McKinsey&Company

JANUARY 2016
McKinsey Quarterly

Knowing when corporate headquarters adds rather than subtracts value

Andrew Campbell and Gabriel Szulanski

Reduce value destruction by applying three tests to initiatives from the center.

It's a familiar dilemma for managers in corporate headquarters everywhere: how to add value to operating units without inadvertently subtracting it through misguided influence, bureaucracy, delays, and time wasting.

Consultants and academics, ourselves included, have wrestled with this challenge for years. We know many head-office initiatives that successfully exploited economies of scale, uncovered opportunities to cross-sell products, or devised strategies to share valuable knowledge. But the net impact of many others is negative. Why else, after all, do spin-offs from large conglomerates often perform well after being released from the warm embrace of the parent company? Why do executives in divisions complain so frequently about corporate functions and initiatives?

We have been experimenting with three simple tests that help companies reduce the risks of unproductive interference by head offices.[1] They entail asking whether the project adds significant value, whether there are risks of unintended value subtraction, and whether the initiative will encounter barriers to implementation. In this article, we'll describe the application of these tests to one company's recent efforts to improve its websites, as well as another company's initiative to make its sales force more effective (see sidebar, "Failing to surmount the barriers," on page 6). But analytical tools alone are not enough, so we also reflect on how

[1] The first two tests evolved out of Andrew Campbell's work on centralization. For more, see Andrew Campbell, Sven Kunisch, and Günter Müller-Stewens, "To centralize or not to centralize," *McKinsey Quarterly*, June 2011, on mckinsey.com.

to improve the dialogue between business units and the center. That interaction is critical to the effectiveness of the three tests.

The three tests in action

The project to improve websites was typical of many head-office initiatives. The managers concerned wanted to go ahead with an upgrade to make the sites more mobile friendly and improve their search rankings, as well as integrate the sites across the company's four businesses. The stakes may seem small, but it's easy, even with the best of intentions, to do more harm than good. That's why we believe that managers at headquarters and in the businesses need rules of thumb to guide such decisions.

Some head-office initiatives—preparing financial statements, paying taxes, or conducting internal audits, for example—are required for external governance or compliance and form part of an organization's right to do business. But many others, such as the website example, are discretionary and can be evaluated with our added-value, subtracted-value, and barriers-to-implementation tests.

1. The added-value test

Head-office projects should focus on significant opportunities. A corporate headquarters, after all, only has a limited amount of executive capacity, and the business units themselves can only cope with a limited number of initiatives from the center. So what is a significant opportunity? Our rule of thumb is that such projects should have the potential to improve a company's overall performance—sales, profits, return on assets, or value to beneficiaries—by a number that is large enough to make the risk of subtracting value worth taking. As a starting point, we suggest 10 percent. The exact number isn't important; it could be 5 percent or 20 percent, as long as it is large enough to command the attention of HQ executives.

In the case of the company that wanted to improve its websites, the upgrade was likely to deliver a considerable increase in sales: the number of mobile users was increasing and search rankings were becoming significant. A 10 percent impact was not impossible. So the project, at least on the overall level, appeared to pass this test. But we have learned from experience that good evaluation calls for disaggregating projects into their component parts and applying the added-value test to each part.

It was clear that all of the websites in question needed an upgrade. But the issue was whether to manage the project from the center or in a more decentralized way. A center-led project would not generate sales 10 percent higher than a decentralized project would. Also, the second goal of more fully integrating the four websites would, on its own, not have passed the 10 percent test.

The analysis would have been speculative, and managers might have disagreed. But it would have been hard to argue that centralized project management of the upgrade or greater integration of the websites would deliver significantly more than a decentralized, nonintegrated approach.

This suggests that the head-office project should not go ahead unless the results of the other two tests were favorable. It is OK to pursue small sources of added value if the risk of subtracted value is low and there are few barriers to execution.

2. The subtracted-value test

This test may seem obvious, but companies rarely apply it in a formal way. Managers in business divisions may be more sensitive to the risk of subtracted value than managers at headquarters, who may be overoptimistic, but neither side is wholly unbiased. Anecdotes from previous company initiatives and an analysis of possible downsides can help uncover areas where value could be subtracted.

For the upgrade objective, a plan to centrally manage the project appeared to involve relatively few risks of subtracting value. One risk was timing. Separately managed projects would let each unit choose the moment most suited to its business needs. Another risk was complexity. It might have proved harder to upgrade all sites simultaneously. But neither risk seemed large. However, raising the issue of subtracted value can suggest ways to manage projects with a view to reducing even these small risks.

The risks were greater for the integration objective. Integration would require some control of standardization from the center, which might reduce initiative in the businesses or their willingness to experiment. So the subtracted-value test suggests that centralizing the upgrade could be sensible, but the integration objective might be risky.

3. The barriers-to-implementation test

The barriers test allows executives to assess the likelihood that a project will be well implemented. Academic research on initiatives to transfer skills and good practices has helped us distill a list of nine barriers to successful implementation. We've observed that projects facing more than three of these barriers are so unlikely to be implemented successfully that they are not worth pursuing (see exhibit).

In upgrading the websites, the company faced only one barrier: the project leader had not led a similar project before and therefore wasn't fully credible. But he was well supported by outside advisers.

As for the integration part of the project, there were a number of barriers. Neither the project leader nor the consultants had the necessary skills. It wasn't clear what should be integrated to achieve a good outcome. There was little evidence that integration would increase sales or cut costs. Moreover, some of the businesses were lukewarm about integration and thus not likely to embrace it fully. There was little contextual pressure for integration—no burning platform. With at least five barriers to implementation, this part of the project would have failed the implementation test.

The verdict

Generally, if the opportunity to add value is big, it may be worth trying to manage subtracted value, to look for ways around the implementation barriers, or both. But if the opportunity to add value is small, problems with either of the other two tests should suffice to deter the initiative.

In the case of the website project, the three tests support management's instinct to centralize the upgrade part of the project. But the integration part should only move forward if ways could be found to reduce the risks of subtracted value and to remove barriers to implementation.

In reality, the company launched a project to achieve both objectives, with unfortunate results. While the upgrade was successful, integration delivered few benefits at a high cost. The project ran over budget and was late, which was damaging to one business with a summer sales peak. Moreover, after the project was complete, the policies put in place to protect standardization discouraged the businesses from experimenting with ways to upgrade their sites. Looking back, the business heads doubt that the project in total added much net value. They would have preferred to have kept control of their own sites.

Exhibit

Initiatives facing more than three of the following barriers to implementation are less likely to succeed.

1 The actions needed for a good outcome are poorly understood	2 There is little evidence that a proposed change will yield improved results	3 The designated change agent is not motivated to lead the project
4 The change agent does not have credibility	5 People whose contributions to the project will be needed aren't motivated	6 People who will have to change their behavior will probably find it hard to do so
7 Few spare resources are available to help those who need to change	8 There is little contextual pressure to motivate change	9 The managers concerned have a history of poor relationships

Source: Adapted from Gabriel Szulanski, *Sticky Knowledge: Barriers to Knowing in the Firm*, London: SAGE Publications, 2003

McKinsey&Company

Failing to surmount the barriers

A technology company we know launched an initiative to identify strong sales-force practices within its international division and to transfer them across the division's country-based units. The project was called Wave II, stimulated by a successful project—Wave I—that had focused on revenue-growth opportunities.

Wave II involved identifying good practices in the sales processes of the different country units. These processes were then to be consolidated into a best-practice template for a set of software modules that the entire sales force could use.

The project passed the added-value test: managers knew that the performance of the sales force in different countries varied by as much as 25 percent. If the company could reduce this variation and the country-based units with the best-performing sales forces could improve their current levels, the payoff would be well above 10 percent.

In addition, the project passed the subtracted-value test. The sales task in each country was similar, so it wasn't likely that standardized processes would harm any of the country-based units. Moreover, the project team contained people from different countries, so its members would probably know which ideas were universally applicable and which would work only in some places.

However, unlike Wave I, Wave II faced several barriers to implementation. First, there was no urgency for change. As one manager explained, "we had an excellent year . . . outperforming the US part of the group, so why make changes? There is no crisis." Second, there was no hard evidence to convince skeptics that a good practice in one country would work in another. Third, changes in each country would need to happen in quick succession because the changes were linked. This would make it hard for the country units to implement them. Fourth, few extra resources were available to support countries making changes.

Unfortunately, managers implemented the project without considering the barriers. Not surprisingly, after six months, the initiative was not showing results and was cancelled.

Process supports

The three tests are not simple calculations. Judgment is required, and we are not suggesting that the judgments are trivial. Moreover, the tests are easier to apply in hindsight than before a project starts. We also know that analysis alone is not sufficient. Good decisions come from a dialogue between headquarters managers and business managers based on mutual respect. Each side has something to offer. Because they have access to the big picture, managers at headquarters may see opportunities to add value that business managers miss. Business managers, on the other hand, are better positioned to detect subtracted value and implementation barriers.

Organizational clarity

A clear understanding of the division of responsibilities between headquarters and business units is always helpful. Franchise organizations provide an extreme but instructive metaphor. The franchisees (that is, the business divisions) are clearly less powerful than the franchisor (headquarters). But all parties understand that the relationship will work only if the franchisor provides value for the franchisees and if the franchisees have autonomy in all areas not covered by the franchise agreement. Both sides should evaluate any new initiative by the franchisor to test the likely impact on added and subtracted value.

Without clarity, power struggles and competing agendas can emerge when companies fail to communicate the different roles that headquarters, functions, and businesses should play.

Measuring perceived added value

Although the value that headquarters adds can't always be measured in financial terms, companies can gauge perceptions. One approach is to ask senior managers in business divisions, every three or six months, to assess the net added value of different headquarters functions, processes, policies, and projects on a simple scale of one to ten. A low score typically sparks a dialogue.

The main argument against such an evaluation process is that headquarters sometimes needs to use tough love and hard-to-take medicine, and that the business units may therefore rate head-office performance unfairly. But our experience suggests that managers in the businesses understand the benefits of tough love. And headquarters, of course, can always choose how to react to a bad score after engaging in the appropriate dialogue.

Blowing the bureaucracy whistle

Our final suggestion is to give all managers, especially those in the business divisions, a notional "bureaucracy whistle." Like the famous andon cord, the emergency cable once strung above Toyota production lines that brought managers and engineers running to pinpoint the problem so as to minimize downtime, the bureaucracy whistle should trigger a similarly focused dialogue.

Every month or every quarter, an appropriate management committee can review the reported bureaucracy issues. Of course, such a committee runs the risk of becoming a bureaucracy in its own right. But at the very least, it will show the organization the importance of keeping an eye on subtracted value.

Andrew Campbell, an alumnus of McKinsey's London and Los Angeles offices, is a director of the Ashridge Business School's Strategic Management Centre in the United Kingdom. **Gabriel Szulanski** is a professor of strategy at INSEAD in Singapore.