When separate organizations merge their back office functions

blogs.lse.ac.uk/businessreview/2016/07/20/when-separate-organizations-merge-their-back-office-functions/

7/20/2016

"If you are not already thinking about moving to shared services for your organisation, you probably should be."

This advice from management consultants Accenture has been taken up with gusto by many local and national governments across the globe – particularly since the global financial crisis added new pressure to agency budgets.

Shared service arrangements involve separate organizations merging their 'back office' support functions, like HR, ICT, finance and procurement. This aggregated activity is then delivered from one location to many "customers," the hope being to reduce duplication and increase economies of scale.

Referred to by previous generations as "common services", and widely denounced during the heyday of new public management, when decentralisation and 'agencification' were all the rage, today, shared services are once again in vogue. Recent reforms include anything from state-wide initiatives, such as those in Denmark and Sweden, or sector-specific projects, such as policing in the Netherlands or healthcare in British Columbia. And the UK government has been at the forefront of the reform trend, most recently with its "Next Generation Shared Services" programme.

There have been many successful shared service reforms, but also some failures. In a particularly infamous case in Western Australia, the change project cost $362mAUD (c.£186m) more than planned, and was eventually abandoned as a hopeless endeavor. Recent research in the US found general disappointment with the savings delivered by public sector shared services. And, closer to home, a string of NAO reports in the UK, including one published in May, also found underwhelming results.

What might explain these cases of disappointment, and what can be done about it? In a new research article (Sharing services, saving money? Five risks to cost-saving when organisations share services), we identify a number of issues that shared service reforms must overcome to achieve efficiency savings:

1. **Don’t underestimate start-up costs**

This seems to be widely forgotten when it comes to shared services.

Refashioning organizations to enable effective service sharing frequently takes longer, and costs more, than planned. As well as pointing to ‘micro’ issues (such as internal resistance), we emphasis the concept of ‘path dependence’ , i.e. there are explicit and hidden costs to abandoning previous ‘locked-in’ routines and work practices.

2. **Transaction costs increase**

For efficiency gains to be realised from shared service arrangements, economies of scale must outweigh any increase in transaction costs. And yet there are significant transaction costs involved in setting up shared services, from documenting and codifying existing processes, to agreeing new common operating procedures, writing a contract or service level agreement, and monitoring performance. Even with new technology, there is a risk of creating additional layers of management and coordination. Unfortunately reform proponents often overlook this trade-off, focusing on production-cost savings rather than the transaction-cost burden for clients – a practice condemned by some government auditors.

3. **Reduced service quality**

Inter-agency standardization of back-office processes brings advantages but also risks, including excessive concern for processes over outcomes and slower decision-making. In other words, rules concerning standardization are prioritized over service quality. And while the motto of the ‘user being the chooser’ is popular, it often transpires that the service provider determines what the user can have – ‘the tail wagging the dog’ as it were.

4. **Functional duplication**

By sharing services, managers are expected to end duplicated activities and eliminate ‘redundant’ capacity. However, the emergence of ‘shadow’ teams in customer organizations, repeating the work of the shared service centre, is a common problem that undermines the expected efficiency gains.

There are several reasons why organisations might duplicate services, including the desire to maximize autonomy. To do so organizations might ‘decouple’ their public-facing exterior from their internal operations, i.e. pay lip service to reforms such as shared services while retaining (and concealing) parallel in-house capacity.

5. **Opportunity costs**

Finally, as with any reform, there are opportunity costs to adopting shared services. By expending energy and resources on shared services reforms, governments are *not* doing other things. Is this sacrifice worthwhile from a cost-saving perspective? Might efficiencies be generated through other strategies such as decentralisation to lower levels of government or devolving resources to individual agencies? And does major restructuring for shared services divert attention away from redesigning frontline systems and processes?

Shared services can deliver efficiencies and economic savings, but greater awareness and recognition of the hidden costs and risks involved are necessary. Our research suggests that shared services should be considered as one of a range of options for improving administrative efficiency. Sometimes they will be the best choice, but otherwise reforms to in-house provision may be preferable, especially if clients have diverse needs. Furthermore, greater recognition of the trade-offs between production and transaction costs, and between inefficient and fail-safe redundancies will improve initial cost-benefit analysis. Finally, resistance to shared services is not simply a “people issue” to be dealt with by appropriate change management. It is also an opportunity to engage end-users in reform design and implementation.

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Notes:

- *This blog post is based on the authors' paper Sharing services, saving money? Five risks to cost-saving when organizations share services,* Public Money & Management, Volume 36, Issue 5, 2016
- *The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
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