

think:act CONTENT

Fresh thinking for decision makers

Our new study focuses
on corporate HQs –
Centralization once again
on the rise | Outsourcing
no longer the big trend |
Shared services gaining
popularity | Roles of HQ
functions often unclear

[CORPORATE HQS 2008/2009]

KEY FINDINGS

The latest study by Roland Berger reveals four trends:



1. CENTRALIZATION IS ON THE RISE

The proportion of employees who work at corporate centers currently averages 2.8% and is thus more or less back up to the level of 2002 (3%). Three years ago, the figure had dropped sharply to just 2.3%. Around 73% of respondents expect the trend toward more centralized corporate structures to continue in future. This marks a significant change since 2005, when only 37% identified such a trend.



2. THE IMPORTANCE OF OUTSOURCING IS WANING

The practice of farming out services remains limited to a few areas that are not part of management's mandate. On the whole, the outsourcing trend is clearly in reverse. Only 44% of respondent companies outsource any staff functions at all, down from 53% three years ago.



3. MORE COMPANIES ARE USING SHARED SERVICES

Support functions are increasingly being bundled in shared service centers. The proportion of companies that operate shared service constellations has risen from 38% in 2005 to 49% today.



4. CONFUSION OFTEN REIGNS REGARDING THE ROLES PLAYED BY DIFFERENT FUNCTIONS

Processes and roles are often split in ways that leave overlaps – and potential for conflict. Interfaces are not clearly defined. The roles of centralized and decentralized units are unclear.

THREE EXAMPLES, ONE TREND: CENTRALIZATION!

In early December 2008, Handelsblatt, a respected German business daily, reported that aerospace group EADS was considering an extensive restructuring program. CEO Louis Gallois wanted to condense the group's five existing divisions into just three. Only a few weeks earlier, the EADS Board of Directors had rubber-stamped the centralization of certain staff functions. At Italy's Unicredit bank too, all the signs have, since late summer of last year, been pointing to centralization and divisionalization throughout the entire group. A similar picture is emerging at ThyssenKrupp. Explaining the rationale behind the radical shake-up that will reduce the steel group from five segments to two, CEO Ekkehard Schulz said that heavier centralization would make the steel group "leaner, better and faster".

Three examples, one trend: centralization. Is this all merely a reaction to the global financial crisis? It is tempting to take this view – tempting but wrong. Witness a recent Roland Berger Strategy Consultants study that investigated the role, structure and size of corporate headquarters.

The study is part of a series. Every three years since 1999, Roland Berger has quizzed large and medium-sized European companies about their management models, structural characteristics, the size and role of their corporate centers, and staff functions. The questionnaires on which the latest study is based were circulated in mid-2008; and the trend toward greater centralization was already in evidence before the financial markets imploded.

At the same time, no-one would dispute that the current economic crisis is indeed confronting CEOs around the globe with new challenges that can only be met by agile, effective organizations. The crisis is simply increasing the pressure that was already there, forcing companies to work more efficiently and (re)act more quickly to changes in their field.

WHAT PART DOES HQ PLAY?

In October 2008, the Conference Board, a US-based think tank, asked CEOs about the challenges currently facing them in the context of the financial crisis. More than half the respondent company bosses saw quickly and efficiently executing corporate strategy as the most important aspect in helping them respond swiftly to a changing market environment.

The top three challenges thrown at CEOs by the financial crisis:

- 1) **EXCELLENCE IN EXECUTION → 55.4%**
- 2) **CONSISTENT IMPLEMENTATION OF CORPORATE STRATEGY → 47.4%**
- 3) **SPEED, FLEXIBILITY AND AGILITY → 46.6%**

Source: Conference Board, October 2008, questionnaire circulated to approx. 200 CEOs worldwide

"Excellence in execution" can, however, only be achieved if structures and processes are defined carefully and sized appropriately. That in turn requires companies to have a clear understanding of the part played by headquarters and its component functions. Drawing on our extensive consulting experience, this is the issue on which the current study focuses.

THE TOP THREE CHALLENGES THROWN AT CEOs

by the financial crisis

Of the CEOs surveyed

55.4%

focus on excellence in execution

47.4%

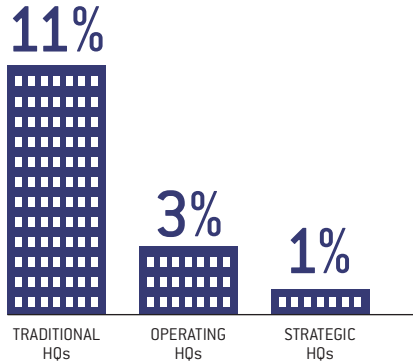
focus on consistent implementation of corporate strategy

46.6%

focus on speed, flexibility and agility

Source: Conference Board, October 2008, questionnaire circulated to approx. 200 CEOs worldwide

WORKFORCE AT HQ



Source: Roland Berger study

SHIFTING PERCEPTION OF ROLES

1 STRATEGY/GROUP MANAGEMENT FUNCTIONS

Clear distinction between operating and strategic tasks at board level

2 FINANCE FUNCTIONS

Globalization and dynamic market structures are driving the importance of flexible financial analysis and control systems

3 HR, IT AND SUPPORT FUNCTIONS

HR department involved in shaping business strategy; IT units being centralized, e.g. through shared services

4 OPERATIONAL FUNCTIONS

Trend toward centralization and bundling of functions; global coordination of R&D departments while decentralized units safeguard expertise and maintain close proximity to markets

Source: Roland Berger study

The key questions companies must ask themselves in this regard are:

- ➔ WHAT PART DOES HQ HAVE TO PLAY RELATIVE TO THE BUSINESS UNITS?
- ➔ HOW SHOULD WE RESOURCE AND SIZE OUR STAFF FUNCTIONS?

HQ SIZE GROWS WITH RISING NEED FOR STRONG MANAGEMENT

The relative size of the corporate center depends to a large extent on what management model a company operates and what part the head office plays in respect of decentralized units. Where strong central leadership is a long-standing tradition, headquarters are generally largest, accounting for 11% of total staff on average. Head offices that focus on running operations are much smaller, averaging 3%. Smallest of all, however, are strategic HQs, which employ only 1% of the workforce on average – and even less at large corporations, where operational management too is devolved to decentralized units.

As our study shows, the trend toward more centralization can be read as a sign that the desire for strong management – and with it greater control – is growing. In recent years, few companies have been able to escape the effects of increasing cost pressure. This factor too is driving the trend toward more centralized structures, as businesses seek to improve efficiency by bundling activities. The examples mentioned at the beginning substantiate this correlation.

On the other hand, where cost pressure is less of an issue and corporate strategies focus on growth and innovation, for example, the opposite trend can often be observed. In such contexts, companies are inclined to accept – and indeed encourage – decentralized structures in order to get closer to their customers and the markets they serve. This insight explains the findings of the 2005 study, in which centralized structures played a far less pronounced role than they do today.

Precisely this sharp distinction proves an important point: There is no magic formula for successful company organizations. There is no "right" and no "wrong". What matters is for companies to constantly review their internal structures and, where necessary, adjust them in line with nascent developments and changing requirements.

STAFF FUNCTIONS IN TRANSITION

The way in which staff functions are organized has also experienced change since the last study was performed. Strategy, group and finance functions tend these days to assign clearly delimited task areas to named individuals in specific areas. Meanwhile, centralization is the predominant trend in human resources and IT and in operational functions such as purchasing and R&D.

Strategy/group functions

At board level, enterprises such as RWE, E.ON and EnBW clearly distinguish between operating and strategic tasks. They do this in order to avoid confusion about precisely who is responsible for exactly what. CEOs mostly oversee staff functions such as strategy and corporate communication, whereas COOs concentrate on procurement, production and sales themes. At such companies, a Chief Strategy Officer is normally responsible for executing corporate strategy.

Finance functions

Corporate finance functions are gaining in significance on a strategic level and evolving into internal business partners. In the context of globalization and fast-growing markets, they are also developing new models of financing.

General Electric, for example, has slotted finance functions into its Business Development unit, giving them a direct say in shaping management and business models. For its part, Roche created a Commercial Operations function with a global reach to provide focused support for Marketing, Sales and Medical Affairs.

HR, IT and support functions

For IT and support functions in particular, the trend toward centralization is very strong. The strategies pursued by operating units are laid down by the corporate center; business units themselves are merely responsible for executing them. This arrangement gives companies the dual benefit of greater efficiency and lower infrastructure costs. Bayer, for instance, has bundled all its service functions in service companies. Hilti has all sales workflows entered and tracked in a central IT system that is then made available to all field staff worldwide.

Operational functions

Purchasing, an operational function, also exhibits a marked trend toward centralization. At Bosch, Corporate Purchasing controls the global sourcing of materials that are needed by multiple business units. While R&D functions likewise reveal a general trend toward centralization, decentralized research clusters also exist in close proximity to other research organizations. Here, centralized coordination units improve efficiency, while decentralized activities keep research close to the customer and guarantee the availability of special expertise.

At 3M, one global center heads up 32 R&D sites in 30 countries. These sites in turn collaborate closely with local operating departments. Novartis has an R&D organization that operates research institutions for five specific indications. At the same time, it also maintains local hubs that enjoy direct access to universities, thereby building up the company's skills base.

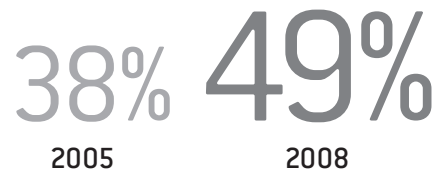
SHARED SERVICES AND OUTSOURCING

Shared services have become considerably more important since the 2005 study. As centralized structures grow in significance, support functions are increasingly being combined in shared service centers.

MORE SHARED SERVICE CENTERS, LESS OUTSOURCING

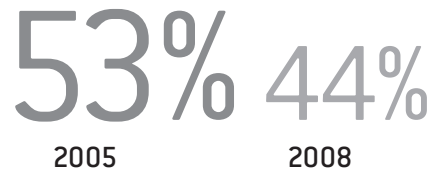
*Trend toward centralization and
prioritization*

CENTRALIZATION/BUNDLING



Percentage of companies with shared service units

PRIORITIZATION/"DOING WITHOUT"

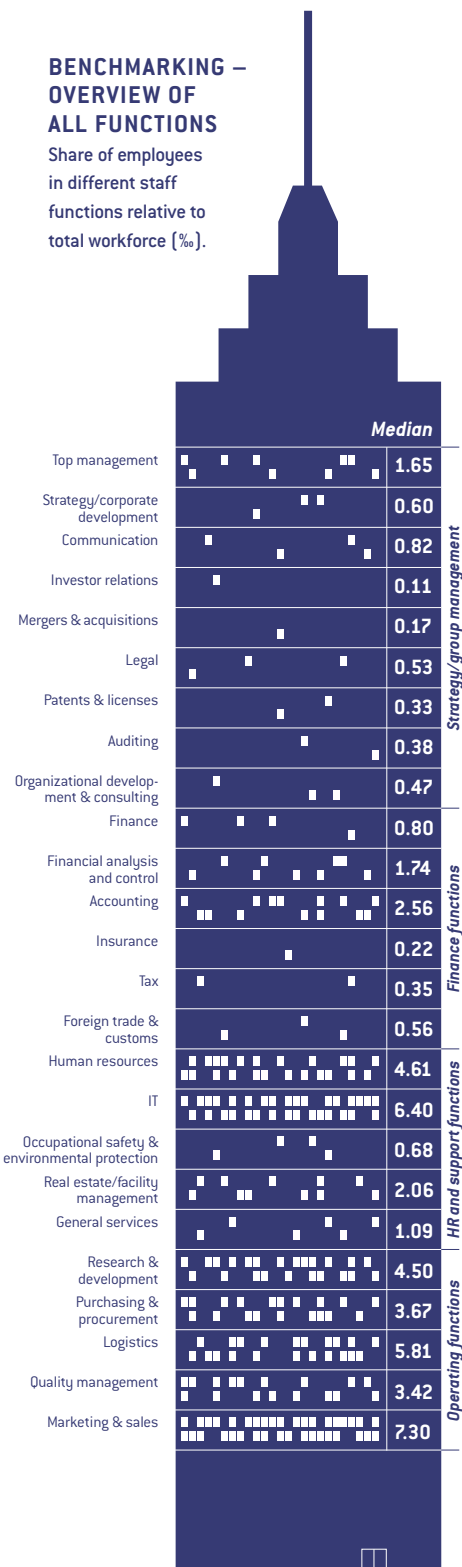


*Percentage of companies with outsourced staff
functions*

Source: Roland Berger study

BENCHMARKING – OVERVIEW OF ALL FUNCTIONS

Share of employees in different staff functions relative to total workforce [%].



BIG BEN – THE ROLAND BERGER BENCHMARK DATABASE
250 companies are stored in our benchmark database, complete with their corporate center and shared services data (including the level of centralization and outsourcing). The data has been collated from studies in the context of our organizational projects and from studies of corporate headquarters in 1999, 2002, 2005 and 2008.

Homogeneous services that lend themselves to standardization – such as payroll accounting, IT and facility management – are especially well suited to this form of organization. Shared service centers are a good way to cut costs and simplify internal processes – with none of the risks associated with interfaces to outside providers.

As an organizational form, outsourcing has already passed its peak. Today, companies are more careful than they were in 2005 about using outsourcing as a tool to roll back fixed costs and reduce factor costs. There is a clear and direct link between corporate concerns of losing knowledge and control and the trend toward centralized structures. Outsourcing today is thus limited to aspects that belong neither to a company's core competencies, nor to its management. Beiersdorf, for example, has outsourced its logistical activities and now has its central warehouse run by an external operator. HOCHTIEF has farmed out the purchasing of office supplies, hardware and software to sharpen its own focus on core activities.

HOW TO AVOID CONFLICTING ROLES

Clearly specified roles are an imperative for every staff function. Only then can enterprises realistically operate efficient and effective organizations – and achieve excellence in the execution of group strategy. On this point, however, many companies still have a lot of work to do. As things stand, many functions play a number of different roles. If interfaces and responsibilities are not clearly defined, this can lead to serious difficulties.

We distinguish between four fundamental types of roles for corporate HQs and staff functions:

- 1) The **LAW GUARDIAN** is responsible for ensuring **EFFECTIVENESS** – for example by enforcing legal compliance and/or prescribed standards throughout the group. Examples: Auditing/Legal
- 2) The **MANAGER** ensures **CONSISTENCY** – for example by steering units and resources in line with corporate strategy. Example: Strategy Development
- 3) The **BUSINESS PARTNER** pays attention to **EXCELLENCE** – for example by providing advice on specific issues to other company units. Example: HR Development
- 4) The **SERVICE PROVIDER** focuses on **EFFICIENCY** – which includes supporting other units by providing standardized services. Examples: Payroll Accounting, Financial Accounting

Most respondents see their corporate center in a managerial role. Very few see head office as a dedicated service provider. This perception reflects the very high standard that companies set themselves – but that many have yet to realize. There is, after all, no reason why the four roles should be mutually exclusive. One function can very well assume more than one role. The HR department, for instance, could act as a law guardian by setting enterprise-wide HR standards, as a business partner by providing advice on personnel planning, and as a service provider by handling payroll accounting. However, as previously mentioned, in practice this regularly leads to role conflicts. The only way to resolve such conflicts is for the company to clearly define the organizational structure and service portfolio for each subfunction, plus the related task portfolios, and say exactly what each is required to do.

A number of key questions can help produce the necessary clarity:

- **WHAT DEMANDS** do our internal customers/business lines place on this function?
- **HOW CAN WE BEST MEET THESE DEMANDS** by splitting tasks between the available roles?
- **HOW SHOULD WE DESIGN INTERFACES** to the business lines and between the roles?
- **HOW DO WE TAILOR THE ORGANIZATION** to fit the various roles and tasks?
- **HOW DO WE INFORM INTERNAL CUSTOMERS/BUSINESS LINES** about services, interfaces and areas of responsibility?

Answering these questions enables specific roles to be assigned to the subfunctions that make up each staff function. Once this exercise in redesign is complete, each function plays the role that suits it best – and can verifiably add value for the company.

RIGHTSIZING – THE ROAD TO EFFICIENCY

Roland Berger constantly updates its own benchmark database. The material it contains serves as an excellent starting point when discussing the tailor-made design of individual functions. Benchmark results provide useful insights and help companies identify the right size for individual functions in light of the industry, size and management model for each company. Moreover, re-conducting the study at regular intervals provides valuable information that can serve as a sound basis for further discussion.

KEY SUCCESS FACTOR: NEVER STOP ADJUSTING THE ORGANIZATION

As we said at the start, there is no "right" or "wrong" in the search for the ideal organization. There are, however, many "suitable" and "less suitable" solutions whose suitability depends on a wide range of internal and external factors. A clear understanding of defined roles is one example. Strategic adjustments, fiercer competition and growing cost pressure are just a few more. Having identified the individual combination of factors for each firm, the next job is to find a suitable organizational structure. Staff functions must then be fleshed out in line with the needs and demands of internal and external customers.

The trends reflected in the findings of the latest study are attributable to external factors that are affecting many companies in the same way. Having said that, the individual factors – and hence also the way they interact – are not static, but are subject to dynamic (and permanent) change. To stay on an even keel, companies must regularly review whether their organization is (still) agile and effective enough, or whether adjustments are necessary. To do so, they must screen each function on its own merits, regularly reassessing each one in light of the company's overriding strategy.

VAST POTENTIAL

Sample projects demonstrate that 10% to 30% of overhead costs can be cut – with no loss of effectiveness!

Actions	Savings
Improving qualifications in facility management	> 21%
Streamlining accounting and financial analysis/control functions	> 11%
Optimizing logistics	> 20%
Reducing headcount in corporate overhead functions	> 23%
Streamlining overhead organization	> 18%
Eliminating redundant R&D structures	> 31%

Source: Roland Berger Benchmark Database

PLEASE CONTACT US IF YOU HAVE ANY FURTHER QUESTIONS

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