
The unbundling of corporate functions: the evolution of shared services and outsourcing in human resource management

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This article analyses the demand side of business services outsourcing. Using insights from a number of bodies of literature, the article interprets business services outsourcing as corporate restructuring involving the administrative functions of the firm. Propositions are developed around the following. First, the existing corporate structure and the nature of supplier markets affect the paths chosen to create shared business services and to move to outsourcing. Second, the trajectory of the move to shared services and outsourcing affects the distribution of capabilities between users and suppliers. The study examines these propositions through a comparison of human resource outsourcing in two leading consumer products companies, Procter & Gamble (P&G) and Unilever. We find that a relatively high degree of centralization at P&G led it to create an internal shared services center before outsourcing, whilst a more decentralized Unilever utilized outsourcing as an occasion for globally standardizing its systems and processes. The article draws implications of these different paths for core capabilities.

1. Introduction

In recent years, there has been a significant increase in the outsourcing and offshoring of business services. To date, much attention has been placed on the supply side of this phenomenon, in particular the rise of Information Technology (IT) services and business process outsourcing companies, not least in emerging markets such as India (Dossani, 2003; Athreye, 2005). However, to appreciate how and why these new

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service markets have arisen, we need to develop a deeper understanding of the demand side of outsourcing and offshoring. Recent research on the demand side focuses on IT (Willcocks and Lacity, 2006) or on offshoring only (Lewin *et al.*, forthcoming). This article builds on such work to develop a more holistic and historical analysis of outsourcing (i.e. make-or-buy) and offshoring (i.e. location) decisions taken together by user firms. These are typically large global corporations which pursue outsourcing and offshoring as part of broader corporate restructuring.

In the article, we provide a historical overview of the unbundling of corporate functions, i.e. the outsourcing of business processes in administrative functions, either preceded by or coinciding with the creation of shared services (SSs), defined as business processes which are shared across units within a company. We address the following questions. When and why have major global corporations started creating SSs and outsourcing functions such as IT, finance and accounting (F&A), and human resources management (HRM)? How important are corporate structure, internal organizational capabilities, and the development of supplier markets in influencing the timing of such decisions? How far can firms outsource functions without undermining their core capabilities?

The article addresses these questions through a comparison of two leading consumer products companies, P&G and Unilever. Large consumer goods companies are noted for a complex internal organization structure required to manage their wide portfolio of products and brands. The companies were chosen as two of the largest in the sector, comparable in size and scope, and regarded as leaders in moving towards SSs and outsourcing. They were also chosen for their headquarter locations in country contexts (USA and UK) with some similar institutional environments (though the Dutch side of Unilever should not be ignored). Data sources include the following: an examination of primary documents, an examination of secondary materials, extensive interviews with managers, mainly higher-level executives, from the two companies (7 from P&G and 11 from Unilever), and interviews with managers from the service providers (nine for P&G and two for Unilever). Unfortunately access was not given to quantitative data on costs and benefits.

The key empirical and theoretical insights are as follows. First, business services outsourcing combines internal corporate restructuring of the administrative hierarchy and a 'make-or-buy' decision concerning firm boundaries. As the empirical comparisons demonstrate, corporate structure and the degree of central control are key factors affecting the decision to create SSs and to outsource. In developing this argument, we also suggest that outsourcing is consistent with a trend towards greater centralization. Second, the trajectory of development of SSs and outsourcing influences the distribution of know-how across firms. We find that the creation of internal SSs first before outsourcing leads to greater retention of capabilities in-house; by contrast, a path to outsourcing, without an interim step of internal SSs, engenders greater reliance on supplier's capabilities. Third, to understand these processes, an

approach is required which draws on a number of bodies of literature, namely theories about the administrative structure of the firm, transaction costs, and the resource-based view of the firm.

The article is structured as follows. Section 2 provides insights arising from historical trajectories in the use of internal and external governance arrangements, referring to some national differences. Section 3 draws on theoretical perspectives to shed light on the creation and outsourcing of Ss. The article then turns to the case studies, considering the evolution of Ss and outsourcing in P&G (Section 4) and Unilever (Section 5). Section 6 compares the two cases, develops propositions, and draws conclusions.

2. Historical perspectives

When viewed in historical perspective, business inputs or activities have long moved backwards and forwards between being integrated (or bundled) and disintegrated (or unbundled). Thus, in some ways, there is little new about the processes which we describe here. For example, there is a very extensive literature on various forms of ‘putting-out’ in the early stages of the industrialization (Pollard, 1965; Mendels, 1972; Berg, 1985). Putting-out meant the absence of vertical integration in terms of the buying and processing of goods, as in many textile industries. Putting-out also covered the performance of various business processes or functions, such as labor recruitment and management, the maintenance of plant and machinery, and sales and distribution. It is now well known that such externalization or use of market mechanisms did not end with the growth of the modern business enterprise in the course of the 19th century, but long persisted (Lazonick, 1990; Scranton, 1997).

Nevertheless, in the large firm sector, over the period from the late 19th century onwards, the dominant trajectory was towards the internalization of various activities within the firm *à la* Chandler’s ‘visible hand’ (Chandler, 1977). This involved both backward and forward integration and later diversification into sectors outside the firm’s traditional activities. It also involved the internalization of business services, some of which had previously been conducted external to the firm. Thus, for example, sales and distribution were increasingly taken over from merchants and were handled by internal departments of large firms (Chandler, 1977). Research and development which had often been left to outsiders was also internalized (Mowery, 2006). Similarly, labor management which had often been handed over to subcontractors or employers’ organizations was taken inside the firm and extensive personnel departments developed (Jacoby, 1985; Gospel, 1992; Jacoby, 1997).

However, a number of correctives must be registered in terms of this larger story. First, the degree of internalization differed across countries due to differences in the national institutional context. Thus, for example, US firms tended to internalize

more than their European counterparts. Hence, in the area of labor management, British companies externalized more than US firms to employers' organizations. Historically, this perhaps reflected the looser organization and weaker internal capabilities within many British companies (Gospel, 1992). Therefore, significant drivers of internalization were not only the growth of markets and technology, but also international differences in corporate capabilities and national institutions. Second, not all large firms internalized to the same extent, and there were external economies to be gained, especially where firms operated in industrial districts and were able to draw on other smaller firms for inputs (Zeitlin, 2007). Third, not all functions were internalized. For example, with the growth of advertising, though firms came to do most of their own promotion and sales, nevertheless many also used external advertising agencies (Fitzgerald, 2007).

According to the Chandlerian story, as firms diversified, so they developed the multidivisional form of organization to manage greater scale and scope. Over time, this spread from the US to European and other countries, though with some departures from the classic form purportedly pertaining in the US (Whittington and Mayer, 2000). The multidivisional form meant a corporate structure with product or service divisions. It also meant the delegation of activities and processes to divisional headquarters and this had advantages of decentralized managerial coordination, as has been classically analyzed (Chandler, 1962; Chandler, 1977; Williamson, 1985; Chandler, 1990). However, it also had certain costs; in particular it led to a proliferation of management and posed problems of coordination.

This broad trajectory seemed set through the 1970s. However, beginning in the 1980s and accelerating in the 1990s, the situation began to change. Initially, many large firms started to de-diversify, selling off unrelated businesses. Certain sectors, such as automobiles and electricals, saw firms dis-integrate their component production. Increasingly, they have also unbundled corporate functions and processes in areas such as IT, F&A, procurement, facilities management, and HRM (Willcocks and Lacity, 2006).

The drivers of this reversal have been various. In terms of vertical disintegration, firms have come to see benefits of lean production and supply in a context of increasingly open and competitive markets (Womack 1990). In turn, financial markets have come to place a premium on the value of more focused firms. In addition, the development of ICT has provided a means whereby inputs and activities can be outsourced and yet still monitored and controlled by the firm. In the United States, the relaxing of anti-trust rules has meant that firms feel freer to expand vertically and horizontally in what they decide are their core sectors.

Some have argued that there has been a trend towards the decentralized network (N-form) company and heterarchical organization (Bartlett and Ghoshal, 1989; Cantwell, 2007). However, reviews of the N-form concept suggest that this has not developed to any significant extent. Research on the decentralized, heterarchical

organization has been limited, but again it suggests that, though regional centers of excellence may be created within some big firms, the amount and significance of this should not be exaggerated (Whittington and Mayer, 2000; Pettigrew, 2003). Drawing on our case studies, we suggest that, though there may be elements of network and heterarchical organization, overall the tendency in big firms has been towards consolidation and centralization.

3. Theoretical perspectives

This section defines terms and discusses literatures which can illuminate the recent phenomenon of the creation and outsourcing of SSs

This phenomenon concerns the unbundling of corporate functions, which is conceptually distinct from vertical disintegration. The former occurs when a firm, which used to provide a business process in-house, decides to buy the same process from an external provider (Sako, 2006). The latter occurs when a firm decides to buy, rather than make, inputs which go into its final product or service. Corporate function unbundling is distinct from vertical disintegration because a business process is not a component input into the firm's final product or service. To use Porter's terminology, vertical disintegration is about 'primary activities' in the firm's value chain, whereas corporate function unbundling concerns 'support activities', normally viewed as the administrative overheads of the firm (Porter, 1985).

The creation and outsourcing of SSs involve a combination of internal restructuring (concerning the structure and hierarchy of the firm), 'make-or-buy' decisions (concerning firm boundaries), and the development of internal resources (concerning capabilities). There are three theoretical perspectives which pertain to this study—perspectives on the administrative structure of the firm (following Chandler), on transaction costs (deriving from Coase), and resources and capabilities (originating with Penrose). We briefly outline these perspectives and tentatively suggest ways they may be developed.

3.1 *The administrative structure of the firm*

As discussed in Section 2, Chandler (1962, 1977, 1990) considered the internalization of an array of administrative activities by a professional cadre of managers in the process of the emergence of the modern business enterprise. The internal administrative structure of the firm may be conveniently classified into the following types. The H-form (holding) company, often growing by merger and acquisition, has multiple administrative centers. The U-form (unitary) company, usually with a narrow product portfolio, has a single set of administrative functions at its headquarters. The M-form (multi-divisional) corporation is adopted with product diversification, devolving responsibilities to each division which creates its own set of administrative

functions (Chandler, 1962, 1977, 1990; Williamson, 1985). Chandler acknowledged a variety of M-forms. For example, so-called ‘strategic planning’ companies retain more entrepreneurial (value creating) resources at HQ, whilst ‘financial control’ companies retain only the administrative (loss prevention) resource at HQ (Chandler, 1991).

The recent phenomenon of corporate de-scoping is associated with a move away from the M-form. De-scoping is likely to lead to a smaller number of product divisions and less divisional autonomy. The creation of SSs amounts to the centralization of corporate functions at the HQ level, which is in effect also a move away from the M-form and even back towards the U-form. In turn, the outsourcing of SSs is about the externalization of administrative activities, and there is little suggestion of this possibility within the classic Chandlerian framework. We need, therefore, to clarify what determines the distribution of administrative activities within the firm, and the impact of transaction costs and capabilities on the externalization of administrative support activities. Thus, the link between the study of administrative structure of corporations on the one hand and transaction costs and capabilities on the other hand requires re-examination.

3.2 Transaction costs

Early theorizing about firms and markets operated at a high level of abstraction and did not usually distinguish between ‘vertical disintegration’ and ‘corporate function unbundling’. Coase in his classic 1937 article posited the ‘make-or-buy’ decision in terms of relative transaction costs in the market vs. costs inside the firm (Coase, 1937). Later, Stigler (following Adam Smith) analyzed the ways in which the ‘division of labor is limited by the extent of the market’ (Stigler, 1951). Both Coase and Stigler were primarily concerned with differential costs of coordination inside and outside the firm. Later, middle-range theorizing led to a more exclusive focus on vertical integration. In particular, Williamson (1975) developed the transaction cost economics paradigm to theorize the relative efficiency of vertical integration (‘hierarchy’) to pre-empt opportunistic behavior. This enabled empirical testing and stimulated studies of the determinants of vertical integration, disintegration, and hybrid forms (Shelanski and Klein, 1995; Parmigiani, 2007). However, other studies have shown that the disintegration of value chains also depends on ‘mundane’ transaction costs which are not predicated on opportunism (Baldwin and Clark, 2003), as well as on a combination of transaction costs and capabilities (Jacobides, 2005; Parmigiani, 2007).

However, much of the theory and related empirical work cited above tended to focus on primary activities in the firm’s value chain. By contrast, we argue that transaction costs of the Coasian and ‘mundane’ kind must be applied to administrative support activities in order to analyze the phenomenon of SSs and outsourcing in business services.

3.3 Resources and capabilities

In defining the essential core activities of the firm, strategy scholars have developed the resource-based and the capabilities view of the firm, following on Penrose (Penrose, 1959). Here, a firm is conceptualized as a repository of resources or capabilities which provide competitive advantage (Penrose, 1959; Wernerfelt, 1984; Teece *et al.*, 1997). The competitive advantage of firms lies in managerial processes or routines, shaped by specific assets, accumulated in a path-dependent manner (Nelson and Winter, 1982; Teece *et al.*, 1997). Capabilities are dynamic to the extent that firms have the ability to learn to reconfigure their assets in order to sense, shape, and seize opportunities created by rapidly changing environments (Teece, 2009).¹ The empirical testing of capability theory, as with transaction costs, has been mainly applied to primary activities in the value chain (Argyres, 1996). As vertical integration gave way to vertical dis-integration as the object of study, the existing distribution of capabilities in the supply market also became an important explanatory variable (Jacobides, 2005; Jacobides and Winter, 2005; Gereffi *et al.*, 2006). Moreover, theories of the firm based on knowledge and know-how explain the value of learning and why firms retain more knowledge than they need to maintain their existing in-house activities (Kogut and Zander, 1992; Brusoni *et al.*, 2001).

However, to-date, the decisions on how to structure the internal administrative hierarchy of the corporation have been largely unconnected to the discussion of resources and capabilities. In large part, this is because the existing theory of capabilities is somewhat abstract. Whilst various versions of the theory appear to imply that firm-specific capabilities are indivisible and shared across business units, they do not identify how they might be distributed in a firm's administrative structure. We contend that, without concretization and operationalization of capabilities, it is difficult to construct testable theories about their link to the administrative structure of the firm, which can inform empirical work.

One way to develop and integrate these bodies of literature is to begin with Porter's characterization of the firm as consisting of primary activities in the value chain and support activities in corporate functions (Porter, 1985). We may conceptualize some support activities as separable from primary value adding activities, whilst other support activities are more complementary and coupled with primary activities. Thus, each corporate function consists of a hierarchy of activities which are tightly or loosely coupled to primary activities to varying degrees. An example from HR is the distinction made between activities carried out by so-called 'strategic partners' and those carried out by so-called 'administrative experts' (Ulrich, 1997;

¹ Similarly, Prahalad and Hamel (1990) define core competencies as 'collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies'.

Ulrich and Brockbank, 2005). The former are seen to possess dynamic capabilities, directly adding value to the corporation, whilst the latter conduct support activities which are more easily separable from primary activities. More generally, capabilities may be typologized into lower-level operational capabilities to achieve technical fitness and higher-level dynamic capabilities to sustain evolutionary fitness (Teece, 2009). There is a sense that operational capabilities are more widely diffused in the firm and outsourceable, whilst dynamic capabilities are more concentrated and not subject to outsourcing.

Table 1 summarizes the focus of each of the three perspectives, providing some critique and suggesting possible development.

Table 1 Comparing three theoretical perspectives

Theory	Theoretical and empirical focus	Critique and development
Administrative structure of the firm	Strategies of scale and scope lead to the internalization of administrative activities, the development of a hierarchy of professional managers, and the adoption of the M-form, thus improving coordination and efficiency.	Analysis tends to assume that the bigger the professional hierarchy, the better the coordination and the more efficient. It does not much address the distribution of capabilities between HQ and divisions. It does not allow for the possible externalization of administrative activities. <i>The strategy of de-scaling and de-scoping leads to a move away from M-form. This provides the possibility for the externalization of administrative activities and the shrinking / reshaping of the professional hierarchy.</i>
Transaction costs	Transaction costs affect 'make or buy' decisions, and the degree of vertical integration or dis-integration.	Existing analysis focuses mainly on 'primary activities'. <i>It may be extended to 'support activities' in corporate functions, by analyzing the make-or-buy decisions involved in designing and operating shared services centres.</i>
Resources and capabilities	Sustainable competitive advantage of firms depends on resources and capabilities. These resources and capabilities affect firm boundary decisions.	Resources and capabilities are rather too abstract to be associated with a particular administrative structure. 'Support activities' do not much feature in theoretical and empirical analysis of resources and capabilities. <i>It is necessary to typologize capabilities (e.g. operational vs dynamic), in order to build testable hypotheses about their link to firms' administrative structure. Dynamic capabilities may be more concentrated than operational capabilities.</i>

We now turn to the two case studies to provide an empirical basis for our analysis and to generate propositions.

4. Procter and Gamble

P&G had its origins as a soap manufacturer, established in Cincinnati in 1837. By the late 19th century, the company had gone public, family control had progressively declined, and the firm was fast becoming a 'modern', managerially-controlled business in a Chandlerian sense. During the interwar years, the company developed a food-related business and commenced overseas operations, with the acquisition and development of facilities in Canada, the UK, and the Philippines (Dyer *et al.*, 2004).

After the Second World War, the company developed further brands, in particular synthetic detergent and personal care products, which it manufactured in a number of old and new plants, both in the United States and overseas. In the 1960s, P&G entered the paper business, via both acquisitions and the opening of new plants, and these later became the basis for its diaper and tissue brands. Simultaneously, it also developed a number of food products, again by acquisition and internal growth. Later, in a similar fashion, it moved into other personal and then into health care products. From the 1960s, it also expanded rapidly in Europe, Asia, and Latin America. Major acquisitions have been of the Richardson Vicks, Wella, and Gillette companies which significantly increased the company's global brands. Simultaneously, over the last decade and more, the divestiture and closure of brands and plants, deemed to be non-core or underperforming, have increasingly occurred. At the same time, the company has expanded significantly into Eastern Europe, Russia, and China.

In terms of organization, after the Second World War, P&G slowly developed something like an M-form structure in the United States and, within each division, an administrative hierarchy and a brand management organization. Overseas companies were loosely coordinated by an overseas division, but with considerable devolution to each country and duplication of functions across countries. However, as we will see, by contrast with Unilever, P&G was relatively centralized, and acquisitions were increasingly quickly integrated into the P&G system.

In terms of HRM, from the late 19th century, P&G operated a set of policies of a welfare capitalist kind (Jacoby, 1985 and 1997). In the United States, with the rise of unions from the 1930s, it was largely successful in avoiding recognition of external unions. However, though in some acquired facilities it had to deal with unions, all new plants opened in the United States have been non-union. From the 1970s, the traditional approach became diluted as the company grew in size, though it sought to develop so-called 'high commitment' arrangements based on sophisticated forms of team working and direct employee voice. Increasingly, over time, throughout its

various US facilities, personnel and employee relations had become complex and diverse. Overseas, subject to national legal requirements, the company largely left HRM to national managements. As a result, considerable variety ensued. In this context, the HR function in Cincinnati was small and concerned primarily with setting broad policy and managing the top group of managers. In the case of the United States, the development and implementation of HR policy was left to divisional and plant managers. In the case of overseas operations, delegation to national management was even greater (Dyer *et al.*, 2004).

Up to the 1990s, P&G had acted in a classic Chandlerian manner, internalizing functions and developing extensive managerial hierarchies. However, this did not preclude externalizing certain functions e.g. it externalized parts of logistics, market research, and advertising (Dyer *et al.*, 2004). In the HR area, it occasionally used consultants, but only for particular projects. In countries where it operated, it seldom joined employers' organizations for industrial relations purposes, preferring to rely on its internal resources and capabilities.²

From the early-to-mid 1990s, especially under a major change program entitled 'Organization 2005' (O2005) launched in 1997, P&G moved in a more centralized and globalized direction, concentrating on a smaller number of categories and brands to gain scale economies in increasingly competitive markets. Along with this, the company reduced the number of business units, consolidated brand management, and introduced greater control over national companies, all based on the deployment of an SAP enterprise resource planning (ERP) system.³ Foreshortening the story, Global Business Units (GBUs) were established to formulate global strategy in R&D, manufacturing and marketing for two major categories of products (food and personal care). A number of Market Development Organizations (MDOs) were created for local marketing and sales. In terms of HR, Cincinnati headquarters capability and reach increased.⁴

In the mid/late 1990s, on the basis of these developments, P&G began to consider and then to plan a Shared Services Center (SSC) for a number of functions, including procurement, accounting, IT, facilities management, and HR services. In 1999, a single business support unit, Global Business Services (GBS), was established, with three main centers—in Costa Rica, the UK, and the Philippines. This involved the transfer of work from Cincinnati, the business units, and national companies. By the time these arrangements were fully in place, GBS had about 8,000 staff, with about

2 Interview with Lynne Burnett (P&G) 30 April 2007; Interview with Mike Power (ex-P&G) 28 September 2007.

3 Dyer *et al.* (2004), pp. 293-7 and 303-4.

4 Interview with Lynne Burnett (P&G) 30 April 2007.

2,000 in the three SSCs, most of who were newly recruited. The centers were given prime responsibility for broad geographical areas (the Americas, Europe-Middle East-Africa, and Asia respectively) and had been located so as to provide 24-h coverage across time zones.⁵

In the case of HR, the SSCs took over mainly the more ‘transactional’ matters such as payroll, compensation and benefits, and relocation planning. HR staff remaining within P&G’s GBUs and MDOs were to deal with more strategic issues, program development, and site-specific employee and personnel matters. The expectation (largely achieved according to the company) was that these arrangements would provide at least as good a service, reduce costs (through wage arbitrage, greater standardization, and scale economies), and free internal HR managers to concentrate on less routine matters.⁶

From the late 1990s, on the basis of the perceived success of these arrangements, the company began to consider further moves which might deliver additional cost reductions and provide added benefits. This included outsourcing of various kinds. P&G had already used outside firms to perform certain functions such as logistics and advertising; it had also done this, albeit piecemeal, in IT; and it had outsourced the production of a small number of products. Simultaneously, what had been a rather self-contained company increasingly came to see the value of working more closely with other firms, including customers and suppliers (Dyer *et al.*, 2004). In this context, from the late 1990s, outsourcing began to be considered on a larger scale and, along with this, the role of GBS.⁷

The company considered a number of possibilities: to keep GBS as an in-house service provider; to keep GBS in-house *and* to offer its services to other firms; to spin GBS off as a separate company; to spin it off as a joint venture with another company; to outsource most of GBS’s activities to one provider; to outsource most of its activities to different providers. After lengthy deliberations, but also in part because a major potential provider got into financial difficulties, P&G decided to outsource functions incrementally to a number of providers on a so-called ‘best of breed’ basis.⁸ In 2003 this began with the outsourcing of IT and accounts payable to Hewlett-Packard, of facilities management to Jones Lang LaSalle, and

5 G. Siracusa, *The Shared Services Model*, P&G powerpoint; F. Passerini, *A Partnership Culture*, 6 April 2006, P&G powerpoint.

6 Interview with Liugi Pierleoni (P&G) 17 January 2007; Lynne Burnett (P&G) 30 April 2007; Mike Power (ex-P&G) 28 September 2007.

7 Interview with Lynne Burnett (P&G) 30 April 2007; Mike Power (ex-P&G) 28 September 2007.

8 Negotiations to outsource all the activities to Electronic Data Systems (EDS) failed at the last minute when the latter announced a surprise profit warning in September 2002.

then of HR to IBM which had competed for the HR contract with Accenture and Convergys.⁹

In the case of HR, the \$400 million contract covers a period of 10 years and services over 100,000 P&G employees in over 80 countries. Under the contract, IBM acquired over 2000 employees in the three SSCs and to these has incrementally added its own staff. IBM carries out the following broad range of functions: employee data services; SAP HR application development; contact center support; payroll administration; compensation and benefits; training systems administration; expatriate and relocation services; and travel management. These are deemed to tend towards 'transactional' in the sense that they are generic activities which cover all parts of the company and which can be leveraged across all countries. Thus, the role of IBM is not so much to design, but rather to deliver services in these areas.¹⁰

The following HR functions remain within P&G: the management of senior managers; the development of strategy and programs; recruitment; non-routine employee relations; and industrial relations issues. Summarizing the arrangements, these tasks have come to be carried out by internal HR staff of various kinds, located in various places. A small number of staff remain in GBS, dealing in particular with the governance of the contract with IBM; a larger grouping of several hundred, located around the world, are defined as 'practice managers' and are deemed to be a 'corporate function' dealing with the design and maintenance of the HR system; the largest group of HR staff, termed 'business account managers' or 'business partners', are located in the sites of the GBUs and the MDOs and deal with non-routine personnel issues.¹¹

It is too early fully to assess the operation of these arrangements and their costs and benefits. Also, such an assessment would require significant access to financial information. However, P&G claims that the initial establishment of SSs enabled them to reduce costs, including wage costs; to eliminate duplication; and to bring about greater standardization of systems around the world. In turn, according to the company, subsequent outsourcing to IBM had the following beneficial effects: it further reduced wage and other costs; it facilitated integration across HR activities; and it

9 Interview with Lynne Burnett (P&G) 30 April 2007; Mike Power (ex-P&G) 28 September 2007. B. Livingston (P&G) quoted in R. Banham, 'Divide & Conquer', *HRO Today* (May 2004), p. 42; *Information Week*, 11 November 2002; P&G's Route to Business Process Outsourcing, *Gartner Research*, January 2005; C. Tornbohm & C. Da Rold, 'How P&G Outsourced HR to Sharpen Customer Focus', 1 February 2005, p.2.

10 P&G and IBM use a tiered system for designating the work interface: 0 is self-service; 1 is initial case contact; 2 is case management involving more extended project work; and 3 is the governance of processes, involving standard setting and joint planning.

11 Interview with Lynne Burnett (P&G) 30 April 2007; Shellie Weiskittel (P&G) 30 April 2007; Raquel Diaz (P&G) 30 April 2007; Liugi Pierleoni (P&G) 17 January 2007; Sarah Tickle (P&G) 17 January 2007; Agnieszka Kozorowska (IBM) 17 January 2007; Ian Dawson (IBM) 17 January 2007; Madalyn Brooks (P&G) 12 October 2007.

freed up management to concentrate on its core activities of servicing the development and marketing of brands. It is claimed that this has been accomplished while providing the same or better services to P&G managers and employees.¹²

We make the following broad points which we develop below in our comparative analysis of the two case studies.

First, in the development of the P&G arrangements, there were a number of steps which were predicated on one another. Hence, the move to SSs was based on two initial developments, the deployment of SAP-based ERP systems throughout the company from the 1980s onwards and the reorganization and centralization which accelerated through the mid-1990s. Equally, outsourcing was very definitely based on the prior development of SSs. As one executive said of the latter: 'It was absolutely right to implement SSs internally before outsourcing'.¹³

Second, a major challenge has been to work out how to organize retained staff in the HR area. Of course, this is an on-going challenge which would have existed in the absence of outsourcing, but the latter brought the question of internal capability in the area to the forefront. As described above, what has developed is organization on the following lines: a very small continuing GBS function; a small, but now growing, corporate function of specialist 'practice managers'; and a larger group of generalist frontline 'business account managers'.

Third, in terms of the contract with IBM, a major concern has been grey areas and 'seam' issues along the interface between the two organizations. It is not always clear what is 'in scope' and the responsibility of IBM and what is 'out of scope' and the preserve of P&G. There are elaborate rules and procedures for dealing with this issue, but it nevertheless leads to lengthy negotiations between the two parties. For example, relocation arrangements might seem to be a straightforward transactional matter, to be dealt with by IBM, but actual implementation may cause individual employees to ask for non-standard treatment and therefore involvement by P&G managers.

12 Interview with Lynne Burnett (P&G) 30 April 2007; Shellie Weiskittel (P&G) 30 April 2007; Raquel Diaz (P&G) 30 April 2007; Liugi Pierleoni (P&G) 17 January 2007; Sarah Tickle (P&G) 17 January 2007; Madalyn Brooks (P&G) 12 October 2007. In this paper, the focus is not on the provider, but, we add that, for its part, IBM gained a major client; gained access to high quality HR systems expertise; and developed a platform from which it could sell similar services to other companies. Interview with Agnieszka Kozorowska (IBM) 17 January 2007; Ian Dawson (IBM) 17 January 2007). 'IBM lands P&G's HR Operation', *People Management*, 25 September 2005, p. 7; R. Banham 'Divide & Conquer', *HRO Today* (May 2004), p 42; J. Loomis, 'Big Blue Inks P&G contract', *The Journal News* (10 Sept 2003); K. Hegman, General Manager, Global Business Transformation Outsourcing, *IBM Presentation at HRO World Europe 2004*. J. Carolos Perez, 'IBM in final talks with P&G for outsourcing deal', *Information World* (29 Aug 2003); P. Martinez (P&G) quoted in 'IBM Wins Business Transformation Outsourcing Contract with P&G', http://w31.ibm.com/sales/americas/latinamerica/content/bcs_la_procter_gamble.html;

13 Giorgio Siracusa, 'The Shared Services Model', P&G powerpoint.

Fourth, P&G insists that outsourcing has not led to a loss of core competencies in key HR areas such as strategy, design of programs, and recruitment and development of staff. Nevertheless, there are concerns: there are crucial roles, such as payroll and compensation administration, which P&G can no longer deliver in-house; there is some concern as to the possible erosion of IBM's 'feel' for how P&G operates, as ex-P&G staff within IBM retire or leave, as IBM staff come to handle a number of different company accounts, and as P&G itself changes.¹⁴ Together, these are questions for the future, in particular for what happens at the end of the contract.

5. Unilever

As with P&G, Unilever had its origins in the 19th century in fats and oil processing. The modern company was formed in 1929 by a merger of the British Lever Brothers (soap) and the Dutch Margarine Union (margarine). From then onwards, Unilever has been an Anglo-Dutch or, given its large presence across a number of European countries, even a European company, with headquarters in London and Rotterdam and with senior executives from both countries. Through the interwar years, by acquisition and internal growth, the company moved progressively into foods and other products. It further developed extensive operations throughout Europe, North America, Asia, and Africa (Wilson, 1954; Jones, 2005). The resulting company was managed by an extensive hierarchy of professional managers and Unilever was one of the leading 'modern' companies in Europe, with a developing multidivisional and later matrix structure (Hannah, 1983; Chandler, 1990).

After the Second World War, like P&G, Unilever developed synthetic detergents and a range of personal care products. Subsequently, related and unrelated diversification, via internal growth and acquisitions, led to operations across an extremely wide range of activities—household care, personal care, various food products, beverages, ice cream, animal feed, specialty chemicals, trucking and distribution, to name but a few. Though operating a multidivisional and later matrix structure, Unilever was always less centralized than its rival P&G and over time it went through more processes of restructuring (Bartlett and Ghoshal, 1989; Dyer *et al.*, 2004; Jones, 2005). In practice, Unilever operated as a set of national companies, more or less controlled by head office. Its large US and diverse African operations were particularly independent. Later major acquisitions have been of Bestfoods and Ben & Jerry's in the United States. Paralleling P&G, over the last twenty years, de-scoping,

14 Interview with Lynne Burnett (P&G) 30 April 2007; Shellie Weiskittel (P&G) 30 April 2007; Raquel Diaz (P&G) 30 April 2007; Liugi Pierleoni (P&G) 17 January 2007; Sarah Tickle (P&G) 17 January 2007; Agnieszka Kozorowska (IBM) 17 January 2007; Ian Dawson (IBM) 17 January 2007; Madalyn Brooks (P&G) 12 October 2007.

divestiture, and closure of underperforming brands and plants have become a continuing feature of Unilever.

As with its US counterpart, Unilever created strong internal capabilities and developed an extensive managerial hierarchy which held the company together across its constituent parts and throughout the world. However, there were differences between the two companies: Unilever was larger, grew rather more by acquisition, and had more plants in more countries. It also integrated more backwards and forwards. As a result, it had a more complex administrative structure and, despite a strong shared managerial culture, at times resembled a loose confederation of companies (Dyer *et al.*, 2004; Jones, 2005).¹⁵

In terms of HRM, the company had certain similarities with P&G. Traditionally, it was rather paternalistic, though similarly this declined, from the 1960s onwards. The management of senior managers and the establishment of a few broad policy guidelines were set at corporate level; other aspects of HRM were devolved to national and especially constituent company management. However, in contrast to P&G, and given its extensive European businesses, Unilever had more of a tradition of recognizing trade unions and was usually a member of employers' associations. Through the 1970s, however, it increasingly chose to distance itself from such associations and internalized HR activities (Gospel, 1992). However, this internalization occurred in many different forms, across and within countries, and with considerable devolution to national personnel departments and to each individual company's personnel function. This produced an extremely variegated and decentralized system which, making a virtue out of a necessity was thought to have some advantages in terms of flexing employment for each particular context and facilitating a 'divide and rule' approach to industrial relations.

Over time, however, the decentralized and variegated system came to be seen to have growing disadvantages in an increasingly competitive market context. As a result, from the early 1990s, Unilever began to integrate its operations using a set of ERP systems, though in practice these were more varied than in P&G. Later, competitive pressures and fears of falling behind other large players, led Unilever to initiate a number of major change programs. Under 'Path to Growth' launched in 1999, it significantly reduced the number of brands from well over a thousand to several hundred, with a growing emphasis on an even smaller number. In terms of structure, from the early 1990s, it went through a number of stages: it moved away from so-called 'coordinations', a matrix of product and geographical groups; for a time, it moved towards a greater emphasis on geographical groups and then later operated with two divisions, for food/home and personal products; more recently it abandoned divisions and came to centralize on the one company, emphasizing stronger functional organization on a global basis, with constituent companies

15 Interview with Richard Greenhalgh (ex-Unilever) 2 May 2006; Garry Crouch (Unilever) 9 May 2006. See also Interview with Geoff Williams (ex-Unilever), 25 September 2006.

being left primarily with brand management and sales (Jones, 2005: 365–5). Under the ‘One Unilever’ program launched in 2004, it has come to place an even greater emphasis on the whole company and a de-emphasis on the constituent parts.¹⁶

In this context, Unilever began to consider SSs later than P&G. However, by the late 1990s, it had concluded that there were real advantages to be gained from such arrangements. As a result, SSCs for F&A were established in Latin America in 2002 and then developed later in India, Europe, and North America. For IT, there was a growing centralization of the function, but SSCs as such were not established. For HR, SSs were inaugurated in 2003, with the establishment of the Peoplelink organization in the UK, followed by the Netherlands and other parts of Europe, and with the rest of the world following.¹⁷ In practice, therefore, the move to SSs was more diverse across functions and across regions than was the case with P&G.

In HR, Peoplelink took over the following activities: employee administration; employee benefits; payroll; recruitment; relocation; expatriation; and training. Some of the work was very transactional. However, other aspects of the work were higher level and involved close working with HR managers in the companies. Thus, in recruitment, local management provided the job and person specifications; Peoplelink then did the shortlisting and initial interviews; and local management made the final selection. Peoplelink also provided expert advice on matters such as employment systems, the development of pay schemes, and staff development. Outside of Peoplelink, local HR managers came to be designated ‘business partners’, with the job of servicing the businesses to which they were attached and dealing with operational personnel matters. The careers of top managers, overall HR policy, and dealings with unions were also not put into Peoplelink, though in the latter area the SSC provided background support while local management actually carried out negotiations.¹⁸

Over time, the UK Peoplelink organization played an important role in developing a template later used in other areas within Unilever. As stated, it established the practice of three types of work and staff: ‘transactional’ staff, largely based in the SSCs, dealt with more routine matters; a small number of ‘expert’ staff dealt with more specialist matters; and ‘business partners’, by far the largest group, worked within the companies or functions, attached to a line management team¹⁹

16 Interview with Richard Greenhalgh (ex-Unilever) 2 May 2006; Neil Conway (Unilever) 2006; Reg Bull (Unilever) 15 January 2008.

17 Interview with Richard Greenhalgh (ex-Unilever) 2 May 2006; Suzan van Dijk (Unilever) 23 June 2006; Geoff Williams (ex-Unilever) 25 September 2006.

18 Debbie Jenkins, *Building an Award Winning HR Shared Services Center*, Unilever, Amsterdam, May 2006. Interview with Geoff Williams (ex-Unilever) 25 September 2006; Garry Crouch (Unilever) 9 May 2006; Debbie Jenkins (Unilever) 23 June 2006.

19 Interview with Debbie Jenkins (Unilever) 23 June 2006; Garry Crouch (Unilever) 9 May 2006; Suzan van Dijk (Unilever) 23 June 2006; Tibor Bernhardt (Unilever) 14 December 2006.

Again there are parallels here with the system of internal organization and terminology which P&G moved towards, albeit somewhat later in the American company.²⁰

Within Unilever, top management deemed that SSs, not least Peoplelink, were a success and should be extended throughout the company. However, in a fast moving competitive situation, the option of outsourcing was increasingly being forced onto the agenda. Therefore, the company had a number of decisions to make: to develop further its SSs and to align these in each functional area, while keeping them in-house; to develop further its SSs and to align them in each functional area and then, possibly, to outsource them, to one or multiple providers, on either a national, regional, or global basis; to move quickly to outsource, again on either a national, regional, or global basis. Fears of falling further behind competitors, not least P&G, led Unilever to pursue the last option.²¹

As already suggested, Unilever had historically been more ready than P&G to use external bodies and to outsource activities. Thus, through the 1990s, some national companies made decisions to outsource IT and manufacturing. In HR, there had also been an increase of outsourcing in areas such as recruitment and training.²² However, Unilever now lagged P&G and was in a hurry to catch up quickly. Unilever began to outsource business functions at the regional level, especially in Europe, the US, and Latin America. In 2005, Unilever established a competitive bidding process simultaneously to explore outsourcing in Finance & Accounting (F&A) and HRM. As a result, the former in Europe were outsourced to IBM (North America had already outsourced to this provider), while in other regions much remained in-house. In HR, there was considerable debate, but ultimately it was decided to opt for an outsourcing deal which would be global in coverage.²³ At this time, HR was the only function which considered outsourcing at the global level, and, moreover, the fragmentation of IT infrastructure was considered a hindrance in implementing the deal.

In 2006, a €700 million, 7-year contract was signed with Accenture to take over extensive HR functions. This is to be implemented over a 3-year period and to come to cover all Unilever employees throughout the world. Some HR staff will

20 Both Unilever and P&G were influenced in their thinking by the work of David Ulrich. See Ulrich, D. (1997). *Human Resource Champions*. Boston, Massachusetts, Harvard Business School Press., Ulrich, D. and W. Brockbank (2005). *The HR Value Proposition*. Boston, Mass., Harvard Business School Press.

21 Interview with Richard Greenhalgh (ex-Unilever) 2 May 2006; Suzan van Dijk (Unilever) 23 June 2006; Neil Conway (Unilever) 2006; Gijsbert de Zoeten (Unilever) 14 December 2006; Reg Bull (Unilever) 15 January 2008; Paul Bauman (Unilever) 9 October 2006; Fabio Marchiori (Unilever) 9 October 2006.

22 Interview with Debbie Jenkins (Unilever) 23 June 2006.

23 Interview Neil Conway (Unilever) 2006; Gijsbert de Zoeten (Unilever) 14 December 2006; Richard Greenhalgh (ex-Unilever) 2 May 2006; Suzan van Dijk (Unilever) 23 June 2006.

move over to Accenture, but it would appear not as many as moved from P&G to IBM, and Accenture has the task of recruiting a larger number of staff to provide the service. Under the contract, Accenture will take over the following areas: recruitment, workforce administration, payroll, pensions, transfers, exits, and training administration. According to Unilever, Accenture is being given a significant role in the transformation of existing systems—larger we estimate than is the case of P&G and IBM. Other areas remain in-house: the management of the top management team, policy development, the design of pay and benefit systems, and dealings with trade unions and works councils. It should be noted that some of these functions have been moved back from Peoplelink and its counterparts into the main part of Unilever.²⁴

Unilever organizes its internal HR in the following way. HR ‘expert’ teams, which are located throughout the world, handle matters such as management resourcing, development, and progression. Meanwhile, the majority of HR managers, the ‘business partners’, look after a client group (e.g. production, marketing, finance) and some also provide expert advice more broadly within the company. Meanwhile, the SSCs such as Peoplelink are to be closed, with ‘expert’ staff relocated within the company and some more ‘transactional’ staff moved to Accenture or made redundant.²⁵

It is very early to assess the system as it is developing at Unilever and the attainment of stated outcomes. However, Unilever claims that, in moving to Ss, there have been significant advantages: cost savings, especially in labor, but also in procurement; a greater and more efficient division of labor leading to higher quality services; the elimination of duplication and greater integration; better information for management; more sharing of best practice; and the release of internal HR managers to focus on better adding value.²⁶ In terms of the subsequent move to outsourcing, Unilever expects the following: reduced costs via lower head count and lower wages; standardization leading to efficiencies; a quicker introduction of best practices; and the further release of internal managers to concentrate on more value-adding activities.²⁷

24 Interview with Ed Valenzuela (Accenture) 6 December 2007; Belinda Matthews (Accenture) 6 December 2007; Tibor Bernhardt (Unilever) 14 December 2006; Reg Bull (Unilever) 15 January 2008.

25 Interview with Gary Crouch (Unilever) 9 May 2006; Tibor Bernhardt (Unilever) 14 December 2006; Debbie Jenkins (Unilever) 23 June 2006; Reg Bull (Unilever) 15 January 2008.

26 Debbie Jenkins, *Building an Award Winning HR Shared Services Center*, Unilever, Amsterdam, May 2006. Interview with Suzan van Dijk (Unilever) 23 June 2006; Debbie Jenkins (Unilever) 23 June 2006; Geoff Williams (ex-Unilever) 25 September 2006; Gary Crouch (Unilever) 9 May 2006.

27 Interview with Suzan van Dijk (Unilever) 23 June 2006; Neil Conway (Unilever) 2006; Gijsbert de Zoeten (Unilever) 14 December 2006; Gary Crouch (Unilever) 9 May 2006; Tibor Bernhardt (Unilever) 14 December 2006; Reg Bull (Unilever) 15 January 2008. As already stated, in this paper the focus is not on the provider. However, we may add here that, for its part, Accenture obviously gains a major client and a very long-term contract. It has clearly taken on not only

Before moving to comparative analysis of the two case studies, a number of general points can usefully be made about Unilever.

First, it will be noted that Unilever lagged behind P&G in moving to Ss and then to outsourcing. This we explain in terms of the complexity and decentralization of Unilever activities. Subsequently, the company moved very quickly to catch up and made the leap to global outsourcing of HR, though in other areas the pattern of outsourcing has been more diverse across functions and regions. As stated, the initial slow movement is to be explained by the fact that Unilever had diverse ERP systems and had undergone less structural transformation on which to build Ss. Given its rather fragmented development of Ss, it has then been more constrained in its move towards an integrated approach to outsourcing.

Second, Unilever would seem to have made a brave decision simultaneously to outsource and (hopefully for the company) to transform its HR systems. The company used outsourcing as the means of transforming HR, both in terms of what was outsourced and what remained within the firm. However, it would seem to be relying on Accenture to perform a bigger job than is IBM for P&G. At Unilever, outsourcing and transformation are (hopefully) interlinked and synchronised. Therefore, the challenge for Unilever and Accenture is to transition and to transform simultaneously and then to manage the interface between the two parties.²⁸

Third, this poses a question as to retention of core competencies. The points which we made above about P&G hold in the case of Unilever. Critical roles such as payroll and compensation administration are being outsourced to a provider which has to learn about and keep abreast of developments within the outsourcing company. Additionally, in the case of Unilever, more is being outsourced, from a more fragmented base, and with greater aspirations for transformation. Both the risks and potential rewards are high.

6. Comparisons and discussion

Based on the previous sections, we develop four propositions to shed light on the causes, processes, and consequences of the creation of Ss and outsourcing. There are a number of logically distinct paths to Ss and outsourcing, each with advantages and disadvantages for the outsourcer, potentially leading to a different distribution of

extensive transactional work, but also some transformational activities. The three year period of transition would seem to reflect the size of the challenge. Interview with Ed Valenzuela (Accenture) 6 December 2007; Belinda Matthews (Accenture) 6 December 2007; Gary Crouch (Unilever) 9 May 2006; Tibor Bernhardt (Unilever) 14 December 2006; Reg Bull (Unilever) 15 January 2008.

²⁸ One informant stressed that Unilever could not have transformed without outsourcing and that outsourcing was an integral concomitant of transforming.

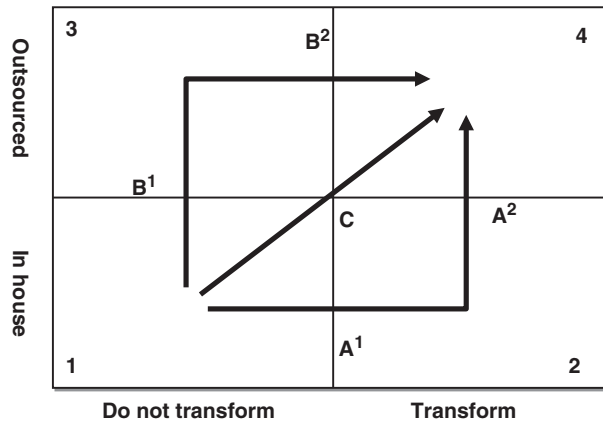


Figure 1 Three paths to transforming and outsourcing business processes.

capabilities between the outsourcing and provider firms. Outsourcing may occur before, after, or simultaneously with the transformation of business processes. Such transformation we take to cover the standardization, consolidation, and centralization of business services. We use Figure 1 to outline these paths.

In path A, a company seeks process improvements by creating an internal SS center (SSC) (A¹). It may stick here, or it may proceed to outsource the ownership and management of such a center to a supplier or multiple suppliers (A²). In this case, the company is likely to retain in-house know-how of service provision and process improvements. In addition, this capability strengthens the company's bargaining power during contract negotiation with suppliers. However, this path has the disadvantage that the company has to commit initially to a large investment in standardization and centralization.

In path B, a company outsources the existing processes, typically to multiple suppliers (B¹). In this case, the supplier takes a lead in providing the technological infrastructure and the know-how to transform specific processes (B²). Here the client is likely to be in a weaker position to provide an input into redesigning processes. Where multiple suppliers exist, the process of transformation involves consolidation and complex coordination.

In path C, a company decides to outsource and hopefully transform HR processes at once, in a 'big bang' or 'throw it all over the fence' approach. This is done with an expectation of rapid cost reductions to exploit scale economies, labor arbitrage, and increasing return on assets.²⁹ The client company also benefits from not committing

²⁹ This was the case when Exult created a SSCs for BP, see Adler, P. S. (2003). 'Making the HR Outsourcing Decision.' *MIT Sloan Management Review*: 53–60., Lawler III, E. E. e. a. (2004). *Human Resources Business Process Outsourcing: Transforming How HR Gets Its Work Done*. San Francisco, Jossey-Bass.

capital in the creation of a SSC. However, without much accumulation of know-how in transforming processes in-house, the client is likely to be heavily dependent on a specific supplier or suppliers.

Based on this framework, broad propositions might be developed in relation to the choice of transition path to Ss and outsourcing: first in terms of determinants (what are the important drivers?), second in terms of timing (when are moves made?), third in terms of processes (how are moves made?), and fourth in terms of outcomes (what are the performance results?). Below, we develop four propositions from comparing the two case companies. Of course, actual company histories are more complicated than any general propositions suggest. Nevertheless, we feel that the trajectories of the two companies may be usefully compared to develop generalizable propositions for understanding the move to Ss and outsourcing and for analyzing consequences.

Before developing the propositions and as a reminder, Table 2 compares the two case study companies along a number of dimensions. It will be noted that the two companies are similar in sales revenue and ROCE, but very different in market capitalization, P&G's being nearly three times that of Unilever's in the mid-2000s. Unilever also differs from P&G in employing around 50% more than P&G. In both companies divisional structure changed at increasingly regular intervals over time; however, Unilever always had more divisions and more national companies from earlier times. Given the significant autonomy given to each national company until the 1990s at both companies, the number of countries where operations exist is a good proxy for gauging the scope and dispersion of operations within these global corporations.

As a further reminder, Table 3 summarizes the nature of the two outsourcing deals discussed in earlier sections, namely P&G's deal with IBM and Unilever's with Accenture. Both are long-term contracts with global coverage, involving multiple HR processes. As shown in Table 3, the scope of outsourcing—i.e. the breadth and depth of processes being—is somewhat similar in the two deals, except in two respects. First, as discussed earlier, P&G implemented a uniform SAP platform throughout the global corporation before outsourcing took place, whereas Unilever had multiple legacy systems at the time of outsourcing. P&G outsourced its SAP HR applications development. Second, in contrast to Unilever, P&G does not outsource the recruitment process as this is deemed to be closely tied to corporate culture.

6.1 Incentive to reduce transaction and coordination costs

Both P&G and Unilever had grown in scale and scope. Organic development and acquisitions led to a proliferation of products and brands, although with periodic reviews leading to some divestments. However, compared to P&G, Unilever always had more brands and more product divisions and subsidiary companies. Each of these product divisions and nationally-based companies developed their own

Table 2 Summary statistics for P&G and Unilever

	P&G			Unilever		
	1986	1996	2006	1986	1996	2006
Sales Revenue		\$34,815 million	\$68.2 billion		£33,522 million	\$49.6 billion
Assets		\$23,064 million	\$135,695 million		£8302 million	\$46,447 million
ROCE	11.94	20.13	20.48	12.24	19.68	22.42
Market capitalization	\$12.9 billion	\$73.8 billion	\$201.3 billion	\$8.1 billion	\$26.9 billion	\$77.4 billion
Employment	72,000	99,200 (1995)	110,000	353,000 (1986)	283,000 (1995)	174,000
Countries where operations exist	30 (1980)	55 (1996)	80 (2003)	70	85	100

Sources: Market capitalization and ROCE from Datastream. Sales revenue and assets from annual company reports. Employment, countries where operations, and plants and facilities from annual reports, Jones (2005), Dyer *et al.* (2004), and internal company sources. Some of the figures for countries where operations are interpolated.

Table 3 Comparing outsourcing contracts at P&G and Unilever

P&G—IBM Global Services	Unilever—Accenture HR Services
<u>The contract</u> <ul style="list-style-type: none"> – Signed in 2003 – 10 year contract – \$400 million in value – 110,000 employees in over 80 countries – P&G sold 3 internal SSCs in Costa Rica, Philippines, and the UK 	<u>The contract</u> <ul style="list-style-type: none"> – Signed in 2006 – 7 year contract – €700 million in value – 174,000 employees in 100 countries – Some internal SSCs (e.g. Peoplelink in the UK), but moved straight to outsourcing in many regions and countries
<u>Processes outsourced:</u> <ul style="list-style-type: none"> – SAP HR applications development – Employee data services – Contact center support – Payroll – Compensation and benefits – Pensions – Training administration – Expatriate and relocation services – Travel 	<u>Processes outsourced:</u> <ul style="list-style-type: none"> – Workforce administration – Contact center support – Payroll – Pensions – Training administration – Transfers – Travel – Recruitment – Exits

Source: Press, company documents, and authors' interviews.

administrative arrangements in HR and other functions. By contrast, P&G had fewer brands and fewer product divisions, in personal care and foods. As a consequence, when it came to the decision to create SSs and to outsource, Unilever had a much more fragmented internal structure with disparate administrative processes across divisions and companies than P&G. Therefore, the potential gains from SSs and outsourcing through consolidation, standardization, and exploitation of internal economies of scale were greater for Unilever than for P&G. Following on this, we therefore suggest the first proposition.

The first proposition is that the more strongly divisionalized the firm, the more incentive it has to move from box 1, to 2, and possibly then to 4 (Path A), or to move from box 1 direct to box 4 (Path C) (see Figure 1). This proposition applies transaction costs to administrative support activities and is concerned with the incentive to economize on costs of coordination through process standardization. The more strongly divisionalized a company, the more disparate and non-standardized are divisional processes. Complexity is also increased by mergers and acquisitions and the expansion of geographical coverage. As a result, there is considerable scope to gain from standardization and consolidation.

6.2 *Impact of the existing administrative structure of the firm (degree of centralization)*

Despite greater potential gains for Unilever, it was slower in moving to global SSs and to outsourcing. This was because Unilever had long given pride of place to divisional and national autonomy, acting as a barrier to the implementation of standardized and centralized processes. As the case studies demonstrate, both firms experienced greater centralization in the late 1990s, P&G with its 'O2005' restructuring and Unilever with its 'One Unilever' program. In each case, the HQ took greater control over a number of activities, including the provision of shared business services. However, Unilever remained more decentralized than P&G, with greater autonomy in divisions and companies. By contrast, P&G HQ was able to exercise its greater control over divisions to move speedily to standardize and centralize administrative activities in the form of GBS, building on earlier restructuring and its move towards a smaller number of brands and categories. Consequently, when P&G decided to outsource its HR function to IBM, its SSs already had a global structure with three centers for the Americas, Asia, and Europe. By contrast, Unilever faced more complex variations by region and country in the extent of SSs at the time it decided to outsource HR to Accenture. On the basis of this, we therefore derive the following.

The second proposition is that the more centralized the firm, the more likely it is that it will move successfully from box 1 to box 2 (and thence to box 4 if desired) (Path A) or from box 1 direct to box 4 (Path C). This proposition identifies the existing administrative structure of the firm as a determinant of the choice of paths. More centralized firms are better placed to move quickly to central SSs (Path A¹). In our framework, this means that the firm is better able to transform various activities internally. It is then in a stronger position, if it so desires, to move to box 4 (Path A²). Conversely, divisional autonomy is likely to be a barrier to the implementation of standardized and centralized processes, and thus to the move to box 2 or box 4.

6.3 *Impact of capabilities in the supply market*

The early timing of P&G's decision meant that the paucity of competent suppliers restricted its choice and led it to create its own SSC in-house. In a sense, P&G itself was contributing to the creation of a new supply market in the act of divesting its SSCs to service providers. By contrast, as a follower, Unilever was able to go through a real competitive bidding procedure to choose from a bigger shortlist of already established suppliers. The resulting supplier perspectives are also quite different in the two cases. In the case of outsourcing by P&G, IBM bought P&G's assets (both tangible and intangible) to start its own HR outsourcing business. P&G transferred part of its capabilities (mostly operational capabilities) to IBM via the sale of assets and the transfer of employees, whilst retaining dynamic capabilities in its GBS unit. By contrast, Accenture HR Services was already well established by the time it offered

to manage outsourced SSSs for Unilever. Consequently, it inherited fewer employees from Unilever, but undertook a larger task. We therefore suggest the following.

The third proposition is that the early adopters, facing a ‘thinner’ supply market, are more likely than late adopters to follow Path A rather than Path B or Path C. Conversely, late adopters, facing a ‘thicker’ supply market, are more likely than early adopters to follow Path B or Path C than Path A. This proposition applies the capabilities view of the firm to supplier markets, and highlights the importance of the timing of decision-making. Thus, first movers in outsourcing may face underdeveloped ‘thin’ supply markets, having little choice but to create SSSs in-house, namely, to move to box 2 (Path A¹). By contrast, a late-comer has the choice to move to box 3 (Path B¹) or to leapfrog by going straight for a combination of outsourcing and transformation, namely, to move to box 4 (Path C). They benefit from thick markets which are large in size and have a high level of effective demand and alternative suppliers with requisite capacity. Where there exist suppliers in proven markets, it will be more possible for the firm to outsource, following paths B or C. There are thus co-evolutionary dynamics in the process we describe.

6.4 Impact on the distribution of capabilities

The fourth consideration concerns how the trajectory of the move to SSSs and outsourcing affects the distribution of capabilities between users and suppliers. Our argument is that the more time is spent on transforming processes internally, the greater will be the retention of capabilities by the user firm. By contrast, outsourcing without the step of creating internal SSSs leads to a greater reliance on the capabilities of the supplier firm. In our cases, P&G was selling its capabilities to operate HR shared services to IBM. By contrast, Unilever was buying capabilities to design and operate HR shared services from Accenture. In effect, Unilever paid more to secure more from Accenture than in the case of P&G and IBM. This is reflected in the deal value of \$400 m over 10 years in the P&G deal, compared to €700 million over 7 years in the Unilever deal.³⁰ What Accenture would seem to be performing for Unilever, which IBM did not perform for P&G, is to transform and consolidate HR processes and to create regional SSCs which Unilever had not had time fully to create. Accenture was deemed already to possess the capabilities to transform processes and to manage HR activities. For Accenture also, the Unilever

³⁰ Unilever paid Accenture €700m to service 174,000 employees over 7 years. That is €100m per annum for 174,000 employees, or €575 per employee. P&G paid IBM \$400m for a 10 year contract, so that is \$40m per annum to service 110,000 employees, or \$364 per employee. So, at the exchange rate prevailing at the signing of the Unilever deal in 2006 (€1 = \$1.28), the per-employee deal value is \$736 (=€575) at Unilever compared to \$408 at P&G. Unilever indeed did pay more to Accenture than P&G to IBM. Moreover, the annual contract value of \$128m (€100m) at Unilever vs \$40m at P&G is likely to incorporate a fixed cost of investment in infrastructure providing some economies of scale.

deal was intended to enable it to learn more about transforming and managing at a more global level. In the case of P&G, the company had already developed the capability to transform and manage HR worldwide. Hence, IBM inherited P&G's operational capabilities through the transfer of people as well as assets. Thus, P&G has retained more know-how in creating and managing SSs, with more of an option to bring outsourced activities back in-house.

The fourth proposition is that the trajectory of the move to SSs and outsourcing affects the distribution of capabilities between the user and the supplier or suppliers. This proposition emphasizes the dynamic aspect of capabilities underlining administrative activities. Thus, though the paths may lead to the same end point of outsourcing, the choice of path creates different legacies which influence the long-term dynamic capabilities of the firm. As explained earlier in describing the three paths, the more time is spent on transforming processes internally, i.e. in box 2 (Path A¹), the greater will be the retention of dynamic capabilities by the user firm. By contrast, Paths B and C will lead to a greater reliance on the capabilities of the provider firm to both design and operate SSs.

7. Conclusions

Of course, there are limitations to a study of this kind. In particular, the research is based on just two cases; the outsourcing side of the story is very much an unfolding process; and access was not provided to extremely sensitive cost-benefit data. In terms of further research, therefore, there is a need to test the propositions with a larger number of cases and to study these two particular cases over a longer period of time. It would also be useful to consider similar firms, drawn from the same sector, but from a greater spread of countries, so as to examine effects of national institutions on outsourcing practices (Grimshaw and Miozzo, 2006).

Despite limitations, however, this study resulted in a number of useful empirical findings. First, controlling for the product market, prior corporate structure has a significant impact on the opportunity to save on transaction and coordination costs by creating SSs and outsourcing. Second, centralization is a key determinant in establishing SSs and making and executing the outsourcing decision. Thus, P&G was more centralized than Unilever, rendering the former the first mover in creating SSs and subsequently in outsourcing services. Third, the thickness of the supply market affected the timing of the move to SSs and outsourcing. Here, Unilever was, for good or ill, able to draw on a thicker market. Fourth, the trajectory of the move to SSs and outsourcing affects the distribution of capabilities between the user and the supplier. Thus, we suggest, the creation of internal SSs first before outsourcing leads to greater retention of dynamic capabilities in-house.

From a theoretical point of view, the study has provided the following insights by combining three areas. First, theories about the administrative structure of the firm

need to take into account the development of SAs and outsourcing which we suggest are consistent with a growing centralization of the modern business corporation. Second, theories about transaction costs and the boundaries of the firm can be fruitfully applied to administrative support activities. Third, notions about capabilities and resources can be made more concrete by considering specific choices concerned with the creation of SAs and outsourcing.

From a practical point of view, we hope that the findings shed light on the strategy and management of outsourcing. Often, a key concern for corporations considering outsourcing is how far firms can outsource functions without undermining their core capabilities. This study suggests that it is not only ‘how far’ but also ‘which way’ (i.e. the path) that is important in retaining relevant capabilities in-house. When formulating strategies on outsourcing, managers therefore should give regard not only to the boundary choice of make-or-buy, but also to the choice of paths.

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