Centers of Excellence Development with in Multinational Corporations

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Abstract:

As organizations expand globally they often find it necessary or more effective to develop Centers of Excellence to reduce cost, improve the efficiency, or leverage organizational assets to improve some aspect of the innovation process. This article will look at the organizational issues involved in the development and launching of new Centers of Excellence in multi national organizations.

Globalization of corporate work forces has become a virtual norm. However, as globalized centers have proliferated and effectively matured, corporations are yielding far more than just the labor arbitrage benefits many companies originally envisioned. There has been a move toward new organizational structures as a source of value creation (Frost, Birkinshaw, & Ensign, 2002; Hammer, 1990; Mieg, 2014). The design of these structures have leveraged different skills and perspectives discovered when spanning diverse cultures and geographies (Birkinshaw & Hood, 2001). Among the factors that have contributed to the effectiveness of these structures are: a spillover effect from having resources in close proximity to each other (Allen, 1970; Eckenhofer, 2011), leveraging existing or developing pools of talent, logistical advantages of a geography, and embedding of individuals who act as connectors or brokers of information between locations and cultures (Amin & Cohendet, 2004; Granovetter, 1985).

The term Centers of Excellence (CoEs) has developed to describe a specific class of organizational structures that capture some of the effects outline above. However this term has developed a number of different meanings depending on the industry or context in which it is used; therefore, it has become necessary to define this term as part of any serious analysis. For the basis of this review a functional definition provided by Forst et. al. (2002, p. 997) will be used:

> [CoE is defined as:] *an organizational unit that embodies a set of capabilities that has been explicitly recognized by the firm as an important source of value creation, with the intention that these capabilities be leveraged by and/or disseminated to other parts of the firm.*

In their definition, Frost et. al (2002) go on to recognize that the development of CoEs is significantly more difficult to accomplish in foreign subsidiaries than in domestic subsidiaries due to cultural differences, logistics, and communications issues.

As CoEs have evolved, it has become increasingly clear that there are significant productivity gains to also be yielded by having large teams work on similar operations together, not only sharing best practices, but also enhancing the ability to drive standardization and in turn a more effective development and use of IT technology and tools. Many companies begin their globalization journey by centralizing the most administrative or procedural work first. Overtime however, the larger prize is to be able to move decision support activities, creative, or tacit tasks to globally centralized locations (CoEs) and away from traditional locations where labor costs are higher. However, since labor is not the only factor the ultimate goal is for the organization to be boarder agnostic and focus on efficient global information flow, capturing of talent, and leveraging of institutional knowledge. Petland (2014)has shown that optimizing the social physics that govern idea flow within an organization creates far more value than just the collection of high quality resources. Truly global organizations coordinate the flow of goods, information, people, skills, and capital on a global scale to meet the needs of the organization (Bowersox & Calantone, 1998; Hammer & Hershman, 2010).

This paper is part one in a series of discussions of initiating, running, and building business continuity enhancements needed as operations centralize and inherently have a greater concentration risk than dispersed business models. This paper will discus the aspects of initiating and setting up CoEs, as well as early success factors.

The options associated with reengineering verses executing a *lift and shift* (moving an existing operation) approach with a less aggressive modification of processes will be considered. In both cases there could be a heavy reliance on process reengineering or quality management processes such as lean six sigma, TQM, or TPS methodologies post shift. In many cases corporations are executing a hybrid type of an approach with some initial reengineering while primarily executing a lift and shift strategy. In addition the concept of going deep in a few skill areas verses going broadly across more skill areas will be explored.

Labor Costs and Geographic Portfolio

Labor arbitrage is clearly a strong consideration in any decision to globalize an operation. However, it should not be the only consideration. Labor arbitrage can be a fleeting benefit as wage scales change, competition for resources expand, as well as, technology and robotics (George, Ramaswamy, & Rassey, 2014). In net, a balanced approach across geographies can often yield the significant advantage in the long run when considering labor cost, talent acquisition, and the quality of the information flow within the organization. An example of this portfolio approach would be the growing trend utilizing domestic or near shore centers, often in the US Midwest with diverse international locations. This sort of strategy has been used by companies such as International Business Machines, Harley Davidson, Master Lock and many others (Lockwood, 2014).

Selecting the *right* number or mix of locations is of course situational, while it is a key consideration as noted for labor costs and business continuity, it is also important for, managing across cultural barriers, languages and time zones. A critical success

factor is the ability to seed CoEs with highly skill, culturally aware, expatriates or local talent who have extensive experience with the parent company who can act as brokers or cultural bridges. Brokers or bridges are intended to be the facilitators of the information flow, skills transfer, organizational culture and the environmental context necessary for their colleagues to effectively process information, share across the organizations, and innovate. Effective facilitators should be aggregating, curating, and integrating knowledge and providing access to information, as well as key insights from both inside and outside the organization (Bonache & Zárraga-Oberty, 2008).

CoEs are often created in developing economies or areas of the world experiencing rapid growth. Over time these environments typically develop an extremely competitive marketplace for talent (Storper & Venables, 2004). Centers that included multiple functions, such as accounting, planning, IT, customer billings and collections tend to have a greater efficiency advantage and can differentiate themselves from competition by offering a broader range of career options and in turn develop a more stable lower turnover work force.

Reengineer VS Lifting and Shifting Work:

There is no right answer to the question of the best way to get started in the development of a CoE. A strong case can be built for either approach. The benefit from starting with a reengineered process is that often to a large degree the process has already been standardized and the shift to the CoE is streamlined work that already has at some level been optimized. The offsetting cost of reengineering first is twofold. First the time to execution can be greatly extended, this has the consequence of extending the time to yield the centralization savings, increasing the overall cost of moving work and

delaying the benefits. It also begs the question as to whether decentralized operations can effectively reengineer a process as effectively as one that has been centralized under one set of management with a steep productivity target as a motivating factor to innovate process improvements (Hammer & Hershman, 2010).

Existing processes have the problem of functional relevance. Often when they are created they are appropriate to a specific business environment and problem; however, if left unattended over an extended period of time or if moved to a different environment they my loose their functional relevance (Kuhn, 1996; Peters, 2003). One could argue that while the lift and shift approach does carry some inherent inefficiencies by duplicating out dated or inefficient existing processes, it has the benefit of turning a set of *fresh eyes* loose on the issues, who are not encumbered by the history of how things have been done in the past. This cultural issue should not be under estimated. It is simply human nature to often cling to old ideas if they had been *invented here* or had been effective in the past (Kuhn, 1996). A new team of employees with no history can often take a more objective view of the process. These new employees often lack institutional knowledge, but they more than offset that with their energy, open mindedness and given that they are typically young and recently out of Universities or other training programs, they tend to be rapid technology adapters.

Many companies are finding that taking a hybrid approach and not fully relying of reengineering or solely lift and shift allows them to take the advantages of the benefits of both approaches while minimizing the costs. By doing a limited level of reengineering, while lifting and shifting work, allows the enterprise to yield the low lying fruit from the reengineered process improvement, while minimally slowing down the

shift, so as to yield the labor cost benefits and ultimately organizational efficiencies faster. This approach also still leaves significant room for the new CoE employees to innovate and drive additional process improvement since the company does not consider the process changes near completion and continues to set high expectations of standardization and productivity on the CoE. The implementation of this could be based on principles from lean six sigma, TQM, TPS, or any number of quality management or reengineering protocols.

Organizational Diversity

There is no one right answer on the number of locations. However, there are several key considerations. First is scale. The most efficient approach is for a function to *piggyback* its new operations in a location where the company already has other operations, such as manufacturing. This allows them to take advantage of avoiding the duplication of infrastructure, such as Human Resources, Legal, Security, etc., and to move faster as there are often *seed* skills that can be tapped to enhance leadership at a much less expensive cost than international assignees.

If an enterprise needs to take a *green field* approach, the decision points become more complicated. First they must consider scale. If a company is not large enough to have scale in a location, any savings are likely to be lost in duplicate structures. Furthermore, scale depends on where in the world a company chooses to centralize and how diverse that cultures are between the locations. Increases in efficiency or innovation attributed to diversity are often an inverted U shaped curve. Small amounts of diversity can lead to mingling of ideas and perspectives can dramatically improve outcomes; however, there is a point of diminishing returns where too much diversity

prevents participants from communicating. For example, many US companies could set up an operation in the US Midwest with a much smaller scale, than perhaps a similar operation in India. First, most US companies understand the market, Universities/recruiting, real estate and all the key elements for developing and staffing a location. In addition there are few cultural barriers and key seed skills are easier to acquire. On the other hand, developing a location in India, as an example, is much more difficult, every aspect of infrastructure is more difficult, most locations need to be hardened to some degree due to uncertain power, recruiting is much more complicated, cultural issue abound and in some cases it is required to get employees to and from work since there may be little transportation infrastructure. As operations move up the value chain, the need to work on a base time zone becomes even more critical. Often a large segment of the potential work force can is eliminated, due to cultural issues with women working night hours. It may make more sense for a company that does not have enough scale, but would like to off shore, to consider using outsourcing partners who already have the needed structure locally.

If an enterprise has the scale to manage their own captive locations, the decision of where to locate will depend greatly on the *home* locations they will be supporting. For example, at higher skilled roles, finding people willing to work off shift for long periods of time can become difficult. Therefore, it may make sense to have an operation in Eastern Europe or the Middle East / Africa to support Western Europe in the same time zone, or supporting the US by utilizing Mexico or Costa Rica. Using such a structure might minimize cultural, time zone based logistics, and language issues.

There are however many issues that are not obvious that may need to be considered. Covering just a few examples: Operations in the Middle East often do not have Friday work hours, often a critical day for the countries they support. While English skills in Mexico among professionals tend to be strong, if they are supporting Canada, then some level of French speakers becomes an issue. Companies that invested heavily in Brazil have found that rapid increases in labor costs narrows the gap at lower levels and by mid professionals the cost is potentially on par with the US Midwest. Another difficult to predict situation is the shifting tides of the labor markets in countries like Argentina where there has been legislation that has become decidedly unfriendly to business. Lastly, one will find that particularly in Latin America and Asia Pacific countries, the gap in labor cost narrows very rapidly at the more senior professional levels, often making it uneconomical to shift the highest complexity work to many locations.

All this leads to a conclusion that if a company has the scale to manage a diverse set of locations many risks and uncertainties can be better mitigated. In developing their strategy firms should consider their absorptive capacity when it comes to diversity of thought, new organizational knowledge, their ability to reengineer, and integrate differences within the organization (Boschma, Eriksson, & Lindgren, 2008). While in this paper we are not intending to take a deep look at business continuity issues, the greater the diversity of locations the greater the business continuity risk that can be managed, as it stands to reason that as operations centralize business continuity risks expands greatly. Depending on the location, it may be more acute than in other

locations. For example in many parts of the world there is not only the risk of natural or pandemic type disasters, but also the geopolitical risk can be much higher.

Other key consideration, in addition to time zone coverage and language skills, is the depth of the educated work force pool to draw from. There are *creative commons* which have developed and continue to develop around the world (Pasano & Shih, 2009). These are place that have depth of talent in key talent areas such as software development or manufacturing. As competition for skills tends to agglomerate around successful locations, staffing can often become circular among competitors driving up labor costs; however, there is also tremendous fluidity in the movement of ideas, skills, and technology. Time zone coverage should not be an aspect that is taken lightly. In many countries, off shift work is not the cultural norm, nor does it come without added infrastructure costs to accommodate second or third shifts. In other locations such as India where off shift work is common, it is also typical that as an enterprise hires people at higher skill points in the value chain, they have more options and while they may be willing to work off shift for a period of time, it will drive even higher than normal attrition levels.

Pre-Launch Procedures

Once all the key location considerations have been evaluated and a select location or locations has been determined, there are several next steps to lead to a successful transition.

First is to establish a very disciplined approach for documenting and actually shifting the work. Documentation of tasks on the surface would appear simple, but many companies find that while they may have procedural or tacit knowledge, which

require some level of experience in situ; therefore, it is difficult to move these procedures to a new and largely inexperienced team without extensive training (Alnuaimi, Singh, & George, 2012). Developing a methodology for the training and the *hand off* or the *go live* point is critical. Often there is a period of time before the employee/manager in the new location is ready to take on the new tasks independently. This is far more complex than it appears on the surface. Often an employee/manager at the sending location is losing their job, they not only will have motivational issues to do training, there may also be legal or union issues. However, in most instances where the methodology is cut short, the results tend to be less robust then when there is adherence to the established process.

Many organizations infuse strong and experienced leadership to help facilitate a startup location's success, particularly since the CoE is typically hiring a new and inexperienced work force. Often this works; however, it is extremely important that the culture of the manager and the team be assessed before making such a move. Issues like communication style, evaluation of employees, processing of rhetoric, leadership styles, disagreement styles, trust, scheduling of work, power distance, independence / collectiveness, etc. should be considered in management and leadership decisions (Hofstede, 2009; Meyer, 2014) If executed properly, this can be another leverage point to minimizing labor costs since, it allows the center to leverage a small number of subject matter experts to improve the over all productivity. In addition to the expected labor cost and productivity benefits, often this scaling effect can allow the company to utilize on average a lower skill or band level of the average employee.

The CoE needs to be built to manage a higher level of attrition than the traditional work locations. First, in many of the emerging market locations, a higher attrition level is simply the norm that companies deal with (Zheng & Lamond, 2010). However, a managed but higher than traditional level of attrition may be a desired state as a means to manage to a lower average labor cost, as newer employees are often less expensive than the people they are replacing as they have had some natural movement up the compensation chain. The key is to manage this attrition to not only a reasonable level, but to ensure that programs are in place to retain the highest skills who will develop into future leaders in the CoE, in turn reducing the need for expensive assignees.

One of the most critical mechanisms for managing an inexperienced and higher turnover work force is to develop highly extensive and robust training programs (Newman, Thanacoody, & Wendy Hui, 2011; Zheng & Lamond, 2010). These programs are most effective when they are twofold. First is focusing on job specific training, but additionally, skill training that transcends specific jobs, such as systems, communication, business acumen and developing productivity methodologies such as lean six sigma. Lean six sigma is particularly critical for driving productivity in intellectually based processes. First it is common framework that teams can focus around, typically beginning with relatively small projects, moving toward larger more comprehensive processes as skills develop. Secondly, it tends to spread in use almost virally throughout an organization as the staff see its value internally and perceives it to have strong external value to their careers.

Companies tend to take one of two approaches to moving decision support activity into a CoE. Neither approach is inherently better, they just offer two contrasting options that should be tailored to the complexity and needs of the organization. The first approach is to go deep quickly in one particular functional area and then systematically spread to other areas. The alternative approach is to go broadly across many functional areas, but in a much more shallow manner and then systematically expand deep. Both of these alternatives have pro's and con's and are not mutually exclusive as there can always be a middle ground approach. The pro of going deep is that typically this approach can allow a company to move more quickly into the centralized operation, yielding the benefit faster. The con is that skill based is narrower and career paths can be perceived as less robust. Alternatively, going shallow and board, will often take longer, but the pro is that the skills developed are broader in capability and the staff will perceive more alternatives in their career path, which is certainly a strong recruiting tool in the market place for skills (Borini, Fleury, & Fleury, 2009; Inzelt, 2008; Kiessling, Harvey, & Dabic, 2008).

Post- Launch

After the CoE is established and fully operational, there are two additional success factors. First is to rapidly develop the highest skilled staff to *localize* leadership. Second, unlike a back office operation, where the operating unit general management (GM) is fairly indifferent about how the work gets done, as long as it gets done effectively. For example, the unit GM should not care how an accounts payable operation executes the job, as long as 99.9% of the bills are paid on time, discounts taken and operational costs achieved. When it comes to decision support activities, the

unit GM does very much care how the work is done and is intimately tied to the results. According, one of the final operating success factors is that the CoE should never silo themselves from the units that they support, but form one integrated team that is agnostic to locations, boarders, or time zones.

Lastly, is the ongoing debate about the benefits of running a company owned CoE, as this paper has described, versus, simply outsourcing an operation. The key differentiating factors are not only the issue of scale described above, but also, whether an operation is both critical and strategic. If it meets both of those criterions, it would not likely be a candidate for outsourcing. While clearly operations that are neither critical nor strategic are strong candidates for outsourcing, the tough decision falls into that middle zone where the operation is deemed to be critical, but not necessarily strategic.

Conclusions and Implications

A successful CoE, should not only deliver lower labor costs and higher productivity, it allows for new organizational structures that position the organization for significant growth in innovation and efficiencies. However in order to achieve these benefits a series of critical success factors must be substantially achieved which include:

- Selecting the right location or locations balancing the labor savings potential, with the skills in the location, the time zone compatibility with the respective mission and language skills and cultural compatibility. While labor cost is an important consideration it should be balanced among the other success factors. Further, the labor cost is best managed

by having a diversity of locations, since the movement of labor markets and currencies are very hard to predict on a long-term basis.

- Having a highly disciplined approach to the transfer of work, as well as, a strong leadership organization, in most instances dominated by expatriates, while local skills are developed technically and in alignment with the organizational culture. In addition, operational integration can have a profound impact in both the initial and long-term viability of a CoE location.
- It is also critical to have an organizational structure that is oriented around offering a very high level of ongoing training and the ability to seamlessly manage a much more than traditional level of attrition is key managing a strong and vital operation.
- Lastly, the mentality of the CoE organization should be built on supplying a robust level of service, while at the same time having endless drive toward year after year productivity gains.

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