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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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

1. Shared service centers as an operational phenomenon
2. Shared service centers as an issue in the internal governance of the firm
3. Shared service centers as an issue in the corporate strategy
4. Shared service centers as an issue in the theory of organization (design)

The phenomenon of shared service centers

Not in this presentation
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
  - 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)

<table>
<thead>
<tr>
<th>References</th>
<th>Type</th>
<th>Scope</th>
<th>Defined savings</th>
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<tbody>
<tr>
<td>ING</td>
<td>Administration</td>
<td>Benelux</td>
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<tr>
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<tr>
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<tr>
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<td>Europe</td>
<td>36%</td>
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<td>Finance &amp; Payroll</td>
<td>France</td>
<td>40%</td>
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<td>Finance</td>
<td>Germany</td>
<td>62%</td>
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<tr>
<td>Finance</td>
<td>Europe</td>
<td>45%</td>
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<tr>
<td>Finance &amp; HR</td>
<td>UK</td>
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<td>Europe</td>
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<tr>
<td>Finance</td>
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Source: Atos Origin, Atos-Odyssee, Atos KPMG Consulting and NNC
Virtual all large firms operate one or multiple SSC’s

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<thead>
<tr>
<th>ABN Amro</th>
<th>Galileo International</th>
<th>P&amp;O North Sea Ferries</th>
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<td>IDV</td>
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<td>Boots Healthcare International</td>
<td>Invensys</td>
<td>Sabic</td>
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<td>Johnson Controls</td>
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<td>KLM Cargo</td>
<td>Shell</td>
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<td>Clogic</td>
<td>Kimberly Clark</td>
<td>Solectron</td>
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<td>Deutsche Post/DHL</td>
<td>Mercedes Benz</td>
<td>Symbol</td>
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<td>Dietsmann</td>
<td>Minet</td>
<td>Syntex Roche</td>
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<td>Motorola</td>
<td>TWA</td>
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<td>Nestle</td>
<td>TW4 (Time-Warner)</td>
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<td>Nike</td>
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10-02-06 Nolan Norton Institute
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 **transparency** 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 what 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

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
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

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

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

7. Performance control

Lack of attention for Corporate change processes & tactics

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

- 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.

- 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

Contracts (and financing)
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*

1. Deployment corporate strategy in business plans for market activities
2. Agreeing tentative service level agreements
3. Operational plans per sourcing unit
4. Pre-consolidation; solving minor conflicts
5. EB checks consistency with strategy, resolves conflicts, approves business plans, operational plans and SLA’s

-----

**Executive Board**

**Corporate strategy**

**Market activities X…Z**

**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

- Chairman/CEO
- Member A
- Member B
- COO
- CFO

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

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

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

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

Synergies between ssc’s are exploited
Working with SSC’s implies a change in style of management for the Board ...

<table>
<thead>
<tr>
<th>Type of control</th>
<th>Type of business system</th>
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<tbody>
<tr>
<td>Operational</td>
<td>Operator</td>
</tr>
<tr>
<td>Strategic Plans</td>
<td></td>
</tr>
<tr>
<td>Strategic Guidelines</td>
<td>Shared business system</td>
</tr>
<tr>
<td>Financial</td>
<td>Single business system</td>
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</tbody>
</table>

Model original McKinsey

Holding Company
Strategic Architect
Strategic Controller
Operator

Stand-alone
Shared/similar skills
Shared business system
Single business system
SSC are part of a larger process of unbundling vertical integrated businesses, creating a new type of business unit.
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

The changing structure of the European postal industry

Postal Industry: at crossroads

Postal Industry: part of company’s broader portfolio

Vertical integration

Unbundled

U-curves

L-curves

National Economies of Scale

European Economies of Scale


Source: NNC Analysis

Or outsourced to third parties

Source: NNC Analysis
What are the building blocs of the modern financial services firm?

National organization

- Treasury
- Asset management
- Back office (Separately for banking and insurance)

Mid-office
- Product development
- Marketing support

Distribution infrastructure
- Office
- E-banking
- Account management
- Call Centers
- Etc.

Head quarters (incl. corporate staff)

Facilities services
- Computer services

Profit Centers (Modern BUs)

Market segment (brand)
- Account

Market segment (brand)
- Account

Market segment (brand)
- Account

Market segment (brand)
- Account
Case: high-tech firm

Knowledge exploitation
Economies of scale
Co-engineering
Low-cost / transactions

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

Staff
Services

PD-CEO

BU CS
BU DS
BU MMP
BU TT
BU EB

Systems Development laboratories
Shared manufacturing resources
ATO
International Marketing & Sales

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

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
Modular organisations are a two sided sword: transparency 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.

* * *

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

<table>
<thead>
<tr>
<th>Traditional building blocs</th>
<th>Modern building blocs</th>
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<tbody>
<tr>
<td>Value creating units</td>
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<tr>
<td>Activities to increase the maximum willingness to pay</td>
<td>X₁</td>
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<tr>
<td>Activities to optimise the mix-match flexibility</td>
<td>X₂</td>
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<tr>
<td>Co-creation with customers</td>
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<td>Infrastructures / economies-of-scale activities</td>
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<td>Value appropriation units</td>
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<td>Value defending units</td>
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<td>Staff units</td>
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<td>Top-management unit</td>
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<td>Household and hygienic units</td>
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<th>Result generating units</th>
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<td>Revenues units</td>
<td>X₁, X₂, X₃</td>
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<td>Units with measurable contribution</td>
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<td>X₆</td>
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<th>Top-management unit</th>
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<td>X₇</td>
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<td>X₈</td>
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<td>X₉</td>
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<th>Household and hygienic units</th>
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<td>X₱</td>
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X₁ = e.g. call centre; X₂ = co-engineering; X₃ = sales activities that in themselves do not add value but are own operated to avoid distributors appropriating the value; X₄ = R&D, design; X₅ = e.g. patents; X₆ = ICT-operations; X₇ = those staff activities that are organised operationally, in a shared service centre, e.g. eHRM; X₈ = e.g. public relations, X₉ = those staff departments that serve the executive board; X₁₀ = e.g. facilities management; X₁₁ = e.g. security.

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

<table>
<thead>
<tr>
<th>Tricker, Bleicher</th>
<th>Goold, Pettifer &amp; Young</th>
<th>Consequences of unbundling, emergence of platforms, etc</th>
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<tbody>
<tr>
<td>The formative role (mission, identity, values)</td>
<td>Governance &amp; compliance role</td>
<td>The formative role</td>
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</tbody>
</table>
| The performance role (a.o. strategy, portfolio of businesses) | Value adding parenting role  
Shared services role | The performance role |
| The conformance role (reporting, compliance, etc.) | Governance & compliance role | The conformance role |

- Mission, identity, values
- Architecture, external control, grand strategy in network industry
- Strategy – business portfolio
- Strategy – enabling platforms portfolio
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)