SHARED SERVICES OR OUTSOURCING?

Assessing Scope, Process Maturity and Organizational Design

Kevin Lewis, ISG Director; CPA, CGMA
INTRODUCTION

As organizations grow in size and complexity, either through geographical expansion or additional lines of business, a duplication of non-core functions such as IT, accounting, HR and some back office tasks is common. To address this duplication, organizations often consider outsourcing some functions, developing a shared service approach, or applying some combination of the two.

Both shared services and outsourcing offer value, and each approach has specific strengths and advantages. Shared services can be an effective way to gain access to new geographic markets, increase the size and diversity of the management pool and gain a greater sense of control over the operating model. Outsourcing, meanwhile, can apply economies of scale across multiple clients, help manage location concentration risk and attract talent and offer a diverse career path.

The key to an effective decision is to remain objective and develop a solid business case of the alternatives and the benefits and risks of each approach in the context of business needs and risk appetite. This ISG white paper examines some of the basic considerations involved in assessing scope, process maturity and organizational design when evaluating shared services versus outsourcing options.
BASIC CHARACTERISTICS

The concept of shared services (sometimes referred to as “insourcing” or “captive”) involves the centralized management of functions such as IT, HR and accounting, so that the services are provided in a standard and efficient way to the various business units or offices. Reasons to take this approach may include unwillingness to relinquish control (perceived issue with outsourcing); confidence that the work can be done more efficiently in-house; or lack of familiarity with the possibilities of an outsourcing arrangement.

Under outsourcing, functions are turned over to an outside vendor, who then provides services according to a contract, with predictable price, scope and standard of service. Outsourcing might be chosen over shared services for the following reasons: vendor offers greater experience and expertise; lower price because of economies of scale and possibly labor arbitrage if the work can be moved offshore; or increased likelihood of applying enforceable service levels to the work outsourced.

At a high level, three areas that need to be considered in a shared services versus outsourcing decision process are:

- The scope of the work
- The maturity of the processes involved
- The firm’s organizational structure

SCOPE

The key starting point is to assess whether the functions under consideration are better suited for outsourcing or shared services. Individual processes should be evaluated and filtered for portability and ease of transition, e.g., can the process to be transitioned be performed elsewhere? Operational, legal and financial risk must also be considered. For example, does the benefit of reducing cost through outsourcing outweigh the risk of assuming additional compliance risk by transferring sensitive information to a third party?

Another key criterion is the level of maturity of the outsourcing market in a particular sector. This can be gauged by the number of service providers operating in a given space and whether the service area is established or emerging. While clients may clamor for innovation, they are loathe to be guinea pigs for untested solutions. The level of complexity of the interactions involved in a given process between internal or external stakeholders is also critical to consider. While basic transactions might lend themselves to outsourcing, complex and unique functions are likely better suited to staying in-house.

That said, as part of their assessment, client organizations should consider the drivers of complexity: is customization necessary and does it add value? Or is it a result of inertia and established practice? If the latter, significant improvements can be achieved through leveraging the economies of scale provided by a service provider’s standard set of services.

The number of people performing a function is another consideration. Traditionally, the sweet spot to gain the interest of a multinational service provider was 100 FTEs. As the outsourcing market becomes increasingly competitive, however, that threshold is shrinking and we see large providers taking on 50 FTEs to gain a foothold and launch a “penetrate and radiate” strategy. Different tiers of providers should also be considered – if the scope is relatively small, a niche provider might be a better fit than a large multinational.

Service bundling – whereby, for example, five functions involving 20 people each are combined into one initiative – is a potential option if the objective is to attract a tier one or tier two player. Strengths and weaknesses of providers, as well as the perspective of internal stakeholders, must also be considered. Given these myriad variables, a mix of outsourcing and shared services is often viable. Under such a scenario, three processes could be bundled for outsourcing while another two remained in-house under a shared services model.

For many organizations considering their sourcing options, the “partial FTE conundrum” presents a vexing challenge. Following the economic recession and business downsizing, many short-staffed enterprises responded by decentralizing and spreading workload to remaining employees across different business units. By taking on responsibilities of former colleagues across different departments, many employees today perform disparate and unrelated tasks. For example, the members of a Human Resources team might collectively spend 30 percent to 40 percent of their time on accounting and customer service. As a result, outsourcing the HR function creates the risk of creating significant gaps in other areas of the business. In such a situation, a detailed time allocation analysis of individual roles and responsibilities is needed to understand whether functions should be outsourced, moved to shared services or potentially eliminated.
The geographic distribution of workforce involved in a particular function can further complicate the sourcing decision process. When identical or similar functions are performed in multiple sites without clear documentation or process control, decentralized “tribal knowledge” inevitably develops, with every location essentially doing things its own way.

In such a situation, outsourcing can potentially be effective, as a third-party provider would likely have the capabilities to rationalize and standardize the multiple processes being employed. At the same time, if the multiple sites cross national boundaries, regulatory and legal requirements come into play and can dictate whether or not an outsourced solution is viable.

**PROCESS MATURITY**

The initial focus on process maturity should assess the extent of standardization and documentation of functions under consideration. Additional critical measures of process maturity include tracking and reporting mechanisms. If measures do exist, are they accurate and applied in a relevant way to enhance quality? In many instances, ISG observes either a lack of measurement or a lack of relevant use of measures.

If these attributes are lacking, if the processes are deemed portable and if market maturity is adequate (per the considerations discussed above), outsourcing can be a viable option. Service providers invest significant resources to deliver the expertise, tools and technologies to apply process discipline and standard templates to drive standardization and achieve significant improvements.

As an alternative, process standardization and documentation can be done in-house, provided the requisite tools, templates and knowledge are available. If those capabilities aren’t in place, careful consideration should be given to the level of investment required to achieve the necessary level of expertise. One path client organizations should avoid is to undertake an internal process standardization initiative and then outsource the process, as this essentially means paying for the standardization twice.

The root causes of process complexities and differences must be assessed. Do they reflect specific national regulatory or legal requirements? Or do they simply result from the tribal knowledge and historic practice mentioned earlier? Understanding whether or not different processes have to be different facilitates the task of driving standardization.

**ORGANIZATIONAL STRUCTURE**

An organizational structure assessment involves understanding internal costs and identifying whether hidden or shared costs are present. A baseline of existing costs, along with consideration of future requirements, is an essential prerequisite to an effective sourcing decision.

Another consideration is that of future costs – including the costs of setting up a facility (real estate, furniture and fixtures, cabling, lighting and telephones, etc.) – as well as the technology for maintaining ongoing operations. While an internally managed environment may be cost-efficient, changes in the competitive landscape could require massive investments in new tools and technologies. Under these circumstances, a third-party service provider could be much better positioned to transition to the new landscape and adapt and implement the necessary changes.

The assessment must consider the maturity of organizational design in terms of strategy (both current and future), process discipline in terms of process documentation, adherence to service levels and performance metrics and governance mechanisms. Governance should be designed to ensure that the shared services center (SSC) delivers value on an ongoing basis by instituting discipline and establishing the protocols of management both within the SSC and with the business units that are the beneficiary of the services.

The business must also address what the new structure should look like. Criteria here include identifying functions to retain, along with those that are better suited to outsourcing. Functions that add value and involve core competencies of the business should be retained, while basic commodity functions can typically be performed more cost-efficiently by a third party.
If moving to an outsourced arrangement, the retained organization team must have the necessary skill set. Too often, businesses that outsource move technical professionals into management positions without adequate preparation or training. Ill-prepared for the challenges of managing staff, these individuals frequently revert to their comfort zones of doing hands-on work. The result is duplication of effort and inefficient service delivery.

To manage the transition to a new service delivery model, mechanisms need to be in place to anticipate and deal with disruption, to maintain existing service levels and to ensure regulatory control and compliance. Working with key stakeholders to define and then meet expectations is critical. Communications regarding organizational changes and options related to attrition – such as early retirement options – must be clearly articulated.

**MYRIAD FACTORS**

Shared services vs. outsourcing decisions will vary and have different impacts depending on the geographical location of existing operations (North America vs. South America, Western Europe, etc.) The different impacts will also vary based on the organization, regulatory requirements, current technology, process maturity, site selection and risk profile. There is no magic potion, no right or wrong way to approach the situation and determine the right answer.

However, a systematic approach that objectively considers the multiple inter-related factors involved will increase the probability of making an objective decision that yields measurable results.
Your operational excellence is our business.

Visit the AccessISG™ Sourcing Portal for more sourcing information, insight and tools.

Click the envelope to contact us or go to http://info.isg-one.com/ContactUs.

Information Services Group (ISG) (NASDAQ: III) is a leading technology insights, market intelligence and advisory services company, serving more than 500 clients around the world to help them achieve operational excellence. ISG supports private and public sector organizations to transform and optimize their operational environments through research, benchmarking, consulting and managed services, with a focus on information technology, business process transformation, program management services and enterprise resource planning. Clients look to ISG for unique insights and innovative solutions for leveraging technology, the deepest data source in the industry, and more than five decades of experience and global leadership in information and advisory services. Based in Stamford, Conn., the company has more than 850 employees and operates in 21 countries. For additional information, visit www.isg-one.com.