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The new functional agenda

How corporate functions can add value in a new strategic era

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This report was originally published by Booz & Company in 2012.

Executive summary

Functional organizations in major companies are facing dramatic change. Businesses are becoming more focused around capabilities, and demanding that leaders of functions play a more strategic role. With less stable environments and more intense competition in many markets, there is a premium on agility and flexibility, and increasing emphasis on performance results. These pressures are forcing many functions to boost operational excellence even further, usually while reducing costs.

The net result is a golden opportunity for HR, IT, finance, operations, R&D, marketing, sales, sourcing, and other functions and shared services. Instead of striving to be "best in class" in everything they do, functions can become "fit for purpose": changing their portfolio of activities to focus primarily on those that are strategically important to the enterprise or that add high value.

But given the day-to-day transactional needs of the business and the long-range in-depth efforts needed to build distinctive capabilities, how can a functional leader take on this new strategic role? The new functional agenda addresses this dilemma. It has three elements: (1) establishing priorities in line with the company's overall strategy and the enabling role of the function, (2) aligning the operating model to deliver value in line with those critical priorities, and (3) allocating resources accordingly. For functional leaders, this new role places a high premium on interpersonal skills and strategic insight — which can be a primary source of success not just for the function, but for the enterprise as a whole.

The functional leader's dilemma

What is the role of the corporate support function? Until recently, the answer was relatively straightforward. Functions existed to carry out the many specialized tasks that every corporation needs done. Human resources recruited employees, managed benefits transactions, and oversaw the evaluation and promotion process. Information and communications technology ran and helped support the company's computer systems. Finance carried out all processes related to accounts, debts, and taxes.

Most of these functional roles were primarily transactional in nature; they fulfilled day-to-day needs, met legal and regulatory requirements, accommodated requests from every business unit, and put out the inevitable fires that erupted when there was a conflict or urgency. When functional leaders were asked to improve, that meant doing the same things more efficiently and at a greater cost savings.

Over the past several years, however, CEOs, business unit leaders, and functional leaders themselves have been raising expectations. They have been asking questions: How can support functions play a more strategic role? How can they deliver more value to the organization at large?

How can support functions play a more strategic role?

This significant increase in expectations has several causes:

- ***Market environments and patterns have become less stable, and the competitive intensity has increased.*** Many companies — faced with rapid shifts in customer needs and demand patterns, the emergence of innovative new competitors, and greater macroeconomic uncertainty in many regions of the world — are placing more emphasis on both better and more timely information and insights to help them make decisions, and greater organizational agility and flexibility.

- ***Companies are becoming more focused.*** More chief executives are aware of the "coherence premium": the advantage held by companies that do only a few things in the market but do them exceptionally well. They are bringing all their products and services in line with their market strategy and core capabilities. This means fewer priorities, more long-term investments, and an emphasis on making the most of their operational, HR, IT, marketing and sales, and other resources. Functional leaders are now expected to play a stronger role at the heart of strategic decision making; they are not just operators of a service bureau, but critical enablers of the capabilities that set a particular company apart from its competitors.

- ***There is more opportunity to raise the return on discretionary investment.*** Over the past decade, through outsourcing and process improvement, many functions have become more efficient in performing their day-to-day activities. So it comes as no surprise that the resources dedicated to routine transactional tasks have been dropping. Such tasks now consume perhaps 35 percent of staff time, whereas they once consumed 70 percent. This development enables functional leaders to allocate more time, attention, and money to discretionary activities: the strategic tasks that can make the organization more competitive.

- ***The pressure on flawless execution is increasing.*** Most functional departments have made great strides in maximizing efficiency and improving operations. But in many cases, there is still a lot of room for improvement. This is forcing many functional leaders to look for new paths to operational excellence and greater value, usually while reducing costs.

If you are a functional leader, this situation provides you and your staff with a golden opportunity to play a more strategic role for your company. Instead of balancing services among all business units equally, or striving to be "best in class" in every detail, you can focus on helping your functional organization become coherent and "fit for purpose." In many cases, you have a mandate to operate in a broader context: emphasizing activities that are strategically important or that add high value for the rest of the enterprise, and decreasing activities that add little value. You may also be able to focus, for the first time, on resolving function-related conflicts among different parts of the larger organization (for example, conflicts over incompatible IT systems or redundant marketing efforts).

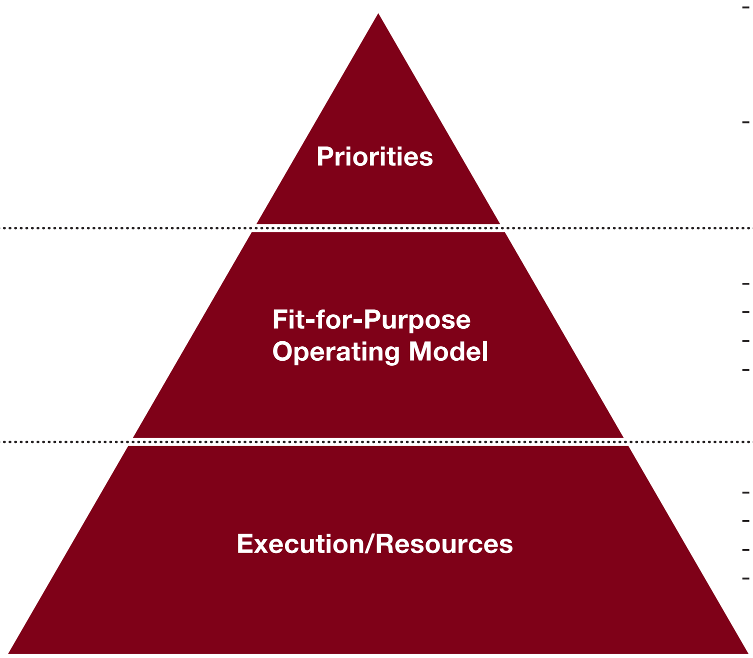
Focus on helping your functional organization become coherent and "fit for purpose."

At the same time, you still have to manage your own house. Transactional tasks remain; businesses continue to demand service. You are still judged on your operational effectiveness and efficiency. Many things that you would like to see improved, including some all-important cross-functional initiatives, are outside your control or jurisdiction, yet seem to require your involvement and influence. Managing across these boundaries takes a high level of leadership skill. There may also be mixed signals from senior management; it isn't always clear what it means to be strategic, or how to resolve conflicts between the day-to-day transactional needs of local businesses and the long-range in-depth efforts needed to build distinctive capabilities. How, then, can you take on this new strategic role, maximizing your effectiveness in both directions, without having your function torn in two?

That is the purpose of the new functional agenda. It resolves the functional leader's dilemma by explicitly putting attention on the different needs of the organization, in context of each other. In place of the usual long list of "critical things to do," it moves you and your staff toward a clearer set of priorities, and enables you to act accordingly. It helps your people become more insight-driven, and more aligned to the enterprise strategy, so that they can become true partners with their colleagues in line management and better contributors to the business's success.

The three elements of this agenda all fit together: (1) establishing priorities in line with the company's overall strategy and the enabling role of the function, (2) aligning the operating model to deliver value in line with those critical priorities, and (3) allocating resources accordingly (*see Exhibit 1*).

Exhibit 1
Anatomy of the new functional agenda



- Functional role and goals in:
  - Differentiating capabilities
  - Competitive necessities
  - Basic business capabilities
- Implications for operating model and resource deployment

- Roles and responsibilities
- Decision rights
- Performance measures
- Processes and tools

- Capability building
- People deployment and development
- Investments in processes and technology
- Elimination or redeployment of bad costs

Source: Strategy&

Choices and commitments: Establishing priorities

The first step is to articulate your functional agenda — the priorities, roles, and activities needed to support your company's overall strategic mission. At many companies, this is set by the senior team and aligned with the strategic planning process.

Top executives, including some or all functional leaders, should agree on the company's value proposition — its chosen "way to play" in the market, how it intends to attract and hold customers. Will the company be a value player, outpacing rivals through lower costs? Will it distinguish itself as an innovator, launching technologically sophisticated products and services? Will it provide a compelling customer experience? Or will it forge some other way of delivering value?

In every successful company, the value proposition is closely linked to the company's most critical capabilities: the things it has learned, over time, to do particularly well. Amazon's strategy is based on its skill with online user interfaces, logistics, and technology. Walmart's success depends on its ability to keep prices low and the task of shopping convenient. Inevitably, functional leaders are involved in defining, building, and maintaining these capabilities. Thus, they need a clear understanding of the company's overall value proposition and how their work fits with it.

In setting priorities and allocating resources, the functional leader must distinguish among three different types of capabilities:

- ***Differentiating capabilities*** provide a company with the distinctive competitive advantage needed to outperform. These are typically cross-functional; they gain their power from the fact that different functional proficiencies come together in ways that other companies cannot easily copy. Examples include distinctive product innovation and design, ultra-premium brand building, and exceptional consumer insight for target markets. These capabilities deserve a major share of investment and attention by the functions that contribute to them. The company's strategy depends on them, and so does the function's reputation.

- ***Competitive necessities*** are the "table stakes" that enable a company to compete in its industry. In many companies, these include logistics, sourcing, back-office processes, and integrated IT architecture. They are essential to survival and success, but they can often be managed for cost and efficiency, rather than to perform at a world-class level, or even at the same level as competitors.

- ***Basic business capabilities*** are those needed to keep the company running. These services — everything from payroll to employee benefits to basic computing needs — remain the responsibility of the functions. They are critical but non-differentiating. They should be tightly controlled for efficiency, and often automated, outsourced, or relegated to low-cost shared services, thus freeing up resources that functional leaders can redirect to differentiating capabilities.

Different companies deploy the same capabilities in different ways, depending on the strategic value proposition. One consumer packaged goods (CPG) company, for example, might have a "fast follower" strategy with a distinctive approach to merchandising. Its differentiating capabilities might involve trade promotion, logistics, and sales force management, while product design is a competitive necessity and manufacturing is largely outsourced. Another CPG company might see itself as an "innovator," regularly launching new household products. It would invest heavily in R&D and consumer insights — its differentiating capabilities — while treating logistics as a basic business expense to be handled by external vendors whenever possible.

As a functional leader, you must learn to balance resources among these three types of capabilities. Business capabilities are very costly to build and maintain, and many functions have gotten used to spending more on competitive necessities and basic business capabilities than they need to. Differentiating capabilities get shortchanged as a result, and the company loses ground. Being best in class in every process or activity within a given function simply isn't possible, no matter how professionally satisfying; no function has the funds or organizational stamina to be excellent at everything. Instead, you need a clear sense of which category each activity falls into. There must be some activities where being merely adequate is appropriate, where "good enough" is actually good enough.

This can be a very difficult path. Many people within your function, and in the business units you serve, will push back on the idea that their day-to-day capabilities need less investment. In the short run, you still need to tailor your approach to the local priorities of every business, and to your organization's culture. But in the long run, if you don't have a clear and consistent idea of the right trade-offs and priorities, you will never muster the capital or attention you need to fulfill your strategic imperative.

There must be some activities where being merely adequate is appropriate, where "good enough" is actually good enough.

The delivery of value: Aligning your operating model

With a clearer idea of functional priorities, you can channel investment more wisely. But you still need to execute effectively and continually raise performance in everything you do — hence the need to redouble attention on your operating model and execution. You can best accomplish this with an overall blueprint: a plan spelling out how you will deliver the most value to the organization as a whole, how you will work together with other functions to ensure the delivery of the greatest value, and how you will align your functional operating model with your company's overall strategy.

The blueprint explicitly defines a number of key elements that may have gone unexamined in the past. For example, you may revisit the roles and responsibilities in your organizational structure, along with existing patterns of centralization and decentralization. Differentiating capabilities may benefit from global centers of excellence. Competitive necessities, which may vary from one region to the next, may require more decentralized operations — or, alternatively, may fit best in shared services. Some basic business capabilities can probably be outsourced.

Differentiating capabilities may benefit from global centers of excellence.

The way you measure performance should also be explicitly defined both at the functional level and at the level of each function's specific activities (*see "Measuring Functional Performance," page 14*). In developing the blueprint, you may also rethink decision rights (who has final approval), processes, and tools.

In making these decisions, collaborate with business leaders and your counterparts in other functions. For example, a differentiating product development capability may require setting up common activities across IT, R&D, marketing, and sales. The marketing and sales functions will need to improve their marketing-sensing capabilities to understand what the customer wants, and R&D and product management will need to draw upon those insights in designing new features. IT will be called on to provide an underlying infrastructure to support knowledge transfer and collaboration. What conversations do you need to arrange, among which individuals, to ensure that these new systems and structures are in place?

True business partnerships: Allocating functional resources

In this third component of the functional agenda, you determine the degree of control and the right level of resources and funding needed to fulfill the promises you have made. Then you continue monitoring your investment to ensure that you can execute at the level required and maintain efficiencies of scale.

In keeping with this effort, decision rights must be allocated between the function and the business units. This allocation must be conducted on a company-wide basis, with input not just from other functions but from all the business units as well. You need to interact with business unit leaders regularly, redesigning processes and upgrading systems tools as necessary. By setting up both formal and informal processes for allocating resources, you ensure that these decisions are made on behalf of the whole enterprise, and not within a functional silo.

Leading from within

If you are a functional leader, your role today is more challenging than ever before. Your most important work, on differentiating capabilities, is combined with that of other departments. In many cases, you share authority instead of maintaining unilateral control. You need a level of credibility and integrity high enough that you can counsel business unit leaders, even telling them hard truths — for example, when their priorities conflict with those of the overall enterprise.

As companies become more coherent, you may increasingly be called on to help build or develop distinctive capabilities (*see "Reframing the Finance Agenda," page 15*). That may mean shifting abruptly from a service bureau orientation, where your role is to fulfill every request, to a more strategic approach, where you help set and maintain priorities and sometimes have to say no. Even as its leaders espouse greater coherence, your organization may not move smoothly in that direction — and if it does, the leaders will still need to figure out how to maintain a decentralized decision-making system that has served the company in the past.

A well-designed and well-executed functional agenda makes it easier for you to play this role. If you can establish a genuine functional agenda, in line with your company's essential advantage, you will not be operating alone. The process reinforces a higher degree of alignment between the corporate center, the local business leaders, and your own team. It allows you to undertake the difficult step of focusing your efforts on distinctive capabilities, and helping to bring the firm's strategy to life. As you gain practice in saying no to multiple priorities, and focusing on the few most critical capabilities, you enhance your own ability to lead. When the company moves in the direction of a capabilities-driven strategy, and needs your function to take part wholeheartedly, you and your team will be ready.

Measuring Functional Performance

Every function's first priority is to support the company and its various business units in their efforts to build the capabilities needed to carry out the strategic mission — this lies at the heart of the value they deliver. Thus, it is essential to define and measure explicitly just how much value each function is delivering through its activities and initiatives. Functional leaders can assess this value through four distinct indicators:

1. ***Quantifiable impact:*** Measure all of the function's activities against definable business outcomes that are aligned with the company's strategic priorities and tied to a specific time frame. Some impact-oriented metrics might be drawn across functional lines. A centralized consumer insights capability, for instance, might be measured not just within marketing and sales, but by the number of weeks it can reduce the time to develop new products during the next 18 months.

2. ***Clear drivers of value:*** Identify the sources of your function's greatest contributions to the enterprise. Improved demand management might depend, for example, on having sophisticated analytical tools providing streamlined access to data, greater scale, and bundling of expertise. Metrics should establish the degree to which these tools exist and are used.

3. ***Cost-effectiveness:*** Continue to track the relationship between expenses and outcomes. Your function's contribution to the enterprise — measured through financial performance improvement in revenue or profit — must outweigh the cost of its activity.

4. ***Market validation:*** Use signals related to market forces to drive your function's effectiveness and efficiency wherever possible. This may include the use of charge-backs, service-level agreements, and make-versus-buy assessments (analyzing whether to build a capability in-house or outsource it).

Leading companies deploy rigorous processes and tools to ensure the alignment of ongoing and proposed functional activities and investments with the functional priorities and the operating model, and to ensure maximum value creation. Within the context of continuing pressure on support budgets, this helps functional leaders allocate their resources to the activities with the highest value.

Reframing the Finance Agenda

The finance function is typically thought of as a constraint on expansion costs, not as an enabler of growth. But at a large CPG company, leaders in finance became champions of a growth agenda. It started with a conventional cost-cutting move: In the wake of the Great Recession, the company's leaders asked finance to cut 20 percent of its operating costs by doing more with less.

The top finance team met to consider the measures, and soon realized that it could deliver greater value to the business in other ways. This company was known for its successful brands, based on a strong product appeal that it continued to develop, which allowed it to dominate several CPG categories. This was the basis of its value proposition. It was also known for its ability to grow through acquisition. However, the decentralized culture, in which business units had long operated with their own separate support functions, had left "mini-pyramids" of functional support that had little to do with one another and competed for the company's resources.

After comparing their expenses to those of other functions, the finance leaders resolved to raise their productivity, and to provide better support for the company's frequent acquisitions, particularly in the areas of due diligence and integration. The leaders met to design a new, leaner operating model for the function, incorporating new metrics for effectiveness and value delivery. This new model included the outsourcing of a variety of financial activities such as standard financial reporting, and the development of a shared-services capability for all the company's financial planning and analysis activities, based on service-level agreements made with the heads of all the business units. This gave finance an unprecedented high level of accountability for the business units it served.

Thanks to resources freed up under this initiative, the finance function was able to regroup. It began to take on an advisory role, helping business units think about where they should channel their investments for growth and how to manage and control costs. In this new capacity, the finance department regularly consulted with the heads of the business units on key business decisions they had to make. This was particularly helpful in the course of making and integrating acquisitions, a key element of the company's strategy.

Today, regular surveys suggest a high level of satisfaction among the function's internal clients and the heads of the business units. Because finance has stepped in to actively manage business unit costs, the cash available for reinvestment can be measured more accurately. The function's larger role in the acquisition process provides the company with better due diligence and integration, and a clearer picture of the return on the investment made in each acquired company. One critical factor was the effort to include the business managers in early conversations about finance's strategic role and operating model. That enabled the finance department staff to work closely with the business unit staff to understand their needs and how the finance function could best meet those needs. It also enabled the company to overcome the reluctance that many people felt to share information and services across business unit boundaries.

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This report was originally published by Booz & Company in 2012.

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