New framework about the differences between Shared Service and Outsourcing models

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In the 80's the U.S. companies as a result of cost-cutting measurements centralized some corporate functions into corporate headquarters. But his tendency did not meet the market changes because the companies had to be close to their customers and markets and diversified operation had to take out. Therefore, companies turned to diversification that satisfied these market demands better. Both outsourcing and shared services appeared in this time and became popular among the U.S. companies. The outsourcing as one of the implemented forms of decentralization an outside company performs certain service activities for the company. When these activities are provided by an internal service provider and this creates a market within the company, we can talk about application of shared service models.

However there is the question, which trends and which models are more popular today and why. In the last decade both outsourcing and shared service models live their second flowering. In the literature there is a lot of hesitancy about it.

I am researching the different global sourcing models and mainly the shared service model. This research study demonstrates that it is not easy to differentiate the variant models. I disclose the main differences between two sourcing models, the shared service and outsourcing models.

Design/methodology/approach

This research is mostly based on literature review but I did 10 interviews with key experts from Hungarian service markets to disclose the market tendencies and the conditions for further growth and I used each interviews to disclose the picture about the differences of the models.

Introduction

The outsourcing (that term comes from „outside resource using") means moving out some organizational action or function (this is the classical outsourcing) or a whole process (this is the Business Process Outsourcing, BPO) from the organizations to external organization and then buys the service in the required amount. Organizations mostly choose outsourcing because of focusing on core competencies, decreasing of operational costs and improving service quality. But it could be a good action for the introduction and managing of certain organizational changes.

Shared service model operates in shared service center (SSC) that is a centralized organizational unit to deliver certain internal services mostly for the other organizational units or partly for other companies. The classic shared-service model was also created to achieve savings. It is reached by creating economies of scale and enhancing of efficiency, so delivering services for more and more customers but with the same resources. It was available mostly at the services with high volume and many transactions where it could be minimized the number of interactions with customers. The high number of transactions is important because these functions could be standardized quite well and that is one of the sources for cost-cutting.

Because of the similarity of the aims and the applied tools in these models, many experts think that shared service model is a specific type of outsourcing. That is why there are the term of SSC outsourcing (Thorniley, 2003) or internal outsourcing (McLemore, 1997) in the literature. It is important to accentuate that there are basic differences between shared services and outsourcing models.

Base of differences

It is the simplest to illustrate this difference that outsourcing means at least one of the organizational function to move out, hand over to another, external (not the same) organization. So outsourcing in the logical framework of sourcing models means step over the organizational boundaries. On the contrary in the shared service model there is no handing over anything, but reorganizing in the organization, so the certain function remains in some way among the organizational boundaries.

There are many ways to accomplish it. So I deem very good approach of Terbócs (2007) about SSC:

> *„...a service delivering organizational unit that is not wholly independent of the organizational units served out." (Terbócs, 2007:17)*

This broad definition facilitates integrating the different shared service solutions that come up in the corporate practice into one theoretical framework. The differentiating characteristic is that shared service center becomes not wholly independent.

Although the two models choose different solutions but the aims and applied tools are very similar. This similarity is the reason why these models are confused in the literature. Another reason of confusing is that matured shared service centers deliver services not only inside but outside of the organization as well. In this case shared service center looks like a market service company similar to those that deal with outsourcing actions. A third reason is that shared service centers are mostly organized into a wholly owned but independently affiliated firms (as a kind of spin-off company) that is called in the literature as internal outsourcing (Hinek, 2009).

But in my approach the two models are differentiated from each other, none of them is a subtype of the other. They exist beside each other and deliver different solutions to a very similar problem. It is important to write that movement or collaboration could be among the models so using of one sourcing model is not meant a final and not reversible decision from the companies.

Advantages and disadvantages of the two models

Each company likes to figure with fix and expectable costs but there are always assignments that contain hidden cost elements. In the global company culture it is not the question than it is worth to use outsourcing but it is must to prove using internal resource. But of course it has also danger if a function created value move out from the company. So the most important element of the success in outsourcing actions is that who is the executor. Outsourcing is a long-term cooperation about a company function that means the service company has the overview and decisional competency about service division. So the question is that supplier could ensure the necessary service level and the agreement regulate properly the power, expectation, competencies. Several problems come from the bad expectation of client organization units. If the aim is only the cost reduction than it is almost sure that the client will disappoint when recognize that service from the supplier looks more expensive. It needs to measure that there is a balance between the profit ratio of the supplier and the efficiency of the company (Sebők, 2001).

Outsourcing enables over cost benefits the focusing on core competence. By using shared services the point is the same but the achievement is more limited than in outsourcing. In a matured service market the supplier companies could operate with more advantageous costs because of big volume and specialization. Using of shared service reduces the opportunity to focus on core competencies more because the company management or division management needs to deal with the operating, improving, controlling of shared service center if it was outside of the organization. From the initial situation the shared service center reduces the time and capacity greatly.

The relationship of shared service and outsourcing models is characterized by more opinions that shared service model is only a precedent before outsourcing and the final solution for these functions is outsourcing. According to David J. Dell and Yuliya Tsaplina there are three scenarios about the future of shared service model (Beaman, 2004):

- In the first scenario shared service is a step in the establishment of outsourcing. It helps the company to cognize its internal costs, requirements, service levels and competencies. It takes accountability in focus. These companies outsource at least one important function to preserve their corporate flexibility and avoid new investment into the technology. In this case it could be recognized that those services that were organized firstly in shared service center then to an outsourcing provider, could enable bigger saving, better service level or more benefits.
- In the second scenario the shared service model is alternative to outsourcing. In this case the company treats the function as a core competence.

- In the third scenario shared service model is a waiting state. The shared service center is established firstly then it is controlled and benchmark with the market players. It is typically used in premature markets. If the market was premature and able to deliver service with adequate quality and price then sign a contract with a third party.

These three scenarios show that the relationship of shared service and outsourcing deals with very practical questions. Does the company know it operational costs, could it measure, could it benchmark with the market level, etc.? In the first and the third scenario shared service model is a precedent of outsourcing, and in the second it is an alternative. In the next structured chart I summarize the advantages and disadvantages of the two models:

Table 1. Advantages and disadvantage of Shared Service and Outsourcing

OUTSOURCING		SHARED SERVICE	
Advantages	Disadvantages	Advantages	Disadvantages
Bigger cost-cutting (Lowes et al., 2009)	Come up the hidden costs (eg. Related with hand over, information collection, contracting, etc.) (Tóth, 2012) (Lowes et al., 2009)	Lower risk because of the bigger control over processes and output (Lowes et al., 2009)	Keeping function in-house could be bigger risk than handing over the service to an outsourcing provider where the sevice are cutting-edge (Lowes et al., 2009)
It means better service quality if the supplier has specialized knowledge, experience in the specific field (Lowes et al., 2009) (Tóth, 2012)	This knowledge is inherited not only by outsourcing providers. (Lowes et al., 2009)	Business requirements and systems are unique. This could mean a differentiating competitive edge. (Lowes et al., 2009)	The unique systems and solutions could cause competitive drawback in many times (Lowes et al., 2009)
Quicker adaptation because the provider has the same interest about the time dimension (Lowes et al., 2009) (Tóth, 2012)	The provider will focus only on those parts of the process that it is controlled but the biggest value is created by the end-to-end processes (Lowes et al., 2009)	More responsive to the business needs the relationship is stronger (Lowes et al., 2009)	The organizational closeness creates complacency and the organization lose its freshness. Contracting with an external partner could be accelerated for the work (Lowes et al., 2009)
A costly investment in future could be avoided (Lowes et al., 2009) (Tóth, 2012)	There is no harmony between the aims of the provider and the organization (Lowes et al., 2009)	It is not necessary to share the strategy and other core information with a third party (Lowes et al., 2009)	
It needs bigger flexibility fix costs to convert variable costs (Lowes et al., 2009)	Attention of consumers is decreasing (Tóth, 2012)		
Sharing responsibility, diversificate operational risks by outsourcing (Tóth, 2012)	Sharing the risk of confidential information (Tóth, 2012)		
	By handing over the functions and dismiss human labor, organizational culture dying (Tóth, 2012)		

Source: own collection

Shared service model is chosen by the companies because in this case control of the services is easier than in outsourcing and it is very important when information related the function is sensitive, tacit, complex, expensive but reproducible. The strategical a service, the bigger is the probability of using shared service model. It is also important in using of shared service model that the tighter the cooperation is within the organization, the important is avoiding of communication difficulties, the bigger is the probability of using shared service model. Maturing of the service market, so the number and quality of service provider companies influence the decision as well. The matured is the market, the bigger the attraction to use outsourcing model. Volume of services also influences the decision. It is worth to contract with a market specialist if the service has low volume but a service with high volume should keep in the organization logically.

In the next chart I compared the shared service and the outsourcing models on the based of organizational views:

Table 2. Comparison of Shared Service and Outsourcing models

Organizational views	Shared Service	Outsourcing
Structure of relationships	Network among the organizational units	Bilateral relationship
Organizational strategy	Yes	No
Risk sharing among the partners	Yes	No
Reducing the duplication process	Yes	Eliminated
Knowledge sharing among the partners	Yes	No
Centralized control	Yes	No
Change in the human resource	Study and train employees	Reducing of number of employees
Process reorganization and standardization	Yes	No

Source: own editing based on Petkovic & Lazarevic, 2012

The shared service model needs higher capital investment, establishment costs and higher operational costs than in outsourcing because there is fewer benefits come from specialization by serving different organizational units. Using shared service model it is slower and harder to reach financial success because service volume need to reach an adequate level (Out, 2008).

But a whole outsourcing could also be more expensive than a shared service model if the outsourcing provider has not enough clients that improve economies of scale. While an outsourcing provider always wants to reach profit on service provided. So if a company place out a function to a third party without knowing its own cost level, could pay more for the services than keeping them in-house.

It is important to highlight that choosing among sourcing models is not for eternity. It could imagine that company reaches the aim in more step, through more models. For example in first step organizing functions into a captive center based on shared service model then create an affiliate and final sell it for a third party provider. But there is no constraint for companies to use only one model. There are multisourcing companies that use more delivery models in parallel to avoid dependency.

Summary

I think that choosing between the two models is a continuous question for company managers. It is worth to choose an outsourcing model if a company wants to change in very short and the focus is on the cost-cutting. Choosing a shared services model is the right decision if there is more time to accomplish changes and focus is on control unique processes. But both models could be competitive only if the company has the adequate system, process, labor and volume in the organization or in the units.

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II.

Culture(s)