Arthur D Little

Energy & Utilities Viewpoint

Reshaping the Corporate Center

How to turn your corporate headquarters from a cost factor into true value generation

Despite their success in improving operational efficiency, many corporates struggle when it comes to optimizing support and back-office functions. Simply cutting cost and setting crude targets for these functions results in little more than frustration for everyone involved. Arthur D. Little uses a different approach; one that looks not just at the cost of each function but also at the value of the services it delivers. Our approach offers a far more precise assessment of what needs to be kept, what needs to be done differently and what needs to be discontinued. The result? Corporate headquarters many companies have never dared to imagine: business-focused, flexible, lean where possible, strong where necessary – a true support for the business.

The energy industry is currently having its fair share of programs to reduce costs and improve operations. Typically, the areas most closely linked to operations have fallen under the spotlight first and, as a result, generation, transportation, distribution and sales are expected to be in better shape in the future.

The headquarter, however, is a different matter. Few support functions have escaped the impact of cost-reduction programs yet there is very little evidence of any imagination having been applied to the challenge of improving the headquarter's effectiveness. As a result, many companies are still far from best in class when it comes to headquarter size and cost.

Learning from manufacturing companies

Analysis by Arthur D. Little of the headquarter functions of several leading services companies (Figure 1) reveals that the efficiency of support functions varies widely, especially when compared to manufacturing. The results of the survey suggest that services organizations have had very mixed success in optimizing the back office. For example, in extreme cases, such as IT and Accounting, the "worst" data point is one hundred times greater than the "best". At the other end of the spectrum, some companies are close to the benchmark set by very lean manufacturing companies.

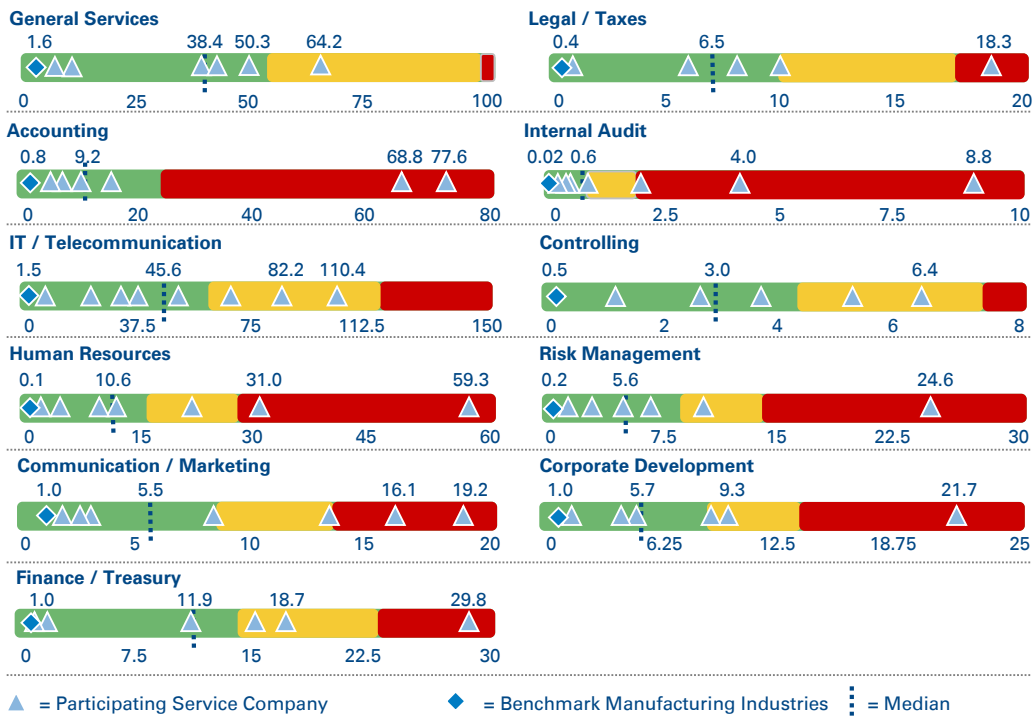
Redesign with value in mind

Treating support functions purely as cost centers and aiming to reduce costs incrementally each year can raise as many problems as it aims to solve. Taken to the extreme, the approach will result in a support function reduced to the bare essentials. But what is essential and who decides? How far would an organization be prepared to deviate from "essential" to "nice to have" if "nice to have" improves morale and increases productivity? How essential is a cafeteria? A company newsletter? A company-owned conference center that employees can use for their vacation?

There is only one way to answer these questions: by assessing the value of each service and support activity in relation to the cost it creates. Such an approach looks at each support function – and the specific services it provides – on its own merit and leads to the only meaningful way of optimizing the headquarters: improving, redesigning, trimming or discontinuing individual services and activities according to the impact they have on the organization overall. (Figure 2)

This value-based assessment forms the foundation of Arthur D. Little's approach to headquarter redesign. Our approach also incorporates several unique features that set it apart from standard cost-saving programs and allow it to generate more useful and sustainable results.

Figure 1: Benchmarking of central functions in services and manufacturing companies



- All figures represent number of employees in a function per 1'000 employees in the company
- The main activities under any given function have been normalized across companies in order to ensure comparability
- Color coding is set as follows:
  - Red range starts at 150% above median
  - Yellow range starts at 50% above median
  - Everything below that is green
- The benchmark for manufacturing industries is obtained by averaging several efficiency-leading companies from different manufacturing segments

A unique, two-pronged approach

Arthur D. Little's Value-Driven Headquarter Redesign brings together two familiar methods of addressing corporate redesign – one analysis based, the other more fluid and creative – to create an approach that delivers the best of both worlds. We describe the two key aspects of our approach as EVO (evolutionary) and REVO (revolutionary).

EVO refers to the familiar approach of analyzing the current situation in detail, finding areas for improvement and developing recommendations for change. EVO is useful because the detailed analysis uncovers the hidden causes of the issues observed and improvement recommendations are based on those findings. But EVO also has shortcomings: analysis can become over-detailed without delivering any additional insight ("analysis paralysis") and recommendations tend to be incremental. Because the ideas for improvement are based on such detailed analysis, they often lack creativity. Real leaps in improvement are hard to come by under a pure EVO approach.

Figure 2: The self-perception will be compiled through an objective indicator to the created value as well as through a subjective assessment of the service provider

Example

Activity: Group closing for actual, forecast and plan
Provider: Group accounting

Value creation of the results of the provided service

Client

Board member – Mr. Smith

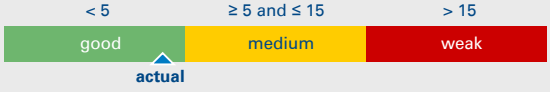
Qualitative value description

Closure at the specific date under consideration of the terms for fast-close and IFRS regulations with an discretionary audit certificate

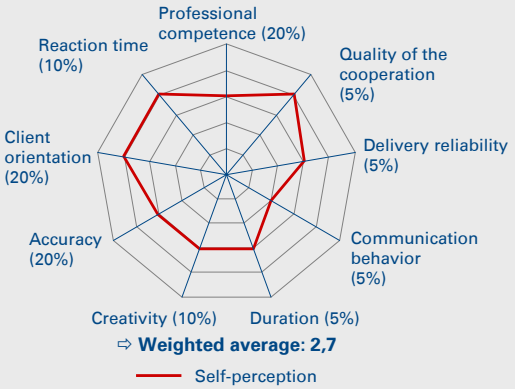
Quantitative value indicator

Number of annotations of the auditor
→„good" < 5 und „bad" > 15
→ actual = 4

Target corridors for quantitative indicators of the value creation:



Assessment of the creation process



REVO is the opposite of EVO: new ideas for the structure and service portfolio of an "ideal" headquarter are developed on a blank sheet of paper. Key questions and potential answers are brainstormed and organized in an "Option Space," which allows different combinations of answers to be tested. The completely open format of this exercise allows for the development of solutions that nobody has considered before.

In addition to producing new structural ideas, REVO is useful for defining "ideal" principles for the headquarter, e.g. when it should have sole decision authority, when it should have a voice in a decision, when it consults, and when it simply receives orders.

The clear advantage of REVO is its ability to create a space for creativity and blue-sky thinking. The disadvantage is that the solutions it proposes may be too far-fetched, impractical or impossible to implement. However, merging EVO and REVO produces an approach that cancels out the weaknesses of each component and draws on the strengths of both.

Establishing a framework for analysis

Arthur D. Little's Value-Driven Headquarter Redesign uses "service trees" as a framework for analysis (Figure 3). These are hierarchical structures for each central division or unit that begin with the main elements of their respective service portfolios and then divide into the sub-activities that flow into them. This structure has several advantages:

- Clear service portfolios are established for all headquarter functions.
- Supply relationships/interfaces between headquarter departments become transparent.
- A service tree can be expanded into a resource matrix by allocating staff time, and even cost, to each service, resulting in a high degree of cost transparency even if the accounting system cannot deliver cost data at a service or activity level.
- The foundation is laid for a later discussion about which services are required by whom, what value they deliver, and who should be responsible for them.

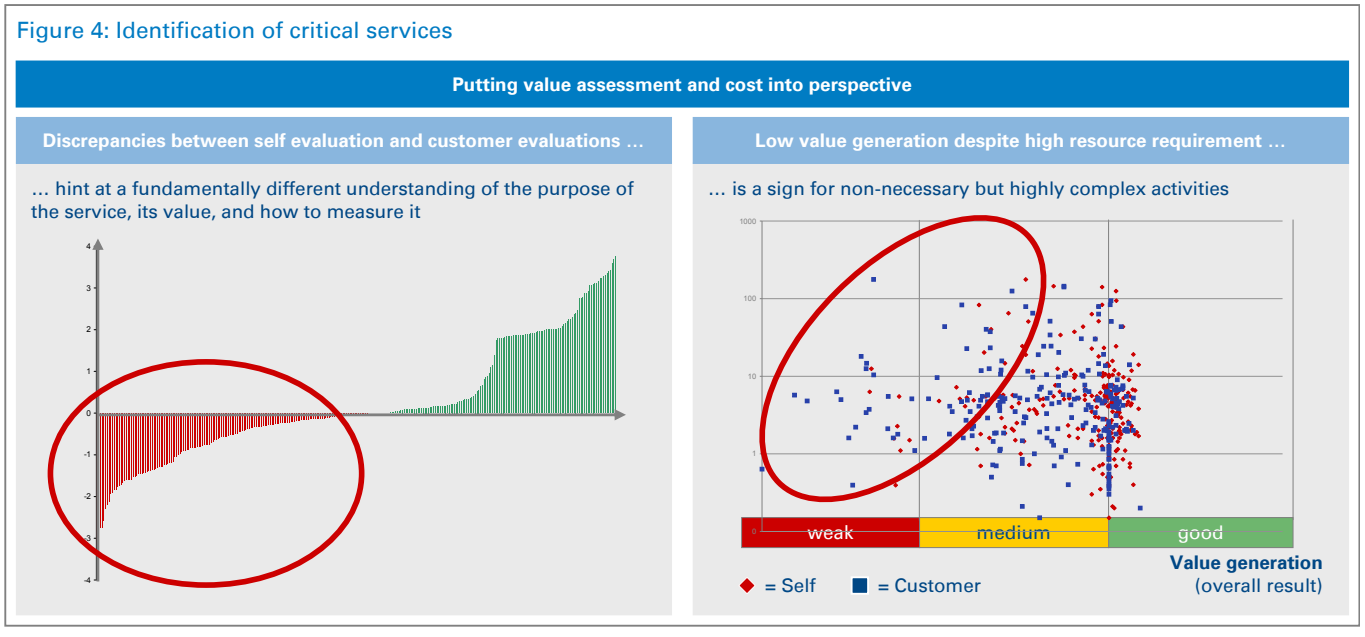
Figure 3: Illustrative partial service tree for Human Resources

Service structure	Resource requirement			Cost
	HR1.1	HR1.2	⋮	
Standard Services	Σ	Σ	Σ	Σ
Compensation and benefits	Σ	Σ	Σ	Σ
Job description	x.x	x.x	x.x	x.x
Job classification / valuation	x.x	x.x	x.x	x.x
Remuneration strategy and management	x.x	x.x	x.x	x.x
Benefits administration	x.x	x.x	x.x	x.x
...	x.x	x.x	x.x	x.x
Personnel services	Σ	Σ	Σ	Σ
Services / counseling for employees	x.x	x.x	x.x	x.x
Relocation management	x.x	x.x	x.x	x.x
...	x.x	x.x	x.x	x.x
Personnel administration	Σ	Σ	Σ	Σ
Time management	x.x	x.x	x.x	x.x
Payment processing	x.x	x.x	x.x	x.x
...	x.x	x.x	x.x	x.x

Evaluating services from two perspectives

A key feature of Arthur D. Little's approach is the way in which the value of each service is determined. Both the internal customer and the service provider have the opportunity to rate each service activity according to agreed criteria. Combining these two different perspectives provides a clear indication of the points at which the recipient and the provider of a service have different ideas about what is important.

Figure 4: Identification of critical services



The process of evaluation follows these steps:

- Definition of the underlying benefit of each main service in the service tree. This definition needs to be agreed between the service provider and the recipient. It defines the value proposition of each service and provides critical input for the next step.
- Definition of objectively measurable indicators that help determine whether or not the service delivered lives up to its value proposition. For example, the number of complaints that the company's auditor has each year could be a useful indicator for measuring how well the accounting department does in delivering the annual report.
- Subjective assessment by the service provider, according to a fixed set of dimensions, of how well a service is delivered.
- Subjective assessment by the service recipient, according to the same dimensions. If the recipient rates speed as important but hardly satisfactory while the service provider rates precision as important and great, there is clearly a need for further discussion.

The resulting overall value rating for each service is then plotted against cost (Figure 4). This provides an indication of where major adjustments to the service portfolio or to the cost of delivery are required. This can mean process redesign, the discontinuation of certain services (along with its resource requirements), but possibly also the strengthening of certain critical activities.

The benefit of involvement

An important benefit of Arthur D. Little's approach is that it requires involvement – in the definition of the service trees, in the REVO workshops, in the value assessments, in the discussion of the findings, in intermediate decisions. Our consultants do not design the headquarter for our clients but design it with our clients and their employees. This not only makes for better results, but is also a tremendous asset at the implementation stage. Managers and employees who have been involved in shaping the new headquarter are far more likely to be supportive of change when it is implemented.

Conclusion

The energy industry has made significant progress in recent years in improving operational efficiency, but much remains to be done with respect to the support functions and the corporate headquarter. Traditional cost-cutting models have a tendency to destroy activities that add value, they are de-motivating and they hardly ever live up to their expectations. Arthur D. Little has developed a strong approach for redesigning the support functions in a way that simultaneously reduces cost and increases value to the business.

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Arthur D. Little

As the world's first consultancy, Arthur D. Little has been at the forefront of innovation for more than 125 years. We are acknowledged as a thought leader in linking strategy, technology and innovation. Our consultants consistently develop enduring next generation solutions to master our clients' business complexity and to deliver sustainable results suited to the economic reality of each of our clients. Arthur D. Little has offices in the most important business cities around the world. We are proud to serve many of the Fortune 500 companies globally, in addition to other leading firms and public sector organizations.

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