BRIEFING

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Efficient pricing principles for shared services

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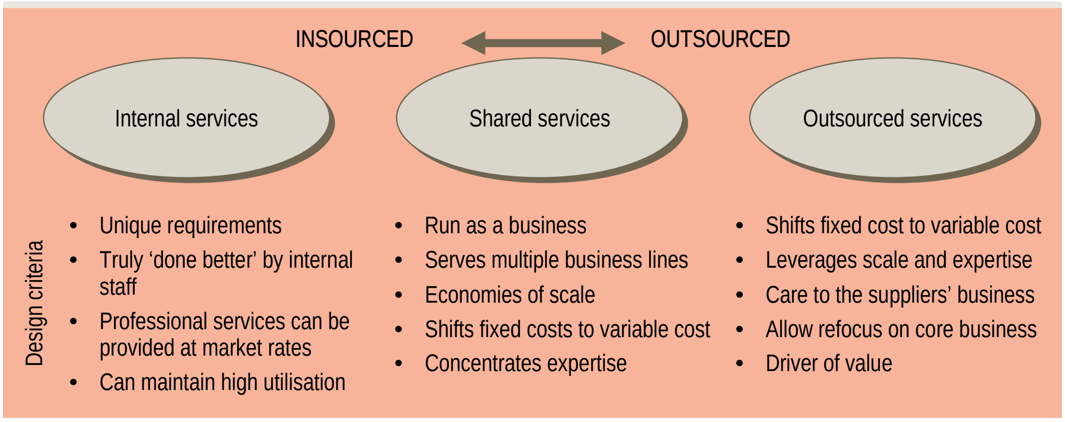
Key points

- Achieving efficiencies from shared services is an evolutionary process, based heavily on the shared services model that is adopted (that is, from basic to market oriented).
- Newly formed shared services models are likely to be highly mechanised, basic business models where cost savings are limited to those derived via economies of scale and may come later after establishment costs are absorbed. Growth in the scope of shared services and efficiency gains is progressive, not immediate.
- The charging regime chosen should:
  - reflect and distribute the scale of efficiencies that are being generated;
  - allow Directorates and the shared services unit itself to understand the varying cost pressures across Directorates and service delivery;
  - provide Directorates and the shared services organisation with information on the costs of service provision, by services area and cost centre, and through this provide incentives to monitor and manage cost pressures

What to expect from Shared Services

Shared services are usually introduced to capitalise on economies of scale, moving administrative tasks away from individual business units into a central operation unit. From an organisational point of view, there is a continuum of service delivery options, as outlined in chart 1.

1 **Service delivery continuum**



Source: , K. (2001) Sharing administrative functions at lower costs: a position paper prepared for the business/higher education round table.

Shared Services activities are really only appropriate where there are economies of scale in delivery which are best captured when an organisation is able to concentrate its staffing expertise and run the operation through a business model that can ensure that the economies are being generated. Even still, achieving economies of scale is typically an evolutionary rather than immediate process, particularly given the upfront costs of establishing a Shared Services centre.

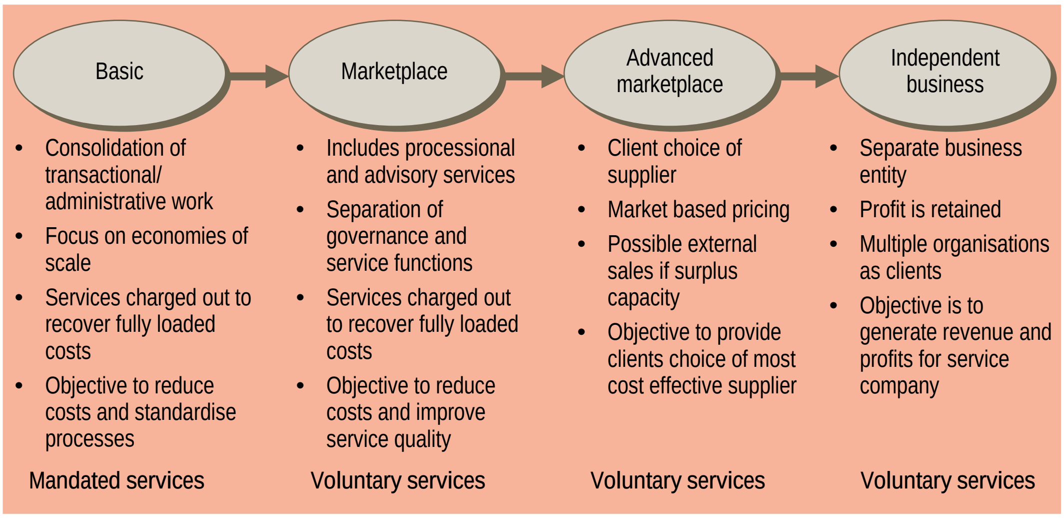
> Shared services creates a dynamic internal market place for services. It is like any business – the customers determine its fate. Shared services requires an understanding that the role is to provide a service at cost, quality and timeliness that is competitive with alternatives, to a clearly defined group of clients. It is not the same as centralised functions – the difference is the principle of the marketplace[1].

The efficiency gains that should be expected from adopting Shared Services depend in part on the model of shared services involved.

For instance, where basic structured Shared Services organisations are in place (Chart 2), the efficiencies are likely to be generated solely through economies of scale, and eliminating (reducing) duplicated fixed costs. From an organisational perspective, the associated charging regime should also reflect this – the cost of delivering Shared Services should be verifiably lower than in-house delivery, but not necessarily reflecting a substantial cost reduction in the early stages.

It is only once the Shared Services organisation has matured and achieved its own efficiencies that a better understanding of the overall organisational efficiencies may be had, and more complex charging and cost allocation arrangements may be implemented.

2 Continuum of shared services models



Source: Woods, K. (2001) Sharing administrative functions at lower costs: a position paper prepared for the business/higher education round table. Note: adapted from Quinn, Cook and Kris (2000) Shared services – mining for corporate gold. Prentice Hall.

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[1] K. (2001) Sharing administrative functions at lower costs: a position paper prepared for the business/higher education round table

Pricing principles for Shared Services

There are a range of approaches taken to charging regimes for shared services, which will impact on the fee charged, see table 3.

3 Alternate approaches to charging and effect on fees charged

Charging type	*Characteristics*	*Advantages and disadvantages*
Flat rate	Some business units are charged a flat rate based on a determined metric such as number of employees irrespective of the level of demand for different services ▪ Flat fee for financial year	Very simple to implement, however there is limited information on the true cost of delivering the services, and a high risk of cross subsidisation – over and undercharging. No incentive for business units to review demand for services.
Budgeted rate	Business units are charged a differentiated fee by service area (e.g. ICT, human resources, finance etc), that attempts to estimate the distribution of use of these services by each business unit ▪ Flat fee for financial year	Does differentiate across both business units and services being delivered. However, there is still limited information the costs of delivery, limited incentives for rationalising service demand can be difficult to explain final charges.
Activity based costing	Where the shared services organisation is aware of it's per unit/per activity costs, business units are charged based on the level of each service they require: a post-paid system. Charges aggregate key costs of service such as labour, systems and overheads. ▪ Variable fee based on aggregated cost estimates of service demanded and delivered throughout year	Requires significant information on the internal costs of the shared services unit and the level of service demand from business units. However, there is a much lower risk of cross subsidisation, and a higher incentive for business units to rationalise demand for services. Depending on the scale of cross subsidisation in flat and budgeted fee structures, overall fees could be higher or lower for business units.
Full direct charging	In mature shared services organisations it may be possible to charge for exact staff and resource time that is allocated to each task, as it is incurred ▪ Variable fee based on actual costs of services demanded and delivered	Requires a high level of visibility on exact resources required for service delivery for individual business units at specific times. Does provide incentives for rationalising demand for services, and improving efficiency both within the business unit and the shared services organisation.
Market based costing	A highly mature shared services organisation that has also been able to expand to service delivery for external clients would have in place highly technical costing and billing systems to allow for market based pricing options ▪ Variable fee based both on services delivered as well as wider competitive market pressures.	Very few shared services organisations internationally that have achieved this. The system is based on expanding the client base to external clients and gauging the price factors in the market, as well as allowing business units to seek services externally as well, further market based competition.

Source: Deloitte (2007) Shared services: is the price right? Accessed on 29/06/2012 at http://www.deloitte.com/assets/Dcom-CostaRica/Local%20Assets/Documents/Industrias/CSC/071211-(en)_Shared_Services_Pricing.pdf

What to expect from charges for shared services

An appropriate charge for shared services depends on what the goal of the charges is, and what type of information it will be reflecting. For instance charging regimes can be used to:[2]

- provide business units and the parent organisation with information on the **total cost of their service demands** – in terms of time and resources;
- assist both the business units and the parent company/organisation to **clarify the services that are required** over what time frames;
- improve cost control activities through a clearer understanding of the costs to **rationalise the level or timing of service demands;**
- use resources more effectively and improve productivity.

Charges for shared services can be culturally difficult for Directorates to accept. In many cases the tasks involved are such that a business unit would have previously allocated to overhead costs and accounted for in annual budgets, hidden within bulk payroll systems and allowing business units to operate with reduced concern for the total cost of the services in-house.

In contrast, when a shared services centre is set up, the costs of accessing these previously in-house services immediately becomes obvious, and in some case may be viewed as an additional or variable cost that was not previously faced.

To ensure that a shared services model is both efficient, as well as workable within the organisation (with limited consternation from business units) there are some key fundamentals of a charging regime that should be considered.[3] Charges should be:

- Equitable – there should be no cross subsidising of costs by other business units.
- Repeatable and accurate – the same volume of work should cost the same irrespective of the business unit that is being charged.
- Understandable – both the Directorate and shared services centre should understand clearly how the charge has been arrived at, and what the charge actually is. This is likely to include a billing tracking system that allows both the shared services centre and the business unit to extract information on the volume and type of services delivered and the costs associated. The business units should also be able to allocate these charges to cost centres within their operations.
- Controllable or predictable – the business units should be able to anticipate how a change in demand for shared services will change the amount they are charged
- Economical – the established system should be relatively inexpensive to run.

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[2] CNJohnson & Associates (2009) Best Practices for Shared Services Chargeback. Accessed on 29/06/2012 at http://www.cnjohnson.com/Shared%20Services%20Best%20Practices.pdf

[3] ibid