# Understanding The Challenge that is Shared Services

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*Shared services imply a break from traditional forms of organizations – particularly the multi-divisional, or business unit, organization form – and represent an "unbundling" of the vertical integrated firm.*

Despite the fact that SSC's have proved to be an effective tool for improving operations over the past, not everybody is completely happy with their shared service centers. In particular, three major concerns stand out.

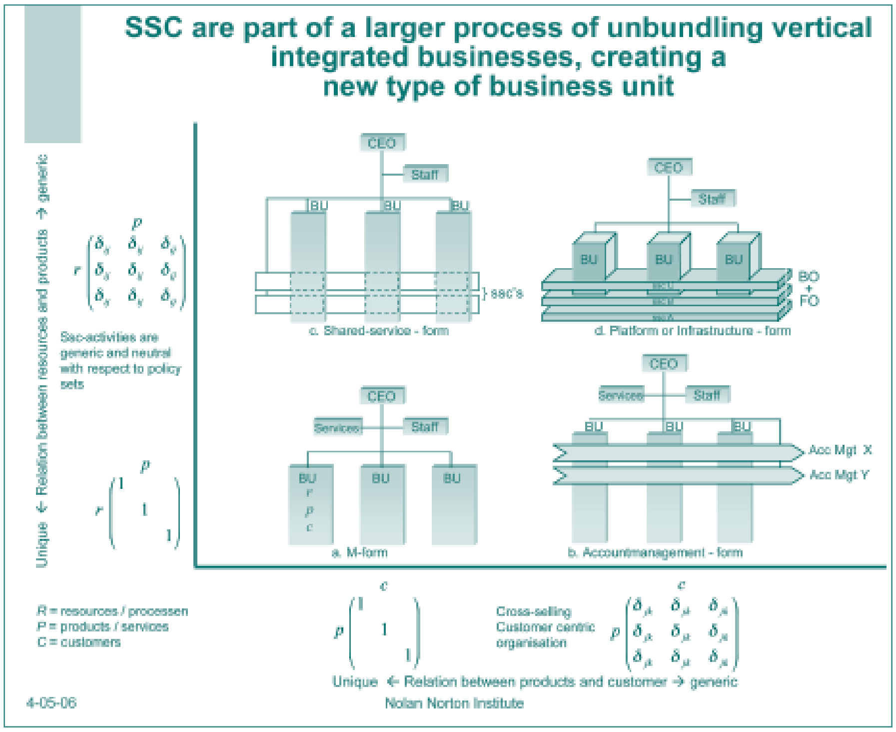
First is the market and customer orientation of the organization: the attention paid to the SSC during implementation is perceived to be detrimental to market and customer orientation. A second concern is the motivation of business unit managers: their ensuing dependence on SSC's is perceived to reduce their status, and thus their motivation. A third concern is that the executive board gets too involved in operational issues by having to resolve conflicts between business units and SSC's, thus reducing the degree of delegation of entrepreneurial decisions to the lowest levels possible in the organization. The proven benefits of SSC's are countered by these concerns and create a tension in organizations, which might easily ~~easily~~ hamper the organization from developing strategic opportunities, markets and the motivation of its members. This tension can be overcome and turned into a platform of understanding by developing a broader perspective on shared services. This broader view has now been applied for some time in sessions with executives and managers and has created a true understanding of SSC's, enabling a more strategic deployment of shared service centers.

### What Shared Service Centers Really Are

First we have to be clear on what a shared service center is. A useful definition is: A shared service center is an accountable entity in the internal organization of a firm or institution to provide specialized services to divisions and business units, on the basis of a service level agreement (SLA) and with full charge out of costs on the basis of a transfer price system. With this definition, an SSC is an operation, and not a central (staff) department. Also, an SSC becomes an engineered cost center as well as an investment center. SSC's can also exist as either independent (profit) firms, or as joint-ventures between a number of firms. In the Netherlands, all banks have outsourced their payment transactions to Interpay, a corporation organized as a joint-venture between all these banks. Interpay is an example of a world class payments transaction processing shared service organization.

SSC's were introduced to reduce the costs of duplication of similar processes within each of the divisions or business units of a firm.

Figure 1




With that, other benefits accrued: cost reduction due to standardization, better use of purchasing power, e.g. of IT-equipment and services, achievement of economies of knowledge, etc.

To understand why, despite the benefits, concerns still exist, we must first recognize that the multi-divisional organization form, or business unit organization form (the M-form), is the most important innovation in the field of organization in the twentieth century. SSC's, and even more account management as profit center, imply a departure from the M-form. The success of the M-form is due to a number of factors which we need to understand in order to move on with SSC's:

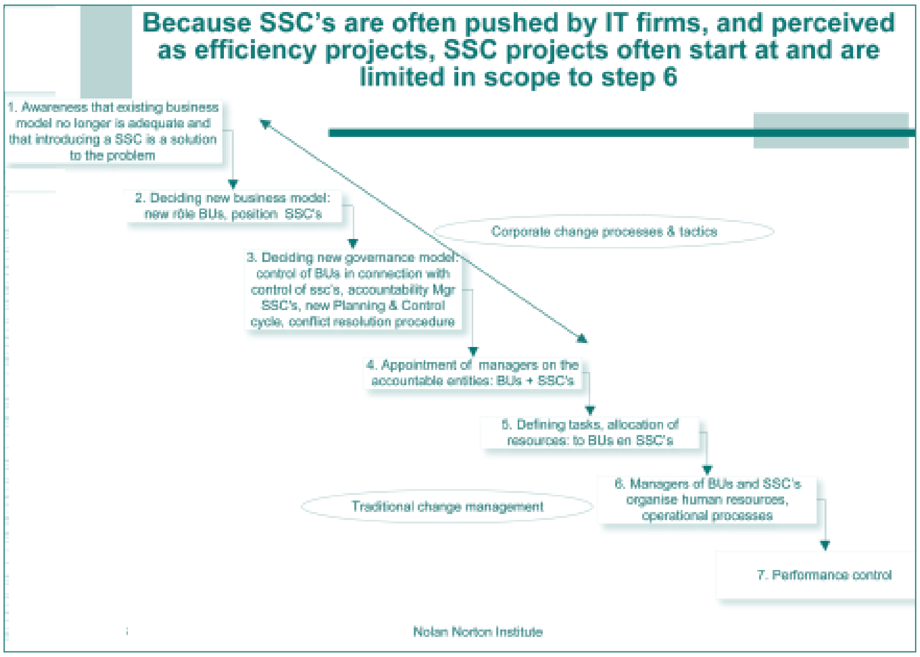
1. The M-form aligned all resources needed for a specific product-market combination on that product-market under the hierarchy of the manager assigned to that product-market combination;
2. The M-form created a complete co-location of knowledge (on markets, on capabilities) and decision making (with respect to products and services needed to serve a specific market) ~~within~~ one manager;
3. The M-form provided the opportunity for able men and women, without capital, to develop themselves to entrepreneurial general managers with bottom line responsibility;
4. The M-form has a clear separation between economizing (in the divisions and business units) and strategizing (at head quarters);
5. The M-form is a simple organization in terms of management accounting and management control;
6. The M-form defines a simple, clear and understandable set of roles and responsibilities between executives, division managers and members of staff department.

Thus, the M-form was a success not only because it was sound from an economic-operational point of view, but also because it resonated with ideas on human resource management: empowering people, a focus on specific markets, coordination processes aligned with the market, non-interference of the Board, etc. This, in turn, explains the tension between the economic benefits of SSC's and the strengths of the M-form. Only by understanding both the success of the M-form and why the model lost its validity, will we be able to see SSC's from a perspective of future organization forms, as opposed to the M-form (in which the SSC is a disturbance).

The successful M-form is implicitly based on a number of assumptions, which no longer hold true for an increasing number of firms and institutions:

1. The M-form assumes that each division or business units, for all its processes can achieve an optimal scale (lowest average costs per product/service against output per year). The reality is that for IT-platforms this optimal scale can no longer be achieved by individual divisions or business units (or even individual firms);
2. The M-form assumes that resources, assets, products and services are uniquely tied. The reality is that, due to IT standardization and modularization, resources, assets and processes can increasingly be deployed alternatively for a wider range of products and services.
3. The M-form assumes that markets are well delineated, no opportunities for cross-selling or system integration across divisions, no opportunities for combining purchasing power, etc. The reality is that cross-selling is a must as is system integration, and exploiting corporate purchasing power.
4. The M-form assumes that costs of coordination across divisions are higher than costs of coordination within a division. The reality is that, due to information technology, process engineering and standardization, costs of

Figure 2




coordination across divisions have fallen dramatically.

5. The M-form assumes that the identification of workers should be primarily with their product-market; identification with one's profession is second. The reality is that many supportive functions have developed into professions, changing not only the order of identification, but creating, as well, a consciousness that these professionals work better on the basis of a contractual agreement instead of hierarchical relations.

As a result of these changes and developments, a process of "unbundling of the vertical integrated firm," has been going on for some time, now. The introduction of SSC's within organizations is one of the expressions of this unbundling of organizations. The SSC represents one of the new building blocks, a module within new organization forms resulting from such unbundling. This unbundling affects not only supporting business processes, but also other assets from the product-market combination, especially cross business unit account management as the profit center (Figure 1).

By recognizing shared services' implementation, operation and governance as part of this process of unbundling, we can understand its consequences for strategy, governance, HR policy, management processes, competencies and required change processes.

**Shared Service Centers as Building Blocks of New Organizational Forms**

Once we understand SSC's are the building blocks of new organizational forms we can define them in greater depth. Deploying shared services implies a change in the constitution of the organization and deployment should subsequently be the responsibility of leadership and linked to change management. In 2002-2003, when we interviewed 35 companies in the Netherlands, including a number of Dutch subsidiaries of multinational companies, all interviewees except one complained about the poor quality of change management offered by the firms hired to help set up and implement SSC's. These complaints were verified by those firms.

Introducing SSC's within the framework of the traditional M-form represents, or should do so, an acknowledgement of the fact that the business model implied by the M-form is no longer adequate. Adapting an organization to a new business model requires a different change process to the introduction of efficiency improvements. There is a fundamental difference between corporate change processes and traditional change processes. Ideally, the process of corporate change starts with the awareness that the existing business model no longer will do. The next step is deciding on the new business model and translating it to a new internal governance system. This new governance system should be built from business units (new style), account management, SSC's and the corresponding (new) management processes. The core of corporate change is that this new internal governance has to be discussed, understood and internalized before implementing any concrete change in the organization. Managers must clearly understand their new roles in the new organization with SSC's, and effective executive boards should remove those managers who fail to understand the new organization. Once this is implemented, resources, tasks and targets can be allocated, and the next change implementation can be executed (including change management).

When confronted with the steps in Figure 2, both in research and in consulting engagements, far over 80 percent of the respondents (both clients and consulting firms) acknowledged that they had started with step 6. In acknowledging this, they immediately understand the problems they encountered and could not solve along the lines of the traditional IT or efficiency projects: transfer prices, attributed decision rights, reserved powers, budget planning, reporting lines, etc. These are all governance issues, to be addressed by the executive board. Too often, an SSC was introduced as an IT efficiency project and the change had been managed accordingly.

**Shared Services Centers: a Broader Perspective**

What are the problems and issues companies and consulting firms should have faced and discussed before entering step 6 in Figure 2~~?~~ A first observation is that those executive boards who perceive SSC's as part of the overall unbundling process in the economy, and thus see shared services from a future strategic perspective, are far more successful than executive boards who see SSC's as a tool for efficiency improvement only. The first type of executive board will meet resistance with perseverance, addressing it without letting themselves be led astray. The second type of executive board either pushes for shared services, creating counterproductive tensions in the organization, or tries to compromise with resisting business unit managers, thus creating a mess of an implementation.

A second observation is that the change process required to introduce SSC's (and also outsourcing) is not within the SSC, but within the divisions and business units. Their managers have to develop the skills and competencies to act as good principals of an SSC (or service firm); that is, knowing how and what to contract. In turn, this requires each manager to know ~~their~~ business processes explicitly and to know what each dollar spent on shared services or on outsourcing contributes to the bottom line. Also, these managers need to understand that their role changes from pure ownership control, through hierarchy, to coordination control. The latter implies that they not only know how to contract, but also have the skill to motivate colleagues who are not part of their hierarchy. This is easier said then done, as the skill depends also on the personality of the manager.

A third observation concerns the issue of trust. The executive board requires managers of divisions and business units to trust the (managers of the) SCC's to deliver according to what has been agreed in the service level agreement. A common strategy is that executive boards select a manager of a division with a solid reputation, who is a significant role model for other division managers, and appoint this person to be the first manager of the SSC. Although sympathetic in itself, it is still not a recipe for success. In a number of our research cases this tactic did not avoid obstruction from other division managers. Two things happen when an SSC's is introduced. A new identity is introduced into the family of members of the executive board and division managers: the SSC-manager. The response of the division managers to this new identity is the same as the response of the first child to the second new born child: competition for attention, in this case: questioning whether an SSC manager should be member of the management team. Moving business processes, resources and people from divisions into one or multiple SSC's is a breach of existing social structures, and impacts the existing identification-based trust. That is, trust based on individuals knowing each other, and understanding and confirming their roles. The loss of identification-based trust is, in most cases, answered by the wrong response. Those involved emphasize culture to solve the problem. However, trust is not created by norm, but through experience. When identification-based trust has been breached and individuals have to cooperate, a switch to calculus-based trust is needed. This is trust based on procedures and decision rights through which agreed service level agreements can be enforced. This calculus-based trust is created by redefining internal governance as well as management control process, which should include a conflict-resolution procedure. The adaptation of the management control process is part of step three in Figure 2 and needs to be defined, discussed and understood before the actual implementation of an SSC. In the adapted planning and control cycle, managers of

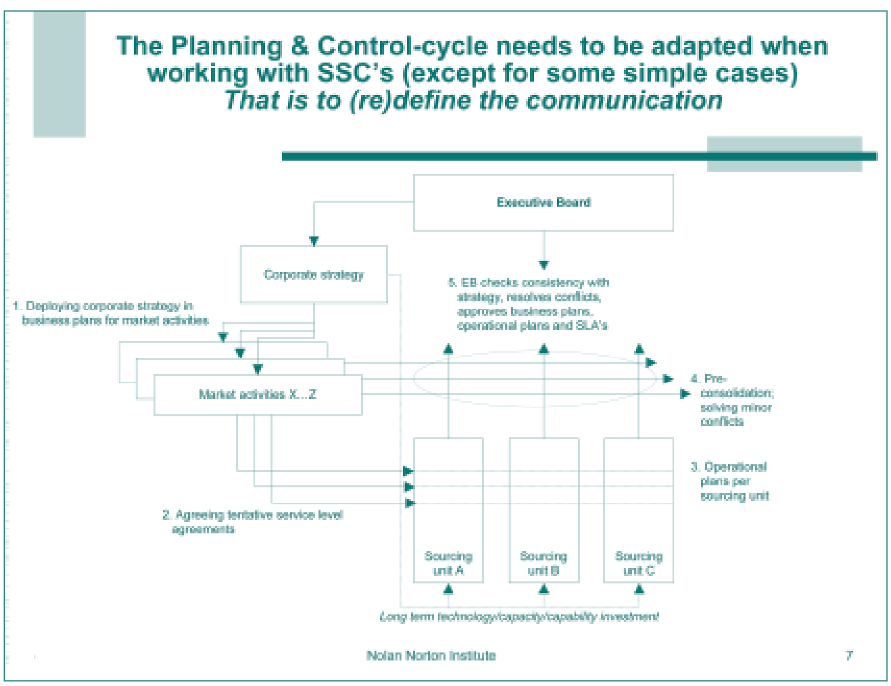



Figure 3

divisions and SSC's are informed which entities have priority over others, who makes decisions, what the structure of communication is and how conflicts should be solved. For example, a publisher who had set up a European counting house, but had not installed beforehand a conflict resolution procedure, was faced with no options but to close the facility after a conflict broke out between some countries and the counting house, which escalated to other countries by lack of conflict resolutions procedure. Defining this planning and control cycle with a specific priority sends a clear message to the organization that market and customer orientation (service, product development, intimacy) have priority over back office efficiency (Figure 3). In some cases, executive boards find it difficult to make such a decision (and providing the shared service center with the title "division" or "business unit") and, instead, stick to the old planning and control cycle. This creates confusion in the organization which translates into poor performance. A well-defined planning and control process serves to anticipate problems and conflicts before these arise and is thus an essential tool to avoid the executive board being overloaded with operational issues.

Elaborating the adapted planning and control cycle is also a good test of whether the new internal governance is properly understood. If it is, managers involved can trust that their interests will be served and that they can be loyal to the new organization. The implementation failure of the SSC for payroll processing between the twelve ministries of the Dutch government (which are independent under the Dutch constitution) is to be attributed to not having defined the needed governance system before implementation. A more general observation is that many SSC implementations go wrong because attention is being paid to the organization of the SSC itself, whereas the first thing to be clear about is the external organization of an SSC, that is: its relation with its customers and the board, i.e., the internal governance of the firm.

A fourth observation concerns the relationship between the SSC and its (internal) customers. Much has been gained by defining service level agreements and measuring their performance, both in terms of efficiency and quality. In many cases, both the SSC managers and the executive boards (at least those limiting themselves to the efficiency view) stress the performance of the SSC. Often, time and money is spent on benchmarking the SSC against other SSC's and independent service firms. European firms especially, with their more family type culture, don't find themselves at ease with this "met-expectation" model of quality. , Due to strict performance targets, those responsible for the performance of an SSC are often unwilling to experiment and be answerable to changes in needs from business units. They tend to see those who they serve as customers, and no longer as colleagues who share a joint responsibility for the firm. Heineken, the beer brewer, for instance has decided that (a) measurable and controllable service level agreements have to be agreed and performed, but (b) that these serve to professionalize the collegial relationship between those working in divisions and in SSC's as they have joint responsibility for the performance of the firm, including its adaptation to the market and innovation. More generally, there is a tendency of SSC managers to be too rigid about serving others. Particularly in hospitals, universities and palaces of justice the met-expectation model for defining SSC quality of services turns out too be too sterile and should be accompanied by the gratifying needs model at least. Anticipating the service needs of those served is the better sign of quality of an SSC.

SSC's, in most cases, have as a motive to reduce costs. Frequently, this means laying off staff and downgrading jobs through simplifying and standardizing tasks. However, although research on this is still not what it should be, especially where cost savings of 50 percent plus have been achieved, ~~it can~~ have more to do with a better exploiting of knowledge and experience. The knowledge and experience of individuals and teams working in SSC's can be exploited by their application to multiple divisions and business units. This is precisely what is needed in the informational society in which the exploitation of disembodied knowledge becomes more important than the exploitation of embodied knowledge in the manufacturing industry. This also explains why SSC's are so important beyond just efficiency To be successful, it has to be acknowledged that those working in an SSC have a different identification compared to the old situation of "division", in which staff identified themselves with the products, customers and markets they served

A number of SSC's have faced motivational problems with their staff. Motivation was frequently addressed as a problem of organizational culture, or resistance to change, and interventions were therefore applied by social behaviorist consultants, with little avail. The real problem is identification as a precondition for motivation. Those SSC's which have stressed the new professional identification of their staff, including discipline-specific professional management, professional training and membership of professional bodies, are more successful in motivation and thus in quality and innovation of services delivered. But as with any profession, these same professionals also

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have to be able to identify themselves with the value proposition to the customers of their clients. This is a challenge which needs to be addressed by SSC managers and the boards they report to in order to turn the concept of the SSC into a real building block of organizations for the informational society.

**Change Starts at the Top and It Starts with Changing Mental Models**

Finally, back to the executive boards. These are key to the success of SSC's. To achieve success, they have to acknowledge that working with SSC's implies a different business model, a new internal governance ~~structure~~ and subsequently a new role for the executive board. In the traditional M-form, the executive board had a simple relationship with divisional managers. The board ~~set~~ the business scope and targets, delegated resources, set corporate policies and monitored the performance of the divisions. Now the resource scope is also set by the executive board, SSC's (for reasons of shareholder value) are mandatory for the divisions, and the managers of the SSC's are accountable to the Board for performing service level agreements. The executive board has a delivery obligation to the divisions. The old bilateral relationship between the executive board and the managers of the divisions has changed into a triangular relationship (see Figure 4).

Yes, SSC's and the underlying new business models have a higher economic performance, but alas, this rose, too, has its thorns. Members of an executive board which fail to understand the consequences for their own roles, tasks and relationships, will not be honored by their shareholders or other stakeholders. Also, because with new organizational forms new career patterns emerge and new skills and competences are needed, executive boards need to spend time and energy in their management development programs to prepare a new generation of managers for the new organizational forms. The new generation of managers have to understand that the word "shared" in shared services centers, originates from the old thinking about the closed, vertically and functionally integrated divisions. We need to understand that "shared," in the framework of the unbundling economy, refers to sharing infrastructure type issues, like roads, energy distribution and payments processing, in order that we can concentrate on our businesses (but setting up and maintaining infrastructures require businesses in themselves).

It is quite understandable that SSC's were initiated and promoted by IT firms because that technology and its specific cost dynamics were obvious shared services candidates. Only by thinking beyond that will we be able to deploy SSC's and outsourcing as building blocks for new organizations.

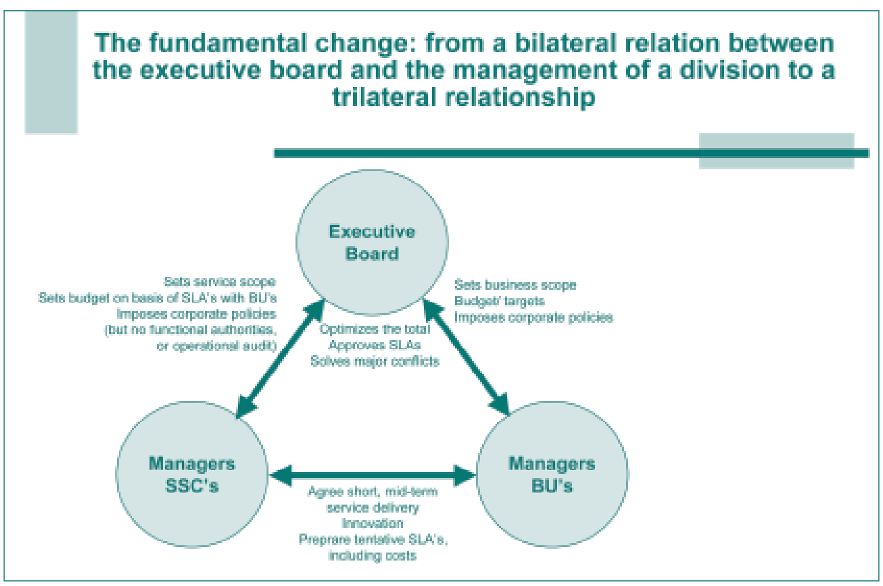


Figure 4

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