

# insights

MARCH 1999 - VOLUME 1, No. 5 \$5.50 A RESOURCE FOR ACHIEVING INTERNAL SERVICE EXCELLENCE

Dear Shared Services Leader:

This issue of SSI is devoted to the topic of outsourcing, the popularity of which has continued to rise, particularly among large companies. We believe this discussion is important because there are still many corporate executives and line managers who view outsourcing as a competing concept with Shared Services rather than one that is complementary. These perspectives can give rise to very different results.

When outsourcing is used as the prescribed remedy for anemic internal service delivery, it often wreaks some undesirable side effects, not the least of which is the cost and embarrassment of withdrawal — having to bring outsourced work back in-house. Conversely, when it is a natural delivery process within Shared Services, companies tend to make more informed and sustainable decisions about outsourcing. They are better able to assess whether any inherent problems exist with the processes used to deliver the services being considered for outsourcing, and can simplify, consolidate or correct these problems rather than hand them off to a vendor and hope for the best.

No one management approach can provide the best solution to meet all needs. Embracing outsourcing as a delivery alternative to insourcing is prudent. Engaging Shared Services as the insurer of desired cost, productivity, quality and satisfaction results is optimal.

We are pleased to announce our new website devoted entirely to Shared Services where you can also access all past, as well as the current issue, of *Shared Services Insights*. We welcome your visit and feedback at <http://www.sharedservices.com>.



Laurel A. Forst  
Editor

## GUEST INTERVIEW

*The recent Shared Services Conference in Coronado, CA gave us the opportunity to talk to Emiko Banfield, PhD, who is Vice President, Shared Services, for Southern California Edison Company (SCE).*

*About four years ago, SCE undertook a Strategic Sourcing Initiative (SSI), which included a cross-functional examination of the utility company's material and services purchasing practices. A total cost model was developed that identified all the cost drivers associated with purchasing outside products and*  
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services, from needs identification, through the procurement processes, to product or service acquisition, continuing through the life cycle and, where necessary, to disposal. The salient element was that total cost, rather than external price, became the basis for decision-making. This allowed SCE to optimize these decisions from a corporate standpoint, as opposed to merely commercial profit margin or operating need considerations. In the years since, not only has the utility dramatically reduced their costs of purchasing external products and services, but, in a role reversal, have discovered a new source of revenue enhancement by becoming a supplier to some of their suppliers!

**AGL:** Emiko, what was your rationale for a cross-functional approach to SCE's purchasing practices?

One of the values of cross-functionality in terms of group composition is being able to examine your entire supply chain, and identify all cost drivers associated with specifications (what you are going to buy), fit for purpose (knowing it will fit your needs at the most cost-effective price), and any other considerations in terms of whether the requirements could be designed more holistically, rather than just product purchases. Take the purchase of a transformer as an example. Are there options that would drive lower overall costs into the life cycle of that purchase? What are the engineering and specification differences, the trade-offs in terms of maintenance requirements and life cycle expectations, between a transformer with a 15 year life and one with a 30 year life? What are the cost drivers associated with the transformer through its life cycle?

There are other cost drivers, regulatory ones

such as air quality requirements and other standards that must be met. The cross-functional team approach to a regulatory driver allows us to bring in people from all the functions affected by the purchase. There will be people from Engineering who must conceive say, an electrical system application, operations people who will install and maintain the equipment throughout its life cycle, and also someone who can provide needed regulatory input. For example, all chemicals must have material safety

data sheets — a legal requirement for the purchase of anything that falls into that classification — which must be on file and available to any employee who works with that chemical.

**AGL:** How does the process transpire?

We start with needs identification and process map the entire supply chain, from cradle to grave in scope. We bring together teams, people involved in every aspect of the procurement process: pricing, procurement, negotiations, material handling, salvage, etc. So we have users, line people, engineering, commercial (procurement) people, logistics distribution people, and those involved with the removal and related processes costs. Even Accounts Payable and Receivable — which actually go into Financial in terms of organizational structure and alignment — are included in the cross-functional team so they can add their financial perspective. They help us determine what overall benefits can be gained from various payment cycle commitments, i.e., electronic funds transfer versus 30 day lag time.

So we really get a complete picture of the total cost of a purchase decision by applying the cross-functional approach. In our old model,

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people would tell procurement what they needed and procurement would go out and negotiate the best price they could through a bid process; other ancillary processes just sort of made their way without any critical examination in terms of the cost they drove. The total cost model enables us to bring various functional perspectives together and make a fully informed, corporate-level decision. As such, we avoid sub-optimizing the company as a whole by indulging, if you will, each of its parts.

*AGL: Was the primary objective to reduce purchasing costs?*

Well, that was certainly a major driving force, but beyond that, we wanted to leverage our supplier relationships, pushing beyond the linear supply chain notion into new ways to create value. We examined both outsourcers and suppliers — those with whom we had an existing commercial relationship built around a product or service purchase, as well as those with whom we had an aligned business objective. We sought to create Strategic Sourcing partnerships with them, based on our internal evaluation of what capabilities and fixed assets we had to leverage and whether these could create value for our supplier partners. Of course, we had to ensure that any changes would be cost competitive in terms of servicing our internal customers, plus we had to make a successful case to utility industry regulators that the benefits would accrue not only to our shareholders but also to our 11 million California customers. Final approval for regulatory rulings to allow us to sell products and services to third parties is anticipated in the first quarter of 1999.

*AGL: Sounds like an enormous undertaking.*

It was. In the early implementation, when we

were on a learning curve, the average team would take anywhere from four to twelve months to complete their analysis. We've become more streamlined since, and the time demands now range from two to four days a week, depending on what part of the cycle the team is in.

Each team focuses on a single commodity grouping, identified by a market scan of where there exists a natural affinity or an ability to group things to gain some economy or synergy. This might involve similar types of equipment with a manufacturer of large apparatus, or through a supplier by the nature of the product or service they provide. So the first task of the team, once convened, is to look at the

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marketplace and our requirements in as broad a scope as possible. That way, when we consider suppliers, we can further refine the scope, that is, if nobody out there can do all of the things we want, maybe some combination — perhaps one major supplier and several niche suppliers — can provide what we need within that particular supply chain. Because of the opportunities for leveraging this creates, we have found some significant value through the cost economies of keeping these decisions as broad and as high in the organization as possible for aggregation purposes.

*AGL: Can you give me an example?*

Sure. Prior to SSI, we had 27 office supply rooms sprinkled throughout our headquarters area. Purchase decisions were made locally. Our people would get a catalog from a local office supply store and buy what they needed on an incremental basis, often only a ten or fifteen dollar purchase. We stepped back and analyzed how we might raise these decisions to the high-

est possible level across the organization. We formed a partnership with a major office supply company, and leveraged our organization-wide volume buying by establishing a standardized set of products. As a result, we now save roughly five million dollars a year just on office supply purchases.

In addition, we try to find the right metric to understand where we are getting savings. In office supplies, we looked at dollars per year per employee, so volume was linked to something that drove volume, i.e., the number of employees. We went from about \$580 to about \$265 per year per employee. And, we were able to close those supply rooms and redeploy them as office space because the contract we negotiated was not just for supplies but also for online access to the supplier's computer catalog with guaranteed next day delivery. We eliminated the storerooms, inventorying, the whole upfront procurement process and manual requisitioning system. We didn't even have to put the catalog on line; we link directly into their catalog, which they customized to show only the

fields of products approved at the price negotiated for the volume expectations.

*AGL: Did you have any problems with your major suppliers?*

None with our major suppliers because their revenues are tied to market share. Before SSI, we had something like sixty suppliers of office supplies; we now have just three. We still use some general procurement activity on a purely commodity basis for areas where it is the most cost effective way to do it, but overall, we shrunk 12,000 suppliers to just 78 partners.

*AGL: How did you choose these partners?*

Through a bidding process. We invited dozens of potential partners to roll out meetings and showed them our supply chain and cost model, and what it cost us to process a requisition, place an order, have it delivered to our loading dock and then distributed by our own porters to a supply room or desktop. So the suppliers could see all

the cost drivers. Our RSVP said that while traditionally what you as a supplier would do is to tell us what your price would be based on this array of products, in addition to

that, we now want you to consider things like fit for purpose, standardization versus customization, and aggregate purchasing (volume leveraging). Also, tell us

how you can help us reduce our total cost by relying on you for all or pieces of the supply chain, or suggest alternate ways of doing things. It was an open-ended invitation; a challenge to suppliers to create value for us — through more effective operations and by reducing our total cost — and additional market share for the suppliers by becoming a Strategic Sourcing partner for SCE.

*AGL: Any surprises?*

We have had some supply chain operational improvements in various commodity areas that were somewhat surprising. One that grew out of exploring mutual strategies with a partner involved a pole yard where we inventoried wood poles. That yard had self-loading pole trucks and a

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staff of seven people to handle and deliver material. One way our new wood pole partner added value was by offering direct delivery of poles to our job site or district yard. Initially, we were concerned we might be sacrificing responsiveness. You know, if an automobile hits a pole, we need to have repairs or a replacement pole available immediately, because of the public safety and reliability issues involved. But we actually improved our response rate after establishing that working relationship, which included a commitment by our partner to meet strict response times for delivery, among other requirements. Another supplier helped us reduce costs by applying their expertise in standardizing over 100 types of cable and wire we were using down to a more manageable 25.

**AGL:** *I understand you have actually become a supplier to some of your supplier partners?*

Yes. We contract tree trimming services through a set of vendors who use vehicles similar to ours — hydraulic equipment with the same type of maintenance and repair requirements. We keep our equipment in 43 garaged locations sprinkled about our 50,000 mile service territory. It's an asset in place expressly for the purpose of keeping the lights on for our utility customers but it's also an asset that sits idle for a good part of the day. We looked at how we might leverage this to generate revenues that would benefit our supply partners (the tree trimmers), as well as our shareholders and customers. We came up the idea of incorporating our supplier vehicles into our vehicle maintenance program, which consists of scheduled and unscheduled activities. Scheduled activities include fueling, preventative maintenance & inspection, scheduled repair, tire maintenance and vehicle washing. Unscheduled activities

include unscheduled repairs, emergency roadside assistance, vehicle towing and vehicle shuttling. The vehicle maintenance program fundamentally involves preventative maintenance & inspection with all other activities being optional. The current projection for gross revenue potential is \$1 million annualized by mid-year 2000.

**AGL:** *Did your Strategic Sourcing Initiative have any effect on your subsequent implementation of a Shared Services organization?*

**“..we actually improved our response rate...”**

The fundamental learning we acquired from our Strategic Sourcing Initiative helped jump start the Shared Services concept, particularly as it applied to the cross-functional approach. Line organizations who are accustomed to doing things independently and simply telling service organizations what to do can now see the value demonstrated by collaborating within the company. I believe we would probably have had a similar success had we implemented Shared Services first. It is the initial cooperative effort across functional lines that makes it easier to collaborate in subsequent organizational concepts because of the precedent set and the confidence instilled.

**AGL:** *Thanks, Emiko.* ■

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## OUR PERSPECTIVE ON...

### OUTSOURCING HAS BOOMED IN THE NINETIES.

Outsourcing has boomed in the nineties. Its acceptance and continued growth affirms corporate America's interest in increased flexibility including internal service delivery. For many companies, however, it has become a convenient place to dump problems that defy easy solutions.

The reasons for choosing outsourcing are varied. Companies want to lower costs, boost productivity, access specialized skills, or shed non-core work. Sometimes they simply want to divert internal resources to other purposes perceived as more important. While these can all be valid reasons for outsourcing the real driver for outsourcing is the desire to pass a service problem to an outside vendor. This unspoken agenda is one reason why so many outsourcing efforts end in disillusionment, if not an outright embarrassing disaster.

Typically, services thought to be lower in priority or less vital to internal customers are out-

sourced — things that need to be done but where strategic knowledge of the company or its mission does not add a particular advantage. Services that are perceived as having less business impact are often transactional in nature, such as data systems entry or payroll check processing. Why? Because employees are probably more concerned with being paid the right amount on time, than who prints and delivers their checks.

But whether a service being considered for outsourcing is of lower or higher importance, transactional or expertise in nature, the decision should not be based solely on cost consid-

**“If you have a service delivery problem, the process must first be defined, redesigned and corrected.”**

erations. And, it should never be predicated on the expectation that a service delivery problem can be solved by shifting responsibility to an external resource. If you have a service delivery problem, the process must first be defined, redesigned and corrected. Then, you can employ a fact-based decision-making process for assessing

the advantages and disadvantages associated with outsourcing to determine whether you want to outsource it.

Even when a process is not troubled, outsourcing has risks. Its rapid growth has created a heated competition, especially for larger accounts. Success for vendors is measured in terms of market share and being able to leverage their investment across multiple companies. Losing the bid for a major contract can be disastrous since it may be five or ten years before the account is up for competitive bid again. In this environment, each meaningful contract bid becomes a do-or-die situation for vendors struggling to create a stream of multi-year work. They may even price their services at a loss to gain the account. But once landed, they immediately search for opportunities to make it profitable, such as “discovering” services not covered in the original requirements — premium services with margins that make the account more profitable. This scenario is not unusual, especially for first-time outsourcing companies or those with lingering internal problems that defy correction. It's almost impossible to plan for every

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contingency, so things not apparent when the initial agreement is signed become clearer as the outsourcing relationship matures. And they can become very costly oversights.

In crafting the agreement, it is not in either party's interest to build in separate and conflicting incentives; but, be aware that there is an inherent conflict between your desire for service and the vendor's profit motive to control delivery costs. An important element that should be included in the agreement is problem response times — the cycle time between when you provide the triggering information until the time the vendor resolves the issue. The vendor will seek longer elapsed times to increase their response options; you will want to push for specified timetables that increase service and customer satisfaction.

To minimize these types of problems, we believe it is crucial to conduct requirements discovery to ensure that your internal customers will be getting the services they need in a manner which fulfills their expectations. Relatively few organizations do this. The key is to satisfy your users and payers, versus satisfying those making the decisions based on what they believe the users and payers need or want. If you want buy-in to your outsourcing decision, the evaluation process employed and the outcomes to be produced must be defensible and credible to your internal customers, business unit management and corporate center management.

Customer requirements clarification will add value to your service delivery in many ways, whether through external vendors or through internal resources via Leveraged Service Delivery or Shared Services. Agreement is gained on the current state and level of service delivery —

many times, customers and providers don't share a common understanding on what is as well as should be changed. Immediate action can be focused on issues that most impact customer satisfaction. Performance metrics and standards can be identified and realigned, based on the identified requirements, assuring customers that your service delivery focus is on those aspects most meaningful to them. Processes can be redesigned

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**“Ultimately, satisfaction with outsourcing is driven by how well performance expectations are met or exceeded.”**

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and resources realigned to meet requirements that are most important, or most in need of change to reach competitive levels. Performance can be enhanced through requirement-specific training and other interventions. Requirements can help identify conflicts among customers for the same service, determine whether they are real or imaginary,

and provide insight into how customer sets can be prioritized for optimum service delivery.

Ultimately, satisfaction with outsourcing is driven by how well performance expectations are met or exceeded. As such, they should be reflected in the pre-defined performance targets. For these targets to be reasonable, they must be based on factual data about requirements and current performance. The transition from internal to external (vendor) service delivery is complex and demanding. Your people will need help with transition issues, something best accomplished through a clear, factual understanding of how your organization currently operates, particularly with respect to people resources. This can best be determined through rigorous customer requirements discovery. ■

# SHARED SERVICES Q&A

**Q.** *What can we apply from our experience as a Shared Services organization to help make successful outsourcing decisions?*

**A.** The most important application from Shared Services is the definition of customer-based requirements. It is critical these be at the service level and have tangible, quantitative and validated measures, in terms of quality attributes, to use as a basis for negotiations with prospective outsourcers. There is also a need for developing a process or “sensing device” to know when changes occur in your customers’ requirements, so they can be incorporated in new or future contract negotiations with outsourcers.

**Q.** *If we outsource expertise-based services, how can we retain the necessary competencies should we subsequently be forced to bring the services back in-house?*

**A.** This is the primary reason why we caution companies against outsourcing expertise-based services. If you have one FTE (full-time equivalency) expended on delivering an expertise service, you should not outsource. If you outsource the service, it is difficult to justify the cost of providing an attractive professional environment to retain the same level of competency. Therefore, we recommend you negotiate upfront with the outsourcer that they will help with the training and development of your staff in the event you decide to insource the services at some later date.

**Q.** *You’ve said we should not base our outsourcing decision primarily on cost considerations, but reducing costs is our primary motivation; what’s wrong with that?*

**A.** Absolutely nothing! However, in our experience, cost should not be the only consideration. The decision to outsource should include capital and/or technology implications, the intellectual property issues and/or whether the work is part of the organization’s core competency.

**Q.** *How do we maintain control of our internal customer relationships to ensure satisfaction with outsourced delivery process?*

**A.** Regardless of whether you insource or outsource services, never, never give up the internal service management of the customer relationship. Outsourcing is an alternative to insourcing. In either case, Shared Services should manage the outsourcer and the relationship with the customer to ensure their requirements are being met.

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*For questions or additional information about these conferences, please contact Laurel Forst at (203) 531-8500 or laurelforst@amherstgroup.com*



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We welcome your comments and suggestions.

If you have a question for our Shared Services Q & A, write us!

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