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Three steps to sustainable and scalable change

Part 3: Redefining functional service delivery to achieve organizational scalability and efficiency

About the series

Creating sustainable and scalable improvements to a company's cost structure is like building a skyscraper. The first step is choosing the right business model, which provides a blueprint for the effort. The second step is determining how decisions will be made. This serves as a strong foundation. The third and final step is mobilizing resources and putting the decisions into action, which is analogous to actually constructing the high rise. When improving their cost structure, many companies try to jump directly to the construction phase. However, the results are generally disappointing and, even if they are acceptable, they are usually hard to sustain.

Deloitte's three-part series, "Three steps to sustainable and scalable change," takes a detailed look at key activities we believe are necessary to produce cost structure improvements that can withstand the test of time.

When improving their cost structure, many companies try to jump directly to the construction phase. However, the results are generally disappointing and, even if they are acceptable, they are usually hard to sustain.

- Part 1, "Rethinking a company's business model," provides fresh and practical views to help companies choose or confirm the right business model. This can serve as a blueprint to guide the overall effort.

- Part 2, "Aligning operational governance with the business model," presents a framework for aligning and improving the way decisions are made and executed. This step can provide the foundation for lasting improvements; yet, in our experience, it is the one step companies are most likely to overlook.

- Part 3, "Redefining functional service delivery to achieve organizational scalability and efficiency" explains ways companies can deploy their resources to create a cost structure and performance improvements that satisfy the specific needs of the business.

We believe these three steps can help any company make sustainable and scalable improvements to its cost structure.

A function's service delivery model defines how work adds value and relates to the business. Is work unique to local markets or generic enough to be consolidated and centralized? Is it knowledge-based or transactional in nature? During times of business contraction and growth alike, companies should re-examine this balance to adapt to changing business priorities and imperatives, and to produce significant net cost savings and higher effectiveness. Ultimately, maximum value for minimum cost is the power of an effective service delivery model.

When corporate executives consider making organizational changes, they usually move straight to restructuring or realigning resources. Two steps, however, should be taken before a single resource is redeployed:

First, you need to confirm, change, or adjust your company's business model. By business model, we mean the way a company organizes or structures itself to go to market; interfaces with stakeholders, and reacts to external events. The business model serves as the blueprint for a corporate transformation or restructuring effort.

Second, as with a construction project, the foundation needs to be laid. In a business this is the operational governance that conforms to the business model. Operational governance establishes how decisions are made and defines the roles and responsibilities of corporate and the business units or divisions. In general, it's how key decisions are made.

With the blueprints in hand and foundation in place, you're now ready to build the new structure – that is, change how your organization deploys its resources. The objective, and biggest challenge, is to align the way work gets done with the business model and to drive structural cost reduction, along with sustainable and scalable change.

The service delivery model – a construct for change

Since there are varied types of work and ways to perform them, a service delivery model (SDM) serves as a way to help you tell the work types apart and evaluate their ultimate impact on company performance. An SDM starts with the notion that there are four different types of work for each functional area, described in the pages below. How that work is organized and managed will be different for each of the four types.

Eliminating, or at least significantly reducing, random allocation of resources is at the heart of what an SDM is designed to help you do. This means aiding you in understanding the various ways work gets done and answering questions about what, where, who, how, and why (See Figure 1).

Figure 1. What SDM analysis evaluates

SDM analysis helps you evaluate each function	
What?	What type of work, key processes, and activities are involved?
Where?	Which geographic aspects of the operation are involved?
Who?	Which resource in the total delivery model will handle the work?
How?	Which activities accomplish the work? What technology platforms support it?
Why?	What's the rationale for the value in the approach deployed?

Source: Deloitte Consulting LLP

Depending on the company's strategy and business model, SDMs will differ widely both between companies and across functions – from the traditional SG&A functions, such as human resources, information technology, finance, and marketing, to line operations or operational support functions, including production planning, research, engineering, or safety and environmental protection.

Segmenting the types and nature of functional work

In addition to helping you understand the basic parameters of the work, a visual depiction of the SDM – in the form of a basic two-by-two SDM matrix (See Figure 2) – can assist you in defining work according to how it adds value and relates to the business. Work adds value by meeting defined service levels or efficiency requirements; for example, through processing transactions at the lowest possible cost or through more strategic ways that require management involvement and knowledge-transfer activities.

In terms of how work relates to the business, a company should allocate resources based on whether the work is or should be generic – and, consequently, delivered company-wide – or whether it's specific to a business unit or division, and therefore should be delivered locally.

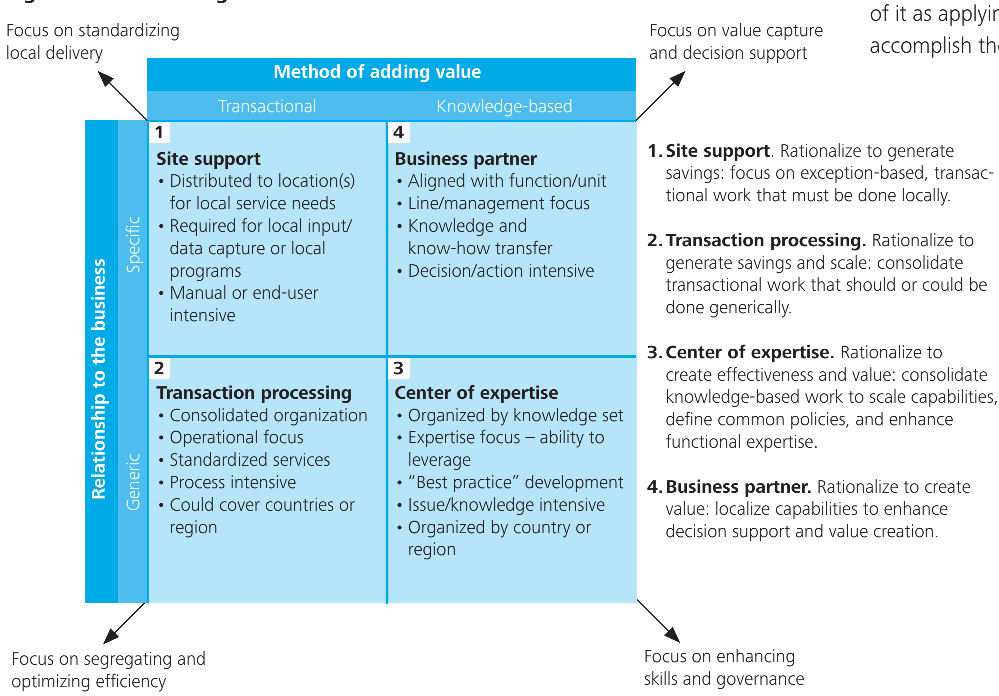
As mentioned above, there are four different types of work for each function, depicted by the quadrants in the SDM matrix: site support, transaction processing, center of expertise (sometimes called knowledge-based work or center of excellence), and business partner. Each quadrant calls for a different skill set or capability, and each should be managed differently. For example, consider how the finance function might separate functions into quadrants:

- Inventory accounting typically maps to site support (Quadrant 1 in Figure 2) and financial analysis to business partner (Quadrant 4) because both tend to be specific to the business units or divisions.

- Accounts payable, however, fits in the generic transaction processing quadrant to optimize efficiencies (Quadrant 2), and tax planning goes in the other generic quadrant of center of expertise that includes specialist activities (Quadrant 3).

Using this framework, you can analyze the current distribution of work and explore other approaches that might improve efficiency and effectiveness. This method of segregating the activities within a functional or operational area involves looking at individual activities, their nature, and what the service requirements are for these activities to support the business appropriately. Think of it as applying special magnets to the work activities to accomplish the segregation.

Figure 2. The SDM organizational matrix



Source: Deloitte Consulting LLP

To determine the optimum distribution of work, a first step is to identify those activities that absolutely must be delivered on site to be effective. This can be called "inextricable" work since it requires on-site knowledge or relationships to effectively meet service requirements (see Figure 3). All work that is not inextricable should be considered for consolidation and standardization.

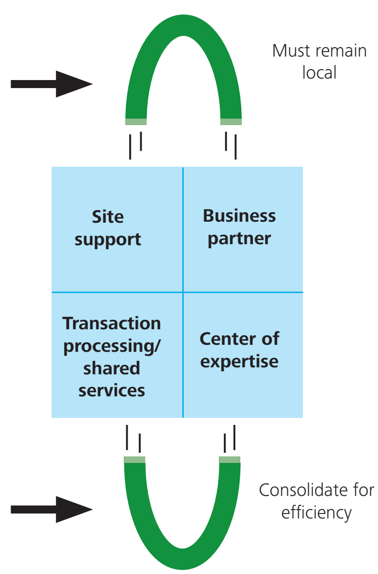
On the surface, many functional areas seem to contain all four types of work: site support, transaction processing, center of expertise, and business partner. But, based on our experience, further analysis can often reveal that between 60 percent and 80 percent of the work volume is transactional in nature. Of course, many jobs may have both transaction processing and center of expertise characteristics, but that makes it hard to excel at either. If there is heavy emphasis on the transactional work, which is not unusual, there probably is little time to focus on the knowledge work. As a result, such competencies are typically under invested or under developed when looking at a functional organization as a whole.

An effective SDM encourages specialization in just one type of work, as long as the volume of activity supports it, and the maximum level of aggregation of service requirements allows you to gain efficiencies. Increased specialization in a particular type of work usually produces more effective service.

Figure 3. Applying magnets to determine optimal SDM

By analogy, when making adjustments, there are two large magnets that pull on functional activities

The inextricable local work magnet:
- Identifies all of the work that must be performed at a specific business unit/division site to maintain responsiveness to customers, facilitate a quick turnaround time, or to meet location/physical proximity requirements.
- Shows work that can stay local, however the rest can be consolidated, where it can be much more efficient.



The consolidation magnet:
- Pulls everything that is not site-specific or business unit/division-specific to be consolidated and standardized to produce scale.

Source: Deloitte Consulting LLP

Extending the basic two-by-two SDM matrix

The two-by-two matrix described above works well in many situations, but companies with global operations may need a more encompassing approach – one that adds a third dimension (see Figure 4).

How does it work? Consider the case of a consumer products company with operations in more than 70 countries. The company's existing SDM included some consolidation of back-office operations, but this was not a fully developed or coordinated solution. Company executives sought a more effective geographic vision and SDM to help them meet a wide range of delivery needs.

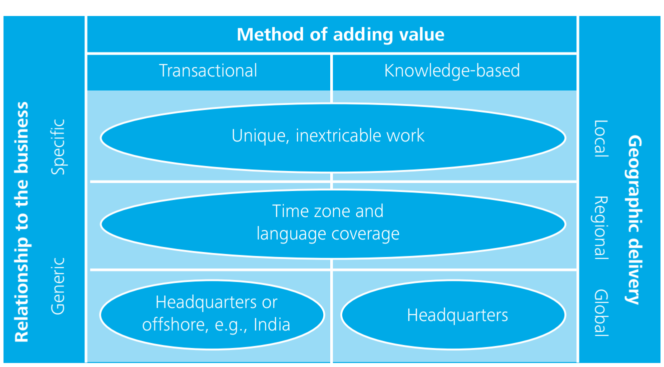
Analysis of the company's situation resulted in three recommended levels of aggregation (the original two-by-two matrix approach, as well as a geographic layer added on):

- Local delivery to accommodate truly unique work that is inextricable from local sites.
- Regional delivery to provide geographic, time-zone, and language coverage, and to leverage opportunities for labor rate arbitrage.
- Global delivery to consolidate certain generic work in a single location to increase efficiency and coordination, as well as to enable backup redundancy and promote more effective business continuity risk management.

In addition to adding a third layer to the SDM matrix, companies with enterprise IT infrastructures may want to look beyond individual functional areas and apply the SDM to end-to-end processes. These might include record-to-report, purchase-to-pay, hire-to-retire, or, as in the case of the global consumer products company, forecast-to-stock.

Figure 4. Redefining the SDM for a global company

For global companies, a third layer of aggregation may be necessary for an effective SDM



Source: Deloitte Consulting LLP

Through its SDM analysis, the company discovered that it could aggregate many existing transactions within its forecast-to-stock process. For instance, several processes performed at the local level could actually be redesigned for delivery at a regional level. Likewise some activities, such as re-packs that were being performed in country-level warehouses, could actually be performed within international manufacturing centers. Only a few "inextricable" work activities, such as customer returns and inspections, remained at the local level to comply with local regulations. Figure 5 shows the resulting SDM with local work and two different levels of aggregation and consolidation.

Figure 5. SDM for a global forecast-to-stock process

	Transactional	Knowledge-based
Local	**Site support – Country/warehouse** • Receive, store and deploy finished goods • Determine discrepant material disposition **Site support – International manufacturing centers** • Demand planning • Schedule production, supply planning • Purchase materials and services • Execute production • Palletizing process • Plant maintenance • Manage lots/batches	**Business partner** • Vendor managed inventory • Product exit strategy • Monitor and manage supply chain KPIs
Regional	**Transaction processing/Shared services** • Statistical forecasting • Sourcing and procurement of primary transport • Manage purchased finished goods • Create and maintain purchase requisitions • Manage inventory, storage and movement	**Knowledge centers** • Supplier quality assurance • Export • Customer returns • Manage material disposal and waste
Global	**Transaction processing** • Procure and manage subcontracting • Purchase materials and services from global vendors • Manage procurement contracts and requests for quotation • Manage master data (vendor and item data)	**Knowledge centers** • Monitor and measure supply chain KPIs • Capacity planning • Sourcing strategy

Source: Deloitte Consulting LLP

A closer look at the SDM components

To gain a better understanding of how SDM analysis can be used to break down types of work and the value they provide, take a closer look at the components of the SDM framework originally presented on page 3.

Site support

Site support work includes processes or activities specific to each business unit or division. This work is so unique it is considered inextricable – it must be performed at the business unit or division to maintain responsiveness to customers, facilitate a quick turnaround time, or meet location or physical proximity requirements. It requires local interaction or data capture and manual processes. Examples include inventory accounting, in-store promotions, on-site technology support, and photocopying. This typically cannot be consolidated across the globe or even regionally.

However, decentralized business models, ineffectively integrated mergers or acquisitions, management preferences, and legacy differences in systems, processes, and policies often cause companies to keep work local even when it clearly could be consolidated or centralized. Any of these factors can be the source of inertia that holds back the rationalization and realignment of functions. Ultimately, local site support work should be kept to a minimum, leaving truly unique work at the business units, divisions, or other local sites. By applying an SDM analysis to each function, you can take existing, widely dispersed work and consolidate it into a shared services center – or even outsource it – where it can be managed far more efficiently. This also allows you to redefine policies and processes and consider more automation of the work.

Transaction processing

Work that is not sensitive to location and is not knowledge-based falls into the category of transaction processing. Typically these activities are process-intensive, such as payroll, accounts payable, collections, and the IT help desk. Although much of this work could and should be centralized, many companies still spread it across their organizations among divisions and business units. In an SDM analysis, it often shows up in the site support quadrant disguised as site-specific work.

The SDM analysis can help you distinguish transaction processing work from that which really should stay local. Everything else should be a candidate for consolidation at the corporate levels, in shared services centers, or through an outsourcing provider. The analysis also can help you address process issues involving local site support work and transaction processing in parallel, with the objective of minimizing site support activities and maximizing the degree of standardization wherever possible.

While work consolidation and process standardization are the main levers for this quadrant, don't forget service-level definition. You need to establish service levels to achieve the proper balance between cost and service performance, moving to either point of the spectrum according to your specific needs.

Transaction processing activities, the quadrant into which the vast majority of most companies' activities fall, should add value through economies of scale that allow low-cost execution while meeting defined service needs, whether delivered regionally or globally. Shared service centers also are more easily scaled upward or downward than decentralized operations. They allow you to adjust your related SG&A spending faster in response to business and environmental changes.

To obtain additional savings, consider pursuing opportunities to offshore or outsource the shared service center. Outsourcing should be considered both selectively and more comprehensively. Time-to-value in consolidating transaction processing, along with your company's ability to execute consolidation strategies, may determine the attractiveness of outsourcing.

Center of expertise

An effective center of expertise (COE) leverages a company's core strengths by centralizing resources for any type of specialist activities or expert services that are not transaction-based. These knowledge-intensive competencies may include compensation and benefits design, internal audit, treasury and tax planning, architectural planning, engineering standards, product pricing, and knowledge management.

Companies often have underdeveloped or overly distributed COEs that are a loose network of resources assembling around a process or activity. For example, business units will have their own internal auditors instead of consolidating this service centrally in order to apply the knowledge across the company. The challenge is to connect these loose networks to define a working group and standardize the group's efforts to facilitate the ease of operations and a more coordinated impact in defining common policies or leading practices.

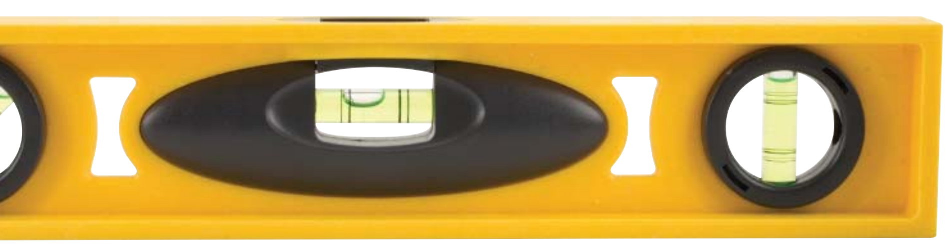
Another problem with decentralized COEs is that employees with specialized knowledge often become distracted by transaction-related duties. This dilution of the specialized capabilities can lead to sub-scale performance in both types of work. Dilution can also prevent proper alignment and leverage of the employee's expertise.

At the other extreme, some companies that have established COEs can over-centralize, thereby becoming more of an administrative or transactional function. Functions that have a stranglehold on the company as they too vigorously pursue "functional excellence" can lose touch with value creation.

Ideally, COEs should manage enterprise-wide knowledge work, as well as related policies and programs. This means deciding what activities require a concentration of expertise; determining whether these activities can be consolidated across the globe or, at a minimum, regionally; and assessing what changes to the organization and talent pool are warranted. The goal is to organize experts and related resources and information so they can be shared, compared, and leveraged across all business units and divisions.

Since highly-leveraged knowledge work maps to the COE quadrant, it may also be the best point of entry for new information about, and benchmarking of, best practices from outside your company. In this way, the COE can recommend actions intended to create greater value in that function across the organization.

Although COE activities can carry a high price tag for the specialized knowledge they require, the expense can be offset by applying that knowledge to many different parts of the company. The new structure can provide high synergies, lower costs, and organizational flexibility.



Business partner

Business partner activities are characterized by several factors. First, this type of work is non-transactional and knowledge-based, which moves it from the left side of the matrix to the right. Second, and most important, business partner work requires management involvement or relates to decision support. This aspect moves the activity from the bottom of the matrix to the top and distinguishes it from COE work.

Examples of business partner activities include employee relations, and business and product planning and forecasting.

Similar to the site support quadrant, this work focuses on maintaining responsiveness to customers, improving turnaround time, and meeting unique location and physical proximity requirements by supporting local decision making or local management.

However, the business partner quadrant is typically the weakest part of an SDM because business partners become mired in transactional activities. As a result, they aren't able to truly reflect or hold capabilities needed to perform as a business partner. They may also lack the necessary resources, tools, and training to allow them to earn a true advisory role to their leaders. Plus, because the work is distributed, there may be several employees in different business units exploring the same issue, such as engineering standards or ways to account for inventory.

Instead, activities that do not require site-specific input and management involvement should be pushed out of the business partner quadrant. For example, breaking down knowledge-based activities into smaller tasks may reveal activities that could move to the transaction processing quadrant – for instance, the data collection aspect of financial planning analysis. Other work might move to a COE so it can be leveraged by all business units and divisions.

Business model, operational governance, and SDM alignment – achieving sustainability

When you are architecting or redefining your company's SDM, an inevitable question arises: What is the most efficient and effective way to perform a given function in light of your business model and associated strategies?

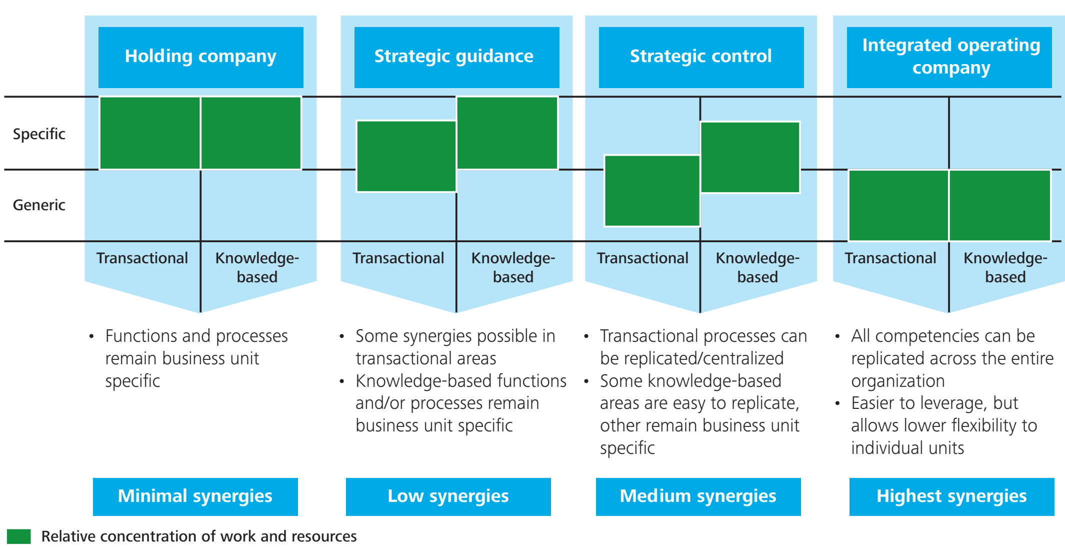
Looking to the four typical types of business models – which range from decentralized (holding company) to centralized (integrated operating company) – to guide the deployment of resources allows you to use a systematic approach for improvement, as introduced in Part 1 of this series, "Rethinking a company's business model." There are clear implications under the holding company or integrated operating company, as well as the two models in between – strategic guidance and strategic control (See Figure 6). Work is distributed out to the sites in a holding company and consolidated for an integrated operating company, with a mixture in between on the business model spectrum.

Synergy and the corporate footprint increase along the spectrum, left to right. The greatest savings are ultimately realized at the integrated operating company level. Integrated operating companies often have a cost advantage in SG&A expenses when compared to more decentralized companies.

Even a moderate shift from strategic guidance to the strategic control business model can yield several percentage points in savings, which is significant. This does not include the savings attainable by simply optimizing, as opposed to redefining, service delivery in each of the company's key functional areas.

Although it is tempting for a company to consolidate work to keep costs down and possibly operate as if it were an integrated operating company, the savings will not likely materialize unless there is alignment between the SDM, business model, and operational governance (who decides what and how decisions are made – see Part 2 of this series, "Aligning operational governance with the business model"). If the SDM and governance are in conflict with the business model, the solution will not likely be sustainable. Additional savings outside of personnel-related efficiencies are also typical through operational governance realignment. (e.g., policy redefinition to achieve standardization and redefine expectations or requirements, such as demand management).

Figure 6. The SDM shifts according to the business model



Source: Deloitte Consulting LLP

Along with the organizational differences, work gets distributed differently between corporate and operating units under each of the business models. Using Figure 6 as a guide, consider how the different business models and the distribution of work in an SDM are related:

Holding company. In the holding company model, all work is performed locally in the business units with minimal synergies and considerable redundancy. Each business unit has its own HR, IT, finance, marketing, engineering, and operational support functions. This business model has the smallest corporate footprint, so the SDM mapping on the two-by-two matrix will be top heavy, with most of the work residing in the site support and business partner quadrants.

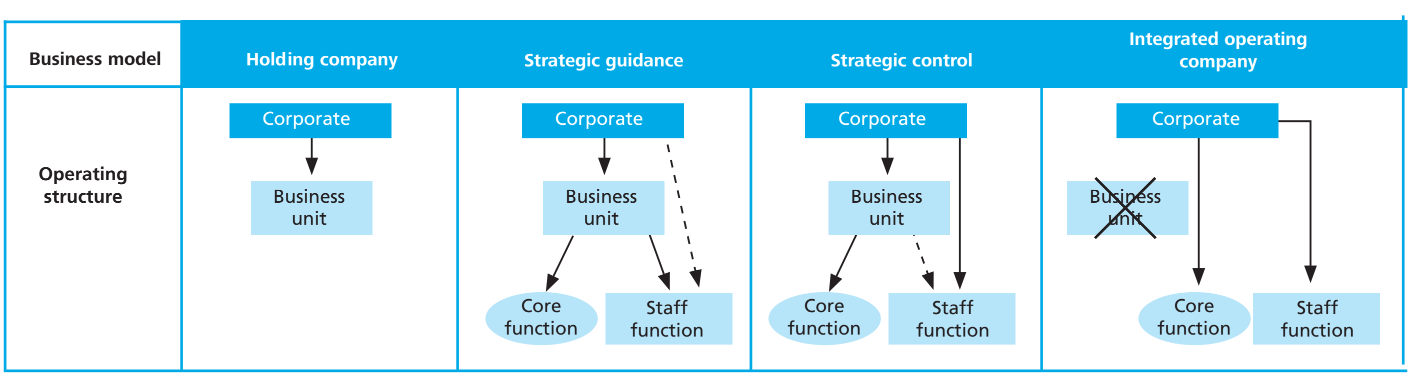
Strategic guidance. Moving slightly toward more centralization, companies using the strategic guidance model consolidate some work – mainly transactional – into shared service centers, or more typically "consolidation," or through outsourcing to take advantage of synergies. This model attempts to help business units and divisions retain knowledge-based functions and processes, but still relies on much of the work to be done at local sites in a distributed manner. It still has a small corporate footprint and, consistent with the name, corporate typically exercises only guidance on the strategy of each business unit.

Strategic control. Companies under the strategic control model use consolidation to balance even more work between corporate and the business units. Transaction-based processes are often consolidated in shared service centers and some knowledge-based functions move to corporate. Because of a strong corporate center that exercises control, much of the work is done centrally – so the corporate footprint is larger than in the strategic guidance model.

Integrated operating company. Combining shared service centers and a strong corporate center allows an integrated operating company to realize the greatest synergies because of consolidation of all transaction-oriented work in shared services centers and specialist, knowledge-based work at the corporate level. This business model has the largest corporate footprint, so the SDM mapping on the two-by-two matrix will be bottom heavy, with most of the work residing in transaction processing and center of expertise quadrants.

The SDM should depend on the business model and it should be supported by key operational governance considerations (See Figure 7). Moving to the right on the business model spectrum toward strategic control and integrated operating company results in corporate picking up more responsibilities across all types of work. For example, shifting from strategic guidance to strategic control means pulling transaction-oriented work, such as accounts payable, from the divisions and business units and consolidating it in a shared services center. Conversely, moving to the left on the business model spectrum toward strategic guidance or holding company means that more work will be localized in the business units and divisions.

Figure 7. Typical reporting of support and core functions under different business models



Source: Deloitte Consulting LLP

Redefining the SDM will lead to significant, simultaneous changes across the organization. First, roles will change for many people in the organization as work is arranged to achieve an optimum distribution. Not only will individual jobs change, but also entire units, functions, or departments as they align to an improved way of doing things. Often, organizational capabilities may be insufficient to operate under a new SDM and, as a result, there is a combined challenge and opportunity to improve the overall organizational capability and culture.

The organization structure will change as the modified roles are grouped together and employees take on new responsibilities. This extends all the way from corporate to the business units and the field.

With all of this change, you shouldn't assume that the organization will have adequate capabilities in key performance areas. For example, as the focus turns to a single type of work, organizations typically adjust their work processes and measurement activities. So a new organizational structure will demand that you devote time and effort to building new capabilities.

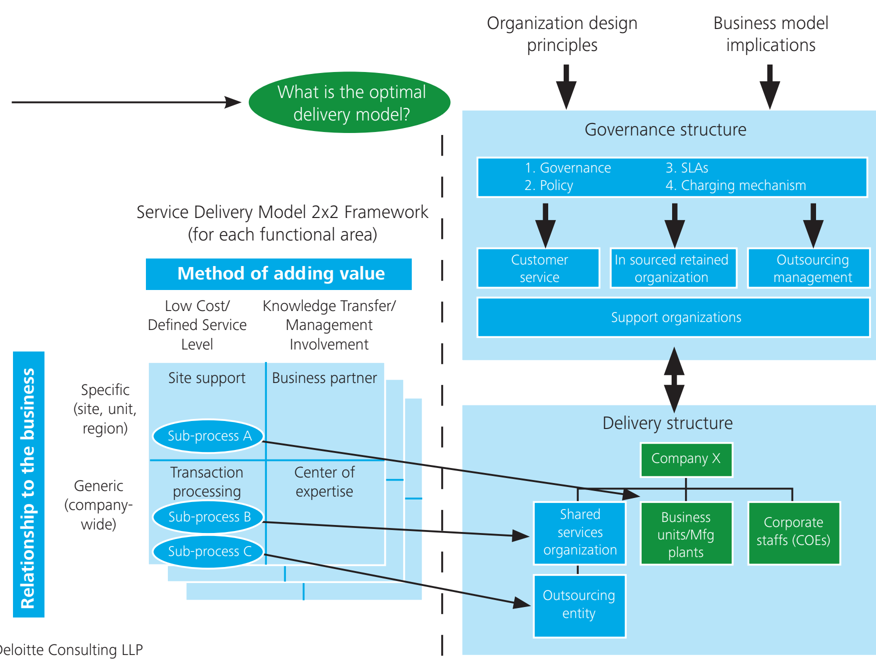
Since business units relate to one another differently, you'll also need to change how decisions are made. As a result, you'll need to adjust your governance processes and decision forums along the way.

The SDM is at the center of all these adjustments. It serves as a focal point and a basis for management consensus – inside and outside the function. That's why companies that use SDM effectively require that functional service delivery and related governance are part of every function's annual strategic planning process.

Figure 8 shows how adjustments in SDM lead to changes in organization structure – in terms of both governance and service delivery, and at both headquarters and in the field. The SDM guides optimum placement of activities based on the business model and objectives that your company is pursuing.

Given the transformational changes that are likely when you refine your SDM, consider making the SDM analysis and subsequent actions a dedicated program with an authoritative leader. Apply effective change management practices to prepare your organization and to lead it step-by-step through the transition.

Figure 8. The SDM's impact on organizational structure and placement of activities



Source: Deloitte Consulting LLP

The view from the top of your skyscraper

The metaphor used throughout this series of discussions about structural change is the building of a skyscraper. While the efforts involved in refining your SDM and making the subsequent organizational changes are similar to that type of project – some might say monumental – the benefits should be just as rewarding in terms of cost savings and operational performance, impact and effectiveness. The key is to align these SDM efforts with your business model and related strategies, and your operational governance and related strategies, to produce a solution that is both scalable and sustainable.

Appropriately deploying resources using a rationalized SDM is the key to scalability. By consolidating work that lends itself to standard operation and assigning only essential work to local units, you can increase synergies and help functional and operational organizations "scale up" in response to business growth. In this way, functional costs do not necessarily grow at the same rate as revenue. And in times of business contraction, bringing better balance to functional SDMs can help you in your efforts to produce significant net cost savings and increased effectiveness. In both instances – in times of growth and contraction – being at the top of the skyscraper gives you a clear view in all directions and, hopefully, the clarity to make more informed business decisions.

Evaluating your Service Delivery Model

Is it time to redefine your SDM? The following questions can help you decide.

- Does your organization have minimal functional redundancy or fragmentation?
- Are expenses by function equal to or lower than your peer companies?
- Are the roles and responsibilities of your corporate office clear?
- Do all key decision makers understand their role in the larger organization and when/how they should interact with corporate counterparts?
- Do business units have a voice for significant decisions which impact them?
- Are shared services and COE capabilities prevalent in your company?
- Are functional service levels consistent across functions throughout your company?
- Is outsourcing or offshoring utilized in your organization?
- Are there few and well defined executives titles/ roles for key functions in the company?

If you answered "no" to many of the above questions, it is worth reconsidering your current SDM.

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