CEO: A VISIBLE HAND IN WEALTH CREATION?

by

C. K. PRAHALAD* and Y. L. DOZ**

* Harvey C. Fruehauf Professor of Business Administration at the University of Michigan, USA.

** Timken Professor of Global Technology and Innovation at INSEAD, Boulevard de Constance, 77305 Fontainebleau Cedex, France.

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C. K. Prahalad
Harvey C. Fruehauf Professor of Business Administration
The University of Michigan

Yves L. Doz.
Timken Professor of Global Technology and Innovation
INSEAD, France

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Abstract

CEOs have become increasingly visible in the value creation process of the firms they head and CEO compensation, as well as demands on their performance, have increased considerably. In this paper we argue that the essence of the work of the CEO is to maintain a dynamic harmony between their firm’s portfolio of businesses and activities, the value creation logic they hold, and the internal governance process they run. We observe that maintaining such harmony raises difficult action dilemmas, and argue that the high level of public security which surrounds many CEOs of larger firms has mixed consequences on their leadership capacity.
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During the past decade, many CEOs of large companies have become very visible public figures. Lee Iaccoca of Chrysler, in particular, can be credited with launching a new style of corporate leadership which included a public persona for the CEO. CEOs and the press appear to have enthusiastically embraced this approach. Consider, for example, the visibility of Jack Welch (GE), Bill Gates (Microsoft), Percy Barnevik (ABB), Edzard Reuter (D. Benz), Jan Timmer (Philips), Sir Colin Marshall (British Airways), Anita Roddick (The Bodyshop), Lord Weinstock (GEC), Akio Morita (SONY), Lou Gerstner (IBM), George Fisher (Kodak), and Micheal Eisner (Disney), just a few among many highly visible CEOs. These CEOs’ actions are chronicled and their strategies are scrutinized in public. The performance of their firms, good or bad, is often attributed, (not only by the business press, often on the look out for good stories and role models for their readers, but also by their directors and shareholders,) to their personal business savvy and leadership. Greater visibility has certainly focused attention on CEOs as individuals. But does a more visible corporate leadership reflect a new reality in the internal governance of large firms, or an epiphenomenon? Is it the result of a greater role for CEOs? Is public visibility reflecting the fact that CEOs now matter more? Probably more fundamentally, how much does the CEO actually matter and does the CEO help create wealth in a large firm? What is the work of top management? What is the value added of the CEO and the top management team in the new competitive game? Is the emergence of the CEO as a public figure necessarily good for the firm, or does it create a new set of problems? We will examine these issues in this paper.

The Growing Importance of the CEO and Top Management:

The past decade has brought unprecedented change to many CEOs. A wide variety of factors - deregulation, global competition, emerging markets, knowledge-driven competition, technological discontinuities, hostile take over moves, excess capacity, growing customer expectations, and the rise of non traditional competitors - have forced a fundamental
reexamination of the wealth-creation process of large firms (Prahalad and Hamel, 1994). Industry and corporate transformation is everywhere - from utilities to financial services.

In the midst of such transformation, top managers cannot take a "hands off" approach nor just content themselves with the good stewardship of the assets they find at the beginning of their tenure. Helping the firm navigate successfully through the complex and rapidly evolving competitive terrain has emerged as their basic task. Shareholders demand value creation. Strategic action is often required from the CEO. For example, stockholders have taken significantly more interest in strategy (e.g. Mr. Price, an investor in Chase stock, is reported to have pushed for the merger of the two banks, Chase and Chemical, to create a mega bank and reap the benefits of rationalization, Business Week, September 11, 1995) and are more willing to force the issue and replace the CEO, if the incumbent is unwilling to change (or is seen as committed to too traditional an approach) as was evident in the case of the CEOs of General Motors, Westinghouse, American Express, and Sears in North America, and Suez and Alcatel in Europe. Bigger risks beget bigger rewards, and CEO compensation has risen spectacularly through the past decade, and become tied more closely to their firm's performance. Conversely stock prices have become more dependent on who is appointed to the top position: investors believe the CEO matters.

The role of top management is no longer just control and coordination; it is anticipating, articulating and managing change. Change involves rethinking the portfolio of the firm, reconceptualization how that portfolio creates value for its shareholders, as well as rejigging the internal processes of governance, in short, reinventing the company. Top managers have to simultaneously manage the process of "forgetting old ways" and "learning new ways" both for themselves and for the organization. To anticipate and lead change the CEO needs to change faster than the organization, and manage his/her own role change proactively! CEOs have to find a balance between continuity, where it is essential to the self-confidence and commitment of their subordinates, and meaningful change where circumstances require it. Continuity in values and principles allows substantive business portfolio and internal governance changes. The task is intellectually demanding, politically sensitive, and administratively complex. It is no surprise that during the last decade, as the role of the CEO in wealth creation is getting recognition, he (she) is also becoming the object of so much public attention.
We will develop the role of the CEO and wealth creation in three parts. First, we will outline a framework for thinking about wealth creation in a diversified firm. This involves careful management of the quality of interactions between the configuration of the firm’s portfolio of assets, the CEO’s logic for value creation and the firm’s internal governance process. Second, we will identify some of the key dilemmas CEOs face in the process. Finally, we will discuss the implications of the emergence of the CEO as a public persona for the effectiveness of wealth creation.

The Wealth Creation Process:

Our understanding of the process of sustained wealth creation in the context of rapidly changing competition can be conceptualized as the interaction of three interlinked elements, as shown in Exhibit (1) below:

Exhibit 1

The CEO: A Visible Hand in Strategic Architecture

Sustained wealth creation requires the mobilization of an appropriate bundle of resources and assets. In a changing environment managers need to periodically reevaluate the configuration of assets and resources that they want to own or access. Invariably, therefore, portfolio reconfiguration is high on the list of new CEOs who are less constrained than incumbents by past commitments. A portfolio configuration choice carries with it, explicitly or not, a value
creation logic: How does this particular bundle of assets create value, over and beyond each business or/and each category of assets? The portfolio configuration sets the specifications of the value creation logic; while, in turn, the value creation logic sets rules for inclusion and exclusion in the asset portfolio. A thoughtful CEO works on both portfolio configuration and value creation logic at the same time. His/her theory of the business is about how they relate and support each other. The portfolio composition and value creation logic also drive the internal governance processes within the firm, the organizational, administrative and political reflection of the value creation logic. Governance is about deciding the basic organizational building blocks that constitute the diversified firm, as well as the processes and values that govern subunit performance disciplines, strategic and operational priorities, interunit relationships, and the appropriate internal dialogues and behaviors. As is obvious, internal governance has a significant influence on how the asset portfolio is managed, since it is the value creation logic in action, and therefore conditions the actual capacity of the firm to create wealth.

Wealth creation demands constructive and harmonious interactions between portfolio configuration, value creation logic and internal governance process. Building, maintaining and making such interactions evolve in the face of changing circumstances is the essence of the work of top management. To better understand this work we will first examine the three elements of wealth creation in some detail below, stressing that they need to be considered as separate, but that any top management choices can only be made from a consideration of their interdependencies:

**Assets and Resources: The Portfolio Configuration**

Portfolio reconfiguration is perhaps the most visible manifestation of CEO action in almost all major firms. Many firms have divested businesses that they had acquired only a few years earlier. Very few firms escaped diversification during the 1970s and early 1980s and refocusing the portfolio, afresh, in the late 1980s and early 1990s (Markides, 1995). What is the rationale?

In almost all cases, portfolio reconfiguration is based on a fresh assessment of the *meaning, basis and value* of relatedness among businesses in the portfolio, often resulting from a new
value creation logic. Relatedness is hardly a new concept in strategic management, but the emphasis in considering relatedness is shifting from seeing it as an economic given to seeing it as the result of managerial thought and imagination and of management choices about the kind of value creation logic they wish to pursue. While Wrigley (1970) started the research on patterns of diversification and performance, Rumelt's seminal work (1974) has been the cornerstone of the voluminous research work on diversification and performance during the last twenty years. Rumelt classified firms as related, related linked, related constrained and unrelated or conglomerate, based on (a) specialization ratio (percentage of business attributable to the firm's largest single business), (b) vertical ratio (percentage of revenues attributable to the largest group of vertically integrated businesses within the firm), and (c) related ratio (percentage of revenues attributable to the largest group of related businesses within the firm). While sales data were used to sort the diversification patterns into one of the four diversification strategies, the underlying logic for classification was product-market and technology derived. The tests of "relatedness" in this schema is "objective" in the sense that an outsider studying the portfolio can arrive at the same conclusion as that of insiders, making relatedness an economic given. This scheme, with minor variations, has endured. More recently, Dosi, Teece, and Winter (1994) showed that many firms are "coherent" diversifiers, meaning that their pattern of diversification is consistent with their learning and skill base. This pattern of diversification is path-dependent and idiosyncratic with respect to the firm. What might appear to be unrelated diversification in the earlier Rumelt schema may appear to be "coherent" here. This view of diversification is derived from the history of the firm. It raises the possibility that "relatedness" as seen by managers may be different from an "objective outsider's" perspective.

Relatedness, though, once no longer seen as a given, may be defined along various dimensions, not just the learning and skill development path of the firm.

1. Business selection: Perhaps the simplest form of corporate relatedness is merely to select "good" businesses. Although there is a lot more to General Electric's success, selecting businesses in leading positions, or with the potential to achieve leading positions, with activities sheltered from the most ruthless forms of competition, is one of the cornerstones of the company's strategy. This value creation logic was clearly articulated by CEO Jack Welch. It is based on dominating an industry - being #1 or #2, or out. Less clearly stated, but well
understood, are the other assumptions behind the logic: relentless cost reduction, picking businesses not subject to intense Japanese (and Korean) competition, and where the playing field favors Americans. All these criteria for value creation can be applied to the entire portfolio of GE. Every one of the businesses, as stand-alone entities, can apply these tests and so can corporate. When Jack Welch became CEO, many of its businesses were already dominant players with world scale (if not world wide) operations such as lighting, appliances and medical systems. Welch had a varied enough portfolio to buy and sell businesses. Relentless cost cutting prepared many of them for effective global competition. These underlying strengths allowed the creation of much shareholder value from selective divestments and acquisitions.

Conversely, the plight of Philips stems largely from inescapable exposure of its core businesses to ruthless Asian competition and to starting positions that had eroded over time with little portfolio redeployment and insufficient selectivity.

Dynamically, a business selection logic can also start with value-creating industry consolidation. Industry fragmentation can lead to the prevalence of poor general management skills, given a large number of small firms, to under investment in technologies, and to an inability to capture the value of scale that may be invisible to the incumbents. Poor capital market systems, as in many developing (and planned) economies can lead to the same inefficiencies in an industry. Industry consolidation can also build barriers to entry unavailable to a fragmented one. Hence, a portfolio of assets can be assembled (often through acquisitions), with the goal to rationalize an industry and extract value from the process of industry consolidation. This approach was common in many industries during the 1960s and 70s (e.g. elevators, cement, and retailing in the USA and in the UK) and is becoming common again (e.g. financial services, entertainment, telecom, airlines...). ABB’s strategy of consolidating the electrical power business is a good example of this perspective on the portfolio consolidation. Corning’s very successful entry into medical diagnostics labs was predicated on a similar logic. Some entrepreneurs, such as Wayne Huizenga, have exploited consolidation and rationalization opportunity repeatedly, in various industries.

2. Parenting similarities: Creating value from an unrelated corporate portfolio is easier when the businesses share common strategic and managerial characteristics. For example, Hanson
Trust has always been described as an unrelated diversifier with businesses as diverse as brick making, coal, jacuzzis, and chemicals. Hanson managers, though, believed that their businesses had common characteristics and required similar management skills. Hanson's criteria for fit into their portfolio were: basic businesses providing good, essential products, not high tech, not people intensive business, good management at the operating level, reasonable asset backing, stable rate of change, good cash flow, and discrete businesses (Haspeslagh & Taubmann, 1992). This view is based on what Goold and Campbell (1994) have called the parenting advantage; the capacity of corporate management to add value to the business units based on a common set of corporate capabilities. Interestingly, though, Lord Hanson was not sufficiently convinced that Hanson's advantage was corporate rather than individual and would survive the death of his partner and his own imminent retirement. In early 1996 he announced the split of Hanson Trust into four separate companies in different sectors.

3. Core Competencies: Considering relatedness from the standpoint of core competencies (Prahalad & Hamel, 1990) yields a totally different view from that of parenting advantage. A very diversified portfolio such as Cargill's (commodity trading, meat, chicken and pork processing, salt, fertilizer, petroleum trading, mini steel mills, financial services, citric acid, orange juice, animal feeds, and seeds) would be classified as unrelated. But top managers inside the firm may think and act otherwise, as reported by Cargill's CEO Whitney MacMillan:

"Experience in the handling of bulk commodities, knowledge of trading, processing expertise, international understanding, risk management; these are the attributes of Cargill that underpin all our businesses. These core competencies represent the collective learning and judgment of all our 125 years of experience in all our businesses. They have been built over the years as the result of an unending process of refinement and improvement. They help hold us together and give us a sense of unity of purpose that would otherwise be difficult to define. They drive our development of new business opportunities and shape our ability to respond to future challenges.

"What is the largest risk facing a multi-product line, multi-geography, multi-cultural, multi-lingual, multi-national corporation in maintaining core competencies and developing new ones? In my opinion, the largest threat is in our own organizational insularity. We must guard against the trap of becoming so locked into being diverse lines of business and different
geographies that we lose the ability to leverage our resources and expertise to their full potential.”

Relatedness, in Cargill for example, is not based on product-market configuration, nor technology similarities, but on shared competencies and knowledge assets. Different businesses within Cargill demand different parenting skills from the parent, in contrast to Hanson’s logic, but all share a common set of core competencies. Cargill is not alone in taking this approach. Many other seemingly diversified firms would consider their diversification as related. 3M, Canon, NEC, Sony, P&G, and ABB, are some examples.

4. Interbusiness linkages: In some portfolios, managing the interlinkages provides value. For example, the distribution efficiencies and the clout with retailers of P&G, as a portfolio, is different from what any one of its businesses can command. But this value would not be realized if its stand alone businesses in the portfolio independently negotiated terms with major distributors such as Wal Mart. Similarly, ABB involves many of its different businesses in major contracts in emerging economies such as China or India, and GE adds the strength of its financial service operations to support such deals. P&G, ABB and GE have to manage their businesses differently from Hanson. Hanson would consciously avoid benefits from such a coordination and prefer the accountability to performance that their system provides. Hanson made no pretense of constructing synergies between his acquisitions, as illustrated by the operation of two of Hanson subsidiaries, Imperial Tobacco Limited and Elizabeth Shaw (a chocolate firm). Both were based in Bristol, England, and delivered goods to newsagents and corner shops throughout the United Kingdom. Yet Hanson was opposed to any sharing of distribution resources on the ground that any economies of scale would likely be outweighed by "the general sloppiness that would result if each company thought that distribution was the other's problem". (italics added; Haspeslagh & Taubmann, 1992).

5. Complex Strategic Integration: Core competencies which transcend individual businesses in the portfolio not only create the basis for value creation by enabling the discovery of valuable new interlinkages as in the previous case, but more importantly the identification of new business opportunities which draw on competencies from multiple units and reconfigure them in creative ways (Burgelman & Doz, 1997). The goal here is to create a portfolio that is capable of internally generating new businesses; yielding a capacity for self-revitalization.
Hewlett-Packard with a clear focus on creating businesses at the intersection of Measurement, Computing and Communications (its so-called MC2 strategy) represents one such portfolio. In 1994, more than 60% of the sales of Hewlett-Packard came from businesses that did not exist in 1990. Nearly all the growth came from internal development of new products and new businesses. Value creation in such a portfolio is as much about growth and proactively reinventing the business portfolio based on core competencies as about rationalizing existing assets or defending existing businesses.

Our quick review of various types of portfolio configuration logics suggests that relatedness, contrary to the view in the literature, may not be an economic given but remain very dependent on the cognitive framework of top managers (Prahalad & Bettis, 1986; Stimpert & Duhaime, 1997). Song (1992) showed, for example, that diversification strategies are significantly influenced by the experience of the CEO.

Identifying the appropriate configuration of the portfolio, in contrast to deciding whether a portfolio is related or unrelated based on simple, universal tests, is a top management task. But how to assess a portfolio logic, once one escapes the simplifying assumption of objective relatedness to accept the view that relatedness is in the eyes of the beholders, puts the burden of creating a robust logic squarely back on the shoulders of management.

Creating the portfolio configuration logic, from a CEO perspective, is based on asking the following questions:

1. What is the value of a bundle of assets and businesses combined as compared to the value of these businesses as independent units? Why should we have a portfolio of businesses? The portfolio must benefit business units, and the business units must add value to the portfolio. The relatedness among the businesses in the portfolio may not be obvious at a first cut analysis. Often, the most valuable dimensions of relatedness need to be discovered. Top managers must be able to articulate the value of relatedness or the reason for a business to belong to the portfolio.

2. Which underlying value creation logics are at play (from the selection of well-positioned businesses to the discovery of new “white space” opportunities through complex strategic
integration)? While some CEOs, such as Lord Hanson, focus on one logic, others, such as Percy Barnevik at ABB, attempt to develop a composite value creation logic. How good is the match between the portfolio of assets and the value creation logic one wants to apply?

Top managers must be able to articulate the incremental value created by managing the increasingly complex portfolio logic as one moves from industry rationalization and portfolio restructuring to internal growth through active management of the competency portfolio. The portfolio logic will force two kinds of questions: What kinds of assets do I want and what connections between these do I need? It is obvious that these questions are interrelated. The logic of the portfolio is a result of the history of the company (the cards that one is dealt) and the creative interpretation of opportunities by top management of the firm (how well one can exploit a hand). The CEO's role in developing a process for this creative interpretation of opportunities plays an important role in arriving at the portfolio logic.

The Value Creation Logic: The CEO’s Theory of Relatedness

Implicit in the choice of portfolio configuration, if not explicitly articulated by the CEO, are assumptions about how the firm will compete and create value over and beyond what separate businesses could achieve. Value creation logic is about understanding the business model, resource intensity, risks, and the critical competencies needed for success as a diversified corporation. To clarify the point, let us consider some explicit statements of the value creation logic.

Each one of Hanson Trust’s businesses is strategically defensible and differentiated. Each commands significant market share. These businesses are unlikely to attract new competitors or be subject to radical technological change. Under these circumstances, good general management disciplines, budgeting, controls, incentives, autonomy, and low overheads, can provide opportunities for extraordinary value creation. From the perspective of a business, the advantage of belonging to the Hanson portfolio is derived from the general management disciplines provided (imposed) by the parent. From the perspective of the group, it is having strategically defensible businesses that enjoy monopoly types of advantage. Further, high quality managerial skills might not be available to the businesses as stand alone entities in
some mature industries. In sum, Hanson is able to attract and retain better managers than "member" companies could on their own and to give them better management tools.

To an extent General Electric follows a similar logic, but on a global scale. GE is in a wide variety of businesses - from lighting to financial services. The original portfolio logic was business selection, the simplest in our categories of portfolio relatedness. GE sold businesses where the #1 or #2 criteria could not be met, such as consumer electronics, and built up its activities where it could, such as in medical imaging. The portfolio restructuring at GE, during Jack Welch's regime, was accomplished by divestment of more than $7 billions worth of businesses and acquisition of more than $17 billion. More than 52% of GE today is in financial services. Second, the GE management process imposed discipline on the various businesses and improved their performance. Third, and this is where it increasingly departs from the value creation logic of Hanson and other conglomerates, GE is able to selectively move to managing interbusiness linkages, for instance using its finance arm to lease large systems such as jet engines, power plants, or medical systems, GE, though, was unable to move to create new opportunities. In emerging businesses such as "factory with a future", being #1 or #2 had no meaning. When GE invested in it, the factory automation industry was just emerging, boundaries of businesses were unclear and the firm faced nontraditional competitors. GE, in this business, went for scale, as in other businesses. A series of acquisitions were made, and after some experimentation, GE quit the business. The logic of a priori portfolio selection applies only to existing businesses with reasonably clear boundaries. Being #1 in multimedia industry, at today's stage of evolution of the industry, for example, means very little, so did it in factory automation ten years ago.

While the value creation logic at GE is clear (and is now blindly adopted by many CEOs as a model for their own company), and its success widely hailed, it is important to recognize that Welch started with unique endowments. Not all firms, nor CEOs, do. For instance, the value creation logic at Motorola is quite different. Since it never enjoyed such a rich endowment of businesses as did Welch at GE, nor businesses which could be sheltered from Japanese and European competition, its value creation logic is based on quality ("6 sigma"), continuous and radical improvements ("10 X"), positioning oneself at the beginning of the wave of growth in emerging businesses such as (successively) semiconductors, mobile and cellular communication, and in emerging markets such as China, the ASEAN, and India, and
integrating technologies and markets into mutually supportive patterns. Implicit in Motorola's value creation logic is the capacity to bet on new products, scale up, grow rapidly, price aggressively, be global, and obsolete oneself. The value creation logic is more demanding here than in "richer" companies. This is a very different logic from GE's.

The value creation logic a CEO can feasibly follow is thus the result not just of the theory of relatedness the CEO adopts, but also of the original endowment of the firm he/she inherits and of the compatibility of different parts of the portfolio with elements of the value creation logic, and of the CEO's assumption about administrative and leadership skills in the company. Mature businesses are compatible with GE's value creation logic, emerging ones perhaps not; limited endowments forced Motorola to design a value creation logic to build strength in emerging businesses and markets. Motorola's logic, though, is strategically and organizationally very demanding, in the sense that it attempts to maximize value creation from limited assets in a competitively exposed situation.

In order to co-select their portfolio configuration and their value creation logic, particularly the most demanding ones, managers must develop a point of view about likely patterns of industry evolution as well as an approach to influencing it. Intellectual leadership of an industry is a critical ingredient in developing new businesses (Hamel and Prahalad, 1994). Examples of inventing new value creation models, even in old established industries, for single businesses are numerous. Consider the following:

a. Swatch took leadership in the wristwatch business by bringing high fashion, European design, excellence and low cost in manufacturing and technology, and continuous product development to an industry where the Swiss had lost leadership. It is the marriage of high fashion with high technology; fashion and efficiency, that represents a new model of value creation. Seiko and Citizen did understand and optimize on efficiencies - their model of value creation- but did not see the industry ready for fashion a la Swatch.

b. Nike has brought advertisement intensity, design, advanced technology, market segmentation, global logistics, to an old, traditional industry
c. Levi is experimenting with mass customization, with uniquely "fitted" jeans, "just for you", based on new information technology and new manufacturing and logistics capability.

Benetton, Charles Schwab, Wal Mart, CNN, Southwest Airlines, and British Airways, are all examples of firms inventing a new value creation logic for a business. How does one know that the new logic is appropriate? In order to discover a new value creation model, one needs to develop industry foresight (a unique point of view regarding the patterns of industry evolution) through a thoughtful and imaginative assessment of underlying market drivers, trends and critical discontinuities. Given a perspective, managers need to validate it through a process of market based experiments at low cost (Hamel & Prahalad, 1994). Ultimately, it is the market that validates a new model. Top managers must ensure that the industry foresight is based on deep understanding of the forces of change, rather than their stylistic preferences. This calls for a process of discovery inside the firm- one that involves a large number of people at all levels in the organization such that a wide variety of inputs are gathered and synthesized (Hamel, 1996). The goal of this process is not one of analysis but of creating a new synthesis; identifying new opportunities that are often "invisible" to industry incumbents. Developing such a new value creation logic can be compared to disciplined imagination (Szulanski & Doz, 1995).

Moving from individual businesses to related, but diverse, competencies and markets, adds a level of complexity, and as we suggested, few firms seem to have a clear interbusiness value creation logic: HP, Motorola and Kodak may be exceptions. Part of the difficulty stems from how tightly the portfolio logic and the value creation logic are intertwined. Discovering new opportunities and innovative business model(s) impacts the approach to portfolio configuration. On the other hand, a decision on the portfolio suggests an implicit value creation logic. Hanson and Hewlett-Packard are distinct both in their portfolio, their opportunity horizon and therefore, their value creation logic. Most top managers do not deal with this interrelationship explicitly. While the portfolio is frequently reconfigured, the underlying value creation logic is not explicitly reexamined. Identifying a set of business opportunities based on existing portfolio of core competencies and identifying a set of core competencies that will be needed to manage a desired portfolio of businesses in the future is a creative task. Different managers can discover new patterns of relationships, based on
competency assessment, across existing businesses in their portfolio as well as new businesses that could be added to it (Burgelman & Doz, 1997).

Once made explicit, the value creation logic becomes the intellectual link between the actual business portfolio and the governance of the firm. As well as what tangible assets to include, the basic business models and risks (the object of the value creation logic) for individual businesses and for their integration determine the competencies that have to be nurtured. For example, in a portfolio where value is created by continuous development of new products and businesses drawing on competencies and expertise dispersed between existing business units, as in Motorola, Kodak or HP, it is important to manage inter-business unit relationships, as well as to continuously reconfigure resources to address emerging opportunities (Galunic & Rodan, 1997). Stability to business unit charters is not a virtue here. In fact, it may become a limiting factor (Galunic & Eisenhardt, 1996). On the other hand, the charters of business units can have great stability in Hanson Trust. Hanson's value creation logic is based on each business operating as a stand-alone entity focusing on achieving the lowest cost position. The extent and form of encouragement and incentives to inter-unit cooperation are also a function of the value creation logic, and so is the balance between induced strategies and autonomous renewal.

Articulating the linkage between portfolio configuration and value creation logic is not easy for CEOs. First of all, the two often remain treated separately in their minds. While CEOs are willing to discuss the logic for the portfolio configuration very explicitly, they do not often articulate a model of value creation for it. Value creation logic is either ignored or remains implicit. GE, Hanson, Motorola are exceptions. This leads to a consideration of the merits of each commitment decision individually, and thus probably to an underestimation of the potential for higher levels types of portfolio configurations, and the need for interbusiness linkages and complex strategic integration processes.

Second, generic non-strategic logics of value creation are widely accepted by managers, irrespective of the nature of their portfolio, and relying on these logics sometimes exempts them from a more strategic look at their configuration. Restructuring and reengineering are the most popular non-strategic value creation logics. They provide a denominator driven, cost reduction model. Cycle time reduction is another. While attention to cost, productivity and
cycle time are crucial, these focus on efficiencies. Wealth creation is about growth and new business development as well - the management of the numerator. Once a top management team accepts this notion that sustained wealth creation is also about profitable growth, then generic, cost reduction oriented models have less value. One has to discover a unique logic tailored to the portfolio (and alternatively a portfolio that may fit a value creation model). The vogue of reengineering, and the very real productivity gains to be achieved, have blinded many CEOs to the need to be strategic in how they think of value creation in their firms.

Third, the portfolios of firms are not always amenable to a coherent value creation logic. Consider Kodak. Kay Whitmore, Kodak's CEO in the early 1990s, had struggled to identify and validate a portfolio logic, but some of his assumptions, such as the advantage of being active both in chemicals and pharmaceuticals were questioned from the start. Kodak's portfolio, in 1993, consisted of chemical imaging (film and paper), copiers, printers, medical reagents, over-the-counter and proprietary drugs, bulk chemicals, and cleaners. Under the new CEO, George Fisher, the portfolio has been pruned to an Imaging Business (chemical and electronic) which can capitalize on linkages and new opportunities. Other businesses have been divested - Eastman Chemicals, Sterling Drugs and Lysol Cleaners. The value creation logic in fast moving imaging businesses is certainly different from that in bulk chemicals!

Fourth, because integrating a portfolio configuration and a value creation logic, conceiving of and deciding on relatedness, is such an individual and time dependent process, mistakes can and often do happen. For example, Daimler Benz diversified all through the 1980s due to the conviction of Edzard Reuter and his team that they would become a "one stop shop" for all communication needs of society - be it motor, air, or rail transportation or telecommunications. Similar visions of one stop shopping for financial services or multimedia products abound. However, consumers may want to have a choice and not be constrained by choices made for them by one vendor. Daimler Benz may have assembled, via a series of acquisitions, all the skills needed to be a "one stop shop for transportation" but the customers may not wish to give it so much power. A reality check, therefore, is in order. Reuter's successor, Jürgen Shrempp, quickly started shedding businesses (Fokker and Dornier in commuter planes, most of AEG's businesses in electronics,) and putting others into joint ventures with partners for whom they are more strategic: (rail transportation with ABB, missiles and satellites with Matra,) perhaps as a prelude to divestment... In contrast to Daimler
Benz under Reuter, other companies may suffer from CEOs whose value creation logic is too tame, putting too much emphasis on subunit autonomy, but in so doing leaving too many opportunities where interunit linkages are key, ignored or mismanaged. AT&T's travails in international development and its ultimate de-merger into three companies may be an example of underachievement by design: the portfolio configuration choices called for an integration value creation logic, but the governance logic emphasized line of business autonomy. Failure here is less visible than at Daimler, since it takes the form of opportunity costs, for instance in penetrating emerging markets.

Fifth, value creation logics become obsolete, and CEOs do not always notice it. Intel had become much more successful at microprocessors than at memories before its CEO noticed (Burgelman, 1994; Burgelman & Grove, 1996). In the airline industry, British Airways, among all European airlines, noted the importance of information technology and adopted yield management innovations much earlier than its competitors who remained wedded to a technical (e.g., Lufthansa) or political (e.g., Air France) logic of value creation (Lehrer, 1997). Swissair became an outstandingly successful caterer before its top management became aware of how the way it created value had changed. Conversely, in the early 1990s, Gould's CEO decided to redeploy his company from traditional automotive components to fast-growing electronic ones, a laudable undertaking but one that ignored the deep differences between the two business and led Gould into deep trouble, bankruptcy and an emergency takeover by a Japanese company. Product types may evolve incrementally in ways that are hard to notice at first (Intel), the business may not ostensibly change but the foundational knowledge key to value creation may (airlines), the center of gravity of a firm's activities may move incrementally (Swissair), or management teams may wrongly emphasize continuity and miss out on discontinuities (Gould).

Last but not least, value creation logics and the portfolio configuration choices are almost never independent exercises performed by the CEO alone. They emerge at least partly from the internal strategy process and the interplay of subunit and corporate interests and perspectives. In that sense tomorrow's value creation logic results from yesterday's internal governance process, seldom an ideal situation! In many companies vested interests and concerns about centralization and corporate vs. subunit roles cloud the debate and prevent
incumbent CEOs from discovering or implementing new value creation logics. The CEO is hostage of the existing governance logic.

Internal Governance Logic: Value Creation in Action

Internal governance structures the "part-whole" relationships in a diversified firm. How are the parts defined? How do they relate to corporate management as well as to each other? How is the governance logic conditioned by the portfolio and value creation logic? These are some of the critical questions that CEOs face. An internal governance process that is inappropriate to the value creation logic will result in the firm not realizing the inherent potential of the portfolio.

We believe that a systematic approach to understanding the internal governance logic is a necessity. Such a logic is based on four building blocks:

1. **Structural clarity** based on a determination of basic administrative units into which the firm is divided,

2. **Administrative processes** that allow for dialog across units, enforcement of accountability, measurement and consolidation of performance,

3. **Basic premises** or key assumptions about the nature and quality of interactions between the building blocks of the company,

4. **Values, beliefs, and behaviors** that all employees are expected to understand and conform to.

We will examine each one of these below:

**Structural Clarity:**
Irrespective of the portfolio configuration of the firm, a large company has to disaggregate itself into smaller administrative units for management. It is also important to note that one needs to manage product and business areas, functional expertise, and geographies. In many
situations, program or project management can also be a unit of disaggregation. But at least in all large firms, there is a need for business, geography, and functional building blocks. (We have deliberately excluded from this analysis the need for managing conceptual overlays such as core competence on three basic dimensions of structural clarity).

In most firms, the debate is not about the need for three dimensions, but about the relative roles of the three dimensions, and which to pick to structure subunits, and along which to manage interactions between units. The issue of matrix organizations, the tensions over relative influence of the three dimensions in strategy and operational direction, and the pathologies accompanying unresolved conflicts between them are sufficiently well documented not to deserve special attention here (Davis & Lawrence, 1977; Prahalad & Doz, 1987; Ghoshal & Bartlett, 1990).

Disaggregation choices revolve around three issues: How small or big should a unit be? should each administrative unit have the complete set of resources it needs? and finally, how self contained should its mission be?

Some companies have rather deliberately broken themselves up into many units to set up an internal selection environment, either among existing activities (part of Barnevik’s motive in choosing ABB’s decentralized organization) or among new growth initiatives proposed by individual managers (eg, Johnson & Johnson, 3M, Matsushita). While a firm is going through a process of rationalization, disaggregating the firm into small, self-contained units can make sense. It provides a focus and clear accountability for cost reduction In other words the portfolio selection logic is most obviously consistent with radical decentralization. It is less obvious a choice as interunit linkages and core competencies are important. ABB, for instance is now backing out of its extreme decentralization. And obviously, where critical decisions are few but big, an internal selection process is hardly appropriate. Aerospace groups, which may be relatively diversified, but often have only a dozen key product programs, cannot be decentralized in the same way as 3M with its sixty thousand products.

Yet, it is important to recognize that no resource allocation process can enable top managers to cope with choices in any substantive depth if the number of subunits exceeds 30 to 45, a cognitive limit which CEOs of many large firms are intuitively coming to terms with. This
does not mean that senior managers responsible for sectors or large units cannot allocate resources to smaller business units within their sectors- a multi stage, multilevel resource allocation process. Further, intermediate level managers can encourage business units to collaborate with others for growth by identifying opportunities that transcend their individual business scope but may be beneficial to each. Very small business units can also lead to under investment in critical technologies and in emerging markets. So while firms such as ABB can describe their approach to decentralization as managing very large number of entrepreneurial units, the demands of internal growth and the increasing pressure for resource shifts across major businesses and geographies in most firms will require top managers to deal with fewer and larger aggregations. This calls for the maintenance, or resetting of intermediate levels of organizational aggregation. Key intermediate levels of general management are not dispensable. The portfolio and value creation logic will determine and limit the choices one can make in organization.

In a decentralized diversified company, managers responsible for an administrative unit (be it a SBU or a territory) will argue for a self-contained mission and a complete complement of resources. This makes them operate as if they were independent units and selectively draw on corporate services only as they deem fit. This approach to governance may be fine for Hanson (given its portfolio and value creation logic) but is it also acceptable for HP or Kodak? Are there too many opportunities that cut across any given configuration of administrative unit lines (say, a large project that cuts across several SBUs, or global account management that crosses several countries) such that any one-time determination of the boundaries and missions of SBUs (and national or regional organizations) will result in too many missed opportunities. The organization may need semi-permeable membranes separating the administrative units rather than brick walls. But then what is the meaning of a unit? a temporary project? a focal point for concentrating efforts and allocating resources? While R&D organizations have for long operated in that way, can the approach be generalized to a whole corporation?

Administrative Processes:
Significant research attention has been bestowed on the administrative processes such as budgeting, planning, performance appraisal, measurements, incentives and rewards and the supporting technical infrastructure of communication and information and control systems.
Without trying to review the abundant management control literature nor relate it to our argument in this paper, let us just argue that the nature of dialogue between administrative units and corporate management needs to be contingent on the value creation logic adopted by the CEO. The administrative and the technical infrastructure provides a formal basis and framework for dialogue within the firm such as plans for the year, budgets for the quarter, performance expectations, or common design disciplines (based on common CAD tools). The design of the infrastructures supporting these processes and the way they are used can have significant influence on the nature of the dialog as well as the ability to build a corporate architecture that adds value. The dialog can be arms’ length as in the case of Hanson. White, one of the Vice Chairmen of Hanson had this to say:

“I don’t even know all the presidents of our companies. I know their names, but I have never been to any of our plants. I’ve never visited our headquarters in Iselin, New Jersey, either. There is no need for me.” (Haspeslagh & Taubmann, 1992).

In this approach to governance, the dialog is primarily through the administrative systems and hence the need for strong budgeting controls and a strong management team at the business units. There is an assumption of "few surprises" - possible in slow moving, mature businesses. Conversely, to take an opposite example, the approach at Canon is best described as "heart-to-heart, mind-to-mind" communication (Tsushin Vision, 1995). Consensus decision making, deep personal knowledge of the businesses and markets by all levels is a prerequisite at Canon. The administrative control process can act as the backbone but not a substitute for intense and frequent personal communications across levels of management. In either case, Hanson Plc. or Canon, Inc., the need for a strong and appropriate administrative and technical infrastructure for facilitating the dialog is critical. However, the nature and the complexity of the administrative infrastructure, and how much of the subunit-corporate dialog it encompasses will be different depending on the nature of the portfolio and value creation logics.

While structural clarity and administrative processes provide the anatomy and the physiology of the company, the psychology of the company - how it acts within the broad framework of structure - is determined by the basic premises and the values, beliefs and behaviors.
Basic Premises:

What we call basic premises within the company are key expectations imposed by the CEO and top managers. For example, in GE, after the initial decentralization, Jack Welch has built a basic premise about "boundaryless" behavior to share information and best practices across boundaries, hierarchical levels, countries and businesses within the company. In this case the premise that a large firm represents a laboratory of good practices and that there is value in sharing these across boundaries transcends expectations of full autonomy created by the structural and administrative processes. In Hanson, another decentralized firm, conversely, the premise of autonomy of the business units implies that they need not talk to each other. The boundaries are sacrosanct. In HP and 3M for example, there is an expectation of continuous business renewal measured as a percentage of sales from new businesses. This premise imposes an expectation of growth, but more importantly, an expectation of internal growth. Line managers, in these firms, have an obligation to leverage their resources in terms of both efficiency and innovation. At Motorola, six sigma, as a premise, suggests that they will strive for perfection in all they do and in all their relationships - including with their suppliers. Ford 2000, is an expectation that the European and North American operations will collaborate. This is a dramatic change in expectations for Ford from its 90 year history of working separately across the Atlantic. Ford 2000 represents structural and administrative changes, but the big change is in the expectation of a qualitatively different dialog across building blocks, imposed on the organization by the new CEO, Alex Trotman. For a company that historically was very US-oriented, AT&T's premise of "anytime, anywhere" suggests a globalization intent. The new premise at Philips is "Let's make things better". It is about "taking the next step and making whatever it is you are making, better.... So, when people say " let's us make things better", they speak from the head, and from the heart. And while we've long been known for making better things, perhaps from now on we'll be known for making things better".

The goal for a CEO of setting and communicating basic premises in an organization is to indicate the nature and quality of interactions between structural building blocks as well as the limits to the use of administrative processes. It provides a way to interpret and temper the behavioral signals given by the structure and the administrative process. The structure may provide clarity to boundaries but it should not restrict the capacity of an organization to create wealth. The premises provide an expectation of quality of interactions (that cannot be
described in structural terms nor fully encompassed in measurement and control systems) among the building blocks.

Each basic premise has to be accepted company wide to be useful, as they normally temper the fragmenting forces of the administrative infrastructure. It is often a CEO sponsored initiative to implant them in the whole organization. It is a statement of how the CEO expects to create value, and of differentiation of his or her firm from others who may be similarly organized. Basic premises forces the organization to go beyond a sterile interpretation of relationships in the firm based exclusively on the formal structure and administrative processes. The roles and responsibilities of managers must be creative and evolving to incorporate adaptive behavior. This expectation leads to a focus on values and behaviors.

Values and Behaviors:
While structure and administrative processes provide the basic framework for organizing and monitoring the resources of the company, behaviors are critical to create an adaptive learning environment that allows for creative combination of resources to address new opportunities.

Two preconditions force the need for clearly understood values and behaviors. One, in a volatile industry environment. No structure can predetermine the nature of adjustments that need to be made. Managers must go beyond predefined roles. Matrix is not a structure but a mindset (Ghoshal & Bartlett, 1993). Second, as CEOs adopt more demanding portfolio logics, there is a growing need to constantly discover new opportunities which allow managers to leverage competencies creatively. Constant reconfiguration of competencies to address new opportunities will force frequent changes in structure. Business unit boundaries may have to be redrawn. Given such a precondition for leverage and value creation, values and norms of behavior become the anchor of stability and clarity, more than the formal structure. In an era of constant change in competitors, products, prices, customers, and resources, organizations need anchors to provide stability and comfort. Deeply held values and behaviors are the pillars of such stability.

There is a shifting emphasis in most firms from formal structures and administrative processes, critical as they are, to basic premises; and values and behaviors. Flexibility in resource reconfiguration, ability to learn and adapt continuously, to innovate and address new
market opportunities- all at the heart of value creation- requires emphasis on the "values and processes". However, internal governance is about seeking the right harmony between the four aspects described in this section.

The Search for Harmony:

The CEO and top management are at the heart of managing this harmony. The CEO is always plagued with issues such as: “How much do I rely on structure? on values and behaviors? How do I convince the organization that these values are critical and that I expect them to be followed in their daily work? What personal example should I set? Do I penalize managers for not supporting and living these values, even if their performance exceeds budgets? How do I communicate standards of behavior as a prerequisite for standards of performance?” These questions are at the heart of managing apparent contradictions such as demanding control and accountability of performance of sub unit managers, as well as allowing them to experiment and grow. Contradictions are about predictability of performance and, at the same time, promoting change, about providing clarity to existing configuration of business opportunities (existing SBU structure) and, at the same time, creating new "white space" opportunities, about managing within a structure and creating opportunities that lie outside the existing structure managing against or despite the existing structure.

The key to internal governance is understanding the implications of the portfolio configuration and value creation logics and using the four elements of governance to continually harmonize the complex and conflicting demands. The search is not for a static but a dynamic and evolving harmony. The CEO must search for both a harmony between the three logics as well as a harmony between the four elements of the internal governance process.

In searching for harmony, the CEO may reach different stable configurations of interactions between the three logics, or strive for a dynamic evolutionary capability. Hanson Trust constitutes a harmonious but static relationship between the portfolio composition logic, the value creating theory and the internal governance process selected by Lord Hanson. Hewlett-Packard, or Canon, on the other hand, constitute evolving configurations, where the harmonious relationship is around change processes. Where Hanson puts emphasis on formal
structures and processes, Canon and HP emphasize values and norms and basic premises and principles. HP's or Canon's value creation logics are of distributed entrepreneurship and evolving business portfolios, built around core competencies. While they maximize adaptation, they may not optimize the relationships between the three logics at any point in time.

Maintaining strategic harmony is a demanding action agenda for the CEOs, whose traditional approaches to internal governance were too often based on one of two approaches: In one, the stylistic preferences of the CEO drive the process. The CEO's preferred style, control driven, details oriented (e.g. Harold Geneen at ITT) or hands off, decentralized, ("if you meet the budget, you are out of trouble") prevails irrespective of the portfolio and value creation logics. In the other, tools are sometimes mistaken for personal leadership, as an increasingly formal approach to internal governance is fuelled by the ground swell of enthusiasm for decentralization. Consulting firms promote it. The desire to measure the contribution of a business unit by economic value analysis (EVA) makes decentralization a prerequisite. CEOs seem to like it as well. Is disaggregating a firm into stand-alone business units, (the result of decentralization in most firms as well as the necessity to apply EVA methodology), necessarily appropriate in all cases? We believe not. We believe that it is dysfunctional to endow governance principles such as SBUs, matrix organization, teams, EVA, decentralization or any other, with quasi religious sanctity. They all must be discussed, evaluated, and adopted, or not, in the context of a portfolio and value creation logic.

The CEOs’ Intervention Capabilities: The Dilemmas

In the process of searching for harmony between the three logics, the CEO must concern himself/herself with the bandwidth of intervention modes available to his/her. A CEO has at his/her disposal all the internal governance tools but must recognize that there are no universal solutions. No single package is useful in all cases, as it is likely to impose a dominant logic as a straightjacket on all businesses (Prahalad & Bettis, 1986). Neither can governance, in a diversified firm, be totally geared to the unique requirements of single businesses. That would be impossible to manage. Neither can the process be idiosyncratic and bound by the
stylistic preferences or personality of the CEO. It must be geared to the needs of the portfolio and the value creation logic, and encompass a range of differentiated intervention models.

Increasing the repertoire of intervention modes suggests that a CEO must start with a framework to define internal governance. It is useful to start with the following questions to develop such a framework:

1. What in the internal governance process is *non-negotiable and mandatory*? There may be three kinds of issues that are mandatory. First, applying the formal "rules of the game". In all the firms we know, accounting procedures are non negotiable. But, only in some, the technical architecture, often a critical precondition for sharing competencies and components across business units, is a non negotiable. Secondly, a few achievement or performance standards are non negotiable. In most firms, meeting budgets is one such non negotiable. Performing better than one's cost of capital is another. Thirdly, where you put your efforts is becoming non negotiable. For example, in all firms where CEOs have thought deeply about values, they are non negotiable. A deep breach of value, even when achieving outstanding performance is not acceptable. In some, commitment to customers and total quality are non negotiable.

2. What aspects of the internal governance can be *unique and tailor made* for a specific business unit, function or a geography? For example, compensation for attracting the right talent for a specific business can be a local decision.

3. What is the role of *perceived fairness in the system*? It is very important that all employees see the system as being inherently fair. Building employee commitment, loyalty and excitement requires a deep-commitment to fairness. But fairness is as much perception as reality. In allowing for uniqueness, a CEO must worry about it being interpreted as unfair practice. But fairness is not the same as uniformity of systems and procedures (W.C. Kim & R. Mauborgne, 1993). Uniformity can easily be seen as lack of fairness and courage, for instance when all units, no matter how successful, are required to cut investment.

4. *How can mixed signals in the organization be avoided?* In the desire to fine tune the system, one can easily create multiple interpretations of the expectations imposed on the
organization by top managers. The more a CEO uses precedents for establishing shared premises the greater the risk of mixed signals. For example, a demand for growth and at the same time pressure for profit improvement can be seen as a mixed (up!) signal if it is not properly explained to the organization. Mixed signals can paralyze an organization. However, creating the right level of tension and anticipation cannot be achieved without complex signals. The right balance is the key to high performance.

5. What aspects of the mix of governance mechanisms have the most impact? Which have the most associated costs? How do we understand the "invisible and hidden costs"? For example, what are the consequences of reengineering, downsizing, and multiple restructuring on the motivation of employees?

6. What is the level of due process built into the governance mix? Do people have a voice? How personally expensive is it for people to have their voice heard? Does the system provide for fair treatment of employees at all levels?

7. What is the balance between the investment in continuity and stability of the enterprise and the investment in change and flexibility? Continuity and stability to the team and processes within the firm dramatically reduce the costs of transactions as individuals start to work with each other, establish patterns of interactions, develop trust and accumulate intellectual assets. Continuity is a critical factor for knowledge accumulation and exploitation (Doz & Chakravarthy, forthcoming). On the other hand, over emphasis on stability in the context of dramatic changes in the external environment will create paralysis. Change and flexibility, which alter the pattern of interactions, work flow and skill mix in the organization are critical for survival.

8. Management is not about providing a static efficiency but continuous capability development. Efficiency at a point in time is critical to a high performance system. However, the building of the next round of advantages, the next practice, the next layer of efficiency and advantage, is equally critical. Quality of harmony between the various logics is measured not just by how well they knit together at a given point in time but by the ability of the system to push the next round of capability development.
In thinking about his/her role in harmonizing portfolio configuration, value creation logic and governance process, the CEO must recognize the inherent difficulties. The issues outlined above are the critical dilemmas. In addition, CEOs have to deal with substantive issues. For example, a significant part of the wealth creation opportunity is centered around stretching the imagination of the organization and focusing them on aspirations that are outside the range of the current resources of the company (Hamel & Prahalad 1994). But stretch can become fear and anxiety if not properly managed. Stretch is very motivational if employees voluntarily commit to it because of their understanding of the rationale for it, and turn imposed stretch into personal reach. Reach works if there is a compelling view of the future that is associated with it; if it provides personal meaning to every employee. On the other hand, if stretch is imposed administratively (as in budgets), it can lead to fear, anxiety, and dishonesty in the organization where managers stop being candid and start hiding slippage and sandbagging numbers. In some cases, an expectation of stretch targets by top management can create a sense of euphoria in the organization. Too much enthusiasm for growth, and change can also have the same effect as fear. Managers start feeding targets that are not grounded in reality. Hope is not a stretch target. Enthusiasm, like fear, can also create dishonesty in the organization. Reach is about commitment and not compliance, about voluntarism - giving the discretionary time, effort, and imagination on the part of the employee.

Similarly, a CEO in a large organization must strive to provide clarity to the tasks, values, performance expectations, and standards. The roles of various units must be clear and understood. This is the function of "keeping the machine well oiled and reducing the frictional losses" in the system. However, clarity must coexist with a capacity for experimentation. Over emphasis on clarity can kill enthusiasm for experimentation. Experiments that are likely to change the way the system is currently managed and challenge the dominant logic are a very critical element of longer term vitality in a large firm. CEOs must balance a commitment to the current system and at the same time provide support to the seeds that will challenge it.

Unless they are very careful, CEOs are likely to become too distant from the reality of the businesses that they are managing. A check on the calendar of a CEO can provide very useful hints on the distance that exists. Outside commitments, routine corporate reviews and corporate calendar, personal style and preferences, can leave very little time for in-depth understanding of the emerging opportunities - be it in the laboratories, in manufacturing or in
the changing mix of customers. Distance is a natural outcome of the job but staying informed of the key issues is a result of active management of one’s time and of installing ad hoc processes that bypass and transcend the formal ones. The expectation is not that CEOs must be gluttons for detail but must have enough understanding of the emerging detail to extract a sense of the essence. For example, a CEO today must know what is happening in the information technology business to recognize the impacts it will have on distribution and retailing, customer interface, focused marketing, logistics, distance collaboration, the nature of dialogue between individuals, teams, and administrative units, and the cost structure of businesses. The goal is not to become an expert on the details of "virtual reality" or large data base construction techniques, but to recognize the implications of these to the businesses (value creation logic) and to the internal governance processes. The goal is for the CEO to listen to the arguments, suspend judgment, and recognize that he/she cannot and need not have a solution to all the problems that the organization faces. Many of the solutions evolve and the CEO must unburden himself/herself from the self imposed (and sometimes culturally imposed) burden of "knowing the answer" to all questions.

**CEO Effectiveness and Public Image:**

It is obvious that the CEOs must creatively manage the harmony of the interactions between the three logics. But harmony depends not just on analytical skills but also on the capacity to motivate and provide an emotional dimension to the company. Analytics and passion, clarity and experimentation, efficiency and innovation must all coexist. Ideally, CEOs must be able to constantly and creatively balance these factors.

The reality is that CEOs, like others, have limitations. We can identify two major sources of limitations. One widely recognized source of limitation is the background and the stylistic preferences (limitations) of the CEO. While many a CEO intellectually recognizes the impact his/her stylistic preferences have on the internal governance processes, few have the persistence to modify them (Kets de Vries, 1984). The difficulty is in modifying behavior patterns and managerial frames that one has grown up with. The search for an outside CEO is often triggered by an intuitive feel, on the part of directors for the demands of a rapidly changing portfolio and value creation logics. These changes require a different internal governance logic. Boards come to the conclusion, often painfully, that nobody from the inside
can break away from the ingrained managerial frames and styles fast enough. Employing an outsider becomes a way of dealing with the limitations of the incumbent CEO and his team. The changes in Alcatel, IBM, Kodak, Sears, K Mart, and American Express are just some examples of this process.

There is another, somewhat subtle, limitation to the effectiveness of a CEO in balancing the three logics. The public image of the CEO can both facilitate or limit his/her capacity for managing the quality of interactions between the three logics. The public image is built by either a conscious decision on the part of the CEO to use it to influence the organization (to cut through layers of bureaucracy and reach the rank and file with his/her message directly) or a public persona is created by the press, with or without the cooperation of the CEO. The public image of the CEO has the same characteristics as the public image of a politician. CEOs cannot ignore their public image that evolves over time - it can be an advantage as it sets expectations, but can also act as a limiting factor (Sutton & Galunic, 1995).

The public image of the CEO is reflected in the organization. All employees have access to that image and interpret it. For example, employees at GE, based on the public image of their CEO Jack Welch ("Neutron Jack" as he was called in the press) can come to the conclusion that profits at any cost are a must; being a dominant player is a must (#1 or #2), that outsourcing is acceptable, that lack of internal growth may be tolerated, divestment of businesses is part of corporate strategy, and that the corporation is not committed any single business, that there is no loyalty between employees and the firm and the "new social contract" is about assuring employability, not employment, and so on. Let us, for the time being assume that this list is a by product of the public image of the CEO - his statements to the press, the Harvard cases, the video tapes, and the book by Tichy & Sherman (1993) all publicly available material. Employees can learn a lot about what is valued in the company and what is the meaning of success. For example, whether there is value attached to protecting core competencies or keeping a technology edge, managing a small business with good profits but not a dominant market share, managers can learn to justify continuous profit increases in the face of no growth and/or cyclical businesses including in industries with excess capacity? There can be an increased awareness of what skills are lost as people are let go. Employees learn much about what aspects of management can be sacrificed to accomplish financial goals.
The public image of Bill Gates is arguably in stark with Gates, the attitude is in contrast, growth, market dominance, establishing their products as the industry standard, “take no prisoners, winner take all”, a wide scope of businesses, enormous technical and market foresight and imagination, brashness and irreverence, -somewhat different from GE. Microsoft employees recognize that individual contributions are greatly valued; that their firm is constantly increasing the scope of what they do and challenging incumbents in major industries such as banking, education, by changing the dynamics of that industry. (For example, Microsoft's failed attempt to acquire Intuit - of Quicken fame- was an attempt to enter the financial services business and pose a challenge not only to traditional banks but brokerage services as well).

The other side of the public image is one of weak management, indecision, unwillingness to change, protecting the past, not in touch with the realities of new competition- an image that the press had created for Gérard Worms at Suez. For example, it was felt that he could not find the appropriate balance between the portfolio of businesses he put together with new demands of governance. Give such a public image, are employees willing to commit to change in the absence of confidence in their CEO? Do they believe that radical changes will be supported and experiments allowed under his leadership? Do they feel that the CEO and top management know where they are going? (That was never in doubt in GE or Microsoft). On top of these nagging doubts about the capacity of the CEO to lead and allow the organization to be innovative, questions of personal integrity can paralyze the system, as at Alcatel.

The public image of the CEO has many important attributes. For example;

1. It can build stockholder confidence. Jack Welch (GE) and Goizueta (Coco Cola) have built impressive reputations as allies of stockholders and builders of market value. They may get there using different approaches but both have this reputation. On the other hand, Jordan (Westinghouse) does not. Does the public image (matched, over time by performance) increase market value of firms?
2. It can scare competitors. Being #1 or #2, or as in the case of Bill Gates' approach to launching "Windows 95" can give second thoughts to competitors. "Do I want to take these guys on?"

3. It can inspire confidence in the company. The public image of the CEO can inspire confidence as in the case of Bob Galvin during the 1980s at Motorola and George Fisher at Motorola and at Kodak now, or of Percy Barnevik at ABB.

Public image for the CEO is a mixed blessing. Once a strong public persona is created, it is not easy for the CEO to provide a credible, conflicting message to the organization. The CEO becomes hostage of the image. How long do a public images linger? Should we be thinking about public image as a "brand franchise" with all its attendant benefits and limitations?

There are also very visible companies with very clear public images such as Hewlett-Packard, 3M, Marriott, Rubbermaid, and Motorola (now), but the public image of the CEO is not very clear or pronounced. Why is this so? We suggest that public image is sought and often given to CEOs who are involved in dramatic restructuring and reengineering efforts (or those who run businesses with very dominant market shares). Such efforts provide for drama. On the other hand, neither HP nor Motorola nor 3M have been involved in major restructuring. They have not made big and dramatic take over bids. Their growth has been internal. Their strategic change is based on a longer term view of the industry, its evolution and the role their organization will play in it. The reinventing of the company is an ongoing, intense, but "low decibel", effort. Their change efforts are "middle- out" efforts (efforts of middle level managers). This process is akin to treating the firm as "distributed intelligence" working within a shared, common strategic architecture, a much less visible process than the traditional strategizing at the top followed by restructuring of portfolio and organization.

While the low visibility CEO can have more degrees of freedom to communicate and manage the balance between the three logics within the firm, the high visibility CEO can use the public image as an amplifier to his message. The contemporary CEO has to ask the following questions:
1. What is the evolving public image (and the corresponding image among employees)? What is the consistency between my values, concerns, goals and the emerging public persona? What are the implications of a "misfit" between the two? Can I afford to ignore the public image that may be emerging, its impact on the firm or on my abilities to manage?

2. Where do employees, customers, suppliers, investors take their cues from? What is the impact of a "barrage" of publicity on the CEO as a person?

3. What degrees of flexibility do I want to preserve in challenging the organization to focus on different issues; for example, from a focus on restructuring to growth. This can become a problem, especially when the CEO has ten or more years in the job and must change the key message more than once.(e.g. message at GE focusing more on soft issues since 1991).

4. When does the external (public) message gain more credibility than internal messages? Why does this happen?

Conclusion:

The CEO has become critical in the wealth creation process. Simultaneously, employees at all levels have become significant contributors to the competitiveness of the firm. High quality leadership, it appears, is a prerequisite to enable empowered employees to function. The CEO has to take responsibility for creating the right environment. We believe that this process of creating the right environment consists of first developing harmony between the portfolio, value creation, and governance logics. It is an evolving, dynamic process. Secondly, we believe that there are inherent dilemmas in managing this delicate process. It demands a good sense of timing, sequencing, social and interpersonal and intercultural sensitivity. Stylistic preferences (limitations) must be understood. Finally, CEOs must ask themselves if they can avoid a public image or whether they can use it purposefully. They must also consider the implications of this image creating process (voluntary and involuntary), and the image on sustained vitality and capacity for growth and wealth creation.
References


