bcg.perspectives
by THE BOSTON CONSULTING GROUP

THE PARENTING ADVANTAGE

HOW TO MAKE IT WORK

WHO DOESN'T WANT TO be a good corporate parent? Parenting advantage has long been a very appealing concept, but many companies struggle with its application. What does it take to deliver on the promise?

The Boston Consulting Group held the opening panel of the Strategic Management Society's 2015 Special Conference on "Rethinking Corporate Headquarters: Approaches for Managing the Multi-Divisional Firm." Three experts provided a first-hand examination of parenting strategies from their individual perspectives:

- Andrew Campbell, Ashridge Strategic Management Centre, one of the inventors of the parenting advantage concept
- Jörg Krell, the former head of the corporate office of the Bayer Group, the leading chemicals and pharmaceuticals company
- Torsten Kunz-Aue, the head of corporate development of the GEA Group, one of the largest equipment suppliers for the global food industry

The panel was moderated by Ulrich Pidun, a BCG director and the global topic leader for corporate strategy. Some edited highlights of the discussion follow.

Parenting Strategy Follows Corporate Strategy—the Bayer Example

Pidun: We all know the basic idea of parenting advantage. As a corporate parent, you can add value to the businesses in your portfolio in many ways, but you can also destroy value. A good parenting strategy is not just about adding value but about maximizing the net value added.[1] That's the ambition. But it's not easy to implement. Today we want to explore what it takes to make it work. What do the best companies worldwide do to create parenting advantage? Which levers do they pull? How do they combine these levers to create an effective parenting strategy? Let's start with Jörg Krell.

Krell: In my opinion, parenting strategy has to follow corporate strategy. This means that the right parenting strategy can change over time. Let me illustrate by describing three distinct eras in the development of Bayer.

Prior to 2002, Bayer was essentially a chemicals company with a broad portfolio of chemicals, polymers, and pharmaceuticals businesses. These businesses were organized in 16 divisions with a hands-on corporate center. The management board of eight members was actively involved in resource allocation, operative steering, and the fostering of synergies among the businesses.

Starting in 2002, the company embarked on organizational transformation, creating four legally independent subgroups—HealthCare, Crop Science, Polymers, and Chemicals, each with full operational and strategic responsibility for its businesses—and three service companies. This reorganization prepared the ground for a major portfolio transformation, which led to the divestiture of the chemicals businesses (it was spun off as an independent company under the name Lanxess) and major acquisitions in consumer care and pharmaceuticals. Bayer refocused on three segments: HealthCare, Crop Science, and MaterialScience.

As a result of this shift in corporate strategy, the parenting strategy changed from hands-on management to what we call a strategic guide. Bayer now had a nonoperational management board with only four members who focused on steering the group strategically and on managing the corporate portfolio. From my perspective, this parenting strategy paid off handsomely: Bayer's share price rose from €10 in 2003 to about €130 in 2015.

Now, Bayer is commencing another transition. The company recently announced that it will spin off MaterialScience as an independent company under the name Covestro. Going forward, Bayer will focus on health care and Crop Science and thus become a pure life-sciences company. This move will also require a different parenting strategy and corporate organization because the remaining two subgroups provide the opportunity for stronger integration.

Pidun: An investor might ask, given the direction in which Bayer seems to be heading, why not go all the way and break this company into its parts, and let me decide where to invest? What value does the corporate center add?

Krell: First of all, Bayer's mission is "science for a better life." There's common ground in that. Second, you derive synergies from business and technology services, and you shouldn't underestimate the impact of these on the overall competitiveness of the group. You get economies of scale. You get functional excellence. That's one important source of added value. In addition, there are corporate functions that are most effectively handled at the center. Finance, treasury, tax, audit, and compliance, for example. And finally, executive leadership development is an area where the corporate center can really add value, because you want to develop managers and leaders with diverse backgrounds, who have seen different businesses, who have had foreign assignments, who have worked in different functional areas. The people in the top jobs need to be able to integrate various functional views. This kind of development is best enforced on a corporate level because the businesses, quite understandably, will always tend to hold on to their best people, even though that is not in the interest of the overall corporation. You need a strong corporate center with very clear rules about what is required for someone to progress up the executive hierarchy.

Adding and Subtracting Value

Pidun: We said at the outset that a corporate parent has many ways to add value, but it also has many ways to destroy value. How does a company make sure that it comes out on the right side of this equation?

Campbell: To avoid subtracting value, there are three tests that any corporate initiative or corporate function should be put through. The first is the added-value test: is there real evidence that this function or this initiative is adding, or will add, value? It's a fundamental question, but the danger with this test is that it's easy to answer yes. Executives often make assumptions that reinforce their original ideas—particularly when they proposed the idea in the first place. So, to give this test real bite, the hurdle needs to be significant. My own rule of thumb is 10%—we should believe that the initiative will raise profitability of the whole organization by at least 10%; otherwise, we are wasting time on it.

This then leads to two other tests. One is, what is the risk of subtracted value? Again, a very good question to ask and a very hard question to answer. My own advice to corporate executives is, listen hard to the divisions, listen hard to the people in the business units. They are the ones most likely to detect the risk of subtracted value, and if you give them the opportunity, they will shout quite loud about it. If there are risks of subtracted value, you are better off doing nothing, unless the prize is big—unless it's that 10% prize.

The third test is a barriers test about implementation. This comes from Gabriel Szulanski's work.[2] He showed that if there are more than three barriers to execution, then the initiative nearly always fails—and often with negative consequences. He developed a list, and you can check your project against it.

Krell: I must say that I find your threshold of 10% very high. I would argue that for many companies, corporate initiatives with a profit improvement potential of 2% to 5% can be quite substantial. Should one think about lower thresholds?

Campbell: This is my rule of thumb. In some situations it might be a 5% hurdle or 2% hurdle or even a 20% hurdle. But the basic idea is that the hurdle needs to be high enough to compensate for the risks of subtracted value and the risks of incompetent or ineffective implementation. If you're not ambitious to drive the share price—and I mean double or triple it—and you spend your time on 2% stuff, you're not going to add significant value. My view is this: don't waste your time on the 2%. Corporate executive time is very scarce. It's the scarcest resource in the organization. It needs to be allocated very carefully.

Increasing the Value of the Corporate Center—the GEA Transformation

Pidun: Let's turn now to GEA, which is right in the middle of a major corporate transformation and organizational restructuring. Torsten, can you tell us about the development of GEA's organization and the thinking behind the current moves so we can get an idea about what it takes to make parenting advantage really happen? And what are some of the pitfalls along the way?

Kunz-Aue: First of all, GEA is another example of what Jörg Krell described as parenting strategy following corporate strategy. In 2012, we launched a major review of our business portfolio and corporate strategy. As a result, we decided to sell our former core business—heat exchangers—and to focus on serving the global food industry. We investigated a large number of potential applications of our technologies and identified the areas that were most attractive for us, in which we could grow organically or through acquisitions.

After cleaning up our portfolio and defining our future growth strategy, we next asked ourselves whether we had the right organization in place to support this growth. When we started our transformation, we had some 30 business units organized in four stand-alone segments, each with its own administration and its own go-to-market approach. We also had separate regional setups and sales organizations for all four segments—some located only 20 kilometers apart. Our customers kept telling us, GEA is really a great company, but we have to find that out for ourselves, you never tell us what you can do for us. This was because our own people did not know what the entire group was able to deliver.

We realized that, in order to reach our growth ambition, we needed a less complex and more integrated organization. Each segment worked on its scale, but at a certain point, you cannot scale a structure any more. To really grow, you need new structures.

Our transformation started at the center: GEA had been using the rather hands-off parenting strategy of a financial sponsor. We established a corporate center that acts as a functional leader, with fully centralized global support functions and shared services centers for the transactional activities. This increases efficiency and ensures functional excellence throughout the group.

All the businesses are now bundled into two business segments, each with full P&L responsibility—one for the equipment businesses and one for the project-oriented solutions businesses. In each country we have only one sales organization that serves all of our customers. In this way, we have consistently implemented our concept of OneGEA, which will help us execute our ambitious growth strategy.

Campbell: I would be nervous, if I were you. In my experience, OneGEA campaigns lose traction with the tests of added versus subtracted value. People start doing stuff in the name of One and not because it adds value. This is especially the case with One global functions, and those global functions easily turn into empire builders. They think this is their opportunity to control everything. As you move through the next couple of years, beware!

Kunz-Aue: I fully agree. As soon as you have centralized functions, they claim more territory. They say, I can do this better, I can do that better. Controlling that impulse will be a challenge, but we are aware of the risks. We have plans to monitor it, and we are prepared to change gears once again, if necessary.

The Essence of a Value-Adding Parenting Strategy

Pidun: If you try to summarize your experience, what is your advice for managers who are currently rethinking their parenting strategy and the role of the center?

Krell: For me, a key learning from my Bayer experience is that you have to look at parenting advantage from the perspective of the businesses. The question is not how you can control the operating units, but how you can best support them. And whatever your parenting strategy is, establish clear rules for decision making. What are the decisions that the parent makes, and what are the decisions that the operating units are responsible for? And live by those rules. Live by those rules vigorously!

Kunz-Aue: I think timing is also important when you are considering changing your parenting strategy and corporate organization. Our company was in good shape, we had solved our major strategic problems; there was no urgent need to make changes. And that's a good time to rethink your structure because you have the time to thoroughly consider what you want to do, to learn from other companies, and to evaluate different options and their benefits and risks. The drawback is, of course, that it can be hard to convince your people that you really need to change.

Campbell: I talked about rational tests that can be applied to help reduce subtracted value. But rational analysis alone won't do the job. You need something more.

We don't have easy solutions—but one of them I think is quite well illustrated by the Bayer example, which is about establishing real clarity about the different roles that people are playing. With a new model, they created clarity around the roles of the subgroups, real clarity around the service roles, even going so far as to set up separate legal entities, calling them service businesses and treating them in a completely different way, I assume, than in the past. I think those that achieve this kind of clarity are really good at avoiding subtracted value.

Pidun: Thanks for the good discussion.

Notes

1. For more details on parenting strategies and how to create value with the corporate center see *First, Do No Harm: How to Be a Good Corporate Parent,* BCG report, March 2012; *Designing the Corporate Center: How to Turn Strategy into Structure,* BCG Focus, May 2013; and *To Centralize or Not to Centralize?,* BCG article, December 2015.

2. See, for example, "Getting it Right the Second Time," *Harvard Business Review,* January 2002.