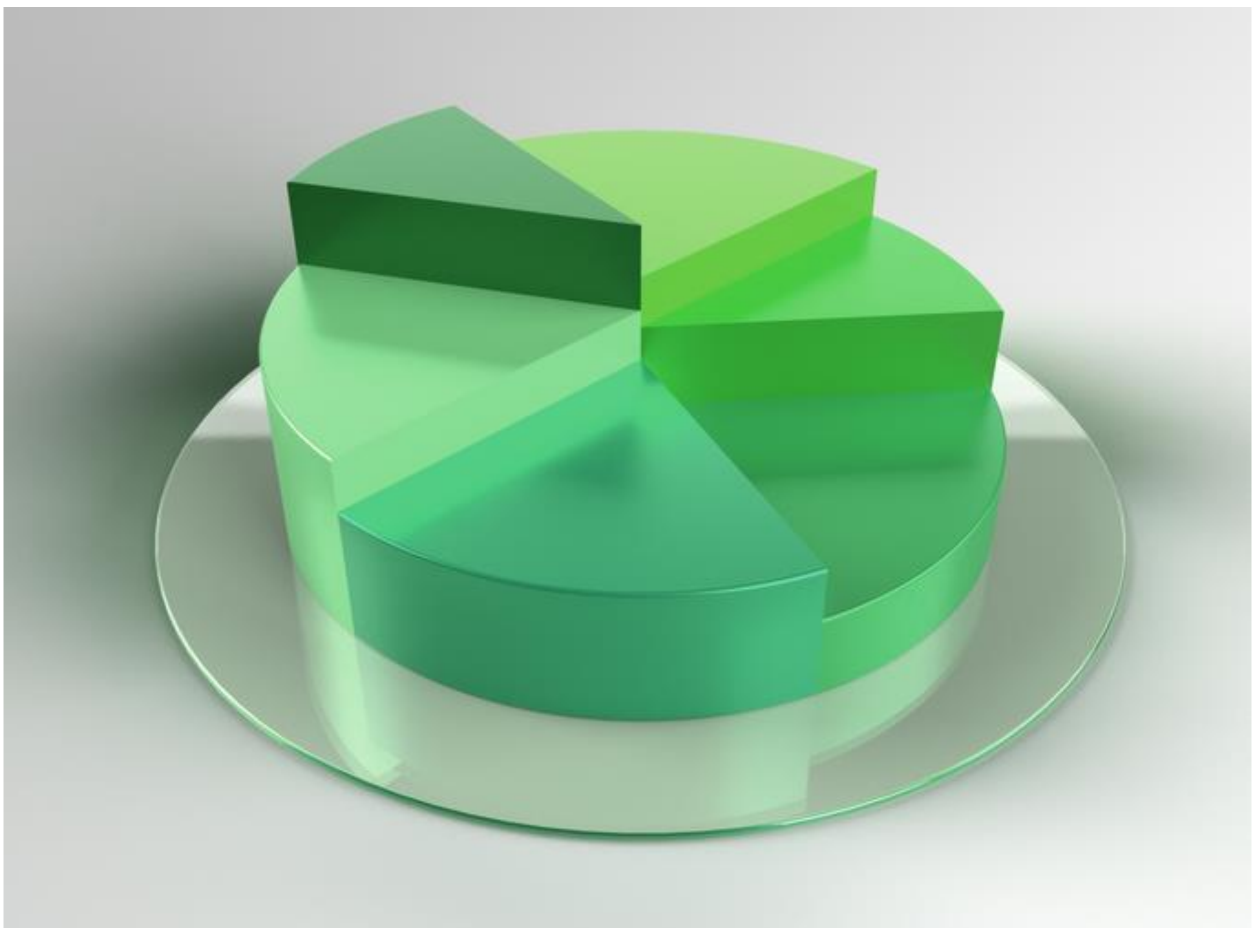
Advancing The Role of Corporate in Strategic Resource Allocation

by Marwaan Karame

Here are the key challenges that companies face in optimally allocating resources and a framework that redefines the role of Corporate as a strategic business partner that business unit managers will want to engage.



The strategic allocation of resources, whether it is investment in traditional capital, innovation or brand development, is arguably among the most significant roles a corporate center (a.k.a. "Corporate") can play in driving value across a portfolio of businesses. The impact can be quite significant, where the right playbook for allocating resources can return well over 3x, 5x or even 10x the investment to implement.

Although tensions always exist between Corporate and their business units, the type of tension will determine whether the relationship is healthy or not. Corporate leaders often micromanage the job of business unit leaders but are ineffective because they are too far removed from what is occurring on the ground. Instead, they should think and act more like an investor and devote their efforts and time to making better strategic resource allocation decisions across the portfolio of businesses rather than within each business unit. However, if business unit leaders have greater degrees of freedom to make those decisions, then greater accountability and responsibility must come with it, where they own their decisions, results, and the consequences of their actions.

Like an investor, corporate must view the business units objectively, like a portfolio of stocks, where they invest more in the business units they believe will create the most value, and withdraw resources from the businesses struggling to create as much value, so that those resources can be reallocated to fuel value-creating growth elsewhere. It is easy to get caught up in internal politics and historical beliefs, but continually reminding the corporate team to "act like an investor" tends to mute these distractions and increase the likelihood of success.

In fact, the most effective corporate leaders go beyond the role of overseer to one of strategic partner, providing new perspectives like an investor that challenges the status quo. One of the most effective ways to improve the strength and quality of the partnership between Corporate and its business units is through a structured and comprehensive Strategic Resource Allocation ("SRA") playbook, which builds upon a granular understanding of the current business with a rigorously tested view of forward-looking opportunities. It limits bias and anchoring by basing decisions upon a fact-base derived from agreed performance metrics and methodology. Such a fact-based approach lessens the tendency for annual planning activities to descend into counterproductive negotiation exercises beset by gamesmanship.

However, Corporate must acknowledge and leverage the fact that business unit leaders are closest to their consumers and their competition. Business unit leaders understand the markets in which they play, know their consumers' needs, and have developed a pragmatic understanding of the business model choices available to achieve their targets. In this respect business units have an informational advantage on the prospects of their business, but beyond that, their knowledge of the opportunities that exist in other parts of the company are limited.

The SRA playbook is designed to simultaneously leverage the institutional and market knowledge of a business unit and supplement it with a Corporate's "outside/in" view driven by an objective fact-base that optimizes the allocation of resources both within each business unit, as well as across all business units. Corporate plays the essential role in evaluating and balancing the competing capital needs of different business units, while ensuring the overall portfolio realizes its value creation potential through five key steps: 1) aspirational goal setting, 2) build a fact-base, 3) develop the case for change, 4) construct a strategic value creation agenda, and 5) create a repeatable process.

Step 1 – Aspirational Goal Setting

Beyond the goals set by guidance or management plans, the first step we recommend is setting aspirational goals with an objective to double the share price within 3 to 5 years. The messaging is simple, tangible, and clear. Alternatively, for publicly held companies, the objective can also be based on becoming a top quartile TSR (total shareholder return) performer relative to the S&P or peer group. Regardless of a how these goals are set, they need to be aspirational. Aspirational goals play an important role in expanding the minds of management to think outside of the box and consider alternative strategies that will close the value gap between their current state and the aspirational goal.

The process of setting aspirational goals and then asking what needs to happen to reach those goals allows management to get a clear understanding of the growth, return, and reinvestment rates needed to make these aspirations a reality. This process is very illuminating, because it quickly reveals how much organic and non-organic investment will be required given the company's reinvestment effectiveness. It also helps make it crystal clear that a 'peanut butter spread' approach to resource and investment allocation across business units, products, customers, and regions will fall short of an aspirational objective. This sets the stage for management to want to get smart on where value is being destroyed and created within the company.

Step 2 – Build a Fact-Base, Getting Smart

A critical next step is to get smart by creating a fact-base on where and how the business units create value and how they rank against one another. It depends on the business, but the value pools are customarily mapped around products/brands, customers/customer segments, regions/geography, and/or organizational structure.

Third-party market growth data is integrated into the forecasts of opportunities to help determine which will generate the greatest value per dollar of investment. Charting value creation expectations against reinvestment rates provides a clear visual depiction on whether business units are evenly spreading investment across its portfolio of opportunities or if they are smartly tilting investment toward opportunities that are driving the greatest value and pulling back investment from those opportunities that need to earn the right to grow.

To be effective at this stage, corporate should limit the burden on business units with additional information requests and extra work. The objective is to demonstrate the value of the analysis using data that is currently available. Where there are gaps in the information, common sense assumptions will suffice to develop directionally correct conclusions. Although the data may not be perfectly accurate, there will be plenty of time to verify it later in the process.

It is important, however, that Corporate involves the business unit leaders to establish buy-in on the methodology for filling in the gaps, while emphasizing the goal is NOT to be "precise" , but rather "approximately and directionally right."

Step 3 – Develop a Top-Down Case for Change, "Size of the Prize"

Next corporate must develop the case for change by quantifying the "size of the prize". The magnitude of the opportunity creates excitement, answers the "so what" question, and creates trust between Corporate and the business units. The size of the prize is Corporate's top down or outside/in view of the potential to unlock value across the portfolio by simply reallocating resources.

What it is not, is a prescription, a budget, goal setting, incentive target, negotiation, or mandate. Rather, it is a collaboration with each business unit on what the possible (not probable) value might be for a reallocation of resources. The process is meant to create healthy provocations to help business units think outside the box and challenge the status quo, but it is not meant to drive a corporate agenda.

One of the biggest challenges of SRA is reducing the allocation of resources to a business that believes they have value creation opportunities, but where there are better opportunities elsewhere. Business units must understand that they compete for resources and create more value than the next best alternative by developing an optimized plan that reduces resources allocated towards weak performers and reallocate them to strong performers.

This step also provides a preview of the types of insights business units will derive by taking the next step of the process by exploring the value created at more granular levels of their business. "Size of the prize" helps justify whether more work needs to be done at the business unit level to develop a more precise and deeper analysis. It also allows Corporate to illicit valuable feedback on the information business units would like to see to make better investment and operating decisions in the future.

Step 4 – Construct a Bottom-Up Strategic Value Creation Agenda

At this point, business unit leaders are typically excited to delve deeper into how to maximize the value of their business, given the resources they are being allocated, their ranking relative to other business units, and upon seeing the size of the prize. Here we take into account the practical considerations of operating and market constraints that come with investing more or less across the business unit's portfolio of customers, products, segments and/or geographies.

Cross-functional working group sessions are conducted to determine the organizational capabilities needed to execute on the strategic alternatives and leverage the institutional knowledge of business unit leaders to determine the feasibility of the resource allocation strategy. In some cases, where the size of the prize suggests more investment, marginal market penetration may be limited and therefore more investment may not be practical. Alternatively, where the size of the prize suggests less investment or divestment, the impact on other parts of the business may restrict pursuing such strategy, because the downside may be larger than anticipated at corporate. It is in this step of the process, where buy-in from the business unit leaders will determine whether the execution of resource allocation will be successful.

Step 5 – Create A Repeatable Process, Institutionalizing Strategic Resource Allocation

Finally, it is important that managers understand that value creation is a never-ending exercise. To the extent a company succeeds in creating value, it will attract competition for that value. SRA must then be institutionalized as a repeatable process that continually seeks to optimize a company's choices with a granular understanding of its business and the competitive environment in which it exists, while streamlining the process to dynamically adapt as new investment opportunities present themselves.

By going through the previous steps of the SRA playbook, Corporate has essentially created the blueprint for institutionalizing the process, and the templates and tools needed to establish a consistent way of analyzing opportunities. Institutionalizing SRA means keeping it on the management agenda throughout the year and integrating SRA models and presentation material into strategy development, business planning, forecasting, financial and reporting systems. Lastly, this process requires a disciplined approach to conducting SRA training of key managers and team members to help embed the skillset needed within the organization.

Through well-defined, complementary roles and a structured, comprehensive SRA playbook, Corporate and its business unit partners can establish an effective foundation for long-term value creation. Corporate can move from overseer to value-added strategic partner by establishing a portfolio-wide playbook for value creation and challenging individual business units to find the best uses of capital within their respective business and relative to other opportunities in the portfolio.

Corporate becomes more alert to new business opportunities and more realistic about legacy investments that have destroyed value but continue on due to the lack of facts and conviction required to make the tough choices. As this thinking embeds further into a company over time, the potential for value creation is further unlocked and long-term value ambitions can be realized.

Such a step-change in value creation potential can transform not just company financials, but also a company's culture. This transformational change can be a major source of a company's competitive advantage that leads to excess returns where the sustainability of those returns is paradoxically a function of its difficulty to implement and hence to replicate.

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