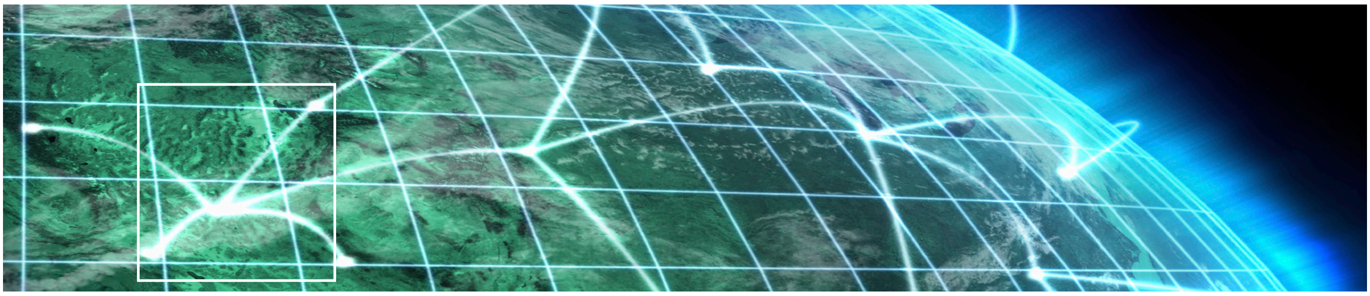
Arthur D Little

Strategy & Organization Viewpoint

The Headquarters Redesign

A New Paradigm for Corporate Governance in Turbulent Times



For a long time, steering a corporation from its head offices was like a long-distance drive on a straight and broad highway: a smooth and comfortable ride – no sharp turns, constant speed and high reliability. For most corporations, the global economic crisis in 2009 changed this driving mode to "off-road". Today we frequently need radical turns to steer the corporation in the right direction. This trend affects whole industries. The energy sector, for example, has to cope with the energy revolution; mobility is dealing with digital transformation. The role and effectiveness of a corporate headquarters become more important to mastering these changes. Additionally, all industries have to cope with an increasing demand of regulations affecting control, audit and compliance functions. In this Viewpoint, Arthur D. Little portrays a new governance paradigm and a lean head office set-up that adds significant value to the organization.

Questioning Headquarters Performance

There are many angles from which to discuss "headquarters performance". From a leadership and governance perspective, performance is judged by the quality of support for the top management team. In this sense, good headquarters performance means effective governance support, including provision of frameworks and guidelines to the overall organization. In a study that Arthur D. Little conducted with more than 100 corporations, we found an alarming pattern: the value attributed to headquarters functions by internal customers – both management and staff – shows a high number of "low performers". Nearly 70% of respondents perceived their head offices as cost drivers without adequate value adds (see Figure 1). At the same time, headcounts at corporate headquarters have been growing substantially since 2000.

To achieve a clear picture of the effectiveness and efficiency of organizations Arthur D. Little applies proven tools such as the

Figure 1: Headcount development and internal perception of the corporate headquarters

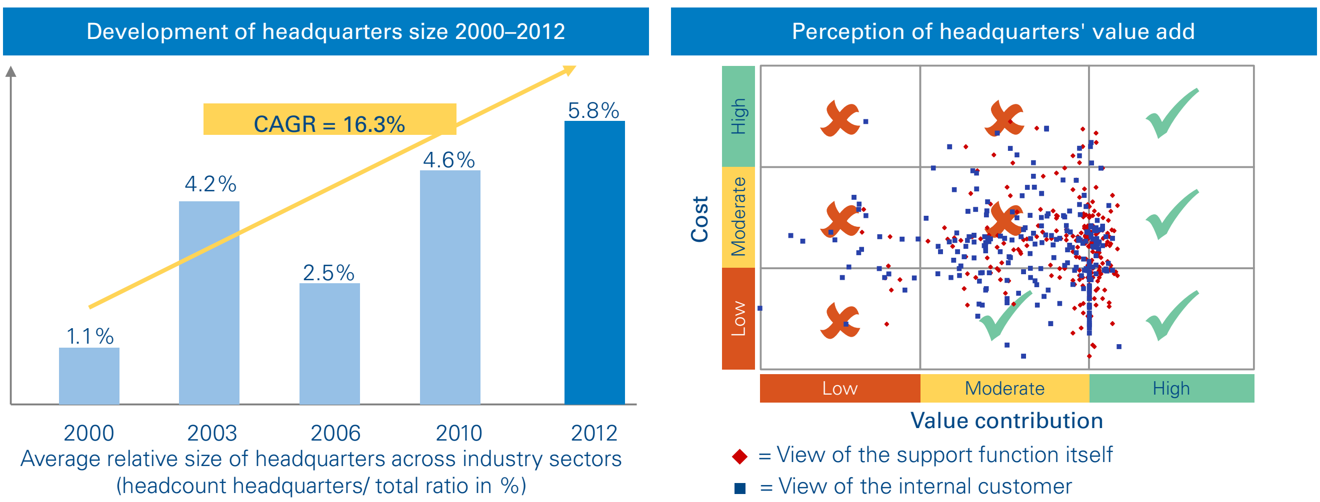


Figure 2: Symptoms of ineffective and inefficient headquarters

	Symptoms	Key questions
Effectiveness	■ Poor performance of corporate functions that neither supervise nor serve effectively ■ Negative value-add perception of the services provided by corporate functions ■ No clear steering model that defines the level of autonomy for operations	■ How do we steer our operations, and how much do we interfere with them? ■ What is the minimum set of corporate functions that the leadership team needs to steer and control effectively? ■ What are the value-added services of corporate functions that contribute to the business?
Efficiency	■ Unclear roles and responsibilities of corporate functions ■ Lack of leadership competencies ■ Slow decision-making processes ■ High level of comfort in terms of headcount structure compared to benchmarks	■ What are the specific tasks and responsibilities of corporate functions, and how do they interact with their counterparts? ■ Do we have the right people on board to fill these positions? ■ Do we delegate responsibility to the right level to unburden the leadership team in decision-making? ■ Is the headcount structure well balanced to perform the services efficiently?

ASA (activity-structure-analysis) and RACI tool (Responsible, Accountable, Consulted, Informed) to make transparent what people spend their time on and what they are responsible for. In many cases the analysis demonstrates that much time is spent on central "support" nobody is asking for. We can reveal overlaps between departments and identify positions doing the same tasks without coordination.

Typical statements from internal interviews illustrate the low valuation of headquarters:

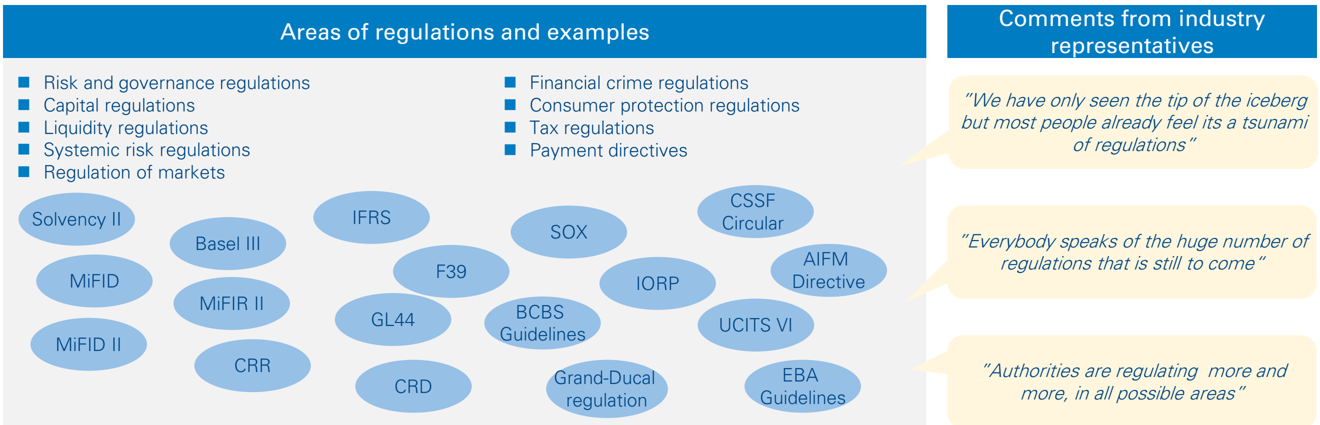
- "not agile but bureaucratic and slow"
- "do not mobilize synergy, but are bystanders of internal competition and antagonism"
- "does not drive cost efficiency, but contributes to costly corporate structures and projects"

Both dimensions of organizational excellence – effectiveness and efficiency – are addressed in these judgments. A closer look at them shows a variety of symptoms and key questions (see Figure 2).

What are the root causes behind these symptoms? We find that the traditional answer – "It is the organizational structure, represented in an organigram" – does not hit the point. Actually, it is not the basic organizational structure that divides strong performing head offices from weak performers. It is, rather, the organization of work within these structures that is mission critical:

- Headquarters functions interfere too much with the business and burden operations with data requests, and reports are considered vital for decision making on a group level. Unclear roles and responsibilities at headquarters give room for interpretation, leading to strategies and standards that are not aligned with the business.
- More than 75% of corporate functions have a headcount level that exceeds benchmarks. Cost efficiency is not realized because profit-and-loss thinking is not being applied to tasks in the headquarters.
- Mobilization of synergies is hindered because there is no responsibility that would systematically promote critical mass. Many companies are still at the starting point of service bundling across the firm, with significant synergy potential remaining untapped.

Figure 3: Regulations in the financial industry



- Speed and agility are compromised because decision makers' time is wrongly allocated: Top decision makers are involved in day-to-day routine questions, and these become bottlenecks. A given committee structure also limits delegation to lower hierarchy levels.

The implementation of new regulations also puts additional responsibility on the CEO and the board of directors. The governance structure requires control functions that provide professional consulting services to the board. Figure 3 shows examples of recent regulations in the financial sector. Industry representatives expect a tsunami of further regulations still to come.

Applying the Lean Management Paradigm

Starting with the hypothesis that the organizational structure is usually not the core of the problem, we have come up with a set of four basic levers to introduce change and performance improvement. Applied systematically, these levers have contributed to very convincing performance improvements.

1. Sort Tasks

We can introduce a very simple differentiation, looking at the portfolio of tasks conducted by a corporate headquarters: strategic and governance tasks such as strategy development, defining a transfer-pricing policy, and setting the benefit and compensation standards can be differentiated from executing tasks such as project execution and involvement in transactions. Each of these groups requires its own management style, competence and environment.

The mixture of supervising and control tasks with complementary services usually has a negative impact on the overall performance of the specific function. In brief: the headquarters role isn't carried out effectively.

2. Subsidiarity

Having sorted out different types of tasks allows for a critical discussion on division of labor. Who is doing what? The principle of "subsidiarity" – calling for the execution of tasks at the lowest hierarchical level possible – is a very traditional yet extremely effective lever.

The more process responsibilities are delegated from "the top to the bottom", the higher the potential to apply effective and efficient management. However, there is an important precondition to make it work: subsidiarity requires a culture of trust in which the top management is willing to release decision competency to the lower hierarchy, and these managers are competent and committed to taking over new responsibilities.

3. Task-Specific Management

Sorting tasks and channeling these tasks to the appropriate level of the organization allows the organization to apply the key driver for better performance: task-specific management. Isn't it part of conventional wisdom that different tasks require specific management techniques, styles and requirements? There is no surprise in this simple rule. But how often do we not comply with this? A push towards task-specific management leads us to centers of excellence with specialized know-how and a critical mass. Typical examples are IT services, accounting, payroll and facilities management. We have applied this approach across various industries. What are the advantages that we can achieve? As a rule of thumb, efficiency gains of up to 35% are possible in a specialized and shared service-oriented environment. Do quality and agility suffer? On the contrary: indicators for both dimensions will climb up.

4. Specialize and Improve

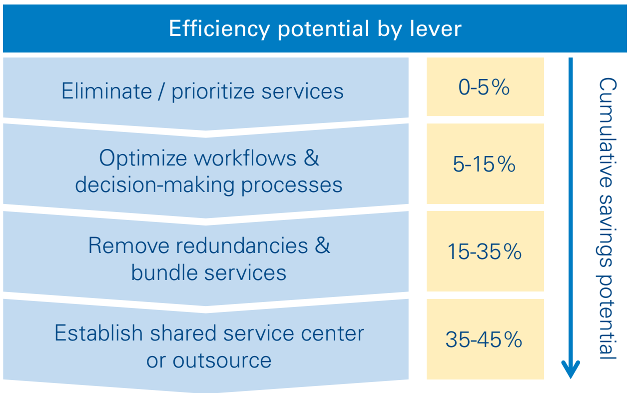
The levers of sorting, reassigning (subsidiarity) and task-specific management unleash a lot of potential when they are applied consequently and comprehensively. The premium that can be earned is then based on specialization and continuous improvement.

Service units in a shared service center deliver services that are competitive compared to the external market. Bundling of services in a separate organizational unit provides the necessary transparency to judge on the output performance level. Continuous specialization and improvement leads to high process efficiency as soon as the performance level is monitored and managed. In a second step, performance can be further developed by sharing benchmarks according to specified KPIs for these services.

Benefits of a Lean and Effective Headquarters

Applying the lean management paradigm leads to an agile headquarters that enables the company to cope with market challenges and manage the efficiency of its whole organization. Depending on the scope of organizational improvement, efficiency gains of up to 45% cost savings are a realistic target (see Figure 4.) How is this premium earned? Applying the four levers discussed above will trigger a discussion on the effectiveness and efficiency of tasks. It is our experience that a number of tasks can simply be eliminated without any harm. Secondly, separation of tasks, subsidiarity and specialization will be the basis for optimized workflows. Managers running units with "clear and clean" portfolios will apply specific KPIs and management styles, and will drive towards continuous improvement. The most prominent effect, however, comes from a critical review of the overall portfolio of tasks. When equipped with the right management approach, head offices will continuously identify redundancies and bundle services within

Figure 4: Efficiency gains by organization scenario (cumulative potentials)



the corporation. Finally, service centers and outsourcing options will unleash substantial benefits.

Furthermore, establishing shared service centers allows for a demand-driven provision of services (pull principle) that discloses further cost synergies within the new organizational structure.

Key Success Factors to Keep in Mind

What can we learn from this discussion? The basic structures of our headquarters were designed years ago. Given the requirements of today's market environment, we need more agile and effective set-ups for corporate governance. However, traditional reorganization that leads to new structures and organigrams does not help. Instead, we have to focus on our governance methodology. There are four levers that we have been using successfully to improve governance:

1. We sort headquarters tasks according to their governance and execution nature.
2. We then apply the principle of subsidiarity and drive execution down to the lowest level possible.
3. We apply task-specific management procedures and empower managers to "run" their headquarters businesses more effectively.
4. Having applied these mechanisms, we then can benefit from continuous improvement.

Is all of this easier than traditional reorganization? Actually, it is not. Such an exercise touches habits, roles, responsibilities, traditional workflows and beliefs. It is a therapy that can be very painful. But it can also be extremely effective – replacing frustrations with ineffective headquarters with pride in a truly agile organization that steers well.

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Arthur D. Little

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