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shared service centers

Professor Ilan Osrhi: 'Captive centers are evolving'

Cost advantages are not the only consideration

Shared service centers in developing countries are indicated as captive centers. Captive centers are offshore subsidiaries or branch offices that provide the parent company with services. Cost advantages are not the only consideration in implementing captive centers; the availability of professionals has to be taken into account. Professor Ilan Oshri, Loughborough University (UK) and an associate at the London School of Economics Outsourcing Unit, analyzed firms' strategies and identified evolutionary paths along which the basic model develops..

Erik Beulen

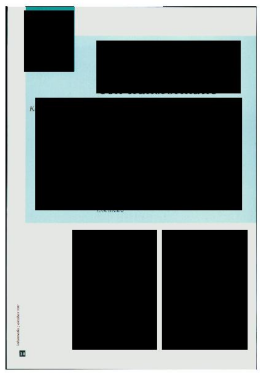
Shared service centers are subsidiaries or branch offices of the parent company. The function is centralized to realize economies of scale and/or to ensure access to qualified professionals. Professor Oshri starts to explain the difference between shared service centers for providing services and shared manufacturing plants. Examples for possible shared service center tasks include back office processes such as finance, procurement, expenses or HR.

Professor Oshri: 'There are little scale constraints for contemporary shared service centers in comparison to the shared manufacturing facilities we have seen in the 1980s. In the services, the transactions can be automated and a significant increase in scale, on most cases results in a fraction increase in capital investment.'

This characteristic of services is lowering the barriers of implementing a shared service center for providing services compared to shared manufacturing plants. This is the reason why we see a variety of business models emerging in shared services in comparison to a relatively heterogynous model of shared manufacturing.

Profession Oshri: 'WNS [a Business Process Outsourcing service provider] is a perfect example of unlimited capacity by highly automating the service provisioning. Their BPO services portfolio includes processes that support, amongst others, the travel and leisure industry [as well as] banking and financial services.'

The implication is that size for shared service centers matter less. However, especially in cap-



tive centers, shared service centers in developing countries, predominantly large multinational firms, are active. Professor Oshri provides an example: 'In 2002, IBM launched a corporate project to consolidate the procurement function. Initially they structured the procurement function in nine regional centers instead of by country. Two years later, they transformed the nine regional centers into three captive centers, one in Eastern Europe and two in Asia. Currently, IBM has added satellite centers to ensure the availability of qualified professionals.' Other examples Professor Oshri details in his book on captive centers are financial institutions, including Citygroup, HSBC and Santander.

Country attractiveness

In the 1990s, most companies decided to implement their shared service centers in India. Professor Oshri stated: 'Currently, there are 120 countries hosting shared service centers. Companies have to carefully select their destination of choice.'
The BRICS countries (Brazil, Russia, India, China and South Africa) are relatively attractive. In selecting country/countries of choice, the following selection criteria can be applied: costs, skills availability, environment (including government support, business environment, living environment and accessibility), quality of the infrastructure, risk profile and market potential. These criteria have to be monitored frequently. External consulting and advisory companies, such as A.T. Kearney, Gartner and KPMG, provide annual country rankings.
Professor Oshri: 'To create an entry point in the market, some multinationals select North African countries for their captive centers. Egypt was one of the popular offshoring locations until the 2011 uprising as it was perceived as an entry point for the Middle Eastern market.'
To smoothen the risk profile, nearshore is also an option. American companies might consider, for example, Canada or Panama as their destinations of choice. The Czech Republic, Poland and Hungary are important nearshore locations in Europe. For European countries, membership to the European Union is an important consideration as a location of choice. This membership facilitates providing services, including data exchange and the traveling of the involved professionals between the involved countries. Professor Oshri agrees, stating: 'Eastern Europe is a growth area in terms of the number of new captive start-ups, whereas India is declining in this respect. The most important root cause for the declining impact of India is the real-value other locations offer in certain business functions.'

Type of captive centers

The basic captive center is the starting point for all captive centers. A basic captive center is a wholly owned branch office or subsidiary used mainly for IT support, back office data processing, call center operations, software development, or business process outsourcing in an offshore location. These services are provided only to the parent firm (Osrhi, 2011, p. 17). Oshri has identified five other fundamental types of captive centers (figure 1). The hybrid captive center outsources part of the processes to external service providers. As Professor Oshri explains: 'The hybrid captive centers are often outsourcing processes to local vendors.' This fundamental type of captive center is a blended 'make' and 'buy' type.
A third type of captive center is the shared captive center. Contrary to the hybrid model, this type is typically 100 per cent powered by the parent company. No external service providers are involved in the service provisioning. However, the shared captive centers not only provide services to the parent company but also to other external clients. 'Deutsche Telekom and Vodafone captives are good examples for shared captive centers', Professor Oshri states.
A fourth fundamental captive center model is the divested captive center. The parent company has to decide if they prefer to partly or completely divest. The most important question is related to the assurance of the service continuation. Professor Oshri elucidates: 'Parent companies have to

transform internal Service Level Agreements into an external contract. A classic example is British Airways (BA). In 2002, BA divested their shared service center in India employing 300 professionals to a private equity firm, Warburg Pincus. Currently, WNS is a leading global business process outsourcing company employing 25,000 professionals across 29 delivery centers world-wide and serving 200+ global clients.' In this divestment, guarantees for service continuity were built in, such as no changes in leadership and capped turnover of staff. Also, the labor conditions of the transferred staff were protected.

The fifth fundamental captive center type is the terminated captive center. Professor Oshri expounds on the reasoning behind this type of captive center: 'Not all captive centers are successful in the long run. For example, DELL decided to back source their call center for private customers. DELL faced issues with the quality of the provided services.'

The final fundamental captive center is the migrated captive center. Availability of skills is a critical factor driving changes in location. The creation of satellite captive centers by IBM is one example. 'IBM decided to add a captive center in Sofia to their Budapest captive center for Eastern Europe. The high-end procurement services are currently provided out of Budapest while Sofia has taken over more repetitive work.'

Migration paths

There are multiple reasons to transform a basic captive center. It is important that the parent company constantly monitors the provided services. Also, it is important that the environment is accessed frequently. This is predominantly related to the location and alternative locations for the captive center. This is not limited to the availability of skills. Geopolitical stability requires monitoring, as well.

There are three possible migration paths explained in Oshri's book (figure 2). First is the transformation of a basic captive center into a migrated captive center. The example of IBM's procurement captive centers fits this migration path. Professor Oshri states: 'Mostly the availability of skills is driving this migration path. However, the cost perspective sometimes is also important.' Not only inflation, but also the conversion rate of the local currency into the company currency, drives the cost level. Financial instruments can protect the impact of fluctuation in exchange rates; however, this is not free of charges.

Secondly, the transformation from a basic captive into a shared captive into a migrated captive is also a choice. The British Airways – WNS case is a perfect example. New external customers expanded the geographical spread into 29 delivery centers and increased the number of staff from 300 to over 25,000 professionals. The service portfolio had been expanded significantly. This is similar to migration paths in the IT industry. Philips decided in the 1990s to merge their IT operations with BSO, a local Dutch service provider. This captive center provided services to the parent company as well as to other external clients. Philips transformed this organization into a global service provider. This captive center was divested to Atos in 2005, which from 2000 onward, had a partial ownership of the captive center. Philips remained a stake in their captive center from 2000-2005.

Thirdly, a captive center can be transformed in a terminated captive, and finally transformed into a migrated captive center. Professor Oshri rationalizes this path: 'In addition to the earlier mentioned case of Dell, only last month, Santander decided to migrate its call centers from India to the UK. Their clients were not happy with the services provided by the [current] providers.' Backsourcing to the home country is not a light decision. The transformation is costly and not risk free. However, customer satisfaction is paramount. 'It is important to mention that also strategic rethinking might result in implementing a backsourcing strategy. General Electric (GE) might be an interesting case', Oshri says. Last year, GE was considering bringing back 15,000 information technology jobs to the US. IBM is considering a similar strategy for their US information technology service delivery centers. The global economic crisis might have had an impact on their consideration.

Future

Research & development (R&D) captive centers are on the rise. Professor Oshri asserts: 'China is becoming a leading country in R&D captive centers.' Most business process outsourcing (BPO) captive centers have been divested. The multinational companies recognize the maturity of the BPO service providers. This leave the question, are captive centers here to stay? In his book on offshoring strategies, Professor Oshri argued the opposite: '[T]he destiny of captive centers is far from death' (Oshri, 2011, p. 232). This vision is an important contribution to the debate about structuring organizations, which is not limited to 'make or buy' decisions. Professor Oshri enriched this debate by introducing migration paths for captive centers. Global Business Services will remain important to support the core business processes. Business executives need to include this in setting their business strategy.

Reference
Oshri, I. (2011). Offshoring Strategies: Evolving Captive Center Models. Cambridge: The MIT Press.

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This contribution is based on a telephonic interview with professor Ilan Oshri on July 14, 2012, and on his 2011 book on offshore strategies, published by MIT Press. The author is grateful to the interviewee for sharing his valuable insides embedded in this contribution. This contribution is approved by the interviewee.

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Summary

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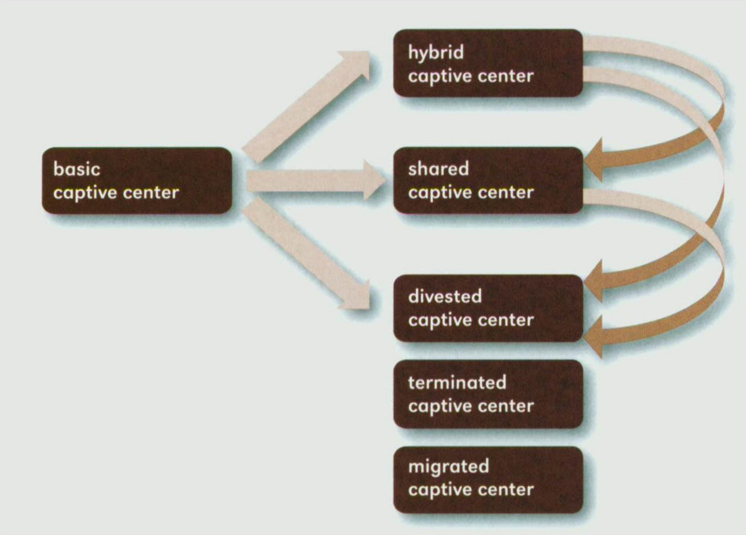


Figure 1. **The six fundamental types of captive centers** *(Oshri, 2011, figure 1.2, p. 6)*

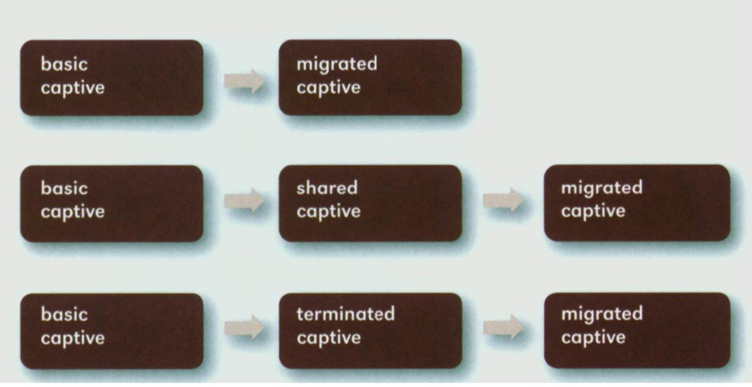
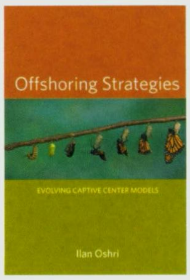


Figure 2. **Possible migration paths (Oshri, 2011, figure 2.7, p. 45)**

Prof. Ilan Oshri

Prof. Ilan Oshri is a full professor at Loughborough University, UK. Ilan received his PhD in technological innovations from Warwick Business School (2003). Since then Ilan held Assistant Professor and Associate Professor positions at Rotterdam School of Management in the Netherlands. Ilan was the founder of the Case Development Centre and also the co-founder of the Global Sourcing Workshop. Ilan is an Associate at the LSE Outsourcing Unit, a regular speaker at industry events and a contributor to various professional magazines.

For the last 10 years Ilan has built a research program that brings together technology management and globalisation aspects. One particular stream within his work on offshoring is the study of offshore captive centers. With the assistance of several research students Ilan explored captive center models, their entry strategies, their innovativeness and more recently their evolutionary path. The results of this study are summarized in one of his books: *Offshoring Strategies: Evolving Captive Center Models (2011).*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