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The One Thing You Need to Know About Managing Functions

They require their own strategies.

by Roger L. Martin and Jennifer Riel

The One Thing You Need to Know About Managing Functions: THEY REQUIRE THEIR OWN STRATEGIES

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Idea in Brief

THE PROBLEM
Line businesses increasingly see corporate functions as a drain on resources, taking capital away from investment in frontline initiatives and eroding their companies' competitive advantage.

WHY IT HAPPENS
Corporate functions typically do not formulate a strategy tailored to the needs of the business. As a result, they end up spreading themselves too thin or overinvesting in best-in-class operations regardless of whether they support their companies' overall strategy.

THE SOLUTION
Leaders should engage in a strategy-making process that starts by asking, What is the implicit current strategy of the function, as reflected in the choices that it makes every day? and then asks, What are the strategic priorities of the rest of the corporation, and is the function critical to them?

"Where should we start?" asked Stephen.

Recently appointed head of innovation at a large, diversified apparel company, Stephen had been tasked with building a culture of innovation across a pretty traditional, operations-focused set of brands. So, at the end of an innovation workshop we led for him, he asked us for advice on the smartest place to get started.

Our answer? With strategy. Begin by thoughtfully articulating the critical choices facing the innovation function. This, we said, would help his team understand where it was headed and how it would get there. He rolled his eyes. "We don't need a strategy for our team," he said. "The brands love us. They know they need us. Creating a strategy would be a waste of time—and we're overwhelmed as it is. In fact, we have more work than we can handle."

And there it was: the very best reason to start with strategy. Stephen's team had more work than it could possibly do. He was trying his best to serve the

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company and was struggling to keep up. Inevitably, work was falling through the cracks as his team tried to do everything for everyone. By denying that he needed to make strategic choices as the head of a function—about how his team allocated resources, what it prioritized, what it ignored—Stephen was in fact making a choice. He was choosing not to choose. And as a result, his team was failing to achieve much at all.

It's a dynamic we've seen again and again in our work consulting with and studying dozens of firms (including some mentioned in this article) across a variety of industries. Most companies accept the notion that corporations and business units need strategies. Leaders might not be great at crafting them—or executing on them—but they do at least recognize the value of clearly articulating how their companies and businesses will win in a particular way. For corporate functions—shared service organizations such as IT, HR, R&D, finance, and so on—the need for strategy is less widely understood. In many firms, functions just exist, serving the company in whatever manner and at whatever scale the business units demand.

That is a big mistake, especially given the huge and growing amount of money involved. (See the exhibit "The Rising Cost of SG&A.") If functions do not adopt a strategy consciously, they will almost inevitably end up defaulting to one of two unconscious organizational and cultural models, both of which are likely to result in their becoming a drag on corporate performance rather than a driver of it. In the following pages we'll describe the two unconscious strategies, explain why they are damaging to company performance, and present a strategy-making process that will help functions align with corporate and business strategies.

You Have a Strategy Whether You Like It or Not

There's a secret about strategy that no one tells you: Every organization has one, whether or not it is written down and whether or not it is the product of an official strategic-planning process. It can be deduced from the actions the organization takes because, essentially, strategy is the logic that determines what you choose to do and not do in service of a particular goal. The goal may be implicit. It may have evolved over time. The choices may have emerged without discussion and exploration. The actions may be ineffectual in achieving the goal. But the strategy exists nonetheless.

When Finance decrees that all investments must have a cash payout within seven years, it is making a strategy choice. It is placing a bet that the relatively immediate benefits from a quick return will outweigh the potential benefits that come from making longer-term investments. When IT decides to outsource application development, it is making a strategy choice. It is betting that lowering costs through outsourcing is a more effective way to create value than building applications internally would be. And when HR chooses to standardize hiring practices around the world, it is making a strategy choice. It is choosing to pursue scale advantages from a shared approach rather than benefits (such as agility and adaptation to local culture) of customizing by region.

Does it really matter if such choices are made without an explicit strategy? We believe it does, because it means a function has fallen prey to one of the two damaging strategies:

Do everything the business units want. We call this the *servile strategy,* and it is predicated on the belief that functions serve at the pleasure of the business units. Or, as one CEO recently told us, "Business units do strategy; functions support them." That view feels instinctively right to many managers. A company exists to create products and services for customers, so the business units, which do the creating and serving, rightly drive corporate strategy.

But we should not forget that functions serve customers too: the business units that use their services. Functions that unconsciously adopt the servile strategy try to be all things to all people. As a result, they wind up overworked and underwhelming. They become undifferentiated and reactive, losing their ability to influence the company and access resources. They struggle to recruit and retain talent, because no one wants to work for an ineffectual part of the firm.

A servile corporate function lives under the constant threat of being made redundant. It spreads its resources too widely and thus doesn't serve any business unit particularly well, sometimes prompting units to create their own functional capabilities or to look for a more effective (or at least cheaper) outsourced provider.

Put the function first. The servile strategy produces some miserable outcomes for people working under it, so

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it's no wonder that many functional leaders, especially in large organizations, adopt a radically different approach that treats functions and business units as equals in terms of power and importance.

In this *imperial strategy,* leaders put the function's work front and center and pay relatively little attention to how it aligns with the needs of the businesses or the overall strategy of the firm. The IT team creates a center of excellence in machine learning and data analytics—because that's where the action is in IT these days. The risk and compliance team builds a huge apparatus around risk assessment and then looks for ways to insert itself into corporate decision making wherever it can. The finance team builds sophisticated reporting systems that generate mountains of financial data that may or may not be material to the business units' work.

All imperial function leaders we've met claim that their initiatives are great for the company and its businesses, but they can seldom back up this assertion with any evidence beyond pointing to the example set by companies known for excellence in the function's domain: IT benchmarks Google, finance Goldman Sachs, procurement Walmart, and logistics FedEx. And they emulate those firms irrespective of whether their company's strategy resembles that of the benchmark in any way. Meanwhile, frustrated line managers complain that functions divert corporate resources from the units toward activities that make little difference to the company's competitiveness in the market.

The result, unsurprisingly, is a function that serves itself rather than its customers, much as a monopoly business would. And at some level, such functions are monopolies: Business units are often prohibited or strongly discouraged by senior management from using outside vendors for their HR or finance or other services. The trouble is that imperial functions all too easily fall prey to the worst tendencies of traditional monopolies: bloat, arrogance, and overreach. And like most monopolies, they inevitably experience a backlash.

It doesn't have to be like this. Corporate functions can and often do contribute greatly to a company's competitive advantage. Procter & Gamble's customer insights and analytics function, for instance, is critical to helping P&G better understand its customers—a key source of its competitive advantage and a driver of its strategic choices. Similarly, paper and packaging manufacturer WestRock's logistics function plays a central role in driving the innovations in flexible, customized delivery that have given the firm an edge over its competitors.

To follow the lead of these exemplars, functions must eschew unconscious strategies and instead make clear, focused, and explicit choices aimed at strengthening and safeguarding the capabilities that set their company apart in the marketplace.

How to Create Effective Functional Strategy

The first two questions a functional leader should explore when putting together a strategy relate to defining the problem: First, What is the implicit current strategy of the function, as reflected in the choices that it makes every day? And second, What are the strategic priorities of the rest of the corporation, and is the function critical to them?

Asking these questions forces functional leaders to confront what is working about their current strategy and what isn't (whether implicit or explicit). Perhaps there are disconnects between their strategy and that of the company, making the function's choices poorly aligned with organizational needs. In trying to serve all parts of the firm the function may be underserving those that are key to its success. Or perhaps the function isn't helping the firm develop the right organizational capabilities to deliver on the corporate strategy.

Important though the exercise is as a first step, do not dwell too much on these questions. There is often a temptation to do a great deal of research—documenting what your organization is doing in detail, what functions in competitors are doing, and so on. Exploring ways to solve a problem is far more valuable than obsessing about it. A reasonable expectation is that a group of smart people, using their existing knowledge, should be able to answer the two questions to a good-enough level after a few hours of discussion. For example, it wouldn't take a lot of deep analysis for a car company's executives to determine whether safety and reliability or branding and design were their company's main challenge.

Once consensus has been reached around the status quo, the next step is to consider alternatives to it. This involves answering another pair of interrelated questions:

Where will we play? For functions, this question is relatively straightforward. Leaders must identify their primary customers inside the firm (which should be the units most important to the firm's overall strategy), the core offering of the function to these customers (which should be closely related to the firm's competitive advantage), and what part of that offering will be outsourced and what part delivered by the function itself.

Let's say that an HR function has identified its main problem as a lack of design creativity across the firm. It might determine that its primary customers are business-unit CEOs, its core value offering is recruiting and developing young designers, and its core internal capability is design talent scouting. It might choose to outsource learning and development to top-flight business and design school partners, and rely on outside agencies for administrative recruiting and training.

In determining where to play, different functions may focus on different parts of the corporate strategy. Consider a digital-platform company pursuing aggressive growth in China and Asia. Its HR function should probably focus on that challenge, but its risk and compliance function might focus more on EU regulations, where policy changes could threaten the company's core business.

How will we win? For corporate or business-unit strategists, determining how to win is relatively straightforward: offer a value proposition to your primary customers that's better than what's offered by companies competing for those customers. General Electric needs to figure out how to provide better value to its business customers than Siemens does; Coca-Cola needs to provide better value to soda drinkers than Pepsi does. In each of these cases, the competitor is easy to identify, and its value proposition and business model can be deduced by observing its products and prices in the marketplace and studying its financial reports.

With functions, the how-to-win question is more challenging. It's not always easy to figure out the relative value to a firm of any given function. Although Verizon can probably do a good job of estimating the value provided by its network function versus T-Mobile's network function, it would most likely have a harder time differentiating between the relative values of the two firms' HR or finance functions. What's more, one company's functions aren't really competing directly with other companies' functions in the same industry. That's because the competing firms may have very different strategies, requiring different capabilities. HR might be hugely valuable for one company, whereas finance is hugely valuable for another. The HR function at the HR-driven company would not want to benchmark HR at the finance-driven company. Functions should compare themselves with functions in other companies only if the companies' strategies are similar. Likewise, it would make no sense for HR and finance to benchmark each other. Often, the appropriate benchmark is an outsourced provider.

The functional team should emerge from its inquiries with a number of possible strategies that answer the questions of where to play and how to win differently from the way the existing strategy does. At this point, the team has to make a choice. It cannot know for sure which of several potential strategies is the right one. But with the slate of possibilities in mind, functional leaders should ask themselves, What would have to be true for each of the strategies to be successful? They should articulate the capabilities and systems required and ask under what conditions the firm should invest in building these capabilities rather than those. With a clear idea of what the enabling conditions are, they can devise tests and experiments to help narrow their options still further.

To illustrate this kind of strategy making, we'll look at talent management at Four Seasons Hotels and Resorts.

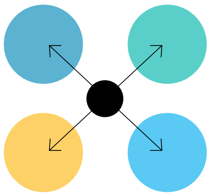
Talent Strategy at Four Seasons

For decades now, the heart of Four Seasons' corporate strategy has been its ability to define luxury as service: to make guests feel welcome, happy, and completely at home. Founder Isadore Sharp, in his 2009 book, points to the company's employees as the driving force of this strategy: "[Our long-term staff] were focused on more than their jobs; they were concerned about guest comfort and their ability to enhance it. And our ability to attract, develop, motivate, and retain such people made our…culture a rare advantage."

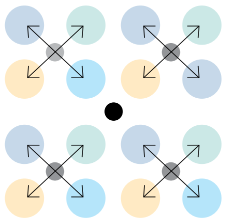
Indeed, Four Seasons' talent function plays a crucial role in producing its competitive advantage. If we look back at what Sharp and the talent team did through our lens of functional strategy, we can see how they defined their problem and the choices they made to solve it.

The Territory That Strategy Left Behind

In the first half of the 20th century, the world's large corporations were almost all organized around functions, including manufacturing, marketing, HR, and finance.

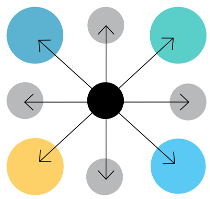


But beginning in the late 1950s and continuing through the 1960s, most shifted to a structure organized around product-centered business units, in response to the need for each product line to have a clear strategy and accountability in order to win against competitive products and brands.



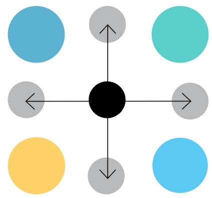
As firms grew in scale and scope, it became unwieldy to have the head of manufacturing, the head of marketing, and the head of sales all juggle their particular piece of each product line. A new corporate structure emerged, in which product-line business units developed their own independent functions. Each business unit or product team now performed its own HR work, financial accounting, research and development tasks, and logistics support services, giving rise to the conglomerate form of business organization popular through the 1970s and 1980s.

Over time, the pendulum swung back, as it became clear that the conglomerate structure failed to add enough value to the businesses to outweigh the costs of maintaining all those individual functions. Corporations began to recentralize many functional activities, enabling greater specialization, efficiency, and consistency in each area.



These centralized functions were purpose-built to create cost efficiencies or to add value in ways that would not occur if the services were performed in a decentralized and smaller-scale way. Purchasing would be cheaper, global recruiting would be more efficient, and R&D would be more effective at scale, the theory went. Marketing, HR, and finance would be more consistent across the businesses.

Unfortunately, through this evolution, the questions of what these functions should (and should not) do and how they should think about strategy were largely left unanswered. The practice of business strategy didn't take shape until the 1960s, when the transition to product-line organizational structures was largely complete. **As a consequence, strategy theory and practice focused entirely on product lines, and the functions were the territory that strategy left behind.**



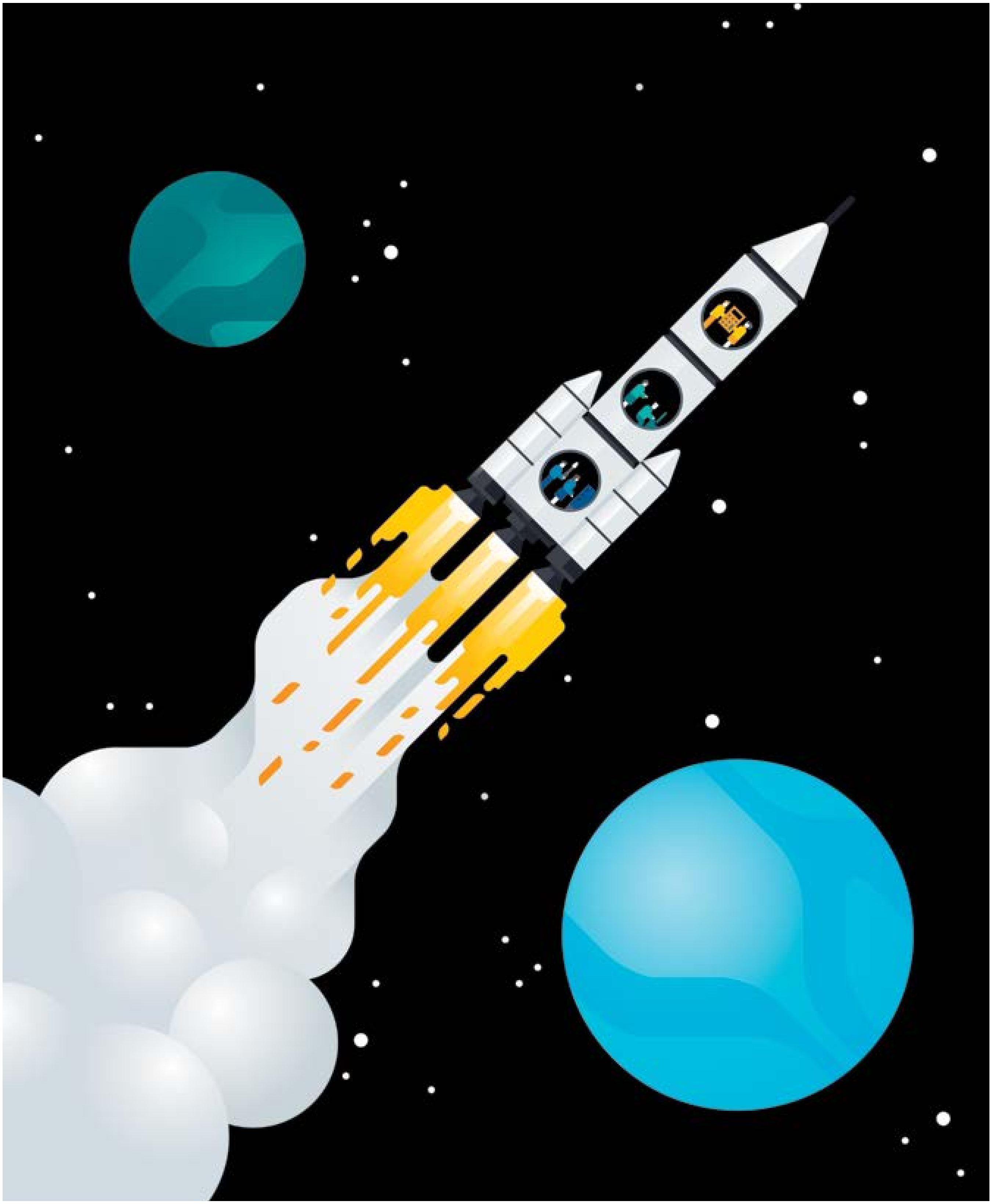
Defining the problem. Labor costs in the hotel business, as in most service-based industries, represent a large share of operating expenditures (currently about 50%). Accordingly, most hotel chains treat labor as a cost to be minimized. Frontline hotel staffers are treated as replaceable cogs in a massive, fast-moving machine. No wonder, then, that according to the Bureau of Labor Statistics, the 2018 annualized employee turnover rate in the industry was 73.8%.

Since turnover of frontline employees is so high, most major chains focus their hiring efforts on getting good general managers (who are likely to stay longer) and then building mechanisms to quickly hire lots of new entry-level employees each year. They rarely invest much in frontline retention because it is seen as a lost cause; the huge turnover rate is treated as an inevitability. Instead they focus on cost-cutting to address labor issues: minimizing staff hours, standardizing to boost productivity, and so on.

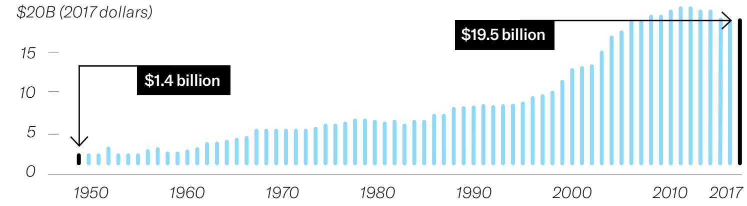
When Sharp entered the hospitality business, he saw all these norms in operation. But he slowly began to push back on them. At the time, hotel chains defined luxury largely in terms of space: grand architecture and décor, complemented by highly standardized, obsequious service. Sharp believed that luxury was not just about space but also about how people were treated. And frontline staff would be the key to delivering a new form of service that was warm, welcoming, and capable of filling in for the nurturing support system that guests had left at home and the office.

The standard hotel talent strategy (accepting frontline turnover as inevitable and working to mitigate it; investing in retention and development only for general management staff) would not work with Sharp's new vision for the firm. As the company grew, the talent team needed to make a set of choices that would align with firm strategy and build frontline service capability.

Determining where to play and how to win. The Four Seasons talent team identified the frontline staff as its internal customer and focused on hiring, retaining, and motivating those employees in ways that set it apart from competitors. Rather than hire by résumé or through third-party recruiters, Sharp committed the necessary resources to put candidates through five interviews—the last with the hotel general manager—before they could be hired. This



The Rising Cost of SG&A
To measure the economic importance of functions, we tracked selling, general, and administrative expenses (SG&A) of firms in the Dow Jones 30 Industrials, which provides a good proxy for how much corporate functions cost the modern large American corporation.



process produced a more thoroughly vetted cadre of hotel staff, hired for attitude rather than experience.

The talent team also invested in extending staff tenure, making its entry-level jobs the starting point of a career rather than a dead end. This produced a virtuous circle: If the average tenure at Four Seasons approached 20 years, the talent team could invest 10 times the resources per person in hiring, training, and rewards than could competitors, whose employees tended to stay for a year or less. The result for Four Seasons would be far better trained and more experienced hotel employees, without higher talent costs overall.

Under Sharp, Four Seasons enjoyed happier, more loyal, more capable, and longer-serving workers—enabling it to deliver superior service and earn leading-price premiums. It built rigorous systems to ensure that its service capabilities were always present. Its recruiting and hiring system was formalized and scaled. Its training systems became legendary. Four Seasons thrived under Sharp, becoming the largest and most profitable luxury hotel chain in the world. And its talent strategy was a crucial element of this success.

Building Strategies for Supporting Functions

Not all functional strategies are as directly tied to the competitive advantage of a firm as is the talent function at Four Seasons. In cases where the connection is more tenuous, it is still very important to understand the choices of the function and the role it plays in helping the company win overall. In the simplest terms, supporting functions need to operate in efficient and cost-effective ways that enable the firm to invest in its sources of competitive advantage. If support functions don't make good choices, they put the overall firm strategy at risk.

Consider a typical risk-and-compliance function. For some companies, superior risk assessment and mitigation is a source of competitive advantage. But for most, that is not the case, even though the function is essential to keeping the firm in business. For a typical risk function, the strategy problem can be defined in any number of ways. It might be a matter of standards: How do we ensure our compliance training is sufficient to prevent disaster and keep the company out of the news? Or it might revolve around stakeholder issues: How can we help build the company's reputation with investors? Or, How might we help our managers understand and quantify operating risks?

The function also has choices regarding whom to serve and with what offering. For instance, it can choose to serve frontline employees or the business-unit leaders; the CEO or the board of directors. It may see all those groups as potential customers, but it must determine which is the core consumer with whom it seeks to win. A compliance unit that sees the firm's main risks as health and safety issues, for example, might want to focus on managers running factories. It might choose to focus on providing expertise to managers making operating decisions (about factory layout, say, or choice of equipment to be used) or compliance training for workers.

The how-to-win trade-offs are similar. A compliance function supporting decision makers worried about safety could win by forging trusted relationships with those decision makers, going deep rather than broad, so that it comes to be seen as a reliable partner in high-level decision making. Or it might win by creating individualized online employee compliance training in a high-impact but scale-oriented format, allowing the decision-making manager to increase the frequency of risk-awareness-raising interventions without incurring the significant costs and time involved with conventional training efforts or off-the-shelf training software.

FUNCTIONS DO NOT have to be servants to corporate overlords, nor should they be petty tyrants building their own empires. Like their business-unit counterparts, functions can use strategy to guide and align their actions, to more effectively allocate resources, and to dramatically enhance the competitive value they provide. Just like the rest of the company, they make choices every day, and by developing a coherent strategy to guide them, they can become vital engines of the business.

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