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ENLIGHTENED LEADERSHIP: COMPARATIVE ADVANTAGE

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The choice of Shared Services over any other approach to service delivery is essentially an exercise in “right-placing” -- performing functions in the place where they can be done best and most efficiently, simultaneously freeing other “places” (i.e., businesses) in the company to make the best use of their resources. This is a company-internal example of the long-recognized economic principle of Comparative Advantage. David Ricardo, one of the founders of modern economic theory in the early 19th Century along with Adam Smith, described how this principle explains the economic differentiation of countries, each benefiting by concentrating on those economic activities in which it has the greatest advantage over others in costs, technology, resources, labor skills, proximity to markets, etc.

Comparative advantage has always been a factor in international trade: the U.S. imports fruit from tropical countries because bananas grow a whole lot better in Nicaragua than New Jersey, giving Nicaragua an enormous advantage. In fact, even if were possible to grow bananas efficiently in New Jersey, the opportunity cost of doing so would make it ill-advised; the capital and labor invested could easily earn higher returns in New Jersey by doing something else, leaving banana growing to the places that have a comparative advantage. Within a company, the Shared Services model is basically a way to apply comparative advantage to business functions like HR, payroll, etc., by seeking to identify which places in the company are the best for handling that particular process. Metaphorically speaking, a Shared Service Center (SSC) is a “place” that has the greatest advantage in climate, soil, practices, access to customers, and so on for “growing” some specific service. In principle, the company that finds, or more likely, builds such a place will enjoy the same comparative advantage as a Nicaraguan banana grower.

These principles apply to both domestic and international Shared Service operations. A company operating in only one country can still benefit from setting up an SSC that cultivates the expertise, best practices, efficiencies, and responsiveness that bring the greatest improvements in ROI. Doing Shared Services at the global level brings an even higher order of potential reward to the enterprise along with a higher order of complexity in deployment. Quality, implementation times, labor costs, etc. can all be dramatically improved if global comparative advantage is brought into play.

Many global companies already have considerable expertise in leveraging international comparative advantages. The offshoring movement is a simple example of how companies arbitrage labor costs: if clothes can be stitched in China for a fraction of the cost in North Carolina, a clothing manufacturer who moves production offshore is simply attending to the lessons of Ricardo and Smith on economic advantage and international trade. But this is a solution that plays with only one aspect of clothing production -- labor costs. Such solutions only work when the advantage gained on one variable substantially outweighs any consequences that arise with respect to other variables. Thus, for the clothing manufacturer, there would be no point in offshoring if the labor cost advantage were more than offset by increased shipping costs, tariffs, or lack of quality control, etc.

Analogous issues arise with doing Shared Services internationally. There are complex tradeoffs to consider with respect to labor costs, customer accessibility and service levels, governance, etc. Thus locating a regional or global SSC in a country with low labor costs would bring few advantages if, for example, labor quality were significantly poorer or if differences in language or time zone meant that accessibility to the customers of the service were significantly degraded. Hence, establishing an international SSC involves weighing a web of both comparative advantages and disadvantages and effectively balancing the payoffs and tradeoffs involved.

In Global Shared Services, a key tradeoff is the potential loss of country-specific expertise. Local operations may have a natural comparative advantage in knowledge of local business practices, such as the legislative and regulatory framework, national retirement plans, holiday schedules, etc. In deciding whether to replace such local operations by an international SSC, the comparative advantages of centralization must be weighed against such local advantages. The design of global operations must seek to ensure that local expertise is effectively transferred to the global SSC. In all such tradeoffs, the central issue still comes down to finding the best possible place to grow bananas. 🍌

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