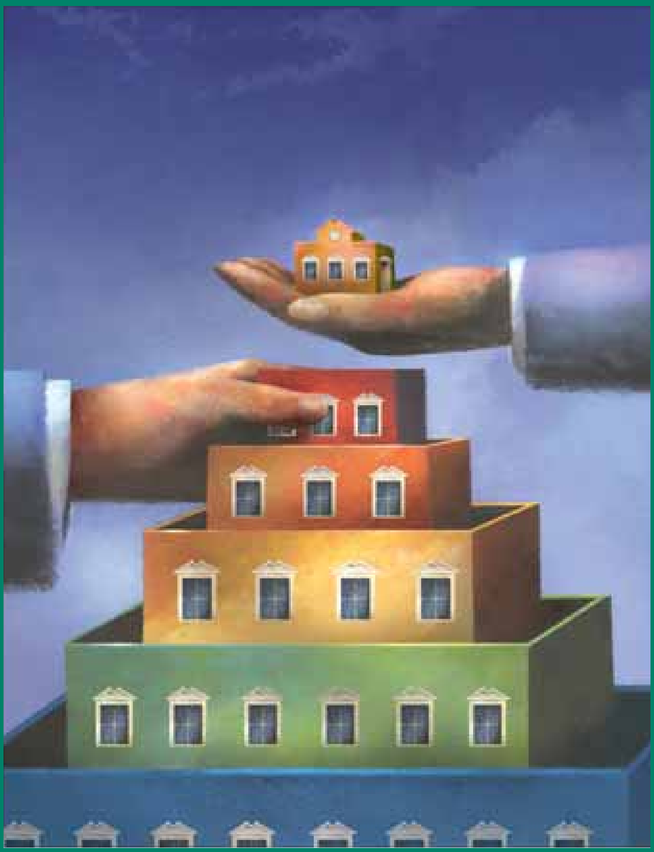
BCG REPORT

Lean and Active

A New Perspective on the Role of the Center



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Note to the Reader

Over the past two years, the Organization practice of The Boston Consulting Group has been striving to understand how the corporate center—otherwise known as headquarters—can create value by shaping organizational behavior and interactions, raising operational capabilities, and improving overall performance. During our research, we interviewed more than 35 senior executives and conducted a Web survey of executives from a diverse set of companies. In addition, we analyzed BCG's Corporate Center Benchmarking Database of information from more than 400 companies and reviewed more than 60 BCG projects investigating the role of the center.

Through our analysis, we developed several models describing how corporate centers can help steer the businesses they oversee to greater growth and profitability. Contrary to conventional wisdom, which holds that corporate centers are cumbersome and bureaucratic, we believe that they can inject vitality and creativity into the organization. We are pleased to present our findings in this report.

Acknowledgments

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Preface

All athletic movement begins at the center. The hips provide the power that allows baseball players to drive a ball hundreds of feet, soccer players to kick a ball nearly as far, and dancers to spring into the air in seeming defiance of gravity. Although it may appear that power comes from a flick of the wrist, a knee flexing, or a calf constricting, those actions are the last of an integrated set of movements that begin at the center of the body.

Ideally, the corporate center would have the same direct connection to the business units it supports, guiding their moves and powering their outstanding performance. In reality, however, the corporate center rarely functions so gracefully. *Bureaucratic* and *inefficient* are two words that often describe the performance of the corporate center.

Today the role of the center is more relevant than ever. Globalization, technology, and the speed of innovation are forcing companies to be increasingly nimble. If the center sends out the wrong message, interferes with creative local initiatives, or imposes bureaucracy, it actually destroys value. It is no wonder, then, that nearly all senior executives cite the role of the center as one of the top five issues on their agenda.

In the following pages, we identify the challenges that executives face as they envision what they want their center to be and how they hope to achieve that vision. We also identify four models for the corporate center that are suited to today's business realities. Although the models suggest varying levels of engagement between the center and the business units, all four require that the center be lean *and* active. How can that be? This report explores the apparent contradiction between the center's size and its ambitions. It also illustrates how a center's role and its ability to create value are related more to the quality of its staff and the clarity of its purpose than to its size.

Becoming a Lean and Active Center

The role of the corporate center—its structure, mission, and influence—is in flux. During the conglomerate era of the 1960s and 1970s, the center became large, bureaucratic, and often meddlesome; its hegemony over the business units earned it the title of *imperialist* center. In the 1980s, a wave of decentralization took place. The individual business units regained authority over operational issues, and the center was relegated to financial planning. Yet, although the center lost power, it did not lose bodies. In the 1990s, therefore, minimalism of both scope and size came into vogue. Viewing headquarters as a pure cost center, executives began to shrink its staff. The center became small and lean—and gave an even wider berth to the business units. (See Exhibit 1.)

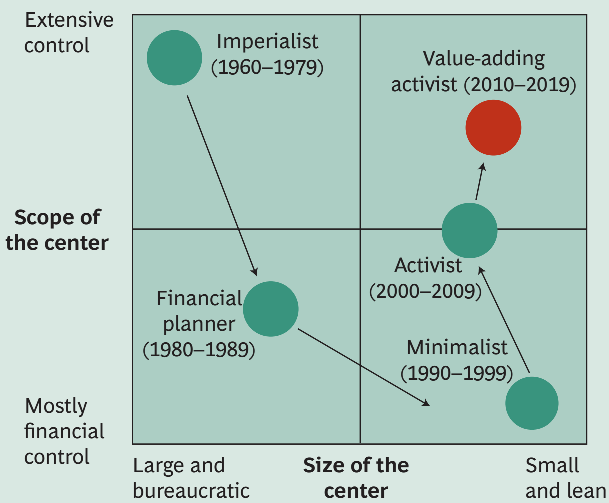
New Demands from the Marketplace

In around 2000, the pendulum began to swing back. As a series of external and internal trends converged, the need arose to revisit the role of the corporate center. Executives decided to inject the center with both power and responsibility. Although no one has sought a return to a larger center, many companies today are seeking a more activist one.

Externally, the growth of global markets has forced companies to find ways to become more competitive. Many have sharpened their focus and made their portfolio of businesses less diverse, while becoming more global. The pace of change—fluctuating demand, shifts in competitive landscapes, the speed of imitation, and the spread of expertise—has also accelerated and, in many cases, overwhelmed the ability of local businesses to respond adequately.

At the same time, globalization has placed new demands on internal operations. Companies are building global networks in such functions as manufacturing, sales, and research and development. They are managing an increasingly complex portfolio of operations across many local markets. Heightened competition is forcing these companies to be more responsive to local market needs and regional developments while they try to orchestrate global activities and achieve synergies among businesses. Fortunately, technological advances are driving down coordination costs. The traditional tradeoff between the reach and richness of available information is losing its significance. For the first time, companies can enable systems integration on a truly global scale.

Exhibit 1. As Its Role Has Evolved, the Corporate Center Has Become Lean and Active



Source: BCG analysis.

Today few companies have fully confronted and taken advantage of these developments. Most continue to struggle to create a center that meets the new external and internal needs. Senior executives understand the importance of the center's role, and they have demanding expectations.

In interviews, we asked them to rate the current importance of various characteristics of a corporate center and then to predict how important those characteristics would be in five years. The executives told us that they had higher expectations for the future role of the center in almost all areas—from the quality of personnel to the degree of involvement in business unit activities. (See Exhibit 2.) In other words, senior executives expect that the corporate center of the future will not only be lean but also *be more active and create significant added value.* They want the best of both worlds.

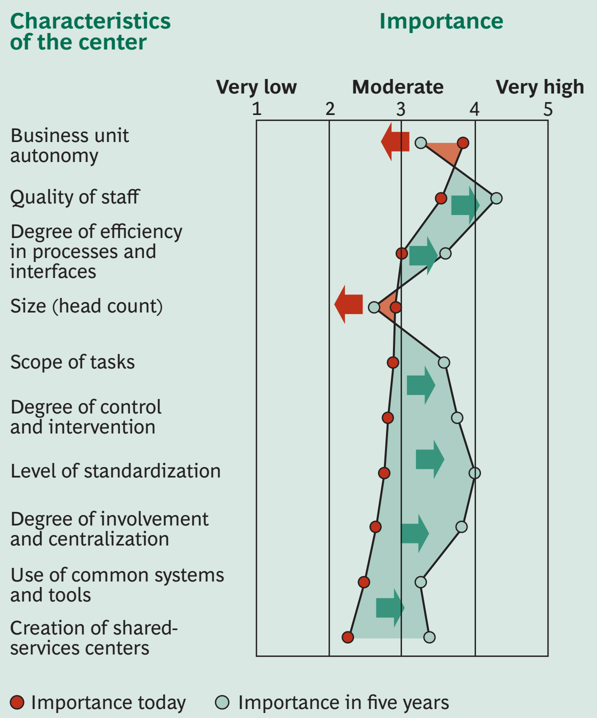
The Gap Between Aspirations and Performance

Creating a lean and active center that adds significant value is a huge challenge. Although aspirations are high, performance is low, with most centers delivering poor results. Our research indicates that this is especially true for such center functions as controlling, corporate development, and human resources.[1] (See Exhibit 3.)

The problem is that many executives do not know exactly how to activate the functions of their company's center. In particular, the best way to allocate roles between the corporate center and the business units is often

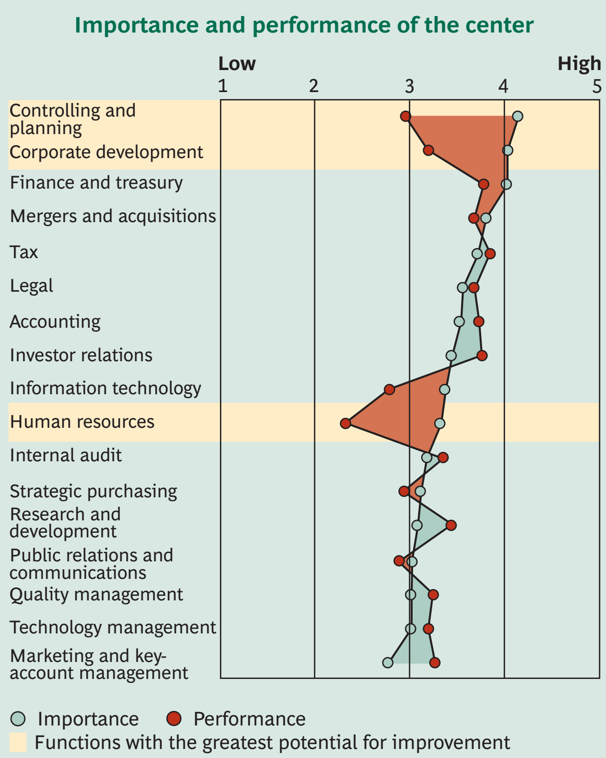
1. *Controlling* is a European term that encompasses the annual planning and budgeting, regular performance reviews, and incentive and compensation setting that all companies perform.

Exhibit 2. Executives Expect Most of the Center's Characteristics to Gain Importance in the Future



Sources: Interviews with executives; BCG analysis.
Note: In interviews, 35 executives were asked to evaluate the importance of various characteristics today and in the future. The average of their responses is reflected in this exhibit.

Exhibit 3. Controlling, Corporate Development, and HR Have the Greatest Potential for Improvement



Sources: BCG Web survey; BCG analysis.
Note: In our Web survey, nearly 200 executives were asked to evaluate the importance and performance of various functions. The average of their responses is reflected in this exhibit.

unclear, and redundancies, conflicts, and inefficiencies abound. As a result of these shortcomings, many centers have a credibility problem. Senior managers want the center to do a better job of identifying issues and challenging and guiding the business units. At the same time, however, executives at the business units question whether the center can effectively intervene and add value to their operations. Not surprisingly, they often perceive the center as unproductive overhead.

Many centers have a credibility problem: they are perceived as unproductive overhead.

The frustration and confusion stem largely from contradictions inherent in the expectations of senior business executives.

- *Capability Versus Cost.* Executives expect the center to play a more active role and to be staffed with people who possess greater expertise or higher capabilities, but most executives also want to reduce the center's cost.

- *Accountability Versus Collaboration.* Executives want to allocate distinct responsibilities to the center and to the business units. At the same time, they expect the center and the businesses to develop a strong sense of cooperation and to join forces in order to maximize performance. Even though the business units are expected to retain ultimate responsibility for profit and loss, executives foresee the center's sharing accountability for business performance.

- *Motivation Versus Discipline.* Executives recognize the increasing importance of so-called soft activities such as developing human capital, shaping corporate culture, and engaging and motivating the best caliber of employee. At the same time, they enforce discipline by focusing on such "hard" activities as more precisely defining the center's processes, methods of communication, approval mechanisms, and sanctions. Executives look mostly for quantitative metrics to gauge how various functions of the center create value.

Successful organizations are learning how to manage these tensions in order to create centers that are both lean and active. It is not an easy task, but we believe that those companies that achieve this goal will generate considerable value—from the center and from throughout the organization—and gain an advantage over their competitors.

Understanding the Role of the Center

Traditionally, any discussion about the role of the center started with a simple question: What type of center should we build—a financial holding center, a strategic-management holding center, or an operating center? But that classic question no longer applies, and a new perspective on the role of the center is needed.

Today, as the external and internal environments have changed and as the aspirations of senior executives have grown, a minimalist financial holding model is simply not an option. It is no longer sufficient to measure financial and accounting performance across business units and then simply allocate resources accordingly. Centers must address the external threats of greater exposure to global risk, increased competitive pressure, and accelerated change. Simultaneously, they also must cope with the internal challenges posed by tighter governance requirements and increasingly complex reporting practices that may hide the business units' true financial performance. Advanced control and intervention mechanisms are required in order to measure and anticipate performance and to allocate resources strategically.

Likewise, the more popular strategic-management holding model, in which the center sets strategy but is not involved in operations, also falls short. This model draws a line between operations and strategic guidance, but today's center must cross that arbitrary line if it is to deliver insight and impact. The center should be able to talk to customers and suppliers, team up with operations, and pay attention to any so-called weak signals—inconclusive but important information—that may be emanating from inside and outside the organization. Strategic guidance can no longer follow a linear, top-down process; rather, it must result from an iterative process that brings together insights from both operational and corporate perspectives.

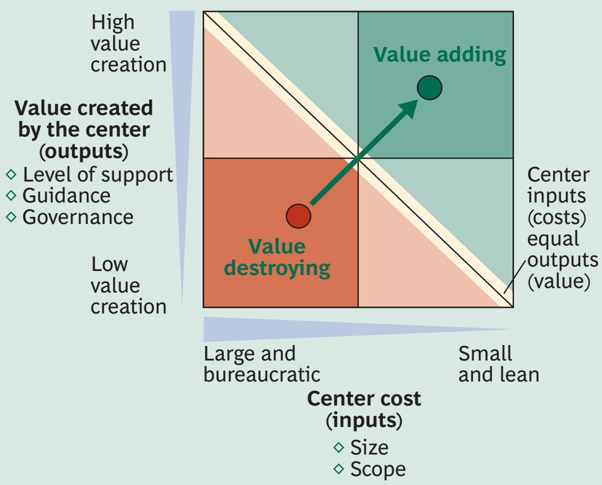
Finally, the classic operating, or imperialist, model is also inadequate to deal with today's challenges. This model's central-management approach lacks agility and leaves companies unable to oversee their global markets and operations.

In the modern era, corporate centers need to assume a more pragmatic and flexible approach that emphasizes opportunities to create value rather than strict adherence to a particular model. Most likely, the successful center will combine elements of the different models in order to understand, embrace, and improve business operations.

It may be helpful for executives to think about the center as a factory, with definable inputs and outputs. By *inputs,* we mean the size, scope, and cost of the center. These "raw materials" are used to fashion and mold a center. By *outputs,* we mean the level of support, guidance, and governance that the center provides to the business units. In this scenario, a center is deemed to add value if the sum of its outputs exceeds the cost of its inputs. (See Exhibit 4.) This rule applies not only to the center as a whole but also to each of its functions and activities.

Although easy to understand, this metaphor is hard to apply in practice. While certain inputs, such as the cost of staff, are easily quantifiable, a center's outputs traditionally defy precise measurement. The value that a center creates flows indirectly through the business units. Also, the center's value over the long term is a reflection of its record of building, buying, developing, turning around, and selling or closing businesses. Companies, however,

Exhibit 4. Corporate Centers Either Add Value or Destroy It



Source: BCG analysis.

need a shorter-term perspective, which takes into account both quantitative and qualitative analyses, in order to understand whether the center is operating effectively. Finally, although the center is not in business to win a popularity contest, upward feedback from the business units should be an important metric. In addition to surveys, several tools—such as network analysis and activity-based analysis—can help assess the center's performance and provide useful benchmarks. These assessments should be conducted routinely to check the center's "pulse."

Building a Better Center

To ensure that its value exceeds its costs, a center must align its capabilities and characteristics with the company's strategy and business portfolio. This step is especially important today, when strategies and portfolios are in constant flux. As corporations buy and sell assets, spin off and merge businesses, and change strategic direction, the center needs to morph and adjust as well if it is to maintain credibility as the best steward of corporate assets.

Our research suggests that companies can increase the center's effectiveness by making adjustments in four of its critical dimensions.

- *Role.* Traditionally, the center has had only limited involvement in business unit operations. Now, however, the center should be more engaged in guiding and supporting the activities of the business units. As one European chief executive explained, "Our country organizations and our customers expect center management to be closely involved in the operating business."

- *Focus, Scope, and Size.* The center's traditional focus has been on efficiency, and the center itself has been viewed primarily as a cost center. Now the center needs to add substantial value and demonstrate high levels of performance and service. "I don't want to build up a functional bureaucracy that keeps itself busy," said one chief executive. "We need to focus on the right issues to create value."

- *Structures, Processes, and Mechanisms.* The dominant model for the center has been a formal organization structure with dedicated functions. Today's realities trump that rigid organization. Now the center requires more flexible and adaptable structures that permit virtual interactions to occur and informal networks and teams to form and disband. "We introduced informal cycles and committees across business units to establish groupwide platforms for information sharing and best-practice exchange," one chief operating officer told us.

- *Staff and Capabilities.* Managers at the center have traditionally had deep functional expertise but not much operating experience. Now the center needs both sets of skills. The center should have top-notch personnel who combine strategic thinking with operational expertise. As one executive committee member said, "We need higher-caliber people in the center who are accepted by and can communicate effectively with the business people."

How can companies make their center as effective as possible by fine-tuning these characteristics?

Role

Different organizations require different types of centers, and the first challenge for any company is choosing the right model. The diversity of a company's business portfolio is the key factor determining which model or role of the center suits the company best. Diversity means more than just portfolio diversity. It also applies to the diversity of the company's geographic footprint, customer segments, products, technologies—and even value chain, if some activities have been outsourced or otherwise deconstructed.

Corporate strategy is the second major influence shaping the role of the center. The overall corporate strategy will determine how centers extract value by improving the performance of individual business units or by exploiting synergies that cross the businesses' boundaries.

With these two factors in mind, we have identified four models for the role of a center. If they are applied appropriately, all four models—and any creative hybrids that borrow from them—will add value. As a rule, the more diverse a company's business portfolio, the fewer opportunities its center has to unleash synergy by creating links among its businesses. The first model we outline is appropriate for a highly diverse company whose center has the narrowest scope for intervention. Each succeeding model provides greater opportunities for intervention. The four models are the performance-managing center, the portfolio-developing center, the synergy-driving center, and the integrated center. (See Exhibit 5.)

The performance-managing center oversees a group of unrelated businesses. It manages by financial objectives, selects and motivates senior managers, establishes performance management systems and metrics, challenges business unit strategies, and allocates resources.

The portfolio-developing center manages a set of diversified, loosely related businesses. In addition to carrying out the duties of the performance-managing center, it drives strategic initiatives across the organization and actively shapes businesses by seeking opportunities for consolidation, entry into new markets, and global expansion. It also brings together complementary skills and assets from the respective businesses.

The synergy-driving center leads a set of related businesses. In addition to maintaining the responsibilities of the portfolio-developing center, it fosters the exchange of best practices and know-how; facilitates and organizes cooperation; leverages scale in key business functions; develops common operational systems and tools; and creates shared strategic resources, such as research and development. (For an example of this model, see the sidebar "Cemex: The Synergy Behind Cement.")

The integrated center drives a single business or a cluster of closely related businesses. Besides conducting all the activities listed above, this center model directly steers and manages significant operational functions such as manufacturing or sales across regions, products, or businesses.

The role of the center needs to be considered in its organizational context. Large corporations generally have

Exhibit 5. Portfolio Structure Heavily Influences the Role of the Center

Portfolio type	Unrelated	Diversified	Related	Integrated
Degree of diversity in the business portfolio	High—businesses have little in common	Moderate—businesses are loosely related	Low—businesses are related	None—a single business or a cluster of closely related businesses
Center model (way in which the center adds value)	**Performance-managing center** ◇ manages by financial objectives ◇ selects and motivates senior managers ◇ challenges business unit strategies ◇ allocates resources	**Portfolio-developing center** ◇ identifies common opportunities and potential for growth ◇ fosters platforms for collaboration ◇ helps develop business unit strategies ◇ drives strategic initiatives	**Synergy-driving center** ◇ fosters the exchange of best practices ◇ facilitates internal cooperation ◇ develops common tools and systems for business units ◇ creates shared strategic resources	**Integrated center** ◇ directly steers operating businesses ◇ globally coordinates operations and functions across regions, products, and businesses

Degree of intervention

Source: BCG analysis.

CEMEX: The Synergy Behind Cement

CEMEX is an example of a company with a synergy-driving center. A local Mexican cement producer until the early 1990s, CEMEX has become one of the top building-materials producers in the world, with a presence in more than 50 countries, sales of approximately $22 billion, and earnings before interest, taxes, depreciation, and amortization of $4.6 billion in 2007. CEMEX has complemented its business's organic growth with strategic international acquisitions.

The company's synergistic approach to knitting together its operations is summarized in the "CEMEX way," which codifies a method of driving global economies of scale and sharing best practices. The principal components of the CEMEX way are a rigorous standardization of processes, a bundling of functions and key activities with few local differences, and a systematic approach to sharing best practices across the globe. The center orchestrates, facilitates, and supports all these activities.

CEMEX's approach assigns global responsibilities for activities such as optimizing cement plant operations to managers such as country heads, who devote 15 to 20 percent of their time orchestrating the development and implementation of standardized best practices across all CEMEX businesses. The rest of the time, the managers oversee their individual operational responsibilities.

Having operation managers rather than center staff oversee horizontal, companywide best practices helps CEMEX facilitate communication and collaboration across country operations and foster an atmosphere of trust and constructive cross-fertilization. This approach also replaces the typically confrontational and often destructive relationship between the center and the business units with an open and constructive mode of collaboration, as well as a shared vision and shared objectives.

multiple layers and multiple hubs that oversee divisional and regional businesses. It is crucial to delegate different roles to the different layers. Typically, the corporate center, which faces the most business diversity, assumes a performance-managing or portfolio-developing role. Centers at divisional and regional levels, which we call subcenters, oversee a related set of businesses and activities and should gravitate toward a synergy-driving or integrated role.

Two complementary lenses are required in order to fine-tune the corporate structure at the different levels. The first applies to the structure of the business portfolio: specifically, companies should assess whether the organizational grouping of their business activities permits the creation of links that unleash synergy among those businesses. Does a group of businesses, for example, have similar key capabilities or share common resources?

If, within a given portfolio, a cluster of businesses is closely related, then those businesses could be effectively managed by a synergy-driving subcenter. By contrast, if the relationships among businesses within a portfolio are weak, then the individual businesses should probably report directly to the corporate center because the rationale for a subcenter is missing. Without a clear division of roles between the corporate center and subcenters, the risk of redundancy and excessive bureaucracy rises.

The second lens applies to the optimal spans of control—or the number of direct reports per manager—maintained at each of the company's management levels. Low spans of control create excessive bureaucracy and slow down decision making and execution. High spans run the opposite risk: too little oversight. Both extremes can significantly inhibit value creation. Usually, however, a company's spans of control are too low overall. Before introducing or modifying structures, companies should consider spans of control and their effect.

In reality, unrelated businesses frequently report into a single subcenter, leading to relatively low spans of control at the corporate-center level. The following opportunities to delayer such organizations may arise:

- Some subcenters of these business clusters are simply artifacts of earlier corporate configurations. Many companies have narrowed the range of businesses they operate. As this process continues, they often can take out subcenter layers.

- Linkages between businesses can change over time through new technologies, outsourcing, collaboration with outside parties, and other forms of deconstruction. As links disappear and business clusters break apart, many subcenter structures may become unnecessary.

- Some unrelated clusters were created during mergers and acquisitions and were never fully integrated into the overall organization. As companies refocus and sharpen their operations, organizations, and business portfolios, they may be making some of these subcenters obsolete.

- As corporate centers aspire to be more involved in operations, their role increasingly converges with the role of the subcenters below them. Eventually, it may make sense for the corporate center to assume the responsibilities of the subcenters.

Private-equity firms can shed light on how a center can add value by using the right levers.

Many large, diversified companies can operate successfully without subcenters, maintaining adequate spans of control, transparency, and divisional focus. Some of these centers are able to oversee 15 or more business units by allocating responsibility for subgroups of businesses to dedicated teams and functions within the center and by providing shared services to the entire group for such activities as accounting, or to specific subgroups for more targeted activities such as R&D and marketing. This approach usually produces fewer redundancies, allows the center to oversee activities deep within the organization, and increases the company's overall agility.

Assessing and designing a corporate structure are best done using an iterative rather than a top-down approach. That is, it makes sense to begin by assessing linkages and opportunities for synergies across business units and then to derive effective organizational groupings before defining the roles of the corporate center and possible subcenters. Given the dynamic nature of many portfolios and businesses, companies should regularly revisit their corporate structure and the role of the center to make sure that both remain aligned with the business portfolio and corporate strategy.

Focus, Scope, and Size

Mastering the tradeoff between being lean and being active is a stretch for every center. Companies can make the stretch less taxing and easier to achieve by focusing on the right levers for adding value, separating services from management functions, and adjusting the size of the center accordingly.

Focusing on the right levers. BCG has identified 11 levers that centers can use to add value. (See Exhibit 6.) They apply not only to the center overall but also to each center function. Corporate centers should not attempt to pull all 11 simultaneously; doing so would only dilute management's focus and impede success. Rather, the key to success is in figuring out which levers to apply and how and when to apply them. Further, some levers should be delegated to divisions, regions, or business units. Generally, the more diverse the portfolio, the fewer levers the center should pull.

Private-equity players can help shed light on how a center can add value by using the right levers. By focusing on only a few levers but managing them effectively and rigorously, private-equity firms are able to stay lean while creating value. Typically they use the following levers:

- Striving for superior leadership on the board and in senior management

- Exerting a strong influence on the strategic direction of the business

- Setting aggressive targets and strong financial incentives for the board and for senior management in order to foster a performance-oriented culture

- Driving change at the company and being willing to make bold moves through mergers and acquisitions, sweeping internal improvements, and external hiring

Although private-equity firms and public companies operate with different time horizons for investments and different legal and tax requirements, both are trying to steer portfolio businesses and generate shareholder return. Public companies should therefore draw on the lessons from the private-equity sector and decide which levers they should focus on. In evaluating each lever, they should ask three broad questions:

- Does the lever create the most value at the corporate level? Which role should other organizational layers assume in applying the lever?
- How well does the center currently deploy this lever?
- Are the right corporate resources being devoted to the lever?

The answers to these questions should help companies determine whether they are deploying resources and capabilities for maximum value.

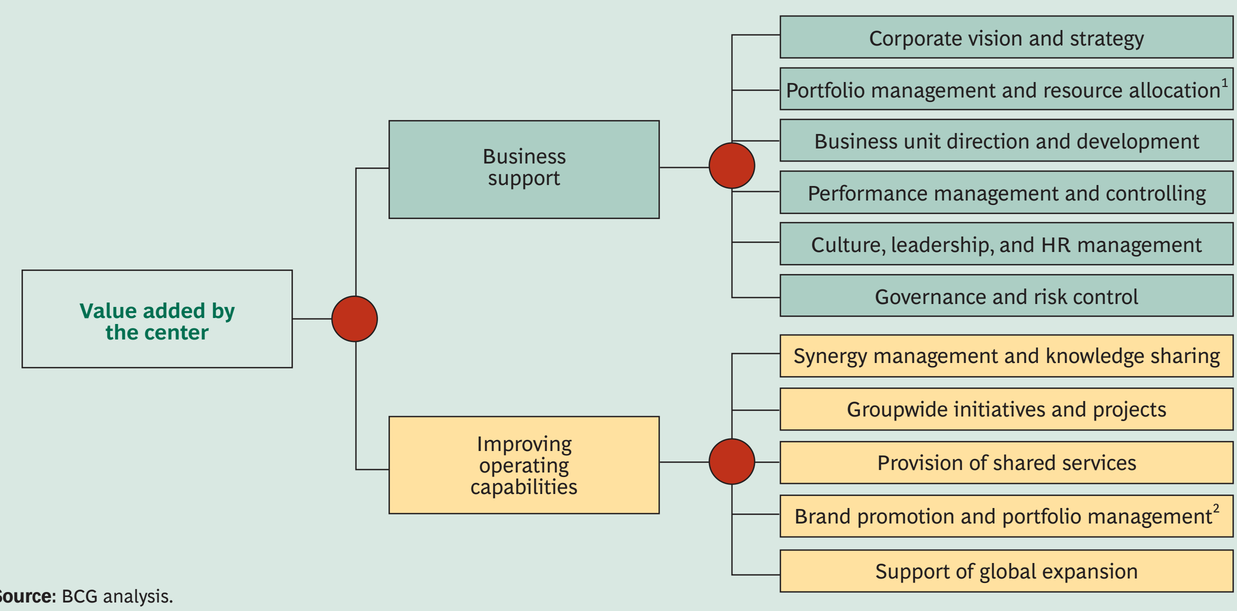
Separating services from management functions. Service activities—from advisory services to payroll processing—have internal customers and can be outsourced or placed in shared-services centers. Free-market and internal pricing mechanisms should ensure competitiveness in service delivery.

Management functions such as governance and leadership, by contrast, do not lend themselves to this approach. There is no direct internal customer who will seek out alternative providers and compare prices and levels of service. Consequently, such management functions should be relatively autonomous and invested with sufficient authority.

Separating service and management functions prevents the center from diluting its attention to its core tasks: governance, leadership, and control. It also prevents managers from imposing their own agenda for services on the organization, and it plays a major role in keeping the center lean and active. By separating service functions, a company can reshape the corporate center as a focused steering entity and, at the same time, improve the customer focus and quality of internal services.

Adjusting the size of the corporate center accordingly. Benchmarking is a good way to start understanding the size of the center, but the biggest challenge with this approach is finding ways to compare apples with apples. The Boston Consulting Group has compiled the BCG Corporate Center Benchmarking Database, which details the efficiency and structure of the corporate centers of more than 400 companies. We recently analyzed the corporate centers of European industrial-goods companies that are similar in size, degree of globalization, and number of layers. Not surprisingly, the centers of companies that have an integrated business portfolio are generally larger

Exhibit 6. The Center Can Add Value Through Several Levers



Source: BCG analysis.
[1]The portfolio-management and resource-allocation lever includes management of investment capital.
[2]The brand-promotion and portfolio-management lever includes sales support and coordination.

than the centers of companies with related businesses—which in turn are larger than the centers of companies with portfolios of diversified and unrelated businesses. (See Exhibit 7.) However, our analysis also shows that the differences within a peer group remain significant. For a deeper understanding, it is critical to compare the size of each function within the center and, if possible, to take into account different degrees of service separation.

Structures, Processes, and Mechanisms

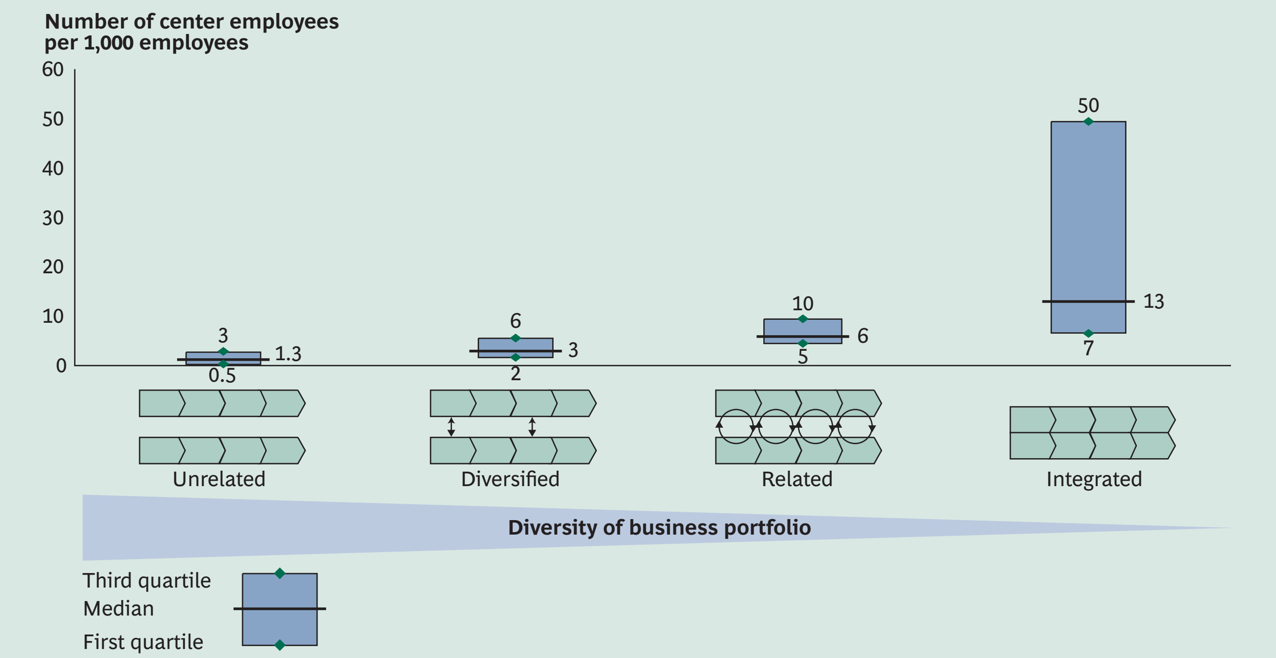
Centers need to align their reporting and approval procedures, performance management routines, and rules and regulations so that they all support the center's intended role. Our research has identified four activities that help to revitalize a center's processes and mechanisms.

Focusing on creating value through the annual planning, budgeting, and strategic-review processes. Many companies suffer from ineffective planning processes, which can last too long—sometimes all year. Such processes can be extremely detailed in some areas but superficial in others. At times, there may be too many turf battles and too few real discussions about new opportunities. Planning, budgeting, and strategic review are important processes, so companies must be clear about how they help create value and what the center really contributes. Most centers should pay less attention to the formalities of planning and budgeting and devote more time to fostering discussions about strategy, competitive threats, and the future.

Forming—and disbanding—ad hoc teams. Given the dynamic nature of today's businesses, centers should have the flexibility to form and disband task forces and teams that are devoted to specific tasks such as restructuring, geographic expansion, and acquisitions and integrations. Such ad hoc groups should consist of line managers and representatives from across the organization. Those assigned to the teams should be given the time and resources they need to complete their missions, and they should be rewarded for their participation.

Developing a high-caliber pool of managers to staff ad hoc teams and temporary assignments. Finding talented individuals for these hot-spot projects, however, is a challenge. In the wake of recent restructuring and cost-cutting initiatives, few companies have idle manage-

Exhibit 7. Integrated Companies Tend to Have the Largest Centers



Sources: BCG Corporate Center Benchmarking Database, which captures data from more than 400 companies; BCG analysis.

ment capacity. One solution is for the corporate center to develop a pool of experienced managers and other high-potential individuals to either serve in these roles or fill in for line managers who have been temporarily assigned to corporate projects. Although such a squad may seem redundant, cultivating this talent pool will position the center to deal with new opportunities—or, if necessary, to address problems by replacing poorly performing line managers. Properly managed, these talent reserves will pay for themselves many times over.

Regularly eliminating center activities and regulations that don't add value. All companies have ineffective procedures, rules, and regulations, and all centers need to guard against creeping bureaucracy. Committees consisting of individuals from the center and from the business units should routinely review regulations that constrict creativity and inhibit performance.

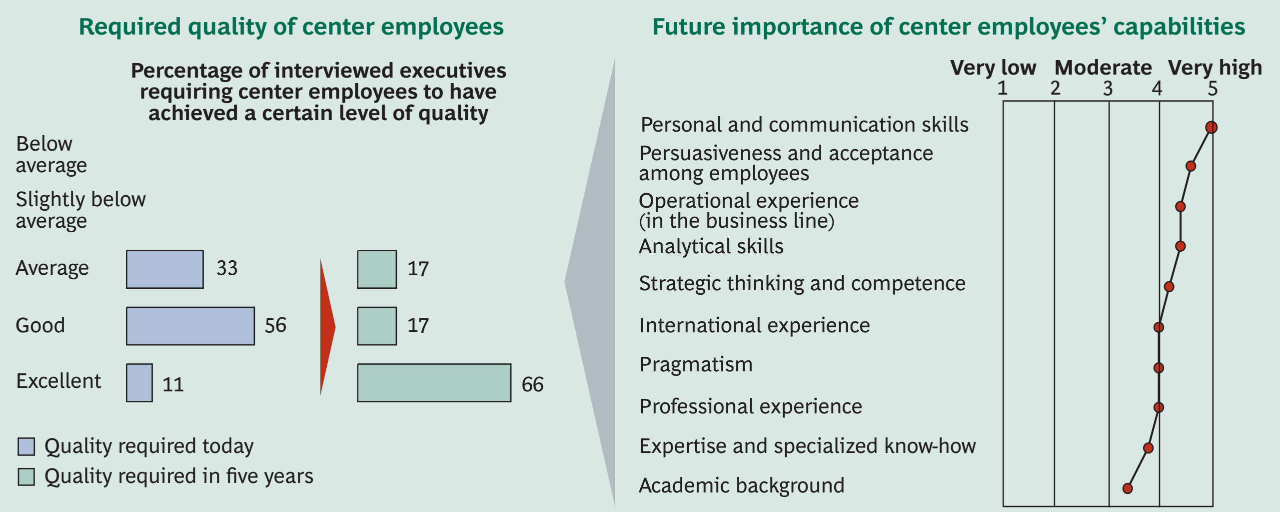
Staff and Capabilities

The success of the activities conducted by the center will depend largely on the talent of its people. The center should be an attractive home for talented individuals—from both inside and outside the company—who possess a mix of operational and strategic skills. It is important to rotate people in and out of staff positions at the center so that corporate management understands the challenges of working in an operating business and vice versa. Only a few of the center's functions are highly specialized and don't lend themselves to this approach.

Effective rotation often requires rigid rules for career development. Certain jobs should have mandatory time limits so that employees do not feel stuck, while other jobs should have requirements for levels of experience and credentials so that only the best candidates are selected. Defined career tracks, evaluation routines, and training and development programs will give people in the center a sense of purpose and momentum. Pay and promotion based on performance will generate a sense of energy and excitement among high achievers.

On the basis of our interviews with chief executives, the "ideal" corporate-center staff would consist of communicative, compelling strategists who possess operating expertise and pragmatism. (See Exhibit 8.) To hire and retain people who come even close to meeting this description, HR management will need to play a larger role than it does in many centers today. (For a further discussion of steps that companies can take to improve their HR, corporate-development, and controlling functions, see the sidebar "Three Keys to Success.")

Exhibit 8. The Importance of Staff Quality and Human Resources Management Will Increase



Sources: Interviews with executives; BCG analysis.
Note: In interviews, 35 executives were asked to evaluate the required quality of employees at the center and their required capabilities. The average of their responses is reflected in the right-hand chart.

Three Keys to Success

In our interviews, executives told us that three of the center's functions require the greatest improvement: HR, corporate development, and controlling. Below we identify best practices in each area.

The HR Advantage

Although many companies report significant dissatisfaction with corporate HR, this function is capable of delivering value and competitive advantage. In particular, our research suggests, a number of practices are critical.

Becoming a strategic partner. The HR function is the best place to connect a company's people strategy with its corporate strategy. The following specific actions and initiatives can help achieve this goal:

- Developing a strong recruiting and talent pipeline that can support growth targets. Such a pipeline can be cultivated through training, career development programs, and other measures.
- Increasing the diversity of the staff in order to tap into new pools of talent and address the needs of global customers. For example, companies could develop managers who have international experience and can work in strategically important emerging markets.
- Developing a strategic and quantitative approach to work force management for both white- and blue-collar employees. Such an approach would anticipate and tackle labor shortages that are likely to arise for various jobs as the work force ages in many countries and as qualified employees become scarce. Labor and skill shortages can be particularly pronounced in rapidly developing countries, where economic growth generally exceeds population growth.[1]
- Supporting the sharing of best practices through job rotation programs, incentive systems, career development, and other measures.

Organizing for success. The HR function itself needs to be highly focused and lean. Successful HR functions generally concentrate on a few strategic tasks and work in close cooperation with line management. Service-oriented and transactional tasks, such as payroll processing, should generally be separated and moved to shared-services centers. Such a shift should leave the corporate HR function with a balance of two types of employees: specialists on HR topics such as compensation or legal issues, and generalists who understand business needs and have experience in business operations.

Measuring performance. Corporate HR should continually make the case to line management about the value of human capital. Yet today's controlling systems are oriented more toward inputs such as head count and costs than toward output, or the value created by the work force.

Controlling systems measure both inputs and outputs in recognition that employees are the most important asset at many companies—and they link HR productivity with economic profit. One approach calls for analyzing the value added per person (VAP), the average cost per person (ACP), and head count (P) in the following equation: economic profit = (VAP – ACP) x P.[2]

The Right Mix Through Corporate Development

One of the most fundamental questions facing any corporate center is how best to develop its company's business portfolio. Our project experience and research suggest the following practices:

Setting and maintaining a clear baseline. Corporate strategy should be the starting point for building and maintaining a portfolio of businesses. The strategy should be based on systematically identified and developed corporate capabilities. It should lay out the portfolio's desired scope and focus, as well as value creation targets.

Segmenting businesses. A company should analyze both the markets in which its businesses operate and the competitive position of individual businesses. Markets should be assessed on their size and potential for growth, industry margins, price trends, and entry barriers. The competitive position of businesses should be judged on their relative market share, relative margins and growth, and other competitive advantages such as brand, technology, and distribution assets. Businesses should be segmented accordingly into one of four categories: divest, hold, develop and grow, or turn around.

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1. See Rainer Strack, Jens Baier, and Anders Fahlander, "Managing Demographic Risk," *Harvard Business Review,* February 2008.

2. See Felix Barber and Rainer Strack, "The Surprising Economics of a 'People Business,'" *Harvard Business Review,* June 2005.

Three Keys to Success (continued)

Evaluating how businesses align with value creation goals. Centers need to quantify the current and expected financial performance of their businesses, using capital efficiency and cash margins as the primary metrics. Performance targets should relate to portfolio roles of individual businesses, with different targets set for mature cash-generating businesses than for emerging investment-intensive businesses, for example. The center should therefore be challenging and adjusting individual business plans in order to develop realistic scenarios of financial performance and risks. External benchmarks can help the center set targets for business profitability and growth rates.

Continually challenging the business portfolio's composition. Centers must continually take into account whether businesses fit within the rest of the portfolio. Have the expected revenues, cost savings, and synergies been realized? How does the mix of businesses relate to the overall corporate vision and investors' preferences? Would another company be a better owner for this business?

High-Quality Controlling

The aspirations and activities of the controlling function should mirror the ambitions of the center. Different centers will have different controlling functions.

The performance-managing center will have a very lean controlling function and will delegate most of the operating aspects of controlling to the business units, focusing instead on the top-level planning, budgeting, and reviewing cycle. It is crucial for corporate controlling to go beyond the technical details of planning, such as consistency and consolidation, and to focus on interpretation, opportunity, and risk assessment. Corporate controlling will delve deeply into business operations only occasionally.

At the other extreme, the integrated center will play a much more active and operational role in controlling. In cooperation with the corporate-development function, corporate controlling will initiate and drive a process that establishes portfolio strategy decisions and top-down targets for the planning and budgeting process. The discussion in the planning process will be detailed and based on operating strategies and key performance indicators. In addition to high-level metrics, such as economic profit, various operating metrics, such as cash flow and margins, will be part of the target and incentive systems. The controlling function should conduct frequent business-performance reviews with individual businesses. These reviews should focus on operating goals and improvements and business performance—and if targets are not met, the controlling function should become deeply involved in helping to improve the lagging businesses. At integrated companies, corporate board members will be more closely involved in the controlling process.

In all centers, corporate controlling must develop a system that integrates external value creation—as measured by total shareholder return—and internal value metrics. Strategies have to be evaluated along several dimensions. How will a particular strategy, for example, affect business fundamentals such as margins and growth; shareholder fundamentals such as earnings per share; and the potential use of free cash flow to pay dividends, repay debt, or repurchase shares?[3]

3. For more about value creation, see *Avoiding the Cash Trap: The Challenge of Value Creation When Profits Are High,* the 2007 Value Creators report, September 2007.

Pulling It Together

Redesigning the center is not minor surgery. It is an invasive undertaking that requires an organization to essentially rewire its central nervous system. Further, designing the type of lean and active center outlined in this report is not a one-shot process; it requires ongoing effort. (See the sidebar "The Creation of a New Center.")

Today, globalization and technology allow companies to source, sell, and manufacture throughout the world. At the same time that they are spreading their wings in this way, they also need to look inward and make sure that their centralized operations are working to the benefit of their far-flung empire. More than ever before, the role of the center should be at the heart of corporate activities and the focus of attention for senior executives.

The Creation of a New Center

Creating a new center for a large company is a tall order. An industrial goods company with 80,000 employees created a new, integrated center only after conducting extensive research to make sure that it fully understood its capabilities and needs. This research exercise consisted of the following activities:

- Interviewing more than 200 executives—from both the center and the business units—in order to develop a profile of the center's strengths and weaknesses and the allocation of roles among the organization's layers
- Assessing the skills of the center's current staff by evaluating their operating experience, reputation, and other qualifications
- Analyzing all the activities performed by the center and subcenters; breaking down head counts and costs for 270 activities; and assessing overhead costs of $1.5 billion
- Evaluating the logic of the business portfolio, with an eye toward forging strategic links between businesses that have common technologies, customers, assets, and other elements
- Assessing the company's spans of control and the issues related to its organizational layers, such as communication, transparency, and agility in decision making
- Reviewing relevant external benchmarks to challenge organizational beliefs and add a new perspective

On the basis of this research and analysis, the company developed scenarios for different center types and roles, looking not only at the main center but also at subcenters. These scenarios included detailed descriptions of roles and resource requirements; the likely spans of control within the center and the subcenter; and an overview of how the center's structure would align with the portfolio of businesses.

These scenarios were presented to the management board during a two-day workshop. The board ultimately chose a radically new approach: it decided to eliminate an entire layer of management and to create a new, integrated corporate center that would be more agile and cost about 30 percent less.

The new center required the company to redesign the key processes of both management and service functions.

The Creation of a New Center (continued)

About half of the overhead resources were reallocated and transferred to new entities, which included a shared-services organization with more than 2,000 employees and a corporate center with about 250. The new structure streamlined communications, clarified responsibilities, and reduced complexity, especially in the annual planning, budgeting, and strategic-review process.

The corporate center was staffed in an organized fashion. First, the company came up with detailed job descriptions for the top three management levels at the center, the shared-services center, and the business units. The job requirements emphasized both operational and international experience. In a cascading process, senior executives first offered jobs to the very top layer of managers, and then those managers helped to fill the jobs in the second layer, and so on. The staffing process took about three months to complete. The new managers, meanwhile, developed action plans to cut costs and improve service quality.

For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to senior executives. Recent examples include:

The Future of HR in Europe: Key Challenges Through 2015
A report by The Boston Consulting Group, June 2007

Managing for Value: How the World's Top Diversified Companies Produce Superior Shareholder Returns
A report by The Boston Consulting Group, December 2006

"Realizing the Potential of Multibusiness Companies for Organic Growth"
Opportunities for Action in Operations, July 2005

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