
Driver
90 80 70 60 50 40 30 20 10
10 20 30 40 50 60 70 80 90
Organizational Structures, Systems and Processes
Controls
Synergies
Driver

Figure 4

Managerial systems associated with generic corporate strategies

Operating companies	**vs.**	**Acquisitive conglomerates**
Operating synergies		Financial synergies
Coordination		Autonomy
Centralization		Decentralization
Economies of Scale		Duplication of facilities
Operating synergies from shared facilities		Overlapping turf
Economies of scope		Easier accountability
Vertical integration economies		Entrepreneurial spirit
Technology transfers and cross-fertilization		
Cross-subsidization		

Figure 5



Firm 1:
Firm 2:

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