

Internalizing Your Way to Benchmarks and Best Practices

Internal benchmarking offers unique opportunities to shared services functions, without the drawbacks associated with external benchmarks. With internal benchmarking, departments can improve their processes and develop best practices through the use of internal data only.

As managers and leaders within shared services, we constantly ask ourselves “how do we compare with others in our industry?” or “are our costs in line with best practices?” Does our cost of processing a purchase order fall within industry standards? How many HR representatives per employee should we plan for? How do our total operating costs for IT compare with those of other companies? But are these constant desires for external comparisons and benchmarks of any real benefit? Can they actually motivate us for change?

Why does it cost only US\$100 to process a purchase order for Business Unit X and US\$300 to process a purchase order for Business Unit Y?

One of the problems that most experience when looking at industry benchmarks (i.e., external benchmarks) concerns the ‘so what’ question. So what are these numbers telling me? Is this a true ‘apples-to-apples’ comparison? Are

these numbers applicable to my industry? Are they recent numbers or benchmarks using two to three year old data? Even if they are good numbers, how do I use them to change what I’m doing now?

The role of internal benchmarking

Isn’t the true role of benchmarking to incentivize change, process improvement and the development of best practices? Fortunately, an internal benchmarking option exists that encourages such change within processes and eliminates many of the problems of external benchmarks. With internal benchmarking shared services organizations catch a bit of luck, for they are uniquely positioned not only to develop these benchmarks, but also to use them to improve overall business practices. All of this can be accomplished without spending substantial time and effort to obtain and analyze external data.

In an internal benchmark, a shared services group quantifies its internal processes, costs and metrics as a first step. Next, they identify how their processes support individual business units. Finally,

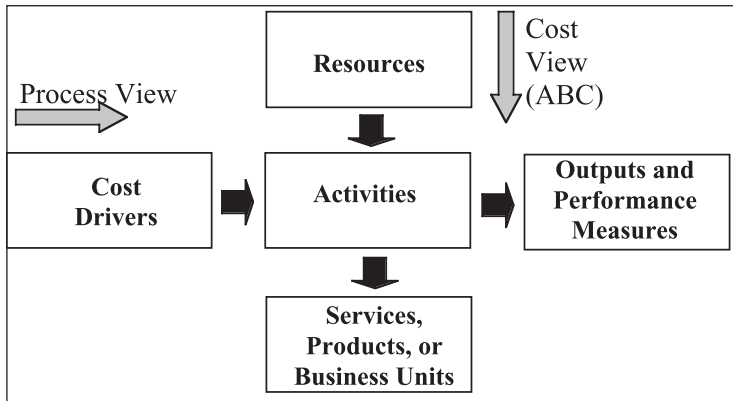
they quantify problems that arise on a daily basis. Although we typically design standardized processes, we know, in practice, the difficulties in maintaining standards when supporting multiple business units. Many business units pose **unique challenges** based on their own business processes and their daily requests to shared services. With internal benchmarking, both the unique and the standard practices are quantified and then analyzed to improve processes and develop best practices.

unique challenges

Developing internal benchmarks

A primary approach for developing internal benchmarks involves using Activity Based Costing/Management (ABC/M) techniques to identify and quantify the specific activities and products that support individual business units. The ABC/M technique (see Figure 1) begins with cost resources or budget items, i.e., salaries & benefits, office space, travel, computer expenses, etc. Each resource is then traced to a process or activity (i.e., the work performed) based on how the activity uses that resource. Once

Figure 1



differences in cost drivers and how to lead other business units towards X's best practice.

In a slightly different scenario another shared services department may have a single function (and department manager), but personnel are resident on-site at business units in varied locations. In this case, process improvement focuses on differences in processes, costs and services provided at each different location. Thus groups performing similar activities begin to develop best practices corporate-wide. Examples are illustrated below.

Example A: Purchasing Department in a Single Location

In this example a purchasing department located at headquarters supports three different business units. The initial ABC/M analysis transforms cost accounting data into activity cost benchmarks (see Figure 2). With this view, the manager knows exactly what his department does and what it costs them to perform their activities. For example, the department spent 30 per cent of its resources (US\$175,000)

activity and unit costs are developed, they are traced to the products, services or customers (i.e., business units) they support. This vertical axis is referred to as the **Cost View** or ABC (Activity Based Costing) of ABM.

The **process view** is then used to assist the process improvement and best practice analysis. In the process view, each activity is analyzed for cost drivers (i.e., **root causes**) that require an activity or task be performed. This analysis requires standard investigation techniques: process mapping, why trees, affinity diagrams, etc., and provides much of the detail necessary to distinguish value-added from non-value-added practices. Each activity also includes an output and therefore a performance measure. These outputs and performance measures often provide a valuable indicator of success in eliminating non-value-added activities.

Internal benchmarking using ABC/M techniques can differ depending on the structure of the individual shared services department or group. For example, consider a department physically located at a single location. In this

scenario, internal benchmarking identifies the costs of providing various activities and products, including why the costs of supporting each business unit are different. For example, why does it cost only US\$100 to process a purchase order for Business Unit X and US\$300 to process a purchase order for Business Unit Y? Then you can begin to ask the question, since Business Unit X is our 'best practice,' can we duplicate this practice for all other business units?

Ongoing process improvement analysis then focuses on the

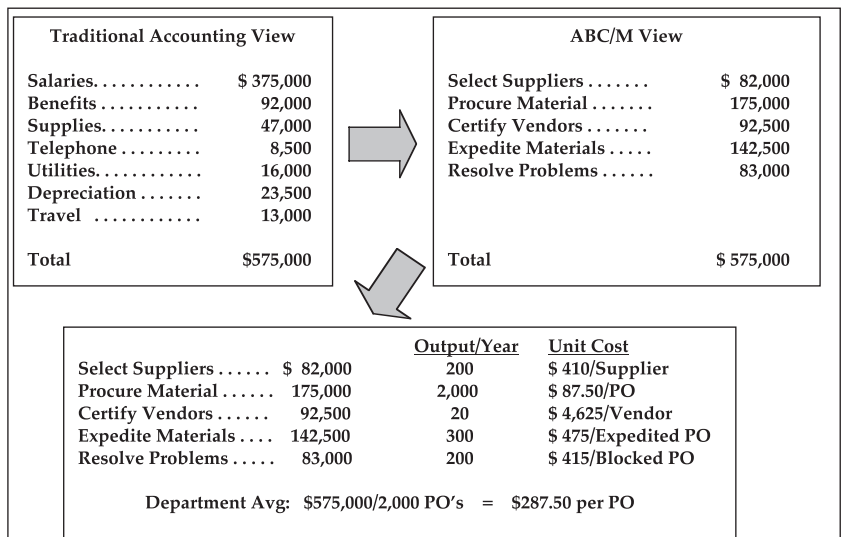


Figure 2

Figure 3

	Total Volume Unit Cost	Business Unit A	Business Unit B	Business Unit C
Select Suppliers	200 Suppliers \$410/Supplier	100 \$41,000	70 \$28,700	30 \$12,300
Procure Material	2,000 PO's \$87.50/PO	500 \$43,750	1200 \$105,000	300 \$26,250
Certify Vendors	20 Vendors \$4,625/Vendor	15 \$69,375	4 \$18,500	1 \$4,625
Expedite Materials	300 Expedites \$475/Expedited PO	150 \$71,250	100 \$47,500	50 \$23,750
Resolve Problems	200 Problem POs \$415/Blocked PO	125 \$51,875	60 \$24,900	15 \$6,225
Total		\$277,250 \$554.50/PO	\$224,600 \$187.17/PO	\$73,150 \$243.83/PO

procuring material through 2,000 purchase orders (POs) – at an average of US\$87.50 per PO.

If you were the manager and were given data that an external benchmark for purchasing departments was US\$100-US\$150/PO – how would you compare this against your own department? Would you use the total department cost per PO of US\$287.50? Or just take the cost of processing a regular PO - US\$87.50? Or what about a PO that requires expediting and then has a problem and is blocked in the system – do you use US\$977.50 (US\$87.50 + US\$475 + US\$415)? With internal benchmarking such questions are no longer relevant.

Rather than being concerned about how costs compare with other companies' data in an 'apples-to-apples' look, the manager can concentrate on improving internal processes in the department. For example, why are there so many problems to resolve and why is so much material being expedited? By examining the cost drivers that force these activities, the manager can eliminate non-value-added work and lead the department to best practices and lower costs.

When the purchasing department's activities and costs are next applied to the various business units (see Figure 3), one can quickly identify the best practice (i.e., Business Unit B). Internal analysis now focuses on problems and special processes caused by various business units, e.g., why does Business Unit A require so much more expediting and have so many more problems than the other business units? Would it be worthwhile to meet with Business Unit A's managers and discuss the potential for improving business practices – similar to how Business Unit B operates? The purchasing department begins to function almost as an internal consultant to help improve efficiencies and lower

costs for the entire corporation.

As an additional benefit, going through this activity analysis provides the data for service level agreements and chargebacks – and documents the charges that business units receive from the purchasing department. One would expect that Business Unit A, as the 'worst practice,' might be incentivized to help purchasing find ways to reduce their chargebacks. Note how this incentive would not exist in a typical chargeback where calculations are based on total numbers of PO's processed. In this case, the best practice business unit (B) would get the highest allocation since it had the most number of PO's (1,200).

Example B: IT Departments Co-located at the Business Units

In this second example, parts of an IT department are located at geographically dispersed business units. This often occurs with IT functions because of requirements for hands-on hardware and software support. However, the personnel perform many of the same activities and processes. Therefore, ABC/M analyses captures the identical activities and products provided at the multiple locations. Once this data is captured, cost driver and non-value-added analyses can be performed as discussed in the first

► cont'd p. 21

Location	Desktops	Laptops	Peripherals	Phones	Servers
Headquarters	800 PCs \$2,000	600 LT PCs \$2,500	2,200 \$400	2,200 \$600	50 \$12,000
Location A	1,500 PCs \$1,600	300 LT PCs \$3,000	1,200 \$250	1,600 \$200	30 \$11,000
Location B	750 PCs \$2,400	500 LT PCs \$4,000	800 \$275	950 \$700	20 \$12,500

Figure 4

- *TIVOLI Case Management System supporting IAC.* *assessment tool designed internally.*
 - *E-learning.*
 - *HR Intranet Knowledge Management still being developed.* *What are the three main challenges for you ahead?*
 - *SAT – Line Managers self* *1. Service excellence, i.e., delivering what we promise.* *2. Line Management capability.* *3. HR Business Partner capability to deliver against a heightened strategic agenda.*
- Denyse.Corfield@uk.nestle.com*

Benchmarking at Nestlé UK

“Nestlé HR uses **benchmarking** to bring the outside world into our business. We regularly exchange data on policies, benefits and conditions with other companies within our sector. These exchanges ensure we remain aware of trends and stay competitive. We use a variety of approaches for benchmarking salary levels within the market, including membership of pay and benefits clubs, collaboration with other company surveys, use of Internet pay data and “one off” job salary matches. Where we have the need for specific measures, for example the overall ratio of HR to business heads or costs of payroll per payslip, then we initiate an exchange with companies that we want to benchmark against.

In my experience, most organisations are very open to these exchanges so long as the data is not business critical or commercially sensitive. We also use benchmarking at the feasibility stages of major projects to gain understanding as to how and why other organisations have made similar changes. You can learn a lot from seeing a change live in another setting, including the benefit of hindsight. It’s useful to hear “what I would do differently if I had the time again.” It is rare that you will copy the benchmark examples, but it does allow you to refine your own thinking to produce a better proposal to fit your own organisational culture and setting.

We benchmarked with four other organisations that had already made the change to a Shared Services model before we made our own changes within HR. This gave us a better understanding of the implications of the changes to the business as well as to HR itself, provided measures of performance and gave us some real life examples of success.

I see benchmarking as part of our day to day business activity. It's about learning, comparison and exchange of experience. If you don't know how you stand up against the outside world, then you can't really expect to grow and improve.”

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► ‘Internal’ cont’d from p. 17
example.

In addition, internal activity and product benchmarks can now be compared across multiple locations and business units. Figure 4 shows comparisons of benchmark costs for IT products – both in terms of numbers of units and yearly total operating unit costs – for three different business locations. Managers can thus begin addressing why disparities exist in these cost benchmarks and if some locations

have discovered better ways of doing business. Such data facilitates best practice group analysis and corporate-wide process improvement.

Summary

Internal benchmarking is not meant to replace external benchmarking. Instead, internal benchmarks apply the wisdom of Delphi’s oracl: ‘know thyself’ first. By understanding internal activities and products, SSCs have a unique opportunity to provide value from within.

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