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# Headquarters: Irrelevant or Irreplaceable?



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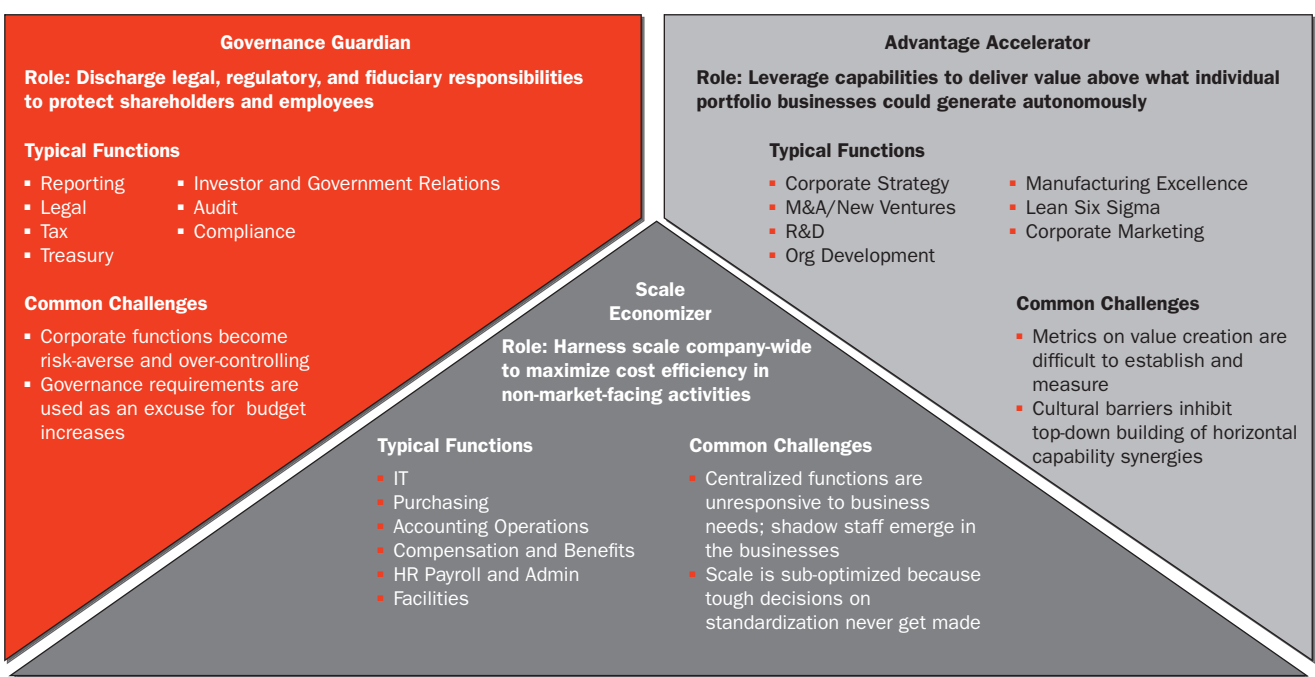


# Headquarters: Irrelevant or Irreplaceable?

For years, the prevailing wisdom has dictated a lean, mean corporate core. Keep headquarters small, the argument goes, by delegating as much decision-making authority and accountability as possible to the business units. Support functions should be farmed out to consolidated shared-services centers, while the corporate core's sole focus should be on governance, strategy setting, and resource allocation. There's nothing wrong with such logic, but the implied premise that "bigger means bloated" is faulty.

The truth of the matter is that there is no one easy answer or magic number when it comes to sizing the corporate core. Its ideal size depends on a myriad of factors unique to your business, including the regulatory environment, competitive capability requirements, and the efficiency expectations of your stakeholders. Ultimately, the right size for your corporate core is a function of the roles you expect it to play, whether of (1) Governance Guardian; (2) Advantage Accelerator; or (3) Scale Economizer (see Exhibit 1).

**Exhibit 1**  
Corporate Core Roles



Source: Booz Allen Hamilton

*“Putting Headquarters in Its Place: The New Lean Global Core”* was published by Booz Allen Hamilton in 1999. Since then, Booz Allen has been tracking and driving the trends in corporate headquarters, including HQ roles, where value is added, and how to make transformations happen.

Big corporate centers have earned their bad reputations, so it's little wonder that they are the first target in so many corporate restructurings. Years of bureaucratic, “Big Brother” behavior, glacial decision making, and opaque overhead allocations have not won HQ many allies among the P&L-bearing business units and newly streamlined support functions. Consequently, in recent years, the best practice in sizing the corporate core has been to shrink it and cut its costs.

The irony is that there is no evidence to suggest that a streamlined core contributes much in the way of incremental value to a company (see Exhibit 2). In fact, our analysis shows no correlation between the efficiency of the corporate core (as measured by the size of its headquarters staff relative to revenues) and shareholder returns (as measured by stock price growth). Of far more impact are variables such as the external competitive environment, the company's business strategy, the performance and potential of businesses in the corporate portfolio, and the ability to focus and execute.

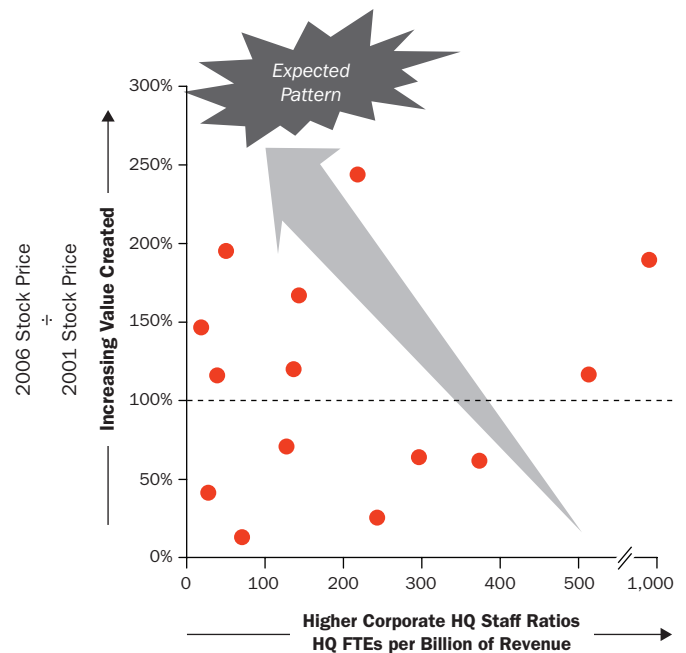
This calls into question companies' single-minded devotion to cutting costs in the corporate core. If big is not necessarily bad, what constitutes good?

### **Balancing Efficiency with Effectiveness**

First, companies need to recognize that the optimal size for the corporate center is not simply a function of efficiency, but also one of effectiveness. Headquarters needs to strike the right balance. But how do you assess the effectiveness of the corporate core? Over

### **Exhibit 2**

Corporate Core Efficiency Doesn't Necessarily Drive Better Shareholder Returns: Booz Allen Sample of Companies



Note: Stock index is defined as stock price in June 2006 as percentage of stock price in June 2001; stock price adjusted for split and dividends  
Source: Booz Allen Hamilton

the past few years, Booz Allen Hamilton has collected over 50,000 individual responses from around the world to an organizational diagnostic tool we have posted online. This tool helps respondents profile their organization and its ability to execute (go to [www.orgdna.com](http://www.orgdna.com) to take the survey). According to our findings, “strong execution” companies (those that quickly translate important strategic and operational decisions into action) are significantly more likely to have a corporate staff that “supports” rather than “audits” the business units (78 percent versus 49 percent for “weak execution” companies) (see Exhibit 3, page 3).

Unfortunately, most companies are not strong execution companies. Not surprisingly, the corporate staff at these weak execution companies more often “audit” than “support” the business units, resulting in unnecessary bureaucracy, hindering decision making, and adding cost.

It's a bit of a chicken-and-egg dilemma. Does the dead weight of the corporate core contribute to a weak performance culture or does the weak performance culture disable the corporate core? Regardless of the answer, we believe that half the battle is in setting explicitly clear roles and expectations for the corporate core.

**Clarifying the Role of the Corporate Core**

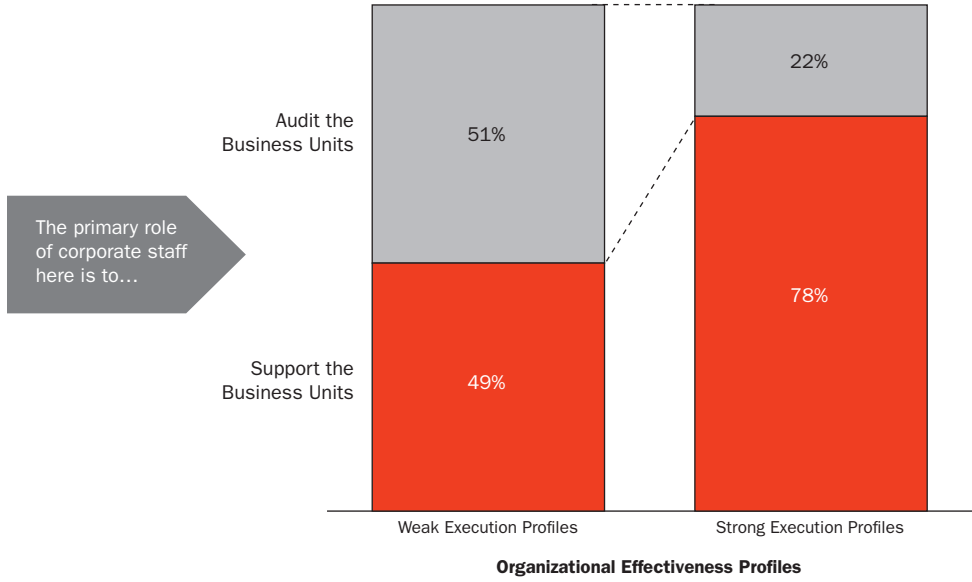
Years of being misunderstood and dismissed as “overhead” have contributed to corporate staff cynicism, and this treatment has obscured the real and enduring value the corporate core can contribute in one or more of three distinct roles, as shown in Exhibit 1, page 1: (1) Governance Guardian, (2) Advantage Accelerator, and (3) Scale Economizer. A company's competitive environment, corporate strategy, and shareholder demands may dictate its choice of these three roles and the size of the corporate staff needed to fulfill them. But it is up to management to determine the appropriate balance of efficiency and effectiveness across each role.

**Governance Guardian.** There is no opting out of this role, which encompasses all of the legal, compliance, and finance activities needed to conform with corporate governance standards and regulatory requirements. Although the added value contributed by this role is limited, it is not a significant drain on resources either, as economies of scale are easily leveraged and head-count needs are low. In our experience, a company of about 10,000 employees can comfortably handle governance activities with about 30 staff.

**Advantage Accelerator.** It is here where the corporate core makes the leap from “auditing” the business units to releasing the value trapped between and among them. In the Advantage Accelerator role, considerable incremental wealth is created if the core does its job right.

The Advantage Accelerator concentrates on the sources of competitive advantage identified in a company's strategy, whether innovation, leadership development, consumer marketing, manufacturing

**Exhibit 3**  
Corporate Staff Should Support, Not Audit



Source: Booz Allen Hamilton Org DNA Database (50,000 responses)

excellence, or any other critical capabilities. By allocating resources to the development and sharing of these winning capabilities, the corporate core makes explicit choices about where an advantage matters most in a company's market.

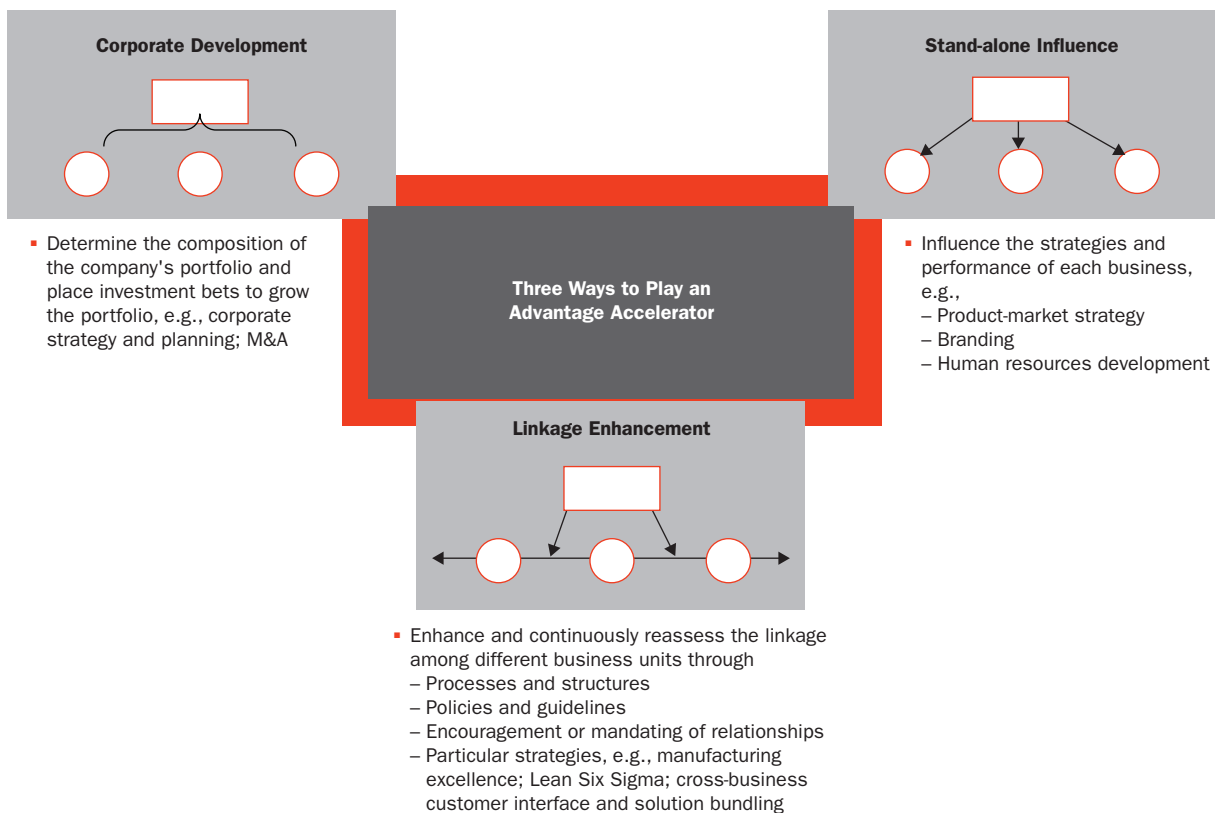
Not surprisingly, the Advantage Accelerator role is the most challenging of the three. To be effective, the corporate core must not only add value to the business units, it must add more value than the businesses could generate on their own—and more value than any other corporate parent could provide. Hence companies need to prioritize their investments in these capabilities. They must focus on capabilities that are truly differentiating; what one must be the best at to *win*. Other capabilities represent “table stakes,” or what one must be good at to *not lose*. In general,

this role can be performed in one of three principal ways: corporate development, stand-alone influence, or linkage enhancement (see Exhibit 4).

Given this range of options, each company will staff the Advantage Accelerator role differently, so simple benchmarking of the size and expense of this role compared to that in other companies will not prove fruitful. One company that views the creation of a strong corporate brand as critical might have 200 marketing professionals in the corporate core, for example, as compared to five at its chief competitor's headquarters. But this competitor might well have 200 HR professionals in corporate headquarters, because it deems leadership development and succession planning as critical. The ultimate test of the Advantage Accelerator is whether or not it creates value.

#### Exhibit 4

##### Advantage Accelerator Roles



Take a look at the *Fortune* 500 today, and you will see every variation on the Advantage Accelerator theme. Procter & Gamble and 3M, for example, have invested heavily in corporate R&D, and have enjoyed big new product payoffs as a result. Dow and GE, on the other hand, have focused on building a strong multi-business manufacturing function to encourage manufacturing excellence at the individual business unit level as well as across businesses. BP has pushed hard to create a high-performance HR culture in its corporate core, which oversees the establishment of stretch targets and personal performance contracts. Citibank's corporate center has emphasized the bundling of products and services from the company's diverse portfolio into integrated solutions that drive differentiation in the eyes of its customers. Different companies cultivate different competitive advantages at the corporate level.

**Scale Economizer.** Beyond observing minimum fiduciary obligations and cultivating strategic competitive advantages, the corporate core is basically overhead. Think of all those functions that are sensitive to economies of scale, scope, and specialization (e.g., IT, purchasing, accounting, facilities, payroll), and you have a good sense of what overhead encompasses. It cannot be eliminated, but it can certainly be optimized, and that is the third role of the corporate core: the creation of common processes, standards, and consolidated pools of expertise. More often than not, this takes the form of shared-services operations, either housed in corporate headquarters and reporting to corporate functional heads such as the CIO, CFO, or CHRO; established as organizationally distinct centers under a shared-services leader; or outsourced/offshored. The corporate core is still ultimately responsible for optimizing the efficiency and effectiveness of certain back-office or overhead functions; that is its third and critical role.

### **How to Design an Efficient and Effective Headquarters**

Some companies—Berkshire Hathaway springs to mind—never move much beyond the first role,

that of Governance Guardian. Adopting a “financial holding company” approach to their investments, these companies maintain a skeleton crew of legal and financial resources at the corporate level. Most companies of any size, however, move beyond this first stage and seek out ways to identify and add value at the corporate core. Moreover, these companies have typically also addressed the opportunity to leverage economies of scale in overhead functions.

Once organizations establish which one, two, or three roles they want headquarters to play, it becomes a matter of achieving the optimal balance of efficiency and effectiveness (see Exhibit 5, page 6).

#### **Step 1: Establish Corporate Governance Baseload**

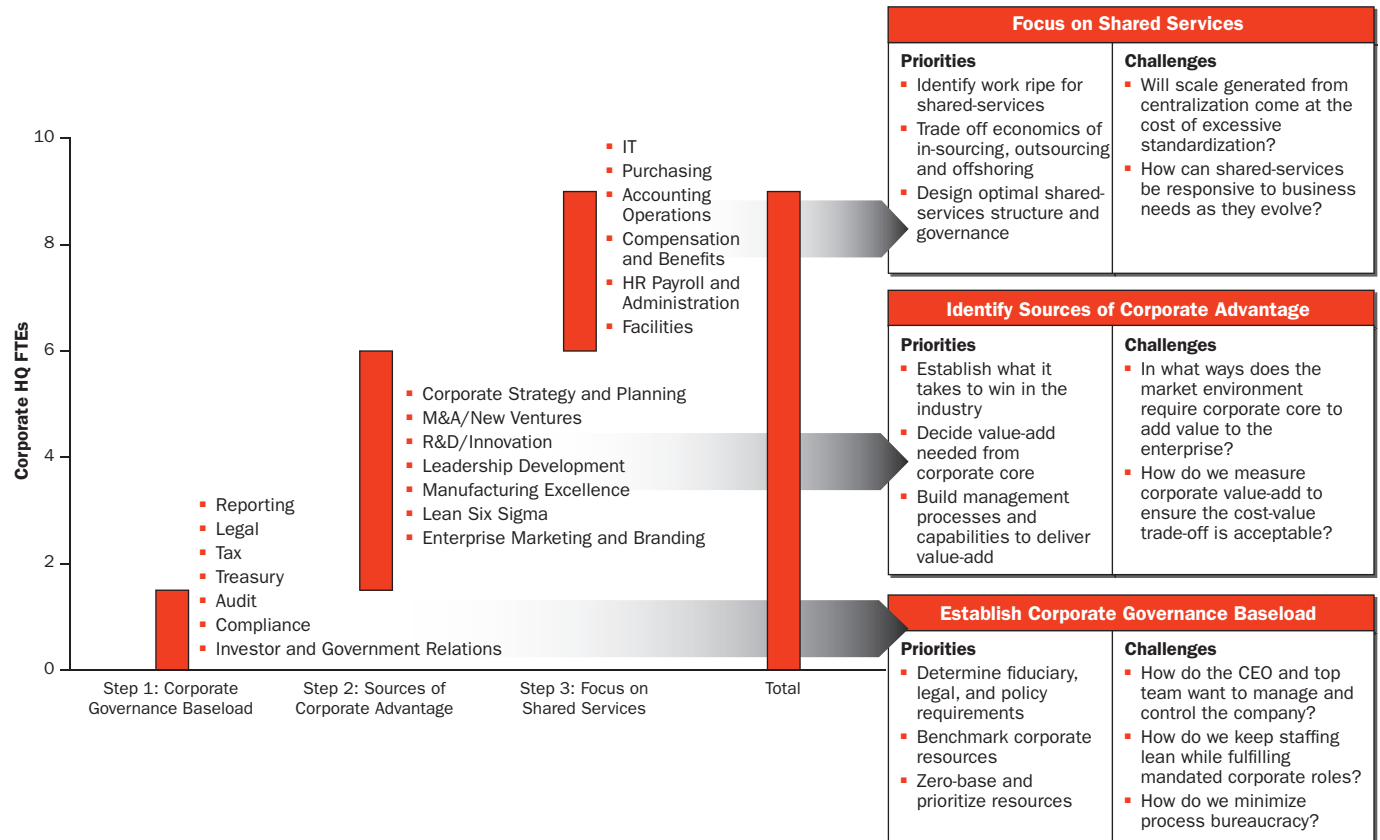
At a minimum, the corporate core is charged with minding the store: It must meet its fiduciary, legal, and policy requirements. Once this threshold is crossed, however, companies should weed out unnecessary auditing activities that are unproductive, even value-destroying. Aggressive benchmarking of staff numbers versus those of competitors is a required first step to provide reference points. However, companies should also take a fresh look at these functions and prioritize them from the bottom up. Whatever technique they employ, companies are likely to be surprised at how few staff they need to fulfill the role of Governance Guardian and how the resource need diminishes, relatively speaking, as the company grows in size. In our experience, the number of staff needed to maintain the Governance Guardian function typically increases only 50 percent when a company doubles, even triples, in size.

#### **Step 2: Identify Sources of Corporate Advantage**

Once legal and regulatory requirements are met, companies can indulge in more rewarding pursuits—identifying where the corporate core can add substantial, measurable value (see “Choosing Advantages That Matter,” page 7). Companies need to then lay out, in detail, how this wealth creation will be achieved, by designing the staff resources and processes to support it (e.g., transparent, economically

## Exhibit 5

### How to Design an Efficient and Effective Corporate Core



Source: Booz Allen Hamilton

driven resource allocation, clear and unambiguous decision rights). If major wealth creation opportunities are not readily apparent, companies should keep the corporate core small and focused solely on its fiduciary responsibilities.

### Step 3: Focus on Shared Services

What remains after you define the Governance Guardian and Advantage Accelerator roles is the support or back-office functions, which are often rife with untouched scale economies. If you find that routine back-office work (or highly specialized, non-business-specific work) is being performed in the businesses, then shared services may well represent an opportunity for your organization. If you already have shared services in place, you need to establish

mechanisms for continually reassessing their cost efficiency and service responsiveness. Outsourcing is often an attractive option. Companies enjoy a greater economic benefit at lower transaction costs with a more accountable and market-competitive set of vendors. The best way to assess the efficiency and effectiveness of your shared-services functions is to consult internal business users and benchmark these services against those of other external providers.

Of course, the shared-services approach is not always a panacea, so businesses should have some freedom to opt out if they are dissatisfied with the services provided. Shared services will prosper in the long term only if they are delivering real, measurable value.

### Case Study: Choosing Advantages That Matter

A major multi-business industrial recently undertook a comprehensive review of the role and value of its corporate core functions and discovered some startling insights, along with cost savings. By understanding what was really needed to win in its market, this company selectively invested in the types of advantages that mattered most.

The company's HQ had built up a coordinating interface with key customers on behalf of its multiple businesses, believing this to be an advantage that mattered to large business customers. However, this interface was layered over the additional interfaces that each of the business units had with the customers. The overlap caused confusion for the customers, and provided a convenient channel for customers that wanted to leverage their bargaining and purchasing power across multiple businesses. This perceived advantage was in fact destroying value for the company. So the company eliminated its corporate customer interface model, dispersed and delegated more customer authority to the business sales heads, and also achieved cost savings.

Interestingly, the same benchmarking and analysis of corporate value-add identified another area—purchasing—where more corporate coordination was indeed the right answer. In an industry with razor-thin margins and raw materials making up 60 to 70 percent of the cost structure, a purchasing advantage was needed to make a big difference. By concentrating governance, people development, category planning, and supplier quality control and development at corporate headquarters, the company was able to consistently build its purchasing capabilities. In this case, the corporate core did accelerate an advantage.

### Picking Your Spots

By now, it should be evident that there is no easy or direct answer to the question, “How big should my corporate core be?” It depends on a host of both external and internal variables, which together determine the role the core plays in your organization—

that of Governance Guardian, Advantage Accelerator, Scale Economizer, or some combination thereof. It is only when you assess and optimize each of these three roles individually that they determine the corporate HQ that is right for your organization and maximize shareholder value.

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**Also contributing to this piece was Deniz Caglar.**

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