Golden rule - Process drives location, Elias van Herwaarden, Founder, Locationperspectives

Choosing a location for shared services can be a challenge for companies because it involves more than merely cost implications and the decision once made cannot be easily reversed. It's not about just picking a site, but about understanding the company's needs and processes well, to create, build or restructure internationally. We spoke to Elias van Herwaarden, Founder, Locationperspectives, to understand how these decisions are made. Elias has assisted over 150 companies in the BSC space, out of which at least 60% of them have been in the CEE region. He has worked with 650 companies in their cross-border projects through the last 30 years. Here he tells us about challenges that firms have and the golden rule for choosing a location or partner.

Q Outsourcing, partnering or building up your own service center – From your expertise and experience, in what situations would you suggest each of these models to companies?

This question should actually be asked by every company. Make or buy is a very fundamental decision that has been with industry for a long time. For instance, Ford Motor Company - Initially they made everything from the wheels to engine. But now, they buy the chairs, they buy the wheels and they still develop the engine, but even here, they partner. So, for companies to be successful and survive, they must focus on their core competence. You do best with what is real proprietary, that is close to you and that which cannot be standardized. Because if it can be standardized, anybody else can do it. That is why we have 10 million people in the world working in the business of SSCs.

Now, if it can be standardized, you have to decide whether 'you' need to do it or whether you can use your corporate brainpower to do more intelligent stuff. It is about using shareholder's money to create value. And implicitly there is a money consideration behind it. As a company you want to look at the drivers. Check – can this be standardized? Do I have the right cost structure to deliver these services? Is somebody better at it? How critical are these services? If they are less business critical, you might want to partner with somebody or outsource. But if you would do that, check again - Who can guarantee that these processes will always be delivered on time, in the right volume and in the right quality?

Outsourcing can be a very quick decision and it can reduce your head count quickly; increase operational expenses and you will see some quick results. By contrast, a company might may say, "This is a long-term journey and we want to know how to do it. We do not want a third-party service provider to get all the intellectual capital and development knowledge about our processes because we need that capital to grow way beyond transactional services." It is also possible that companies will opt to set it up for their own learning, and after 5 years say, we standardized everything, now let's move on. Like Carlsberg did...they created shared services, rolled-out standardization and then outsourced say 40% of what was created. So, the learning curve is a consideration as well in the make or buy decision.

Critical mass can also play a role. Eg. In the case of a HR director of a French firm. He had set his sights on establishing a BSC in Cairo. When he and I discussed the nature of his future BSC, it revealed itself as very much standardized, well organized. The envisaged headcount needed was 35 people. So, I told him, to outsource, because the jobs were standardized. The very low headcount implied that the overhead costs of setting-up a captive operation would likely would just likely ruin the project's business case.

> *Outsourcing gives quick results, setting up takes a while. If you don't want to share IP or want to be transforming for a long time, it's better to set up your own SSC.*

But as a final point to make-or buy: there are many BSCs that combine captive and outsourced processes. We typically refer to this as a Hybrid Model.

Q What sort of challenges do companies face when they decide to set up their SSC?
It varies with different companies, and has to do with the company DNA, culture and the individuals involved. I have worked with a media company who didn't want to consider Hungary for their BSC because of that country's restrictions on free press, media and freedom of speech. They said that they would not want to be associated with an environment that restricts such freedoms. Which means that CSR and reputation were very important for them.

Then there are external and internal challenges. Think of external ones in terms of: Can we attract and retain the talent? How will costs escalate? And of course, the recurring questions like political and regulatory stability. On that point: I keep telling people that BSCs have been doing very well in countries that are not necessarily among the world's most stable ones. But there is always the initial perception – the fear of the unknown. The latter also explains why many centers are located in Tier-1 or Tier-2 cities. I think companies should put special effort in fighting their mental fog. The big mistake would be to select a location by relying on generic rankings by consultancies or analysts. When you are setting up a BSC to last, you'd better do your homework.

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On internal challenges: stakeholder management is probably the most important one. But here are wider people factors as well. A clear example of this happened during a recent project where the CFO had to cast the final choice between a city in Poland and one in Portugal. After proper due diligence on both options he decided for Portugal. He felt it would be easier to send his staff there for supervising process migrations than it would be to send them to Poland.

Q What should be the proximity of the SSC to the company? For instance: If the Company is in Europe, would you suggest they have their Operations in another continent like India or Philippines. Or would you suggest something closer to home like a Poland or Bulgaria?

Some processes require cultural sensitivity, language knowledge, time zone proximity, while others do not. The reason why many Indian BPO providers came to Europe was not because it was less expensive, but because they needed language skills to service their clients. They also needed cultural skills and those needs are very often found by opting for near or in-region locations. For me the golden rule to choose the location is – process drives location. What you want to do, determines where you want to be at. So, if it is about a service with just an English language base, you may very well locate in India, Malaysia, or the Philippines. But if you require 400 to 800 German speakers, it's a different process with different requirements. Having said that, I recently visited Majorel - an international outsourcing provider –, in Georgia. Their Tbilisi facility has over 1000 German speakers. Yet few would consider the country for such purposes. But there are more examples. Take Egypt. It offers near native language capability for both Asia and Europe. With over 212 thousand people working in business services is has become an important destination for the sector globally. So, proximity is important as long as you look at it from a process perspective.

If as a company, 80% of your services require proximity and 20% do not, then you might still want to concentrate all processes in one place because of cost efficiencies. This means that proximity is a very restricted word. I think that the question should be 'Why do we need to be close?' instead of 'Do we need to be close?'
Regarding proximity, it also is important to note that within 12 months after its creation, an SSC will likely have increased scope and be doing stuff that wasn't in the original blueprint! I saw this with a US company. It relocated its SSC from Switzerland to Budapest, with a clear definition of which processes would go to Hungary. Only 6 months after the Budapest decision had been taken, I happened to visit my client's operations in the Philippines. During the **Gemba Walk** I saw that they were conducting processes which were supposed to be in Budapest and I asked about it. They said: "We thought we could do it from here and so we took it". So, SSCs are not static -they move, grow and evolve. Like a friend of mine says: "Shared Services is not about a destination, it's about a journey."

Q What do you think is the potential for a multinational to set up SSCs in the CIS Market? What are the gaps? What are the advantages?

Let's take the example of PepsiCo. They have their SSC in Voronezh.. P&G is in Moscow, and JT International is in Saint Petersburg. Beyond Russia we have ABInbev in Kharkiv and Nestle in Lviv, Ukraine. These are just top-of mind examples. So, there certainly is proof-of-concept that it can be done.

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The opportunities for servicing the CIS region from outside the CIS have increased through the recent years. Mainly as result of regulatory changes. But I think the opportunity for servicing the CIS from within the CIS is even more important. There are cohorts of SSCs - from Russian companies, by Russian companies - for Russian consumers. This is a huge market. There is an opportunity with the given market size. But reportedly there are challenges regarding compliance, costs, and the industry is not as mature. But there are many examples of CIS companies and foreign companies that have been working well in shared services. Just consider that KPMG and PwC operate their regional center from CIS.

But the same holds true for servicing CIS from nearby coutries. Kone elevator has been servicing Russia from Bratislava for more than a decade now. The wage costs in Russia are particularly on the high end. There was a time when Saint Petersburg was 35% above Warsaw. Today it would be more than 15%. I also think that over the last 10 years, the administrative/regulative environment in Russia and CIS has advanced and things can be done electronically. So, Russia has moved-on and this is an opportunity for Shared Services because you can do multi-country shared services. I also think there is the opportunity to service that market from abroad. The availability of Russian Language skills in increasing across the EU's part of Central and Eastern Europe.

Q What areas of business in a multinational company are conducive and practical to locate in the CIS region and what areas of business would be challenging to operate? Which industry or sectors? What criteria should they satisfy?
I suggest that there a couple of guidelines regarding the choice of business area: Start with the easier functions first: Why do companies starting with shared services typically begin with Accounting? - Because it is clearly standardized. Start with the relatively easy stuff. Do not start with legal, or procurement or complex processes. HR can also be very cumbersome.

Size –Big is beautiful: If you have a sizable market in B2B or B2C, then you will have an amount of potentially transferrable work that will help build your business case. So, volume is another consideration. If you don't have a lot of business in the CIS region, then maybe you shouldn't start setting-up a center there.

Shared services I think are not that much industry or sector specific. Certainly, there will be noticeable differences between say an SSC that supports a consumer-driven business and one that serves a B2B company. But I hardly came across any SSC destination where one industry dominates. Where BSCs are concerned: there's no single country or city for chemicals, or another for consumers good – they are located all over the globe based on their process needs.

Key sectors for shared services activity: IT, commercial/professional services, banking & insurance, consumer goods, telecommunications, life sciences & health care, industrial goods, and energy. The current covid-pandemic in fact seems to lead companies to transfer more activities to their shared services organizations.

Q What should CIS do to attract Cos from the west?
CIS-based providers should demonstrate proof of their experience and knowledge. They have to show insight. Even work that they have done within the CIS can be showcased. They also have to make it clear that there are many multinationals operating captives, or outsourcing business services across CIS already. EPAM, Softserve, Global Logic or Digiteum are some examples of successful CIS service providers. There are sufficient examples in the market to learn from.

As told to Kavita Krishnamurthy

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