

Talking Point

Shared Services Financial Management

"Balancing Precision and Simplicity"

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Keeping it simple and straightforward pays dividends when developing pricing and chargebacks in Shared Services. If not, we easily fall into the accuracy trap, a black hole that quickly becomes complex and consumes substantial management resources. The lure of accuracy is strong. As individuals who constantly deal with numbers, we want precision; but how much precision and complexity is really necessary to accomplish our goals and still meet the needs of our clients?

To answer, I go back to a phrase of Einstein's, "It is a simple thing to make things complex, but a complex thing to make things simple." If Einstein can condense his theories of relativity to $E = mc^2$, surely we can maintain simplicity in the often complex decisions associated with cost allocations.

We're not dealing with rocket science, but rather common sense principles. For example, is it necessary for an IT department to maintain several hundred items on their service price list to provide cost transparency for their clients – or could this list be pared to a dozen or two? Should we develop bronze, silver, gold and platinum levels of service to provide our clients with more choices – or will

one or two choices suffice? Should we implement weekly time keeping to provide more accurate costs – or will a simpler process work just as well?

I use a simple set of rules to help clients sift through the decision process for costing and chargeback allocations. You might not agree with each rule, but they are useful as a starting point – and often as the final solution. If you choose to become more complex than these rules, the question becomes: what is the payoff of adding complexity, since each level of detail will cost you additional time and valuable resources.

Rule 1: Evaluate and develop rates and costs once per year. A corollary is to apply the chargebacks once per year for each of the business units – typically at budget time. More complex systems can be implemented to track and charge out costs on quarterly, monthly or weekly bases. The benefit is that monthly variations in outputs and usage can be quickly incorporated. However, the numbers often seem to smooth out over quarterly and yearly cycles. In addition, even if a business unit begins making changes in their processes and

consumption of services in order to reduce their allocations, it typically takes nine months to a year for any real cost savings to appear. Reductions in allocations through process improvements and changes can usually be incorporated into the following year's budget cycle.

Rule 2: Limit service options and levels. A single price option might be sufficient if the primary intent of chargebacks is for calculating business unit profitability analyses. Lengthy service options and price lists are often the result of distrust between clients and shared service units. Therefore, we attempt to provide more detail, when in fact the root cause lies elsewhere. Complexity and details do not necessarily breed trust and can hinder communication. One IT group was considering approximately 300 items on their price list. Imagine the effort required to track and charge out all of these items, plus trying to explain each one to every business unit. From the consumer standpoint, we want simplicity in pricing, so long as we trust that we are getting a fair deal. As one shared services manager told me, when IBM or other large supplier organizations come in to make sales pitches, they don't lay

out a list of 300 or 500 different services they can provide. Instead they have a few primary offerings, and one can get into more details on specific sub-areas if required.

Rule 3: Develop costs and service options based on consumption, and not on generic allocations such as # people, # invoices, etc. Generic allocations are simplest, but can also be the most misleading. Generic allocations do not correctly account for different consumption patterns among business units. Managers know that certain business units and their business practices cause more headaches than others. Therefore, the more 'difficult' ones should be charged appropriately, which might help discourage such processes and behaviors in the future. Many shared services organizations use activity based analysis to identify their activities, costs and the appropriate business units consuming the costs. But again, when implementing activity based analysis, simplicity should rule. Techniques are available which can be implemented quickly and efficiently, and without the need for additional expensive software systems.

Rule 4: No cross charging among Shared Service departments.

Internal cross-charging scenarios give me headaches. For example, IT charges out costs to payroll, accounting, purchasing, etc. in addition to the business units. Then payroll (and the other shared service departments) must include IT costs in their chargebacks. But payroll also supports IT, therefore they must then charge back some cost to the IT department. Now IT's total costs have changed again and

so they must re-calculate their chargebacks to each group, which then causes payroll (and others) to re-calculate, and on and on. Although software solutions can be programmed to perform cross-charging calculations, I have to ask if the slightly more precise numbers actually provide any additional insight into company-wide efficiencies – particularly since shared services costs are typically a fairly minor cost when compared to total business unit expenses. If you feel you must cross-charge, then limit it to the highest cost element, which is usually IT, and do not flow other charges back to IT.

Rule 5: Do not implement weekly time charging if the data is primarily to be used for developing chargebacks. Weekly time charging systems add unnecessary cost and complexity. A simpler (and sometimes more effective) process can be to gather data once per year during a one-to-two week cycle and use this as the basis for developing costs (particularly when using activity-based techniques). Updates can then be performed yearly (see Rule 1). Updates can also be scheduled several months after implementing a major system or if a process change has occurred.

Rule 6: Charge actual costs versus market pricing. Performing market analyses and developing external benchmarks to identify potential external prices usually provides limited value. You're now doing twice the work (with the resulting additional costs) since you still must spend money and time to understand your own costs and prices. Plus, most find it difficult to develop true 'apples-to-apples' comparisons between external

providers and your specific services.

Conclusion

In summary, the rules above provide guidelines for either beginning a new chargeback program, or evaluating your current chargeback system. Every time you deviate from one of these and get more complex, you should ask, "Is the complexity providing us with additional data to make better management decisions and improve our processes?" If the answer is no, then consider simplifying. For the best use of chargebacks is not to become a complex accounting exercise, but rather to improve communication lines with business units, with the ultimate goal of improving processes to save money.



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