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Why corporate-center efficiency matters

Getting the most out of a corporate center has never been so important or complex. The latest research points to new ways to help a center get more efficient.

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Research finds that in the course of four years, 90 percent of businesses reshape their corporate centers. Your business is probably one of them: wrestling with digitization, talent shortages, new ways of working, and a more competitive market environment will naturally raise questions about both what the corporate center should do, and how.

Firms also make changes in response to intrinsic motivations. C-suite members may want more agile corporate centers that support increased speed, faster resource reallocations, and closer proximity to customers. Better profit and loss statements are often a happy side effect.

But not often enough. Much of the time, organizations find that their hard-won changes achieve too little or prove too short-lived. That frustration led us to look for fresh insights into what makes a corporate center succeed in today's business environment.

How today's corporate centers are changing

A corporate center includes all the top management in a firm's uppermost organizational unit, in charge of overall profit and loss. These people make decisions that matter to the entire company. Consequently, our focus is not primarily on questions of geography. We are instead most interested in the leadership principles and organizational philosophy a firm employs in determining the role that a corporate center has in running its businesses.

Our empirical results show that corporate centers are changing. We found that they fall into one of several archetypes. Some are familiar: As always, we see "financial holding" corporate centers, which steer groups of highly independent businesses, and "operators," which leverage central skills to run shared operations for the entire company.

The majority of firms use a mixed model. "Strategic drivers" set the overall strategy, guidelines, and policies that guide business units as they make decisions. Others are more flexible in their approach to steering the business units: "Dynamic entrepreneurs" focus on building infrastructure support for priorities and aggressively managing the company portfolio, while "adjustors"—a newer archetype we identified—frequently modify their steering model according to the type and maturity of the businesses they're running.

We do not intend to dive into a conceptual discussion on the "right" archetype. Our interest instead is to assess the corporate center's impact on a company's financial performance and, in particular, its efficiency.

When addressing corporate-center structural questions, however, it's important to take a broad view. Our research therefore combined publicly available data from 142 companies (and their corporate centers) with insights from McKinsey's proprietary CBF360 benchmarking database, which covers the general and administrative (G&A) resources and costs of more than 3,000 companies.

In our sample we could not (yet) find a clear pattern between the corporate-center archetypes and EBIT or EBITDA. Nevertheless, as our research effort continues, we will further investigate that topic.

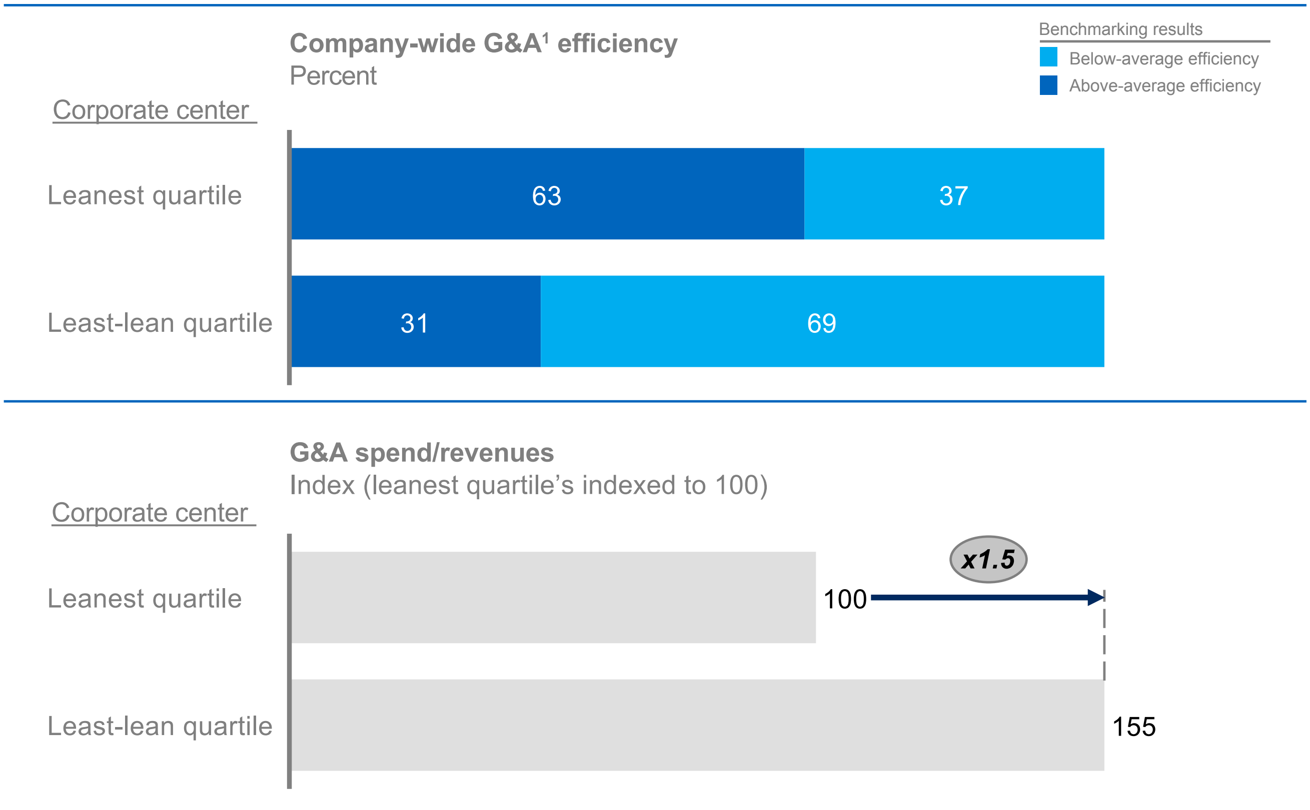
We also started to identify possible relationships between the corporate center archetypes and cost efficiency, especially in G&A functions. But again, no pattern emerged.

In every archetype, leanness is the key

Corporate-center leanness—defined by the share of resources in the corporate center compared to the entire company—proved to be a strong predictor of company-wide G&A efficiency. About 65 percent of the time, the leanest quartile of corporate centers, regardless of archetype, belonged to the firms with better-than-average overall G&A efficiency, both in the corporate center and in the other parts of the organization (exhibit).

Exhibit

A leaner corporate center is more efficient in its general and administrative (G&A) functions.



[1] General and administrative

SOURCE: McKinsey Corporate Center of the Future team

At the same time, about 70 percent of companies in the least-lean quartile of corporate centers showed below-average G&A efficiency. This pattern is supported through the analysis of the G&A-to-revenue ratios of the above-mentioned groups of companies, agnostic of the corporate center archetype.

The implications of a lean corporate center

We interviewed 20 experts, including senior executives, academics, and consultants, about why corporate leanness matters so much. The first and perhaps most obvious reason our interviewees cited is that a lean corporate center may make less work for the rest of the organization, creating a sort of multiplier effect that reduces G&A expense by more than the cost of the corporate center itself.

Their second cited reason is that a lean corporate center may serve as a role model for other parts of the business. By living according to norms of cost-consciousness and efficient resource use, the center encourages the same behaviors well outside the four walls of the headquarters.

On the whole, we saw efficient and inefficient corporate centers of every type. No archetype had a monopoly on efficiency. We conclude that the decision to follow one or the other corporate center archetype should be driven by the needs of the businesses you are in and the capabilities you currently have in the corporate center.

Once the choice is made for an archetype, however, the company should endeavor to make its corporate center as lean as possible. Its efficiency is key for the overall G&A cost position of the company.

In a forthcoming article, we'll describe ways to move towards a lean corporate center.

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