The Economist

Reprinted from The Economist November 13th 2008

maxxim consulting

Centres of attention

Companies may still have too many heads at headquarters

DOWNSIZING is the undisputed global management trend of the moment. This week Nortel, a Canadian telecoms-equipment company, Britain's BT and DHL, a logistics giant owned by Germany's Deutsche Post World Net, were among a host of firms announcing thousands of job cuts. As well as pruning heads in business units, some chief executives are trimming their headquarters (HQs), too.

Nortel is a case in point. On November 10th the company said that it had lost $3.4 billion in its third quarter and was taking urgent steps to cut costs. These include shedding 1,300 jobs and handing over activities such as marketing and R&D, which were previously run from the centre, to business units. Among those leaving are its marketing and technology chiefs.

Like Nortel, many firms have grappled with the problem of creating the right relationship between the centre and the periphery. In the 1970s large and hyperactive HQs sprouted along with the rise of multinationals. In the 1990s the trend shifted to the minimalist centres favoured by private-equity owners, who just wanted them to ensure that operating managers hit their targets, stuck to agreed strategy and complied with laws and regulations. But over the past few years many corporate centres have been gradually expanding the scope of their activities again.

Of course, every company's situation is unique, and there is no single, perfect division of labour between HQs and other offices. But the chances are that the downturn will cause the pendulum to swing back towards minimalism. At the very least, it will force firms to determine exactly what their HQs contribute.

The amount of ignorance that still exists is striking: in a survey of 20 large British firms conducted earlier this year by Maxxim Consulting, only four chief executives knew how much their head offices cost to run, or how many people were in them. "This is a clear indication that there's some serious housekeeping to be done," says Claire Arnold, a co-founder of Maxxim.

One company that put its HQ under the microscope before the credit crunch worsened is Smiths Group, a British firm that produces medical equipment, security systems and other products. In December the firm brought in a new boss, Philip Bowman, who quickly concluded that the firm's London HQ was overbearing and overstaffed. Given that Smiths' business units had little in common, he says he saw no sense in having a large head office and has since pushed many of its activities back into the firm's different divisions.

As a result of these changes, the number of head-office staff has fallen from 100 to 50. Smiths has also taken the unusual step of detailing the cost of its HQ in its accounts: £35m ($70m) in the year to August. The idea, says Mr Bowman, is to create an extra incentive to drive the cost down. The London HQ's remaining employees have been moved from a run-down building on the outskirts of the city–which Mr Bowman describes as "an absolute rabbit warren"–to a modern, open-plan office in the centre. Smiths' boss reckons this will help break down the "silo mentality" that existed under the previous regime.

Some analysts who follow Nortel and Smiths think that the two companies may have bolstered their business units in order to make it easier to sell one or more of them. Perhaps, but there is little doubt that the previous set-ups were not working. Another company looking at its HQ is American International Group (AIG), a troubled insurer which this week received an even bigger bail-out from the American government (see article). AIG, which plans to sell several divisions, has appointed a senior executive to rethink the organisation of its corporate centre. This will inevitably shrink–as will the HQs of many other ailing financial companies.

Still, quite how far to trim is a tricky question if your firm is not on the edge. "Companies must navigate this crisis with the right balance of skills at the centre," says Fabrice Roghé of Boston Consulting Group. If they cut too deeply, they may not have the resources, say, to spot a strategic opportunity that could transform their fortunes. Ensuring that head office has the right number of heads in it is thus more vital–and more difficult–than ever. ■