

EVALUATING THE FIT OF THE PARENT COMPANY WITH BUSINESSES TO DEVELOP CORPORATE STRATEGY (CASE STUDY: IKCO EMPLOYEES COOPERATIVE)

MOHAMMADALI SOBHANALLAHI
FARZANEH ASLIBEIGI

*Technical-Engineering Faculty
Kharazmi University, Tehran, Iran*

HOSSEIN RAHMANSERESHT

Business Management School

AllamehTabatabaie University, Tehran, Iran

Abstract

Deciding business portfolio, investment approach, and parenting management style need to understand how the fit of the parent company and its business, and the degree of potential of value creation by the parent. So, it is important to measure the fitness. This research which analysed factors affecting the characteristics of business and the parent company, offers a model to measure fitness. The proposed model has been implemented in a holding company and its results can be used to develop corporate strategy.

Keywords: Parent company, corporate strategy, value creation, parent company fit.

Introduction

The parent company as an organisation that stands between the business units and investors needs to justify its existence as an intermediary. It needs to have what Goold and Campbell called parenting advantage. In corporate strategy, the concept of parenting advantage has similar power to help develop corporate strategies (Goold, Campbell, & Alexander, 1997).

As companies search for parenting advantage, they need to analyse and assess a number of inputs. They need to understand the strengths and weaknesses of the existing parent organisation: What are the current characteristics of the parent? They need to understand the nature of business currently owned by the parent: What are the parenting opportunities in these businesses?

These inputs do not provide direct answers for corporate strategy. Rather they provide understanding that is useful in the search of value creation insights. This search is an essentially creative process guided by the objective of parenting advantage: The strategist is searching for a strategy that will give the company parenting advantage (Goold et al., 1997). The outputs of this strategy development process are decision about which businesses to include in the portfolio and decisions about how the parent organisation should be designed. This process can help the “strategic architecture” that is used as a tool in order to decide which core competences to possess or develop (Hamel & Prahalad, 1994). Meanwhile advances on strategic alignment of business need to related information systems (Kajalo, Rajala, & Westerlund, 2007), so the fitness result can be

used to design the information systems between parent and subsidiaries. Therefore, to achieve a systematic model to evaluate the fitness of the parent company with business, research is required and this paper identifies factors affecting fit and proposes a method for evaluating how to fit of the parent company and businesses.

Review of Previous Studies

Diversification in the 1960s—the concept of holding in different businesses and industries—was developed. However Rumlet (1986) from Harvard University, in a study of Fortune 500 companies, classified company businesses into single business, dominant business, related business, and conglomerate (unrelated) business categories and showed among these classes, related diversity creates better results than other classes (Rumlet, 1986).

In the 1980s, theorists such as Peters and Waterman in their book “In search of excellence” introduced the concept of “stick to the knitting” (Peters & Waterman, 1982). This means staying with the businesses in which the knowledge, skills, understanding, and experience, can be focused. In the 1990s, Prahalad and Hamel have developed the core competency concept (Prahalad & Gary, 1990; Babaei Zaklily & Mohammad Ali, 2004). Core competencies are capabilities that provide value to the customer and the customer will understand it.

The parenting decisions on business strategy was widely followed by Porter in research in 1987 (Porter, 1987; Goold & Campbell, 1997; Collis & Montgomery, 1998; Johnson & Scholes, 2008 Ruefli & Wiggins, 2003).

According to Porter (1987), and Johnson and Scholes (2008) one of the main reasons for the failure of many diverse companies is that they do not consider fitness and the parenting management styles in investment (Rahmanseresht & Afshin, 2010).

Probably the most influential people to introduce parent management styles were Goold,

Campbell, and Alexander (1994). Their research led to the identification of management styles at the corporate level, and parenting advantage and parenting matrix were developed (Goold & Campbell, 1987; Goold et al., 1994; Goold et al., 1997).

Definitions and Concepts

Corporate Strategy and Value Creation

A diversified company has two levels of strategy: business unit (or competitive) strategy and corporate (or company wide) strategy. Competitive strategy concerns how to create competitive advantage in each of the businesses in which a company competes. Corporate strategy concerns two different questions: what businesses the corporation should be in and how the corporate office should manage the array of business units. Corporate strategy is what makes the corporate whole, adding up to more than the sum of its business unit parts (Porter, 1987). Parent companies affect value in four ways through stand-alone influence, linkage influence, central function and services, and corporate development activities. In each of these areas, it is possible for parent companies to create value. It is more common, however, for these areas of influence to result in value destruction (Goold et al., 1994).

Parental Fit in Parenting Matrix

The parenting matrix developed by Goold and Campbell introduces parental fit as an important criterion for including businesses in the portfolio. Businesses may be attractive in terms of the BCG or directional policy matrices, but if the parent cannot add value, then the parent ought to be cautious about acquiring or retaining them (Johnson & Scholes, 2008).

There are two key dimensions of fit in the parenting matrix: ‘Feel’ the measure of the fit between each business unit’s critical success factors and the capability’s (in terms of competences and resources) of the corporate

parent, and ‘Benefit’ that measures the fit between the parenting opportunities, or needs, of business units and the capabilities of the parent (Johnson & Scholes, 2008). The power of using these two dimensions of fit is as follows.

Figure 1 shows four kinds of business along these two dimensions of feel and benefit:

1. Heartland business units are ones which the parent understands well and can continue to add value to. They should be at the core of future strategy.
2. Ballast business units are ones the parent understands well but can do little for. They would probably be at least as successful as independent companies. If not divested, they should be spared as much corporate bureaucracy as possible.
3. Value trap business units are dangerous. They appear attractive because there are opportunities to add value (for instance, marketing could be improved), but they
- 4.

are deceptively attractive, because the parent’s lack of feel will result in more harm than good (that is, the parent lacks the right marketing skills). The parent will need to acquire new capabilities if it is to be able to move value trap businesses into the heartland. It might be easier to divest to another corporate parent who could add value, and will pay well for the chance.

Alien business units are clear misfits. They offer little opportunity to add value and the parent does not understand them anyway. Exit is definitely the best strategy (Johnson & Scholes, 2008).

This approach of considering corporate portfolios places the emphasis firmly on how the parent benefits the business units. It requires careful analysis of both parenting capabilities and business unit parenting needs (Johnson & Scholes, 2008).

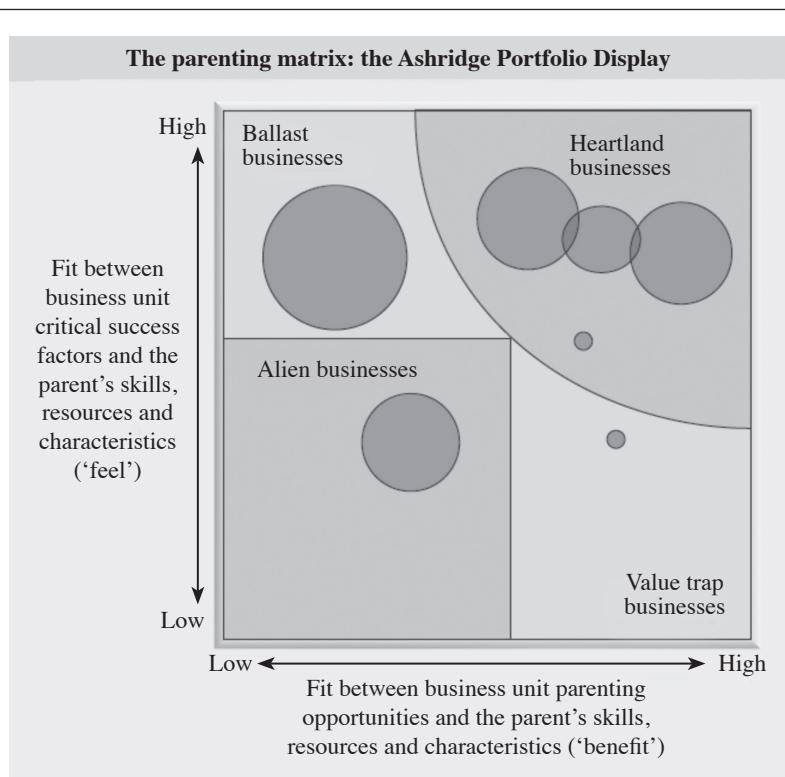


Figure 1. The Parenting Matrix by Johnson and Scholes (2008).

Parental Management Styles

Goold et al. (1997), based on parenting influence through the planning and control aspects in business units, identified eight

parental management styles. Three types were more common among them namely, strategic planning, strategic control, and financial control. Characteristics of each style are listed in Table 1.

Table 1

Parenting Management Styles

Components of distinctive	Parenting management style	Strategic planning	Strategic control	Financial control
Parental role	Develop strategies based on the synergy and potential relationships between businesses	Coordination and review of strategies, setting goals and making appropriate financial strategy and set strategic relationship between businesses	Tight controls to improve financial performance businesses	
Business role	Focus on implementation strategies	Develop strategies in coordination with the parent company	Business is independent but should adopt a strategy that meets the company's financial goals	
Fit level of business	Diversity-related	The relative diversity	Unrelated diversity	

Sources. Goold et al. (1994); Goold et al. (1997); Johnson & Scholes (2008); Rahmanseresht & Afshin (2010); Gottschalk (2007).

Factors to Evaluate the Fit between Parent Company and its Subsidiary Companies

Firstly, the strengths and weaknesses of the company's subsidiaries (the competitive business strength) and business opportunities and threats (industry attractiveness) are identified. Then the amount of feel and benefit of the parent company, according to parental characteristics, should be evaluated to estimate the fitness.

The characteristics of the parent company

According to Goold and Campbell, characteristics of the parent company are:

1. mental maps,
2. structures, systems, and processes.
3. function central services and resources.
4. people and skills, and
5. decentralisation contracts (Goold et al., 1994).

Based on these characteristics, a holding company with a philosophy of creating a unique insight to create value can be identified. In addition to parental characteristics, detailed analysis of the business is also an important part of the work.

Characteristics of business

After the definitions and scope of each business are determined, two sets of characteristics can be analysed per unit: parental opportunities in business and key success factors of that business. Business characteristics can be identified from two perspectives namely from within the organisation and outside the organisation. The organisation's ability to conduct business and subsidiary performance is assessed internally and response to market opportunities and threats of the business is considered being external. Parenting opportunities can be derived from several sources; such as business may be defined as poor, lack of skills and resource, strategy unacceptable, and excessive overhead of such resources.

The analysis should focus on the key success factors likely, affected including the parent organisation. This analysis may lead to changes in the parent organisation or business. So, three types of fit test can be used.

1. Does presumption of parent organisations or opportunities for value creation match with business opportunities?
2. Does any of the parental characteristics, have efficiency for desired business opportunities?
3. How is the fit of key success factors and parental characteristics?

Understanding key success factors of the business model and evaluating them, can provide a clear picture of the subsidiary characteristics.

Evaluating business based on SWOT

The business model is the logic of how a company creates, presents, and describes business value. According to Osterwalder's model, the business model consists of essential components namely customer segments, the value proposition, channels, customer relationships, revenue streams, key resources, key activities, key partnerships, and cost structures (Osterwalder & Pigneur, 2010).

Business model components

Customer Segments define the different groups of people or organisations an enterprise aims to reach and serve.

The Value Proposition describes the bundle of products and services that create value for a specific Customer Segment.

Channels describe how a company communicates with and reaches its Customer Segments to deliver a Value Proposition.

Customer Relationships describe the types of relationships a company establishes with specific Customer Segments.

Revenue Streams represent the cash a company generates from each Customer Segment (cost must be subtracted from revenue to create earnings).

Key Resources describe the most important assets required to make a business model work.

Key Activities describe the most important things a company must do to make its business model work.

Key Partnerships describe the network of suppliers and partners that make the business model work.

Cost Structure describes all costs incurred to operate a business model (Osterwalder & Pigneur, 2010).

Materials and Methods

This study sought to provide a model for assessing the fit between parent company and its businesses. Using designed questionnaires and semi-structured interview survey, data were collected. The results of the implementation in one parent cooperative of Iran Khodro Industrial Group, is now reported in the following sections.

The Research Phases

Three phases of the study, the research model, and a case study are described in the following:

1. Identify the essential factors in characteristics of parent company and businesses, and methods to measure them.
 2. Analyse parent opportunity to create value based on
- a. parental characteristics, and key success factors of any businesses and analysis of SWOT (to identify strengths, weaknesses, threats, and opportunity).
 - b. Evaluate the fit through relationship between parenting opportunities to create value with business.

Research Model

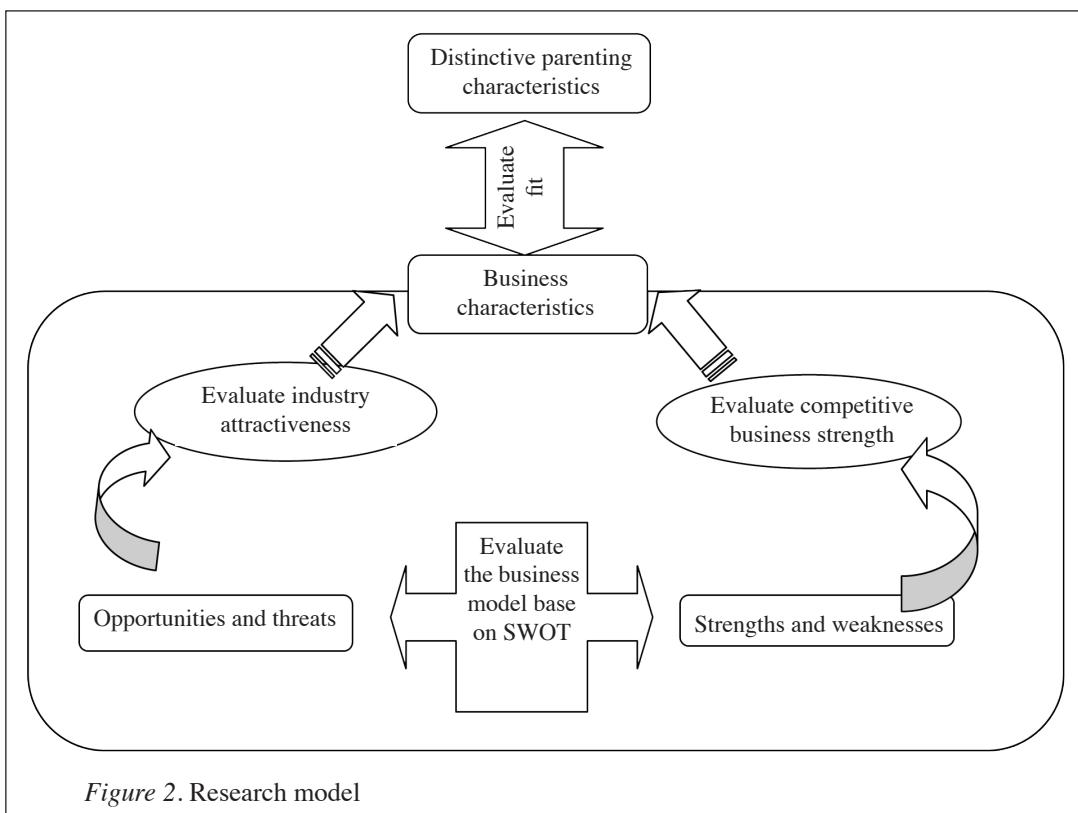


Figure 2. Research model

Table 2

Characteristics of the Parent Company

Characteristic	Measurement
Mental maps	Interviews with senior managers. Work experience of board members. Strategic direction of the board of directors in the last three years. Performance report in the past three years.

(Continued)

Characteristic	Measurement
Function central services and resources	Interviews with managers. Current structure, regulations, and procedures in parent organisation.
Decentralisation contracts	Interviews with managers about delegation and decentralisation of the relationship
People and skills	Capabilities of personnel (based on skills, education, and work experience)
Structures, systems, and processes	Organisational structure and information systems.

Measurements and Empirical Exploration

Parenting characteristics

Table 2 shows how each of the components of the parental characteristics was measured in the parent company.

Business characteristics

In order to evaluate the capabilities of competitive business and industry attractiveness,

business model based on Table 3 was used to evaluate components. The business model based on SWOT analysis evaluates the strengths and weaknesses to assess competitive business and evaluates business opportunities and threats to assess the industry attractiveness.

Competitive businesses, industry attractiveness factors, and the key success factors of the business that were declared by expert of the parent company is presented in Appendix 1.

Table 3

Evaluation of the Components of a Business Model Based on SWOT

Revenue / cost structure	Infrastructure (key resource, key partnership, key activity)	Value proposition	Customer (segments, channel, relationship)
Strengths and weaknesses		Competitive business	
Opportunities and threats		Industry attractiveness	

To measure these factors, a questionnaire was designed. This questionnaire determined the weight of each factor in Appendix 1 and evaluated the different parts of the business model components (infrastructure, the value

proposition, customers and the revenue / cost structure) of various dimensions of industry attractiveness and competitive business by using a number of items (Appendix 2). Criteria and the items were provided by the parent company and

business experts' views. Items were measured using a Likert scale and responses were given by senior managers in the businesses.

1. Population:

The population of the questionnaire was all managing directors of the company's businesses. The questionnaires were sent to 35 senior executives in 16 companies. A total of 75% return rate of the questionnaires was observed and the results were compared with the key performance indicators, data from 12 participants were used in this study.

2. Validity and reliability of questionnaire:

The relationships described Appendix 2, cover all components of the business model and key success factors which was confirmed by the expert team in parent company and business units.

To determine the reliability of the instrument Cronbach's alpha was used. Using SPSS software, Cronbach's alpha value of 0.819 was calculated, which is acceptable for this research.

Determine the fit of the Parent Company for Value Creation in Business

Parent company's potential value creation can be evaluated by the parent company's potential to solve weaknesses, preserve and promote the strengths, use opportunities, and neutralise threats. In an analytical process, the correspondence, between each of the weaknesses and threats in business and opportunities that a parent company has because of parenting characteristics, is formed. Parent company's potential help for value creation was determined through questionnaires and interviews. The form for analysis that is shown in Table 4, was completed for each business.

Table 4

The form of Analytical Process to Evaluate the Fit

Help potential b_i	Approach of value creation	Addressing to parental advantage (parent characteristics) a_i	weight of the related key factors	Related key factors in business	Weaknesses / threats
Minimal					1
Low					2
Moderate					.
Very high					n

The first column group, parental help potential for each key success factor can be estimated as

very high, moderate, low, and minimal. The fit score for parent company and each business was

calculated using the following equation:

$$\text{The fit score} = \sum_{i=1}^n a_i b_i$$

An Application

Measuring the fit of Parent Company and Businesses

This study was carried out on a cooperative holding company to measure the identified characteristics and the fit of parent company and businesses. The senior management utility for

management styles was evaluated to compare with the results of the proposed model. Table 5 shows the value creation opportunity in businesses because of parental characteristics.

After identifying business strengths, weaknesses, threats and opportunities and analyzing parental potential help to businesses in removing the weaknesses and threats, the degree of fit was determined by the parent company and the business in accordance with Table 6. For simplicity of implementation, the parent potential help for each value creation opportunity was considered equally.

Table 5

The Value Creation Opportunity Because of Parental Characteristics

Improvement of provision (such as helping to provide raw materials timely and with good quality and cost, assisting in facilitating recent legal permits, etc.)	
Preparation and provision of technology, management, and development	
Assistance in resolving the problems of business with external stakeholders, such as institutions and government agencies, raw material suppliers, and shareholders.	Stand-alone influence
Assistance to business in certain circumstances such as liquidity crisis	
Support finance investment projects, and risky and long-term projects	
Infrastructure development (aid to development planning and control system – the establishment of a management information system, environmental studies, etc.)	
Human resource development (helping to recruit, motivate, train, and develop managers and employees)	
Assist key activities of value chain (such as the transfer of a number of experts to help the business in solving problems in product/service quality)	Central function and services
Help support value chain activities (such as helping to develop infrastructure, human resource development, and technology development subsidiary of the company) in comparison with competing holding	
Transfer of skills and resources of a business to another business and facilitate the sharing of resources and expertise among them	Linkage influence
Resolve conflicts and develop areas of cooperation between businesses in the prevention of intra-group competition (competition between affiliated companies)	
Find internal and external partners to execute joint ventures	Corporate development activities

Table 6
The fit Score in Each Business

Business No. 16	Business No. 13	Business No. 12	Business No. 11	Business No. 10	Business No. 9	Business No. 8	Business No. 7	Business No. 4	Business No. 3	Business No. 2	Business No. 1	The fit score
22	28	20	18	22	31	15	9	19	22	17	9	The fit score (based on 9)
6.4	8.1	5.8	5.2	6.4	9	4.4	2.6	5.5	6.4	4.9	2.6	The fit level
High	High	High	Moderate	High	High	Moderate	Low	Moderate	High	Moderate	Low	The fit level

Measuring Utility of Businesses and Parent Company's Experts

In measuring the utility of business managers and experts about parenting influence in planning and controlling aspects, strategic control management style was selected as the dominant mode. This result according to accepted fitness level for strategic control (Table 1), and result showed in Table 7 seem logical. A questionnaire

was used to determine utility management style. The questionnaire was based on questionnaires by Goold and Campbell from Strategy Institute in London. The population of the questionnaire was 25 managing directors in business units and the parent company. The questionnaires were returned (65% response rate), and the average was calculated for utility of parenting management style for nine participants (Figure 3).

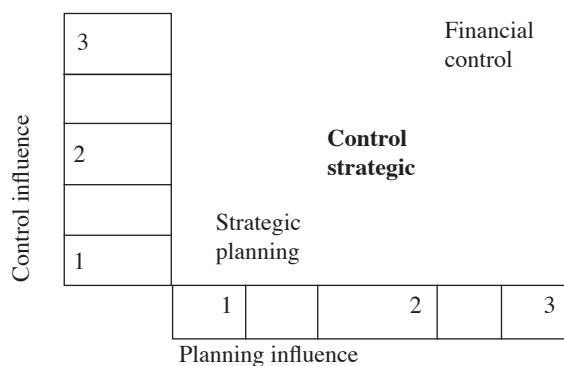


Figure 3. The manager's utility for parenting management style

Conclusions

Deciding on which business portfolio, investment approach, and parenting management style to choose, one needs to understand how the fit of the parent company and its business, influences the degree of potential of value creation by the parent. So, it is important to measure the fitness. This research analysed factors affecting the characteristics of business and the parent company, thus offering a model to measure fitness.

Proposed model has been implemented in a holding company and its results can be used to determine the corporate strategy of the company. The results showed that the proposed analytical model is compatible with the utility of managers regarding parenting management style. So, this model can be used to evaluate the fit of the parent company and business units. The suggested analytical model and the data analysis process provide ideas for better strategic architecture and planning of corporate strategy.

Appendix 1

Key Factors Affecting Competitive Businesses and Industry Attractiveness

Industry attractiveness	Competitive businesses
Market growth rate	Ability of technological innovation in the production process
Number of competitors	Ability to use different aspects of e-commerce for business
The total risk of return of investment	Product or service with lower costs (economic scale of production)
Entry barriers for new competitors	Product or service quality
Variability of demand variables	Establishing appropriate distribution (wholesale and retail)
Bargaining power of suppliers	Techniques for rapid and accurate evaluating market and customer segmentation
Impact of governmental laws and regulations	Commercial and business skills
Opportunities for different products and services	Properly advertise according to customer segmentation
Market profitability	Factors related to human resources (skilled and efficient)
Fluctuating prices	Factors related to financial resources
	Ability to rapidly respond to changing market conditions
	Experience in business management
	Good brand image among customers
	Factors associated with key partnerships with suppliers, contractors, etc.
	Access to raw materials and services needed
	Market share in business
	Margins related to business
	Customer service
	Communication with customers

Appendix 2

Item Measure to Determine Competitive Business and Industry Attractiveness

Systems and procedures to support the adoption of new ideas for innovation and value creation	Ability of technological innovation in the production process	Competitive business
Management systems to support business value defined	Ability to use different aspects of e-commerce for business	
Cost of services / products offered in comparison with competitors	Product or service with lower costs (economic scale of production)	
Affordability of operating costs		
Key activities to be effective		
Introduce innovative approach and new models to the market		
Alignment of the business proposition customer needs	Product quality or service provided	
Quality of products / services compared to other competitors		
Communication channel for the delivery and distribution of products to customers	Establishing appropriate distribution (wholesale and retail)	
Implementation of communication channels with customer segmentation		
Customer segmentation	Techniques for rapid and accurate evaluation of market and customer segmentation	
Communication channels to promote products services	Commercial and business skills	
Proper advertising according to customer segmentation	Proper advertising according to customer segmentation	
Human resource with the expertise needed to create business value proposition		
Clear vision of future business objectives		
High employee motivation and satisfaction		
Clear responsibilities in delivering value proposition to customers	Factors related to human resources (skilled and efficient)	
Belief in responding to the needs of customers and their satisfaction		
Development of staff competencies		
Fair compensation for employees		
Employee loyalty		
Threatened loss experts		
Financial resource to create value proposition	Factors related to financial resources	
Sustainable revenue streams		

(Continued)

The ability to rapidly respond to changing market conditions effectively	Ability to rapidly respond to changing market conditions	Competitive business
Adequacy of management procedures and systems to provide a product or service		
Focus on opportunities rather than past successes and future goals	Experience in business management	
Proper management experience		
Efficiency of service delivery processes and product		
Customer loyalty	Good brand image among customers or the public	
Organisational image in the community		
Relations with key partners		
Balance between outsourcing and internal jobs		
Threatened security of the resource market	Factors associated with key partnerships with suppliers, contractors, etc. Access to raw materials and services needed	
Threat of losing key partners		Industry attractiveness
Partners willing to cooperate with competitors		
Commitment to a sustainable relationship based on a win-win with key partners		
Market share compared to the major competitors in the market	Market share in the business	
Margins compared to competitors	Margins related to business	
Support services provided to the customer	Customer service	
Rate of customers leaving		
Customers easy access to the communication channel	Communication with customers	
Quality of relations with customers		
Threat of becoming irrelevant communication channels with customers		
Threat of market saturation	Market growth rate	
Market growth in business		
Threat of replacement products and services by competitors	Number of competitors	
Threatening competitors to obtain market share current		
Risk of capital return in business	Total return of investment risk	
Probability of imitation of the key activities		
Barriers to entry into the market of products and services for business	Entry barriers for new competitors	
Replacement cost for consumers		

(Continued)

Variations in the demand parameters of customers	Variability of demand variables	Industry attractiveness	
Change in market demand			
Bargaining power of suppliers	Bargaining power of suppliers		
Impact of changes in governmental regulations on business	Impact of governmental laws and regulations		
Opportunities for better quality of services and products	Opportunities for different products and services		
Ability to assess customer needs more resources			
Opportunity to provide service to new customer			
Margins threatened by competitors and technology	Market profitability		
Opportunity to create more revenue streams and business models			
Threat growing faster than revenue expenditure	Fluctuating prices		
Sustainable revenue streams			

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