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A new look for the corporate center: reorganizing to maximize value

Peter Kontes

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At most large companies today, the activities and structure of the corporate center are based on a traditional functional support model that is no longer appropriate for maximizing the value of the company. In the modern corporation, the center should be organized not around support functions, but around clearly defined value-creating activities. The resulting structure would look very different from the traditional model, giving the CEO added leverage for achieving superior performance over time (Figure 1).

The need for change

The primary role of the modern corporate center should be to assure that company resources are invested to maximize profitable growth and long-term intrinsic value. But corporate centers were not created for this purpose. They were created primarily to assure control (targets and plans), compliance (policies and standards) and cost efficiencies (scale economies) in largely single-business national market companies which often grew into the multi-business global companies of today.

These traditional centers generally comprised functional silos organized around finance, human resources, marketing, IT, legal, etc., usually reporting directly to the CEO. But while companies themselves have changed enormously over the last 30 years, most corporate centers today are still a legacy of this traditional structure, presenting management with significant problems, including:

- **Unclear roles and responsibilities for creating value.** The functional silos do not share common performance objectives, measures or decision processes for managing their activities. For example, the finance, strategic planning and IT units often have completely different and competing views on what information executives require, with the result that business units receive multiple and often conflicting performance objectives, performance indicators and decision criteria. As another example, HR departments often design and implement incentive compensation plans that are not aligned either with capital market requirements or with the capital management practices of the company, and this can have unintended, but costly, consequences for future financial and strategic performance.
- **Hard to measure contributions to value creation.** These functional silos are hard to benchmark in terms of quality or cost of outputs. While measuring these factors properly within and across companies would present challenges in the best of circumstances, the fact that there is so little clarity of mission and so few common measures of success across these silos makes the task of benchmarking almost impossible. Thus, no one seems to know what

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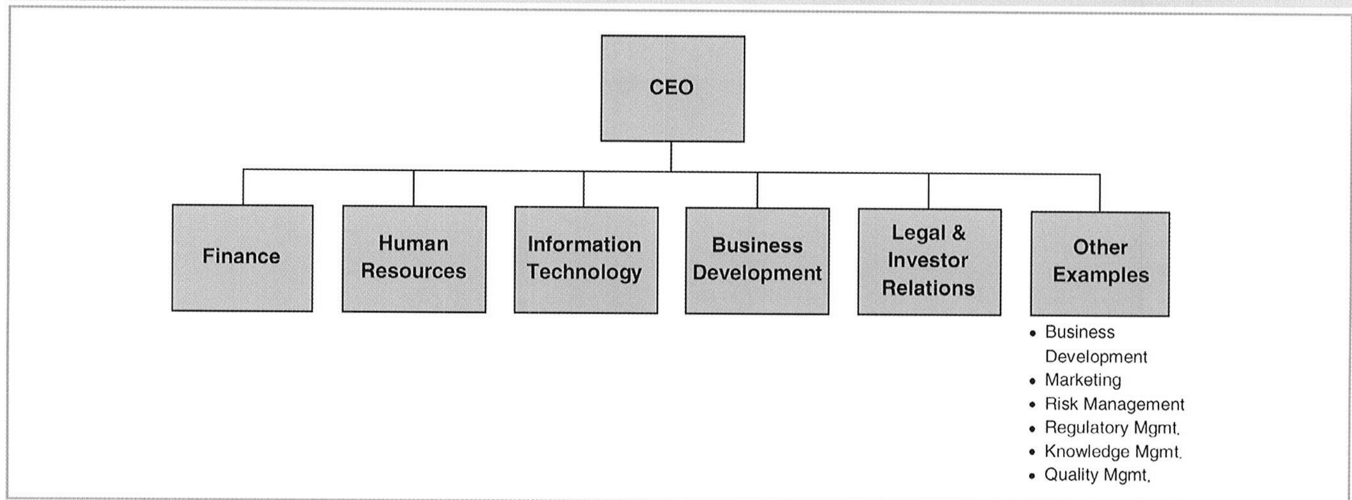
Figure 1 Typical corporate center model



the "right" amount is to spend on (or the "right" amount of output to be receiving from) the finance function, or the HR function, or the IT function.

- **Added complexity of decision making.** Because of their relatively narrow focus, it is often difficult for these functional units to contribute meaningfully to broader strategic and organizational issues. On issues that do require multi-functional inputs (i.e. almost every important issue), these silos can be difficult to align and coordinate, with one result being too much upward delegation of process decisions to the CEO.

Most companies do recognize the need for change and have attempted, with varying success, to modify or adapt the traditional corporate center structure to contemporary needs. For example, in many companies, some form of a business development function has been added to the center, and IT has been elevated from a narrow technical function to a broader information management role. Some companies have also created corporate-based centers of excellence, such as marketing and knowledge management, to leverage competitive advantages spanning multiple business units. And in almost all companies, the role of the CFO has been expanded from reporting, treasury, audit and tax to include more "strategic" responsibilities.

In our view, these modifications, while directionally helpful, cannot overcome the inherent shortcomings of the traditional corporate center: It is imperfectly aligned with the objectives, the complexity and the scale of the modern corporation. Consequently, we believe top management should consider redefining the activities and changing the structure of the center. It could then become a powerful enabler of, and not an obstacle to, superior performance.

To improve the performance of the corporate center, top management needs to address two challenging tasks: first, how to create a new model of the center and, second, how to replace the old model of the center.

Creating a new model of the center

The corporate center has a complex role. It serves as both a wealth creator (formulating and executing corporate strategy) and as a wealth creation catalyst (enforcing standards, allocating resources and building capabilities). These tasks, in turn, can be subdivided into a number of specific activities such as target setting, strategy formulation and executive development. As a first step, management needs to specify what activities are essential to maximizing value and, of these, which ones should be the responsibility of the center rather than the business units. The next question is how best to organize these activities to ensure a consistently high standard of performance around each one. These activity "clusters" can then become the basis of a new structure and process for managing the corporate center.

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There can be many ways to think about clusters of activities that drive value, and the best answer will vary by company. One way is to consider the idea of corporate "value creation centers", units that have an explicit objective of creating value for the company and the resources to do so. These units comprise activities related to specific drivers of profitable growth and value, and can be managed by multi-functional teams to achieve the company's objectives.

As a starting point for designing a new model, value-creating activities could be clustered into six types of units, each accountable to the CEO: an enterprise strategy unit, a strategic management unit, an executive development unit, specialized centers of competitive excellence, a finance unit, and corporate services units (Figure 2).

1. Enterprise strategy group

The mission of this unit would be to help the CEO and top management create a distinctive and profitable growth strategy for the overall enterprise, including:

- determining the highest value-at-stake issues that should comprise the top management agenda (linking management activity to capital market requirements); and
- determining the highest-value corporate strategy, including: (1) the highest-value corporate participation or portfolio strategies (which new products, markets or businesses to enter and which to exit, as well as the best means of entry and exit); (2) the highest-value corporate competitive strategies (how to leverage corporate assets or competencies to increase value across the portfolio); and (3) the highest-value corporate financial strategies (what credit rating to manage to and how best to distribute cash to shareholders).

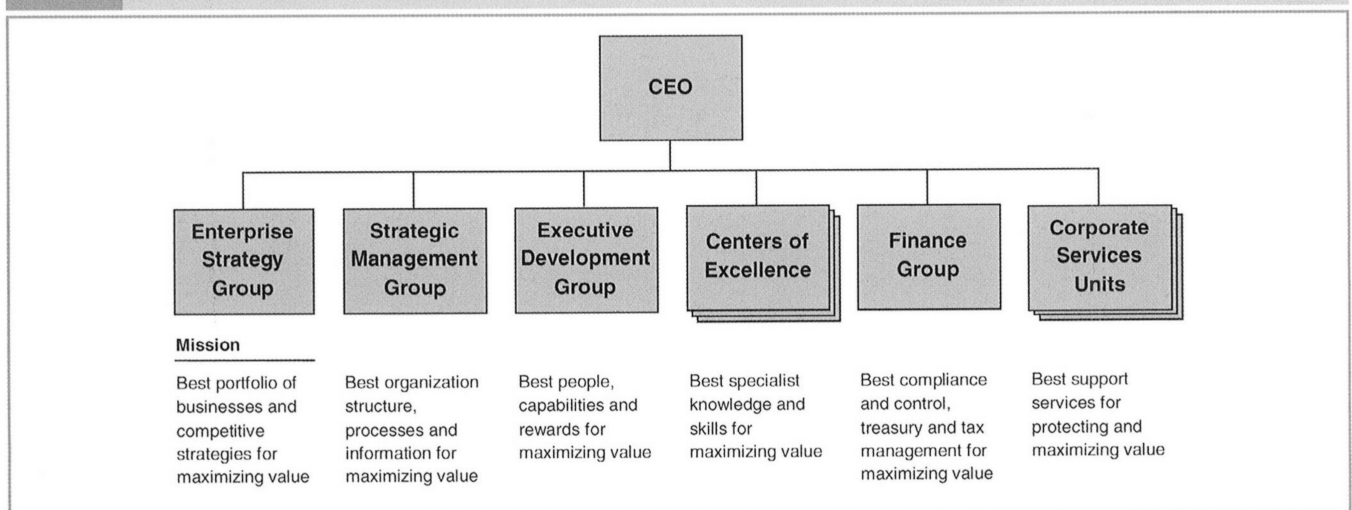
Note that this is not a strategic planning unit focused mainly on process, but a strategy formulation unit focused on helping resolve high value-at-stake enterprise issues. Neither is it a business development unit looking for deals, although at some companies this activity could be a part of its responsibilities. And finally, it is not a unit with responsibility for business unit strategies.

2. Strategic management group

The mission would be to help the CEO and top management build an enduring enterprise-wide advantage in creating value, including:

- establishing financial performance standards for the corporation and lines of business (linking strategic performance to capital market requirements);
- establishing best practices for key strategic management processes, including strategy formulation, resource allocation and performance management;

Figure 2 Alternative corporate center model



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- establishing best practices for strategic management information, including standards, metrics, methodologies and reports; and
- establishing best practices for management of organizational structure, including business unit boundaries, management roles and responsibilities, and intra-company transaction rules (transfer pricing, etc.).

The operating role of this unit would be to help ensure the best possible alignment between the corporation's standards, processes, information and structure and the goal of maximizing value. This is a continuous process of improving decision-making standards and practices at all levels, always driving to increasing profitable growth and value faster than the competition.

It should be noted that while setting financial performance standards and determining financial strategies are normally thought of as purely finance issues, they are actually critical elements of enterprise and line of business strategies. Financial performance standards in the form of economic profit growth goals and relative shareholder return targets should be at the very foundation of superior strategy formulation and approval.

The strategic management group described here has no analog at most companies today. It would include activities sometimes found in strategic planning, some that are found in finance, some found in IT, some found in HR and some usually not found in any part of the corporate center.

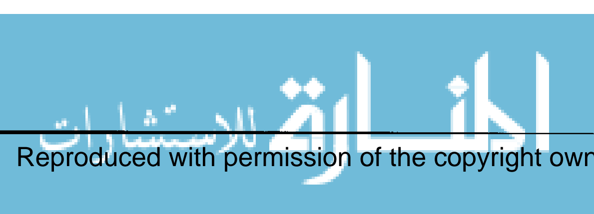
This unit would help establish a competitive advantage in the quality and capabilities of the senior management team. These are the executives who have the most impact on enterprise and line of business strategy formulation, execution and delivery, and therefore the most impact on the profitability, growth and value of the company over time. As such, they form a distinctive resource that should legitimately be managed by the CEO, with the support of a dedicated executive development group.

Ideally, every member of the senior management team would be a superior value creator. To achieve that goal, companies must be proactive in identifying, developing, promoting and rewarding individuals who clearly meet that test. To further these objectives, the role of this unit would include setting standards, policies and practices for key activities, including:

- placement and promotion of senior executives;
- capabilities development, including continuous education and knowledge sharing;
- recruitment of high-caliber senior executives from outside the firm; and
- compensation aligned with value creation performance.

Where specialized capabilities are essential to sustaining and growing the value of multiple business units within the company, the CEO may establish special units focusing on those capabilities. These units would have accountability for setting enterprise-wide standards, policies and practices and helping to ensure that the required capabilities are established at the appropriate levels of the company. Depending on the industry and company, examples might include: a marketing management center of excellence (for consumer products companies); a regulatory management center of excellence (for pharmaceutical companies); or a risk management center of excellence (for financial institutions).

The mission of this unit is to provide excellence in the classical functions of financial reporting and control, legal and regulatory compliance, treasury and tax management. Post-Enron, there is certainly a heightened awareness of the absolute necessity for performing these functions to the highest standard to protect not only shareholders, but employees, creditors and all other stakeholders in the company's financial well-being.



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The mission is to support the corporation and business units with excellent capabilities in activities where enterprise-wide standardization (e.g. compliance) and efficiency (e.g. scale economies) justify centralization. Examples include human resources, legal, IT, investor relations and facilities management.

Along with finance, these activities are all important and need to be well managed, but they should not determine the core organization structure of the corporate center as they often do today.

The existing activities and structure of the corporate center have antecedents going back decades, in some cases centuries. Often they are rooted in legitimate needs for compliance and control. And they are truly groups of considerable and well-entrenched power in the organization. In these circumstances, a rapid ''root and branch'' approach to change, however attractive in principle, may be utterly impossible in practice. On the other hand, to move too slowly or tentatively almost ensures a failure to change.

Despite the difficulty, we believe taking on these changes can ultimately benefit most companies by making the center's role in value creation more explicit and by organizing the center to align its activities with that role. The best path for making these changes will be different for every company, but some general guidelines for transitioning to a new corporate center organization might include the following:

(1) **Commitment.** Unless the CEO and top management are fully committed to aligning the organization with maximizing the value of the company, the requisite foresight, planning and energy to make the changes recommended here will be missing.

(2) **Planning.** Any change of this magnitude must be carefully planned to ensure proper ownership and buy-in, and also to ensure that critical activities continue to be performed properly through the transition. A ''blue ribbon'' panel of top executives can be one mechanism for designing the new model, planning the change, advising the CEO on the best path to implementation, and educating and selling the rest of the management team on the benefits of the new model.

(3) **Staffing.** The new units should be as small as possible, and staffed with exceptionally able individuals. Some team members will be functional specialists, but some should be senior or fast-track line executives on two- to three-year assignments at the center. This mix will help to ensure more innovation and knowledge sharing, and better management alignment to the changes while reducing the odds of the units becoming too inwardly focused. Finally, these should be considered highly attractive assignments, giving line executives a company-wide perspective of key financial, strategic and organizational issues and the opportunity to work with the CEO and the rest of the top management team on resolving those issues.

(4) **Delivery.** Each unit should have a clearly specified mission and deliverables to the CEO, and each should be annually evaluated for how well it has met its objectives and helped the company to maximize value. While the measures of success will necessarily be a combination of ''soft'' and ''hard'', they should be objective- and output-oriented to ensure the units do not migrate from being ''value creation centers'' to being once again ''cost centers''.

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Organizational structures,
Organizational design,
Strategic management,
Value added,
Corporate governance

Organizational structure and process do not solve all problems, but they are critical determinants of the potential of any organization to perform at the highest level. We believe the new direction for the corporate center we are proposing here could support and stimulate far higher value creation than the legacy models with which most companies are trying to cope.

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Journal of Business Strategy editor Nanci Healy interviewed Peter Kontes earlier this year to find out more about how he came to advocate the concept of a new type of corporate center.

JBS: What led you to develop the off-center concept?

The idea arose from our consulting work. The way corporations are organized into functional silos – marketing, finance, etc. – has the advantage of concentrating expertise but the practitioners within each silo have difficulty coordinating with one another. We started to ask if there is a different way for the center to organize that is more aligned with the drivers of the company's value rather than aligned with historical and functional competencies. This was the germ of the idea.

JBS: Is the off-center concept an outgrowth of your consulting work in value creation?

The ideas developed over time as we worked with clients and observed issues both within and across existing functions at the center.

As one example, the role of the corporate planning function is often poorly defined: sometimes it is limited to managing a process and adding up the numbers; sometimes it engages with the business units in strategy formulation, but without much value added; and sometimes it includes business development, looking for deals. But no matter how defined, a lot of activities we at Marakon consider vital to corporate strategy just weren't being done or were disconnected. One huge hole in the corporate center is lack of insight into the sources of competitive advantage across the entire portfolio. There was an absence of accountability across functions for rigorous understanding and thinking in this area, yet superior revenue and profit growth depend on building portfolios that outperform the competition.

As another example, setting corporate performance objectives typically comes out of finance, often as part of the annual planning or budgeting process. But finance doesn't have the information on markets and competitors and the economics of different segments needed to connect financial performance objectives to line-of-business objectives. Finance may come up with a corporate ROE target but there is no good mechanism to convert that target directly into individual line-of-business objectives or strategic goals. Further, if you stand back and ask how you would design the organization from a clean sheet of paper, you wouldn't have – as is too often the case – the annual planning or budgeting process driving strategy. These functions cannot be easily realigned within today's silo structure. You need people with both strategic and financial acumen in order to develop the right strategy and to manage the strategic process.

JBS: If the changes must begin with top management, what have you and Marakon done to encourage those changes so far?

With nearly all of our clients we have helped make significant changes to the content of what people do within the existing silos, especially around the tasks of setting performance targets, formulating strategy and allocating capital.

On changing the structure of the center itself, there has been progress, but more limited: few organizations are structured so that those in the center can say with certainty, we are adding to the collective value generated by the business units.

JBS: Have any companies begun this process of restructuring the center? What has their experience been?

The idea of having a group dedicated to strategic management as defined in the article has gained some traction. And we have certainly seen progress in the cooperation between strategy and finance functions in setting goals and generating better information for decision-making. But, while very useful, these process changes have been add-ons within the existing organization rather than a total overhaul of the center structure. To make that happen would require a CEO who is sufficiently frustrated with the challenge of getting real economic value out of the corporate center to be willing to be a pioneer.

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JBS: You say that enterprise strategy groups can help resolve high value-at-stake enterprise issues. Can you give an example of what this might entail?

Among the most important enterprise issues are deciding which new businesses and markets to enter, how to leverage the competitive advantages of the enterprise into consistently superior financial results, and when and how to exit lines of business. Often these issues are interrelated. Our view is that the CEO should have a small, full-time staff that focuses heavily on formulating options around these issues because they can have such a large impact on the value of the firm and because in many cases they cannot be addressed properly at lower levels of the organization.

There are many examples of companies that have complex high value-at-stake issues to address virtually all of the time. Large banks like JP Morgan Chase have a myriad of issues crossing business unit boundaries, including market segmentation, client service models, sources of differentiation, and risk management. Individual lines of business are usually not in a position to address these alone. Pharmaceutical companies like Pfizer have very complex strategic decisions around segmentation, pricing, research and allocation of sales forces that, again, often need to be resolved above the line of business level. Companies in major transition, like Kodak, need to address strategic questions such as which technologies, products, and markets to bet on at the enterprise level because the business units simply don't have the objectivity or line of sight into these issues that the center can have.

JBS: What would a specialized center of competitive excellence do?

Most pharmaceutical companies, for example, have people who manage the regulatory approval process. It's like a center of excellence because managing the regulatory process is critically important. One large energy company created a marketing center of excellence even though they don't do a large amount of traditional marketing. But oil companies do have retail outlets and, although they don't do marketing the way Proctor & Gamble does, they need to do it well. As an institution they were all over the map until they put this group at the center together, using best practices.

Another example: banking tends to have risk management as a center of excellence. It would be hard to distribute risk management throughout the organization because it requires many competencies, including IT. Its primary responsibility is to ensure that the institution is state-of-the-art, regardless of where decisions are being made.

The advantage of calling it a center of excellence is that it doesn't become a fiefdom. It's about learning, dissemination, some decision-making, setting rules and processes. It doesn't tell business units what to do, though.

I don't want to be too dogmatic about this because these are very complicated questions and there isn't only one right way. But it is helpful to ask, how would I design the organization if legacy systems weren't in place? Chances are you wouldn't design it the way it is at all.

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