Managing Shared Services

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Principles of governance

Whether they are in the public or private sectors, shared services demand good governance. Ian Herbert and Ye Lu explain how the right governance framework can blend aspects from contractual and relational outlooks to deliver lean, responsive services.

Business is about people, and organisations are collectives of people. People behave best when frameworks and protocols are put in place so that they can reach agreement with other people and get things done. So for a shared service centre (SSC) to be both efficient and effective means creating a governance structure to ensure that: 1) everyone agrees what should happen; 2) those decisions are carried out as planned; and 3) the service stays fit for purpose as business needs change and further improvements are demanded.

This is no simple matter, because success is ultimately determined by the end customer. The result is a tough set of challenges in terms of managing an SSC and guiding it to success.

No matter how thorough the ‘re-engineering’ of work processes might be within an SSC, most business support services are integral to the business in some way, and that makes it difficult to ‘routinise’ and measure them. At the same time, some customers may have individual needs and so a balance will need to be struck between standardisation and customisation.

Service volumes and customer needs may change at any time and the SSC will be expected to cope with fluctuating activity levels. More, the way in which tasks are performed will have to adapt to the changing needs of divisional and end customers over time – and, on top of that, the SSC also has to reduce and control costs.

For most SSCs, the starting point for a governance framework is finding the ideal point between the service’s contractual aspects (its legal foundation) and its relational (human) elements.

Contractual models

The contractual approach is rooted in an assumption that business decisions about whether to buy a product or service are essentially rational. In other words, they are based on: quantifiable attributes; a predictable environment; homogeneous products; and a presumed open market.

Transaction Cost Economics (TCE) holds
that free market conditions are likely to produce the optimum cost. However, as customer needs become more variable, complex and/or dynamic, the counter-argument is that if the cost of negotiating, monitoring and supervising the external contract is greater than that of managing activities in house, then the product should be made rather than bought in.

**Relational models**
The relational approach recognises that rigid contracts may not be appropriate when the product/service and its production/delivery are variable, and/or when the business context is fluid. In other words, a more flexible and co-operative approach may be required, in which the two parties work through issues as they arise.

Different combinations of these distinct approaches will lead to one of four broad outcomes:

- One-off bargains are struck on an *ad hoc* basis, with each seeking to optimise price and retain flexibility of supply. In this scenario, functionality is no better than the market.
standard. Quality and reliability (delivery) may be variable and there is little ongoing loyalty to any supplier.

• Contracts are placed with a few preferred suppliers on a medium-term basis, specifying basic quality and functionality thresholds.

• An emphasis is placed on functionality, quality and reliability through the personal involvement of leaders from both sides. In this version, compromises may need to be made on pricing and delivery.

• A mutually beneficial relationship is struck to improve all aspects of delivery, given the two different sets of emphases. (In the public sector, this is where possible conflicts can arise between shareholder and taxpayer value – see Professional Outsourcing, passim.)

Subjective elements

While a key theme of the SSC model is to commoditise back office activities, the inputs and outputs of many business-support tasks are likely to remain subjective – perhaps even intangible. This creates a number of challenges. Among these are:

• Many services (while low-level) are integral to the ways in which core parts of the organisation work. Indeed, they may even define the customer experience, especially if the prime product is a commodity, such as electricity or gas.

• Services are typically provided by professional functions such as finance, HR, procurement and IT, which have often been insulated from direct commercial pressures.

• External supply chains tend to be dyadic (one to one) in nature, whereas for the middle manager in an SSC environment the situation is more akin to being the hub of a 360-degree network.

• Both inputs and outputs will probably involve explicit and tacit knowledge.

So how to meet these challenges? One way of framing the problems of the SSC environment is as a supply-chain management issue. Inter-Organisational Cost Management (IOCM) is a discipline inspired by Japanese carmakers such as Toyota, which pursued target costing and continuous improvement in their long-term partnerships with suppliers. IOCM seeks to understand the roles of trust, communication and information-sharing (learning) between organisations so as to achieve mutual benefit.

While techniques such as Just in Time (JIT) and target costing might now be commonplace in some industries, they still require a significant degree of interpersonal involvement and cooperation between participating firms, so that quality can be improved, costs reduced and inventory lowered. Those are the same broad aims as an SSC, and so if managers were to consider a shared service as a semi-autonomous unit within an intra-organisational supply chain, then they would find much to learn from supply chain management thinking.

Outside the box

In any event, the externalisation of business support services requires new ways of thinking, and these may involve a new organisational structure and new internal relationships. After all, for most processes, it is not just the task that is being changed, but also the behaviours and outlooks of the people who are doing it (as well as of their customers).

Moving to a market-based, contractual arrangement with a BPO provider is relatively straightforward in terms of governance. However, with the SSC model activities remain under the overall control of client management and so a hybrid style is required.

On an axis between contractual and relational governance, the appropriate style is
one that is sensitive to business context – to whether it is stable or dynamic, for example. It also needs to be sensitive to whether the task is predictable/routine or not, or to whether it involves explicit or tacit knowledge, or can be measured objectively rather than subjectively. Nevertheless, the challenge remains that, within support functions, different tasks have different contexts and routines.

Clearly, any SSC’s governance framework needs to accommodate a variety of outlooks and tensions. So it may be that, rather than a single, hybrid style of governance, there will be different modes for different activities on a ‘horses for courses’ basis – for example, the finance purchase ledger might be governed in a different way to staff recruitment. Mixed sourcing might also be appropriate; activities that suit a more contractual style could be outsourced, while those suiting a more relational style might be better kept in house.

Overall, the governance framework needs to be aligned with the management style of the parent organisation, while acknowledging that the SSC works at arm’s length to the corporate hierarchy. This means that traditional business functions will be expected to adopt a more empowered, entrepreneurial outlook to problem-solving and identify further opportunities for improvement.

Between contractual and relational governance styles there is a range of possible strategies, therefore, depending on the organisational and business contexts. By choosing the right point at the right time, the SSC should be able to ensure that things get done in a way that reacts to changing circumstances and to individual customers.
• Governance models

Transaction orientation: Market vs management
In groundbreaking work on the nature of markets and hierarchies, the economist Oliver Williamson argued that human factors, such as bounded rationality, opportunism, greed, and uncertainty, can cause markets to deliver less than ideal performance. In such cases, activities are best done in house.

Positioning the SSC as a semi-autonomous division within the parent organisation creates a need to balance the drive towards standardisation with sensitivity and service flexibility. A hybrid approach seeks to blend the best of both worlds over the long term.

People orientation: One-to-one vs networked relationships
A one-to-one relationship between the parent organisation and the SSC is key to maximising the organisation’s profit through standardisation and improvements in efficiency. This requires alignment with corporate policies and behaviours.

However, the SSC is also the hub of a network of relationships between: i) divisions that provide the raw data for accounting; ii) end customers who drive outputs; and iii) third parties. Within this network the SSC might also manage a supply chain that supplements its own resources with those of a third-party (BPO) organisation. In this way, the SSC needs to be viewed as embracing both one-to-one accountability and a network of responsibilities.

Process orientation: Push vs pull
Traditionally, Western organisations have adopted a ‘push’ policy, in which relatively standard goods are produced with long batch runs to maximise efficiency. In this way, any surplus is held in inventory until it can be sold, invariably through ramping up the marketing effort.

By contrast, in the Eastern, Toyota-style method, it is customer demand that ‘pulls’ the product through the system. In this case, effectiveness, rather than efficiency, is prioritised through Just-In-Time (JIT) production, which allows firms to react to changing customer requirements.

This is not to say that production process quality is neglected in the latter case, or that waste is tolerated. Rather, process efficiency is achieved through complementary working practices, based on empowerment and continuous improvement.

Again, with its variety of activities, an SSC has to operate as a hybrid, combining characteristics of both these two approaches. That is ‘pushing’ divisions towards standardisation to drive down costs while, at the same time, reacting to the ‘pull’ for rapid response, flexibility and adaptability from divisions and end-customers.

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Antony Roberts-York, CEO, UBS Poland Service Centre