Support Service Transformation and Intra-Organisational Governance Mechanisms

Ye Lu and Ian Herbert
School of Business and Economics
Loughborough University
Loughborough, UK

Abstract
The transformation of business support services through some form of 'externalisation' mechanism, SSC or BPO, can drive down costs and enhance functionality. Yet, actually achieving increases in efficiency and effectiveness will depend to a large extent upon how well divisional 'customers' in the mother organisation and the support service can work together in practice. Good implementation needs two things: contractual 'hard' points, agreed up front, together with informal relationships to accommodate ongoing demands for change and drive continuous improvement. This paper explores how a hybrid governance framework based upon the most appropriate elements of a contract v. relational outlook might deliver adaptable and dynamic support services across a number of organisational and business dimensions. It also explores the critical role that transfer pricing can play in hybrid relational contract governance.

Key Words: contractual governance, relational governance, shared service centre, transfer pricing

1. Introduction

The transformation of business support services through some form of 'externalisation' mechanism, SSC or BPO, can drive down costs and enhance functionality. By concentrating service activities in a specialist business unit located at a carefully chosen site, possibly off-shore, it has been claimed that the SSO can substantially reduce the cost of support service provision. (Herbert & Seal, 2012) For example, Quinn, Cooke and Kris (2000) suggested that an 'easy' 25-30% reduction in costs is possible; with the promise of further improvement as the SSO itself may be threatened by relocation to an even lower cost site or contracted out to third party providers. It is also argued that the SSO should provide better service than the old functional service departments (Ulrich, 1995). This process might also be seen as part of a wider re-configuration of the multi-divisional corporation in what has been termed *corporate unbundling* (Sako, 2006; Gospel & Sako, 2010; Helper & Sako, 2010).

The specific concern in this paper is the provision of finance as a business support service to the corporation. In this form of corporate unbundling, previously embedded support services such as finance, human resources and IT are 'lifted and shifted' either to a third-party contractor (Business Process Outsourcing referred to here as BPO) or to an in-house or "captive" shared service centre (SSC). In the case of the SSC, activities continue within the hierarchy of the organisation but are physically (and likely, psychologically) distanced from the core operations of the organisation. Thus, both the BPO and SSC routes can be viewed as externalising business services, even though the SSC strictly represents a hybrid model that combines a market orientation with ongoing hierarchical direction and control. Perhaps because service externalisation is a relatively new field, scholarly literature is only just starting to emerge. However, viewing SSCs and BPOs as a supply-chain management issue provides a number of useful insights from a more substantive literature which has three main dimensions.

The first approach, rooted in rational economics, emphasises the nature of the make-or-buy decision specifically the role of Transaction Cost Economics (TCE) in asking: is it better to do the work in house or out of house and at what price? (Williamson, 1975).

The second approach draws on an equally substantial body of literature under the heading Inter-Organizational Cost Management (IOCM). The concern being to reduce cost whilst maintaining and/or improving the product's attributes. Much of this thinking is inspired by the Japanese experience in pursuing target costing and continuous improvement methodologies. As an example, in their 2004 paper, Cooper and Slagmulder describe how trade-offs of products' functionality, price and quality (FPQ) were applied in a number of Japanese automotive companies to achieve target costs.

The third approach, supply-chain management (SCM) is largely based on various strands of institutional theory. Specifically, the role of human agency and behaviour in forming and conducting inter-organisational relationships based on trust, communication, information sharing and hence mutual knowledge creation (Seal & Vincent, 1997).

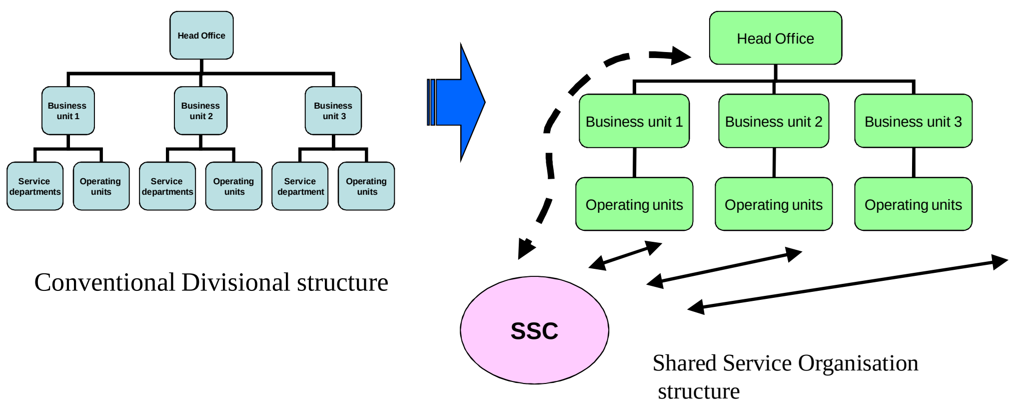
In recent years, there has been a resurgence of ideas about how the invisible hand of the market can better govern the interchange of goods and services, both at the start, middle and end of the production cycle and a key mechanism in the governance of intra-organisational exchanges is the internal service level agreement and transfer pricing. The paper will discuss how, in the context of externalised business support services, a governance framework can blend aspects from both contractual and relational outlooks to deliver lean, responsive and adaptable services.

The paper is organised as follows. First, the nature of service externalisation and in particular the shared service centre model is explained. This is followed by a review of the literature on interorganisational relationships. Next, a framework for governance is proposed which is based on a continuum between contractual and relational governance styles. The role of the Service Level Agreement and transfer pricing is then introduced and some empirical evidence is presented to demonstrate variations in practice. Finally, some recommendations for further research are proposed.

2. Why an enlightened approach to governance is needed for support services

Business support services are essentially intangible, and thus generally involve both the interpretation and processing of tacit as well as explicit knowledge. This brings a number of challenges. First, many services, whilst comprising low-level transactional tasks, are integral to the way in which core parts of the mother organisation work, indeed they may even define the overall customer experience, especially if the prime product is a commodity, e.g. electricity and gas. Second, services are typically provided by professional functions such as finance, HR, procurement and IT which historically have tended to be insulated from direct commercial pressure. Third, external supply chains tend to be dyadic (one-to-one) in nature (Kraus & Lind, 2007), whereas for the middle manager in an SSC environment the situation is more akin to being the hub of a 360^{o} network, see figure 1.

Figure 1. Moving to an SSC - adapted from Herbert & Seal (2012).



Whilst physical goods might enjoy a level of buffer inventory, service activities cannot be stored and thus the SSC will somehow have to cope with fluctuating activity levels. Moreover, the way in which tasks are actually performed will have to adapt to the changing needs of customers over time. To ensure that support services stay aligned with customer needs, and at the same time provide sufficient operational flexibility, a clear governance frame-work is required.

2.1. Intra-organisational relationships

One way of framing the challenges of the SSC is as an internal supply-chain management issue (SCM). Thus, enabling the extensive body of literature on governing external relationships to be drawn upon under the heading of *SCM and IOCM*. The latter has been inspired by the Japanese experience in pursuing target costing and continuous improvement in long term partnerships with key suppliers (Cooper & Slagmulder, 2004). But, this approach can equally apply to the semi-autonomous SSC as an intra-organisational supply chain.

At a more general level, institutional theory helps us to understand human behaviour, in forming and conducting inter-organisational relationships through trust (Coad & Cullen, 2006), communication and information sharing (Cooper & Slagmulder, 2004). The starting point for the design of a sound governance framework within IOCM is choosing the appropriate point on a continuum which has a contractual orientation (legal) at one end and a relational orientation (human) at the other end.

2.2. Contracts v. relations

Macneil (1980) defined a contract as “written contractual and management-initiated mechanisms which guide human behaviour to achieve the desired objectives”. Based on Williamson’s (1985) transaction cost economics, formal contracts work as a safeguard to prevent the hazards involved in exchange processes, and thus minimising cost. Thus, in the domain of intra-organisational relations the Service Level Agreement (SLA) acts as a contract but may be configured in more flexible ways given the extent to which the overall governance is seen as leaning toward a contractual or relational orientation.

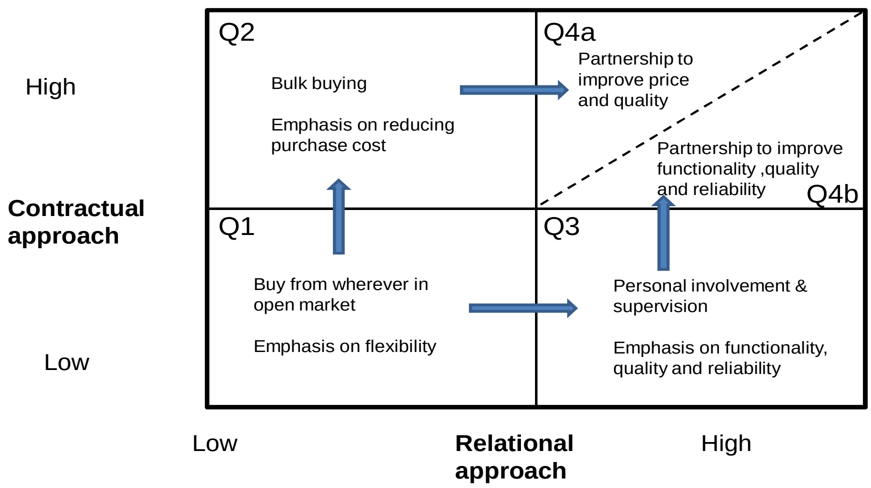
The **contractual** approach is rooted in the assumption that business decisions about whether to make-or-buy products/services are essentially rational, in other words based on 1) *quantifiable* attributes, 2) a *predictable* environment, 3) relatively *homogenous* products, and 4) the assumption of an *open market*. Transaction cost economics (Williamson, 1989) holds that free market conditions will likely produce the optimum (lowest) cost. However, as customer needs become more unique/variable/complex/dynamic the counter argument is that if the overall cost involved in negotiating, monitoring and supervising the external contract is greater than the cost of managing those activities inhouse, then the product should be *made* rather than *bought in*.

The **relational** approach recognises that rigid contracts may not be appropriate when the product and its production/delivery are *heterogeneous/variable*, and/or when the *business context* is fluid. (Poppo & Zenger, 2002) In other words, a more flexible, co-operative and understanding approach, in which the two parties work through issues as they arise may be required. Techniques such as Just-in-Time (JIT) and target costing as pioneered by Japanese automobile companies, particularly Toyota (Womack, Jones & Roos, 1990), might nowadays be seen as commonplace. Nonetheless, they require a significant degree of interpersonal involvement and cooperation on the part of participating firms to actually improve quality, reduce costs and lower inventory. (Tan, 2001)

Trust-based cooperation between business partners “improves the performance of inter-organisational exchange” (McEvily et al., 2003). Some scholars have argued that formal contracts undermine trust and relational governance acts as the substitute for contracts (Goo et. al., 2009). Alternatively, Popper and Zenger (2002) presented empirical findings to argue that there can be a complementary relationship between contractual and relational governance. Subsequently, Goo, Kishore, Rao, and Nam (2009) extended this view based on their research of South Korean IT outsourcing relationships finding that as a contract becomes more customised the greater level of relational governance is desirable (Goo et al., 2009).

For the purpose of illustration in this paper, the following framework has been constructed. Figure 2 depicts how the two approaches lend themselves to four broad positions in terms of emphasising various combinations of price, functionality, quality, reliability and flexibility. This diagram extends the function, price and quality (FPQ) trade-offs (Cooper & Slagmulder, 2004) through three stages: independent, interdependent and integrated. It is explained below through a hypothetical case scenario in the catering trade. One style of business has a need for basic ingredients on a volume basis at the lowest possible price whereas another needs higher quality ingredients as part of a more intangible service offering.

Figure 2 Relation vs. Contractual Governance



Key to figure 2

Q1 *Independent:* In the bottom-left quadrant numerous one-off bargains are struck on an ad hoc basis, each seeking to optimise price and retain flexibility of supply. Functionality is no better than the market standard. Quality and reliability (delivery) may be variable. E.g. a small fast-food outlet may buy ingredients from a variety of suppliers according to price (as long as the customers do not complain). There is little ongoing loyalty to any individual supplier.

Q2 *Interdependent:* This sees contracts placed with a few preferred suppliers on medium-term contracts specifying normal quality and functionality thresholds. E.g. in a chain of fast food outlets buys its fries in bulk to reduce cost but each would likely feel the loss of the other party's business.

Q3 *Interdependent:* This sees an emphasis on functionality, quality and reliability through the personal involvement of the two sets of principals; e.g. an 'à la carte' restaurant where seasonal produce can be variable in terms of quality, functionality and availability. As such compromises, entailing negotiation, might need to be made in terms of substitutes vis-a-vis price to secure a continual supply of the appropriate ingredients. Each party is dependent on the flexibility of the other to make the deal.

Q4 *Integrated:* This sees both routes becoming long term, mutually beneficial, relationships aimed at improving some or all aspects of P, F, Q, R, SF across the supply chain, given the two different sets of emphases. E.g. in Q4a the large fast food chain might now work with farmers to develop strains of crops that give it exclusive access to better functionality and standardised quality of, say, potatoes. This might then enable in-kitchen technology and processes (such as frying) to be made more efficient. It might also allow the preparation process to be routinised and reduce variability to the consumer on a global scale, whilst still achieving low prices. Alternatively, in Q4b, the à la carte restaurant might wish to source fresher/tastier ingredients than its rivals regardless of domestic seasonality or, for example, specialise in niche areas such as organic/sustainable produce. This may require an intimate knowledge to be developed with the wholesaler about overseas markets and transport options, along with investigations about the provenance of growers. As the ingredient cost is a relatively modest proportion of the final price of the meal, price is likely to be less important, as long as it remains relatively competitive with rival restaurants.

2.3. Governance of externalised services

The complementary relationship between contractual and relational governance in the integrated mode could be applied in the externalisation of support services. Long-term-oriented business service exchanges need both formal and informal agreements (Ivens, 2005). Indeed, actually achieving increases in efficiency and effectiveness will depend to a large extent upon how well divisional 'customers' in the mother organisation and the support service can work together in practice. Good implementation needs two things: contractual 'hard' points, agreed up front and an on-going relationship between people around changing demands and continuous improvement.

2.4. One size may not fit all?

The externalisation of support services requires new ways of thinking. For each process it is not just the task itself that is being changed but invariably the behaviours and outlooks of the people who are doing the task, and perhaps also their customers. This may have implications for the organisation structure. Moving to a market orientation with a contractual arrangement with BPO provider is relatively straightforward in terms of governance. However, with the SSC model, activities ultimately remain under the overall control of management and invariably a hybrid style of governance will be required. On a continuum between contractual and relational governance, the appropriate style will need to be sensitive to the business context, whether it is stable or dynamic, plus the different types of task which make up the overall set of activities. This will depend on the extent to which the task is: 1) predictable or uncertain; 2) routine or ad hoc (complex); and 3) can be measured objectively or, alternatively, the outputs are inherently subjective.

3. Governance mechanisms

3.1. Service level agreements

A service level agreement (SLA) sets out the 'hard' points of the service, i.e. the 'what, when, where and by whom?' of the task. It will scope the nature and volume of the activities to be performed by the SSC, and set down agreed performance standards together with quality assurance mechanisms. The SLA provides task and output responsibilities that contribute to the overall governance framework. It provides a basis for process compliance that can be audited. Often a series of 'service catalogues' will specify in much greater detail, outputs and responsibilities for individual activities within the overall SLA. For example that all sales ledger balances are reconciled and signed off each period, whereas quarterly reconciliations may be appropriate in the case of, say, the non-current asset register. The SLA will also set out how formal liaison between the parties (meetings and reports) will operate, and if necessary, procedures for dispute escalation/resolution. The SLA may also set out how the cost of the SSC will be recovered.

An appropriate SLA should be clear about the 'tough' part of specifying performance parameters for routine tasks, but also leave sufficient space for the parties to 'love' each other as they cope together with uncertainty and adapt/improve the service to changing organisation imperatives. The processes of learning and adaptation require a more relational cooperation between the firm and service providing party as indicated by the scheme in figure 3.

Figure 3. Types of Service Level Agreement

Contractual - detailed		**Formal - agreed 'hard' points**		**De facto***	**Mutual adjustment**
		Working document	**Periodic**		
Control tool – penalties for sub-par performance (BPO)	Contract for monitoring cost and performance (BPO)	Setting a desired but flexible service level around system 'hard points'. Professional codes.	Planning and resource allocation tool (budget driven). Professional codes.	Driven by detailed process. Maybe IT standardised (ERP) or external 'hard points' (accounting deadlines). Professional codes.	Collegial, Functional, professional codes.
Contractual style ⟷ **governance style** **Relational style**					

* Essentially, mandated by the process, e.g. in financial reporting where the deadlines and formats are set down by a combination of ERP protocols, corporate policy and external standards/timescales.

The alternative approach is to outsource some of the service activities to a third-party BPO (Ramachandran & Voleti, 2004). This could be the intermediate step before building a major long-term BPO relationship (Gospel & Sako,2010).

3.2. Fit-for-purpose SLA

A *fit-for-purpose* SLA should set out the 'tough' part of performance parameters for routine tasks, but also leave sufficient space for the parties to 'love' each other as, together, they cope with environmental uncertainty, and adapt/improve the service to changing business imperatives. The processes of customer adaptation and learning require mutual cooperation between the SSC and its customers. However, different activities require different approaches and this is demonstrated in the Noslom case .

Case Example

Noslom Brewery (name changed) distributes a range of barrelled and bottled beer to thousands of retail outlets each week. The delivered quantities are entered into a handheld PDA by the delivery crew and transferred by *Wi-Fi* at the depot to the corporate ERP system. Sales invoices are produced in a 'lights out' manner and emailed to the customers. With a high volume of transactions and routines based on quite explicit knowledge, it might be expected that this process would be outsourced. However, both system design and processing is kept inhouse and operated by onshore staff. Whilst workers are well paid, they are relatively few in number and the systems are subject to continual change and improvement, for example, when major customers require alterations to their delivery and inventory routines, and when new technology becomes available.

In contrast, to the largely automatic ERP system, there are exceptions which require manual intervention. For example, there may be a dispute with a retailer about, say, the quality of the beer (especially live cask conditioned products) and a barrel(s) has to be returned. In this case a credit note will have to be agreed and the liquor duty reclaimed from the authorities. If the barrel has been part used the exact quantity returned might be disputed. On some occasions the brewery will insist that an engineer visits the site to verify that the cellar conditions in which the beer has been kept were satisfactory. ‘Negotiating’ a resolution involves a good degree of verbal/written communication (tacit knowledge) to be brought together. For example, does the site and/or the individual manager have a dubious history of such claims? Settling such claims is a relatively labour intensive process and so is undertaken offshore, in a captive SSC operated by a global BPO provider. The designated workers are known to the brewery and, if the volume of returns increases, then another FTE may be assigned (with agreement) to the operation with the cost being added to the monthly (fixed) charge. The captive centre is governed by quite tight SLA terms, such as time taken;
a) to respond to a new call, and
b) to close out individual reclaims.
In addition, all telephone calls are monitored for quality, and customer feedback surveys are routine. In contrast, the inhouse IT-based process which is strategically significant to the effective operation of the brewery has little in the way of a formal SLA. The staff members are highly-paid professionals and any operational problems would likely be systemic and thus come to the attention of all levels of management very quickly.

In the Noslom case there are two types of SLA. First, an informal, *de facto*, regime based on the routines of the Nolsom order-to-cash (O2C) process and the protocols of the proprietary ERP system with its well-documented procedures and regimes. In addition, there are also certain interdepartmental ‘hard points’ (critical performance indicators) such as producing the right numbers on time for the accounting system. Finally, there is the inherent sense of professionalism on the part of the core IT staff underpinned by the behaviours expected in Nolsom’s corporate culture.

Second, there is a more formal contract with the operator of the overseas SSC albeit, and somewhat paradoxically, this is based upon the more interactive and subjective routines of the sales credit system. There is quite a prescriptive SLA with the third party SSC setting out how the service should operate in the form of various performance measures. However, there is also some flexibility in dealing with individual customers and overall changes in demand. In the contract there are no specific penalty clauses to compensate for substandard service, but there is a procedure by which individual problems can be escalated upwards until resolved. The ultimate control is the threat of contract termination or non-renewal at the end of the five-year contract period. Figure 4 shows how these two approaches, might be reflected within a range of SLA permutations.

Figure 4 . Service Level Agreement

Contractual style **Relational style** **Explicit process knowledge** **Tacit process knowledge**					
Contractual - detailed		**Formal - agreed 'hard' points**		**De facto**	**Mutual adjustment**
1. Highly specified (punitive sanctions)	**2. Prescriptive. Tight spec. to target cost**	**3. Working document - cost and customer service important**	**4. Periodic/ Scoping reference**	**5. Process-led little scope for SLA**	**6. Informal liaison**
Use as control tool – penalties for sub-par performance (BPO)	Use for performance monitoring and control but also for progressive cost reduction (BPO)	Setting a desired but flexible service level around system 'hard points'	Planning and resource allocation tool (budget driven). Corporate codes and behaviours expected	Driven by detailed process. Maybe IT standardised (ERP) or external 'hard points' (accounting deadlines). Professional codes and behaviours control workarounds	Collegial, Functional, professional codes and behaviours. Outputs largely subjective

* Examples of process driven expectations might be financial reporting where the deadlines and formats are set down by a combination of ERP protocols, corporate policy and external standards/timescales.

Findings from the CIMA-Loughborough SSC Forum suggest that there is a range of approaches to governance through SLAs but these mainly comprise of the 'light touch' styles 3, 4 and 5 in figure 4. Some SSCs tend not to use formal SLAs beyond initially scoping the service and supporting financial appraisals of the SSC model to corporate management. On the other hand, some organisations use detailed SLAs when they are also servicing external clients or are using SLAs as a formal device in the overall internal governance regime, see Trainco case panel.

Trainco – detailed SLAs

With only 600 employees, Trainco is quite a small organisation in SSC terms.

However, with around one third of the staff scattered around the world in small start-up ventures and projects the key theme of the SSC is to create unity and integration around common standards in support services. This contrasts quite markedly with the more common rationale of the SSC being primarily about cost cutting. Trainco has created an SLA for each of its 12 support services, each with three permutations of service, gold, silver or bronze. This enables individual teams across the world to be clear about what support they will get (and pay for) from head office and thus which support services they may wish to source locally. At the same time, the SLA also scopes the responsibilities of local staff for accounting, HR, IT, Health and Safety, Marketing, etc. Thus, local engineers are empowered to get on with the core business.

The company puts a lot of effort into drafting and continually refining the SLAs and there is a formal renegotiation of each SLA as a part of the budget setting process each year. When we asked whether this was simply 'over the top' for a small company the Finance Director was very clear that it was time well spent because the SLAs provided a means of negotiating, rather than imposing the sort of rights and responsibilities that were normally simply mandated in other thorough documents such as the budget manual and other corporate accounting edicts. He also made the point that once negotiated the SLAs provide a comfort blanket rather than a straightjacket. As one divisional manager put it;

'We spend a lot of time each year scoping and negotiating the SLAs but, once that's done, we never refer to them. If I have to take them out of my drawer then it means the service has failed and we can't allow that to happen!'

3.3. Changing times and the move towards a relational style

As the relationship becomes established, and mutual understanding and trust is established, it is likely that there will be less emphasis on the 'letter' of the SLA. Instead a co-operative partnership should evolve aimed at continuous improvement of the service along with appropriate adaptation to emerging contextual requirements. Indeed, one very large multinational company (100,000 employees) has abandoned its own SLAs because they were seen by staff as anti-trust systems, stifling co-operation, rather than providing a supportive framework within which to work. Thus, over time, the relationship had become more relational than contractual, see figure 5. The final case study, Pressco, demonstrates a similarly more fluid, 'horses for courses' approach.

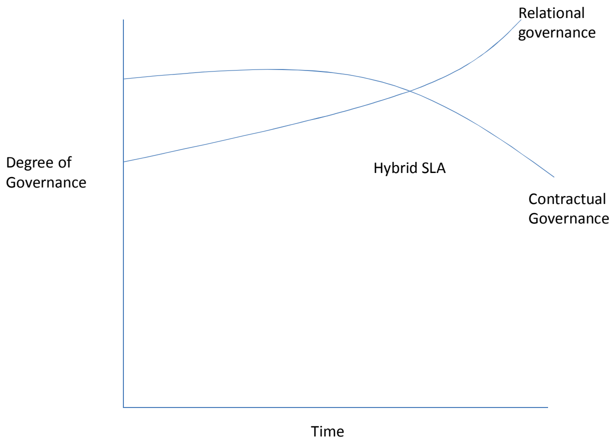


Figure 5 Service Level Agreement Development

Case study- Pressco 'horses for courses'

Pressco (name changed) had enjoyed a long tradition in newspaper publishing but, due to a number of technological changes, not least the internet, it has steadily been reshaping its business model to recast itself as a more diversified general media and digital publishing group. With the need to also cut operating costs, senior managers saw the aggregation of finance activities embedded within the 30+ business units as an opportunity to make savings through economies of scope and scale, and labour arbitrage.

The SSC was set up in 2003 to relocate various finance transaction processes from across the 30+ business units to a city in the middle of the UK that had relatively modest labour and infrastructure costs, but still enjoyed good transport links to the capital. In conjunction with external consultants, SSC management spent a considerable amount of time working with business unit managers to draft SLAs based around key performance indicators to govern relationships with divisions. However, over the years, after a number of iterations, the SLAs remained in draft form because they involved reciprocal rights and responsibilities, which the businesses were not so keen to sign up to. As a senior manager explained:

We tried to write an SLA and originally they [the business managers] said they wanted a fairly detailed document. …. and when they saw it they realised it involved them having to do things, and they suddenly weren't interested in such a detailed one. They just wanted one page, just one page that says what we, the SSC, are going to do.

In the end, the SLA expanded to four pages and although still unsigned, its primary function appeared to be more of a 'scoping' document than a 'formal' contract. However, it was clear that there was a significant informal dialogue between the SSC and the business managers. Monthly liaison meetings both monitored service levels and challenged processes with a view to continuous improvement. The CEO role of the SSC was now shared between the FD of the two largest divisions as a further means of improving governance.

In 2012 a major chunk of the business was sold, along with a significant proportion of the SSC. A part of the deal was that the 'old' SSC would continue to do work for the new operation during the handover period, and the 'new' SSC would continue to use the ERP systems - subject to a dividing firewall. Both aspects necessitated very detailed SLAs which were contractually binding.

3.4. Towards a contractual style

Figure 5 gave the impression that the logical progression for an SSC is from a contractual style (directing change) to a relational style (fostering longer term adaptation and improvement). However, some SSCs start off more informally, with SSC staff working with divisional staff to 'feel' their way through the initial change process. But, as time goes on and steady-state operation is achieved (more explicit, predictable and thus routinised) then it may be that the governance style actually becomes more contractual to embed the improvements, perhaps as a prelude to either offshoring to a captive centre and/or contracted to a third party BPO provider.

4. Transfer Pricing

In the network of interdependent parties that comprise the set of relationships between the SSC, divisional customers and external suppliers, it is vital to balance the business customers' needs for volume flexibility and process adaptability with a) appropriate cost and b) sensible standardisation across the corporation. Striking the right balance between a control-driven, contractual approach, and a more evolutionary, relational, approach is important and ultimately influenced by business context, corporate culture and the people involved. Ultimately, price drives behaviour within the governance framework by measuring the economic value being added thereby enabling the allocation of resources. Put simply, despite the importance of soft skills in inter-organisation management, price is still the way the score is kept.

4.1. Origins of transfer pricing

The multidivisional organisation form (M-form) developed in the USA as a response to the need to control vast organisations such as General Motors which had arisen to take advantage of economies of scale in both domestic and international markets (Chandler, 1962). Drury (2005) and Seal (2012) state that the motives of applying transfer pricing in the multidivisional organisations includes ensuring the divisional autonomy, evaluating divisional performance and achieving goal congruence. The conflict between measuring performance based on divisional profitability and protecting the interests of the whole organisation was seen as one of the major problems of transfer pricing (Eccles, 1983). One mechanism for coordinating the interactions between divisions is to design a transfer pricing system which both fairly reflects the value added by the supplying division but at the same time is not seen as disadvantageous to the buying division, such that co-operation and thus the synergy of the whole corporation is stymied. Put simply, there is a trade-off between encouraging individual divisions to maximise their individual profitability vis-à-vis the total contribution of the corporation. There is much evidence suggesting that conflicts of transfer pricing objectives might cause internal friction and disharmony (Colbert & Spicer, 1995).

Attentions should be paid to the imbalance of power relatives between service purchasing divisions and SSC; the client firms and outsource companies in negotiating SLAs and setting agreed price. Potential differences in approaches between different business support functions could also be investigated in future articles. Also there is the need to explore how to make sure the congruence of goal during the implementation process of transfer pricing in this hybrid relationship.

Management writers have traditionally been concerned with the pricing of inter-divisional transactions based on relatively tangible goods in manufacturing contexts, using either: 1) a cost plus approach; 2) internal negotiated prices; 3) market prices; or 4) some combination of the three[1]. In contrast, support activities such as finance, HR, purchasing and IT have tended to be treated as cost centres rather than profit centres, with the annual cost being treated as a central overhead to be apportioned across the business divisions, usually on a relatively broad brush basis.

4.2. Pricing of externalising service

The transformation of business support services through some form of ‘externalisation’ mechanism, SSC or BPO, can drive down costs and enhance functionality. Yet, actually achieving increases in efficiency and effectiveness will depend to a large extent upon how well divisional ‘customers’ in the mother organisation and the support service can work together in practice and the backstop of a working relationship is often the lowest common denominator ‘price’. For business support services that have traditionally been organised as relatively self-serving functional units, the transition to actually operating as a market orientated unit is not easy. In order to raise awareness of the cause and effect relationships between effort and results in a service setting the ultimate solution is to recharge all the SSC’s costs to the buying divisions. This will cause divisions to question the value proposition of the service and the performance levels they actually receive. However, when we have pursued this reluctance many of the case organisations in the CIMA-Loughborough project, management often said that they are happy enough if support services actually get transformed into better, more responsive services. To many corporate executives, transfer pricing is the ‘icing on top of the cake’, once there is evidence of fundamental transformation at a function level. That is activities have been migrated, re-engineered and the divisions are happy with the SSC’s service. Pressco, see panel, is indicative of a general reluctance to levy activity-based recharges to divisions. Whilst the chief objective at the start of Pressco’s SSC journey was to reduce the cost of finance in absolute terms, corporate managers are also concerned that the SSC's costs should be more transparent and controllable once untangled from divisions. Indeed, without the cost of support functions in the divisional budgets there is a better visibility over the costs of the core business.

Case example - Pressco

At the media company *Pressco* (name disguised) featured in article 2, a Regional Finance Director, explained that the recharges from the SSC were 'broad brush' and determined at the start of each fiscal year. Given the emphasis that SSC management had put on 'business-like' relations with the business units, it was surprising that there was no *post hoc* adjustment for actual activity levels or actual costs. *She* explained thus.

It is all 'wooden dollars' as far as I am concerned. I appreciate that you have to get re-charging relatively accurate in order to understand your results, in order to compare and benchmark, and all of that, and obviously for the statutory requirements you need to have those allocations…(*)

… but, when you get into immaterial levels or when you get into arguing with the group about, 'why is my IT recharge this amount,' it doesn't really bother me. As long as we get an allocation that we understand and that it is in the budget, … we can manage our controllable costs around that. I don't get into arguments about how much I am being recharged. (Regional FD)

* A reference to Inland Revenue regulations on transfer pricing - Pressco is an international group

Notwithstanding, the general lack of enthusiasm for transfer pricing the enquiry also found that transfer pricing mechanisms are likely to become more common along the course of the long term externalisation journey. As the SSC becomes stable, then cost might be further reduced by drawing on third-party sourcing options to supplement the inhouse operations. Other SSCs, especially in the public sector offer their resources to other public sector bodies and thus need to negotiate 'commercial' prices for their services, which then become *de facto* rates for their 'mother' organisation.

5. Conclusion

The paper has explored how a hybrid governance framework based upon the most appropriate elements of a contract versus relational outlook can deliver adaptable and dynamic support services. The relational contract between SSC and head office, (or BPO and clients) includes both the 'tough terms' about what should happen and 'soft terms' which leave the space for negotiation and adaptation to changing business context demands and continuous improvement of processes. Transfer pricing, as the way to encourage better performance and lower costs in the operation of multinational companies, could also play a critical role in this new hybrid governance. An appropriate price will drive the right behaviours by measuring the financial performance as benchmarked against their SSC's based on a better understanding of the value added by the SSC. Corporate management's will be able to move to rationally allocate resources, which is the key element to ensure that support services are efficient and fit for purpose.

6. Summary

An attraction of externalisation through an SSC is that ‘contracts’ can be drawn up to mandate change in professional support functions, whilst also maintaining control through monitoring performance and providing mechanisms for dispute escalation and remedy. The exact form of SLA will depend on the overall governance style of the organisation and the specific nature of the task.

7. Acknowledgment

The authors are grateful to the organisers, paper reviewers and conference participants for their helpful suggestions, and to the General Charitable Trust of the Chartered Institute of Management Accountants. Thanks also to Kathleen McLoughlin. .

References

Chandler, A. D. (1962). *Strategy and structure: Chapters in the history of the American industrial enterprise.* Cambridge, Mass: MIT Press.

Coad, A., & Cullen, J. (2006). Inter-organisational cost management: towards an evolutionary perspective. *Management Accounting Research*, 17, 342–369.

Colbert, G. J. & Spicer, B. H. (1995). A Multi-case Investigation of A Theory of the Transfer Pricing Process. *Accounting, Organization and Society*, 20(6), 423-456.

Cooper, R. & Slagmulder, R. (2004). Interorganizational cost management and relational context. *Accounting, Organizations and Society*, 29, 1-26.

Drury, C. (2005*). Management Accounting for Business* (*3rd ed.)*. London: Thomson Learning

Eccles, R. G. (1983). Control with Fairness in Transfer Pricing. *Harvard Business Review* (November-December), 149-161.

Goo, J., Kishore, R., Rao, H. R., & Nam, K. (2009) The Role of Service Level Agreement in Relational Management of Information Technology Outsourcing: An Empirical Study. *MIS Quarterly* (March), 33(1), 119-145.

Gospel, H., & Sako, M. (2010). The Unbundling of Corporate Functions: The Evolution of Shared Services and Outsourcing. *Industrial and Corporate Change*, 19(5), 1367-1396.

Helper, S., & Sako, M. (2010). Management innovation in supply chain: appreciating Chandler in the twenty- first century. *Industrial and Corporate Change*, 19(2), 399-429.

Herbert, I. P., and Seal, W. B. (2012). Shared Services as a new organisational form: Some implications for management accounting. *British Accounting Review*, 44(2), 83–97.

Ivens, B. S. (2005). Flexibility in industrial service relationships: the construct, antecedents and performance outcomes. *Industrial Marketing Management*, 34, 566-576.

Kraus, K., & Lind, J. (2007). Management control in inter-organisational relationships.

In Hopper, T., Scapens, R., and Northcott, D (Eds.), *Issues in Management Accounting Research* (3rd ed). Prentice Hall: Harlow, 269-296.

Macneil, I. R. (1980). *The New Social Contract: An Inquiry into Modern Contractual Relations*. New Haven, CT: Yale University Press.

McEvily, B., Perrone, V., & Zaheer, A. (2003). Trust as an organizing Principle. *Organization Science*, 14(1), 91-105.

Popper, L., & Zenger, T. (2002). Do formal contracts and relational governance function as substitutes or complements? *Strategic Management Journal*, 23, 707-725.

Quinn, B., Cooke, R., & Kris, A. (2000). *Shared Services: mining for corporate gold.* Harlow: Pearson Education.

Ramachandran, K., & Voleti, S. (2004). Business Process Outsourcing (BPO): Emerging Scenario and Strategic Options for IT-enabled Services. *Interfaces*, 29, 49-62.

Sako, M., (2006). Outsourcing and Offshoring: Implication for productivity of Business services. *Oxford Review of Economic Policy*, 22(4), 499-512.

Tan, K. C., (2001). A framework of supply chain management literature. *European Journal of Purchasing and Supply Management*, 7(1) 39-48.

Ulrich, D. (1995). Shared Services: From Vogue to Value. *Human Resource Planning*, 18, 12–33.

Williamson, O. E. (1975). *The Economics of Organisation: The Transaction Cost Approach.* New York: Macmillan Free Press.

Williamson, O. E. (1985). *The Economic Institutions of Capitalism: Firms, markets and relational contracting.* New York: Macmillan Free Press.

Seal, W., Vincent-Jones, P. (1997) Accounting and trust in the enabling of long-term relations. *Accounting, Auditing & Accountability Journal*, 10(3), 406 – 431.