The Conference Board
European Council on Corporate Strategy
Roles, Structure and Challenges of the Corporate Office

The Challenge of Shared Service Centers

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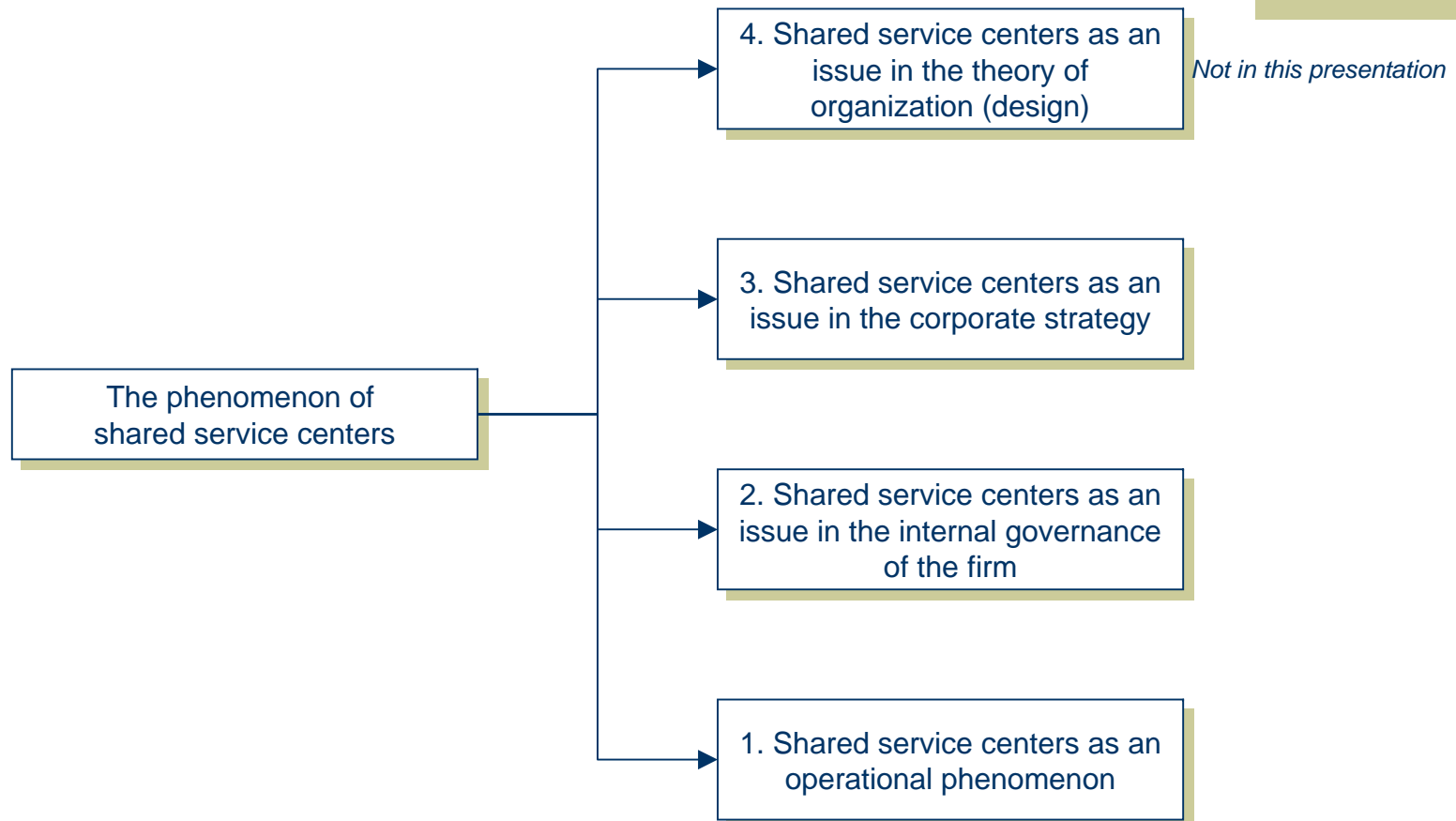Hans.strikwerda@nolannorton.com

London – February 10, 2006

Proposition

◆ It is not only a challenge to work with shared service centers effectively, the real issue is to see how this form of the unbundling of vertical and functional integrated organized businesses, challenges our concepts of operating models, internal governance and corporate strategy

Levels of observation and understanding

The phenomenon of shared service centers

4. Shared service centers as an issue in the theory of organization (design)

Not in this presentation

3. Shared service centers as an issue in the corporate strategy

2. Shared service centers as an issue in the internal governance of the firm

1. Shared service centers as an operational phenomenon

What is a shared service center?

♦ **A SSC is an accountable entity in the internal organization of a firm tasked to provide specialized services to operational entities (divisions, business units) on basis of a service level agreement and full charge out of costs on basis of a transfer price system**

- A SSC is an operation, not a (central) staff department
    - A SSC is an engineered cost center and often an investment center as well
- Due to modularization SSC's may perform as well value chain activities (e.g. assembly), not just support-activities
    - No statutory nor policy tasks are organized in SSC's
    - Most frequent types of services:
        - Accounting
        - HR-transactions and HR-services
        - Computer services
        - Facilities
        - Legal services, insurance
        - Purchasing
- A SSC may contain either front-office, mid-office or back-office activities

A few examples of firms running SSC's (2005)

References	Type	Scope	Defined savings
ING	Administration	Benelux	20%
delta lloyd	Administration	Netherlands	30%
AIRBUS	HR	Europe	Expected 50%
france telecom	HR	France	Expected 60%
CCF	HR	France	Still in progress
Unilever	HR	France	N/A
CROWN	Payroll	France	Still in progress
EXIDE CORPORATION	Finance	Europe	41%
gsk GlaxoSmithKline	Finance	Europe	36%
Altadis European Tobacco Company	Finance & Payroll	France	40%
faurecia	Finance	Germany	62%
RENAULT NISSAN Growing together in a new dimension	Finance	Europe	45%
NHS	Finance & HR	UK	Still in progress
SOLECTRON	Finance	Europe	30%
JOHNSON CONTROLS	Finance	Europe	20%

Source: Atos Origin, Atos-Odyssée, Atos KPMG Consulting and NNC

Virtual all large firms operate one or multiple SSC's

ABN Amro
Allergan
Allied Mills
American Express
Airbus
Armstrong World Industries
Avonmore
Basell

BNP Paribas
Boots Healthcare International
Borealis
Canon
Clogic
Deutsche Post/DHL
Dietsmann
DSM
Exide
Evans Halshaw
ECN
Fort James

Galileo International
GE Capital
GSK
Heineken
Highland Distillers
Hyperion
Informix
IDV
ING
Invensys
Johnson Controls
KLM Cargo
Kimberly Clark
KPN
Mercedes Benz
Minet
Motorola
Nestle
Nike

PO Nedlloyd

P&O North Sea Ferries
PWZ
Pearson
Philips
Polaroid

Progress Software Europe
Readers Digest
Renault - Nissan
Reuters
Sabic
Sealed Air Corporation
Shell
Solectron
Symbol
Syntex Roche
TWA
TW4 (Time-Warner)
Telewest
Trinity Mirror
Union Carbide

Alcan
Bristol Myers-Squibb
Dow Chemical
PHH
Reebok
Smurfit
Tasco
Tetrapak

What are benefits of shared service centers?

- **Cost savings**
    - Direct costs savings (20-50% of costs of processes organized in SSC's)
        - Reduction of duplication of departments/processes
    - Indirect costs savings
        - Standardization
        - Higher quality of internal services
        - Faster and more accurate implementation of changes in law, regulation, policies

- A larger part of costs of processes/services become **flexible** for business units

- Higher **transparancy** in the organization for the Board

- Business managers are more **concentrated on their business** (customers, markets)

- Achievement of **synergies**: economies of scale, scope, knowledge exploitation

- Higher **strategic flexibility**, in case ssc's are organized as plug & play environment, lower entry and exit costs to restructure portfolio of businesses

- Creates organization forms that are more responsive to higher educated workforce and hence the call for more horizontal accountability

What are unintended or unexpected negative effects of shared service centers?

- Organizations discovering that implementing a SSC is not just an efficiency improvement, but a **fundamental change** in its internal governance and hence suffering the effects of wrong processes for change management
    - Failure to adapt the system of internal governance to working with SSC's
    - Failing to establish mechanisms for trust, resulting in business managers hiding or doubling processes
    - Boards failing to see that their role changes from running a portfolio of businesses to running one integrated business system, with subsequent need for conflict resolution

- SSC-workers facing **loss of identity** and subsequent loss of motivation

- BU-managers finding themselves **lacking the competence of coordination control** (as opposed to ownership control)
    - Discover that they lack understanding of the processes in their organization, and thus are unable to specify in a contractual way want they want and need and subsequently are overruled by SSC-managers
    - Undue detailed service level agreements with subsequent coordination costs

- Boards trying to control businesses through SSC's

Types of SSC's by ownership and reporting

MBO (e_1) ——
Inside industry (e_2) ——
Outside industry (e_3) ——

Legal boundary of the corporation

Board

Statutory and compliance tasks

Staff dpt.

Central Service (c)

Conflict between staff culture and operations culture

(100-x%)   (x%)

Joint Venture (e)

Business Unit

Business Unit

Business Unit

Shared Service Center (b)

Service Firm (f)

Plug & Play Infrastructure

Preferably multi vendor sourcing

(d)

Non-stable operations

Shared Service Center (a)

Public Shared Service Center (g)

Adapted from Strikwerda, J. 2003. *Shared Service Centers: van kostenbesparing naar waardecreatie.* Assen: Van Gorcum - Stichting Management Studies

A number of operational aspects of SSC's (1/2)
Lessons learned – do's & don'ts

- ◆ Processes need to be specified in modules, in order to understand which modules can be transferred to SSC's and which not
  - ▪ Performance management needs to be at multiple points in processes
  - ▪ Issue: process specification is time consuming and prone to errors

- ◆ Interoperability (semantic standardization + IT standards) needs to be imposed on the organisation top down
  - ▪ Issue: often this is driven by the choice of compute program instead of business requirements

- ◆ Business units need to understand what (spending on) specific services (IT, HR, etc.) contribute to their business in order to make allocation decisions
  - ▪ Issue: often not known, no attention paid to because operational motive is to save costs

- ◆ SSC must first concentrate on delivering required services & quality, next to cost reductions
  - ▪ Issue: often cost reduction has priority, limiting business units in their market/customer responsiveness

- ◆ SSC need Activity Based Costing in order to confront BU's with integral costs of their requirements

A number of operational aspects of SSC's (2/2)
Lessons learned – do's & don'ts

- ◆ Managers of business units not trusting the capabilities and quality of services of SSC
    - ▪ Holding back processes / duplicating processes
    - ▪ Sabotage of ssc's
    - ➔ Establish new system of internal governance and its internalization prior to implementing SSC

- ◆ Managers of ssc's overbearing business managers and pushing services

- ◆ Unclear or wrong status of SSC, e.g. SSC being labeled as a division, resulting in decoupled processes for target setting and resource allocation

- ◆ Lack of clarity whether the services of a ssc are mandatory to the business

- ◆ Lack of clarity who decides the budget of a ssc, who decides on the scope of its services, transfer prices
    - ▪ Issues about costs and prices of SSC's compared to old situation or market offerings

- ◆ Lack of collegial behavior through arms length use of service level agreement, too much time spent on SLA's

- ◆ Loss of expertise in business units on e.g. IT, and therefore lack of expertise in being a professional customer of the SSC

Because SSC's often are pushed by IT-firms, perceived as efficiency projects, SSC-projects often start at, are limited in scope to step 6

1. Awareness that existing business model no longer is adequate and that introducing a ssc is a solution to the problem

Lack of attention for Corporate change processes & tactics

2. Deciding new business model: new rol BUs, position SSC's

3. Deciding new governance model: control of BUs in connection with control of ssc's, accountability Mgr SSC's, new Planning & Control cycle, conflict resolution procedure

4. Appointment of managers on the accountable entities: BUs + SSC's

5. Defining tasks, allocation of resources: to BUs en SSC's

Traditional change management

6. Managers of BUs and SSC's organise human resources, operational processes

7. Performance control

SSC's are a fundamental change in the operating model deploying the vertically and functionally integrated divisions

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          ┌──────────┐
          │    HQ    │
          └─────┬────┘
   ┌──────┐  │  ┌──────┐
   │ Staff├──┼──┤ Staff│
   └──────┘  │  └──────┘
   ┌─────────┼─────────┐
┌──────┐ ┌────────┐ ┌──────────┐
│      │ │        │ │          │
│Division│ │Business│ │Operating │
│      │ │ unit   │ │ Company  │
└──────┘ └────────┘ └──────────┘
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Resource scope

Business scope
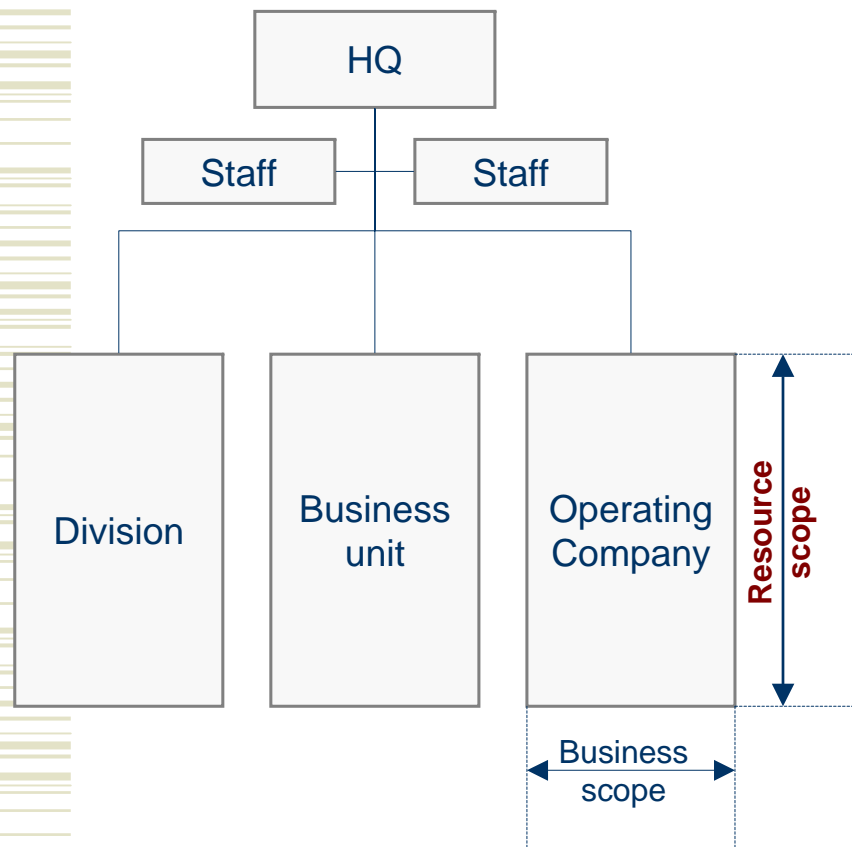
- ◆ The M-form implicitly assumes that the division managers has hierarchical control over all his resources (Sloan)

- ◆ By using SSC's the accountability of the business managers with respect to turnover, profit, market share etc. does not change

- ◆ The difference is that the business manager has to achieve his performance by contracting services over which he has no hierarchical control and in most cases are mandatory

- ◆ Now the resource scope is a variable next to the business scope to coordinate the activities of the firm
  - ■ Change in status & identity of BU-managers
  - ■ Introduction of new identity and role (SSC-manager)

Many cases go difficult or even wrong because it is neglected to adapt the system of internal governance to working with ssc's prior to implementing ssc's

Corporate Governance

Internal Governance

Board

Staff dpt.

Central Service (c)

Business Unit

Business Unit

Business Unit

User Board

Shared Service Center (b)

Plug & Play Infrastructure
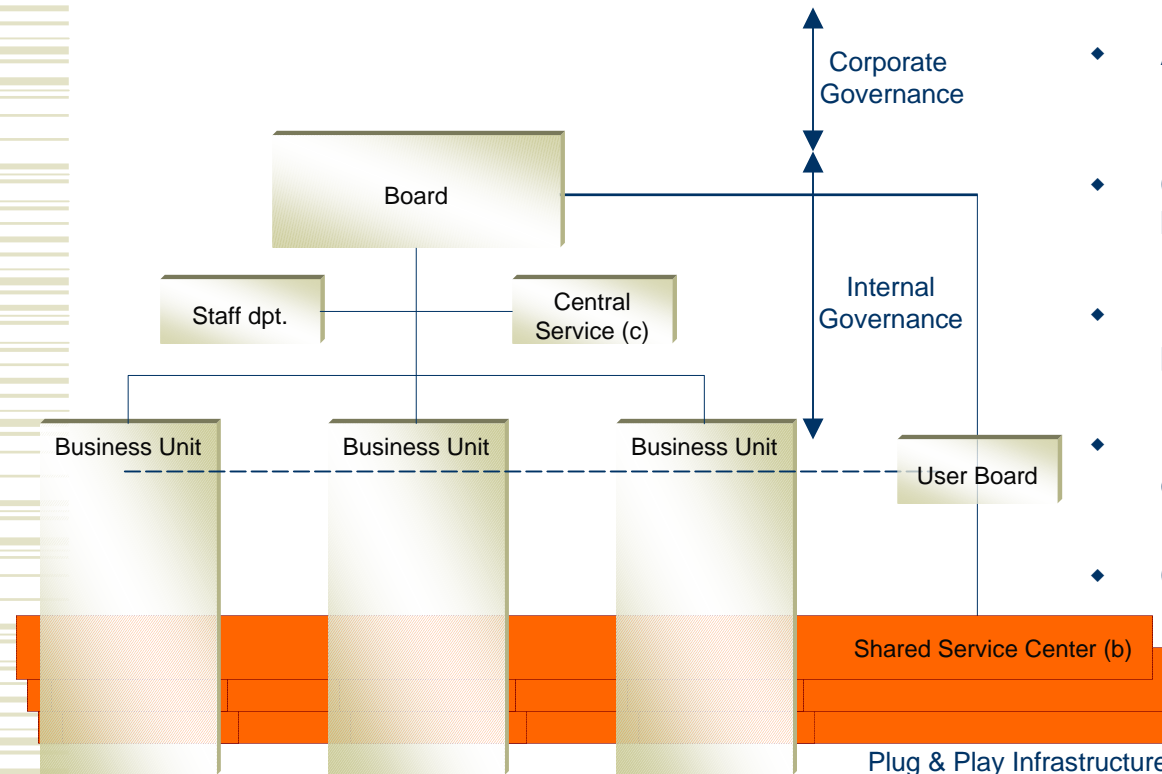
- ◆ Accountability, attributed decisions rights, reserved powers of SSC-managers

- ◆ Changes in attributed decisions rights of business managers

- ◆ Planning & control process, including the process of defining and approving SLA's

- ◆ Monitoring performance of SSC, corrective actions

- ◆ Conflict resolution procedure

Some HR consequences, for business management

(Few companies adapt their management-development programs to working with SSC's)

- Perception of loss of status, needs to adapt to new type of status
- Perception of loss of power, needs to build a new type of power base
- Lack of competencies to contract required services
  - Implicit internal contracts (processes) have to be made explicit (shift from implicit & self-coordination to explicit & imposed coordination
  - Requires knowledge of critical parameters (functional, abstract knowledge)
- Reduced information asymmetry/ agency costs with the Board, loss of power vis-à-vis the Board
- Quite some business managers and even board members are unable to switch to coordination control due to personality

Ownership control - hierarchy
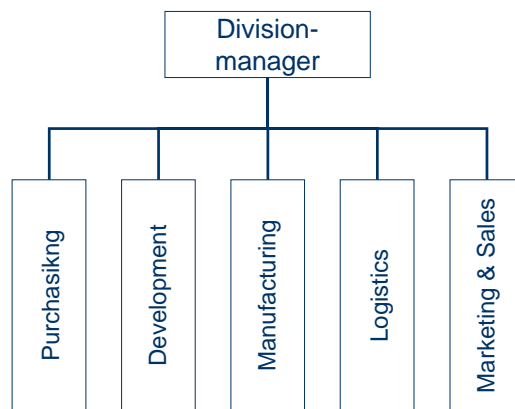
Coordination control-orchestrator
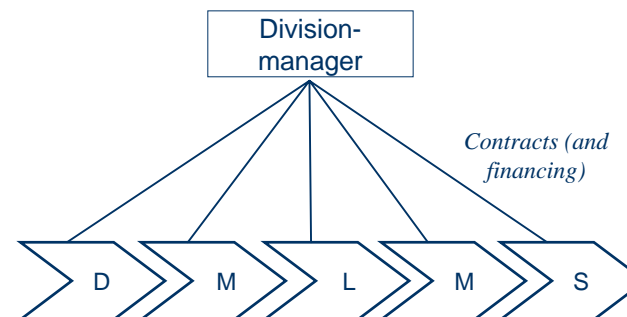
The Planning & Control-cycle needs to be adapted when working with SSC's (except for some simple cases)
That is to (re)define the communication

Executive Board

Corporate strategy

1. Deployment corporate strategy in business plans for market activities

5. EB checks consistency with strategy, resolves conflicts, approves business plans, operational plans and SLA's

Market activities X…Z

4. Pre-consolidation; solving minor conflicts

3. Operational plans per sourcing unit

2. Agreeing tentative service level agreements

Sourcing unit A

Sourcing unit B

Sourcing unit C

Long term technology/capacity/capability investment

Consequences of a ssc-infrastructure for the allocation of tasks in an Executive Board

Executive Board

- HRM-policy
- Strategy, Alliances
- Secretary of the Company
- Internal Audit
- Legal
- Public Affairs

- Division A
  - BU *A1*
  - ....
  - BU *An*

- Division B
  - BU *B1*
  - ....
  - BU *Bn*

- Control – Accounting Standards
- Treasury
- Fiscal Affairs
- Mergers & Acquisitions
- Information Technology - Policy

- Financial & Accounting - SSC
- HRM- SSC
- IT-SSC
- Customer Service – SSC
- Forwarding & Logistics – SSC
- Manufacturing – SSC
- …

Synergies between ssc's are exploited

Working with SSC's implies a change in style of management for the Board ...

Type of control

Operational			**Operator**
Strategic Plans		**Strategic Controller**	
Strategic Guidelines	**Strategic Architect**		
Financial	**Holding Company**		
	Stand-alone	**Shared/ similar skills**	**Shared business system** **Single business system**
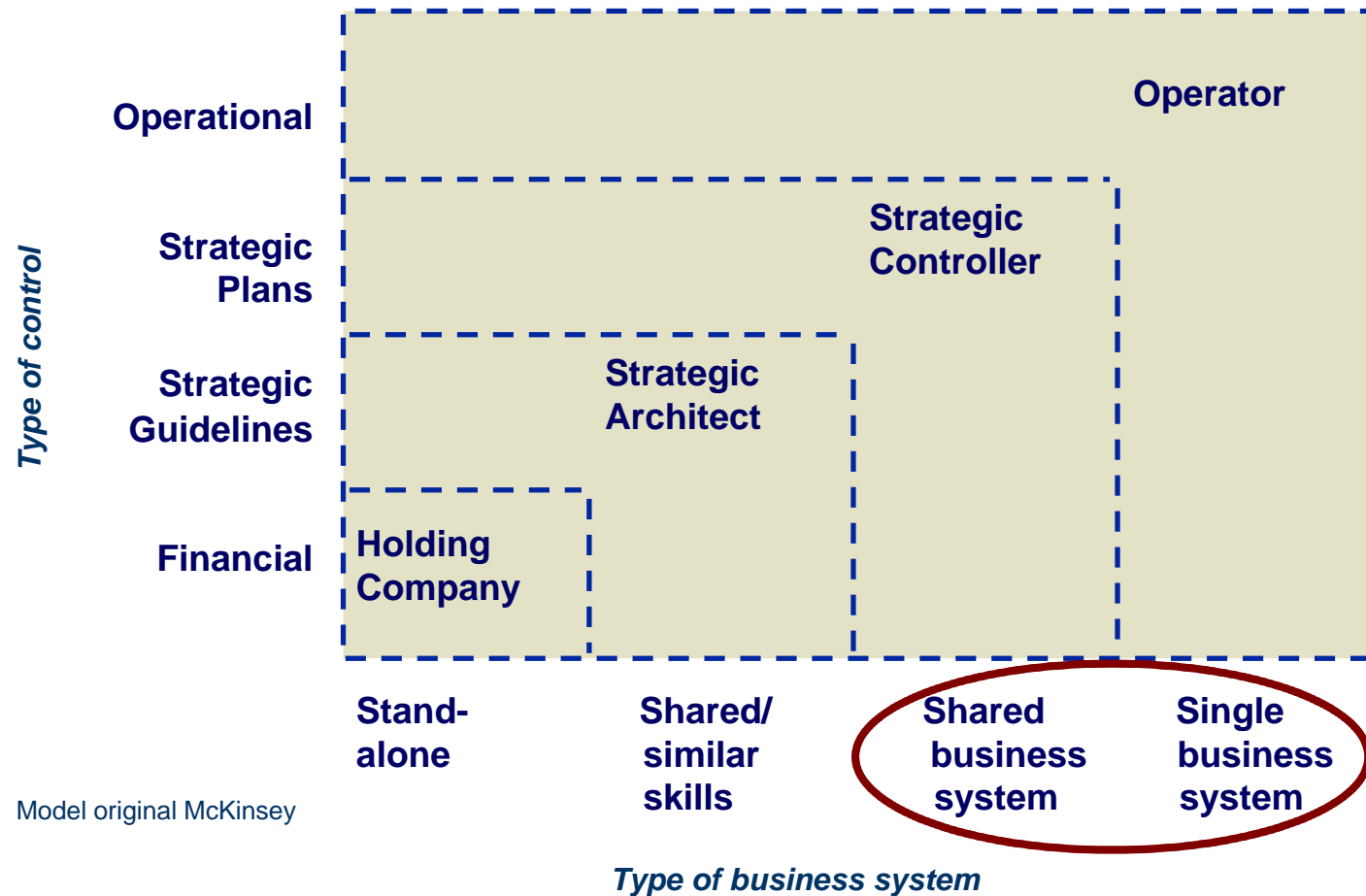
Model original McKinsey

Type of business system

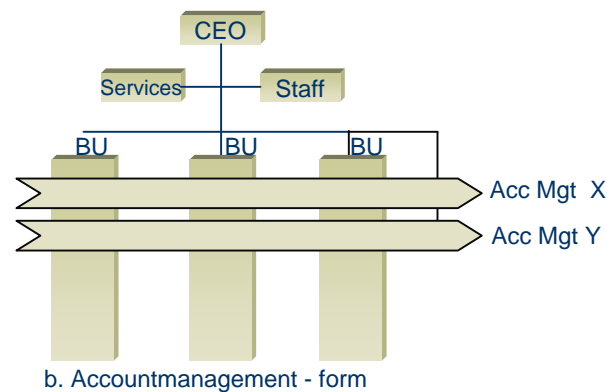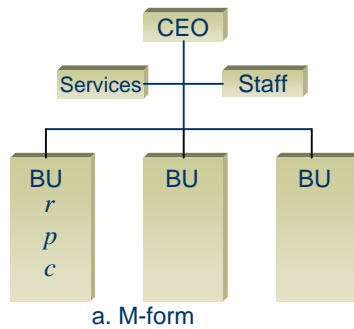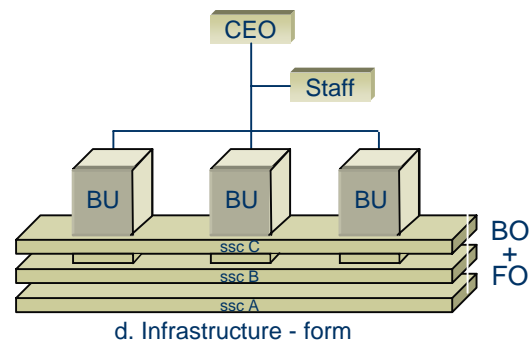# SSC are part of a larger process of unbundling vertical integrated businesses, creating a new type of business unit
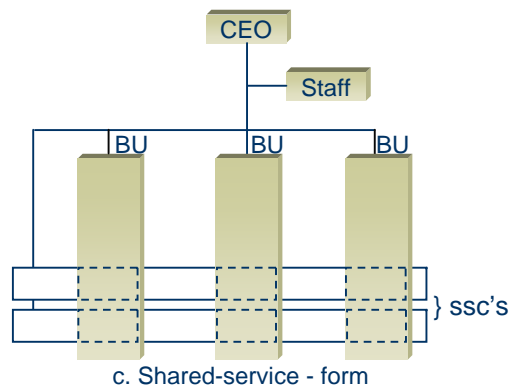
Unique ← Relation between resources and products → generic

$$r\begin{pmatrix} & & p & \\ \delta_{ij} & \delta_{ij} & \delta_{ij} \\ \delta_{ij} & \delta_{ij} & \delta_{ij} \\ \delta_{ij} & \delta_{ij} & \delta_{ij} \end{pmatrix}$$

Ssc-activities are generic and neutral with respect to policy sets

$$r\begin{pmatrix} & p & \\ 1 & & \\ & 1 & \\ & & 1 \end{pmatrix}$$

R = resources / processen
P = products / services
C = customers

CEO — Staff
BU   BU   BU
} ssc's

c. Shared-service - form

CEO — Staff
BU   BU   BU
ssc C
ssc B
ssc A
BO + FO

d. Infrastructure - form

Services — CEO — Staff
BU
r
p
c
BU   BU

a. M-form

Services — CEO — Staff
BU   BU   BU
Acc Mgt X
Acc Mgt Y

b. Accountmanagement - form

$$p\begin{pmatrix} & c & \\ 1 & & \\ & 1 & \\ & & 1 \end{pmatrix}$$

Cross-selling
Customer centric
organisation

$$p\begin{pmatrix} & & c & \\ \delta_{jk} & \delta_{jk} & \delta_{jk} \\ \delta_{jk} & \delta_{jk} & \delta_{jk} \\ \delta_{jk} & \delta_{jk} & \delta_{jk} \end{pmatrix}$$

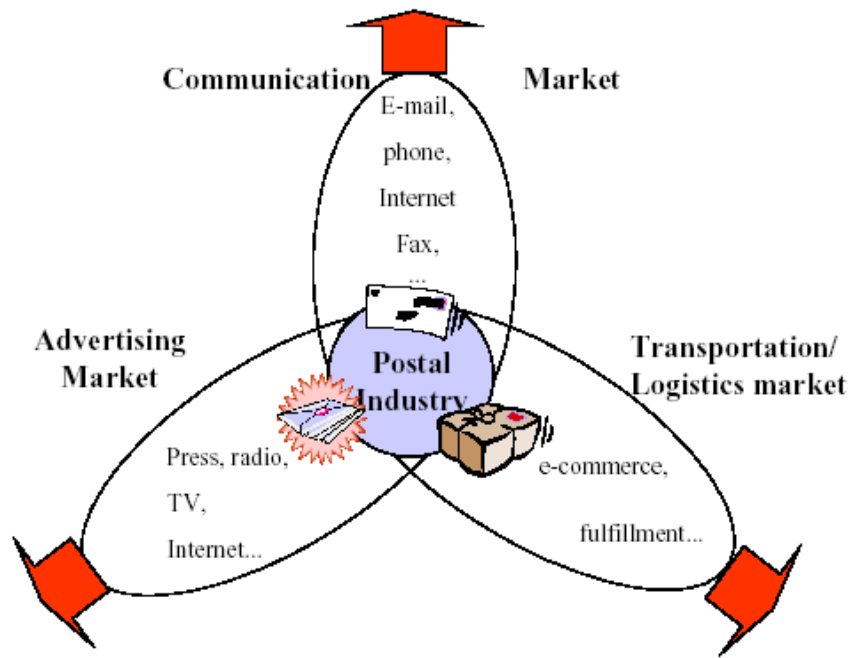Unique ← Relation between products and customer → generic

Logic, analysis and the real world

- Following are three cases

- In themselves the models presented sound logical etc.

- **Reality is**:

  - Case 1: the strategic development sketched is subject to national governments involved in competition *for* postal and logistic markets in Europe*

  - Case 2: In many financial institutions (but not all!) using this model is subject to internal power games, fights for status etc. resulting in dubious organizations

  - Case 3: All went well until a new manager arrived, who wasn't involved in developing this model and had experience only with the traditional business unit organization

*Strikwerda J, Rijnders D. 2005. Possible End Games in the European Postal Market: Cui Bone? In MA Crew, PR Kleindorfer (Eds.), *Regulatory and Economics Changes in the Postal and Delivery Sector*. Kluwer Academic Publishers: Amsterdam

The changing structure of the European postal industry

Postal Industry: at crossroads

Postal Industry: part of company's broader portfolio

Vertical integration

Unbundeld

European Account Management

Marketing

Mail | Express | Logistics | Financial services

SSC Printing facilities

SSC ICT

SSC F&A

SSC HRM

SSC Purchasing

Or outcourced to third parties

U-curves

National Economies of Scale

L-curves

European Economies of Scale

Source: **REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the application of the Postal Directive (97/67/EC Directive),** p. 11, 2002

Source: NNC Analysis

What are the building blocs of the modern financial services firm?

National organization

Head quarters
incl. corporate staff

Profit Centers
(Modern BUs)

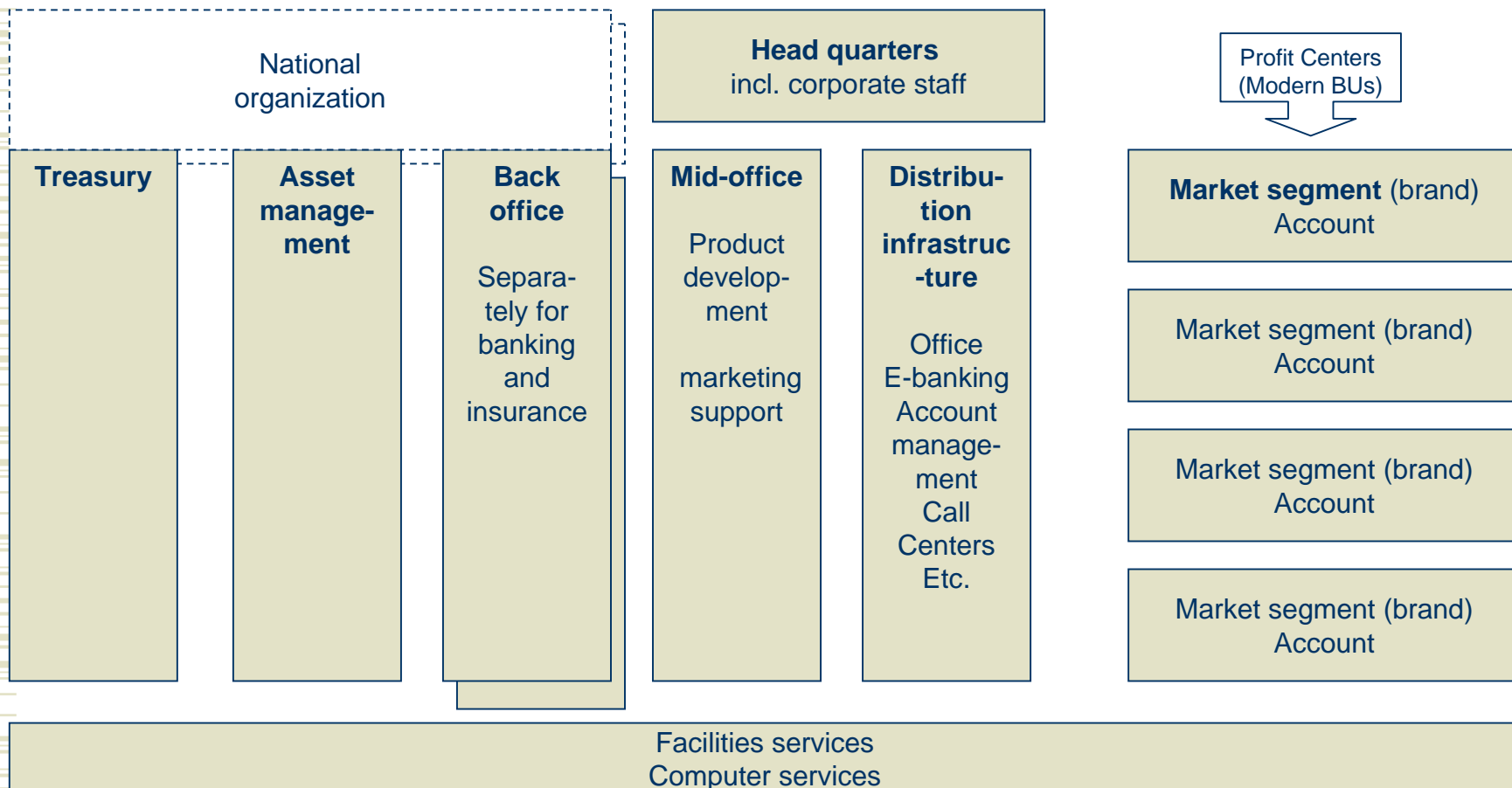| Treasury	Asset manage-ment	Back office	Mid-office	Distribu-tion infrastruc-ture
		Separa-tely for banking and insurance	Product develop-ment marketing support	Office E-banking Account manage-ment Call Centers Etc.

Market segment (brand)
Account

Market segment (brand)
Account

Market segment (brand)
Account

Market segment (brand)
Account

Facilities services
Computer services

Case: high-tech firm

PD-CEO

Staff

Services

① Knowledge exploitation
② Economies of scale
③ Co-engineering
④ Low-cost / transactions

BU CS	BU DS	BU MMP	BU TT	BU EB	Systems Development laboratories
LoB's					Shared manufacturing resources
					ATO
					International Marketing & Sales

Three Paths to Outsourcing Modules (SSC's)
(Most firms do not intend to outsource their SSC's)

Outsourced

(2)   (3)

Made in-house   (1)

Non-modular   Modular

Sako M. 2003. Modularity and outsourcing. In A Prencipe, A Davies, M Hobday (Eds.), *The Business of Systems Integration***. Oxford University Press: Oxford**
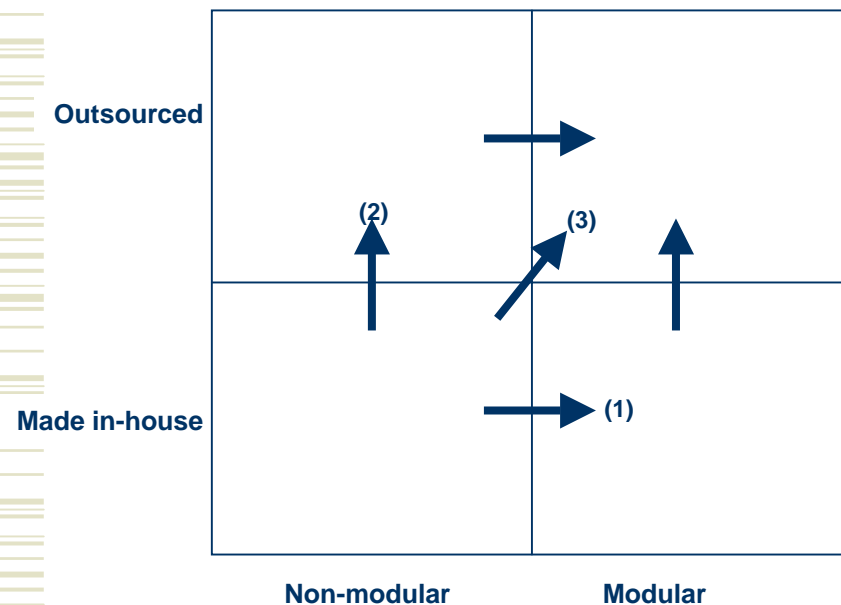
1. **Designing modules and producing in house first before outsourcing**
   1. If when in-house modularization brings significant performance improvements, including those for design integration and complexity
   2. OEM is able to teach suppliers, knowledge on module design and architectural knowledge remains with OEM

2. **Outsourcing non-modular components before moving towards modular design**
   1. Benefits of outsourcing > benefits of modularization
   2. Knowledge of module design (and part of integration) is with supplier

3. **Simultaneously implementing modular design and outsourcing**
   1. Requires capable module suppliers in the market
   2. Fast pace of innovation, but risk of losing in-house capability and control
   3. Suppliers can influence innovation and capture a greater share of returns on R&D-investments

Prediction: By 2010, lack of multisourcing management discipline will result in large-scale business disruption among buyers, suppliers and their value chains.

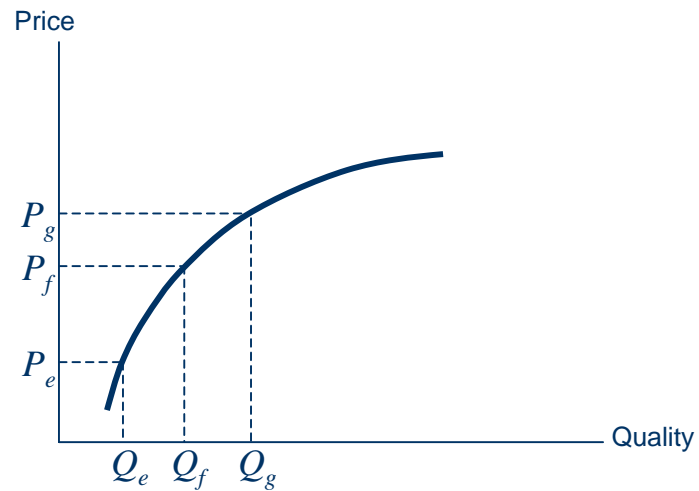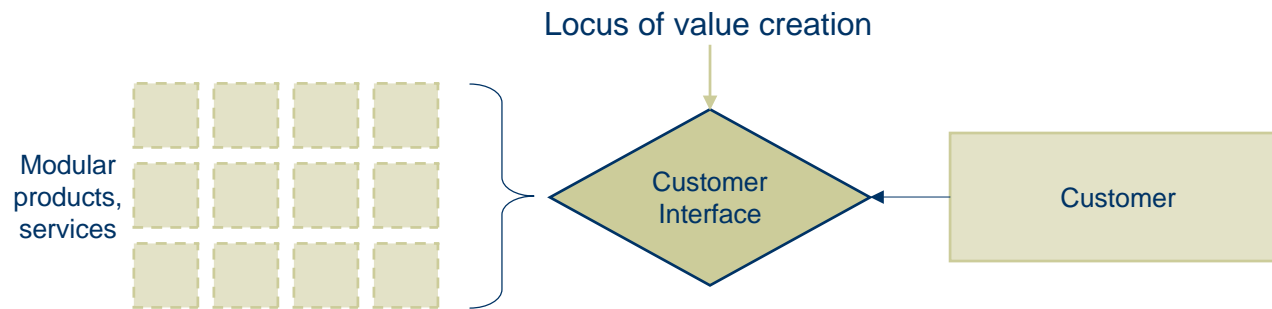## Stop Outsourcing Now
Begin Disciplined Multisourcing

Organizations that lack multisourcing management discipline will lose competitiveness.

✓ They will be unable to react predictably and quickly to implement business strategies.

✓ They will be unable to source needed skills/services from the optimum source, in the optimum timeframe and from the optimum location.

✓ They will experience unpredictable revenue growth and eroding profitability.

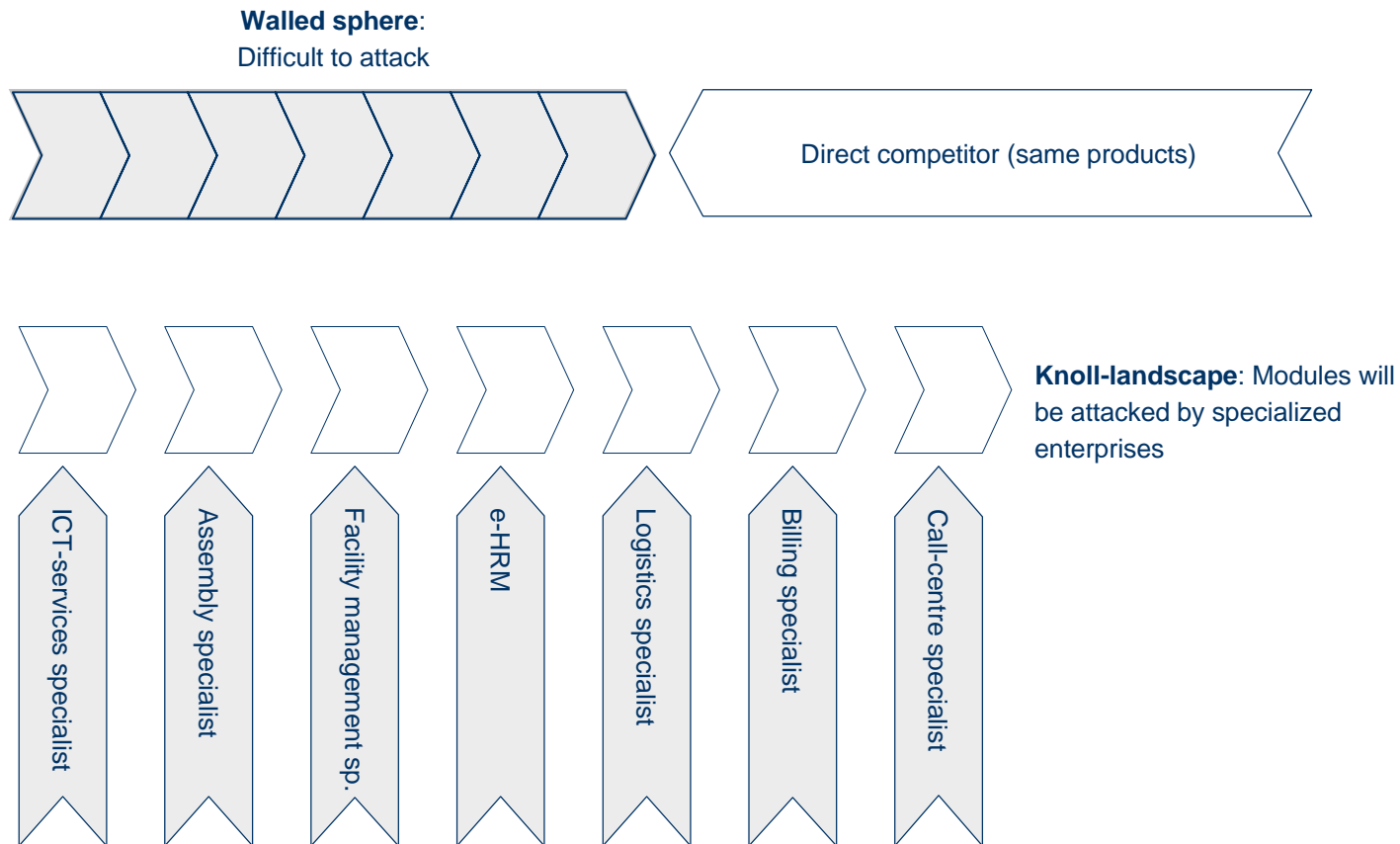**Multisourcing** is the disciplined provisioning and blending of business and IT services from the optimal set of internal and external providers in the pursuit of business goals.

Gartner.

When ssc-call centers are profit centers: the issue of mix-match flexibility

Locus of value creation

Modular products, services

Customer Interface

Customer

Price

P_g

P_f

P_e

Q_e Q_f Q_g

Quality

Modular organisations are a two sided sword: transparancy versus vulnerability to precision attacks

Walled sphere:
Difficult to attack

Direct competitor (same products)

Knoll-landscape: Modules will be attacked by specialized enterprises

ICT-services specialist

Assembly specialist

Facility management sp.

e-HRM

Logistics specialist

Billing specialist

Call-centre specialist

A new logic for the portfolio of operations of a firm: not only capital investment theory-based, as well based on a strategy for external control
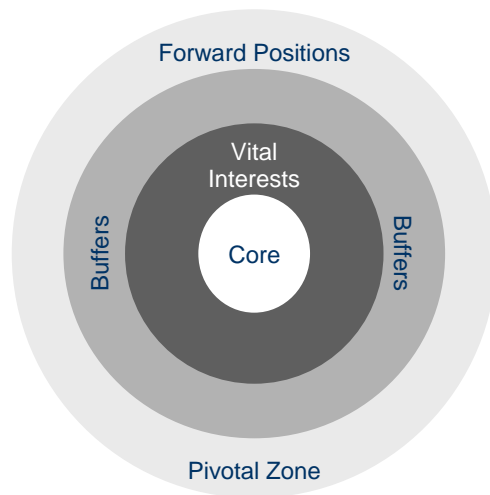
- ◆ Whether value created can be turned into profit, depends on:
  - Mechanisms for profit appropriation
  - Market power, competitive pressure

- ◆ Profit appropriation a.o. depends on the ownership of resources (issue is the ownership of personal knowledge of professionals), and bargaining power of the distribution

- ◆ Competitive pressure may reduce the free cash flow of the firm thus restricting its freedom to manoeuvre into new markets.

D'Aveni, R. 2001. Strategic Supremacy: How Industry Leaders Create Growth, Wealth, and Power through Spheres of Influence. New York: The Free Press.

The transformation of the traditional building blocs to modern building blocs of the corporation

Modern building blocs

		Value creating units				Value appropriation units	Value defending units	Staff units	Top-management unit	Household and hygienic units
		Activities to increase the maximum willingness to pay	Activities to optimise the mix-match flexibility	Co-creation with customers	Infrastructures / economies-of-scale activities					
Result gene-rating units	Revenues units		X_1	X_2		X_3				
Result gene-rating units	Units with measurable contribution	X_4				X_5				
Result gene-rating units	Information activities				X_6					
Support units					X_7		X_8	X_9		
Top-management unit									X	
Household and hygienic units					X_{10}					X_{11}

(Left axis label: Traditional building blocs)

X_1 = e.g. call centre; X_2 = co-engineering; X_3 = sales activities that in themselves do not add value but are own operated to avoid distributors appropriating the value; X_4 = R&D, design; X_5 = e.g. patents; X_6 = ICT-operations; X_7 = those staff activities that are organised operationally, in a shared service centre, e.g. eHRM; X_8 = e.g. public relations, X_9 = those staff departments that serve the executive board; X_{10} = e.g. facilities management; X_{11} = e.g. security.

Strikwerda J. 2005. *Growth, Governance and Organisation: On power strategy and modular organisation*. Van Gorcum - NNC: Assen-Utrecht

Possible consequences of the unbundling of the firm for the roles of the Executive Board

Tricker, Bleicher	Goold, Pettifer & Young	Consequences of unbundling, emergence of platforms, etc	
The formative role (mission, identity, values)	Governance & compliance role	The formative role	Mission, identity, values
			Architecture, external control, grand strategy in network industry
The performance role (a.o. strategy, portfolio of businesses)	Value adding parenting role Shared services role	The performance role	Strategy – business portfolio
			Strategy – enabling platforms portfolio
The conformance role (reporting, compliance, etc.)	Governance & compliance role	The conformance role	

What ultimately defines success of working with ssc's?

◆ An Executive Board that:

- Sees and understands the ongoing process of unbundling of firms and of transactions in the market

- Understands that shared services centres are part of this unbundling process, and are only one of the new modules in defining the operating model

- Understand that this unbundling defines a new power game in its industry and understand what roles various modules/competencies play in the new power game

- Subsequently understand what will be the new logic of the portfolio of building blocs/operations of the firm

- Understands what its implications are for the roles of the Executive Board and acts accordingly

- Understands what its implications are for its MD/HR-policy

(for more operational do's & dont's, see slides 10-11)