

MANAGING PERFORMANCE

Managing Performance Through Shared Services Centers

White paper

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Foreword

Today's business environment is characterized by intense global competition, pressure on companies to improve profitability, and shareholders that become increasingly active and outspoken in demanding value creation from management. In their efforts to reduce costs and improve profitability, companies have widened their focus to tap potential cost savings and efficiency improvements not only in their operations, but also in support or back-office functions. Concepts like shared services, outsourcing and off-shoring continue to gain popularity, promising significant support function cost reduction of fifteen to twenty percent, or more. However, companies intending to implement such concepts should remain realistic and be aware of the many challenges and significant organizational changes necessary.

The purpose of this white paper is to highlight the key challenges in imple-

menting Shared Services Centers (SSCs) as well as the key success factors to address such challenges. To that end, KPMG Switzerland and the Institute of Accounting, Controlling and Auditing at the University of St. Gallen held several roundtable discussions with companies that have already implemented an SSC or are about to do so in the near future. This white paper combines the views and experiences of those companies with the experience of KPMG in advising clients on this topic. Given the large body of existing literature on SSCs, this white paper is not meant to fulfill the role of a broad documentation on basic terms and definitions. Rather, it shall enable companies considering the implementation of an SSC, or the reorganization of an existing one, to learn from the experience of others and to get an overview of current issues and best practice.



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Management summary

Concepts like shared services and outsourcing promise significant potential for cost reductions and performance improvements in support functions. Given today's highly competitive business environment, it is not surprising that an increasing number of companies embrace such concepts. Shared services refer to the consolidation of common functions, systems, processes and personnel across several business units into an internal service unit – the Shared Services Center (SSC) – which is managed as an independent organization. In contrast, outsourcing involves the transfer of such activities traditionally performed within the company to an external service provider through a long-term contractual relationship.

While the concept of SSCs is not a new one, it continues to evolve and is currently subject to a number of major trends. These include a shift away from a pure focus on cost reductions towards improvements in efficiency and quality, as well as the transfer of more value-added activities to the SSC. At the same time, companies continue to look for cost and efficiency gains with regard to transactional activities through increased offshoring to lower cost countries. Furthermore, SSCs may be seen as an intermediate step towards outsourcing. While outsourcing currently appears to be limited to IT in most cases, the trend will likely spread to non-IT activities in the future, as these processes become more standardized and the quality of external service providers improves. Finally, regulatory environments remain complex and differ substantially between countries and regions. As a consequence, compliance and risk management are of high importance for companies as a whole, and their SSC organizations in particular, to cope with a multitude of applicable local regulations and design SSC processes accordingly.

While substantial value can be realized from a successful SSC organization, the

implementation of an SSC represents a major organizational change and companies need to be aware of the challenges involved. Typical challenges include defining the SSC role within the organization, the scope of activities that should be transferred to the SSC, as well as its location. Apart from pure technical and cost considerations, these decisions involve many personnel issues. Frequently, managers of the operating companies meet the SSC concept with great skepticism and are hesitant to give up power over certain processes. The directly affected employees may also not be supportive of the SSC for fear of losing their jobs. Thus, proper change management is important to achieve buy-in to the SSC concept from all stakeholders and to manage employee related issues appropriately. Further challenges concern the internal set-up of the SSC and its relationship to its customers, i.e. the local operating units. To instill the right service mentality at the SSC, it is recommended to formalize the relationship with customers through service level agreements, and effective tools are required within the SSC to manage performance. Additional considerations include the pricing of services provided by the SSC and potential tax implications, security aspects,

as well as the impact of the SSC from an audit perspective and with regard to M&A activities and divestitures.

To address these challenges adequately, careful and systematic planning and implementation are critical over the entire lifecycle of the SSC. This paper presents the key activities required in each of the lifecycle stages of an SSC – from defining a shared services vision and strategy, through the detailed planning, transition and pilot phase, to the day-to-day operation and further evolution. Ten success factors are presented, which address the key challenges mentioned above and based on the experience of companies that have already implemented an SSC as well as on KPMG's experience with such clients.

Current trends

Competitive pressures force companies to constantly search for new possibilities to drive down costs and improve performance in all areas. While initially the focus of cost cutting efforts was on operations, which offered the largest and quickest potential for cost reductions, management's attention has widened in recent years to also include support and administrative functions. SSCs have been implemented to reduce costs and to improve efficiency in functional areas such as finance and accounting, human resources, and IT.

SSCs are currently subject to the following five major trends:

Objectives

The pressure on support and administrative functions to reduce costs and improve efficiency and quality continues. Thus, the concept of SSCs will remain a key focus in corporate performance management. However, the primary objective of introducing or operating SSCs is shifting from pure cost reduction to achieving operational excellence in support functions. In other words, today the main focus of SSCs is on service quality and customer satisfaction, allowing management and employees at operating units relief from non-core activities so they may focus on core operational and strategic tasks. Costs remain an important motive but SSCs try to identify additional ways to deliver value to the organization beyond simple cost savings from consolidating multiple redundant activities or standardizing processes.

Scope

In line with this development, the scope of functions and activities performed by SSCs is also changing. While originally mainly high-volume, transactional activities were transferred to SSCs, there is

also a trend to include more sophisticated, knowledge-based support functions. Examples include legal, finance and controlling activities such as business planning or performance and tax reporting.

Location

At the same time, companies continue to look for cost and efficiency gains with regard to transactional activities through increased off-shoring to lower-cost countries. Currently, preferred off-shore locations for SSCs covering transactional activities include CEE countries such as Poland, the Czech Republic or Hungary, and Asian locations such as India, the Philippines and China. However, companies running SSCs should regularly re-evaluate their location decisions. Therefore, it appears likely that preferred off-shoring locations will change if relative cost advantages of existing off-shore locations diminish and companies can achieve additional cost reductions by moving their SSCs to new, even cheaper locations.

Outsourcing

SSCs may be perceived as an intermediate step towards outsourcing. As outsourcing partners provide services to several companies it should be possible to achieve even greater economies of

scale than an SSC within a single company. Yet, outsourcing is not an option for all activities currently or potentially performed by SSCs. To retain knowledge and control companies might prefer to keep activities and processes that are closely linked to their business and are considered strategic in-house. Furthermore, while the outsourcing market is already well-established for certain functions, such as IT and finance, companies are somewhat hesitant to outsource other functions and processes. This is mainly due to less standardization of non-IT processes and activities across companies, as well as concerns about the quality of existing outsourcing solutions in these areas. Regardless of whether a company eventually pursues the outsourcing avenue or decides to stick with its SSC, the implementation of an SSC will not be a wasted effort. While not necessarily a pre-condition to outsourcing, an existing SSC will facilitate the transition: relevant processes will already have been standardized and redesigned, the company will have a good understanding of the costs associated with various process steps, which helps in evaluating offers by third-party providers, and organizational culture will have changed in a sense that operating units are familiar with support functions on a professional basis.

Rules and regulations

Finally, despite globalization, regulatory environments remain complex and differ substantially between countries and regions. This is particularly true for tax laws, but also applies to labor regulations and corporate law. Thus, companies operating regional or global SSCs will have to consider a multitude of applicable local rules and regulations and design SSC processes accordingly. At the same time, companies with a U.S. listing will have to ensure compliance with the provisions of the Sarbanes-Oxley Act. As a consequence, compliance and risk management are of high importance for companies as a whole and their SSC organizations in particular.



Exhibit 1

SSC versus outsourcing at ABB

At engineering group ABB, the shared services concept is generally preferred over outsourcing, with the exception of IT. As Lars-Göran Lemelius, Head of Shared Services Worldwide at ABB, explains: *“Outsourcing of IT processes makes sense, as IT platforms have reached a great degree of standardization across companies. This is not yet the case in other areas such as finance and accounting, so the sharing of outsourcing providers with other parties does not provide large additional benefits in terms of economies of scale.”* According to Lemelius, ABB has also largely refrained from outsourcing non-IT activities because there is still considerable cost savings potential that can be realized internally through its SSCs. This also avoids the risk involved with moving certain key competencies to outside parties.

Challenges

SSCs within the organization

The first major challenge in implementing an SSC is to define its role and position within the overall organization. Frequently, local operating units meet the SSC concept with great skepticism for fear of supporting a trend towards centralization within the organization and a shift of decision power towards corporate headquarters. It is important to understand that this is not the case. The purpose of an SSC is to achieve the benefits associated with centralized and decentralized organizations, while avoiding their respective pitfalls.

The SSC concept aims to achieve cost reductions through efficiency gains, standardization and economies of scale by consolidating activities and processes at the SSC that were previously carried out at the operating unit level. While critics will say that this represents centralization towards the SSC, there are several important aspects to consider:

- First of all, the SSC typically is not part of corporate headquarters but a separate unit within the organization, carrying out specific, pre-defined services to operating units within the organization.
- Consequently, there is no shift in decision making authority from local operating units towards corporate headquarters or the SSC.
- Thirdly, SSCs clearly differ from the classic, centralized support functions at corporate headquarters. Their primary purpose is to serve their customers, i.e. the operating units. And, in contrast to historical centralized support functions, SSCs are held fully accountable for customer focus and quality. As a result, SSCs do not exhibit a cost-center mentality. For these reasons, SSCs actually foster autonomy of operating units by relieving them of time and resource consuming tasks related to support functions without taking away decision making

authority. This allows management and operating units employees to better focus on strategic issues and their core, customer-related activities.

Scope

Once an understanding of the purpose of SSCs has been established, the organization has to decide the scope of activities to be transferred to the SSC. Important questions include:

- Which activities and processes should be transferred to the SSC?
- Where should the process be cut and how should the interface between operating company and the SSC be designed?
- Should all transferred support processes be handled by a single SSC, or is it preferable to have several SSCs handling different functions (e.g. finance, HR, IT)?
- What geographic scope should the SSC have, i.e. should the SSC operate on a global scale, or does it make sense to have regional or even national SSCs, or maybe a combination of the three?

Addressing these questions is one of the key challenges in the design phase of an SSC project. Answers will depend

on the type of processes to be transferred to the SSC, the objectives a company wants to achieve through shared services, as well as the particular characteristics of the countries in which the company is active, which might facilitate or impede the transfer of activities to the SSC.

Scope of activities

Generally, processes suitable for transferring to an SSC are those that involve high volumes and can be standardized to best exploit economies of scale. At the same time, such processes should not be linked to core operational processes and activities; otherwise it might be difficult to handle them from a remotely-located SSC without compromising efficiency and quality or even continuity. Typical examples of such processes include accounting processes, e.g. the management of accounts receivable and accounts payable, HR processes, such as payroll processing, and travel management (see Exhibit 2).

However, companies increasingly also move higher-value added processes to SSCs, with the aim of realizing economies of skills for highly specialized activities. For example, technology services provider EDS provides support for monthly reporting, valuations and variance analyses to local units through its SSC, as Dr. Jürgen Termin, CFO of EDS Switzerland, explains. According to Lars-

Göran Lemelius, ABB takes a similar approach, in particular with regard to providing local units with support and expertise on US-GAAP.

If processes are related, or are at least sufficiently similar for employees' skills to be leveraged, and if a single location is equally suitable for these processes, then a single SSC makes sense. However, purely transaction-oriented processes and higher-value added, knowledge-

driven support functions should not be combined into one single unit, or efficiency might suffer.

Geographic scope

With regard to the geographic scope of the SSC, the benefits of global SSCs need to be weighed against possible drawbacks. For example, a single global SSC might capture larger volumes and thus higher economies of scale. However, given the multitude of different lo-

cal regulatory and business requirements, the question is whether processes can be and should be standardized on a global basis. An alternative would be to implement several regional SSCs, which typically does not represent a major sacrifice in term of economies of scale, but facilitates interactions between the SSC and its customers based on a shared culture and language. Another advantage of regional SSCs is that they operate in the same time zone as the operating

Processes most frequently transferred to SSCs

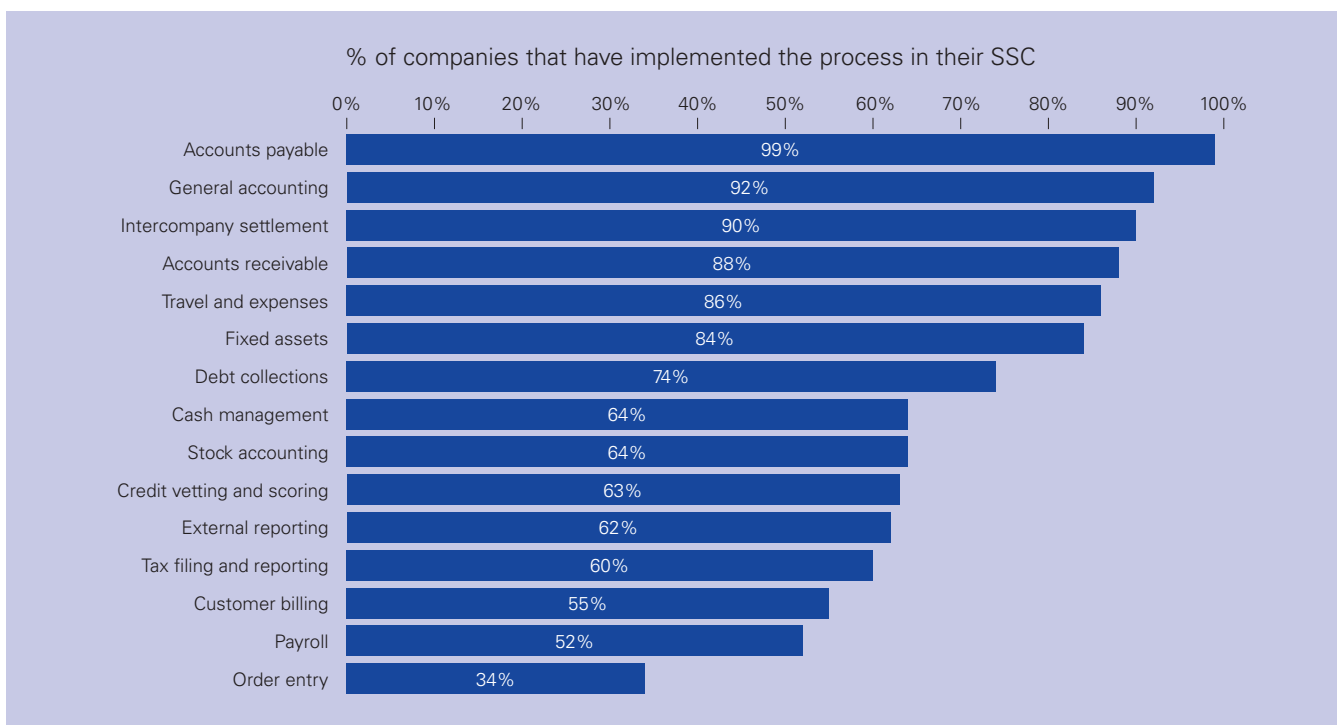


Exhibit 2

Source: 4th European Finance SSO Study 2005, The Hackett Group



Choice of SSC location – developed versus emerging markets

ABB runs its shared services organization using national SSCs, which has proven to be successful even in high-cost environments such as Germany. Other companies, such as Pfizer and Siemens, operate regional SSCs in Ireland and Portugal, respectively. However, “*the location decision is not a definite one,*” says René Jauss, Director Finance and Business Operations at Pfizer Switzerland. Pfizer is constantly re-evaluating cost structures and location decisions and has already moved some processes from the Dublin SSC to SSCs in India and Romania. Interestingly, companies operating SSCs in supposedly lower-cost environments such as Poland or Hungary are also reassessing their SSC business cases. Many companies monitor costs at their SSC closely. This is confirmed by Dr. Jürgen Termin of EDS: the company operates two SSCs in Hungary, but contemplates moving one of them to India.

Exhibit 3

units they serve, ensuring accessibility. Where country specifics do not allow for processes to be handled by the SSC in a cost-efficient manner, national SSCs can be implemented or the respective processes may be left with the local operating units. While companies such as Carlsberg, Ciba Specialty Chemicals, Clariant, EDS, Pfizer, PubliGroupe and Siemens typically establish regional SSCs, ABB has opted for national SSCs. Given its strongly decentralized culture and organization, ABB decided against regional SSCs to facilitate the buy-in from local management. As Lars-Göran Lemelius explains: “Leaving the SSC within the control of the local country managers brought us greater acceptance of the SSC concept. Country managers felt empowered rather than deprived of control, as might have been the case with regional SSCs.” In addition ABB does not expect significant additional savings by further consolidating their local SSCs into a regional or a global structure.

Offering services to third parties

Another aspect to be considered in determining the scope of the SSC concept is the question whether the SSC should be allowed to offer its services to third parties. Some companies are considering this possibility as an option for the future. Others, including ABB, Ciba Specialty Chemicals and Clariant are more skeptical. In their view, offering shared services to third parties is not part of their

core business and therefore does not fit their strategy. Furthermore, offering shared services to third parties requires long-term commitment, which limits a company’s own flexibility.

Location

Closely linked to the scope of the SSC is the choice of a suitable location. Depending on the activities and processes to be transferred to the SSC, a company must determine whether its SSC should be located domestically (on-shore), at a near-shore location, or off-shore. Off-shoring is the transfer of processes to be managed by an SSC to a remote location, i.e. to an SSC in a country other than the company’s home country. If the SSC off-shore location is in a nearby territory, easily accessible, and in the same or a neighboring time zone as the home country, then this is usually referred to as near-shoring. Furthermore, it needs to be decided if the SSC will be established at a new location (*greenfield* SSC) or at an existing company location (*brownfield* solution).

Experience shows that the most successful SSCs are located remotely from company headquarters or other existing operations. Very often these SSCs will be based in low(er) cost countries and therefore this solution allows cost advantages through labor cost arbitrage. The remote location allows them to develop their own service-oriented culture and

avoids the SSC being perceived as part of corporate headquarters by operating units. Factors to consider in selecting an off-shore location include location risks, political risks, compliance and legal matters, business environment, costs of labor and infrastructure, the availability of employees with the right training, technical and language skills, and potential government incentives for foreign investors. Given the concentration of support processes in the SSC and the resulting dependency of the organization as a whole on a proper functioning of the SSC, the choice of location should ensure that the risk of service interruptions is minimal. This eliminates potentially low-cost, but high-risk countries as possible locations. Other risk factors include cultural or language issues, which may result in reduced productivity or quality problems at the SSC.

Therefore, the off-shoring decision should not be based solely on labor costs. While these costs will be the key factor for labor-intensive, high-volume and standardized processes, other factors need to be considered for more sophisticated processes. For example, processes that require frequent contact between the SSC and its customers at local operating units should be staffed with native speakers in the local language in order to avoid potential cultural or language issues. This might require parts of the SSC organization to be located near the customer



Achieving management buy-in

As René Früh, Head of Shared Services for Europe at PubliGroupe, points out, having experienced serious drawbacks at the outset of the project his company found it helpful to involve local management very early in the development and implementation of the SSC project. *“That way, we gave them the opportunity to shape the project, which improved acceptance and made local managers co-owners of the project. In other words, they were part of the decisions and are now responsible for making shared services a success at PubliGroupe.”*

Exhibit 4

units in potentially higher-cost countries. Generally speaking, companies will have to choose between cost and productivity advantages at certain locations and more stable, business-friendly but higher-cost environments in more developed countries (see Exhibit 3).

Change management

The implementation of an SSC represents a major organizational change. Thus, one of the most crucial, yet often underestimated, aspects during the implementation phase is proper change management. Typically, the SSC project will face resistance from two key stakeholder groups: On the one hand, management of the local operating units will perceive the SSC as a threat to their sphere of influence. Moving processes and people to the SSC implies less control and power remaining at the operating units. On the other hand, the SSC concept will also not motivate affected employees, who fear for their jobs or simply prefer to maintain the status quo. If employee concerns are not addressed properly, the resulting uncertainty among the staff will negatively impact productivity and lead to higher employee turnover; if not managed properly the company risks losing well-performing employees.

Therefore, a number of key issues have to be evaluated as part of the change management process:

- secure buy-in and active cooperation from the management of local operating units
- communicate plans and measures appropriately to minimize uncertainty among employees and avoid negative repercussions on the business
- systematically realize headcount reductions in affected functions at operating units
- select the right mix of employees for the new SCC.

Management buy-in

Buy-in from local management will be difficult to achieve without a clear commitment to the project from group senior management. Local managers must be aware that the SSC project is a priority of the company's top management and, as such, cooperation will be expected and monitored. In addition, every effort should be made to demonstrate and explain to local management the benefits the SSC will bring for local operating units (Exhibit 4).

Communication with employees

Employee-related issues are closely linked and are to a large extent determined by applicable labor laws and regulations. Failure to comply with such laws can be very costly and, in the worst case, reduce planned headcount reduc-

tions, thereby endangering the validity of the entire SSC project. It is therefore critical to ensure the compliance of plans regarding headcount reduction, staff re-deployment and communication with applicable laws.

Companies implementing an SSC need to observe consultation processes and notification periods of works councils and affected employees based on a variety of different regulations. In the European Union, the situation is complicated by the fact that European law may be interpreted and implemented quite differently by individual member states. In addition, national regulations and collective agreements between unions and employers may apply. However, all mandatory consultation and notification requirements of the various countries affected by the implementation of the SSC have to be aligned in the transition schedule; no country must be informed before the others, in order to avoid legal action by employees on grounds of discrimination. Thus, the longest national or EU consultation or notification period determines the timing of communication for all affected countries.

Approach to headcount reductions

Apart from the communication issue, companies need to decide how to reduce headcount at the relevant operating units. Alternatives include re-training and moving employees to other posi-



Dealing with high turnover rates

Companies like Pfizer and Ciba Specialty Chemicals try to mitigate turnover rates by offering more attractive career perspectives to SSC staff. According to Thomas Bucher of Ciba Specialty Chemicals, *“it is difficult to find qualified people at reasonable salaries even in supposedly low-cost countries. And we invest substantially in their training, so obviously we want to retain them. In our experience, having regional SSCs with more diverse service offerings also creates more interesting job perspectives. For example, we encourage rotations within the SSC and across different SSCs, so people can get an exposure to a broader range of activities and customers.”* He further argues that SSCs need to be sizeable enough to cope with high turnover rates.

Exhibit 5

tions within the organization (including the new SSC), transferring employees to special personnel service providers and layoffs. The latter is often the most costly alternative, due to legal obligations for severance payments, loss of valuable employee knowledge and a negative impact on the company’s image.

Staffing and training of the SSC

The decision on how to reduce headcount at the operating units is also influenced by staffing considerations for the new SSC. The issue here is to determine the appropriate mix of staff at the SSC. A complete staffing of the SSC with existing employees would limit the number of overall headcount reductions required. However, the success of the SSC will depend largely on creating a culture of customer service and operational excellence. Existing employees in support functions at the operating unit may not necessarily have the required skills or service mentality. Trainings in these cases play a significant role and should be planned and carried out carefully. In addition, employees may be influenced by the “old” organizational culture and emotional links to their previous unit and other parts of the organization. Newly recruited staff will likely make it easier to create a service culture at the SSC, as suitable candidates can be identified and selected in the recruiting process. Yet, new employees lack the knowledge of relevant processes and interfaces within the orga-

nization, a problem which can be only partly compensated through extensive training – you can transfer training, but you cannot transfer experience. As a consequence, staffing of the SSC will have to strike a balance between new staff and existing employees, who bring experience and knowledge of the relevant processes as well as of related upstream and downstream activities. Finding and maintaining the right staff for the SSC is aggravated by typically high employee turnover rates at SSCs (Exhibit 5).

Service Level Agreements

Transferring processes from local operating units to the SSC will create a substantial number of new interfaces between the SSC and its customers, i.e. the operating companies. In order to ensure a smooth functioning of the processes, both parties’ responsibilities and deliverables need to be clearly defined and understood.

This is typically done in service level agreements (SLAs), the main purpose of which is to establish a formal relationship between the SSC and its customers – similar to what would be expected with externally sourced services. SLAs contractually define the services to be provided by the SSC, including their quality, volumes, response times, price and consequences in case of failure to meet specified service levels. In addition, an

SLA should also specify the deliverables or inputs required from local units for the SSC to perform its duties (Exhibit 6).

While this appears straightforward, companies implementing or already using SLAs should be aware of the challenges involved. SLAs are often criticized for their complexity or potential inconsistencies and loopholes. Furthermore, in case of issues between the parties, such as declining customer satisfaction, SLAs often become subject to literal interpretation and serve as a basis for mutual allegations. Therefore, some companies run their SSCs without formal agreements or rely on broad term sheets. However, a high level of detail of the SLA may help avoid interpretation issues and related discussions. Specifically, the level of detail required will be a function of:

- the assessment of potential future problems that may arise,
- the degree to which local operating units are able to exercise control over the SSC,
- and the complexity of the structures and services involved.

Therefore, it is important to organize the SLA carefully to ensure clarity and the necessary level of detail, while avoiding unnecessary complexity. Over eighty percent of SSCs use SLAs to agree the

Topics covered in SLAs	
Roles, responsibilities and key deadlines	85%
Standard service description for standard processes	73%
KPI's for performance measurement	72%
Escalation route and guidelines	63%
Detailed service description and scope for ad hoc and special services	59%
Pricing structure and billing arrangements	58%

Exhibit 6

Source: KPMG

scope and performance of services offered to their customers.

Successful operators of SSCs regard SLAs as a tool to foster constructive cooperation between the SSC and its customers. The goal must be to use the SLA as a starting point for regular discussions to address potential problems and to jointly look for solutions and improvements to existing processes.

Performance management

Ensuring high levels of service quality is one of the key challenges during the entire lifecycle of an SSC. The SSC must demonstrate a service mentality, as if it were dealing with external customers. Customers' satisfaction is critical to achieve acceptance of the SSC. It is not enough to impose minimum quality levels through formal SLAs, the service culture needs to actually be lived at the SSC, and management is responsible for establishing appropriate incentives and performance management tools.

Charge-back mechanisms

First of all, prices, or charge-backs, for the services provided by the SSC have to be determined. Charge-backs can have a significant impact on the perceived fairness and, thus, the acceptance of the SSC concept by local operating units. Possible options include, but are not limited to:

- not charging costs of the SSC to customers,
- simply charging costs of the SSC to customers based on allocation keys such as unit size (measured, for example, by revenues or number of employees),
- pricing specific services or process steps, e.g. charge for each invoice handled by the SSC for the customer regardless of volume, or
- pricing specific services or process steps with different price brackets, e.g. granting rebates if transaction volumes are high.

The concrete choice of the charge-back mechanism will depend on the extent to which process costs can be determined reliably and cost-efficiently, as well as the transparency and incentives it provides for customers. One of the key purposes of the charge-back mechanism is to increase cost awareness for support functions within the operating units. In particular, customers need to be encouraged to maintain standard processes in dealing with the SSC. Thus, exceptional transactions or requests should be priced higher, thereby encouraging the customer to also standardize such transactions. Furthermore, in the interest of fairness and transparency, charge-backs should bear comparison with prices of third-

party service providers. Thus, charge-backs should ideally represent competitive market prices rather than internal transfer prices. In this context, tax considerations also become relevant (see section "Tax" for details on tax considerations).

In practice, companies pursue different charge-back strategies. For example, Pfizer and PubliGroupe chose to run their SSCs as cost centers. Costs are reallocated to local units based on tax considerations. In contrast, companies such as ABB, Clariant and Siemens prefer to run their SSCs as profit centers. Assuming charge-backs have been agreed and fixed, this will provide the management of the SSC with an incentive to create value through further improvements in efficiency or by attracting additional volume from customers. However, potential profits realized at the SSC through efficiency gains or economies of scale should be passed on to customers as reduced charge-backs. Essentially, this implies that the SSC be run as "profit center with zero profit", as ABB's Lars-Göran Lemelius states.

Key performance indicators

A customer-focused, performance-driven culture requires enforcement through performance targets and corresponding indicators. This is true regardless of whether or not a company uses formal SLAs. Key performance indicators (KPIs)

should include financial measures (e.g. cost reduction by processed unit, reduction of networking capital), customer-related measures (such as quality, response times, and friendliness), process-related measures (e.g. processing times, processed volumes, process cost) and employee-related measures (e.g. training received). To ensure that the SSC dedicates itself to achieving its KPIs, it may be useful to split the charge-backs into a basic income component and a performance-based component tied directly to the KPIs. Where possible, overall performance of the SSC should also be benchmarked against the performance of third-party providers. However, if services and performance data are not easily comparable, benchmarking provides little added value and may result in extensive debates about comparability, while more important issues are neglected. ABB for example monitors a focused set of performance measures (SSC Balanced Scorecard) across all SSCs. Besides being able to monitor the SSCs' performance, this also allows for internal benchmarking and effectively spreading best practices across the SSCs.

Governance structure

Another aspect often impeding service quality is the lack of an appropriate SSC governance structure. A regular dialogue between corporate management, the management of the SSC and management of the operating units helps to evaluate the performance of the SSC with

regard to its targets and objectives, as well as whether the SSC objectives are still in line with the overall corporate objectives of the company. Whether such dialogue takes place informally or within formal structures (e.g. steering committees or customer committees) will depend on a company's culture. In any case, managers on both sides need to have open, regular communication channels to resolve potential issues and discuss possible improvements and additional control measures in a constructive manner, emphasizes Dr. Jürgen Termin of EDS.

Good service quality also requires a thorough understanding of customer activities by SSC employees. In other words, it is not enough for SSC employees to master the processes transferred to the SSC; rather, they also be knowledgeable about upstream and downstream processes and their impact on the processes handled by the SSC.

Tax

While tax considerations are unlikely to be the driver behind the implementation of an SSC, potential tax savings may help compensating parts of the costs associated with establishing the SSC. Many countries encourage foreign investment through tax incentives and generally low tax rates. Companies establishing SSCs may wish to exploit such opportunities by using the charge-back mechanism to shift

profits from high- to low-tax countries. However, potential tax issues should be carefully analyzed before deciding on a specific SSC structure and charge-back mechanism.

Transfer pricing

The most important tax aspect is the issue of transfer pricing following the cross-border transfer of functions and processes to the SSC. One of the main problems in this context is that transfer pricing rules differ substantially from country to country, and may not be fully consistent with OECD guidelines for transfer pricing applicable in Europe. This is particularly true for a number of Asian countries. Therefore, the challenge is to determine charge-back prices that are fair, transparent and consistent throughout the organization, and at the same time meet the requirements of all applicable transfer pricing rules and regulations. Under OECD guidelines, the company has to demonstrate that a service – in the sense of a direct benefit – has been provided to the local unit by the SSC and that the charge for the service passes the “arm's length” test. A service charge is considered to be at arm's length if it can be shown that independent third parties would have agreed to the same charge for the same service under similar conditions.

A direct benefit to the local unit can be quite easily proven for services such as accounts payable or payrolls. The situa-

tion becomes more complicated for services that represent a benefit to several units or the company as a whole, but not necessarily to the individual unit. This might apply to services such as strategic planning support or services that primarily relate to external reporting needs of the company. Such services may not be tax deductible at the local unit. Many non-OECD member countries have adopted similar rules.

Arm's length prices can be determined as the market price to be paid for comparable services between independent third parties. This is referred to as the Comparable Uncontrolled Price (CUP) method. Where such a comparable market price cannot be established reliably, companies may use allocated costs plus an appropriate surcharge as defined by local transfer pricing rules. Typical cost allocation keys include revenues or headcount, but many local transfer pricing rules do not dictate specific allocation keys.

Withholding tax

Besides transfer pricing issues, charge-backs for services provided may be subject to withholding tax in certain jurisdictions. In other words, the operating unit may be required to deduct withholding tax from the charge-back price and transfer only the net amount to the SSC. Although in most cases double taxation agreements will allow for recouping the tax, this might not always be possible

depending on the jurisdiction and the service in question. Obviously, this can have a significant value impact on the SSC.

Value added tax

Another important tax aspect is the issue of value added tax (VAT) following the cross-border transfer of functions and processes to the SSC. VAT is a transaction tax and, as such, could be of great significance. Charges from and to the SSC could trigger different VAT treatments and occasionally double taxation for the parties involved. Care should be taken and an in-depth analysis would be an advantage when an SSC is implemented. Furthermore, the services underlying the charge-back have to be clearly determined and classified, because, depending on the nature of the service provided, these services can be taxable within Swiss territory. In other words, Swiss VAT has to be accounted for, zero rated (with credit), exempt (without credit) or alternatively, the place of supply may shift the VAT liability to the recipient party.

For Swiss VAT purposes, if the Swiss SSC only provides services to the group of companies abroad, the Swiss VAT law allows a voluntary registration under certain conditions, which may mitigate the operating costs that arise. However, if the SSC is not VAT-registered and purchases services from abroad (i.e. consultancy services) which qualify for the reverse charge procedure (account for VAT by the recipient), it will be necessary to

pay the VAT authority any resulting VAT above an annual purchase of CHF 10,000. Therefore, planning is essential when implementing an SSC.

Efficient tax management is key to addressing potential transfer pricing and other internal pricing and VAT exposures early in the implementation process. If the SSC concept is incompatible with tax rules in certain countries and the tax status of the local operating unit is at risk, companies might want to consider excluding that country from the SSC, depending on how significant the tax impact would be relative to the savings expected from using the SSC.

Security

Given the consolidation of processes in a single location, the availability and full functioning of the SSC becomes vital for most of the organization. Therefore, security of the SSC should be a major concern for companies. Key aspects to consider include

- IT security, including IT service levels,
- business continuity management to avoid service interruptions,
- and privacy of data and the impact of local data protection laws.

The major issue in implementing an SSC with regard to IT security is ensuring

integrity of data and smooth transition to new systems or processes. Errors in migrating existing data to new processes and systems cause poor data quality at the new SSC and is one of the most frequent IT problems. Extensive controls and audits are necessary to ensure data integrity and availability. Beyond issues relating to data migration and integrity, IT security also includes ensuring secure processes for operating and further developing the IT infrastructure. For example, this could be done based on process definitions provided by the IT Infrastructure Library (ITIL) framework of the Office of Government Commerce (OGC), which is a guideline for the provision of IT services.

A second important security aspect during the entire lifecycle of the SSC is to establish an effective business continuity management. A breakdown of the SSC, due to natural disaster, power failures or epidemics, will have a significant negative impact on the entire company's operations. Depending on the processes handled by the SSC, the result could include the unavailability of IT systems or the inability of the company to issue invoices or pay bills, with obvious consequences for supplier relationships and liquidity. Business continuity management therefore needs to ensure that key processes can be carried out without interruption even during a major crisis. Possible measures include the selection and equipping of a back-up site in a dif-

ferent location, which can assume the role of the SSC should it break down, or a back-up solution for outsourcing to an external service provider.

In contrast to an outsourcing solution, in an SSC concept all processes are retained within the company. As a consequence, one might expect that data privacy would be less of an issue. However, this is not the case: data privacy is definitely a topic to be taken seriously, in particular if specific personal data (e.g. HR or customer data) is to be transferred abroad. Local data protection laws should be evaluated for their effectiveness and varying requirements, and processes involving intellectual property or other sensitive data should not be transferred to risky countries. In addition to local data protection laws, industry-specific rules and regulations might apply, such as banking secrecy laws, bank supervision requirements, health insurance laws or secrecy of telecommunication laws. The IT concept for the SSC also needs to reflect local requirements for data storage and archiving, in particular with regard to accounting, tax and HR records.

Auditors' perspective

From an auditors' perspective, the implementation of an SSC will be relevant in two regards: first, what is the impact on the audit process, and second, how will internal controls of the company be affected.

With regard to the audit process, an SSC requires additional coordination between the team auditing the SSC and the auditors of the various local entities served by the SSC. While previously all activities and internal controls affecting an entity's financial statements were carried out domestically, they will now mostly be handled by the SSC, possibly from a remote off-shore location. In order to avoid so-called auditor tourism, i.e. a situation where auditors of each of the various local entities individually perform audit procedures at the SSC, it is recommended to establish a dedicated team. This group will audit the SSC on behalf of the auditors of the local entities, who will be able to rely on the reports of the SSC audit team for their own purposes. Potential issues arise from differences in perspectives of the individual audit teams – as the auditors of the SSC focus on the department as a whole, they will determine required levels of materiality and sampling which are not necessarily in line with those of individual local units. This can create difficulties for local auditors. In addition, the question of responsibility can be an issue. They take full responsibility for the statutory accounts of the local units, yet have to rely on the work of others for material inputs.

Dividing responsibilities between auditors of the local units and the audit team of the SSC will result in higher audit costs. This is mainly due to an increased need for coordination, exchanging audit



The role of SSCs in integrating acquisitions

Ciba Specialty Chemicals found its SSCs very helpful in facilitating and speeding up the integration of acquisitions. Thomas Bucher reports that his company typically manages to move new acquisitions to the common chart of accounts within one quarter. At ABB, the benefits of integrating acquisitions have been less pronounced, a fact which Lars-Göran Lemelius attributes to the group's historically decentralized structure. At Siemens, Philipp Kündig has had the experience that the strong day-to-day interaction between operations and finance required during the integration phase is sometimes impeded by the remoteness of the SSC. In his opinion, it is therefore important to have the necessary cross-functional expertise locally rather than at the SSC during the integration phase.

Exhibit 7

instructions, and interoffice reporting between audit teams as well as the additional review activities required by other audit teams. The extent to which such additional costs can be compensated by savings of audit costs from the standardization of processes within the SSC is difficult to predict. Experience shows that this might not necessarily be the case and that overall audit costs increase significantly, in particular during the early phase of an SSC's lifecycle immediately following implementation.

The second key concern of auditors will be to ensure that internal controls remain effective. In principle, the standardization of reporting systems and processes as well as the consolidation of activities typically associated with the implementation of an SSC should facilitate internal control, e.g. with regard to monitoring regulatory compliance. However, the splitting of processes between SSC and local operating units also creates new interfaces and thus introduces additional elements of complexity. As a consequence, companies implementing SSCs should carefully assess the implications on their internal control systems and initiate improvements where necessary.

Mergers and acquisitions

Apart from the impact of implementing an SSC on the existing organization, companies are often concerned how an SSC will affect future mergers, acquisitions

or divestitures. The question is whether SSCs facilitate or hinder the integration of acquisitions and the separation of divestitures.

Integration of acquisitions

In fact, at companies frequently engaged in M&A transactions, one of the main reasons for implementing an SSC has been the desire to facilitate the integration of acquisitions and to better realize potential synergies. Standardized processes as well as the knowledge and experience gained during the implementation of the SSC will facilitate the integration of acquisitions. Synergies in the form of cost reductions and efficiency gains in support functions can be captured more easily through the SSC. An SSC truly provides a scalable platform from which acquisitions and new businesses can be integrated smoothly and benefits realized quickly (Exhibit 7).

Separation of divestitures

With regard to divestitures, the situation is less clear. On the one hand, the clear contractual relationships between the SSC and operating units with market or near-market pricing should facilitate a potential buyer's assessment of the true profitability of the target division or business unit. This would not necessarily be the case with centralized support functions at headquarters and company-specific cost allocations and charge-backs between headquarters and the operating units. On the other hand, however, the

lack of a self-supporting back-office infrastructure at the operating units might be a hindrance for potential buyers that do not operate an SSC themselves. For example, financial buyers intending to run the acquired unit as a stand-alone business would have to rebuild at the acquired unit all processes that previously were carried out by the SSC in the seller's organization. Such buyers can be offered to use the services of the seller's SSC for a transitional period until they have re-established the required support functions at the acquired unit. In consequence, this creates additional complexity in the divestiture process or limits the scope of potential buyers.

From the seller's perspective, it is important to evaluate the impact of a potential divestiture on the SSC at an early stage, argues Thomas Bucher of Ciba Specialty Chemicals. If the unit to be sold is a major contributor of volume to the processes handled by the SSC, a divestiture might result in insufficient transaction volumes remaining at the SSC, with negative consequences on economies of scale and costs. Thus, additional cost savings and efficiency improvements might be required at the SSC to maintain the validity of the SSC business case, Bucher points out.

How to set up an SSC

Is your company a candidate for SSCs?

The answer depends on a number of key questions:

- What is the organizational objective for an SSC?
- What are your company's targets for improvement?
- Is an SSC the right option or are there better business models?
- What would be the scope of services to be transferred to the SSC?
- Is the scope sufficient to achieve economies of scale that exceed the cost of implementing and running the SSC?
- What is the location strategy?
- Are there any other key constraints to consider?

The results of this "feasibility study" are summarized in a Shares Services strategy document and initial business case, which should be sufficiently detailed to help the company make a decision as to whether or not there is a case for an SSC.

Typical steps in the process

The complex lifecycle of an SSC can be broken down into the following six phases (Exhibit 8):

1. Strategy

The Strategy phase lays the foundation for the SSC project. In this phase, the company defines a shared services vision and strategy, i.e. the objectives it wishes to pursue by establishing an SSC as well as desired improvements. In addition, key constraints and risks to the project need to be identified and assessed. Based on this risk assessment, the initial scope of the SSC and a location strategy are determined. In a last step, an initial business case is prepared and analyzed to see if there are sufficient potential benefits for the project to proceed to the next phase.

2. Scope & Plan

In the second phase, planning for the SSC becomes more concrete. The focus is on understanding the issues, opportunities and business requirements associated with current business architecture (i.e. people, processes, technology) and developing a conceptual new business architecture involving the SSC. This includes the high-level design of the SSC in terms of processes, technology, organization and controls. As new risks may be identified for the suggested concept, another risk assessment is required, in particular with regard to regulatory, privacy and intellectual property risk. Furthermore, the tax and legal structure of the SSC will be defined in this phase. Based on this work, the project team refines

Stages of an SSC

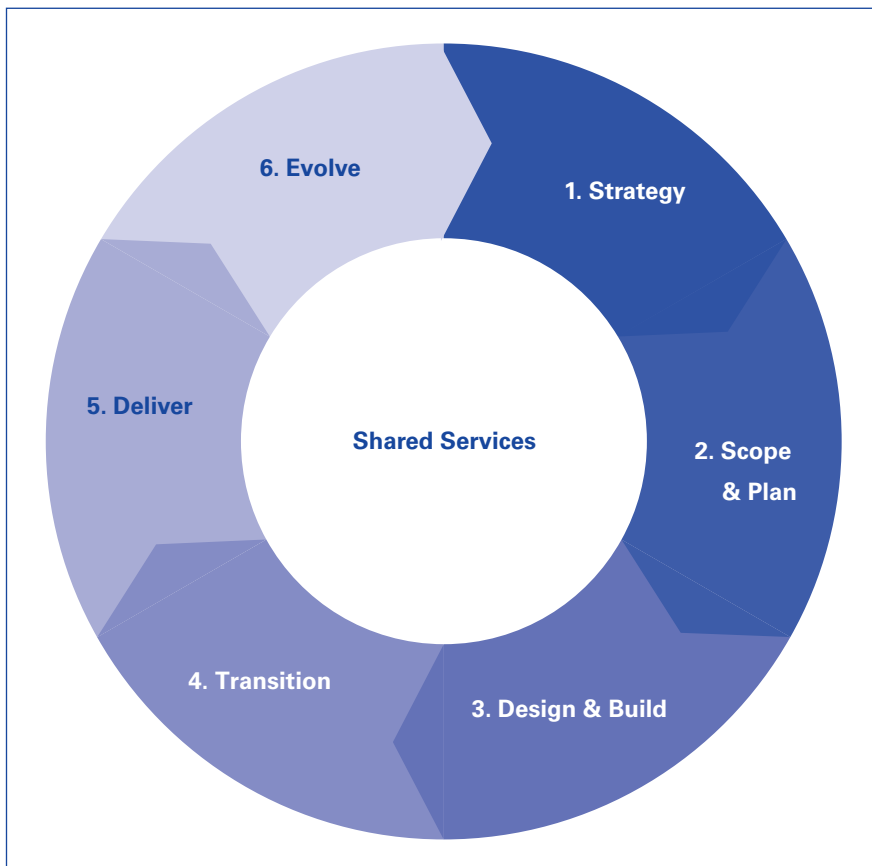


Exhibit 8

Source: KPMG

the business case and develops models comparing status quo costs with those of the planned SSC solution. Upon management approval of the refined business case, the project may then enter the Design & Build phase.

3. Design & Build

The Design & Build phase is the final phase before the actual implementation of the SSC. The main objectives for this phase are the detailed design of the SSC, including the definition of processes, organization, job, staff requirements, physical location and business requirements for technology. Also, service level requirements will have to be determined and an ERP and systems integrator selected. At the same time, a transition plan needs to be prepared outlining all implementation steps. Finally, the transition plan and an updated version of the business case will be submitted to the executive management for approval.

4. Transition

This represents the actual implementation of the SSC. First, the concept will be tested on a pilot unit. A pilot test is important for two reasons – so that the lessons learned in the pilot phase can be leveraged in the subsequent full-scale implementation and because a smooth

and successful pilot test will improve the perception of the SSC project within the organization, thereby increasing acceptance and buy-in.

If implementation of the pilot is successful, the lessons learned will be incorporated in the overall transition plan and process design. In a next step, the transition of relevant processes takes place full-scale for all involved operating units. During the transition process, managing the transition risk and monitoring actual progress versus planned progress will be essential. Based on the lessons learned during the transition and actual success and costs incurred, the business case is updated once again to serve as a basis for measuring the success of the SSC concept during the operational phases. This concludes the implementation of the SSC.

5. Deliver

The Deliver phase refers to daily operations once the SSC is up and running. To ensure an effective functioning in line with expectations, the performance of the SSC has to be monitored on a regular basis. This includes an assessment of dimensions such as the governance structure, service levels, customer satisfaction, contract and regulatory compliance and controls.

6. Evolve

In the last phase, the SSC is periodically assessed in the context of the current business environment and the company's overall organizational strategy to determine whether changes are required. Key activities in this phase include measures to realign the SSC model with the overall corporate strategy, the identification and realization of opportunities for cost reductions at the SSC, and assessing and managing the impact of potential mergers and acquisitions on the SSC model.

What really makes SSCs work

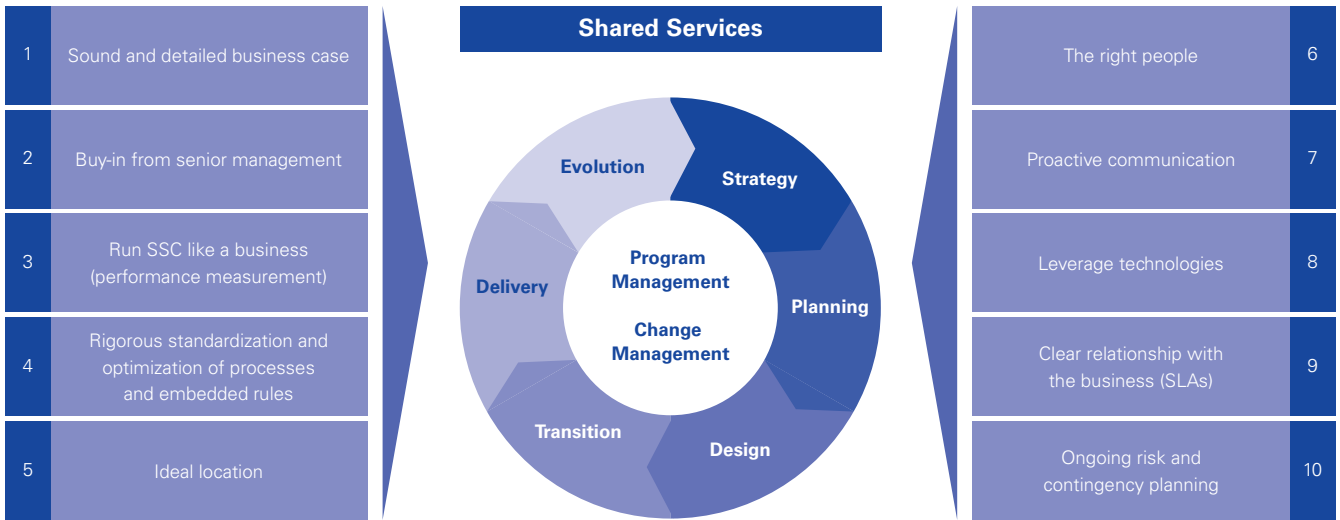


Exhibit 9

Source: KPMG

Key success factors

The implementation of an SSC represents a major organizational change and is therefore highly specific to the respective company. Thus, there is not a standard recipe for guaranteed success. However, based on the experience made during successful implementations of SSCs, a number of key success factors can be identified. These are summarized in Exhibit 9 and explained in more detail below.

1. Sound and detailed business case

Develop a realistic business case specifying the quantitative and qualitative benefits as well as the costs and risks of the proposed SSC concept. This is important for managing the expectations of all stakeholders during and after the implementation. In particular, an initial decline in performance following implementation of the SSC is to be expected. “A drop in performance right after implementation is unavoidable – you have new people and new processes that need time to synchronize,” says Pfizer’s René Jauss. Deviations from the plan due to unrealistic assumptions in the business case will undermine the credibility of the project team and the entire SSC concept.

2. Buy-in from senior management

A clear commitment and active support from senior management must be ensured throughout the implementation process. A senior project sponsor should make statements in support of the SSC concept. Without senior backing, the project team will find it difficult to convince affected management and employees of the importance of the project. Management at operating units should be convinced based on the argument that the SSC will free local units from time-consuming transaction-oriented processes, allowing them to focus on more value-added activities. Furthermore, local management should be encouraged to participate actively in the development of the SSC vision and strategy to ensure their commitment and buy-in to the SSC concept.

3. Run SSC like a business (performance measurement)

The SSC should be run as a profit center with a distinct customer-focused culture. Service quality and customer satisfaction are the key driving factors to be ensured through an effective performance management at the SSC. To that end, relevant key performance indicators should be used to measure performance versus target levels.

4. Rigorous standardization and optimization of processes and embedded rules

Mainly standardization and optimization of processes will allow cost reductions to be achieved meaningfully through efficiency gains and economies of scale. As both Philipp Kündig of Siemens and Volker Laska, CIO of Clariant, emphasize, companies should do their homework first and harmonize their backoffice processes to reduce complexity before implementing shared services.

5. Ideal location

Location is another major factor of the SCC project, as it has cultural and language implications, and to a large extent determines labor and infrastructure costs and affects the risk of the project. Therefore, companies should make this decision carefully and not necessarily with an exclusive focus on labor costs.

6. The right people

As far as the project team is concerned, the company should ensure that the project leader has the authority, experience and change management skills to lead a project of this magnitude. This person needs to be able to drive the process against resistance and be a credible counterpart for operating unit leaders.

With regard to the SSC itself, the company should go for a mix of new hires and existing staff, transferred from operating units. That way, a good balance is achieved between transferring knowledge of processes to the SSC and creating the right foundation for a customer service-orientated culture.

Furthermore, companies implementing an SSC should invest heavily in training. This applies both to employees of the new SSC and those employees remaining at the operating units at the other end of the process. It is recommended to train new SSC staff at local units first before moving them to the SSC. This will improve their understanding and awareness of upstream and downstream activities and facilitate subsequent interactions with local units once the SSC is operational.

7. Proactive communication

The SSC concept and its impact on employees has to be communicated in an open, proactive manner to minimize distraction and uncertainty. A detailed communication plan must be created to define what needs to be communicated at what times, in what form, by whom and to what audience. The communication plan ensures that all communications are

accurate, consistent and compliant with applicable labor laws, regulations and agreements.

8. Leverage technologies

Leveraging technology can help companies realize the full potential of standardized processes. For example, investing in technologies such as contact management, e-billing, e-payment or e-reporting will help shorten response and processing times, thereby improving service and productivity. Also, increased automation is desirable from an internal control perspective. However, the cost of such technologies should not be underestimated when preparing the business case.

9. Clear relationship with the business (SLAs)

The SSC concept relies on clearly defined interfaces between the SSC and its internal customers. SLAs should be used to define mutual responsibilities and deliverables, quality levels, and issue resolution procedures. In addition, the governance concept of the SSC should provide for appropriate oversight by senior corporate management and establish formal or information communication channels to foster cooperation and dialogue between all parties involved in the SSC concept. This may include joint

steering committees of corporate managers as well as managers of the SSC and the operating units.

10. Ongoing risk and contingency planning

Like other large-scale reorganizations, the implementation of an SSC represents a major organizational change which introduces a whole range of additional risks to the entire company. Therefore, it is important to perform regular risk assessments to all phases of the SSC lifecycle, to identify material risks arising from the new SSC concept. The company should also look for possible ways to mitigate such risks and establish an effective business continuity management in case a risk materializes.

How KPMG can help

KPMG is able to provide a comprehensive and integrated approach designed to the specific customer context. The advice is characterized by KPMG's independency and the ability to support the implementation of the targeted solution with multidisciplinary teams (financial management skills, process/operational skills, audit, internal control, tax, legal). KPMG has an established track record in designing and delivering a customized approach that addresses your company's specific goals. Industry knowledge, a strong understanding of the risk associated with sourcing, financial discipline and rigor to the development and delivery of the business case distinguish KPMG as your partner of choice for shared services centers projects.

Depending on the specific context and objectives of the SSC initiative, the KPMG team can support in

- defining the business case,
- determining the scope of activities to be transferred to the SSC,
- assisting to find the ideal location,
- supporting the optimization and standardization of activities and processes to be transferred to the SSC,
- assessing and designing the IT architecture for an SSC,
- developing the legal and tax structure,
- drafting Service Level Agreements (SLAs),
- and managing the project.

With KPMG's proven methodology and tools, our highly experienced team can help your organization across the entire shared service lifecycle.

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