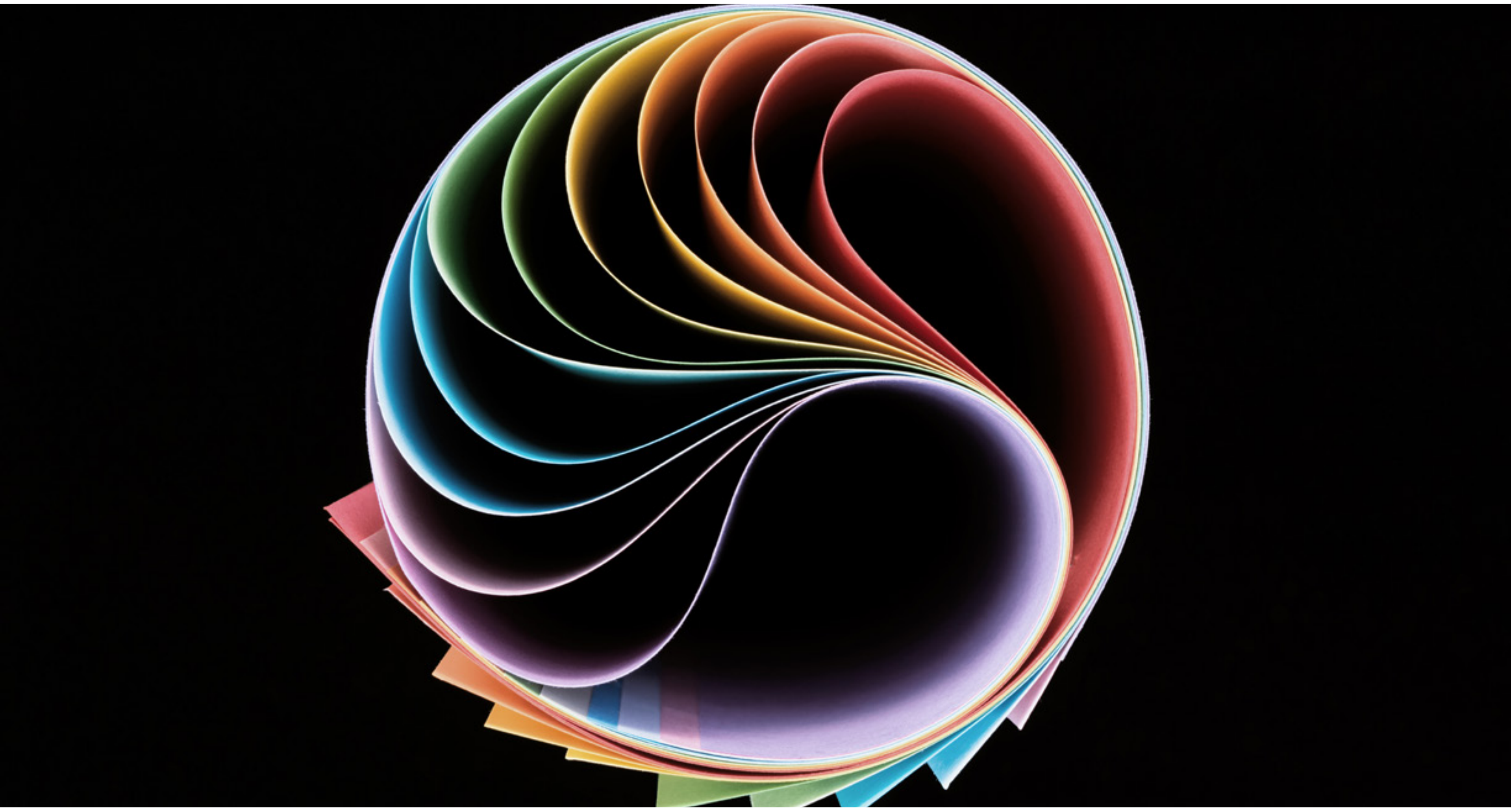
McKinsey & Company

Operations Practice

The future corporate center: Functional efficiency runs in the family

In the corporate center, efficiency begets efficiency—and inefficiency begets inefficiency. The trick is to get more of the former and less of the latter.

by Steven Eklund, Michael Glaschke, and Heiko Heimes



September 2020

Executives everywhere want to make their companies more efficient. But moving an entire firm toward efficiency is a big project. A manager might not have the right resources. Maybe she won't be there long enough to see the job through to completion, or maybe he doesn't have buy-in from the rest of the organization.

There's good news for executives in this position. Our research shows that leanness in the corporate center is an indicator for overall efficiency in the general and administrative (G&A) functions. Accordingly, transformational work in the corporate center can serve as a beacon for the entire company. In addition, we now have evidence that efficiency in one functional area of the corporate center implies efficiency in other functions.

As functional efficiency seems to run in the family, a focused approach in triggering broader efficiency-oriented transformations can be successful.

In an earlier article, "Why corporate-center efficiency matters," we shared observations from our research on corporate centers. Corporate-center leanness, as defined by the share of general and administrative (G&A) resources in the corporate center versus the share in the entire company, strongly predicts the entire G&A efficiency. About two-thirds of the time, the leanest quartile of corporate centers belonged to the companies with better-than-average overall G&A efficiency. And about 70 percent of companies in the least-lean quartile of corporate centers also showed below-average G&A efficiency.

The reasons, the experts we asked surmised, included the possibility that a lean corporate center makes less work for the rest of the organization, creating a multiplier effect that reduces G&A expense by more than the cost of the corporate center itself. A lean corporate center may also serve as a model for other parts of the business, exemplifying cost-consciousness and efficient use of resources.

Additional data on corporate-center staffing levels confirms our initial analysis. Across the different archetypes of corporate center that we described in our previous article—such as the "financial holding" archetype involving highly autonomous businesses, or "operators" running shared operations for an entire company—corporate-center efficiency and overall G&A efficiency are linked.

This insight led us to wonder about something else: is efficiency also linked between corporate-center functions? The answer: Yes. Before we go into the detailed results of our research it is worthwhile to understand which functions are represented in the corporate center and to what extent.

Functional representation in the corporate center

If we take our sample's median into account, we see a clear pattern (exhibit). Compared with other functions, finance, HR, and IT have smaller shares of their functional resources in the corporate center. Instead, they are spread throughout the rest of the organization, including in shared-services organizations. This means that those functions, which are larger in absolute numbers, are the ones with a more 'away-from-corporate-center' setup.

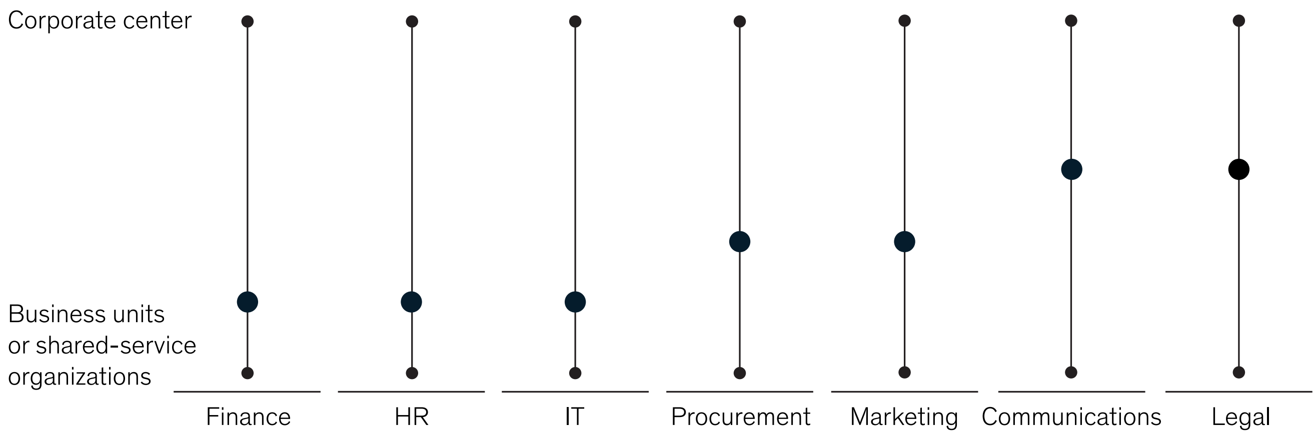
The communications and legal functions tend to be at the other end of the spectrum. They show a stronger degree of "corporate-centerization": more of these functions' people are allocated to the corporate center. Marketing and procurement fall somewhere in between the two poles.

Focusing on a few functions helps explain this pattern.
Finance, for example, is a mix of very different areas of activity, particularly in accounting,

Exhibit

Across organizations, specific functions tend to follow similar centralization patterns.

Distribution of resources within functions (share in corporate center, based on median of sample group)



controlling, tax, and treasury. Finance's low degree of representation in the corporate center is largely driven by accounting, which usually accounts for the largest share of the function's resources—and, similar to IT, accounting relies heavily on the use of shared services. Controlling typically shows a mixed picture, with strong decentralized representation but with steering based in the corporate center. Tax and treasury, on the other hand, often operate quite centrally, but both are usually smaller than the accounting and controlling groups.

In HR, an organizational model emphasizing business partners, shared services, and centers of excellence still has a strong following, even though we can see more agile approaches that build on pooled structures. Given the high share of activities covered by shared services and decentralized business partners, the overall share of HR resources in the corporate center remains low.

Procurement traditionally has been more decentralized, as direct material sourcing often goes hand-in-hand with proximity to local suppliers—especially in an industrial environment. However, category-management approaches have enabled more tasks requiring expertise to be bundled in the corporate center or in shared-service organizations. In some cases, companies can capture even more benefits by bundling activities into a centralized, internal purchasing company.

The stronger representation of communications and legal in the corporate center is to be expected, as both functions typically operate in a standard framework that allows resource bundling. Often these functions report directly to the CEO, and a straight line runs from these functions to the rest of the organization.

Efficiency in one function correlates to efficiency in other functions

Our data suggest that there are close links between the efficiency levels of functions in the corporate center. Companies that manage to get one function to be lean and focused typically are successful in many functions. Likewise, companies with one flabby function in the corporate center typically have other inefficient functions there, too.

We can see this correlation pattern for HR, finance, procurement, marketing, communications, and legal functions that primarily sit inside corporate centers. The efficiency of one function substantially correlates with the efficiency of the others. Correspondingly, if the corporate center has one inefficient function, others are more likely to be inefficient as well.

The degree of correlation between functions within the corporate center is much greater than any correlations between company-wide functions. Consider two hypothetical companies. One has an inefficient company-wide finance function; the other has an inefficient finance function that's based mainly in the corporate center. The first company's chance of having an inefficient, company-wide HR function is half the probability that the second company will have an inefficient corporate-center HR function.

This linkage can lead to unexpected results. At one industrial company, the chief HR officer worked to make her function, which was within the corporate center, 50 percent more efficient. That was her only goal. Following that lead, other functions in the corporate center also got significantly more efficient as well.

Like a helpful contagion, leanness spread from there to the rest of the company. Despite employing less than 1 percent of its staff in the corporate center, the whole firm benefitted from the center's efficiencies in the group-wide transformation, enabling an annual multibillion-euro impact.

A leader who wanted to duplicate this phenomenon might start with finance or HR. These functions are typically among the largest and most relevant to the rest of the organization.

Why is corporate-center efficiency so contagious?

We found several reasons that corporate-center leanness is contagious. Corporate-center functions are often both physically and operationally close, with leaders regularly sharing space and information. That was the case with the officer and her colleagues. As a result, leaders might rely on the same approaches and tools to steer all functions towards efficiency.

In our interviews with corporate-center representatives, we learned about organizations that actively steer functions towards consistency. At these enterprises, a management team typically takes active measures to push for efficiency across all functions.

However, there are also organizations where these types of active measures don't happen. At these companies, functions tend to mimic each other in a trend towards inefficiency. Complex approval processes, extra control mechanisms, and redundant roles might appear in one function first, then spread to others. One basic-materials company, for instance, developed a legacy of inefficient, cumbersome alignment and approval processes—first in HR, then in communications, and then in functions throughout the corporate center.

In fact, we see that a failure to steer corporate-center functions consistently leads to suboptimal efficiency, rather than the other way around. Successful C-suites address function efficiency proactively and regularly, in order to avoid a self-reinforcing spiral towards inefficiency.

There are different approaches to promoting efficiency. We have seen companies successfully apply zero-based budgeting and design. By starting with a clean slate and pressing forward, firms have more freedom to come up with new, cutting-edge internal structures. However, many companies rely on a more traditional approach, working to improve their current setups. A thorough assessment of the service portfolio, together with lean process redesign and digital technologies, can yield significant improvements.

One approach to efficiency isn't necessarily better than the others. It's a question of which approach works best in a given company culture.

Company-wide G&A function efficiency can have its nucleus in the efficiency improvement of a single corporate center function. Our research shows that the efficiency of functions within the corporate center is contagious—one function's efficiency (or inefficiency) seems to affect other functions in the corporate center; in addition we know from earlier research that corporate-center leanness strongly predicts the company-wide G&A efficiency.

If done right, a focused efficiency transformation can help lead a more comprehensive optimization of the G&A functions.

Steven Eklund is a partner in McKinsey's Stamford office, **Michael Glaschke** is a senior partner in the Munich office, and **Heiko Heimes** is a senior expert in the Hamburg office.

The authors wish to thank Stanislaw Kwiatkowski and Kristina Porfirova for their contributions to this article.