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COMMENTARY

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Reflections on the design of corporate headquarters



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Abstract

The design of corporate headquarters (CHQ) is a specialist and important area of organization design. It is important because of the influence that a CHQ has over the portfolio of businesses it owns. A good CHQ can improve the performance of its businesses. A bad CHQ causes its businesses to perform less well. This article describes the lessons learned from a 30-year career researching, advising, and governing corporate leaders. It covers the reasons why CHQ design is so important, why CHQ design work often also involves strategy work, what activities are needed at the CHQ level, and the problem of subtracted value. The ambition is to help practitioners design better CHQ and help researchers design more relevant research.

Keywords: Corporate headquarters, CHQ, Organization design, Diversified companies, Added value, Subtracted value

Introduction

The design of corporate headquarters (CHQ) is a specialist and important area of organization design. It is important because of the influence that a CHQ has over the portfolio of businesses it owns. A good CHQ can improve the performance of its businesses by a significant amount. A badly designed CHQ can cause its businesses to perform less well. I have worked as an academic, consultant and non-executive director in the space of corporate strategy and corporate headquarters for the last 30 years, with a particular interest in organization design. In this commentary, I would like to reflect on why CHQ design is so important, why it is difficult to do well, and what I have learnt about good CHQ design. The ambition is to help practitioners design better CHQs and help researchers design better research.

First, I should explain what I mean by CHQ organization design. As a specialist area of organization design (Goold and Campbell 2002), CHQ design covers the following questions:

1. What activities to carry out in the CHQ? This is partly a CHQ strategy question rather than an organization design question. But, as I will explain later, CHQ organization design projects often involve revisiting the CHQ strategy.



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2. How to divide the CHQ activities into departments or functions? Typically, a CHQ consists of finance, HR, IT, legal, and other functions. But is this the best structure? What are the alternatives?
3. What type of person should lead each of these departments/functions and who should they report to? Some CHQ have a COO role that has responsibility for most of the corporate functions. Some have most corporate functions reporting to the CFO. Some functions in CHQ may report to the heads of business divisions, giving these individuals a role beyond that of running their division.
4. What levels of authority to delegate to business divisions and what powers to retain at CHQ?
This varies enormously from highly decentralized CHQ to highly centralized CHQ where the central functions control all of the staff in their function throughout the organization.
5. How managers in the CHQ should interact with managers in the business divisions on governance topics, such as financial reporting, and on added value topics, such as strategy, budgeting, people assessment, risk management, and performance management? There is some similarity across CHQ in the area of governance, because many face similar governance challenges, but there are big differences in how CHQ add value and in the interactions and processes they use to create the added value.
6. How to manage the CHQ organization? What CHQ meetings, what performance measures, and what processes. Few CHQ measure their performance. Few even have CHQ meetings. Typically, the CEO is so busy managing the portfolio of businesses that he or she gives too little attention to managing the CHQ.
7. Where to locate CHQ activities? In one building or many, in one country or many, co-located with business divisions, or in separate locations.

While there is advice available in each of these areas of CHQ design (for comprehensive reviews see, Kunisch et al. 2015; Menz et al. 2015), there are some overarching challenges that I want to address.

The importance of CHQ organization design

As Gary Hamel (1996) commented about corporate-level managers, “The bottleneck is normally at the top of the bottle.” While he was criticizing many CHQs, he was also underlining the importance of a well-functioning and well-designed CHQ. Some CHQ appear to be performing well. For example, a recent analysis suggests that conglomerate discounts have reduced in recent years from an average of around 10% to single figures, and in Asia, there may even be a conglomerate premium (Pidun et al. 2019). However, a good number of CHQs are performing poorly. Many diversified companies still sell for a significant discount to their break-up value: referred to as the “conglomerate discount” (Thompson 2011). From an economic perspective, this discount can only be justified, if investors believe that the value of the whole company is less than the value that the business divisions would achieve as independent companies. This means that investors are expecting that the value of the business divisions will be greater without the influence of CHQ, their shared parent company. What is more, the discount can be large. It can be as high as 50%. Even a 10% discount is a significant reduction in value. So, it is evident that there are many opportunities for better CHQ design (Feldman 2020).

Another argument for the importance of CHQ design and the need for better design in many companies is the widely shared criticism of CHQ from managers in business divisions. It is rare that managers in business divisions praise managers in CHQ for their help and support. The joke “I am from headquarters and I am here to help you” has resonance because “help”, at least as perceived by division managers, is rare. More normally division managers perceive CHQ to be a burden: asking endlessly for information, slowing down decisions, and imposing inappropriate constraints. This is underlined by the excellent performance that spin offs often produce once released from the “burden” of their previous CHQ or when transferred into the hands of a private equity owner, with a much smaller CHQ (McConnell et al. 2015).

CHQ design is an important area of organization design that can increase the value of the whole organization by eliminating the conglomerate discount of 10–50%, and in some cases, leading to a doubling or tripling of the market value. Since CHQ are often less than 500 people and sometimes less than 100 (Collis et al. 2007, 2012; Kunisch et al. 2012), it is unlikely that there is another place in the organization where design work on a small number of people can have such a large potential impact on value.

Design work should start with strategy

CHQ organization design should start with strategy: form follows function (Sullivan 1896). However, CHQ often do not have a documented strategy for the CHQ. They have a strategy for the whole corporation, which focuses on the portfolio of business divisions. This corporate strategy defines where money will be invested, which businesses are low priority or candidates for divestment, which are candidates for acquisition, and how this portfolio will achieve the corporate ambitions. Corporate strategy rarely says much about the work of or role of CHQ. As a result, working on the design of the CHQ is typically not only about organization design. It normally also involves helping clarify, and sometimes even develop, a CHQ strategy. This CHQ strategy should define which activities need to be done at CHQ, which activities and powers need to be delegated to business divisions and why.

There are two logics for doing something at CHQ either the activity creates added value (the economic justification) or the activity is required by law or by stakeholders (the governance justification) (Campbell et al. 2014; Chandler 1991; Foss 1997). Although these are different logics, they often overlap: good governance can add value, and some added value activities contribute to better governance.

The governance logic for doing something at CHQ is about things like maintaining an effective board of directors, ensuring that the corporation is abiding by the law, and ensuring that there are appropriate controls and information flows such that top executives are informed about and have decision rights over all material events. These activities typically involve significant costs without adding significantly to performance. They are the burden of running a corporation. To pay for this burden and to come out ahead, CHQ must add significant value.

The added value logic for doing something at CHQ is about interacting with the business divisions in ways that help them perform better. Added value exists if the CHQ interacts with the business divisions in ways that causes them to perform better than they would have performed if they were independent companies. The interactions should help to reduce costs, increase sales, increase margins, or improve asset

utilization. Added value activities include things like giving wise strategic guidance, helping select better people, setting more appropriate performance goals, helping make better decisions, encouraging profitable collaboration between divisions, and providing quality services (Campbell et al. 2014).

The benefit of distinguishing between the governance logic and the added value logic is that governance activities are typically best divided into and managed as functions—tax, board support, financial reporting, legal, etc.—while added value activities are typically best divided into and managed as added value propositions. So, a well-designed CHQ would expect to have functions justified by their governance roles and departments or projects justified by their added value propositions. The added value departments would have missions such as “lower cost financing” than available to independent companies, “better people” than could be attracted, and retained by divisions on their own, “more focused strategies” than would typically be followed by independent companies in this industry, “higher performance ambitions” than Unfortunately, although nearly all CHQ have functions covering the governance roles, very few have structures with departments explicitly focused on value added propositions. Instead, most CHQ are structured only by functions, and these functions have a combination of governance roles and added value roles. This means that an added value proposition, such as “better performance management”, typically involves multiple CHQ functions: for example, the finance function helps the CEO set financial performance targets for each division and designs and leads the monthly or quarterly performance review meetings, the audit function checks that the numbers are correct, the strategy function helps set strategic performance targets, and the HR function designs the system that is used for assessing individual performance. Coordinating across all these functions to achieve “better performance management” is hard, and failure to coordinate well often leads to poor outcomes.

The power of the vital few

Most CHQ are ambitious to add more value. In pursuing these ambitions, they set up extra functions, launch new initiatives, and try influencing the business divisions in new ways (Kunisch et al. 2014). When asked for a list of added value activities, leaders in most CHQ produce a long list ranging from items that potentially have a big impact on performance, such as guidance on strategy or help with cost cutting or innovation, to those that have a miniscule impact such as centralized payroll or centralized purchasing of laptops. Moreover, there is rarely any agreed sizing of these sources of added value: there is little common agreement about which have the potential to “move the needle” and which are insignificant. This results in attention on the big sources of added value being diluted because attention is also given to the smaller sources of added value. In addition, attention on the big sources is also diluted by mixing governance activities and added value activities in the same functions.

Despite the ambition of all CHQ to add lots of value, my experience is that CHQ that focus on a few ways of adding value typically do better than those aiming to add value in many ways. Research by consultants at BCG showed that it is possible to try to add too much value (Krühler et al. 2012): companies with value added ambitions beyond the potential synergies in their industries underperformed those with lower ambitions. The success of the private equity industry (or at least some firms in this industry) also

illustrates the benefit of few added value ambitions. The most profitable private equity investments are often business divisions of large companies where the CHQ is trying to add value in many ways. By removing these divisions from their previous parent and by focusing attention on a few areas, such as cost cutting and growth, the private equity firm can often double or triple the value of the business they acquire.

In my opinion, CHQ need to define only three to five sources of added value (Campbell et al. 2012). The CHQ should then be designed around these few sources of added value and the core governance activities. Additional activities, whether added value or added governance, should only be considered if they do not distract attention in the CHQ or in the business divisions from the “vital few”.

The problem of subtracted value

A focus on the vital few sources of added value also has the benefit of reducing the chance of subtracted value. The eagerness of CHQ managers to add value often causes them to launch initiatives that not only distract from the vital few but also subtract value in their own right. For example, one food product company wanted to create more synergy between its US and UK businesses. To kick start this synergy, the leadership decided that each business would launch a product that was successful in the other business. A couple of years later, when the benefits of the product exchange were being reviewed, the review team concluded that one of the products was successful while the other failed. However, in both cases, the decision to launch these products crowded out other product launches that would have been significantly more successful (as was proved when the delayed products were launched the following year). In other words, the opportunity cost of pushing for synergies was greater than the benefits. While most CHQ managers will say that their biggest challenge is to find ways to add value to their business divisions, my observation is that their biggest challenge is to avoid subtracting value (Campbell et al. 2014).

A well-designed research on added and subtracted value clearly demonstrates the dangers of subtracted value (Krühler et al. 2012). The report of this research was titled “First do no harm”, connecting with the physician’s Hippocratic Oath to avoid making the patient more ill, while the physician is looking for ways to make the patient better. In this context, CHQ, like physicians, are seeking to improve the health of their business divisions. Unfortunately, they often make them less well.

Because subtracted value is such a problem and appears to creep into the activities of well-meaning teams and hard-working teams so frequently, good CHQ design should involve designing defenses against subtracted value (Campbell and Szulanski 2016). These may be structural designs, such as high levels of decentralization, or process designs, such as annual challenge of CHQ activity from the business divisions. Defenses against subtracted value are needed because, despite the best intentions of CHQ managers, subtracted value is common.

The process of continuous learning and adjustment

My final learning is that CHQ design is always work-in-progress, not only because people change around the top table, but because the way that the CHQ adds value should be continuously evolving as the needs of the businesses change.

This is less true for governance activities, which can be expected to be more stable. In contrast, added value activities should evolve. As CHQ managers learn better ways of achieving their added value, they should change their activities. As managers running the business divisions learn from their CHQ colleagues, they may no longer need “help” in some areas. As business challenges change, new sources of added value emerge and need to be addressed. It is because sources of added value are changing that CHQ need strategies that are regularly challenged and reviewed.

This is one of the reasons I believe it is best to structure the non-governance activities in a CHQ around added value propositions rather than around functions. While structuring around the added value has the danger of cementing in a particular approach to added value, it also makes it easier to assess whether the added value is being created and to eliminate a team or process that is no longer delivering added value. All of those who have worked in large companies have experienced CHQ processes or requests for information that consume time but add little value. Often, these processes are legacy activities of some long-abandoned added value proposition. For example, one company had an elaborate performance management system that required significant filling of forms, regular information flows, and quarterly meetings between subordinates and their bosses. It had been installed by a previous HR Director who had used it to raise the quality of people in the organization and increase the amount of people exchange between business divisions. But over time, the reason for the system had been forgotten, and its status within HR became that of “best practice”. The current HR Director was not using the system as it had been designed, but had not removed it because his team told him it was “best practice”. If the system had been labeled as part of an initiative to improve people quality and people exchange, it would have been easier to drop it or change it, when the need changed. Regular challenge is needed of existing activities and current beliefs about the added value of CHQ.

To avoid the “top of the bottle” from becoming a bottleneck, and to help CHQ make the whole worth more than the sum of the parts, CHQ need to be well designed. This article shares learnings from 30 years of research and practical experience. It should help design practitioners do better design work and help researchers develop more useful hypotheses to test.

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