

“When you create organizational subunits of any form, they'll have a tendency to focus internally on their own things”

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Introduction

Corporate functions exist in companies that contain a number of business divisions (Chandler, 1962, 1991; Strikwerda & Stoelhorst, 2009). Such corporate functions span a variety of management areas such as IT, HR, marketing/branding, finance and controlling, purchasing, legal, and corporate development. In fact, any stage in the value chain, ranging from R&D to sales, can be centralized at the corporate level (e.g. Argyres & Silverman, 2004; Kleinbaum & Stuart, 2011). Over the last couple of decades, the importance of corporate functions has increased significantly which is reflected in the rise in a number of functional managers in the ‘C-suite’ (Guadalupe, Li & Wulf, 2012; Guadalupe, Wulf & Li, 2012; Rajan & Wulf, 2006), and in individual corporate functions (cf. Aaker, 2008; Angwin, Paroutis & Mitson, 2009; Menz, 2012; Peppard, 2010; Ulrich, 1998).

Corporate functions have the potential to influence the value added of the ‘corporate parent’ (Campbell, Goold & Alexander, 1995b). For example, in the British retailer Tesco, a corporate function provides the business divisions with high quality market research data (e.g. Bell, 2006; Mukund, 2003). This adds value because it saves the business divisions from creating their own market research teams, each collecting similar data. Another example is Danaher, which is well known for its Danaher Business System, a set of corporate capabilities and a way of managing that enable the corporation to double the profitability of many of the businesses it acquires (e.g. Anand, Collis & Hood, 2008; Nadathur & Bourgeois, 2010). One of Danaher’s corporate functions focuses on “lean capabilities”. Corporate functions can, therefore, host capabilities that add significant value to business divisions.

However, corporate functions also frequently do not add as much value as they could or even subtract value. Many of our interviewees, the heads of 40 corporate functions at some 30 of Europe’s leading companies, were quick to point out past periods when their functions had performed poorly: often periods before they were appointed. We also know from empirical research (e.g. Nell & Ambos, forthcoming) as well as anecdotal evidence that managers in business divisions frequently complain about the interference, time wasting and poor performance of some of the corporate functions that should exist to help them. Moreover, research has demonstrated that subtracted value is common-place, particularly as the mandate of the corporate parent increases (e.g. Krühler, Pidun & Rubner, 2012).

While subtracted value has been widely documented little is known about why it occurs. As we tried to understand the root causes of this underperformance, we noted that corporate functions face very different challenges. Some corporate functions are rather new. Recently, many companies have added corporate functions in areas such as supply chain management, real estate, corporate compliance, R&D and corporate sales (Kontes, 2004; Kunisch, Müller-Stewens & Collis, 2012). These corporate functions have to build new skills and develop effective relationships with the business divisions. Other corporate functions are extending the range of activities, building around existing skills and existing relationships. Others are being amalgamated or separated or significantly downsized. These corporate functions are grappling with difficult transitions. The different situations corporate functions find themselves in are well captured by the life cycle stages of launch, growth, maturity and decline.

At each life cycle stage, a corporate function has different characteristics regarding its *strategy* (mandate) and its *organizational design* (see Figure 1). These characteristics create management challenges that are the root causes of subtracted value. The four *value traps*, based on these management challenges, one for each stage of the life cycle, together explain most of the negative stories in our research). By better understanding the connection between the life cycle stages and the value traps in each stage, executives can take actions that significantly improve the value added by corporate functions.

The paper contributes to the corporate strategy literature (Campbell, Goold & Alexander, 1995a; Porter, 1987) by using the life cycle concept (Miller & Friesen, 1984; Phelps, Adams & Bessant, 2007) to help explain the phenomenon of subtracted value by corporate functions. In the following, we describe the value traps, explaining why they are so common. In the full paper we will also give examples of how successful firms avoid them.

The Opportunity Trap

The Launch Stage

The launch stage of a corporate function is an exciting moment. It is usually triggered by the executive team when senior managers recognized an opportunity or need amongst the business divisions. The need might be about creating synergies among the business divisions. It might be about reducing the risk of mistakes with added controls. It might be about giving strategic or operational guidance or support to the businesses. For example, a common need is to help the businesses develop and share management talent. Typically a corporate function is set up to lead this effort by providing central talent development, developing policies to ease the movement of managers between businesses and by developing information systems to help identify the best talent.

The mandate for the new corporate function typically defines the opportunity: the potential to raise performance or to reduce problems. But, given the novelty of the issue, the mandate typically does not define how the opportunity should be executed. The functional leader normally is asked to develop an action plan after studying the situation in more detail.

The Challenge of New Opportunities

The value trap in this stage arises because leaders of these new corporate functions are tempted to pursue the opportunity before appropriate expertise is in place or before sufficient support for the corporate function has been won from the business divisions. Because the functional leader can see the opportunity to add value, he or she can become too eager to have an impact and can fail to prepare properly. We call this the *opportunity trap*.

The opportunity trap is embedded in the nature of the situation a new corporate function finds itself in the launch stage. The opportunity is new, therefore, by definition, the actions needed to address the opportunity are not clear and skills required to execute the actions may not exist in the organization. Often, the mandate is vague and its exact scope tenuous. Clarity about how to add value is lacking. The business case is often not fully clear. A corporate HR manager pointed out that although the mandate was explicit, what it exactly meant remained tenuous: "I think the problem came about because – although the new CEO knew he wanted HR – the management board was not really able to articulate exactly what they wanted this role to do." At another example, a new corporate real estate function was installed in an international insurance company. The head of this corporate function described the uncertainty inherent in his mandate's unique opportunity: "That would presuppose that I already perfectly know what I actually want to do at this point in time. [...] This is often the challenge in life. If one starts doing something new, especially something that no one else has done before, then one has to be the first to figure it out. That makes it interesting but also valuable."

Along with uncertainty about the mandate, there is normally insufficient talent. Typically, the new corporate function draws some managers from other corporate functions and/or some from outside the company. The managers who come from the inside will normally lack the skills needed for this opportunity because it is new. For example a manager may be moved from the compensation and benefits department to work in the new talent management function. The managers who come from the outside will typically lack sufficient knowledge of the company to be able to execute effectively.

One further challenge concerns the relationship with the business divisions. The business divisions may not be fully committed to the mandate and may have different views about the nature of the relationship their division should have with the new corporate function. The corporate function needs to establish credibility with the divisions and create a productive working relationship.

Against this background, the leader of the new corporate function is under pressure to deliver some positive results, to demonstrate that the decision to launch the new corporate function was a wise one. Typically, the corporate function starts to take actions before it is fully ready. Often the actions are more hindrance than help to the business divisions because they come from a corporate function that is not certain about how to execute its mandate and is staffed by people with insufficient experience. The situation can quickly spiral downwards as business divisions start to mistrust the corporate function and managers in the corporate function start to believe that the business divisions are resisting change or challenging its right to exist. Some corporate functions never recover. Many subtract a lot of value before they become effective.

The Ambition Trap

The Growth Stage

The growth stage is characterized by an expanding mandate. The corporate function's original mandate is being delivered and new activities are being proposed. For example, the talent management function may be adding a career planning capability or a recruitment service. The corporate function, encouraged by its initial success, is identifying additional activities that will extend the services it provides to and the influence it has over its internal clients.

The corporate function's organizational characteristics are also quite different from those in the launch stage. The corporate function's set of activities is diversifying. This means that the corporate function is likely to be involved in a mix of control activities, shared services, and value-adding activities. Good working relationships have been established with most of the business divisions. The corporate function also has a growing quantity and quality of resources at its disposal. It is also likely to have teams of experts that are organized into specialized departments each of which may be ambitious to expand (Ulrich, 1997, 1998). An important characteristic of this stage is that the functional head is usually now his/her own sponsor.

The Challenge of Growth

The value trap at this stage is to let ambition run ahead of opportunity. Flushed with success, the corporate function can believe that it should do many more things. As a result functional managers can push for additional mandates. Hence, we call this the *ambition trap*.

The ambition trap emerges from the characteristics of the growth stage: With past successes, growing capability, good relationships with business units and decreasing top management attention, managers in the corporate function have a tendency to believe that the corporate function should be doing more. While an expanding ambition may be appropriate in some areas, it has a tendency to keep expanding until it goes too far. When this happens, the corporate function starts activities that subtract value, and begins to lose the support of the business divisions.

From an organizational standpoint, a main concern is that corporate functions in this stage often lack sufficient strategic guidance from top management. While the sponsor who gave the initial mandate ensures sufficient top management attention in the launch stage, after the initial success the function no longer needs a sponsor. In fact the head of the function often becomes his or her own sponsor. Therefore, heads of corporate functions quite naturally start exercising their increased managerial discretion and looking for ways to extend their influence and power base by adding to their portfolio of activities. A corporate manager underlined this problem: "One of the central problems – a recurring one with these cross-holding functions – is the unbelievable appetite."

As the corporate function expands, it places an additional burden on the business units. If this burden is helpful to the business units, they will support it. If not, they will resist. Unfortunately, our research suggests that many of the activities started in this stage do not add value from the perspective of the business divisions. The recollection of a manager exemplified this situation: "The function thought that the best way to do things was to command from the center. This nearly killed the place."

The Best Practice Trap

The Maturity Stage

In the maturity stage, corporate functions reach stability in terms of their mandate. Notably, the corporate function has typically stopped expanding its mandate, and is focusing more on efficiency, best practice, and the standardization and formalization of corporate activities. The value potential is flattening because there are few new opportunities to add value.

From an organizational viewpoint, the corporate function is typically older, larger, and more established than a corporate function in the growth stage. The corporate function has a stable set of activities, is equipped with rich resources, an array of expertise, and a stable location in the structure. Most tasks are undertaken in a rather standardized and formalized way. Because of its tradition, central position, and its many interfaces with the organization, the corporate function is backed by a strong network of long-standing relationships. The corporate function has also become a more bureaucratic organizational unit.

On Becoming Excellent

At this stage, corporate functions typically focus attention on improving their internal excellence rather than growing their mandate. The value trap stems from this focus. Functional managers start to benchmark their performance against other companies with good reputations, and they start to copy industry best practices. This focus enables the corporate function to claim it is excellent, but often distracts it from the specific needs of its own business divisions, resulting in less value added and an increase in subtracted value. In other words, the desire for acknowledgment amongst peers and for performance measures the function can use to demonstrate its excellence often undermines rather than enhances effectiveness. We call this the *best practice trap*.

The maturity stage's distinct characteristics are part of the reason for the best practice trap. In this stage, corporate functions often start to pay more attention to the efficiency and effectiveness of their function. Corporate functions in this stage have generally reached a size that nurtures an internal focus. Size and age frequently lead to more focus on internal operations and less focus on customers.

Because many corporate functions do not have good internal measures for assessing their relative performance, they start *focusing on their peers*: They start looking to similar corporate functions in other companies for good practice ideas and performance benchmarks. This is often reinforced by the functional leader's desire to acquire professional acknowledgment in the functional community. Because the function is not growing, the functional leader can start to look for new challenges in the wider professional community. Frequently, corporate functions indeed strive for a best in class position as revealed by statements such as the following: "We want to have the best HR"; "We lead in HR"; "We are the gold standard [in this specific functional area]"

Also, many heads of corporate functions justified their activities to us by comparing their function with similar functions in other companies. Looking to functional peers can spur new ideas, and benchmarking can increase operational efficiency. But, they can also avert attention from the needs of internal business divisions and encourage corporate functions to copy the activities of other functions whether there is an internal customer or not.

The Redefinition Trap

The Decline Stage

The decline stage is not as common. But many corporate functions do enter a decline or redefinition stage. This may be because of a change in corporate strategy, because the original mandate has been fulfilled or because of hard financial times.

In the decline stage, the corporate function's mandate is changing or declining. The value adding potential and, thus, demand for the corporate function's activities can change dramatically or dry up altogether. The existing mandate loses its relevance because the corporate function has already 'mined out the value adding opportunity' and/or because the challenges facing the business units have changed. The former corporate head of controlling at a large bank recalled the rise and fall of the organizational development departments in many banks. In the 1990s, large banks typically organized their organizational design competence in large corporate departments. By 2012, most had disappeared. Some organizational development experts were moved to corporate IT to support the standardization of processes. Some found a new home in the corporate development department. But many have left.

The Struggle for Survival

The challenge in the decline stage is often to manage a dramatic withdrawal, or even an exit, from the incumbent activities. This means a fundamental change, which the managers of the corporate function usually do not welcome. Typically, the natural desire of the corporate function's managers is to maintain the status quo – to cling to old ways of working and resist change. They want to prolong the 'old ways' even though the value creating logic has changed. We call this the *redefinition trap*.

The corporate function's strategic and organizational characteristics help explain this trap. From a strategic viewpoint, the corporate function has served the company well, probably for a number of years. This identity, as an important corporate function, makes managers reluctant to shrink their size and resources when their mandate is challenged. They fear losing their power, reputation, influence, and jobs. Moreover, they are attached to the processes and ways of operating that they know. As a result, they are

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slow to change and often continue with activities and people that are no longer needed. They can invest significant time in trying to justify the value added of traditional activities.

In addition, as part of the search for survival, managers in the corporate function are often creative in starting up new activities that replace those that are in decline. Since they typically have spare resources, they can choose to act first and ask permission afterwards.

Unfortunately, these new activities often do not add value and even worse can destroy value. Unfortunately their ability to deliver new activities is often hindered by the skills of the staff they have. Typically these staff is skilled at the old activities. Moreover, since there is pressure to reduce staff numbers, recruitment of new skills is difficult. One corporate strategy function, faced with less demand for strategy work, turned its spare resources towards mergers and acquisitions, taking up a significant amount of time of managers in the business divisions without completing any successful deals.

Conclusion

Corporate functions play an important role in corporate strategy: They are one of the ways in which the corporate headquarters adds value. However, corporate functions are not static; they change continuously. New corporate functions are set up, existing corporate functions grow, and long established corporate functions become redundant or need to change to match new circumstances. By understanding the different challenges that corporate functions face at different points in their life cycle, we can better understand why they so frequently subtract value.

Using the life cycle concept, we identified four stages that corporate functions experience. At each stage, the corporate function has different strategic and organizational characteristics and thus faces different challenges. It appears to be the strategic and organizational challenges at each stage that are the root cause of subtracted value. To help illuminate this, we have identified a major value trap in each stage, and we have shown, for each stage, how some companies are putting in place processes and behaviors that help avoid the value trap.

The paper is making two important contributions. First, this paper helps explain why corporate functions often underperform. Using a life cycle approach, we are helping to explain why underperformance is so common. The life cycle stages create different challenges that appear to require specific actions. Second, this paper applies a corporate strategy perspective to corporate functions. Despite the increasing importance of corporate functions in large firms and guidance in individual functional areas, there is little advice from a corporate-level viewpoint. In particular, by seeing corporate functions as vehicles for adding value, and hence as tools of corporate-level strategy, we are proposing a much tighter link between corporate strategy and corporate functional strategies than exists in many companies. Also, by acknowledging that the main aim of corporate functions is to help the business divisions raise their performance, we are proposing an orientation (add value to the businesses) that is frequently not the dominant orientation of many corporate functions.

We believe this paper will help focus attention on corporate functions from a corporate strategy viewpoint. In particular we aim to help corporate managers improve the value added by corporate functions, an essential element of any successful corporate strategy.

Methodology

The insights of this paper are based on 40 in-depth interviews with heads of corporate functions in 30 large multi-business corporations in the UK, Switzerland, and Germany including Fortune Global 500 corporations such as ABB, Allianz, Credit Suisse, Daimler, Siemens, and UBS. For generalizability purposes, we covered a broad range of corporate functions: corporate HR, corporate IT, corporate finance, corporate development/strategy, and others (such as real estate). In the interviews, we discussed the historical development of the corporate functions and how heads of corporate functions develop strategies for their function. The topics discussed include how they link their corporate function's strategy to the corporate strategy; how they avoid bureaucracy, empire building, and interference; and how they decide what skills are needed at their corporate functions. Specifically, we focused on changes that the head of the corporate function had made to corporate-level activities or roles. Additional sources were a couple in-depth case studies that we wrote and extensive consulting experience with large multi-business corporations.

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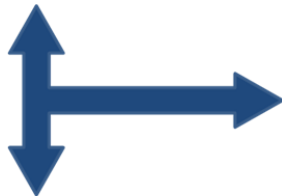
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Figures

Figure 1: Four Traps of Corporate Functions

Life cycle characteristics	Value traps
Strategy (mandate)	A Opportunity trap in the launch phase
	B Ambition trap in the growth phase
	C Best practice trap in the maturity phase
	D Redefinition trap in the decline phase
Organizational design (tasks, resources, formal/ informal design , leadership)	