Brief

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Getting the right size and design of HQ: bigger may be better?

High performing companies are more likely to have a strong (and slightly bigger) centre

A key task for any CEO is to get the size, quality and role of the corporate centre right. Getting it right is skilful: too much control and you can stifle the talent of senior leaders in operating businesses. Too little and you may pump up risk.

For many years the accepted wisdom was that the most important issue was the size and cost of the HQ. The leaner and meaner the HQ, the more impressive. High profile CEOs (such as Martin Sorrell and Jack Welch) were lauded by the media and investors for making a public virtue of a very modest centre.

More recent research suggests that it is not that simple. High performing companies have HQs 20% bigger than average. Other research shows that this is about balancing effectiveness with efficiency. Companies strong at execution are much more likely to have a strong centre that supports, rather than just audits, the business (78% of those strong at execution have a strong centre vs 49% of those less good at execution). But most companies are not strong at execution, and have HQs focused on audit and control rather than supporting and enabling - which means bureaucracy that hinders decision-making and adds cost.

We looked at a range or published material to see what can be learned from the more recent thinking. This included work by consultants Booz and Boston Consulting Group, as well as articles from Harvard and Ashridge business schools. These are the key common ideas and themes.

Four elements of a successful HQ

The evidence from the research is that successful corporate centres display the following:

- ***The right role***: HQs are designed around a deliberate choice of role, rather than a choice of size, with goals that go beyond simply controlling the size of their own central overhead cost.
- ***In support of the business model***: HQs have roles that support the business model of the organization and the sources of strategic strength
- ***Clear contracts***: HQs have clearly articulated 'contracts' between the centre and the business units that make mutual expectations explicit
- ***Future-focused***: HQs are actively managed with the future in mind (where does the business want to grow, and how), rather than history and habit

Three broad roles for HQ

There are three broad roles that effective HQs can play. These are options, and depending on what is right for the business, the centre can play one or more:

1. ***Light touch governance:*** The classic holding company role, to ensure core regulatory, tax, audit, compliance and investor standards are met. To be effective this only requires a small number of people. A company with 10,000 employees can have just 30 in these roles.

2. ***Strategic value:*** This is an activist, supporting and enabling role providing strategic value that individual units cannot achieve on their own. Companies like GE, PepsiCo, Tesco, WPP, famous for lean corporate costs, none the less have activist centres - focusing on one or two such things as lean manufacturing, customer insight, transfer of technologies or senior talent management. These are their chosen core processes in their business model where small central teams can drive accelerated added value. What this means in practice will depend on the business model and sources of competitive strength. If breakthrough innovation plays a major part, it will be R&D. If manufacturing excellence is central, than it may be lean process expertise. If it is a people business it may be talent management. Other functions may include M&A, and corporate investment. This is not about control or enforcement it is about adding real value.

   Smart companies also make sure these teams are not ivory towers, or divorced from the realities of business by rotating the key managers for a two or three year tour of duty at HQ while in their normal career in a line of business. These small central teams may also run informal networks of interested experts across the business which allows them more resource and influence than they can achieve on their own at the centre.

   (For more on informal networks see our *Brief* on *Leadership is influence: making informal networks work as well as formal structures.*)

   There is another increasingly important type of added value strategic role - that of building and protecting the corporate purpose, identity, reputation and ensuring that all the key stakeholder relationships are managed. In an increasingly complex online world of joined up stakeholder groups, the key activities that shape the 'permission to operate' are not the simply the legal and regulatory ones - but the implicit ones of activist consumers, public opinion and lobby groups. There is no longer such a thing as a 'hidden' holding company, and any activist stakeholder will aim to impact the corporate whole and not simply a local business. Managing what the whole company stands for - to engage and motivate employees and customers especially - and to manage the risks associated with that, is an increasingly important role for the centre. This applies to everything from managing 'green' credentials with credibility to supply chain ethics.

3. ***Shared service:*** This is where economies of scale are harnessed to get more value out of doing certain things once or by one team rather than in fragmented ways across the business. Some believe the ability to drive synergies is regularly overrated (sometimes under the vested-interest influence of outsourcing companies). Typical functions may include IT, purchasing, compensation and benefits, and may often report into a CIO, CFO or CHRO.

Six steps to establish the right size and role for the centre

Based on this research there are six steps to establish the best corporate centre for a business:

Step 1: Establish the basic governance requirement. What is left if you strip everything out of the centre except what is required to meet legal and policy requirements?

Step 2: Understand your business model and how it may need to adapt to future sources of growth. Look for common features and interdependencies between business units.

More stable and mature markets can more easily be managed more centrally. The faster moving and more dynamic your markets are, the more that is usually best managed locally. On the other hand, fragmented markets, rapidly changing technology and faster innovation cycles, which intuitively suggest a decentralised approach, can benefit from an activist centre - establishing common approaches, common technologies, game-changing approaches and fast transfer of know-how across business units.

Step 3: Clarify the sources of competitive advantage at the heart of the business model. Where can a corporate centre add value to these? What are the 3 to 5 key activities which, if driven from the centre, can give a quicker, better or cheaper solution than doing them in operating companies.

Step 4: Establish the value of shared services (if any). Where are the economies of scale in purchasing, common systems and processes? This can be combined with group outsourcing. The benefits of shared or outsourced services need to be significant, measureable and delivered in a 1-2 year horizon, or they are best left to business units.

Step 5: Redefine the contract between HQ and business units and make this explicit and widely understood to ensure maximum total value. Describe the exact role of the centre and how it will work with business units. Focus on simple, fast and transparent ways of working. This is not the place for subtlety.

Step 6: Redefine how the executive team works. The degree of central activist behaviour, or of line of business autonomy should be reflected and enabled by who sits on the Executive, what the focus of their agenda is, and how it operates. The more the lines of business are free, and the less the centre does, the smaller and more narrowly focused the group executive should be. The CEO is best placed in this case to manage relationships with unit leaders one-to-one.

Following this six step process leads to the right size headquarters for your business.

There is not one simple model, but neither is there evidence that smaller is always better.

Sources

Sources used for this article include: Collis, Lagace: *Does your corporate HQ fit with corporate strategy?* (Harvard Business Review); Couto, Neilsen: *Headquarters: Irrelevant or irreplaceable?* (Booz); Goold, Campbell, Alexander: Corporate *Strategy and Parenting Theory* (Ashridge); Goold, Young: *When lean isn't mean* (Ashridge, Harvard Business Review); Kocourek, Hyde: *The Model 2 Organisation: Making your company safe for zealots* (Booz); Neilson, Deffarges, Kocourek, Treat: *Putting headquarters in its place* (Booz); Rheault, Trussler : *The Activist Centre* (Boston Consulting Group); Stalk: *Rotate the core* (Boston Consulting Group, Harvard Business Review).

