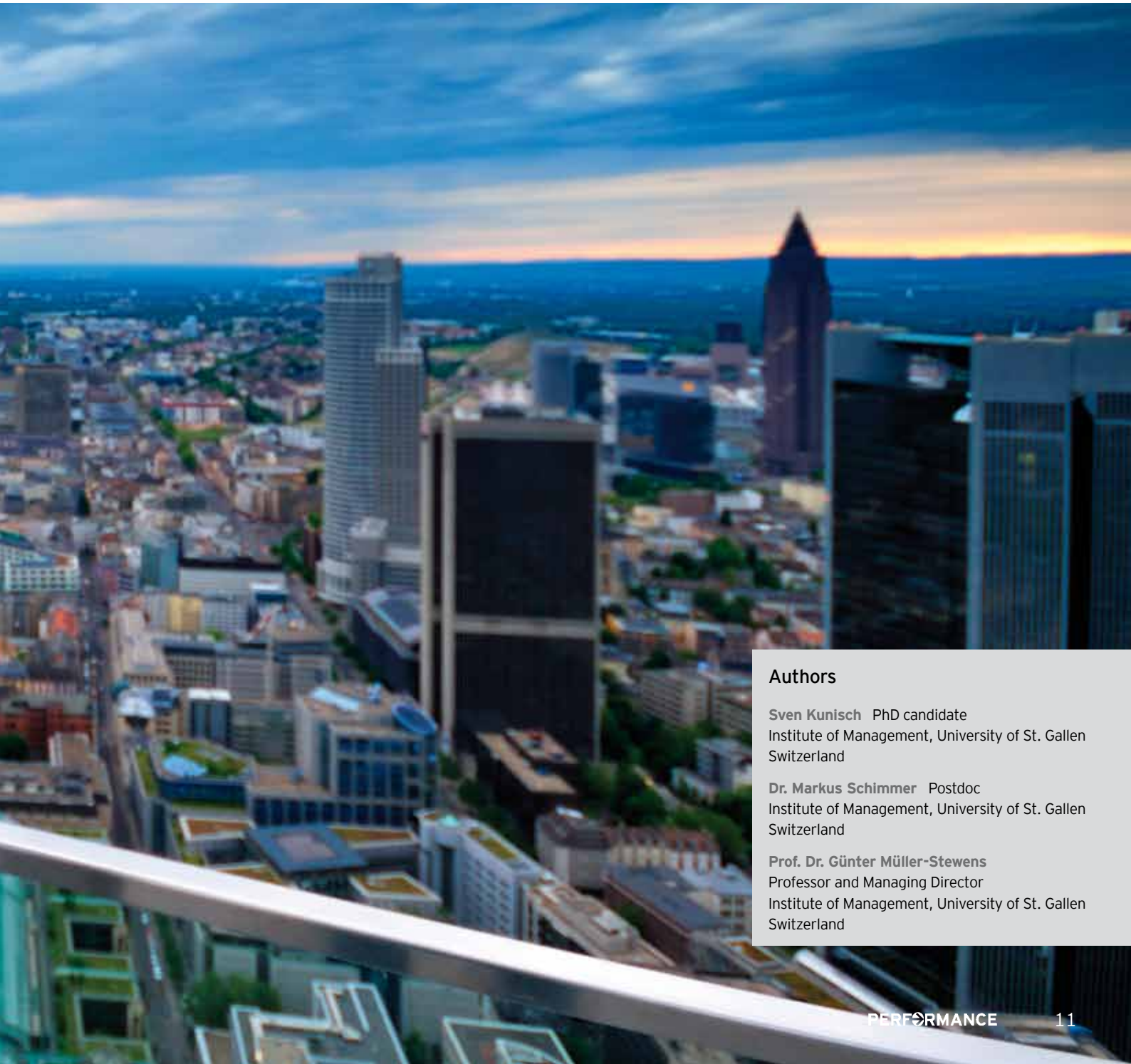
Article

A new look for the head office: corporate headquarters redesigns during times of crisis





Companies appear to have adopted a new perspective on the role of their corporate headquarters (CHQ). Instead of considering it a cost factor that can be easily slashed, companies seem to have recognized the need for a stronger corporate hand. By analyzing recent patterns of CHQ change, this article provides valuable lessons on how companies handle this conflict between CHQ cost efficiency and value contribution.



Authors

Sven Kunisch PhD candidate
Institute of Management, University of St. Gallen
Switzerland

Dr. Markus Schimmer Postdoc
Institute of Management, University of St. Gallen
Switzerland

Prof. Dr. Günter Müller-Stewens
Professor and Managing Director
Institute of Management, University of St. Gallen
Switzerland

In practice, headquarter reviews are often no more than cost-cutting exercises – our research shows that such an approach is dangerous since simply reducing the size of the headquarters is no guarantee of improved performance

D. Collis, D. Young, M Goold

"The size, structure, and performance of corporate headquarters," *Strategic Management Journal*, 28(4):402, 2007.

Corporate managers in today's large companies face a difficult dilemma when considering changes to their CHQ. On the one hand, they want to reduce corporate overheads, bureaucracy, and harmful interferences in their business divisions. On the other hand, they also want to develop and maintain the corporate capabilities that allow their company to compete with its rivals. While resolving this dilemma has always been an important task, finding the right balance is more challenging than ever. Moreover, companies are often inclined to follow trends, which results in a swing between centralization and decentralization.

During times of economic hardship, this pendulum movement has historically swung toward decentralization and a slimmer CHQ. As trimming the CHQ seems to promise quick wins, managers have been enticed into reducing the corporate staff. Nevertheless, there are costs and risks associated with such cuts. Researchers have warned against the adverse effects of these reactive decisions. Some have even advocated a stronger corporate hand during crises.[1]

This article examines how companies resolved the conflict between economic pressures and the design of their CHQ during the 2007–10 global economic crisis. Specifically, it investigates how companies adjusted their CHQ and its service provision. Based on a surveyed sample of more than 750 of the largest companies in North America and Europe, the article reveals three patterns of CHQ change.

Before discussing these patterns of change, it is helpful to briefly revisit the importance of CHQ in general.

Why are corporate headquarters crucial in today's large companies?

Michael Porter's seminal article "From competitive advantage to corporate strategy" highlighted that most of today's large organizations – multi-business and multi-national companies – not only compete in product and regional markets at the business level (business strategy), but also at the corporate level (corporate strategy).[2] The reason for this is that all large companies comprise more than one business (in the product and regional domains), and



investors want a compelling justification of how these bundles of businesses create value for them.

It is the task of the CHQ to maintain the competitiveness of the corporate whole by defining the array of businesses, and by adding value to the individual businesses. These two broad value creation levers constitute a range of activities such as portfolio management, restructuring activities, transferring skills, and

1 M.E. Raynor, J.L. Bower, "Lead from the Center," *Harvard Business Review 79(5): 92–100*, 2001.

2 M. Porter, "From competitive advantage to corporate strategy," *Harvard Business Review 65: 43–59*, 1987.



The four different roles of the CHQ[6]

- **Public company functions**: In nearly all multi-business firms, the CHQ performs obligatory functions. It represents all businesses legally in respect of the regulator(s) and aggregates the financial, tax, and legal data. Similarly, the CHQ can also function as the company's face to the customer and build reputational value.
- **Shared services**: Shared services are services provided by the CHQ for various business units. Owing to the aggregation of demand for these services, the CHQ can realize scale effects and provide them at lower total costs. Typical shared services are HR, IT, and marketing services.
- **Value creation**: In contrast to the first two roles, the "value creation role" of the CHQ is more entrepreneurial in nature.[7] It is considered the major source of corporate advantages and key in justifying the configuration of diversified companies.[8] It comprises various horizontal and vertical coordination activities,[9] such as the leveraging of the synergy potential and the application of management innovation.
- **Control**: The "control role" of the CHQ guides the operations of the individual businesses toward the corporate goals.[10] It can either focus on the outcome (financial), or the behavior (operational), with both options implying very different approaches and requirements in terms of data and operations.

various sharing activities.[3] As many of these activities take effect in a lagged and hard to discern manner across the corporate whole, the corporate level is often contested by both its business divisions and the capital markets. The CHQ is thus under constant pressure to improve, promote, and defend its value proposition.

As companies place different emphases on the various CHQ roles (see above), a great variation in key CHQ characteristics, such as the number of staff[4] and the CHQ design,[5] can occur. For example, in our survey, one company with a total of 1,000 employees had more than 500 CHQ staff, while another company with more than 30,000 employees had less than 20 CHQ staff.

3 M. Porter, "From competitive advantage to corporate strategy," *Harvard Business Review 65: 43-59*, 1987.

4 D. Young, M. Goold, *Effective headquarters staff: A guide to the size, structure and role of corporate headquarters staff*, (Ashridge Strategic Management Centre: London, 1993).

5 O.C. Hansen, M. Peytz, "Designing the corporate center," *McKinsey Quarterly 3(2): 128-139*, 1991.

6 D. Collis, D. Young, M. Goold, "The size, structure, and performance of corporate headquarters," *Strategic Management Journal 28(4): 383-405*, 2007.

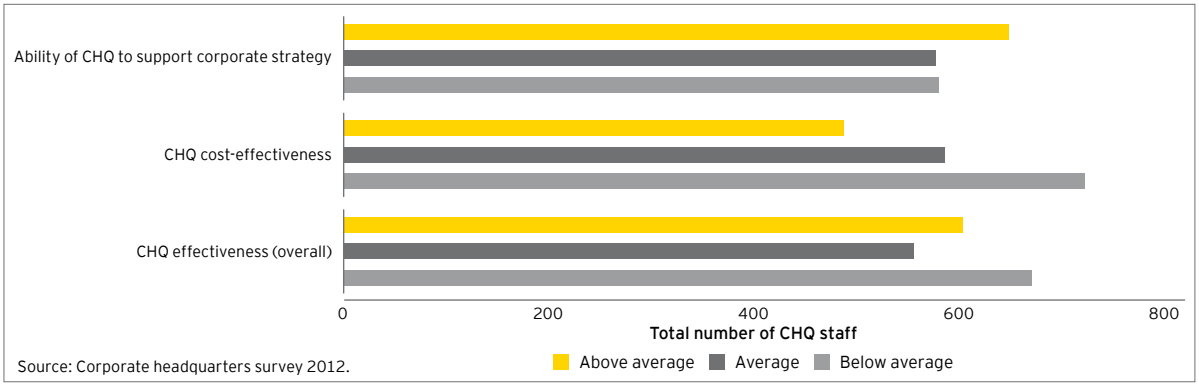
7 N.J. Foss, "On the rationales of corporate headquarters," *Industrial and Corporate Change 6(2): 313-338*, 1997.

8 D. Collis, D. Young, M. Goold, "The size, structure, and performance of corporate headquarters," *Strategic Management Journal 28(4): 383-405*, 2007.

9 J.A. Martin, K.M. Eisenhardt, "Rewiring: Cross-Business-Unit Collaborations and Performance in Multi-Business Organizations," *Academy of Management Journal 53(2): 265-301*, 2010.

10 K.M. Eisenhardt, "Control: Organizational and Economical Approaches," *Management Science 31(2): 134-149*, 1985.

Figure 1. Effectiveness of CHQ vs. CHQ size



Source: Corporate headquarters survey 2012.

The reason for such an enormous variety in CHQ size is simple: different CHQ objectives are related to different CHQ sizes (see Figure 1). For example, companies with above-average CHQ abilities to support corporate strategy tended to have a larger number of CHQ staff, whereas companies with above-average CHQ cost effectiveness tended to have smaller CHQ than companies with average or below-average performance.

Designing the CHQ and maintaining its fit with the business requirements appears to be a formidable task. Striving for the right balance between the CHQ and the rest of the organization has been a fundamental management challenge for decades. In the 1970s, large CHQ emerged with the rise of conglomerates and multinationals. In the 1990s, the trend shifted to the minimalist CHQ favored by private equity owners, who just wanted the CHQ to ensure that operating managers hit their targets, stuck to the agreed strategy, and complied with laws and regulations. In the 2000s, many CHQ once again gradually expanded the scope of their activities, which was partly driven by new regulations (e.g., the Sarbanes-Oxley Act). However, anecdotal evidence suggests it was unlikely that the 2007–10 financial crisis and the subsequent economic downturn caused the pendulum to swing back toward minimalism, thus once again leading to smaller and leaner CHQ.[11]

Survey results indicate elements of centralization and decentralization

Let's look at how companies adjusted their CHQ during the 2007–10 economic crisis. From our analyses, we identified three major patterns of CHQ change:

- Companies scaled up their corporate headquarters rather than trimming them
- Companies tightened corporate headquarters' strategic and functional control
- Companies granted divisions more authority in less strategic areas of decision-making

Companies scaled up their corporate headquarters rather than trimming them

Changes in the size of the CHQ indicate a trend toward larger CHQ instead of smaller ones (see Figure 2). While approximately a quarter of the companies (28.4%) did not alter their CHQ size by more than 5%, almost half (43.8%) increased the number of

11 "Corporate Restructuring – Centres of Attention: Companies may still have too many Heads at Headquarters," *The Economist, Vol. 15 November 2008: 68-68*, The Economist Newspaper Limited: London, 2008.

their CHQ staff, whereas only about a quarter (27.9%) decreased their CHQ staff. This trend was stable across countries, excluding Denmark, Norway, and Greece, where CHQ sizes decreased on average.

In addition, companies on average increased their size and scope across several other dimensions such as CHQ costs, the number of CHQ functions, and the quantity and quality of services they provide for their divisions (see Figure 3). Some of these factors help illustrate potential reasons for changes in the CHQ size by also detailing how the scope of CHQ service provision changed.

Against the backdrop of the 2007–10 economic crisis, the evolution of the CHQ size in the sampled companies may come as a surprise. Conventional wisdom might hold that companies would be more likely to prune their CHQ instead of growing them. Yet a considerable portion of companies increased the size of their CHQ.

Survey methodology

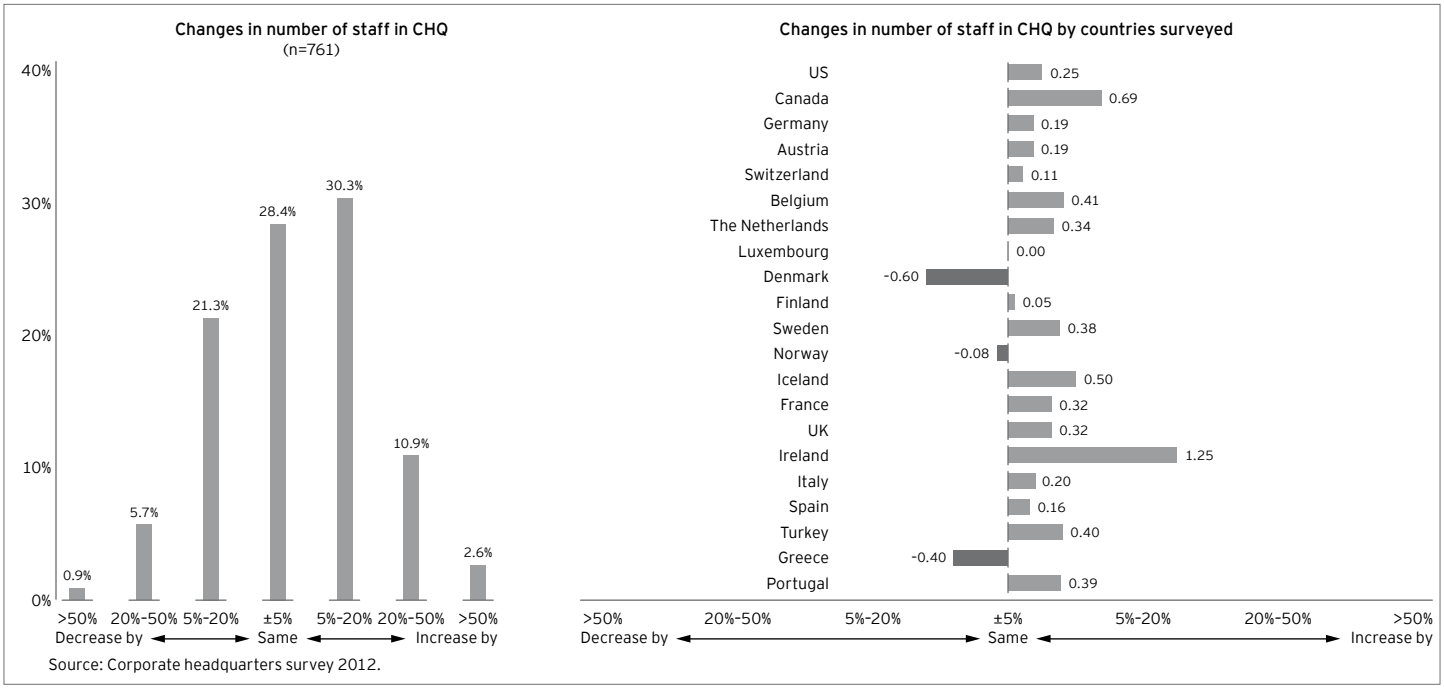
In 2011, we surveyed the largest publicly listed companies in North America and Western Europe to gain a better understanding of how they optimized their CHQ during the 2007–10 economic crisis.

The sample covered the largest corporations in North America (US, Canada) and Western Europe (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom).

It was based on four size criteria: (1) total number of employees greater than 1,000; (2) sales; (3) total assets; and (4) market capitalization greater than US$250m. In addition, the company had to be active in more than one four-digit SIC code. We identified 2,682 corporations (1,490 in North America and 1,192 in Western Europe) that met all criteria in 2009 – the most recent year for which full data was available when we designed the study.

Overall, 761 of these organizations participated in this CHQ survey, accounting for a company-level response rate of 28.4%. The survey's respondents were 867 top-level managers in 21 countries across North America (404) and Europe (463).

Figure 2. Changes in the size of CHQ



Source: Corporate headquarters survey 2012.

It is apparent that in the design of corporate headquarters, "one size fits all" is a flawed approach – benchmarking can be valuable, but only if it is with companies that are pursuing similar corporate strategies

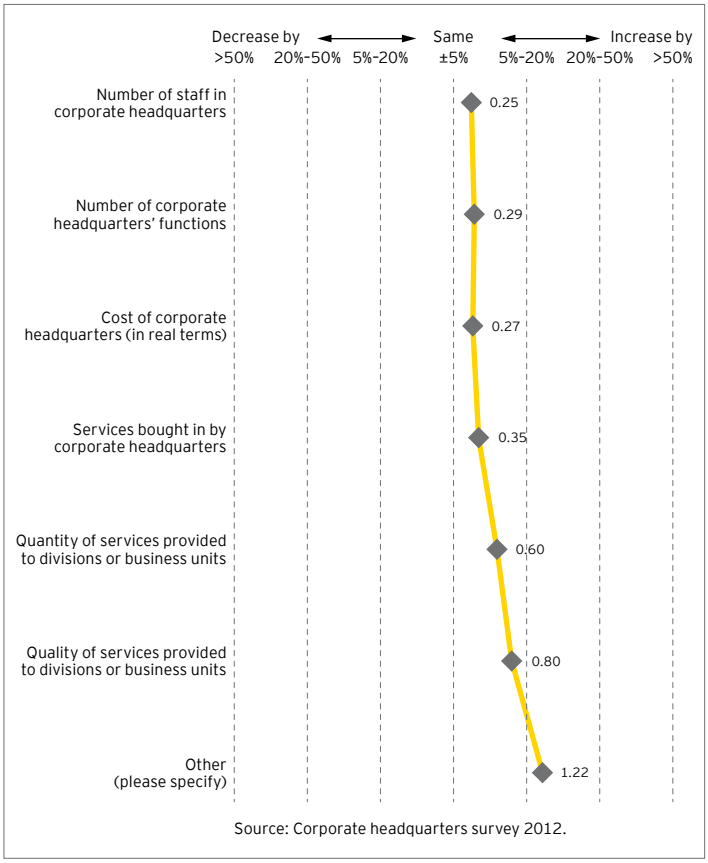
D. Collis, D. Young, M Goold

"The size, structure, and performance of corporate headquarters," *Strategic Management Journal*, 28(4):402, 2007.

Companies tightened corporate headquarters' strategic and functional control

In line with the move toward larger CHQ, there was also a clear trend toward more central control. On average, companies increased the influence of their CHQ on divisional decision-making considerably (see Figure 4). Only a very few companies (4.8%) bucked this trend, allowing overall decision-making to be less centrally driven. Three of every four companies (75.3%) increased the influence of their CHQ; almost half of the companies surveyed

Figure 3. Changes in the size and scope of CHQ



Source: Corporate headquarters survey 2012.



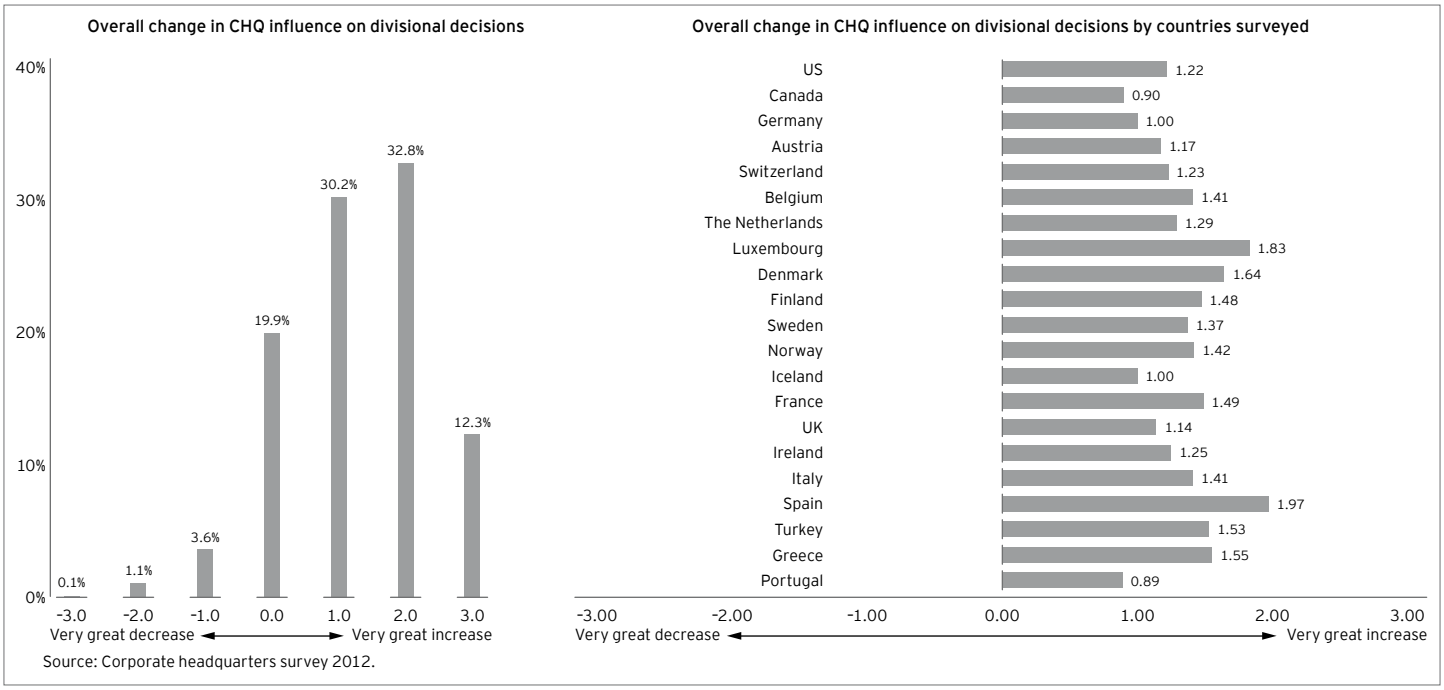
(45.1%) reported a strong increase in CHQ influence. Moreover, this trend is very stable across the different countries.

Despite the increase in overall CHQ influence, the degree of influence varied across the different business areas (see Figure 5). For example, there was particular emphasis on general planning activities such as the setting of budgets and financial targets, major capital investment and business strategy, and new business creation. While the increase in CHQ influence was slightly lower in the functional areas, increases in HR, purchasing and logistics, and IT were still significant. R&D was one functional area that saw the lowest increase in CHQ influence.

Companies granted divisions more authority in less strategic areas of decision-making

In spite of the trend toward more central involvement in general business planning and functional areas, companies on average increased the delegation of decision-making authority to their divisions (see Figure 6). Only a minority of companies (15.9%) resisted this general trend and reduced the delegation of decision-making authority, half (50.3%) reported no change, and approximately one-third (33.8%) increased the delegation of decision-making authority.

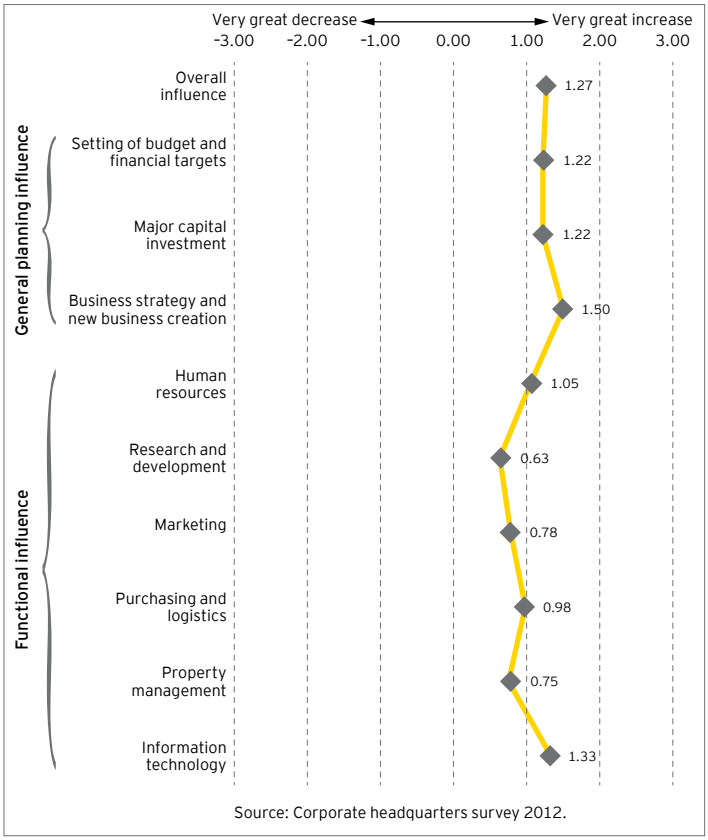
Figure 4. Changes in CHQ influence on divisional decisions



Source: Corporate headquarters survey 2012.

Striving for the right balance between the CHQ and the rest of the organization has been a fundamental management challenge for decades

Figure 5. Areas in which CHQ influence on divisional decisions has increased



Source: Corporate headquarters survey 2012.

The increase in divisions' decision-making authority seems to contradict the otherwise increased CHQ influence. This conflict can be resolved by considering the differences in the nature of the two trends. While the increase in CHQ influence relates to the general business planning of companies' divisions and their functional practices and procedures, the trend toward the delegation of decision-making authority is more concerned with issues related to the daily business operations.

This finding concurs with recent research suggesting that companies have "become flatter" over the last couple of decades. The implication is that CEOs connect deeper down in the organization, while the decision-making authority and incentives are also pushed further down the hierarchy.[12] Compared with the classical notions of centralization and decentralization, the phenomenon of increased CHQ strategic control, together with more decision authority in the divisions, does not fit in either of these two opposing categories but combines elements of both.

In sum, the survey shows important patterns of CHQ change. Contrary to conventional wisdom and earlier similar research,[13] it shows that economic pressures do not necessarily prompt CHQ downsizing but a considered approach to adjusting the CHQ design. Specifically, managers seem to have grown more aware of the contribution the CHQ can make to their companies' long-term survival. Between 2007 and 2010, managers did not submit to the temptation to prune their CHQ aggressively, but strengthened their CHQ role in strategic and functional areas. By decentralizing other operative decision authority, they embarked on a new path of (de)centralization characterized by both a tighter strategic reign of the CHQ and more operative authority in the divisions. This empirical development underlines the validity of the nascent academic discussion of new forms of CHQ involvement that proposes overall "flatter" organizations[14] and internal structures driven by the CHQ value creation role.[15]

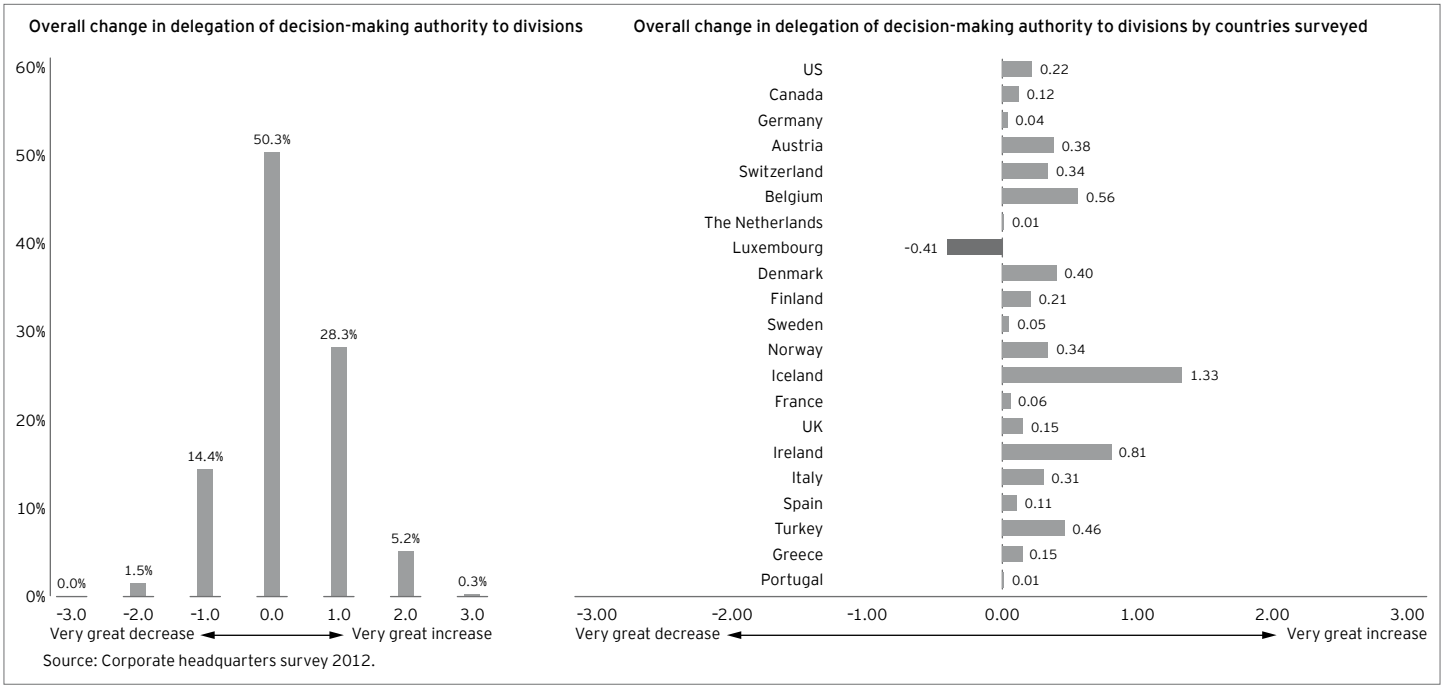
12 R.G. Rajan, J. Wulf, "The Flattening Firm: Evidence From Panel Data on the Changing Nature of Corporate Hierarchies," *Review of Economics & Statistics 88(4): 759–773*, 2006.

13 E. Ferlie, A. Pettigrew, "The Nature and Transformation of Corporate Headquarters: A Review of Recent Literature and a Research Agenda," *Journal of Management Studies 33(4): 495–523*, 1996.

14 R.G. Rajan, J. Wulf, "The Flattening Firm: Evidence From Panel Data on the Changing Nature of Corporate Hierarchies," *Review of Economics & Statistics 88(4): 759–773*, 2006.

15 P. Kontes, "A New Look for the Corporate Center: Reorganizing to Maximize Value," *Journal of Business Strategy 25(4): 18–24*, 2004.

Figure 6. Changes in delegation of decision-making authority to divisions



Source: Corporate headquarters survey 2012.

A considered approach to CHQ change

Irrespective of current trends, managers should act with care when adjusting their CHQ. Owing to the distinct strategic role of the CHQ, the effect of any changes to it will be amplified throughout the organization. Managers need to keep this in mind, particularly when either trimming down or scaling up their company's CHQ. Too large a change either way carries risks and harbors potential costs. If companies cut too deeply, they may not have the capabilities and resources to support their corporate strategy in the best possible manner. CHQ austerity may prevent them from identifying strategic opportunities that could transform its fortunes. On the other hand, a large and overly active CHQ could also become a serious burden and destroy rather than add value.

Figure 7 illustrates the balancing act companies need to perform when adjusting their CHQ. The challenge is to estimate the right amount of CHQ change to create new opportunities and prune obsolete functions and services, while at the same time avoiding excessive disruptive effects. In essence, it is about balancing two diametrically opposing effects: adaptive and disruptive. On the one hand, CHQ changes have a positive impact on performance as they help overcome the misalignment that emerges naturally between any CHQ and its internal and external environments. On the other hand, CHQ changes can have negative performance aspects (disruptive effects), as they destroy corporate processes and capabilities that might have been of value at some later point. Consequently, too much stability (minimal adaptation) and too much change (large disruption) are both likely to be harmful.



Finding the right pace of change is not the only challenge when implementing adjustments to the CHQ. The different choices and direction of CHQ change come with specific risks, opportunities, drivers, and barriers. Table 1 provides an overview of these factors and thus forms an important backdrop to CHQ reviews. For example, scaling up the CHQ could either result in unnecessary bureaucracy or lead to value through improved coordination across the business units. Similarly, trimming the CHQ is a two-sided coin. On the one side, it promises cost savings while, on the other, it may jeopardize future opportunities. Equally, there are drivers and barriers in the internal and external organizational contexts.

16 A. Campbell, M. Goold, M. Alexander, "Corporate Strategy: The Quest for Parenting Advantage," *Harvard Business Review 73(2): 120–132*, 1995.

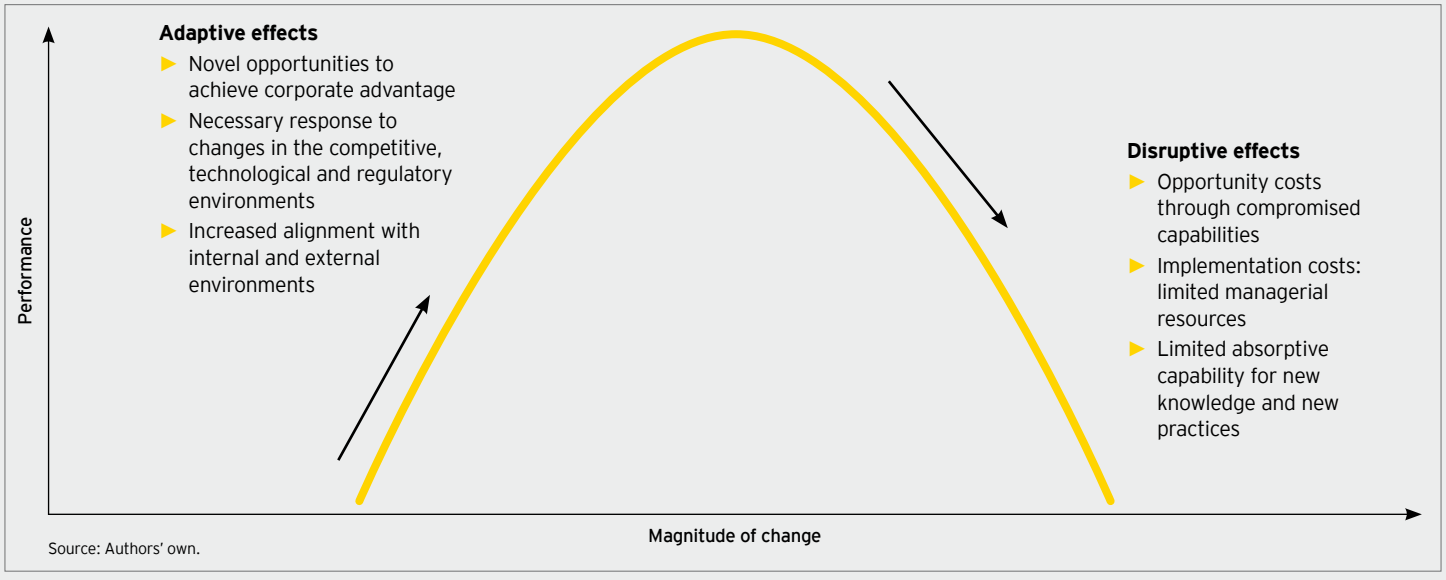
17 M. Krühler, U. Pidun, H. Rubner, *First, do no harm: How to be a good parent*, (BCG: Munich, 2012.)

Conclusion

In today's large companies, the CHQ plays an increasingly important role. As ownership of business units becomes more contested by the growing number of strategic and financial investors, the CHQ needs to work harder to actively add value to its collection of businesses. If the CHQ fails to build a sustainable parenting advantage (i.e., if it fails to add more value to its individual businesses than any other corporate parent could do), the organization it serves will eventually be broken up by a better parent.[16]

The need to justify its existence is a constant burden for the CHQ. Practitioner studies consequently advise corporate managers to adopt a clear and easy-to-communicate corporate strategy. They also recommend that managers should only interfere with business unit operations with caution as they can easily do harm.[17] The potential for any CHQ to add value is specific to each situation and

Figure 7. Adaptive and disruptive effects of CHQ changes



Source: Authors' own.

> Irrespective of current trends, managers should act with care when adjusting their CHQ

depends on the company's industry, its set of businesses, and its corporate strategy. Similarly, there is no one superior CHQ design. Differing markets and strategies require that organizations tailor their CHQ to the distinct needs of the businesses they serve.

Corporate managers need to assess the choices at hand in light of their company's specific circumstances and strategies. The survey results presented in this article indicate that, when contemplating CHQ change during the 2007 to 2010 economic crisis, they broke with historical patterns and overruled conventional wisdom.

The survey results reaffirm corporate managers' decisions to focus on designing and maintaining their company's CHQ so that it will create value for the business. An important part of this effort is to continuously review the CHQ alignment with the organization's business needs. We hope that the discussion and the survey results provide corporate managers with additional insights which help them deliver on this fundamental task.

Acknowledgments
We thank Johannes Luger for helpful comments on earlier drafts of this article.

Corporate headquarters survey 2012

S. Kunisch, G. Müller-Stewens and D.J. Collis, "Housekeeping at Corporate Headquarters: International Trends in Optimizing the Size and Scope of Corporate Headquarters," *Survey Report*, St. Gallen/Cambridge: University of St. Gallen/Harvard Business School, 2012.

Further reading on this topic

A. Campbell, S. Kunisch and G. Müller-Stewens, "Are CEOs Getting the Best from Corporate Functions?" *MIT Sloan Management Review, 53(3): 12–14*, 2012.

A. Campbell, S. Kunisch and G. Müller-Stewens, "To Centralize or Not to Centralize," *McKinsey Quarterly, 2011(June): 1–6*, 2011.

Table 1. CHQ change: advantages, disadvantages, drivers and barriers

CHQ change	Potential advantages	Potential disadvantages	**Drivers** (internal and external)	**Barriers** (internal and external)
Scaling CHQ up ↑	▶ Increased coordination and synergy realization ▶ Build up of CHQ capabilities ▶ Compliance with regulatory requirements	▶ Additional overheads and costs ▶ Bureaucracy and inappropriate interference ▶ Value destruction	▶ Changes in corporate strategies ▶ Good prior performance and slack resources ▶ Regulations, fads, and fashions	▶ Stock market pressure to maintain costs ▶ Business unit opposition ▶ Strategic and structural inertia
No change	▶ Stability at the top: stable processes and networks ▶ Low risk of organizational disruption ▶ No additional costs	▶ Misalignment between internal and external environment ▶ Breeds impression of inactivity in the business units	▶ Strategic and structural inertia ▶ Little attention to corporate strategy ▶ Lack of dynamism in the external context	▶ Ambitions of corporate managers ▶ Mismatch of current CHQ design
Scaling CHQ down ↓	▶ Reduction of overhead and cost savings ▶ Reduction of bureaucracy and interference ▶ Clarification of responsibilities	▶ Restructuring costs ▶ Deterioration of CHQ capabilities ▶ Harmful reduction in corporate capabilities and networks	▶ Economic pressures ▶ Little value added by the CHQ (likely value destruction) ▶ Changes in corporate strategies	▶ Resistance from corporate management ▶ Weak oversight that challenges CHQ design ▶ Strategic and structural inertia

Source: Authors' own.