The shared service vision: rethinking fundamentals

Saving costs is one thing but are you sure your shared services aren't affecting your ability to compete? By Ian Herbert, lecturer at Loughborough University Business School.

The scene is set in the corporate headquarters of a multinational engineering company. Dave Jones, vice president finance, and his shared service organisation (SSO) project team are preparing a presentation to the 'C suite' next week. They are creating a plan to set up an SSO for a range of back office processes across the 42 countries the group operates in.

The plan is to share HR, finance and purchasing functions. The migration of accounting systems is already underway on the back of an ERP implementation. The objectives are to reduce costs through labour arbitrage and standardise group systems and procedures. Frank Richardson and Beryl Ribbons are management accountants from two of the divisions. Tricia Desaux is a financial accountant in the corporate head office.

Dave: The executive wants to see cost savings but it's difficult to make a totally convincing case. It's a no brainer that standardisation and rationalisation will eliminate many shadow systems and reduce headcount; and that labour arbitrage reduces wage costs. But, and it's a big 'but' - how much money will we really save? That depends on the costs the divisions can actually avoid and the costs of setting up the SSO. Moreover, we need to streamline, not simply displace back office tasks onto front line managers and workers.

Frank: Plus, it assumes that the transition goes to plan and that business efficiency isn't compromised.

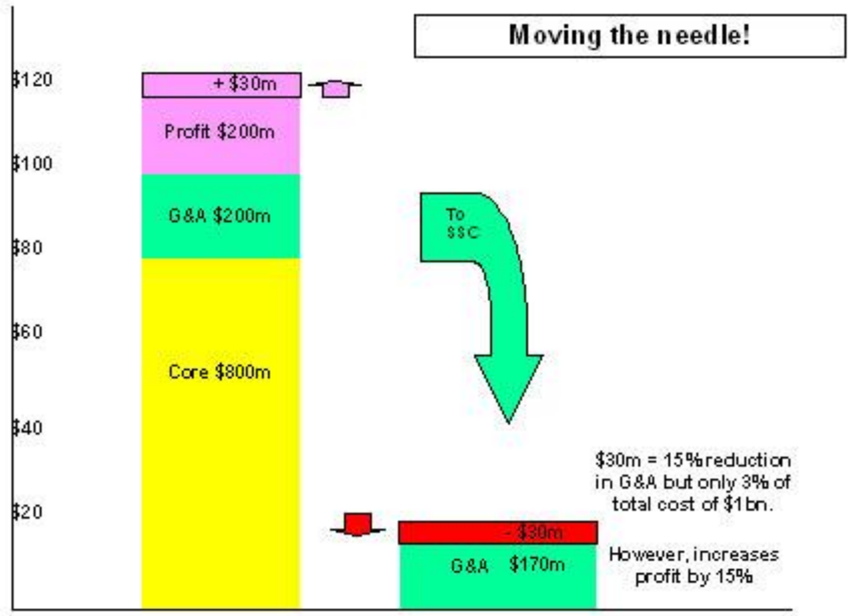
Beryl: And effectiveness - I mean the extent to which operations can satisfy their customers' needs profitably. For example, aggregating all the drill lubricant that we buy achieves economies of scale and placing, say, one order rather than 50 each week saves admin time, but anyone can do that. Let's not forget why our customers use us and pay a premium to do so. It's because when things go wrong we can usually recover faster than others and get the project back on track. That's when our local back office teams really earn their keep. We cannot afford to lose that flexibility with the SSO.

Tricia: Good point. There's a lot of theory about dynamic capabilities in the management literature. It might help if we stepped back and thought about what we're trying to do with the SSO. Perhaps one size fits all doesn't work? I'll sketch up some ideas.

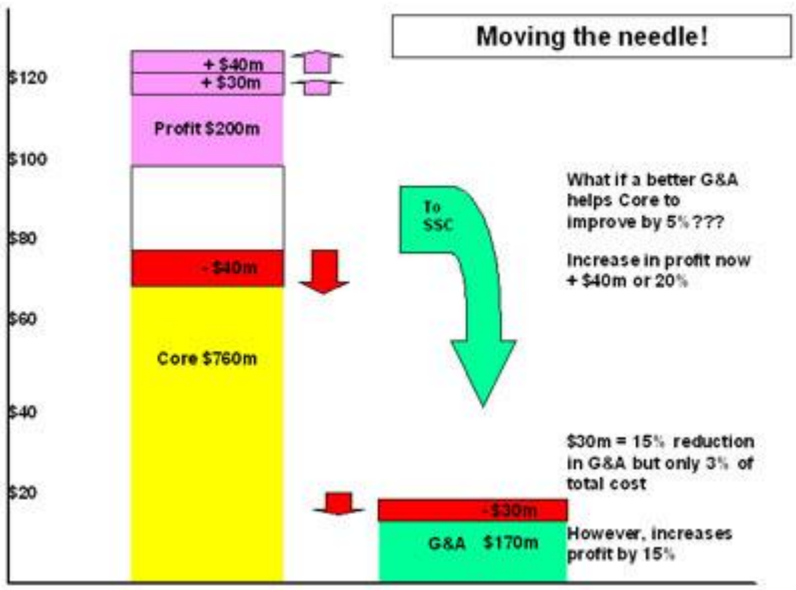
The next day Tricia explains further.

General and admin (G&A) is about 20% of our total cost base of $1billion. The SSC plan suggests that the SSO's baseline cost of $200m can reduce by $30m to $170m a year by Year 3. $10m will be through standardisation and cutting out duplicate processes and $20m through cost arbitrage. Year 1 is a net cost of $10m due to redundancy and set up costs. Year 2 breaks even and Year 3 assumes that all avoidable costs in divisions, such as excess office accommodation, have been avoided.

The SSO will eventually save 15% of the G&A cost and thus increase profit by $30m on $200m, also +15%. Impressive, but will the stock analysts really notice that over three years? Does it 'move the needle' in terms of overall corporate performance? Eliminating waste in the back office sounds like a good message but we know that there are risks and if we discount those cash flows, break even isn't until Year 4. Look at these slides.



But, by offering better services, what if shared services were able to help divisional operations to be, say, 5% more efficient or effective? On operating costs of $800m, that is, $40m - a leverage of four to one and not counting the potential $30m of SSO savings. Doing both would increase profit by 70%.



Frank: And we make operations 5% better by improving operations' ability to react better and faster, that is improve their dynamic capability.

Tricia: As an example, last month we had that problem in India. We had to get another 20 people in place for the last three months to be able to work 24/7 and avoid penalties. But it took four weeks instead of two to get the new team in place. The local finance team took too long in getting the expenditure case prepared and signed off. HR forgot that five of the team required visas and we had them sitting in a hotel in London for four days. The onshore, summer weight work overalls were ordered as offshore arctic and couldn't be used. It's stuff like this that happens all the time but because it happens all the time we accept it.

So to return to the point. Being able to react faster and better is a dynamic capability.

Dave: OK, fair point. But how do we make a case for being better? Given your example, isn't a remote SSO likely to get more of those operational issues wrong than the local teams?

Tricia: OK, here's one I prepared earlier.

Teece, Pisana and Shuen (1997) argue that the concept of 'dynamic capabilities' can help a firm to think about what it does and how it does it with a view to creating a strategic advantage; hence generating above average economic returns.

Essentially there are four paradigms:

1) The competitive forces approach. Developed by Porter 1980, this seeks to position a firm to exploit opportunities or defend against threats in its market landscape. By the nature of the market, positions that produce above average returns eventually diminish.

2) The strategic conflict approach. This emphasises game theory to keep rivals off balance and thus maintain privileged market positions through strategic investments, pricing strategies, market signalling and control of information.

3) Fundamental firm level advantages. This approach argues that enduring positions are built through accumulation of better resources than rivals, and/or the more efficient and effective application of those resources. For example, Henry Ford made similar cars to everyone else but it was the way that he made them, through mass production that gave him a world beating advantage, while it lasted. Toyota then turned that system on its head with the lean approach, see Womack, Jones & Roos, (1990).

4) Dynamic capabilities. This emphasises the continual fine tuning that is required to maintain a firm's optimal fit with a changing environment. Key to this adaptive process are management capabilities and difficult to imitate combinations of organisational, functional and technological skills.

Perhaps there's an opportunity to think about our approach to shared services more fundamentally. Maybe we can strip out some cost. What we must not do is compromise operations or miss a chance to enhance the enterprise architecture which comprises all the knowledge, processes, systems and people in the front and back offices.

I'm not proposing that the strategy changes, just that maybe we need to think about what we do presently in a different way.

Beryl: How can we take this forward?

Dave: What about taking a critical incident such as that issue in India and doing a complete post mortem on it? How much did it cost us? Did we get a repeat contract? How many such incidents do we have each year? How much do we pay in spare resources to stop it happening? Then we can speculate on whether shared services would have made it better, worse or just different.

Frank: Also, we outsourced the majority of IT ten years ago and that gives us an excellent case study to work on. All those questions we've had about the SSO and customer needs have been issues for IT.

Beryl: But we don't have too much trouble with IT. It just works. Of course it could be better.

Tricia: We don't know because we don't tend to think about it in terms of a dynamic capability. Let's not forget the current ERP implementation was partly about forcing change in our legacy systems.

Dave: OK, I'll hold the presentation for a couple of weeks. Let's meet tomorrow with some clear action plans for analysis. We'll need this capability theory to provide a framework for asking questions.

Frank: I'm not sure if we're biting off too much, maybe we should leave HR and purchasing and focus on finance for now.

Dave: Agreed. Let's go.

To be continued in a future edition of Insight...

This article is taken from Ian Herbert's CIMA funded research project into shared services. Contact i.p.herbert@lboro.ac.uk.

Links
Becoming a key player in shared services from May 2009 Insight by Ian Herbert and Will Seal has been nominated for an IFAC Article of Merit award. You can vote for it here.
Management accountants helping shared services boost value
Discuss shared services on CIMAsphere

November 2009

What did you think of this article? Email tim.cooper@cimaglobal.com