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STRONG LEADERSHIP
IN CLEAR STRUCTURES

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Management Summary

The responsibility of a modern corporate headquarters is not just to crunch numbers or to represent the company, but to lead. A powerful corporate headquarters consists of strategists and leaders who are experts in markets and business models. At the same time, when it comes to the head count, corporate headquarters have to have a lean setup but can react flexibly to instruct and enforce and, where required, to lead with a firm hand. The more entrepreneurial responsibility that is transferred to operative management, the more important structures with strong functional and disciplinary guidance and reporting line will become in regulatory functions. Corporate headquarters determines portfolio strategy in addition to the structural and leadership model of operative business. The structure of operative business has to follow market requirements and strategies and not company affiliation. Different divisions require different leadership structures. Therefore, leadership should happen within flexible business models instead of within rigid matrix organizations. Implementing strong leadership requires processes which are subject to a clear division of responsibilities. The success of practiced governance is characterized by team spirit and trust in the horizontal and vertical leadership structure. Here are five theses on strong leadership in clear structures:

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1. Concentrating on a strategic and effective minimum – Corporate headquarters focuses on the actual leadership tasks 2. Establishing organizational structures with strong functional and disciplinary guidance and reporting line – Ensuring powerful functions and a one community thinking 3. Reducing organizational levels and focusing on the business purpose – Proximity to business is mirrored in the structure 4. Strengthening practiced governance – Easing the tension between entrepreneurship and the culture of consensus 5. Implementing a competitive target and resource allocation – "Capital for return" as opposed to spreading resources too thinly

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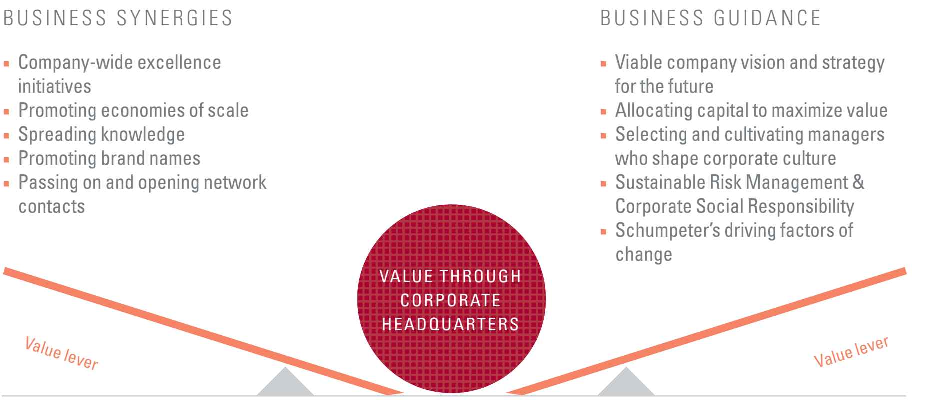
1. Concentrating on a strategic and effective minimum – Corporate headquarters focuses on the actual leadership tasks

Designing a lean and strong corporate headquarters starts by carefully selecting its tasks. Which levers for value creation can and does corporate headquarters want to use? The key here is to focus on a few effective levers.



VALUE LEVERS OF CORPORATE HEADQUARTERS

Here, corporate headquarters can learn from financial investors who focus on just a few tasks as their core management competencies and who apply these in the leadership of their shareholdings. Typically, the focus here is on managing organic growth and on buy and build, targets, resource allocation and related incentive systems. As change drivers they also ensure that changes are implemented consistently. Instead of choosing the highest possible number of levers, the key is to consciously select a few and then subsequently focus on them.

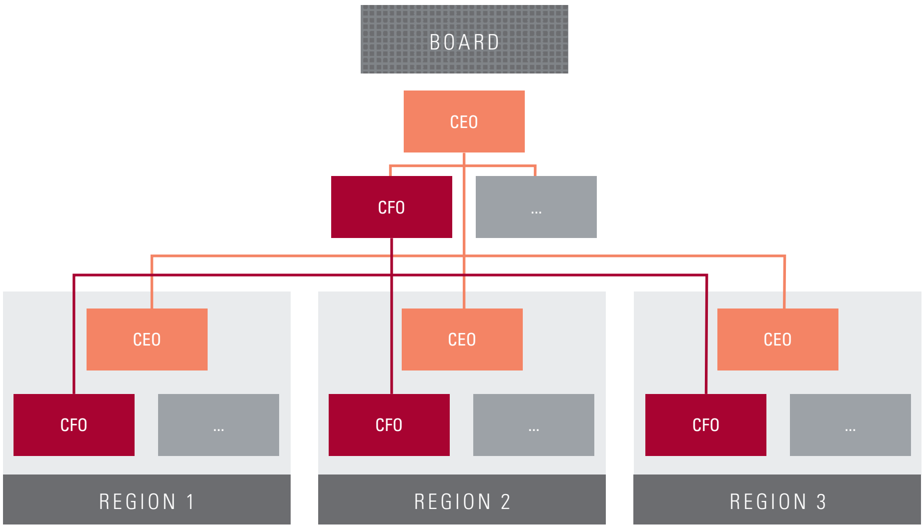
According to the lean approach put forth by Stern Stewart & Co. (see the LEAN Study Vol. 55), those tasks initially assigned to corporate headquarters are the ones classified as supervisory in nature. Any remaining tasks which are neither regulatory in nature nor business-specific in the classical sense will be reviewed and bundled into a Center of Excellence or a Shared Service.

Service functions will become "plug and play" and thus independent of the leadership structure of the company thereby considerably reducing the expense and complexity of recurring portfolio and structural changes.

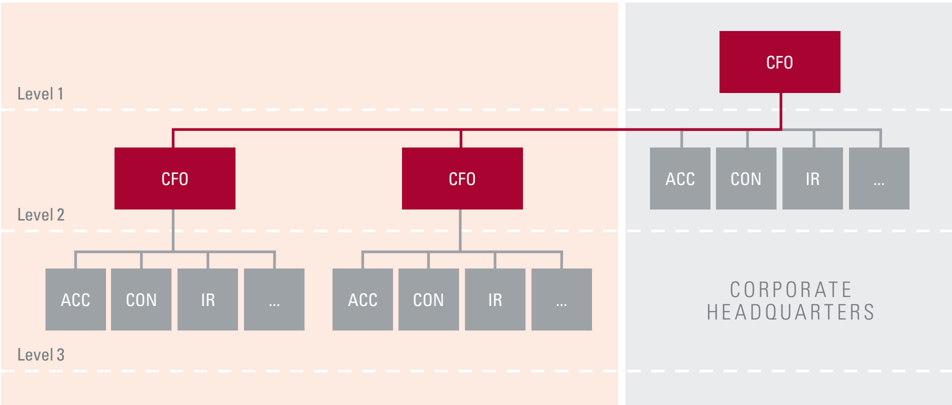
2. Establishing organizational structures with strong functional and disciplinary guidance and reporting line – Ensuring powerful functions and a one community thinking

At the same time a leaner corporate headquarters requires that certain areas in strategic business segments assume more leadership responsibility. As part of the "Leadership Organization" this is by all means a desired lever to have tasks performed as far as possible independently in the business units. In turn, leaders develop in the strategic business areas.
As part of this, global entrepreneurs in the divisions have to be able to take responsibility without extensive control structures and specialist teams being required. In practice, a central realization through a direct disciplinary leadership line has proven itself. The fact that such a strong leadership is possible even without a (too) large number of responsible individuals is exemplified by the "financial organization with strong functional and disciplinary guidance and reporting line" where the CFOs of strategic divisions report to the company's CFO in professional and disciplinary terms. From the perspective of the head CFO position, it is easier to define the course for divisional CFOs as opposed to if enforcement were to come just from the divisional CEO.
The financial organization with strong functional and disciplinary guidance and reporting line described here is the most prominent example but other functional areas also lend themselves to such an arrangement. Procurement organizations with strong functional and disciplinary guidance and reporting line or a sales organization with central Key Account Management are other options to closely integrate the company's functional management into the functional community.

FUNCTIONAL LEADERSHIP AS SEEN WITH THE CFO ORGANIZATION WITH STRONG FUNCTIONAL AND DISCIPLINARY GUIDANCE AND REPORTING LINE



This is a tried and tested approach which takes advantage of specialized excellence of a functional setup without losing sight of the business.
The effect of such a organization with strong functional and disciplinary guidance and reporting line can be ensured with the development of functional governance:
When hiring a Level 3 manager, the approval of at least two Level 2 managers is required, either that of the CFOs of two divisions or the consent of the CFO from one division and of that of the respective functional area head at corporate headquarters. Both have to agree when filling a position. Moreover, personnel transfers among divisions and between headquarters and a division are to become an integral component of career paths. This breaks down the silo mentality and division managers must value the success of the company as a whole above that of their division.
Moreover, stronger ties among divisional CFOs to the CFO of the company has the added benefit of having its functions much closer to the CFO, thus giving the CFO the opportunity to foster the area much better. One thing applies for all organizations with strong functional and disciplinary guidance and reporting line: Strengthening the self image of the community in question promotes confidence. Not only does this ease the implementing of governance guidelines and process steps but also the monitoring these within the division for the ultimate benefit of the company.



STRATEGIC DIVISIONS

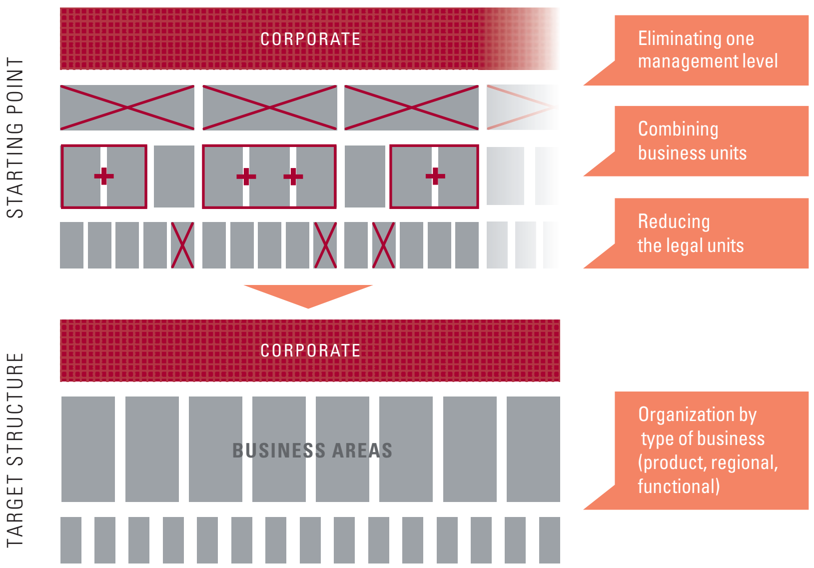
Establishing a performance review process for such cross-divisional functions which include the functional head acts as an incentive in two ways: For one, the process offers an incentive to reach a level of distinction within a division, and it also motivates to work together as one with company leadership.

3. Reducing organizational levels and focusing on the business purpose – Proximity to business is mirrored in the structure

Company leadership has to become flexible when managing operative units. The structure of operative business has to follow market requirements and the strategy in question and not corporate affiliation. Therefore, different businesses can require different leadership structures in one and the same company. A regional business requires a regional structure, economies of scale often necessitate a functional organization, the market calls for a Key Account Structure and in large projects the management cannot be assigned to level 3 managers. All too often, rigid corporate management structures impose a multidimensional matrix on operative business which is neither sharply defined nor does it do justice to any business.

In many companies today there are management levels upon management levels, a fact which creates many smaller units that supposedly can be managed easier. The result is a structure which is built on divisions, ends in business units which, in turn, are segmented into product groups. And while in theory there are few doubts that market proximity is advantageous for such a product / market-oriented profile, the limits imposed by more and more granular segmentation of product market combinations should be heeded. Further segmentation not only means that higher management levels function as portfolio managers instead of global entrepreneurs (thereby distancing them from customers and business), but the increase in interfaces at management levels leads to a decrease in efficiency.

TARGET ORGANIZATIONAL STRUCTURE FOR "GLOBAL ENTREPRENEURS"



This is why the Lead Organization closely looks at whether eliminating an entire organizational level or merging business levels can promote more powerful global entrepreneurs and at how they are organized.

4. Strengthening practiced governance – Easing the tension between entrepreneurship and the culture of consensus

The increasing legal requirements imposed by the capital market, compliance and revision create a narrow framework. Governance that relies too strongly on consensus and control can result in corporate leaders who have to operate more like train conductors with a schedule in hand and who find themselves constantly activating the dead man's switch en route. The strength of governance cannot be gleamed from how granular the rules are, but from whether there is a decision-making power that is structured in a reasonable and effective way, that also extends to its role assignment. But within this, trust and leeway have to exist for corporate decisions.

Based on the three major leadership dimensions of (1) providing orientation, (2) challenging business development and (3) making decisions, decision-making authority and roles are allocated to different leadership groups depending on the task.

Strong leadership results when the first dimension Providing orientation is understood to be a key role for the entire board. An overly pronounced culture of consensus is avoided by decision-making bodies that, wherever possible, are kept small.

Key leadership tasks are distributed among different board departments. For instance, CEOs and CFOs from the company and divisions take part in the monthly and quarterly performance reviews of the company's divisions. The date becomes a jour fixe in the company's leadership calendar and adheres to clear rules regarding structure and content. In order to boost the efficiency of the meeting, decisions are only made if the risks in the division are substantial for the company's success, if the risks relate to corporate strategy or if the decision-making powers of the division's leadership team fall short. All other decisions are delegated to the bodies and committees in an effort to strengthen entrepreneurship.

As a rule, the recommendation stands that separate leadership and communication meetings should be held. Leadership talks take place in focused meetings involving a small number of participants such as in strategic dialogues or in the performance reviews mentioned earlier. Decisions are then communicated along hierarchical levels. The HR Council, Purchasing Committee or Accounting Committee are bodies that can be used for communicating information of this nature.

5. Implementing a competitive target and resource allocation – "Capital for return" as opposed to the non-selective allocation of resources

Target and capital allocation are two other major components of leadership that are designed not to lead individual employees but, rather, to lead the divisions as a whole and to use them to take best advantage of market opportunities. Experience has shown that, in practice, target and capital allocation are often based on the demand which is determined in a bottom-up fashion in individual business units. And so the allocation of capital resources is often not handled based on potential and also runs counter to the strategy. Deterministic allocation keys ensure that large business areas tend to be favored. All too often, volumes for replacement and asset maintenance investments account for a large part of the annual investment budget. Consequently, the non selective allocation of resources means that growth potential can't be adequately tapped and small growth and innovative areas do not receive enough resources.

To remedy the situation, corporate headquarters has to do more than just collect the generated cash flow from the individual divisions. Clear company guidelines which prevent divisions from eating up high surplus in capital resources are a matter of course today. Less practiced, however, is the notion of redirecting these resources towards promising business models by applying a clear approach akin to that of a financial investor's portfolio. This makes the models independent of existing business areas and the policy pursued up to that point.

Based on very clear strategic guidelines, strategic divisions have to offer the company more strategic options on what future development could look like and evaluate it. In doing so, their ideas compete with others for the company's limited resources. By selecting the proposals from the divisions like a portfolio manager, corporate headquarters ties its pledge of capital to performance targets.

By defining strategic guidelines, making the final portfolio selection and by using top-down targets, company leadership has taken charge of shaping strategy. The advantage is that large staff function don't have to be bound permanently and, at the same time, market knowledge of the divisions can be used.

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Stern Stewart & Co. is an independent strategy consulting boutique. Our consulting focus is on the key management issues. This includes strategy and corporate finance, as well as organization and performance management. We see the company's management as a strategic investor in the business and support them to increase the value of their company.

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