

8-2010

IT Shared Service Center and External Market Activities

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Recommended Citation

Schulz, Veit; Herz, Thomas Ph.; Rothenberger, Marcus A.; and Brenner, Walter, "IT Shared Service Center and External Market Activities" (2010). *AMCIS 2010 Proceedings*. 532.

<http://aisel.aisnet.org/amcis2010/532>

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IT Shared Service Center and External Market Activities

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ABSTRACT (REQUIRED)

In the last few years many corporate groups reorganized their IT-Services and established IT Shared Service Centers (IT SSC). These IT SSCs primarily delivered IT services internally; nevertheless some IT SSC provided IT services to external customers as well. These external market activities failed in most cases. In spite of the relevance to organizations, little research has been done investigating the reasons for such failures. In order to address this issue, we have conducted a qualitative study with eight IT SSC cases and five experts interviews. We have triangulated the results between the case studies and the expert interviews and we have identified two set of factors, one explaining IT SCC successes in internal markets and the other explaining IT SSC failures in external markets. The enabling factors for the successes of IT SSCs in internal markets include having the same corporate culture, knowledge of the parent organization and its processes, lower transactions cost, lower average cost, no dependence on external IT service providers, better data protection, improved IT opportunities and obligation to provide services. The factors explaining external market failures include the lack of experience with acquisition, no professional sales and marketing, lack of investment funds, weak unique features of IT services, reassessment of strategic group portfolio by the parent company, higher IT service costs, and inconsistent business models. These findings are relevant to managers of IT SSCs to make decisions on their corporate strategy, as well as to researchers to utilize these findings as a starting point for future research on IT SSCs.

Keywords (Required)

IT Shared Service Center, External Market Activities, IT Strategy

INTRODUCTION

Motivation

In the last few years many corporate groups reorganized their IT-Services by combining main and peripheral departments to form IT Shared Service Centers (IT SSC). This organizational form of IT-Services became increasingly popular over recent years (A. T. Kearney, 2004; Accenture, 2004; Bain & Company, 2008; Fischer and Sterzenbach, 2006; Frost & Sullivan, 2007; Redman, Snape, Wass and Hamilton, 2007; Roland Berger, 2008). The motivators for establishing the IT SSCs typically include quality of service improvement, competitive prices, comparability increases, and the use of synergies and economies of scale (Westerhoff, 2006). In addition, organizations intent to generate additional revenue by supplying IT services to external customers. IT SSC have entered the market as outsourcing-suppliers, which is considered a external market activity (Brenner, Resch and Schulz, 2010). They are competing with large international IT-suppliers, such as

Accenture, Atos Origin, HP Services, or IBM Global Business Services that hold the majority of the market share (Gartner, 2007). In spite of some successes, the external market activities of the IT SSCs should be viewed with skepticism; many IT SSCs failed because of unsuccessful external market activities or were not able to achieve the goals they had set (König, Meyer, Cornelius, Partners, Dutta, Frenkel, Reisen and Walter, 2009). A number of managerial decisions were made that were, with hindsight, considered harmful. Thus, there is a need to investigate the potential of external market activities of IT SSCs.

IT Shared Service Centers

The historical development of the concept IT Share Service Center (IT SSC) is traced below in order to facilitate a better understanding of the term. While various different definitions IT SSCs exist, we present the characteristics that are commonly accepted in practice and literature below (Schulz, Hochstein, Uebernickel and Brenner, 2009):

IT Shared Service Centers

- ... aim to consolidate the supporting processes within the company,
- ... focus on the organization's internal customers,
- ... are semi-autonomous, independent organizational units,
- ... provide supporting processes for the core processes of the company,
- ... supply multiple divisions, respectively customers,
- ... aim to optimize the use of resources within the organization, and
- ... orient themselves towards external competition.

In the trade literature, this organizational form of IT is often known as "IT subsidiary", "internal IT service provider" or as "Captive". For simplification, these terms are used synonymously (Herz, 2009). Figure 1 shows how IT Shared Service Centers may be organized within the business group. Furthermore, external market activities are represented.

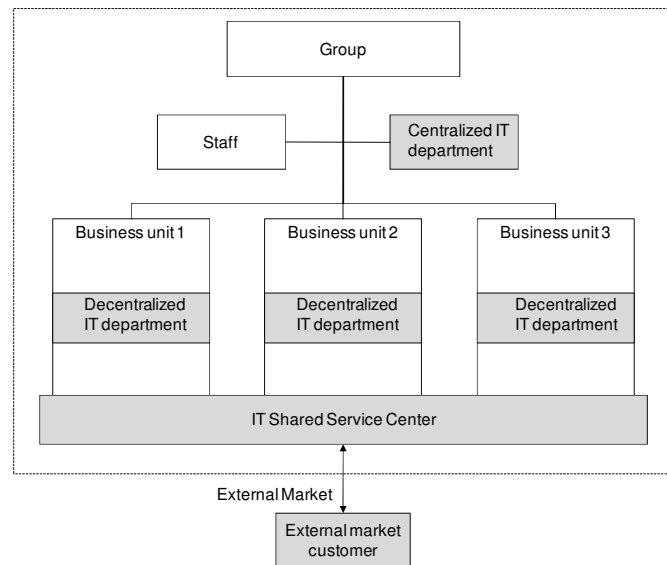


Figure 1: IT SSC and external market activities; according to (Janssen and Joha, 2006)

Literature

To assess what theoretical concepts are known about external market activities of IT SSCs, a systematic literature review was conducted at the beginning of this research project. In particular, we were searching the literature for answers as to why external market activities of IT SSC failed, while IT SSCs are successful at serving internal customers.

The literature analysis was conducted according to the structured approach by Webster and Watson (2002). First, leading journals and books were identified using primarily Proquest ABI/Inform and Google Scholar. Subsequently, sources that had been quoted in publications identified in the first step were added (reverse search). Then, sources that quoted the key articles identified in the previous steps were added (forward search). Finally, practitioner journals and books, whitepapers, and management consulting studies were reviewed in order to identify current developments.

This process identified several sources on IT SSC and external market activities. Most publications are single case studies on the external market activities of an organization. Several IT SSCs began supplying external customers immediately after their formation. Nevertheless, the majority of cases report on failures of such activities. Many IT SSCs had fundamental problems to even acquire external customers. Only a few IT SSCs were able to develop an external customer base and generate a substantial revenue share from external customers. Examples are the IT SCCs of Volkswagen AG (Gedas GmbH), Lufthansa AG (Lufthansa Systems AG) (Computerwoche, 2005), and ThyssenKrupp AG (Triaton GmbH) (Heinzl, 2003).

In recent years, a number of IT SSCs left the external market and thus no longer supply to external customers. The literature describes two different scenarios of external market activity failures: the sale of IT SSCs to external IT Service providers, and the reintegration into the parent organization (König et al., 2009).

Research Questions

The literature review has shown that there is limited prior research on IT SSCs and their external market activities, other than a few case studies and case reports. In particular, a theoretical understanding of why IT SSC appear to be not successful as external service providers, while successfully providing such IT services to the internal organization is missing. This calls for additional research and has motivated this study. To address these issues, we are investigating the following research questions:

- (1) *Why are IT SSCs competitive in the internal market?*
- (2) *Why do many IT SSCs fail with their External-Market-Activities?*

RESEARCH METHOD

In this study, we are conducting qualitative research to address a little investigated issue. Two qualitative studies have been conducted with the aim to answer the research questions and the results have been triangulated. The initial study was an investigation of eight case organizations that have either been successful or unsuccessful with their IT SCCs external market activities. Subsequently, interview data from five experts on the IT SCC issue have been conducted. In the next two chapters, the case study research and the expert interviews are described.

Case Studies

Looking for answers to a complex issue in a yet not very structured field of study, we have employed a multiple-case study method based on Yin's (2002) case study research and Eisenhardt's (1989) approach of building theory from multiple-case studies. Eight case organizations were investigated. In the context of these case studies, corporate documents, such as presentations, instructions and project reports were analyzed. Thirty-four interviews were conducted, primarily with the top decision makers of each IT SSC or the parent company; we have talked to two corporate CIOs and four directors of IT SSC. The interviews for each company took six to ten hours and took place between March 2008 and April 2009. We have selected IT SSC based on the following guidelines: Potential case study firms needed to have more than 1,000 employees and support internationally operating companies with IT services. Multiple countries had to be represented by the firms. Furthermore, the cases needed to cover diverse characteristics relating to external market activities. Of the eight IT SSCs analyzed, four did not have any, two had limited, and two had extensive external market activities. This was to identify the differences and similarities between the business models and learn more about external market activities. IT SSCs from Germany, Switzerland, France, Sweden, Canada, and the United States were analyzed. While the interviews aimed at other issues as well, the external market business was one of the key topics in these interviews. Most of the interviews were conducted in person, some via telephone. All interviews followed a semi-structured questionnaire, which emerged and was refined during

the investigation. This approach allowed for individual ad-hoc questions. This allowed us to learn more about special solutions or procedures of the individual IT SCCs. Table 1 provides an overview of the case organizations.

IT SSC	Country of headquarters	Employees SSC (FTE)	Industry	Time of Interviews	External Market Activities
Alpha Services	United States	> 1.000	Steel	Sept. 2008	No
Beta Services	Germany	> 1.000	Media	Oct. – Nov. 2008	Extensive
Gamma Services	Germany	> 4.000	Pharmacy	Dec.2008 – April. 2009	Limited
Delta Services	Switzerland	> 4.000	Bank	Sept. 2008	No
Epsilon Services	Germany	> 3.000	Aviation	April – June 2008	Extensive
Zeta Services	Canada	< 1.000	Food	Nov. 2008	No
Eta Services	Sweden	> 4.000	Automotive	March 2008	Limited
Theta Services	France	> 4.000	Insurance	Dec.2008 – April. 2009	No

Table 1: Overview about the case organizations

Expert Interviews on external market activities

To strengthen the validity of our results, we have separately conducted five expert interviews on the external market activities of IT SSCs. This allowed us to triangulate the insights obtain through the case studies with the expert interview results.

We also used a semi-structured questionnaire to conduct the expert interviews. Three interviews were conducted via telephone and two in person, with an average duration of one hour.

To get a comprehensive view of external-market-activities of IT SSC, it was important to select a set of experts that covers diverse backgrounds relating to IT SSCs.

Interview partners	Position
Expert 1	Scientist in the field of External-Market-Activities of IT SSC
Expert 2	Ex-CEO of an IT SCC, successful with external market activities
Expert 3	Consultant with broad knowledge on IT-Service markets
Expert 4	CEO of an IT SSC with limited access to the external market
Expert 5	CEO of an IT SSC with no access to the external market

Table 2: Overview about the expert interviews

CONSOLIDATED FINDINGS FROM CASE STUDIES AND EXPERT INTERVIEWS

The interviews were recorded and transcribed. In order to analyze the data generated during the case study research and the expert interviews we used an open coding approach (Corbin and Strauss, 1990). The interview transcripts from the eight case studies as well as from the expert interviews have been analyzed to extract reasons that explain why IT SSCs are competitive on the internal market but often fail on external markets.

We have triangulated the findings from the case studies and expert interviews, which resulted in a set of success factors for IT SSCs internal market activities and failure factors of IT SSCs external market activities and insights into their underlying reasons. All identified success and failure factors were supported by at least 5 cases and 3 experts in order to be considered reliable and included into the result set. After applying this inclusion threshold, two success factors for the internal market that were provided individual respondents have been excluded from the result set. These were that IT SSCs provide to their parent company better quality and superior services compared to external competitors. In contrast all factors explaining

failures on the external market that were mentioned during the interviews exceeded the threshold and were included in the results of this study.

In the following chapters, we are discussing the findings; first, we present the enabling factors that address research question (1): “Why are IT SSCs competitive in the internal market?” Then, we discuss the failure factors that answer research question (2): “Why do many IT SSCs fail with their External-Market-Activities?”

Qualifying internal market IT SSC activities (internal enablers)

With regards to the internal market, the qualitative studies identified the following enablers. They explain why IT SSCs are competitive in providing services to the internal organization compared to alternatives, such as outsourcing to external-party providers.

- Same corporate culture: Unlike cooperation with external IT service providers where different corporate cultures collide, employees remain within the concern with an IT SSC. Each firm has, for example, its own concepts, values, and conduct with employees, as well as communication style. Outsourcing thus entails the danger that differences in corporate cultures could lead to considerable problems. Productivity falls and the firm loses good employees and thus important knowledge as a result of misunderstandings and uncertainty. It can take years for the IT organization to function smoothly once again. IT service provision with the help of IT SSCs can help circumvent this problem.
- Knowledge of the parent organization and its processes: IT SSCs are embedded in the firm and thus have knowledge of internal processes and the divisions of the parent company. The IT SSC can respond to the specific basic conditions faced by a division or firm. This is only possible under certain conditions with outsourcing, as the outsourcer normally conforms to global standards and does not deviate from these.
- Lower transactions cost: Since IT SSCs are integrated into the parent company and since the service transfer takes place in internal markets or across the organizational hierarchy, transaction costs are lower as compared to service acquisition over external markets. The use of an internal IT SSC eliminates the cost associated with identifying a suitable outsourcing partner; also, the cost of monitoring the service relationship is lower.
- Lower average cost: It is commonly assumed that external IT service providers are generally cheaper than IT SSCs. Yet many decision makers felt that the cost saving achieved by outsourcing fell short of expectations. Often, external IT service providers charged fees surcharges for services that were initially presumed to be included in the price.
- No dependence on external IT service providers: The fear that an organization may be overly dependent on an external IT service provider was frequently raised. The main fear was the lack of influence on external IT service providers. In contrast, the parent company may have more leverage on their IT SSC and is not simply consigned to the mechanisms of the market.
- Better data protection: Many companies overestimate the risk associated with data security and forgo outsourcing for this reason. The fear that sensitive information may be accessed by the competition is driving such decisions. IT SSCs are, as a result, deemed more favorable.
- Improved IT opportunities: The use of information technology can create corporate opportunities for the company. IT SSCs can act as business enablers and are – as a result of their close ties with the firm – well placed to support the parent company in the realization of these opportunities.
- Obligation to provide services: The IT SSC is committed to supply the firm with all required IT services. External IT service providers can refuse provision to particular locations or regions of the company.

Reasons for external market failure (external inhibitors)

The results of the qualitative studies suggest that IT SSCs are not competitive in the external market. The inhibitors for external market success are presented below:

- No experience with acquisition: IT SSCs commonly arise from decentral IT departments. The primarily technical specialists who work in such departments perceived themselves as knowing best which IT services would be most suitable for the customers and their business. Internal customers were often restricted to obtain their IT services from the IT department. The service cost was transferred to the firm as fixed costs. Under these conditions, more attention was paid to

the technology than to making the sale. With such prevailing culture and a lack of customer-orientation, IT SSCs found it difficult to sell their IT services on the external market as there was little experience with client acquisition.

- No professional sales and marketing: As illustrated in the previous point, the skill profile of IT department employees was not conducive to customer acquisition. Yet many IT SSCs attempted to gain market share using existing personnel. Rarely, professional sales and marketing specialists were employed. The funds necessary for the development of such efforts were often missing.
- Lack of investment funds: The reason as to why sales and marketing organizations were not established as described above, was the lack of funds. The IT SSCs alone were unable to provide the funds needed. Firms were commonly not prepared to supply the financial means for the development of their IT SSC's sales organizations.
- Weak unique features of IT services: The emphasis of IT SSCs' service portfolios was on commodity IT services such as PC maintenance, upgrades of memory, processing power, and bandwidth, or the operation of ERP systems. When sourcing such services, only the price matters, as it is typical for commodities (Carr, 2003). Since external IT services providers have the advantage of economies of scale, they typically can offer more competitive pricing.
- Reassessment of strategic group portfolio by the parent company: Even if successful in the external market, IT SSCs still may face the threat of possible elimination by the parent company; if the parent company decides to focus on its core competences, provision of IT services is not usually included.
- Higher IT service costs: From the perspective of external market customers, the total IT service cost of IT SSCs is not competitive. Primarily IT service prices and transaction costs that are relevant. From the perspective of external market customers, the sum of IT service prices and transaction costs is too high and hence not competitive.
- Inconsistent business model: In order to serve external market customers, traditional business models of the IT SSC were adapted. IT SSCs are attempting to optimally support internal customers with IT services while also generating profits by supplying services to external market customers. Two different business models would be required. Whereas a profit center approach makes sense for the external business, it does not for the internal business. The IT SSC aims to generate additional profits from external customers, which it does not from internal clients. Substantial profits generated from internal customers would lead to higher IT cost for the business group, which is not desirable. This would require the IT SSC to pay the profits back to the parent company. Therefore, a business model that pursues both of these goals simultaneously is inconsistent and not sustainable.

The case studies and expert interviews also highlighted that the reasons for the success of IT SSCs within companies and their failure on the external market are complex. The factors mentioned above are not isolated. There are strong interrelations between these reasons.

SUMMARY, LIMITATIONS, AND FURTHER RESEARCH

Many companies have rearranged their IT organizations and established IT Shared Service Centers within the company. In addition to providing for the organization's customers, many IT SSCs aim to sell IT services to external customers. However, the majority of external market activities of IT SSCs were unsuccessful.

In order to better understand the failures of external market activities, we have conducted two qualitative studies to investigate the reasons why IT SSCs can be successful internally, yet may experience failure on the external market. We have triangulated the results of the two studies to provide a set of internal drivers and external inhibitors for the activities of IT SSCs.

The analysis of external market activities contributes to a better understanding of IT SSCs. There are however several limitations regarding the interpretation of the results:

- As a first step to a better understanding, detailed qualitative studies focusing on IT SSCs were conducted. Further research may follow-up with a survey-based study to further validate and refine the results. A large sample can be selected, or, as the basic population is finite, it may be feasible to include all IT SSCs operating in a particular market in the sample.
- The expert interviews illustrated that there are many motivators for establishing an IT SSCs. Whether or not the goals associated with their establishment were achieved and whether different motivators led to varying levels of success of the business model requires further investigation.

- This paper's conclusions were based on multiple case studies and expert interviews. While the consistency of responses across the multiple-case studies and the independent expert interviews are a strong indication for a saturated result set that is complete, it is conceivable that modified or additional statements could be attained by analyzing other IT SSCs or by surveying further experts. The method employed and the triangulation between the two parts of the study reduce the likelihood that the result set is incomplete.
- The literature provides little theory on this research area. Thus, our qualitative study was a first step to a better comprehension of the external market activities of IT SSCs. Further research activities must aim to test the applicability of existing theories and develop new theories where necessary.

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