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Effective strategies for internal outsourcing and offshoring of business services: An empirical investigation

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Abstract

The growing pressure to reduce costs and improve efficiency induces many organizations to undertake shared services initiatives. This consolidation and streamlining of common business functions is also known as insourcing, in-house services, business services, or staff services. While adoption of a shared service structure is viewed by many as an appropriate strategy to pursue, most companies still struggle to devise optimal strategies and to generate adequate returns on investments for their projects, because none of the approaches that are commonly adopted is recognized as universally effective.

This paper builds upon the ''structure-environment'' perspective to uncover configurations of shared services organizations and to explain why and under what circumstances some of these configurations exhibit superior results. The conceptual model proposed challenges the notion of ''best practice'' and suggests that the effectiveness of a shared services project depends on the degree of complementarity between the ''needs'' arising from the environment in which a company operates and the specific capabilities developed to address these needs. The theoretical findings are validated empirically through the analysis of a large sample of European firms that recently undertook initiatives in this domain. Four dominant configurations of shared service organizations are uncovered, and their relationship to performance is explored.

Keywords: Shared services; Offshoring; Outsourcing; Strategy; Empirical analysis

1. Introduction

Increasing competition, the progressive globalization of the economy caused by the lowering of trade barriers, and the emergence of new market players that benefit from significant labor cost advantages is pressuring western firms to devise strategies to reduce costs and improve the efficiency of operations. Among the various alternatives the development of shared services (SS) is increasingly regarded as a potential solution to this problem and is being progressively adopted by a growing number of firms. For example Citigroup has established Citigroup Business Services, a shared services organization located in three regional centers around the globe, dealing with financial reporting, payroll and benefits administration, purchasing, accounts payable, and premises management functions for the entire group.

Shared services is the strategy of standardizing, streamlining, and consolidating common business functions and processes in an organization, in order to improve efficiency and effectiveness with both cost reduction and overall profitability in mind. According to Bywater (2001) it is: ''The co-location of internal services which are removed from the business to whom they provide the service-*internal outsourcing*''.

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In a report by The Economist Intelligence Unit (1998), shared services are described as: ‘‘The apportioning of standardized and consolidated business functions or processes with a service mentality to ensure effective operation’’. ‘‘Shared services – also known as insourcing, in-house services, business services, or staff services – is more than centralizing routine transactions: the idea is to leverage best practices, specialized knowledge, and technology to create satisfied internal and external customers’’ (The Conference Board, 1998). According to Goold et al. (2001) it is one of the roles that corporate headquarters can take.

In general, it is believed that moving to a shared service organization (SSO) helps companies save costs, increase available time for value-added activities in line positions, improve measurement capability, and achieve better service quality due to a more focused management attention. American Express and Citigroup report cumulative cost savings 3 years after adoption worth more than half a billion and US$ 350 million, respectively. Average cost savings of 25–30% are not unusual after adopting a shared service structure (Quinn et al., 2000). Not surprisingly, an increasing number of companies consider adopting SSOs. According to a study by Bywater (2001) over 90% of Fortune 500 and Europe 500 companies have already or are planning to implement SSOs.

Shared service organizations are seen by some as the step taken before outsourcing, and by others as the alternative to corporate outsourcing. Sometimes the shared service organization is a third party owned business unit. Thus, in the current debate on business process outsourcing practices and offshoring of services, understanding shared service structures and their performance implications will constitute an important piece. To answer questions about whether to outsource or not, companies need to understand appropriate in-house solutions better. Similarly, the question of offshoring requires a good understanding of service structures that guarantee high performance.

Yet, in spite of this rising interest, there is still some uncertainty about the real benefits of shared services. For instance, of the companies that participated in the Bywater study, 3% are reported to have implemented a shared services strategy, and then rejected it. This suggests that while rarely reported, shared service implementations can also fail. According to Steven Kerr from General Electric (Quinn et al., 2000): ‘‘Shared services, like outsourcing, is not a panacea for all functions. Sometimes it works and sometimes it is not the right strategy—especially if it has been forced upon reluctant business units. It is not a hammer!’’

By the same token, there is also uncertainty about the most appropriate ways to conceive, implement and manage shared services organizations. A number of alternative – and often antithetical – approaches to SSOs have been proposed and implemented. As a result, existing SSOs differ among each other with respect to their overall objectives, their functional scope and even with respect to the specific business model adopted, which span from purely introverted approaches to more extroverted ones that privilege customer service over cost reduction (Citigroup, 2002).

Yet, none of these models has proven to be generally superior. The blurred picture on the practice side is also symptomatic of a knowledge gap at the theoretical level. To our knowledge, there is no academic study to date that examines the link between strategy, implementation and resulting performance in SSOs. Claims are mostly based on conceptual arguments, perhaps supported by anecdotal evidence that associates certain variables and certain performance measures. However, an empirical justification of a link between SSO strategies and performance is lacking. Given the prevalence of this organizational structure and the large potential benefits associated with its success, understanding how firms organize their SSOs and determining superior configurations is a critical issue for businesses at large.

Researchers have also generally overlooked the question of whether different SS strategies display the same degree of effectiveness for firms that have different operational and organizational needs. This is an important gap, because recent studies that revisited the relationships between strategy, organizational structure and management processes have challenged the notion of ‘‘single best practice’’ (Atuahene-Gima and Ko, 2001) and suggested that similar strategies, organizational forms and—by analogy, similar SS models, may produce different results in different environmental settings (Brown, 1994; Brown and Magill, 1998). In summary, a review of the extant literature suggests that there is a need for a sounder characterization of the predominant SSO models (beyond the simple stylized classifications proposed by industry practitioners) and, also, of a better understanding of the relative effectiveness of these models.

The objective of this paper is to fill this gap in the literature and to examine the relationship between different SS strategies and the characteristics of environments in which SSOs operate. Recognizing the need for exploratory research that shed light on the