Insights from the Second KPMG China Shared Services Summit

November 2011, Shanghai

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Introduction

Following the success of the first Summit in Hong Kong last year, KPMG China held its second Annual Shared Services Summit in Shanghai in November 2011, bringing together over 230 representatives from 128 companies.

In recent years, China has emerged as one of the preferred shared services and outsourcing destinations in Asia Pacific. The 12th Five-Year Plan emphasised the importance of the service industry to China and also demonstrated that support for the shared services and outsourcing industry continues to be strong.

At KPMG’s Second Annual China Shared Services Summit 2011, leading independent advisors and senior executives together with multinational corporations (MNCs) who have been through the process provided insights into the different stages of the shared services cycle.

Panels and presentations included insights on global and local trends of shared services, performance measurement, strategy and the evolution of shared services operations, as well as other best practices in running a successful shared services and sourcing strategy.

The conference was opened by Nelson Fung, KPMG’s Regional Senior Partner for Eastern and Western China, and Zhang Qiang, Secretary General, China Council for International Investment Promotion (CCIIIP). They outlined the important roles that outsourcing and shared services have to play in the expansion of China’s economy into higher-value services.
Ning Wright, KPMG China’s head of Shared Services and Outsourcing Advisory, illustrated the vision for sourcing globally. The delivery platform is a hybrid form where buyers will move to using one global outsourcing provider with centralised customer relationship management. “This will be the ideal sourcing ecosystem – China is going to be attractive not only for the Asia Pacific region, but globally.”

Changes to the Chinese economy in the last year are having an impact on the sourcing and shared services ecosystem. Operating in China remains challenging due to a number of factors. These include lower GDP growth, inflationary pressures leading to higher salaries, local governments tightening their monitoring and dispensing of incentives and subsidies, and the introduction of more regulations. This macro environment within China, combined with the external pressures of the global sourcing market, have catapulted the shared services and sourcing model into a new phase of development.

According to Ning, this third-generation sourcing ecosystem will be characterised by more sophisticated hybrid models which combine shared services and outsourcing. These promise to be mutually beneficial to suppliers and buyers. Companies will need to be more rigorous in consolidating scale to improve efficiency and productivity.

Ning expects captives to double in size, while the gap between domestic and multinational service providers shrinks. She explained that for the multinational service providers to compete with domestic service providers in China and to operate in China successfully, they have to develop localised solutions for their clients and articulate a China-to-China value proposition.

The takeaway for buyers is to be mindful of this life cycle concept: how is my company going to grow? They need to monitor how things are maturing. They need to ask themselves, “Do I have the foresight to see how things will change? Does my organisation have these things in place to help us go further?”

“The shared services and sourcing market is heading towards a third-generation delivery model,” Ning said. “China will definitely be the key location for setting up shared services centres. The challenges for companies are how to optimise their operations and how to operate globally and consolidate their delivery centres.”

Sourcing will not be bound by geography. Capability will be balanced across the globe – one integrated global platform where resources and skills are fully leveraged.”

The third-generation delivery model means:

- Consolidation of scale
- Proliferation of the expected hybrid model. Drivers will be operational agility, maturity of service provider and business requirements.
- Convergence of domestic and multinational service providers. Right now there are visible differences in skills between domestic and multinational service providers. Over the next five years, multinationals will try to make their value proposition more attractive by localising and penetrating local markets.
Reasons for the proliferation of the hybrid model

- Operational agility and responsiveness: as organisations get bigger, they cannot get more efficient with one solution. Outsourcing is a good solution when they need to ramp up resources in accordance with market response.
- Costs concern: less fixed investment
- A flexible model: incentives will disappear
- As requirements for end-to-end processing and higher-value from finance, IT and HR increase, companies have to outsource some of the transactional or niche knowledge processes to outsourcing service providers.
Leading industry players are either in China already, or considering how to incorporate China into their global and regional shared services strategies. Several reasons have been given for this coming of age: the quality of its talent; the language capabilities of the talent, which include Japanese and Korean in addition to English; and discounted labour costs. China already has the largest number of captive R&D centres in the world. Its growing offerings of knowledge processing outsourcing coupled with a sophisticated research and analytic talent pool are helping the country lay a strong foundation for future innovation. The government’s continued focus on technology and infrastructure as outlined in the 12th Five-Year Plan plays extremely well to becoming one of the world’s leading knowledge-driven economies.

“It is the first time any country has taken on every challenge,” Edge commented. “China is getting better visibility over its services and people. The BPO and KPO segments, especially, will rise in China and it isn’t just about cost.” For strong growth in talent for BPO and KPO, China needs further support from the government to outperform other markets and stay competitive.

The new report outlines the life cycle of shared services and explores some of the challenges specific to setting up in China. No matter which stage of the shared services life cycle a company is in, a company must have a plan for its SSC to maintain its relevancy and competitiveness. Some of the considerations include justifying a business case, building critical mass, developing a strategy for the SSC and diversifying locations.

Different types of companies in China have different drivers. For the MNCs they are consistency, economics of scale, standardisation, enhanced service levels, better control and transparency. State-owned enterprises have additional motivations. High on their agenda are access to global best practices, visibility of operations and a focus on people management. Privately owned enterprises are looking at consolidation, controls and process improvement to allow for greater board-level focus on core competencies.

Using Lenovo as a case study, Edge concluded that companies should see shared services as a journey of transformation not a cost-cutting measure. Lenovo’s five-year journey involved a logical and phased approach, while carefully meeting cultural requirements with a strong HR and change management strategy.

“Shared services strategy is a commitment; it’s a marathon,” said Edge. “A company must have a five-to 10-year plan for its SSC to keep it relevant and competitive.”
HSBC operates a successful global service delivery model which started out as a cost-driven service centre in southern China for data entry. Today its China service centres have grown to four locations with 6,000 people, and its regionally managed centres, which also span locations in India and the Philippines, have been centrally coordinated to deliver services to six regions in the world.

With five years based in Latin America and many more running operations in South and Southeast Asia, Rumi Contractor, Group Head Service Delivery and CEO, HSBC Global Resourcing Limited, recounted the HSBC story of shared services creation and maturity. Its journey to becoming an integrated global service delivery platform has been a transformational one, driven by a mandate for innovation and customer advocacy while maximising cost efficiency.

Mr. Contractor described the market conditions that contributed to the convergence of a global shared services platform. With revenues falling and the economy contracting, companies must look internally and ask questions such as how to redefine or simplify business.

Starting in the 1990s, shared services were made possible by lower-cost communications and the deregulation of telecoms companies. “Outsourcing gave rise to the shared services journey, which in turn provided the availability to control costs,” he explained. “Cost arbitrage started as the main reason behind shared services. That lever still exists, but inflation is rising faster in China than in the developed world. That cannot be the only strategy you employ.”

He remarked that the best way to continue to move the business forward is to standardise. “You need to know how to convince the partner to operate more SSCs and ensure the partner’s willingness in doing it,” he commented.

Mr. Contractor concluded the session by addressing China’s advantages as a shared services destination, based on his own story with HSBC in Guangzhou and more recently Foshan. “China has the infrastructure and government that other countries would die for.”

The next step is standardisation and simplification, but Mr. Contractor emphasised that there is no one-size-fits-all model, adding that, “You need to look at the cultural requirements, language capabilities, uses for the centre, and consolidation. Over time every organisation builds complexity. How do you get that simplicity back into your DNA?”

Mr. Contractor noted the importance of looking at the entire value creation chain, with innovation as the final link in the chain. “Your path to winning has to do with your primary business… The value chain is constant. You need to be innovative. Innovation boils down to looking at how to do your business and how not to do your business. Shared services can allow you to [transform into] an enlightened organisation and a light organisation.”

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The business case for multinational shared services centres in China

The first panel discussion moderated by Edge Zarrella revolved around why MNCs set up SSCs in China, what the different models are, how the China market differs and what the systems and cost considerations are.

Jason Wang, CFO Greater China, Henkel, emphasised the importance of access to talent, something Henkel has addressed through collaboration with local schools. Companies need to first determine whether to outsource, then evaluate the choices between in-sourcing or outsourcing.

Riccardo Calliano, VP and CFO for GSK China, explained the thought process behind the company’s decision to create an SSC in China.

“We asked ourselves, how does China fit in the puzzle? How has China changed in previous years? Can I use it as a platform for something else? Given the importance of China, if you get it right and can be flexible to adapt, the next question is, do you keep it standalone or are you able to extend the reach to other countries?”

GSK has proved it has the capability and platform to make their SSC in China potentially upscalable for other markets.
Panellists also discussed the challenges of setting up SSCs and the consolidation process. Generally, they agreed that the advantage for SSCs is internal control; however, there are challenges surrounding standardisation, such as fully understanding the legal rules, finding ways to crucially examine the existing processes, and finding a way to standardise and ramp up efficiency.

David Grimme, head of Service Delivery, HSBC Resourcing Limited, recounted HSBC’s experience of moving its call centre from Hong Kong to Guangzhou and how HSBC has been doing a good job in controlling turnover rate. For Avery Dennison’s vice president Finance, Karl Davies, the company’s learning curve on attrition revolves around investing in training and employee communication. “We’re constantly learning and therefore we’re constantly improving,” he said. Henkel’s Mr. Wang also shared his experience where the company focused on the key pillars – defining processes, measuring KPIs and retaining knowledge. “We need to be realistic…a certain level of attrition is good,” he commented.

During the Q&A session, there was also a discussion around data privacy. According to Mr. Calliano, “The benefit of an SSC is that there can be more control and more alignment.”

In conclusion, the discussion highlighted the key issues that companies should pay attention to. Of processes and systems, Mr. Wang said, “Don’t centralise for the sake of centralising. The shared services approach is a good chance to examine all your processes and then standardise.”

On people, Mr. Calliano remarked that, “It’s a long haul. Invest in your people…Lift and shift is a myth. You need to clean things up first, but it’s not just about processes, it’s also a people game.”

“Companies in China should hire experienced specialists to set up better control of data privacy.”
The life cycle of a shared services centre

Kai Cui, partner with KPMG based in Beijing, shared the story of a multinational with a long history in China. This company embarked on a business transformation journey in 2008, which has led, amongst other things, to the development of their shared services model.

One important trigger for the transformation exercise was a loss of shareholder value. Globally, the operating model was restructured in several key ways:

- Management of the business was split, with separate focus on key business sectors and the control and support of its infrastructure such as HR, IT, Finance, Legal, Supply Chain and Real Estate.

- The business was also reorganised into 17 regional clusters, each managed by its own CEO and CFO. As a result of the reorganisation into clusters, three cross sectors and cross business services were also formed: Financial Services (the treasury function), Real Estate (the property and facilities management functions), and Global Shared Services (the transaction processing function for IT, HR and Finance).

In China, its approach to achieving this transformation was described as ‘lift, drop and change’. The move to centralise (lift and drop) services, was not new. In China, the shared services function was born in 2000, starting with HR, followed later by accounting and finance. The shared services function now employs around 400 people and serves dozens of entities within China.

Initially, many operating companies were integrated with the centralised facility, but maintained their individual processes. Management remained decentralised. The result was a low level of standardisation and automation, a weak service mindset, and a uncompetitive culture. This was confirmed in a comprehensive benchmarking exercise. Management concluded that more standardised processes were necessary to increase efficiency and lower transaction costs; consideration needed to be given to offshoring or outsourcing some services; and the pros and cons of moving to lower cost locations needed to be explored.

The challenges of implementing a highly centralised service management capability led to a service management governance framework for all Northeast Asia infrastructure service providers, including shared services, legal, tax, supply chain, treasury, and IT. The key objective was to drive a culture of accountability and transparency. A more sophisticated service level agreement included service level targets and input/output performance indicators, a driver/activity-based charging structure, and a three-tier governance framework that engrained performance monitoring, measurement, issue escalation and customer feedback.

To paraphrase the CFO:

- The platform for optimisation has been built with clear responsibilities for activities now in place.

- The journey for finance process optimisation has begun and the challenge has been extended to related end-to-end infrastructure processes, given the upstream dependency of many finance activities.

- There is greater importance placed upon process standardisation, efficiency and cost effectiveness, with increased transparency through performance reporting and KPIs.

- The organisation has achieved an overall reduction in infrastructure, or accounting and controlling costs.
As China’s outsourcing and shared services industries mature, will there inevitably be a move towards more advanced hybrid models? This was the premise for a panel discussion chaired by James Pang of KPMG China, which also featured Roc Yang of CDG, Yeqing Zhu of GE Capital, Chris Whaley of Dell and Sophia Wang of Genpact.
Roc Yang was first to share his views. He noted that “Many Chinese organisations have only just started outsourcing, so they have yet to conceive of hybrid models. We have certainly seen things changing in the past two years, but it is not yet a dominant model.”

Yeqing Zhu commented on the path taken by GE and the visionary role taken by its head, Jack Welch, in pioneering outsourcing in India, which led to the creation of Genpact and its conversion from a captive cost centre into a profit centre. “As organisations grow and their needs expand, they face a challenge in maintaining controls and developing more specialised service centres;” he remarked. “The relationship develops from contractual, to collaborative, to strategic. This affects how you handle people and how you manage IP. Over time you can find yourself more reliant on specific people.”

Sophia Wang described Genpact’s approach today as that of “A virtual captive – we can provide all the technology and infrastructure for our client, and even assist with management. But it is the client’s own site.”

Ms. Wang also felt that the advantage of a hybrid was that it could be an interim approach giving an organisation the flexibility to evolve in either direction. Chris Whaley took a similar view, suggesting, “A hybrid can be a preferred model when people are reluctant to put everything onto a new system immediately.”

If outsourcing and captive shared services both offer advantages, the critical question is how to gain the best of both worlds – providing access to a wider talent pool but also allowing the right degree of control.

Ms. Wang and Mr. Yang both dispelled the notion that staff would be less motivated working for an outsourcing vendor than they would for a captive.

“Outsourcing gives an organisation access to a bigger talent pool,” said Ms Wang.

“But if you convert to a profit centre will it affect your retention? Not necessarily. It can boost morale if people have a sense of contribution to a business. It is possible to get a double sense of belonging, but it does take investment and effort.”

Mr. Yang added that, “We often get resumes from our clients’ operations staff. They realise they can attain more breadth of experience [working with an external vendor].”

Mr. Whaley spoke at more length on how IP concerns can affect the choice of hybrid model for a large multinational. “The global architects for technology have to remain within the organisation, but outsourcing and shared services can free up those people’s time to focus even more on core business needs and the strategic direction of the business,” he said.

Ms. Wang mentioned another advantage of a hybrid model was the knowledge and best practice that a vendor could bring to the setup process. Mr. Whaley highlighted the example of a vendor adding value by bringing tools such as new innovative reporting techniques. In conclusion, the panelists clearly recognised the effort that needs to go into creation of shared services — and collaboration and clear planning are equally important in hybrid models.
McDonald’s: A story of consistent success

Christina Zhang, General Manager of the APMEA Shared Services Centre for McDonald’s Corporation in Guangzhou, explained how McDonald’s conducted a study across 10 markets covering finance, HR and technology to identify opportunities to improve process efficiency and controls. In 2010 it established a new set of guiding principles with a pledge to enhance value against four metrics: cost, time, quality and compliance.

“Over time there has been a clear need for consolidation and standardisation away from the front counter,” Ms. Zhang explained. “Shared services very much fit with the mantra of ‘governed globally, delivered regionally’.”

For Ms. Zhang, the in-country franchises of McDonald’s are her customers. The SSC in Guangzhou currently supports three markets in Asia with migration of other markets underway. The scope is primarily finance and accounting.

The McDonald’s Global Shared Services (GSS) architecture operates at three levels to facilitate change while staying relevant. The first tier is the GSS Board, which provides the overall vision. At the second tier, Customer Councils provide guidance on SSC development based on customer needs. Finally, the GSS Organisation itself not only provides solutions, but also plays a role in championing the SSC model organisation-wide.

Ms. Zhang emphasised that a stable operating team has been critical to success. “Relationships between the SSC and country management need to be strong and we need to show that we are constantly learning from past experience,” she noted. “I am pleased to say we have had zero percent attrition at manager level over the past year.”

Ms. Zhang is a great example of the managerial talent now emerging in China; people who will drive the development of this industry over the next decade.

McDonald’s has 33,000 restaurants around the world serving 56 million people every day. Given it is such a decentralised organisation, McDonald’s is often hailed as the epitome of globally consistent quality and delivery. Shared services are playing an increasingly important role in meeting that yardstick.
Sustaining growth

A shared services centre can maintain a growth path by gradually expanding its range of services. However, growth brings potential pitfalls and the measures of success may change over time.

Edge Zarrella opened the final discussion of the day by asking how the panelists could continue adding value and whether KPIs changed over time. Eric Cheung, Managing Director, Re:Sources China, Publicis Groupe, was the first to speak explaining that, “We have sustained and grown [our shared services facility] by providing more services such as issuance of employment contracts or procurement.”

Shaun Tan, Vice President for Group Investment & Strategic Initiatives with AIA, added that talent was “a recurring theme and key to sustaining the business.”

Tammy Che, Business Unit Controller, PepsiCo China, felt that the retreat in process costs over time should reflect more clearly on the bottom line. She also agreed that talent becomes more important over time, but challenged the notion of a healthy attrition rate. “People will leave for money or for career development. So I define healthy attrition as a level that my HR department can cope with,” she commented.

Joseph Wong, Finance Controller for B&Q, remarked, “Don’t get in a rut of managing people as a process. To sustain the operation, think about the support and incentives you have. There are many incentives to start up, but an incentive to sustain would be a subsidy for training and development.”

Wong made a very clear distinction between attrition to the business, which should be regarded as a positive thing for morale and motivation, and attrition to the external market. “We had an unwritten understanding with our most talented people that there were opportunities for them if they remained loyal,” he explained.

Edge also asked the panelists about the importance of Service Level Agreements (SLAs). This can be the contractual foundation for a business relationship, but Edge wanted to know whether the document had become more or less important over time.

Mr. Tan mentioned that SLAs were a constant feature, whether internally with served countries or externally with country regulators. While the relationships are critical, the SLA is the contract by which the business is done, and provides stable reference points. Other panelists mentioned that SLAs were most often referred to in times of dispute; moreover it could act as a constraint when the SSC operator saw further opportunities to enhance the business or other processes they could help with. Cheung added that there was little benefit having a uniform SLA across different SSCs unless performance was managed consistently. Cultural and business environment factors often make that surprisingly difficult.

In this respect, the SLA requires fresh consideration whenever the scope of services expands.

A final discussion point related to cost and whether China’s SSCs could remain competitive in a rising cost environment. Ms. Che commented, “We are more customer-focused than cost-focused. So we won’t relocate just for cost. Maybe at some point in the future [we will relocate] once things mature.”

Mr. Wong remarked that “Rising costs will lead to certain inflexion points at which people re-evaluate [their strategy].”

The discussion highlighted some of the keys to sustaining growth, notably the importance of evolving the offering and staying committed to training and talent.
Special thanks to our co-sponsor, the China Council for International Investment Promotion (CCIIP)

About CCIIP
The China Council for International Investment Promotion (CCIIP) is a national non-profit organisation responsible for promoting China’s inward and outward investment in line with China’s economic strategies, with a view to advancing economic development and social progress. Founded by the State Council, the CCIIP reports to the Ministry of Commerce.

The objectives of the CCIIP are to synergise nationwide resources and capacities in investment promotion, and provide a unified platform for China’s investment promotion; to enable effective implementation of regional economic integration arrangements in line with the government’s overall investment promotion strategies; to assist governments at all levels in improving the investment environment, public image and Foreign Direct Investment quality; to develop diversified investment promotion products, and provide efficient service to foreign investors in China; and to facilitate Chinese enterprises investing overseas and participate in international economic and technical cooperation projects.

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