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Shared services

Management fad or real value?

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Shared Services: Management Fad or Real Value?

by DeAnne Aguirre, Vinay Couto, and Gary Neilson

THE LATE 1980S were the heyday of corporate decentralization. Anxious to dismantle top-heavy headquarters operations, many companies rushed to farm out support functions. Vital services, such as sales and marketing, human resources, information technology, finance, purchasing, and logistics, were to be paid for by profit centers. In the name of increased accountability, the autonomous division replaced the all-powerful corporate headquarters.

But decentralization had its own downside. Managers created fiefdoms. The corporation lost economies of scale, resulting in redundant resources, operating facilities, information systems, and supplier contracts.

In the mid-1990s, companies set out to redress the excesses of decentralization. Returning to command-and-control centralization was neither attractive nor feasible. The challenge was to combine corporate scale with the superior service, customization, and focus associated with decentralization, at a price and quality standard competitive with the best that the marketplace had to offer. A new approach known as shared services was born.

What Is Shared Services?

Shared services is a model for delivering corporate support, combining and consolidating services from headquarters and business units into a distinct entity based on market-like principles. (See Exhibit 1.)

The shared-services entity must be able to compete vigorously with outside vendors. Business units are under marketplace discipline in all other respects — they must be free to seek support services that meet the same test. Proprietary standards and corporate culture are out. Best practices are in, if the business units are to gain competitive advantage.

Exhibit 1: **Shared-Services Principles**

Price Transparency	Each service should have its price. The business units can determine how much service it wants at that price.
Business Management	Manage the service like a business unit, not a fixed cost. Serve internal and potentially external customers.
Market Responsiveness	Provide the service levels the business units want, not the levels staff think they need.
Best Practices Proliferation	Identify and deploy best practices quickly and globally.
Process Standardization	Develop streamlined process standards that can be maintained and improved quickly.
Service Culture	Treat business units (BUs) like customers, offering services the BUs value and charging for each.

Source: Strategy&

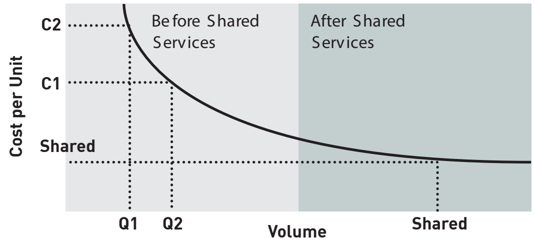
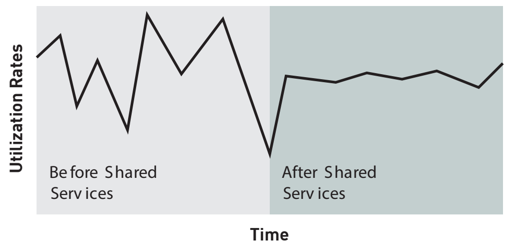
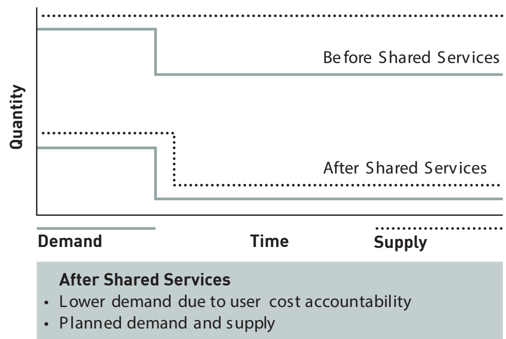
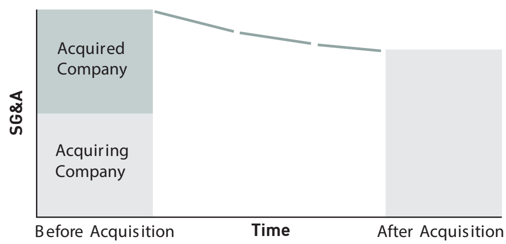
Internal customers can specify their service needs. Providers must meet those requirements, and they can expect to have their performance evaluated using measurable criteria. So structured, the shared-services unit becomes another business unit, perceived and managed as an outside vendor, with no choice but to be competitive on price and service level.

Why the Shared-Services Model Is So Appealing

When executed properly, the shared-services approach combines the advantages of centralization and decentralization. (See Exhibit 2.)

As service organizations are consolidated, work is standardized and redundancies are minimized without the reinflation of corporate head count. Service levels are tailored to the actual needs of business units, and services that don't add value are eliminated, while supply and demand for support-service activities are balanced. Because shared-services providers are answering to business unit customers, their operating budgets are often determined on the basis of

Exhibit 2: **Example Benefits of Shared Services**

Improvement Levers	Example Benefits
Capture Economics of Scale • Share scale-sensitive services across organizational boundaries • Eliminate redundancies	
Leverage Expertise across Business • Capture economies of scope • Transfer best practices to provide higher-quality services	
Establish Customer/ Market-Based Relationships • Focus staff on service to line • Tailor level of service to meet client needs • Create strong incentives for improvement through direct or indirect competition with external market providers	
Enhance Adaptive Capabilities • Allow flexible adaptation to changing customer needs • Leverage mergers and acquisitions	

Source: Strategy&

customer demand — a major change from traditional staff organizations. Not surprisingly, corporations that have implemented shared services have reaped huge cost savings. (See Exhibit 3.)

But the benefits go well beyond cost savings. A shared-services approach frees business units to focus on inventing, making, and selling products or services. As one business unit executive puts it, "We don't have to worry about tasks like payroll or bill payments. We can now focus on new products, customers, acquisitions, and other market issues, not on administrative issues."

By bringing together scarce, highly specialized, expertise-based services such as law, risk management, and communications in centers of expertise, shared services also helps build critical capabilities. It gives corporations new incentives for undertaking large infrastructure projects, and an agency for managing them.

The Best of Both Worlds

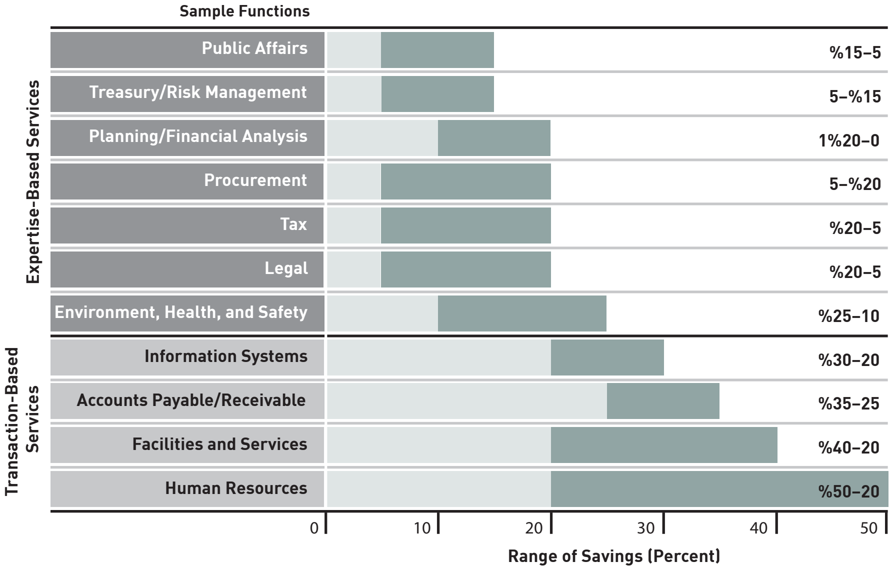
As does any significant concept, shared services has its detractors. Some call it "centralization with a smile." Some business unit managers, threatened with loss of control, worry publicly about accountability of service providers, and argue that cost reductions are achieved at the expense of quality.

We feel, however, that a shared-services model is not a rebirth of centralization but a blend of centralization and decentralization. (See Exhibit 4.)

In a centralized organization, headquarters controls the staff resources and dictates standard policies, programs, and procedures to the business units. In a shared-services environment, business units are customers, as they would be with external providers, and both parties must agree on cost, quality, and service levels.

Furthermore, the services unit can draw from both internal and external resources, including joint ventures and outsourcing. Unlike users of centralized services, shared-services customers have the

Exhibit 3: **Shared-Services Savings by Function**



Source: Strategy&

power to shop and buy elsewhere, although they must do so within certain parameters. Most companies declare a moratorium on outsourcing for a year or two to allow their internal service units to come up to speed. At the end of that time, business units that believe their needs could be better served by outsourcing generally undergo a high-level review by a management board. The decision to permit outsourcing is complex because it can dilute economies of scale. However, many companies have selectively outsourced services to benefit overall corporate economics beyond the specialized needs of the business units.

Where to Locate Services: A Case Example

Where should the shared-services organization be situated? It depends on the type of service being provided.

Most companies bring transactional services together in a central location or in a few geographical centers, using information technology to leverage costs. Proximity eases documentation, cost control, and maintenance of consistent standards. Consolidation encourages business unit managers to view service professionals as "shared" resources rather than "owned." It also reinforces service staff identification with the company as a whole. However, providers of expertise-based services often benefit from being located close to the business units. This dual location approach helps the exchange of information and joint problem solving.

For example, to reduce operating costs and streamline its information technology function, Mobil built a shared-services organization to manage its IT worldwide. To complete the task, Mobil first identified which services to provide, then reengineered the appropriate IT processes, and finally designed the organizational support structure to meet its business strategy. The global organization has

Exhibit 4: **Shared Services versus Centralized Support**

Typical Shared Services	Dimension	Centralization
Shared-services board sets policy and direction	Governance	Senior functional managers set policy and direction
Accountability to business units	Accountability	Accountability to corporate core
Business units set priorities on quantity and quality of services required	Customer Focus	Corporate functions decide on service offerings and delivery
Services are tailored to address business unit requirements	Service Orientation	Services are standardized
Flexibility to source from external providers is often permitted	Flexibility	Use of internal services is mandated
Performance is monitored against internal targets and external best practices	Performance Monitoring	Performance is monitored against internal targets
Business units are charged based on actual usage of service	Chargebacks	Business units are charged based on allocations
Located wherever it makes sense from a customer interaction standpoint	Location	Often physically located at corporate headquarters

Source: Strategy&

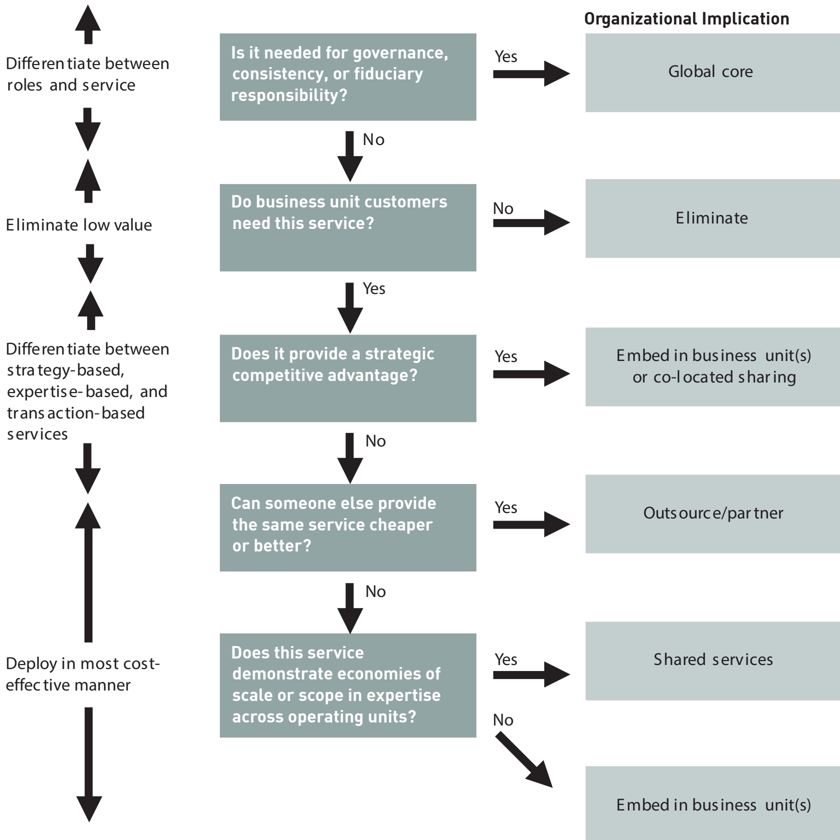
overall responsibility for supplying IT services, including technical infrastructure, applications development and maintenance, and global architecture and standards. Individual business units are supported at the global, regional, or local level, depending on the nature of service and the level of interaction needed with the services organization.

For instance, mature transaction-based services — such as data centers and networks that have standard service definitions and levels, are highly automated, are scale sensitive, and can easily be provisioned remotely — are centralized and managed globally. Services that require regional expertise, such as applications that have unique regional requirements and may have area-specific labor issues, are managed and deployed at the regional level. Services that require personal interaction, such as end-user support, are deployed locally. Finally, IT strategy and planning activities that require intimate knowledge of the business strategy are dedicated to the business units. As service level requirements change and new services emerge, Mobil shifts the deployment of the staff based on the most effective cost- and service-level relationship that can be achieved.

The Pitfalls of Not Differentiating between Types of Services

Many companies mistakenly create shared-services entities without distinguishing between types of services. For example, one company pulled all financial, human resources, IT, customer service, and purchasing functions from its business units, consolidated them, standardized their activities, and initially reduced costs by 30 percent. But dissatisfaction quickly set in as the resulting services proved to be excessively standardized. Training programs were too generic, financial reports failed to capture the drivers of business unit economics, labor relations experts missed the nuances of individual situations, and customer service representatives couldn't master the issues for multiple product ranges. Even worse, activities were con-

Exhibit 5: **Decision Tree for Delivery of Staff Services**



Source: Strategy&

solidated at locations far from the businesses, which slowed both service provision and problem resolution.

Business units began to re-create "shadow" units to provide themselves with the tailored services that they required. Costs crept up to levels higher than before, and the shared-services unit had to be dismantled.

Service segmentation is a critical component of implementing shared services. Each staff function, wherever it exists, needs to be pulled apart into the discrete services it provides. Once identified, these services must pass a rigorous burden-of-proof test. We find that an objective, systematic "decision tree" approach typically helps to determine the right location for each service. (See Exhibit 5.)

Six Principles for Implementation

Our experience with hundreds of organizations has helped us delineate six principles for the establishment of a shared-services structure in any company.

Principle 1: Determine which services to share. Not all services are alike. They differ according to which customers are served, which interactions are required, and which competencies are needed.

In general, organizational capabilities can be segmented into three categories: transaction based, expertise based, and strategy based. (See Exhibit 6.) Transaction-based capabilities require limited contact with providers. The shared-services organization's primary objective for these activities is to achieve the lowest cost while maintaining high quality standards.

Expertise-based services are technically specialized, requiring considerable contact with internal customers for projects such as hiring a diverse workforce, resolving legal issues, or completing new manufacturing facilities on time and on budget. These services require a combination of broad expertise and customization, which can be delivered through a "center of expertise" concept. Professionals must learn best practices in their technical area and apply their knowledge to specific business problems.

Strategy-based capabilities are critical to either the competitiveness of a business unit or the policy-setting and governance roles of the corporation. These services are best left with either the corporate core or the business unit senior management.

Principle 2: Develop a service-level agreement. The objective of shared services is to create a market-based partnership between line and staff services. This represents a fundamental change in established roles.

Business units and service providers should negotiate a kind of prenuptial agreement, called a service-level agreement, specifying the services to be delivered, specific requirements and parameters, unit and total costs, method of charging costs, and time frame for service delivery. Service-level agreements help because they get customers and providers to jointly develop and understand expectations, requirements, and the provider's capabilities. They also help service providers focus on what is important to the customer.

Additionally, these agreements should spell out the customer's business objectives, how the services are expected to support these objectives, and how achievement will be measured. They do not need to be overly formal or legalistic — in fact, rigid specifications can be an obstacle to success.

Under the line and staff partnership arrangement, the goal for transaction-based services must be: "No one does it as well, for less." Shared-services units must consistently match or beat benchmarks for routine administrative services.

In the expertise-based arena, the paradigm must be: "I can help

Exhibit 6: **Types of Services**

	Transaction Based	Expertise Based	Strategy Based
Description	• Routine, repetitive activities, often transactional in nature • Scale intensive	• Activities requiring specialized or technical knowledge • Some degree of customization required by businesses	• Activities requiring business-specific knowledge or enterprise-wide perspective • Strong upside for effective decisions • Policy oriented
Examples	• Payroll • Accounts receivable • Benefits administration • Data-center processing	• Law • Tax • Compensation design • Benefits policy development	• Strategic planning • Market research • Sales • Succession planning
Operating Philosophy	• Managed like a "utility" for cost and scale • Flat organization with broad control spans • Processes designed to be executed wth minimum expertise • Rewards for efficiency and productivity	• Managed to maximize value provided to the business • Team-based organization • Staffed with creative, innovative thinkers • Rewarded for time-to-market, business impact, and value creation	• Managed to maximize value provided to the business • Small teams or individual contributors • Staffed with creative, innovative thinkers • Rewarded for value creation

Source: Strategy&

you find the best way." This means having a clear understanding of the customer's needs coupled with an ability to leverage the internal knowledge network. One of the most difficult challenges in developing the service agreement is establishing the pricing structure. The Texas Utilities Corporation (TXU), which implemented an IT shared service, began this process by defining fundamental charge-out principles. For example, the team agreed to charge by type of service and reflect full costs. Predictable or fixed costs were allocated annually on the basis of simple drivers, and discretionary costs were billed on usage. Once the charge-out mechanisms were developed for each IT service, a major effort was launched to educate the businesses about the new cost structure. This was an important step in demonstrating commitment to serving the businesses. Instead of viewing the charge-out mechanism as merely an accounting tool, the IT staff viewed it as a communication tool that the businesses could use to make sound decisions. Once the business unit managers understood which IT investments were discretionary and which were necessary, which resources were shared and which dedicated, and which costs were fixed and which variable, decision making became much easier. Now the business units are able to make informed decisions about their IT spending and how to regulate it.

Principle 3: Choose leaders and staff carefully. The executives who generally prove most effective at implementing a market-oriented shared-services organization are senior, entrepreneurial line managers. Ideally, services that are characterized as expertise-based are staffed with some of the organization's best and brightest. These are the people who will be interacting with business units and internal customers. They have a bottom-line orientation, a customer focus, and consummate selling skills. They manage their service units like businesses to meet customers' objectives and budgets. Because of their success at running a business, they command respect among business unit managers. They are decisive and act on feedback.

Their compensation is tied both to hitting budgets and to maintaining high levels of internal customer satisfaction.

Leaders of transaction-based services have a proven track record of managing large numbers of staff. They have demonstrated an ability to motivate personnel, and their focus is on cost reduction and quality improvement. Their compensation is tied to reaching cost reduction targets and maintaining high levels of customer satisfaction.

Both leaders and staff in a shared-services organization will be required to learn new behaviors. They must be focused on customers and attentive to market standards of costs, service levels, and best practices. (See Exhibit 7.) They must be accountable for meeting their service agreements with the business units. As one shared-services president puts it, “We motivate our shared-services employees to be aggressive about moving from ‘order takers’ to value-added partners. We teach employees how to build key relationships with their business unit partners. We sensitize our shared-services employees on how a change in service level and cost affects the busi-

Exhibit 7: **Centralized Staff Mind-Set vs. Shared-Services Mind-Set**

Typical Staff Mind-Set	Shared-Services Mind-Set
• We will defer to the central hierarchy (i.e., corporate); they will manage us and make all critical decisions • The hierarchy will produce the best solution • We will rely on our planning and control systems • We will tell the business units the solution • We will change how we do things and when we do things • We must make sure the businesses do it right • Corporate edicts require that the businesses use our services • We will allocate our costs to the businesses • We will set our budget and manage to it • We will tell them what we think they need to know	• We will manage ourselves by satisfying our clients with superior service for the prices charged • We will emphasize teamwork and collaboration • We will advise the business units of best practices and will let them determine what is right for them • Clients come to us because they want to. If we cannot perform the service competitively, we will work with clients to find the best provider • Clients will define their needs in advance • Clients will get what they pay for and won’t pay for what they don’t want or don’t get • We will continuously improve our costs, service levels, and capabilities • We will measure our success on customer satisfaction and business unit success • We will communicate regularly and openly with all our clients

Source: Strategy&

ness unit's bottom line. We organize meetings between providers and users several times a year to measure customer satisfaction. We know more about outsourcing and other benchmark alternatives than anyone else in the corporation and can shape our customers' perception about the kind of value we are delivering."

For their part, the business units must be aware of the trade-off between cost and value. They must learn to be rigorously selective in shopping for services. They must accept flexible sharing arrangements and be responsible for outperforming the marketplace once these services have been provided.

Principle 4: Benchmark the shared-services organization against outside vendors. Beyond these behavioral and paradigm shifts, performance criteria are required to cement the market relationship between shared services and the line.

In the old model, service performance was unmeasured except when performed by outside vendors. With shared services, key performance indicators are identified, tracked, and communicated. External and internal benchmarks and best practices are monitored routinely.

The old model employed standard cost accounting systems, with business unit costs allocated according to traditional drivers. The mentality was: "It all goes to the bottom line anyway." In the new model, activity-based costing allows customer billing based on usage. Business lines compete for internal resources, ensuring that resources go where they generate the most value.

In the old model, outsourcing was virtually nonexistent. In the new model, periodic outsourcing reviews and vendor management assurance are built into the responsibility of shared services.

Principle 5: Establish a governance board composed of business unit executives. Companies have chosen a variety of structures for implementing shared services. They are ultimately distinguished by two critical features: (1) the extent to which the leadership is consolidated under one executive or distributed among several, and (2) the extent to which the roles of setting policy and managing operations are combined or separated.

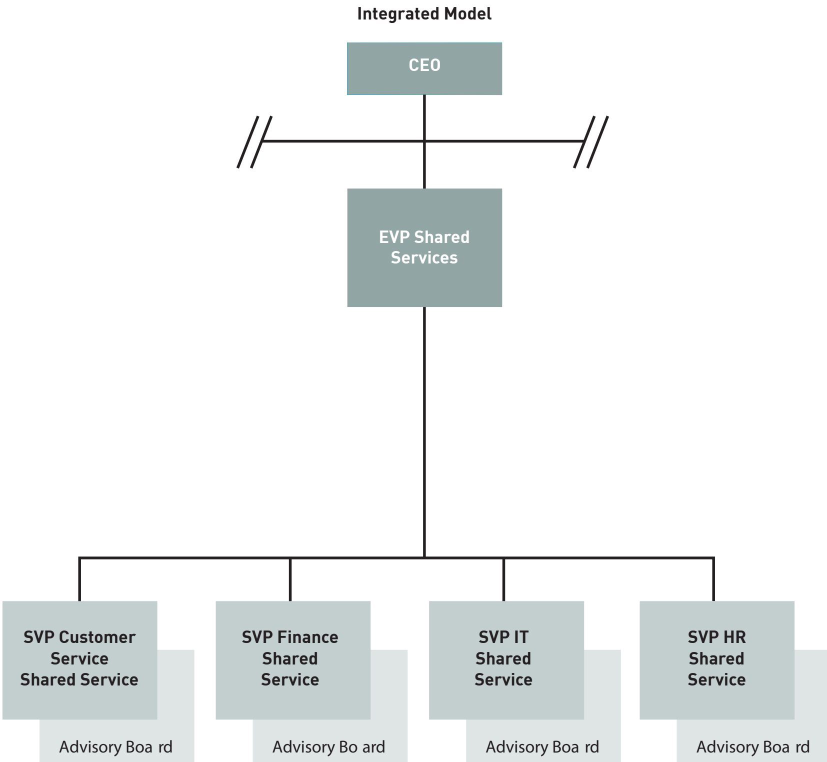
Some organizations have elected to consolidate staff service functions into a new entity overseen by a single senior executive. (See Exhibit 8.) Corporate policy–related decisions associated with staff services are managed at headquarters by a small core of managers familiar with the function, and day-to-day decisions are moved into the shared-services entity. This separation avoids the problems of traditional centralization and the disconnect between staff and business unit requirements. The stand-alone shared-services organization maintains its distinction from corporate staff. The executive running this organization has single-point accountability for providing services to business units and managing those services for maximum efficiency.

Other companies have adopted a distributed shared-services model in which corporate-level oversight is distributed among several senior executives. These tend to be the most senior functional executives, such as the chief financial officer for finance, chief information officer for information technology, and chief human resources officer for HR. The functional heads of the various shared-services units report to these senior executives.

In both models, functional heads focus solely on managing the operations of their respective areas. They build relationships with service buyers, determine demand, develop client service agreements, deploy staff to execute against these agreements, and manage performance.

In either case, governance is performed by a board composed of senior business unit executives, shared-services executives, senior corporate function executives, and sometimes even the CEO. The shared-services board gives the business units — which ultimately fund staff services — a voice. Populating the advisory board with

Exhibit 8: **Shared-Services Organization Models**



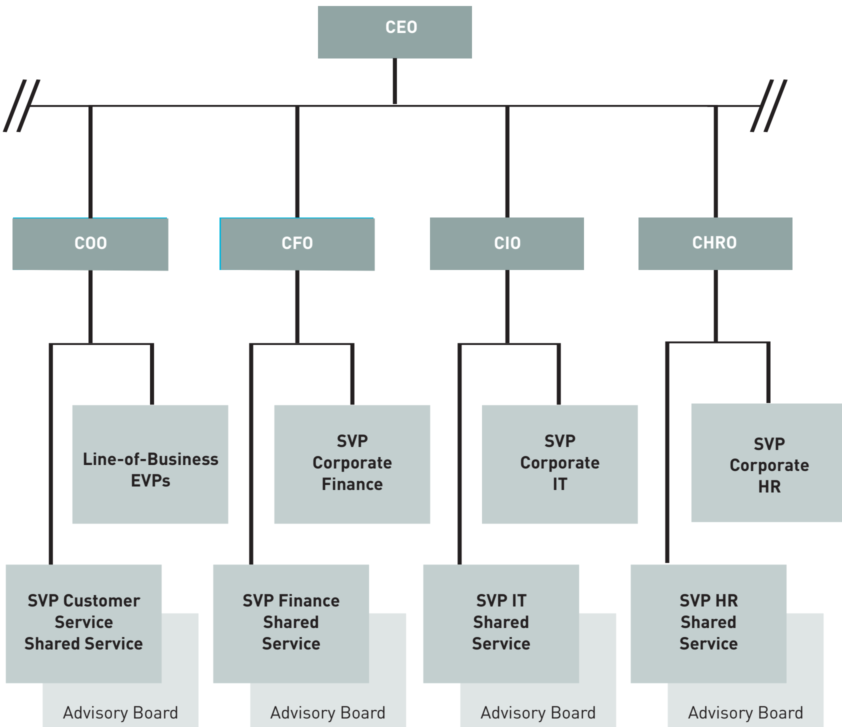
Source: Strategy&

business unit presidents as well as staff functional leaders helps balance the line–staff relationship and minimizes the risk of an internal and staff-centric orientation.

The board provides strategic leadership and direction and ensures that shared services are being consistently managed in accordance with internal customer requirements. In addition, the board sets policy, decides whether and how to permit outsourcing, approves expenses and capital budgets, and resolves significant conflicts over such issues as complying with agreements and determining degrees of standardization.

Principle 6: Select an implementation approach. The burning ques-

Distributed Model



tion that confronts most companies once they decide to move toward shared services is, Should we organize for shared services and then redesign, or redesign first and then reorganize? Some companies have created a top-level shared services organization first, migrated services at headquarters and in the business units into this organization, and then redesigned these services based on internal customer needs. Senior management can send a powerful signal of its commitment by appointing a shared-services leader. The senior leader and functional leaders can then "own" the design and drive quickly toward the implementation.

But leader-driven change is not the only road to transformation.

Many companies whose senior management was initially skeptical about anything that smacked of recentralizing have effectively redesigned the services themselves before opting for a shared-services model. Without a clear understanding of the benefits of service consolidation, they want to know which services are being performed and by whom, who the customers are, and how much the services cost. Once this business case is built, senior commitment to the new model can be obtained. This approach has led some companies to change both process and organization concurrently. This approach typically takes longer and entails complex change management issues. However, it also ensures that the design is optimized.

Managing the transition to shared services along any of these paths is complicated and demanding, requiring comprehensive changes in management processes. It requires fact-based decision making and customized solutions. It demands internal buy-in, ownership, and understanding from line managers and service providers themselves. They must know who their customers really are and be able to demonstrate superior service improvement, cost reduction, and quality enhancement.

However, for all its complexity, the road to shared services is becoming increasingly familiar.

Lessons from the Trenches

Whichever route you choose, successful implementation demands considerable front-end investment and cultural transformation. To clear these initial hurdles, the company, especially senior management, must be fully committed to significant change.

Even with leadership from senior management, though, resistance to change can be tenacious. Business unit managers may not want to give up direct control, sometimes out of fear of losing authority, but more often out of a concern about sacrificing service quality and responsiveness.

Case Study
Deutsche Bank: Sharing Human Resources

In the early 1990s, Germany-based Deutsche Bank (DB) appointed Hans Fischer as head of its global Human Resources division. His task: to transform what had been a regionally organized function with a strong corporate center into a world-class organization aligned tightly with individual business units. In 1999, when David Ulrich was appointed advisor to the bank's HR committee, he identified four roles HR had to fulfill in order for the function to become a true business partner of DB's businesses — while cutting costs and delivering services more efficiently: strategic partner, change agent, administrative expert, and employee champion.

To that end, the bank established an "HR firm" to deliver shared services and develop new delivery channels for employees, built up business partner support aligned to its two primary businesses (private client banking and asset management, and corporate and investment banking), each with its own functions for compensation, recruitment, and the like, and began reducing the size of the HR corporate center. The highest-level strategic functions, which included developing a human capital strategy for the bank as a whole and overseeing delivery of administrative services, remained centralized. Each unit, meanwhile, developed its own HR function responsible for supporting the unit's business strategy by aligning practice teams with client needs, and by overseeing the necessary change management.

The HR firm set up a shared-services unit dedicated to generating significant year-over-year cost reductions while providing a full range of state-of-the-art and standardized HR activities like payroll, administration, performance management, benefits, and international services. The transition was guided by global practice teams, each responsible for the various products and services being developed for use by the business units, and for the channels to be used to deliver those products and services. The teams also worked directly with their business partners to determine when and how to make the firm's offerings available to its internal clients.

Out of that effort, the firm developed two primary delivery channels: HR Online was set up as a Web-based portal that employees could use to gain access to such services as electronic pay stubs, transfers, performance tracking, vacation data, and support targeted to new hires and departing employees; managers could use HR Online for resource planning and approval, among other services. HRdirect is a phone-based system offering first-line support for employee inquiries about online HR products as well as general HR questions.

By 2003, the newly restructured HR function had reduced head count by 15 percent and costs by 20 percent. The number of registered HR Online users had grown to 50,000, and more than 58,000 employees had used the performance management system.

Exhibit 9: **Shared-Services Lessons Learned**

DOs	DON'Ts
• Set the bar high: The CEO should articulate the mission and set aggressive targets • Build the case for change up front with accurate baselines, external benchmarks, and internal surveys • Think big: the bigger the scope, the better • Engage the line managers from the start • Redesign, don't just reconsolidate • Create early wins by starting with transactional activities where economies of scale are unshakable • Keep service-level contracts simple • Communicate, communicate, communicate	• View shared services as simply a cost-cutting exercise • Forget to change the compensation, rewards, and recognition systems • Let the business units buy outside immediately; establish a grace period • Lose focus (maintain strong leadership; transformation takes time)

Source: Strategy&

At Strategy&, our experience with leading companies to push toward a shared-services approach has allowed us to assemble a number of best, and worst, practices. (See Exhibit 9.)

Shared Services — What Next?

Staff services have evolved from corporate services to business unit services to shared services. The continuing evolution will lead us further into management of the extended enterprise. (See Exhibit 10.)

As the market for both transaction- and expertise-based services continues to develop, it is likely that many more services being performed internally will be outsourced. The new challenge: outside vendor management. Shared-services leaders will manage outsourcing opportunities. Over time, they will manage service capabilities rather than service production. In the extended enterprise, the shared-services unit is responsible for outsourcing strategy, performance standards, and results. Thus, it is critical to strengthen outsourcing management skills and solidify the structures that oversee these relationships. Service staff must acquire skills that hold intrinsic value. Compensation must be linked to business performance that is compared with that of external service providers. And benefit plans must apply across companies.

Exhibit 10: **The Evolution of Corporate Services**

	1970s Corporate Services	1980s Business Unit Services	1990s Shared Services	2000s Extended Enterprise
Problem Faced	Command and control	Inefficient processes	Duplication and business unit silos	Demand management; market pricing; differentiated service requirements
Solution	Decentralize service	Redesign business processes with business units	Reorganize processes into internal shared services	Network of internal and external service providers
Scope	Corporate	Individual business units	Enterprise-wide	Industry-wide
Results	Greater alignment through business unit service	Improved efficiency within business units	30% cost reduction through elimination of redundancy and sharing of best practices	20% cost reduction via capturing industry-wide scale efficiencies

Source: Strategy&

The further we get from the old notion of command-and-control management, the closer we get to a world in which the market is the test of every aspect of corporate life. The winners will be those that mobilize capabilities in support of market objectives. Support services are one more capability, even if the customers are internal. Shared services is a significant evolutionary step in this process. +

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