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Lever six: Organization and governance

A key lever to effective and efficient support operations is the right organizational structure and governance

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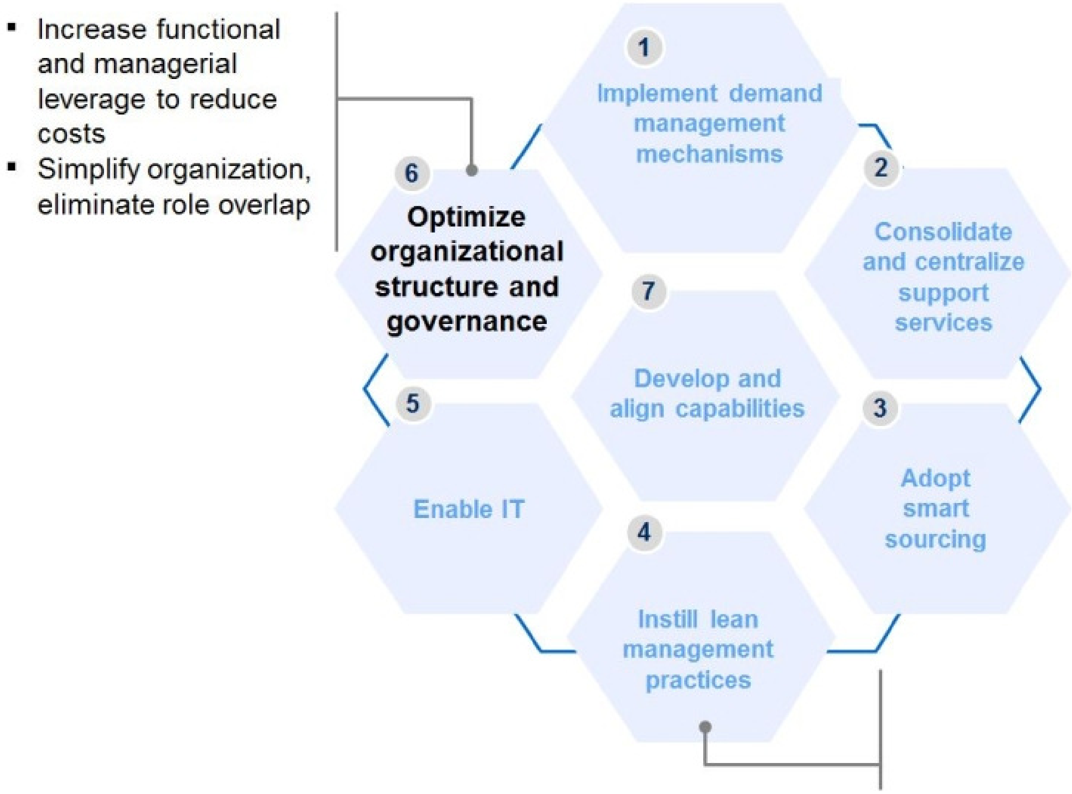
For the introduction to this seven-part series on why and how companies can improve the effectiveness and efficiency of their business and corporate functions, please see "Seven levers for corporate- and business-function success: Introduction", June 2014, on the Operations Extranet.

The first five levers discussed in this series—demand management, consolidation, smart sourcing, lean management, and IT enablement—focus primarily on the mechanics of how business and corporate functions work. But the improvements will be only temporary unless the enterprise also addresses how the functions set and keep their commitments to the businesses they serve. The functions, businesses, and corporate center will need a carefully designed structure in which lines of authority and decision rights are not only clear, but also consistent with the organization's overall objectives (exhibit).

Exhibit: A key lever to effective and efficient support operations is the right organizational structure and governance



SOURCE: McKinsey's Corporate and Business Function practice

In organizations that overlook this important element, dysfunction can quickly emerge. Communication slows down between staff at the functions' front lines and their leaders. Functions fail to manage the delicate balance between maintaining enterprise-wide standards and accommodating the unique requirements of individual businesses. Senior staff members become bogged down in tasks better suited to junior employees. Confusion and conflict arise over the functions' role and funding.

Three steps are central to revamping the structure of corporate and business functions. The first step involves identifying and prioritizing those activities that are most important to the way a particular function supports the enterprise's mission. Separating these points of distinction from activities that merely need to be executed competently allows the company to make fundamental design decisions, such as where to locate authority for particular tasks, how much oversight is needed for effective decision making and coaching, and, consequently, how many direct reports each leader can supervise.

The second step involves deciding how best to align the functional roles—particularly those that interact with the businesses—to the broader enterprise, thereby facilitating smooth interactions between geographic and business divisions.

The third step explicitly allocates decision-making authority between the functions and their "customers" in other parts of the organization. The resulting governance system must give all stakeholders sufficient voice to influence the scope, quality, and cost of the services that the functions provide, while preserving the enterprise's ability to manage constraints and achieve cost and compliance goals.

Step 1: Reflect strategic priorities in the design of the organization

The ultimate goal of any redesign is to ensure that each function supports the enterprise's overarching priorities. Accordingly, much as the business units do, each function should focus investment in the areas that offer the greatest strategic value, and design the structure of their teams accordingly.

This judgment may itself require extensive analysis. An industrial conglomerate, for example, discovered that despite its wide range of businesses, the finance needs of its units varied only according to a few essential characteristics. Businesses selling customized products with long development cycles needed deep and specialized capabilities, such as familiarity with project-based accounting rules. By contrast, thinner margins meant that businesses whose products were more standardized put a premium on rapid turnaround and very low finance support costs.

To eliminate redundancies and achieve its cost objectives, the conglomerate sought to centralize its finance function in a way that recognized the very different operational requirements and levels of support the two types of businesses needed. The end product was a hybrid organizational model in which a single finance shared-services organization housed two largely independent divisions, each with a different operating model. The new approach allowed the same organization to serve multiple business units, while still accommodating the most critical differences in support requirements.

In tandem, segmenting the activities that needed more tailoring allowed the organization to set sustainable targets for spans of control. To enable intensive coaching, areas requiring greater oversight—such as project accounting—kept a fairly low ratio of staff to managers. For managers with subordinates who performed more standardized work, however, performance and development could rely more heavily on data-driven techniques; spans could therefore increase to a dozen or more staff per manager.

Step 2: Align functional structure to the larger organization

If the final structure of a corporate and business function is out of sync with the way the business units are organized, friction will eventually erode the initial improvements. To avoid this outcome, the conglomerate declined to push the shared-services idea to its logical conclusion. Instead of a single, global center, it created regional services centers that accommodated time-zone and language differences.

For an emerging-markets basic materials company, achieving the right organizational configurations for its functions was especially complex. The company had grown rapidly through a series of geographic expansions, in which newly-acquired businesses operated mainly on their own. Moreover, although its developed-market businesses were integrated world-wide, several of its emerging-market units operated on a country-by-country basis. The company determined that to support its next growth phase, it needed greater functional coordination at a global level. One of the benefits this ensured, for example, was that leaders could reassign the best talent to the most critical units and geographies, and IT could develop applications with a consistent architecture across the enterprise.

The resulting organization design reallocated control of country-based functional staff from local business leaders to global functional heads. At the country level, local leaders within each function would be evaluated both based on their work with the country business heads and their ability to roll out enterprise-wide solutions. The nature of the relationship with the local BU leadership would also change from hierarchical to a consultative role, with support expectations defined and monitored more formally so that they aligned both with local business requirements and global imperatives.

Step 3: Implement governance mechanisms to separate supply from demand

As well as addressing structural requirements, the enterprise must create governance mechanisms that will focus its corporate and business functions on the most important issues, even when business requirements change. The chief issue concerns decision rights: for a shared HR function, who determines what the performance metrics should be? In finance, who determines what reports are created? Who makes investment decisions and allocates resources?

In most of the examples we have seen, the customer—whether a business unit or another function—takes the lead on demand, defining its needs and budget, while the function takes the lead in deciding how best to obtain the resources to meet that demand. Neither decision, of course, is unilateral: instead, the function and the business collaborate and negotiate within savings targets or other constraints set by the larger organization.

A US-based health insurer provides an example. Most of its functions now operate on a shared-services model. The businesses and functions have negotiated arms-length service-level agreements (SLAs), which precisely describe the services to be provided, the desired performance criteria, and the amount to be charged. The leadership team fosters transparency in this “contracting” process by requiring the functions to compare their pricing, service levels, and related operational data to external benchmarks. If a business proposes terms that the function cannot meet within the stated budget, the benchmarks provide a starting point for the two sides to find alternatives—simplifying the work to be delivered, relying more on lower-cost offshore resources, and so forth.

Occasionally compromise may prove impossible. The insurer therefore established clear procedures to escalate disagreements if, for example, a business requires a type or level of support that would impose a significant unbudgeted cost on the function. A steering group comprising the CFO, COO, the shared-services head, and the leaders of each business unit has the power to break the logjam, evaluate investment proposals, and resolve these types of disputes.

As organizational structures and decision-making processes become more transparent and systematic, leaders can spend less time navigating the organization and focus more time on the core of their jobs. Yet the transition may require a shift in mindsets and capabilities to enable the organization to adapt to new roles, responsibilities, and ways of working. This topic will be addressed in the final part of this series: *Lever seven: Capabilities*■

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