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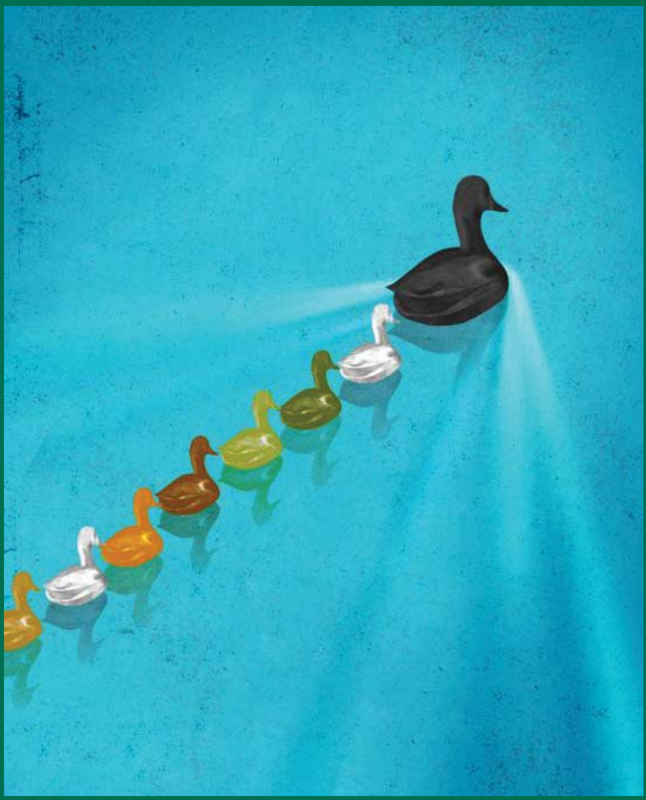
REPORT

First, Do No Harm

How to Be a Good Corporate Parent



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FIRST, DO NO HARM

HOW TO BE A GOOD CORPORATE PARENT

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CONTENTS

INTRODUCTION

MOST CORPORATE CENTERS AT multibusiness companies are struggling to justify their existence today. Many business-unit managers will say that group functions and group-level bosses are often more hindrance than help. As a consequence, boards and corporate-level managers are frequently unsure how best to fulfill their corporate-parenting function. Should they intervene more actively in their portfolio of businesses in order to add value? Or should they hold back and allow for more autonomy? How precisely should they organize the relationship between the center and the businesses? And which corporate activities should they focus on? In short, what should be their parenting strategy?

The stakes involved in coming up with the right answers to these questions are high. The wrong parenting strategy can undermine entrepreneurship in the business units and severely degrade their value-creation potential. By contrast, an effective parenting strategy can create a situation in which the whole really is bigger than the sum of the parts and can deliver a valuation premium for a multibusiness company. And when a company's parenting strategy is an especially good fit with the needs of its business units and the dynamics of its competitive environment, a company can earn a *parenting advantage*—in which the corporate center not only adds more value to the business units in its portfolio than it destroys but also adds more value than any other potential owner of the business.[1]

To identify successful parenting strategies of multibusiness companies, BCG has been studying the value-adding and value-destroying activities of such companies worldwide. The centerpiece of this research is a survey on the sources of corporate value creation that we sent out to CEOs, CFOs, and functional heads at approximately 900 of the largest public and privately owned diversified companies. Executives at about 150 of these companies completed our survey, a response rate of about 17 percent. These companies averaged in the neighborhood of €23 billion in revenues and represented a broad cross-section of industries and regions. (For a copy of our survey, see the Appendix.)

There are three broad conclusions that have emerged from our study:

- As much as corporate parents focus on creating value, they also need to understand how they destroy it. In this respect, the ancient advice, attributed to Hippocrates, for the medical profession goes equally for corporate parents: "first, do no harm."

- Although few multibusiness companies have an explicit parenting strategy, our research identified six distinct parenting strategies that most companies implicitly follow.

- By taking a few simple steps, a company can identify its implicit parenting strategy, assess the effectiveness of this strategy given the company's industry and competitive environment, and select the most appropriate strategy on the basis of its capabilities and the needs of its portfolio of businesses.

NOTE

1. Andrew Campbell, Michael Goold, and Marcus Alexander, "Corporate Strategy: The Quest for Parenting Advantage," *Harvard Business Review,* March 1995.

WHAT CORPORATE PARENTS DO

The starting point of our research was a comprehensive review of the literature on corporate parenting, along with some 50 interviews with experts and practitioners in corporate strategy. From the review and interviews, we developed a list of 28 different corporate activities that can create value for a company's businesses and 19 characteristics of corporate centers that tend to destroy value. To assess the relative importance of these activities and characteristics, we surveyed a global sample of executives from more than 150 multibusiness companies. Finally, using factor analysis, we statistically aggregated the responses into a limited and more manageable set of broader categories.

How Corporate Parents Create Value

The statistical analysis of our survey data yielded the following five broad categories of value-creating activities:

Financing Advantages. Diversified multibusiness companies often have access to capital at lower rates of interest than do comparable standalone competitors. Capital markets reward the reduced bankruptcy risk that comes from a diversified portfolio with easier and cheaper access to funding. Moreover, a company's businesses may benefit from tax optimization across the portfolio, as well as from steady operational cash flows that can be used as valuable sources of internal funding. Such factors confer a financing advantage on the company's portfolio of businesses.

Strategy Development. Corporate managers can also add value through active involvement in business-unit strategy development. They can, for example, provide high-level strategic direction, formulate top-down objectives, design road maps for business development, and oversee mergers and acquisitions. In addition, being part of a larger corporate portfolio can serve to protect a business unit from the external pressures of the capital markets, thus giving it greater room to maneuver when setting its business strategies.

Corporate Resources and Functions. Business units in the portfolio may also profit from using corporate assets or from the cost advantages provided by corporate functions and governance. Such benefits may be realized through distinct corporate capabilities, technologies, or brands, but also through bundled services, such as IT, accounting, procurement, or legal services. Moreover, the businesses may also have advantages in labor and recruiting markets when it comes to hiring and retaining management talent (for example, a strong employer brand, frequent job rotation, or a broader range of career opportunities).

Operational Engagement. Another way corporate managers can add value is by actively fostering cooperation among business units to realize horizontal synergies. They may also add value by influencing decisions on operating objectives. For instance, they can establish detailed criteria and procedures for the approval of business unit investments through rigorous performance monitoring, or even by intervening directly in business operations through centrally guided improvement initiatives such as restructuring.

Business Synergies. Finally, in some cases, business units can generate additional value from direct collaborative interaction without the intervention of the corporate center. They may realize economies of scope and scale through tight integration of research and production. Moreover, they may increase sales through product bundling, through cross-selling activities, or through sharing experiences and capabilities. All these benefits come from horizontal synergies made possible simply because the units are part of the same corporate entity.

Exhibit 1 portrays the average scores from our survey for the five value-adding activities on a scale of 0 to 5, where 0 is equivalent to "low relevance to value creation" and 5 to "high relevance to value creation." As one might expect, the category of financing advantages was the most relevant to the companies in our sample, with strategy development coming in second. The least relevant category for parent value creation was that of business synergies made possible by a set of businesses being part of the same corporate parent—but this low average score is driven in part by the fact that this category is only relevant to a subset of our sample: diversified companies with related (as opposed to unrelated) businesses.

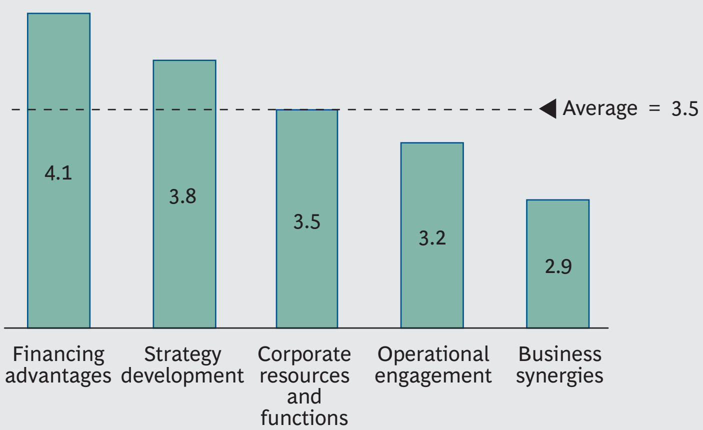
How Corporate Parents Destroy Value

The discussion of the role played by a corporate parent cannot stop there. Our statistical analysis also revealed an equal number of ways in which a corporate parent can destroy value, even as it is creating it through the activities described above.

Insufficient Expertise and Skills. Managers at the corporate center often do not recognize or understand the specific requirements and success factors within particular busi-

EXHIBIT 1 | The Development of Financing Advantages Is the Most Common Parenting Activity

Value-adding activities



0 = Low relevance to value creation
5 = High relevance to value creation

Value-adding subcategories

Financing advantages
- External funding
- Internal funding
- Tax optimization

Strategy development
- Strategic direction
- Active M&A
- Protection from capital market pressure

Corporate resources and functions
- Corporate assets, such as brands
- Central functions, such as IT and accounting
- People advantages, such as employer branding

Operational engagement
- Budgeting and monitoring
- Corporate initiatives
- Fostering cooperation

Business synergies
- Sales synergies
- Managerial synergies
- Operational synergies

Source: BCG analysis.
Note: Results come from 150 respondents to a BCG survey on corporate value creation.

ness units. As a result, they may impose inappropriate policies and services on the businesses.

Inefficient Processes. Corporate processes imposed on the businesses can add cost and delays, not to mention considerable confusion over objectives and expectations on the part of hard-pressed business-unit managers. A typical problem is the approval process for significant decisions, such as when operational managers are put through reviews at the division and group level and still leave the final meeting without full clarity about what is expected of them.

Cost of Complexity. Beyond centrally directed processes, businesses may waste time and resources on internal coordination with other business units in an attempt to influence corporate policies or compete for power.

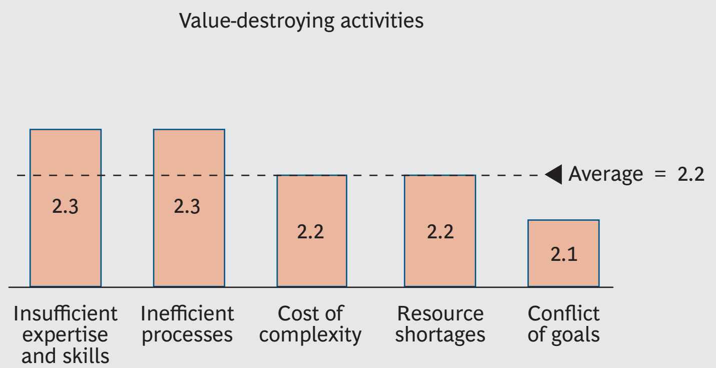
Resource Shortages. Businesses may be deprived of adequate capital and managerial resources because they have to subsidize weaker business units or play a specific role in the corporate portfolio that prevents them from realizing their full value potential.

Conflict of Goals. The corporate center may have objectives that conflict with the optimum performance of individual businesses. For example, the head office may make China a priority to the disadvantage of some businesses with better prospects in other markets. Or the center may undertake a companywide initiative to improve working-capital productivity that makes it more difficult for managers in some units to deliver on a high-service strategy.

Exhibit 2 shows the average scores from our survey for each of these value-destroying characteristics. What stands out is that the most relevant categories—insufficient expertise and skills and inefficient processes—are those that, at least in theory, corporate executives have some control over. This suggests that while some value destruction is structural—the more interventionist the corporate center, the greater the negative impact—it is also frequently organizational and therefore can be managed.

Of course, establishing the relative occurrence of these various activities is only a first step. A sound parenting strategy is something more than just a random collection of value-adding activities. Rather, it is a reinforcing combination of activities that is consistent with the capabilities of the corporate center and the specific needs of the business units. The key question therefore is: how do these value-creating activities combine to form differentiated corporate-parenting strategies? In the next chapter, we describe our efforts to answer that question.

EXHIBIT 2 | The Activities That Destroy Value Most Often Are Organizational—and Can Be Managed



0 = Low relevance to value destruction
5 = High relevance to value destruction

Value-destroying subcategories

Insufficient expertise and skills
- Poor understanding of business requirements

Inefficient processes
- Complicated and costly corporate processes

Cost of complexity
- Wasted resources on internal coordination

Resource shortages
- Businesses are deprived of capital and management attention

Conflict of goals
- Different agendas, opinions, or incentives

Source: BCG analysis.
Note: Results come from 150 respondents to a BCG survey on corporate value creation.

SIX PARENTING STRATEGIES

In our experience, few companies have an explicitly formulated parenting strategy. Typical descriptions of a diversified company as a "strategic," "operational," or "financial" holding company don't do the trick. They focus on how a company is organized, not on how the parent adds value. To address this issue, we performed a cluster analysis to identify any common patterns among and across the responses to our survey.

A Typology of Strategies

Through this cluster analysis, we identified six empirically distinct parenting strategies. Each represents a different approach to being a corporate parent. All can be observed in practice among the companies we studied. (See the sidebar "Visualizing a Company's Parenting Strategy.")

Hands-Off Ownership. A small number of companies, about 5 percent in our sample, pursue what is, in effect, an extremely cautious parenting strategy. We call this approach *hands-off ownership.* These companies focus on creating value by adding new businesses to the portfolio and divesting others, without any ambition to exercise central control over strategic or operating functions. In essence, they manage their business units as pure financial assets, limiting themselves to setting high-level financial targets.

Hands-off owners tend to have very lean corporate centers. Most are so careful to avoid having a negative influence on their businesses that they even avoid providing shared services at the corporate level. A pure example of this parenting strategy can be found at many state-owned sovereign-wealth funds.

Financial Sponsorship. A second group of companies, 13 percent of our sample, builds its parenting strategy mainly on providing financial advantages. We call this approach *financial sponsorship.* Businesses within the portfolio benefit from access to cheaper and more flexible funding and from a reduced tax burden. The parent also offers protection from external capital markets—for instance, by reducing external reporting requirements and lowering the cost of managing external stakeholders.

Apart from these financing benefits, however, the financial sponsor does not get deeply involved in strategy development or the operational activities of business units. Much like the hands-off owner, financial sponsors are extremely wary of destroying value through the center's inefficient involvement in business operations. To be sure, the center does intervene when there are significant performance issues, but only temporarily.

Financial sponsors still occasionally experience value-destroying conflicts of goals among the

VISUALIZING A COMPANY'S PARENTING STRATEGY

As part of our research on corporate parenting, we have developed a simple tool that can be used to assess a company's parenting strategy and to visualize its key dimensions.

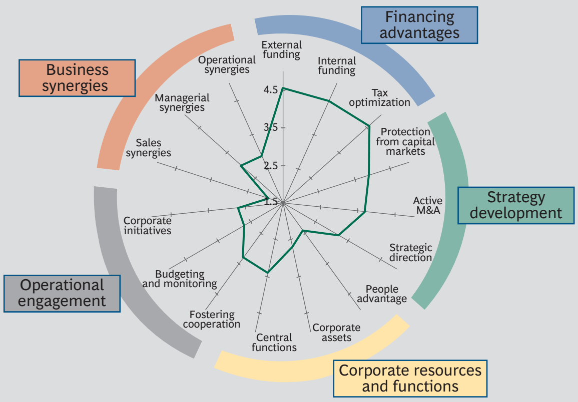
We took the five categories of parenting activities identified by our factor analysis of the survey data, defined three primary subactivities for each, and arrayed them on a spider chart. The importance of each subactivity to the value added of the corporate center is rated on a scale of 0 to 5. (See the exhibit below.)

When we mapped the data from our survey onto this chart, we found that the six parenting strategies that we identified had distinctive visual profiles. For example, the upper graphic in the exhibit below displays the parenting strategy spider chart for the financial-sponsorship strategy, which is dominated by financing advantages. By contrast, the lower spider chart illustrates the profile of hands-on management. Although financing advantages play some role in this parenting strategy, they are not as important as they are for the financial-sponsorship strategy. What's more, other activities such as operational engagement are far more important.

The parenting strategy spider chart is a useful way for a company both to identify its current parenting strategy and to visualize the changes it should make to migrate to another, more appropriate parenting strategy.

Each Parenting Strategy Has a Distinctive Profile

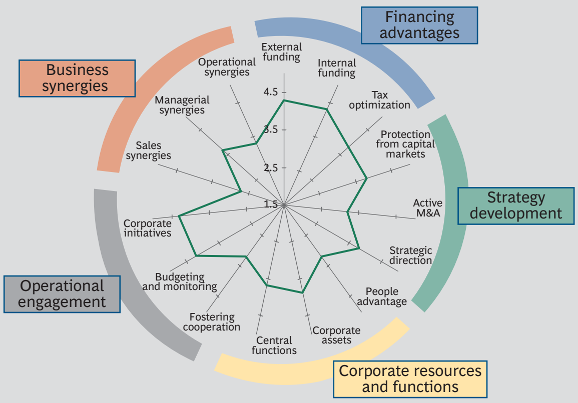
The *Financial-Sponsorship* Value Profile



Key sources of value added
- Access to cheap and flexible external and internal funding
- Protection from capital market pressure and reporting requirements

Key risks of value destruction
- Conflicts of goals, such as short-term (corporate center) versus long-term (business unit) value-creation targets

The *Hands-On Management* Value Profile



Key sources of value added
- Fine-grained planning and budgeting processes
- Detailed reporting systems
- Corporate-improvement initiatives across the portfolio

Key risks of value destruction
- Cost of complexity
- Inefficient corporate processes

0 = Low relevance to value creation 5 = High relevance to value creation

Source: BCG analysis.

corporate parent and individual businesses. For instance, the parent may insist on short-term financial returns that prevent a business unit from investing for long-term sustainability.

Many traditional private-equity firms follow the financial-sponsorship parenting strategy. However, as opportunities to create value through leverage and multiples arbitrage diminish, firms are increasingly moving to a more interventionist approach to creating value at their portfolio companies.[1]

Synergy Creation. Another parenting strategy, practiced by 20 percent of the companies in our sample, focuses on deriving major benefits from synergies in sales, marketing, and operations across the business units. Companies employing *synergy creation* assemble a portfolio of businesses that fit together naturally and can reach maximum advantage through internal collaboration. The business units, however, are fully accountable for their performance, and the corporate parent limits its interference in strategic and operational issues.

Synergy creators often do add value by offering beneficial funding sources for the businesses as well as central functions and services. For example, a strong human-resources function with central talent management and leadership development may support the exploitation of synergies. And a strong employer brand may increase the attractiveness in the recruiting market. The potential downside of this more involved parenting strategy, however, is a growing cost of complexity due to coordination efforts, slow decision making, and relatively costly internal processes.

Examples of companies that have been built on natural synergies are producers of fast-moving consumer goods with a portfolio of strong and independent brands, and chemical conglomerates built around synergies in production technologies and processes.

Strategic Guidance. If financial sponsorship focuses on financial advantage, companies practicing *strategic guidance* focus on strategic advantage. The corporate parent adds value by having superior strategic insight and experience and by defining a clear strategic direction for the businesses. A company that follows this parenting strategy may also actively promote specific M&A initiatives, develop new organic growth options, and help business units divest noncore assets by managing due diligence and the deal process.

Strategic guidance is a common approach at many large Asian business groups

This parenting strategy, which is used by 22 percent of the companies in our sample, does not necessarily require large corporate functions or complex corporate processes. It does, however, require the center to have a distinct set of managerial capabilities (in, for instance, investment valuation, joint-venture management, and productivity improvement) that are relevant to the needs of the businesses and that complement their existing skills. The downside of this strategy becomes apparent when such capabilities are lacking. Poor strategic guidance may lead the business units astray; inefficient resource allocation may prevent them from achieving their full potential.

Many large diversified conglomerates with rather independent subsidiaries have chosen this parenting strategy. It is a common approach, for example, at many large Asian business groups where each subsidiary is a separate legal entity.

Functional Leadership. An even more active parenting strategy, used by 23 percent of the companies in our sample, is *functional leadership.* Companies pursuing this strategy focus on adding value to the businesses in their portfolio through functional excellence, shared corporate resources, and central services. To this end, they build strong corporate functions that bundle expertise in areas that have a long-term influence on business units. Examples include strategy development, capital-investment management, and innovation.

Such centers of excellence establish company wide policies, standardize key corporate processes, encourage the sharing of best practices across business units, and champion improvement initiatives in business unit functions such as risk management and procurement. A functional leader may also bundle support services such as IT, accounting services, and procurement in order to achieve cost advantages for the businesses. This active parenting strategy faces the risk of destroying value, however, through the establishment of costly overhead structures and inefficient processes that result from intensive sharing of responsibilities among the center and the business units.

Functional leadership is the preferred approach at many of the world's leading globally integrated companies.[2]

Hands-On Management. The most active parenting strategy by far, practiced by 17 percent of the companies in our sample, is that of *hands-on management.* In a company pursuing this strategy, the corporate parent goes beyond setting financial targets, providing strategic guidelines, or exerting functional leadership. It gets deeply involved in the management of the business units by influencing operating decisions at the level of the individual business.

> The level of value creation intensity rises steadily with the degree of parental involvement.

A corporate parent that acts as a hands-on manager typically puts in place a detailed and comprehensive strategic-planning and budgeting process with decision-making authority resting in the corporate center. It may also have strict criteria for approving new capital investments or detailed reporting procedures so the center can closely monitor business unit performance. Finally, some hands-on managers actively intervene in operational activities by directing improvement initiatives across the portfolio or in specific units that are performing below expectations.

Obviously, such an activist parenting strategy carries the risk of value destruction from inefficient processes and the high cost of complexity. It works only if the insights and capabilities that the corporate parent adds to the business units compensate for these inevitable costs.

Many companies with a focused portfolio in capital-intensive, mature markets use this parenting strategy. A good example is the utilities industry, which has a highly integrated value chain and for which operational excellence and effective resource allocation are critical.

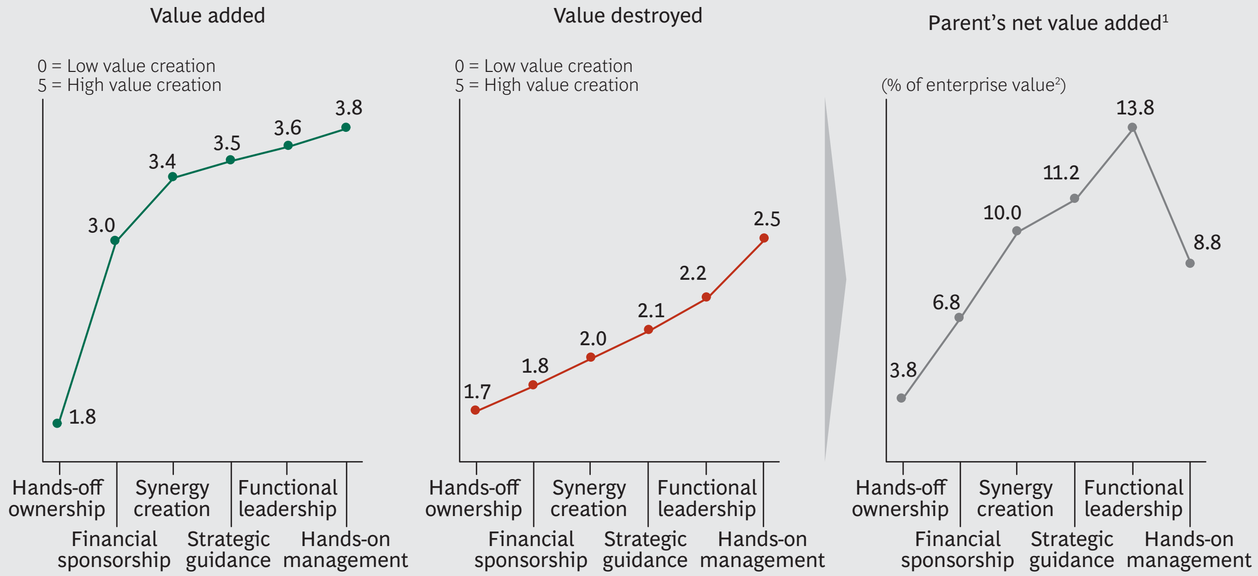
Divergent Patterns of Performance

To assess the performance of the six strategies represented in our sample, we calculated the average scores for each value-creating activity for the different parenting-strategy clusters. This analysis yielded an overall measure of value creation intensity for each strategy. In other words, the higher the score, the larger the contribution of the corporate parent to value creation of the businesses in the portfolio.

As expected, we found that the level of value creation intensity rose steadily with the degree of parental involvement. Hands-off owners reported the lowest levels, financial sponsors somewhat higher levels, and so on up to the hands-on managers who reported the strongest gross value creation from parenting activities. However, as the left-hand graph in Exhibit 3 illustrates, the increase tended to flatten out among the most active strategies, suggesting diminishing returns for parent involvement.

When it came to assessing the value destroyed by the activities of the corporate center, there was a similar increase—in this case, in value-destroying intensity. This time, however, instead of diminishing returns, there was an acceleration of value destruction caused by the corporate parent for the most active parenting strategies, suggesting that once corporate intervention reached a certain point, the costs associated with that intervention increased rapidly.

Exhibit 3 | BCG's Survey Suggests That There Is an Optimal Level of Parent Involvement



Source: BCG analysis.
[1]Based on respondents' estimate of the corporate parents' net contribution to enterprise value.
[2]Market value of equity plus net debt.

Taken together, these two findings suggest that there is an optimum level of parent involvement that strikes the best balance between value creation and value destruction. This conclusion is reinforced by the responses to another survey question. We asked respondents to estimate their parent's total net value added in terms of what the respondents considered to be a "fair" conglomerate premium (or discount). As the right-hand graph in Exhibit 3 shows, the most value-generating strategy, on average, was that of functional leadership. This result suggests that whatever additional value was delivered by hands-on management was more than offset by the additional value it destroyed.

Of course, these assessments are based on the subjective opinions of the corporate executives who participated in our survey. How closely do they parallel the assessments of the equity markets? To crosscheck these estimates, we did two analyses that are widely accepted proxies for the net value contribution of a parent company to its corporate portfolio. First, we calculated an individual valuation premium (or discount) for each of the companies in our study during the period from 2007 through 2009 (immediately before we began collecting survey data) using a sum-of-the-parts analysis in which each company's actual enterprise value (market value of equity plus net debt) was compared with the value of a matched portfolio of focused companies. Second, we calculated each company's Tobin's q, or the ratio of the market value of the enterprise to its book value, during the same period.

> The key is to strike the best balance between value creation and value destruction.

The findings of this analysis can be seen in Exhibit 4. Although our survey respondents overestimated the amount of average net value added by the corporate parent at their companies (10.2 percent), they were still directionally correct. On average, these companies had a valuation premium of 5.5 percent during the period studied.

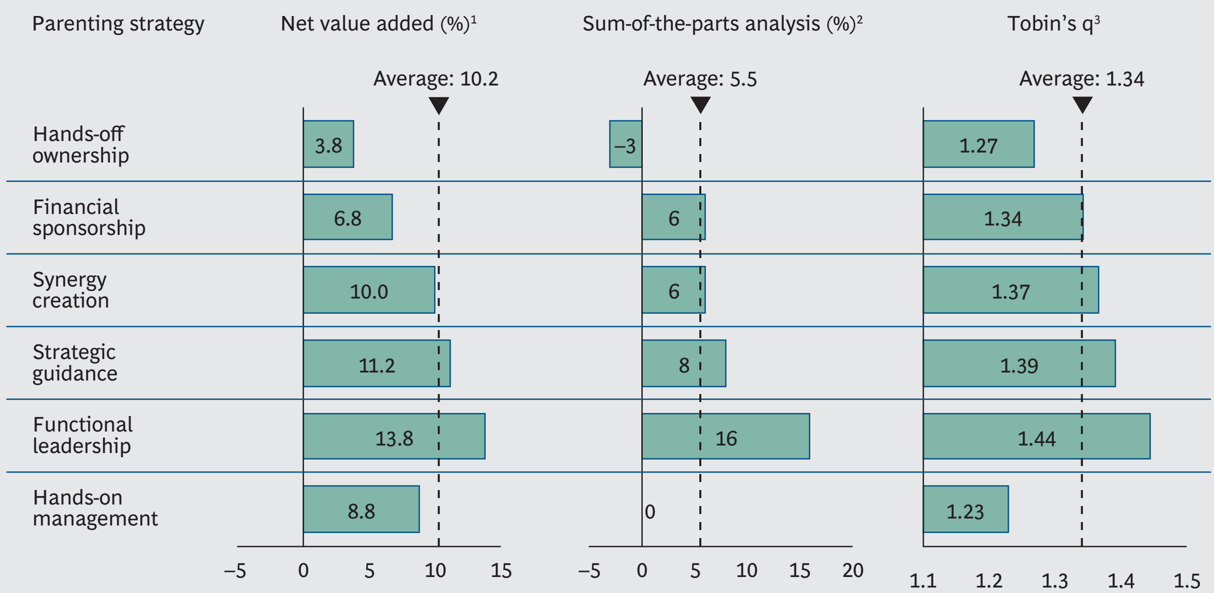
More important, the sum-of-the-parts analysis of the various parenting strategies in terms of net-value added revealed the same pattern as the respondents' ranking. Companies practicing hands-off ownership created the least value (indeed, they had a valuation discount of 3 percent), with steady rises up to the functional-leadership companies (a double-digit valuation premium of 16 percent—even higher than the respondents from those companies estimated), and then a falling-off for the companies using hands-on management. This pattern was also repeated in the Tobin's q calculation.

Does this result mean that functional leadership is, therefore, the best parenting strategy? Not necessarily. It may have been the highest-performing strategy on average for our sample, but the most appropriate strategy for any specific company could well differ. When our sample is disaggregated by industry, the results vary by sector. The highest-performing strategy for energy utilities, for example, appeared to be that of hands-on management. In utilities, value was created by strictly monitoring performance, managing the regulatory environment, and exploiting synergies along the value chain. The negative side effects of heavy centralization appeared to be relatively limited. By contrast, in the consumer goods sector, we found strategic guidance to be optimal. Consumer goods companies with a more involved parenting strategy (either functional leadership or hands-on management) reported high levels of value destruction, so that the net value created was lower than it was for those that used strategic guidance.

What constitutes the most value-generating strategy is also affected by the degree of diversity in a company's portfolio of businesses. For companies with fewer than five business units, hands-on management was the most effective approach. As the number of business units increases, however, the optimum changes. For companies with from 5 to 20 business units, the best strategy was nearly evenly split between strategic guidance and functional leadership. For companies with more than 20 business units, the optimal strategy was that of the synergy creator. The negative impact of corporate initiatives increases as the size and complexity of the portfolio grows: it is increasingly difficult for central executives to understand each business unit, and there are more situations for which one size does not fit all units.

NOTES:
1. *Private Equity: Engaging for Growth,* BCG report, January 2012.
2. *Identity Crisis: What Is the Corporate Center's Role in a Globalized Business?* BCG report, December 2011.

EXHIBIT 4 | Objective Proxies of Net Value Added Confirm the Respondents' Self-Assessment



Sources: Bloomberg; Leipzig Graduate School of Management, BCG analysis.
[1]Based on 150 respondents' estimates of the corporate parents' net contribution to enterprise value.
[2]Based on the sum-of-the-parts analysis for the period from 2007 through 2009; n = 88.
[3]Tobin's q is the ratio of the market value of the enterprise to its book value; n = 124.

CHOOSING THE RIGHT PARENTING STRATEGY

Although the right parenting strategy depends on a wide variety of factors, our research suggests five steps that every company can follow to identify the approach that works best for it. (See the sidebar “Five Questions to Ask When Choosing a Parenting Strategy.”) In this concluding section, we describe these steps using an example based on recent client work to explain how these steps can play themselves out at an individual company.

Develop a Value Map

The place to begin is by determining the range of parenting activities the company is currently undertaking and whether they add or destroy value. The comprehensive list of potential activities in our survey is a good place to start. (See the Appendix.) Ideally, the relevance and effectiveness of the different activities should be evaluated not only on a standalone basis but also on a comparative basis against a peer group of relevant competitors.

At a European multibusiness company with a broad portfolio of industrial businesses, for example, we began by conducting an initial survey of some 50 executives from different parts of the organization, both in the corporate center and in the business units. The survey showed that the major contribution of the corporate center, as perceived by respon-

FIVE QUESTIONS TO ASK WHEN CHOOSING A PARENTING STRATEGY

1. How do we currently add value to the businesses in our portfolio? Are there any ways that we are destroying value?
2. How would we describe our parenting approach today? How does it compare with the approaches of our main competitors?
3. What are the parenting needs and opportunities of our businesses? Which corporate activities can support our overall strategy?
4. What should be our target parenting strategy? Which parenting activities should we should focus on?
5. What are the major gaps that we must close to achieve our target parenting strategy? What should we do more of? What should we stop doing?

dents, was in the area of strategy development—in particular, providing clear strategic guidance and actively supporting growth through M&A. A comparison with key competitors and with BCG's benchmark database of the companies that participated in our global survey confirmed that the company scored especially well on this dimension. (See Exhibit 5.) The analysis also suggested that the company added a lot of value through its corporate resources, such as brands and proprietary technology, but relatively little from its weak central functions and services. Most other activities were less relevant or at the lower end of the benchmark.

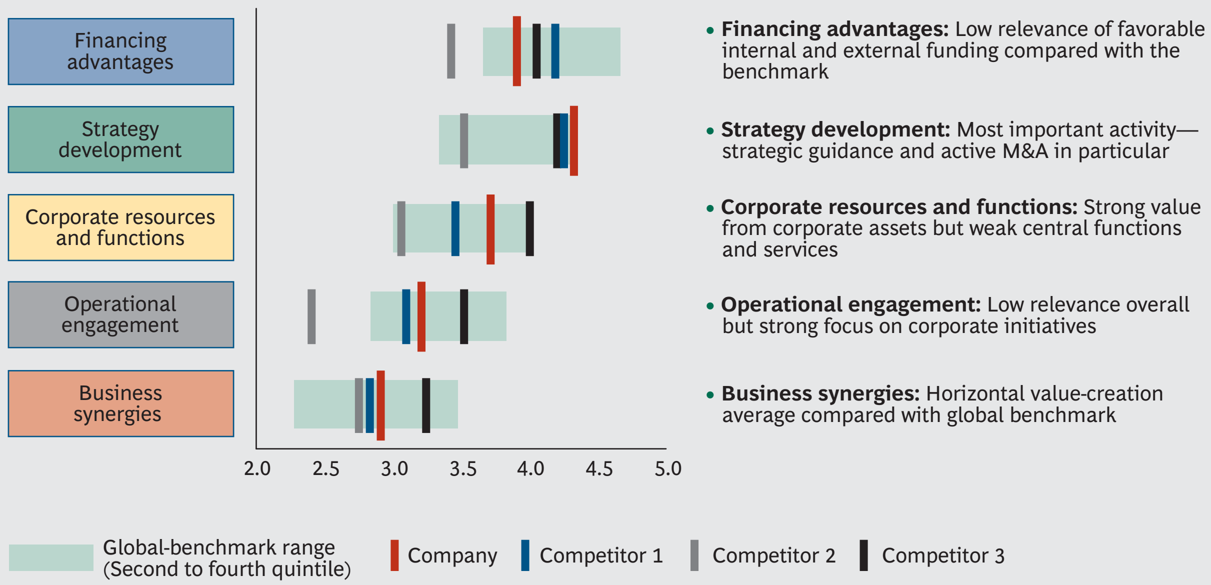
Identify the Existing Parenting Strategy

A sound parenting strategy, however, is something more than a random collection of value-adding activities. Rather, it is a reinforcing combination of activities that is consistent with the capabilities of the corporate center and the specific needs of the business units. In our experience, few companies have an explicitly formulated parenting strategy. They can, however, identify their implicit parenting approach, assess its overall performance in terms of net value added, and compare it with that of competitors.

At the European diversified industrial company, we assessed corporate's value added in terms of the five broad value-creating categories and then compared its profile with the generic profiles of the six parenting strategies. As Exhibit 6 illustrates, the company's implicit parenting strategy fit closely with that of strategic guidance.

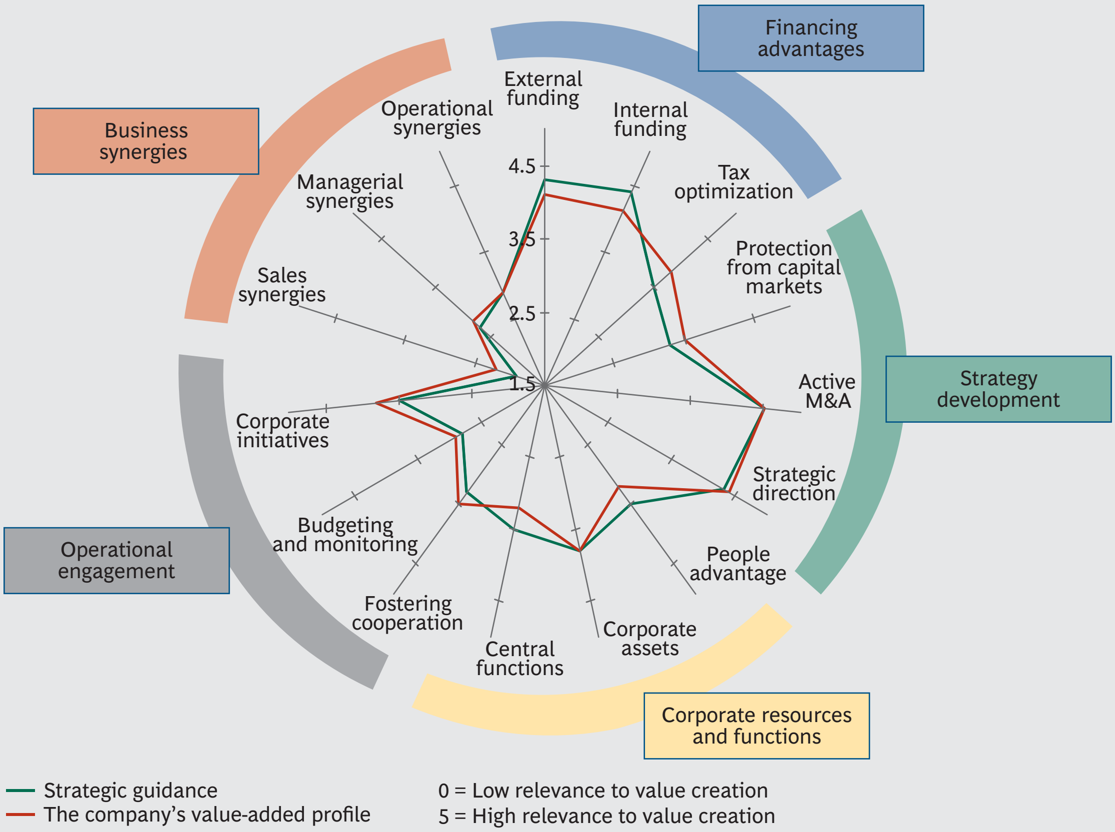
The survey responses of the company's management also suggested that, on average, respondents estimated that the corporate center was responsible for an additional 5 percent of enterprise value above what one would find in a sum-of-the-parts analysis. A similar analysis from the "outside in" for the company's main competitors suggested that the company was leaving considerable value on the table that it could capture if it optimized its parenting approach. For instance, one competitor practiced similar strategic guidance but delivered a much higher net value added. And by pursuing a functional-leadership strategy, another competitor pushed its net value added still higher. (See Exhibit 7.)

Exhibit 5 | A Company Can Benchmark Its Parenting Value Added Against That of Key Competitors



Source: BCG analysis.
Note: 0 = low relevance to value creation. 5 = high relevance to value creation. The global benchmark consists of survey data from 150 global companies.

EXHIBIT 6 | One Company's Implicit Parenting Strategy Was Similar to *Strategic Guidance*



Source: BCG analysis.
Note: Scale starts at 1.5.

Understand the Needs of the Businesses

Of course, a company's current parenting strategy may not necessarily be the right one for the future. That decision depends on the specific parenting needs and opportunities of the business units in the corporate portfolio. Determining those needs should be based on an in-depth understanding of the business models and key success factors of the various businesses, their competitive position, and the challenges they are currently facing.

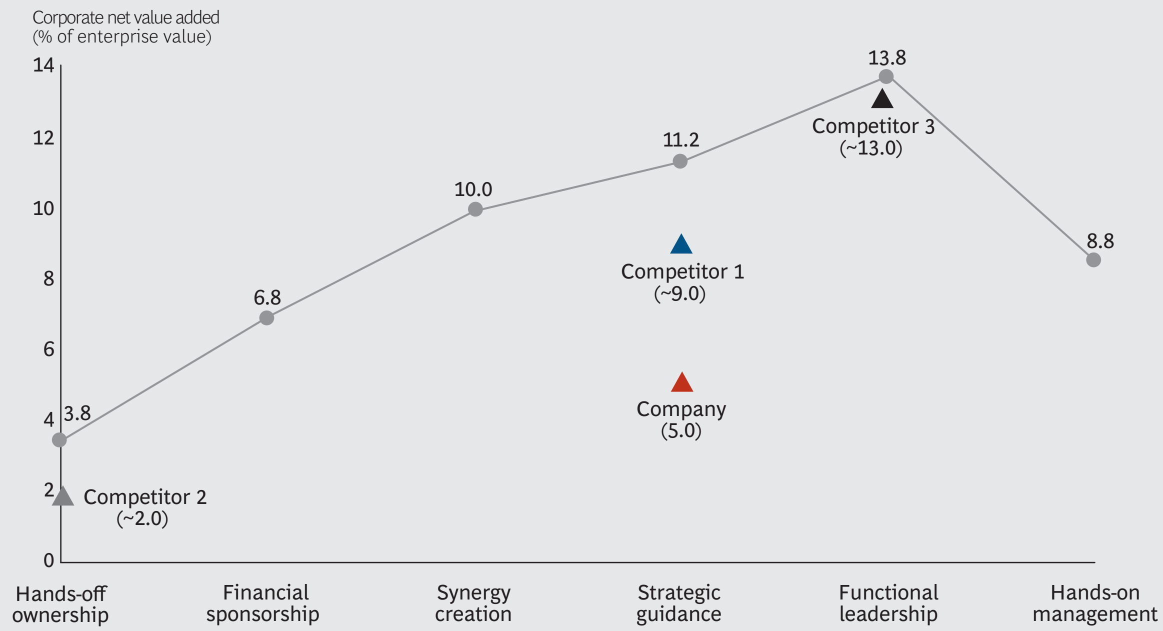
Having sketched the lay of the land for the European industrial company and its competitors, we next asked business unit managers what they believed they needed from their corporate parent. These interviews revealed two areas in which most of the businesses wanted to see a greater contribution from the center and one area in which they felt that corporate's impact was less beneficial and ought to be reduced.

Most of the business unit managers were looking for help in the area of people development, for which they believed that centralized recruiting, a more active internal labor market, and central talent management would greatly improve the quality of the workforce. They also believed that the company would have a cost advantage if it did more bundling of services at the group level. In general, the business unit executives wanted to see more active functional leadership from the corporate center. They did not see much value, however, in the strong role that corporate typically played in pushing companywide improvement initiatives. They felt that the initiatives did not sufficiently address the specific needs and weaknesses of the quite different business units.

Select the Target Parenting Strategy

Once a company has a good understanding of its implicit parenting approach and its per-

Exhibit 7 | The Company's Net Value Added Significantly Lagged Behind That of Two Competitors



Source: BCG analysis.
Note: The gray line represents the average value from BCG's survey of 150 companies.

formance (and how it stacks up to competitors), an assessment of the parent's capabilities and activities and how they add or destroy value, and a clear view of the parenting needs and opportunities of the business units, it is in a position to select its target parenting strategy.

The target strategy may require changes in corporate policies and processes.

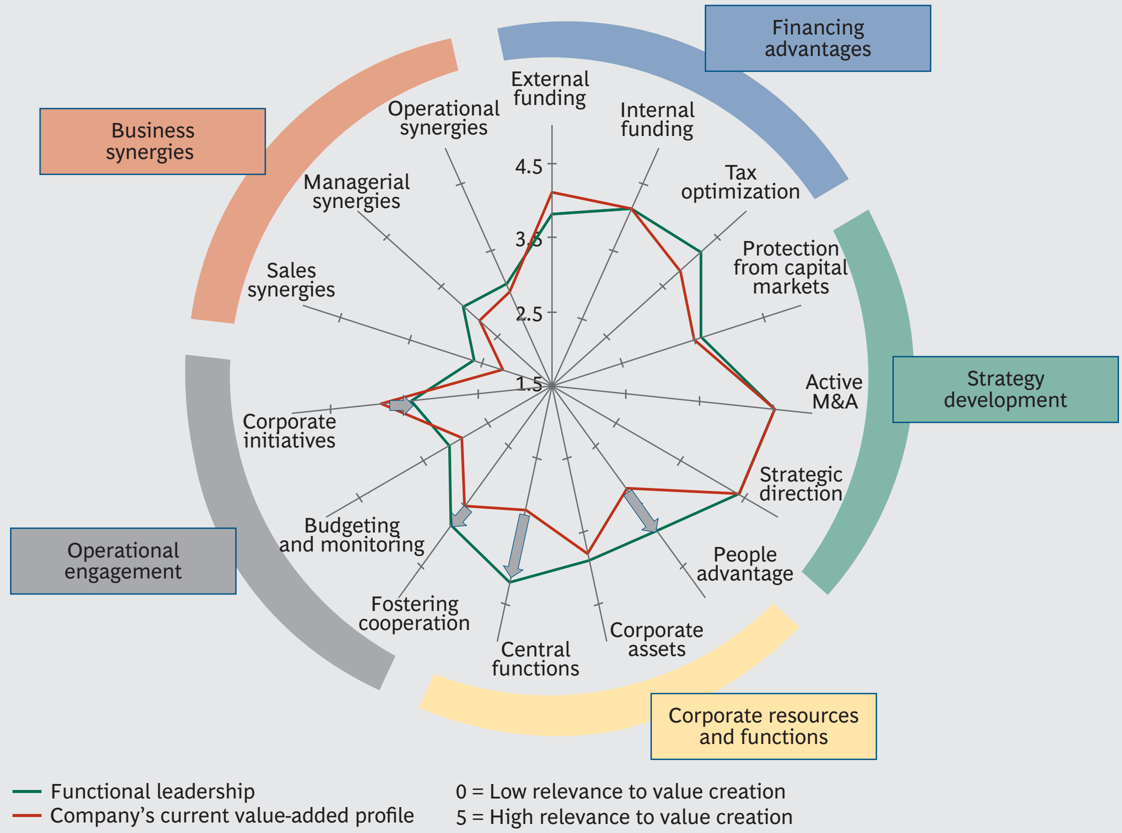
At the European company, for instance, the inputs from the business units, combined with the results of the competitor analysis, had a big impact on how corporate executives saw their role in the company. In particular, the analysis suggested that the executives should be operating more as functional leaders than as strategic guides. (See Exhibit 8.) That didn't necessarily mean eliminating the existing activities that were working well. But it did suggest that the corporate center needed to beef up its functional expertise (especially in the areas specified by the business unit managers) and cut back (or perhaps jettison entirely) its companywide improvement initiatives. This perspective was reinforced by the fact that the company's competitor with the highest net value added also happened to match the functional-leadership profile.

Define a Path to Realize the Target Strategy

After the target parenting strategy is clear, the transformation path for achieving it can be laid out. It may require changes in corporate policies and processes, an adaptation of the organization, building or reducing functional resources in the center or in the business units, and developing new capabilities through training or recruiting.

At the European company, the comparison of the current and target parenting-strategy profile in Exhibit 8 had already sketched this transformation path. The human resources function was charged with coming up with a clear plan for how to bundle groupwide human-resources knowledge, strengthen the employer brand, and professionalize the development of management talent. More generally, explicit measures for increasing functional leadership by the corporate center

Exhibit 8 | The Company's Most Appropriate Parenting Strategy Was *Functional Leadership*



Source: BCG analysis.
Note: Scale starts at 1.5.

were developed and made part of the center's key performance indicators. The company also created centers of excellence for different functions and more explicit companywide policies, standardizing important corporate processes such as strategy development and performance monitoring, and encouraging cross-unit best-practice sharing. And it began bundling support services such as IT, payroll, and accounting in a central shared-services center. Although it may be too early to assess the impact of all these changes, they have succeeded in taking the company a long way toward implementing the parenting strategy that best suits its businesses.

Our empirically derived typology of parenting strategies provides an explanation for valuation differences of multibusiness firms that goes beyond structural factors, such as the degree of diversification or the relatedness of a business portfolio. It also provides a way for companies to get specific about precisely how they plan to create a parenting advantage for their businesses. Such an approach will not only help companies become the best owners of their businesses. It will also help them communicate that fact to existing business units, potential new businesses in the portfolio, investors and financial markets, and other company stakeholders.

APPENDIX

CORPORATE VALUE ADDED VERSUS CORPORATE VALUE DESTROYED

SURVEY INSTRUCTIONS

1. Preliminary remarks
   - You will need less than 15 minutes to complete the questionnaire
   - All information provided will be treated as strictly confidential
   - Individual responses will be processed anonymously and will not be used for commercial purposes
   - You will be asked questions on value creation (positive impact) and value destruction (negative impact)
2. Guidelines
   - We are interested in activities of value creation and aspects of value destruction within your company
   - While answering the questionnaire, please use a general perspective on your company
   - Try to answer the questions by comparing your company to your main competitors
   - Do not hesitate to provide us with estimates—we are interested in your personal judgment
   - A fully completed questionnaire is very valuable to us
3. Benefits
   - We offer to guide you through the questionnaire in a phone call upon request
   - We send you an executive summary covering the key results of our study
   - We discuss the specific conclusions for your company in a follow-up phone call upon request

Thank you for your time and effort—we highly appreciate your cooperation.

If you need more information, please contact Matthias Krühler at kruehler.matthias@bcg.com.

A.1. Value creation of the Corporate Headquarters (HQ)

Corporate headquarters (HQ) stand between their Strategic Business Units (SBUs) and the external capital markets. In this way, they may provide additional value as compared to the SBUs as stand-alone entities that are individually exposed to capital markets.

Strategic guidance and support

HQs can add value by fostering better strategic decisions than SBUs as stand-alone entities. *How relevant are the following activities as sources of value **creation** for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
HQ provides an overall vision or strategic **direction** to the SBUs	☐	☐	☐	☐	☐	☐
SBUs are supported by the HQ with specific strategic **expertise** *(e.g., strategic planning process/methods)*	☐	☐	☐	☐	☐	☐
HQ actively promotes SBUs' **M&A** projects *(e.g., through active involvement in the deal process)*	☐	☐	☐	☐	☐	☐
Company **resources** are allocated efficiently by the HQ	☐	☐	☐	☐	☐	☐
HQ staff reduces value-destroying behavior of SBUs through tight performance **monitoring**	☐	☐	☐	☐	☐	☐
Operational performance is improved by HQ interference *(e.g., manager replacement, turnaround help)*	☐	☐	☐	☐	☐	☐
SBUs can pursue longer-term perspectives due to **protection** from external capital market pressure	☐	☐	☐	☐	☐	☐
HQ actively fosters **cooperation** between SBUs *(e.g., in operations, marketing, or research)*	☐	☐	☐	☐	☐	☐
SBUs are encouraged by the HQ to share **knowledge** and **talent** *(e.g., through corporate initiatives)*	☐	☐	☐	☐	☐	☐
➔ HQ creates significant value to the SBUs through **strategic guidance and support**	☐	☐	☐	☐	☐	☐

Central resources and services

In addition, HQs can reduce costs by establishing central functions and by providing SBUs with cheaper access to markets. *How relevant are the following activities as sources of value **creation** for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
SBUs benefit from central **assets** provided by the HQ *(e.g., brands, patents)*	☐	☐	☐	☐	☐	☐
HQ provides essential **capabilities** to the SBUs *(e.g., risk management)*	☐	☐	☐	☐	☐	☐
SBUs realize cost advantages by using centrally bundled **functions** *(e.g., procurement, IT)*	☐	☐	☐	☐	☐	☐
SBUs benefit from short-term internal **financing** to avoid expensive external debt	☐	☐	☐	☐	☐	☐
HQ offers lower cost of external **funding** than SBUs could achieve *(e.g., greater negotiating power)*	☐	☐	☐	☐	☐	☐
SBUs benefit from **tax** optimization across the corporate portfolio	☐	☐	☐	☐	☐	☐
External **reporting** requirements for the SBUs are minimized due to consolidated disclosures	☐	☐	☐	☐	☐	☐
SBUs benefit from a higher **attractiveness** as an employer *(e.g., career opportunities)*	☐	☐	☐	☐	☐	☐
SBUs benefit from a broader pool of mangement **talent**	☐	☐	☐	☐	☐	☐
➔ HQ creates significant value to the SBUs through **central resources and services**	☐	☐	☐	☐	☐	☐

A.2. Value destruction of the HQ

HQs can also harm the SBUs in the corporate portfolio, resulting in worse strategic decisions or higher costs. In contrast to the activities of value creation, we will now address potential reasons for value destruction by the HQ.

Negative influence

The first area of disadvantages to the SBUs may derive from a negative influence of the HQ. *How relevant are the following aspects as sources of value* ***destruction*** *for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
HQ has insufficient **expertise** and **skills** with regard to the critical success factors of the SBUs	☐	☐	☐	☐	☐	☐
Central decision-making is predominantly driven by **political** matters *(e.g., justification of past decisions)*	☐	☐	☐	☐	☐	☐
HQ prefers investing in SBUs that corporate-level management is **familiar** with	☐	☐	☐	☐	☐	☐
HQ favors growth over value creation (**empire-building**)	☐	☐	☐	☐	☐	☐
HQ favors corporate risk diversification over value creation (minimizing own **job risk**)	☐	☐	☐	☐	☐	☐
As being part of the corporate portfolio, SBUs are eluded from beneficial capital market **pressure**	☐	☐	☐	☐	☐	☐
Ongoing HQ interference decreases SBU managers' **motivation** *(e.g., central overruling practices)*	☐	☐	☐	☐	☐	☐
➔ HQ creates significant value to the SBUs through **strategic guidance and support**	☐	☐	☐	☐	☐	☐

Overhead costs

In addition, central resources cost money—direct costs of central departments and transaction costs due to inefficient process. *How relevant are the following aspects as sources of value* ***destruction*** *for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
HQ offers **services** which are not needed by the SBUs	☐	☐	☐	☐	☐	☐
Overhead **charges** are too high given the scope and quality of the services offered	☐	☐	☐	☐	☐	☐
Some SBU **resources** are only needed to fulfill HQs' requirements *(e.g., reporting obligations)*	☐	☐	☐	☐	☐	☐
HQ requirements prevent SBU managers from running their businesses effectively (**inward focus**)	☐	☐	☐	☐	☐	☐
Complex HQ **processes** reduce flexibility and slow down decision-making	☐	☐	☐	☐	☐	☐
➔ HQ destroys significant value to the SBUs through **overhead costs**	☐	☐	☐	☐	☐	☐

B.1. Value creation from linkages with other Strategic Business Units (SBUs)

In addition to the direct HQ value creation individual SBUs may also benefit from interaction with other SBUs of the corporate portfolio, i.e., synergies.

Sales and managerial synergies

SBUs in the corporate portfolio may profit from sales and managerial synergies.
How relevant are the following activities as sources of value ***creation*** *for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
SBUs increase sales through **cross-selling** to the same customer base *(i.e., sale of complementary goods)*	☐	☐	☐	☐	☐	☐
SBUs increase sales through **bundling** of products from different SBUs	☐	☐	☐	☐	☐	☐
SBUs benefit from sharing **capabilities** with each other *(e.g., customer knowledge)*	☐	☐	☐	☐	☐	☐
SBUs benefit from sharing market-related **experiences** with other SBUs *(e.g., product launches)*	☐	☐	☐	☐	☐	☐
SBUs benefit from joint **development** of new strategic assets and capabilities with other SBUs	☐	☐	☐	☐	☐	☐
→ SBUs create significant value through **sales and managerial synergies**	☐	☐	☐	☐	☐	☐

Operating synergies

SBUs in the corporate portfolio may profit from operating synergies.
How relevant are the following activities as sources of value ***creation*** *for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0	1	2	3	4	5
SBUs realize economies of **scope** due to cooperative actions within an integrated value chain	☐	☐	☐	☐	☐	☐
SBUs realize economies of **scale** from combined activities *(e.g., joint sales force, product platform)*	☐	☐	☐	☐	☐	☐
SBUs benefit from pooling **assets** among each other *(e.g., utilization of production facilities)*	☐	☐	☐	☐	☐	☐
SBUs have cost advantages through combined **purchasing** power on supplier markets	☐	☐	☐	☐	☐	☐
SBUs benefit from lower internal transfer **pricing** compared with arm's-length transactions	☐	☐	☐	☐	☐	☐
→ SBUs create significant value through **operating synergies**	☐	☐	☐	☐	☐	☐

B.2. Value destruction from linkages with other SBUs

SBU linkages may not only add value to the involved units—they can also have a negative influence. In contrast to the activities of synergies discussed above, we will now address potential reasons for value destruction caused by SBU interactions.

Resource competition

Value destruction results from SBUs competing for the same scarce resources provided by the HQ.
*How relevant are the following aspects as sources of value **destruction** for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0 1 2 3 4 5
Marginal SBUs are deprived of **management attention** at corporate level	☐☐☐☐☐☐
Strong SBUs have to subsidize weak SBUs in terms of **CAPEX** allocation	☐☐☐☐☐☐
SBUs have to play a **specific role** in the portfolio that prevents them from realizing their value potential	☐☐☐☐☐☐
➔ SBUs destroy significant value through **resource competition**	☐☐☐☐☐☐

Cost of complexity

Value destruction results from additional costs due to intensive SBU interaction.
*How relevant are the following aspects as sources of value **destruction** for the SBUs in your company (0 = "Not at all" to 5 = "Extensively")?*

	0 1 2 3 4 5
SBUs are wasting **resources** on additional coordination efforts for internal corporate processes	☐☐☐☐☐☐
Decision-making processes are **slowed down** due to high coordination requirements	☐☐☐☐☐☐
Internal power struggles lead to **wrong decisions** and prevent SBUs from realizing their value potential	☐☐☐☐☐☐
SBUs are wasting resources and time on **tactical** maneuvers for influencing HQ decision-making	☐☐☐☐☐☐
➔ SBUs destroy significant value through **cost of complexity**	☐☐☐☐☐☐

C.1. Overall assessment

In this section, you will be asked three questions that aggregate all discussed activities of corporate value creation, all aspects of value destruction, and that reflect your overall perception total net value added.

HQ net value creation

Please bring to mind all previously discussed activities by the HQ (value creation *and* value destruction).
*How is the **net** value creation for your SBUs through HQ activities (–3 = "Highly negative" to +3 = "Highly positive")?*

	–3	–2	–1	0	1	2	3
The net value creation for the SBUs through **HQ activities** in our company is...	☐	☐	☐	☐	☐	☐	☐

SBUs net value creation

Please bring to mind all previously discussed interactions among SBUs (value creation *and* value destruction).
*How is the **net** value creation of our SBUs from linkages with other SBUs (–3 = "Highly negative" to +3 = "Highly positive")?*

	–3	–2	–1	0	1	2	3
The **net** value creation for the SBUs from **linkages** with other SBUs in our company is...	☐	☐	☐	☐	☐	☐	☐

Number of SBUs

How many SBUs does your company have? # of SBUs ☐☐

SBU relationships

Which of the following statements best describes the relationship of the SBUs in your company?

- ☐ Focused operations, more than 70% of our revenues are generated by one SBU
- ☐ SBUs are related to each other, but no single SBU contributes more than 70% to our total revenues
- ☐ There is no major relation between our SBUs, and no single SBU contributes more than 70% to our total revenues

Total net value creation

Finally, please bring to mind all discussed activities of value creation as well as aspects of value destruction (HQ *and* SBUs).

*What is the **total net** value creation in your company—measured as the fair conglomerate **premium** (+) or conglomerate **discount** (–)?*

☐	☐	☐	☐	☐	☐	☐
< –30%	–20%	–10%	~0%	+10%	+20%	> +30%

C.2. Follow-up

For the exclusive purpose of calibrating responses according to specific backgrounds, we finally ask you for some personal data.

Management level

Please indicate your management level within your company.

☐ Executive board (C-suite) ☐ 1 below board level ☐ 2 below board level ☐ < 2 below board level

Organizational affiliation

Please specify your current organizational affiliation within your company.

☐ Corporate Headquarters (HQ) ☐ Division/ Segment ☐ Strategic Business Unit (SBU)

Corporate function

Please indicate your current function within your company *(multiple answers possible)*.

☐ General management ☐ Strategy ☐ Corporate development ☐ M&A ☐ Finance and controlling ☐ HR ☐ IT ☐ Marketing and sales ☐ R&D ☐ Other

Follow-up process and contact details

Please indicate whether you are interested in the following follow-up processes.

☐ Summary report ☐ Follow-up phone call

Name: ______________________

Company: ______________________

E-Mail: ______________________

Thank you very much for your participation!

FOR FURTHER READING

The Boston Consulting Group publishes many reports and articles on corporate strategy and value creation that may be of interest to senior executives. Examples are listed here.

The Power of Diversified Companies During Crises
A report by The Boston Consulting Group, January 2012

Private Equity: Engaging for Growth
A report by The Boston Consulting Group, January 2012

Identity Crisis: What Is the Corporate Center's Role in a Globalized Business?
A Focus by The Boston Consulting Group, December 2011

M&A: Using Uncertainty to Your Advantage
A Focus by The Boston Consulting Group, December 2011

No Time Like the Present to Plan an IPO
A report by The Boston Consulting Group, October 2011

Value Creation Beyond TSR
A Focus by The Boston Consulting Group, October 2011

Risky Business: Value Creation in a Volatile Economy
The 2011 Value Creators Report, September 2011

Riding the Next Wave in M&A: Where Are the Opportunities to Create Value?
A report by The Boston Consulting Group, June 2011

The Art of Planning
A Focus by The Boston Consulting Group, April 2011

Does Practice Make Perfect? How the Top Serial Acquirers Create Value
A Focus by The Boston Consulting Group, April 2011

Best of Times or Worst of Times?
A White Paper by The Boston Consulting Group and the Royal Bank of Scotland, February 2011

Threading the Needle: Value Creation in a Low-Growth Economy
The 2010 Value Creators Report, September 2010

Accelerating Out of the Great Recession: Seize the Opportunities in M&A
A report by The Boston Consulting Group, June 2010

Cross-Border PMI: Understanding and Overcoming the Challenges
A Focus by The Boston Consulting Group, May 2010

Megatrends: Tailwinds for Growth in a Low-Growth Environment
A Focus by The Boston Consulting Group, May 2010

M&A: Ready for Liftoff? A Survey of European Companies' Merger and Acquisition Plans for 2010
A White Paper by The Boston Consulting Group and UBS Investment Bank, December 2009

Searching for Sustainability: Value Creation in an Era of Diminished Expectations
The 2009 Value Creators Report, October 2009

Be Daring When Others Are Fearful: Seizing M&A Opportunities While They Last
A report by The Boston Consulting Group, September 2009

Fixing What's Wrong with Executive Compensation
A White Paper, by The Boston Consulting Group, June 2009

Real-World PMI: Learning from Company Experiences
A Focus by The Boston Consulting Group, June 2009

NOTE TO THE READER

About the Authors

Matthias Krühler is a project leader in the Hamburg office of The Boston Consulting Group. **Ulrich Pidun** is an associate director for corporate development in BCG's Frankfurt office and European topic leader for corporate strategy. **Harald Rubner** is a senior partner and managing director in the firm's Cologne office and a BCG Fellow.

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3/12

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