The version of the following full text has not yet been defined or was untraceable and may differ from the publisher's version.

For additional information about this publication click this link.
http://hdl.handle.net/2066/74887

Please be advised that this information was generated on 2018-11-27 and may be subject to change.
Shared service centers and governance structure change: A transaction cost economics approach

Reinald Minnaar
Ed Vosselman

Nijmegen Center for Economics (NiCE)
Institute for Management Research
Radboud University Nijmegen

P.O. Box 9108, 6500 HK Nijmegen, The Netherlands
http://www.ru.nl/nice/workingpapers
Abstract

A case study (PCM-newspaper publishers) demonstrates how the governance structure of a publisher is altered as a result of the changing relationship between business units and a shared service center (SSC). Drawing on a model based on transaction cost economics (TCE) we try to find theoretical explanations for the observed changes. In turn, these explanations may provide managers with economic arguments to support the choice of certain governance and control structures related to (shared) services.

In the case company, only to a certain extent the choices prove to be consistent with our theoretical model. Particularly, based on our model we would have expected an unambiguous choice for a concentration of the selling of advertisements in a shared service center. Moreover, based on our model we would have expected business unit management to have the freedom to outsource the selling of advertisements to external parties (no captive relationship with the shared service center).

It proved out, however, that business units decided to sell a major part of the advertisements themselves. The paper suggests a number of explanations for this divergence.
Biographical note

Reinald Minnaar* is a senior lecturer Accounting at the Faculty of Management Science at the Radboud University Nijmegen. This research is part of his PhD study on governance and control of shared service centers.

Ed Vosselman† is professor of accounting at the Faculty of Management Science at the Radboud University Nijmegen. His research is on accounting and control in inter-firm relationships and on performance management. His work is published in major journals such as Accounting, Organizations and Society, Management Accounting Research and Journal of Organisational Change Management.

Acknowledgements

The authors are grateful to Paula van Veen-Dirks and Kaleem Zahir-ul-Hassan for their valuable feedback. Furthermore, this article benefitted from fruitful discussions within the Accounting Department of the Radboud University and the Research Center on Accounting and Control Change.

* Reinald A. Minnaar (corresponding author), Nijmegen School of Management, Radboud University Nijmegen, Ph: +31 24 3611765, Fax: +31 24 3612379, Email: r.minnaar@fm.ru.nl
† Ed G.J. Vosselman, Nijmegen School of Management, Radboud University Nijmegen, Email: e.vosselman@fm.ru.nl
1. Introduction

An organizational concept that became popular during the mid nineties is the concept of a shared service center (SSC) in which non-core activities of business units are concentrated. An SSC is a rather independent organizational unit that provides services to other organizational units that originally perform these services within their own unit (‘in house’). The SSC concept is closely linked to the widely used multidivisional structure. The advantage of a multidivisional structure is the delegation of powers and responsibilities to the organizational level where the relevant information and knowledge is available. This at least partly solves the problem of information asymmetry within organizations. However, the disadvantage is that each business unit is engaged in tasks that do not belong to its core business, such as HRM, IT and Accounting and Finance. Because of improved ICT, it is now possible to concentrate these kinds of tasks in a separate service unit and to realize economies of scale. By introducing such a service unit (an SSC), the benefits of a divisional business organization are kept, but without the cost disadvantages (Strikwerda, 2005). Non-commercial organizations, such as ministries, municipalities, hospitals and universities, have also started to embrace the concept and set up SSC’s for supporting tasks (Janssen & Joha, 2006).

This article will examine the impact an SSC has on the governance structure or management control structure of service transactions. What changes occur in the institutional frameworks and incentive structures that ultimately aim to increase the effectiveness and the efficiency of the services? The research takes place against the background of a model designed by Vosselman (2002). In that model the concentration of supporting services is linked with the horizontalization of management control relationships. This paper further develops the model by focusing on management control issues with respect to an SSC.

The remainder of this paper has the following outline. First, the background of SSC's is addressed. Then a TCE-based model will be described, with particular attention to the

---

1 In this article the figure of Janssen & Joha (2006, p. 103) is slightly adjusted as we do not find it relevant to include a staff department. A staff department can also be organized as a central department.
underlying transaction cost economics theory. In a next section the model is tailor-designed to issues regarding the choices in the governance structure of supporting activities (services). Then significant changes in the governance structure of services in the case company (PCM Publishers, PCM hereafter) will be described and analysed against the background of our theoretical model. The paper ends up with a conclusion.

2. SSC’s and a TCE model

2.1. Shared Service Centers

Case studies performed by Strikwerda show that the term SSC is used quite diversely. It is used for independent organizations in low wage countries who deliver worldwide services to other organizations, as well as for departments within organizations that provide supporting services to several other internal departments. Strikwerda distinguished six different types of SSC’s that vary from SSC’s in the form of a central staff department to Business Process Outsourcing (Strikwerda, 2005, p.75).

Jansen and Joha (2006) use a narrower definition and make a strict distinction between an SSC, a central staff department and outsourcing. A central staff department (centralized model) provides top management with relatively much influence at the expense of a customer orientation, whereas outsourcing implies a relationship between business units and external market parties based on formal contracts (see also Bergeron, 2003). An SSC, however, is standing close to the internal customer (the business units) and the internal customer has a degree of ownership over the service. Based on Janssen en Joha (2006, p.103) this distinction can be depicted as in figure 1. The dotted line defines the boundary of the organization at large.
2.2. The choice of a governance structure

The characterization in figure 1 suggests that outsourcing business activities by business units can take place both internally in a hierarchical structure, and externally in the market. A theory that is strongly involved in the choice between hierarchy and market is transaction cost economics (TCE), as to a large extent developed by Williamson (1979; 1993; 1996; 2000; 2002).

This theory forms the basis for research into the choice of governance structures between organizations (Dekker, 2004; Langfield-Smith & Smith, 2003; Nicholson, Jones & Espenlaub, 2006; Van der Meer-Kooistra & Vosselman, 2000) as well as within organizations (Speklé, 2001; Speklé, Van Elten & Kruis, 2007; Vosselman, 2002). From the new institutional transaction cost theoretical perspective, a governance structure is an “institutional framework within which the integrity of a transaction is decided” (Williamson, 1979, p.235). Williamson (1996; 2000; 2002) distinguishes three generic governance structures: markets, hierarchies and hybrids. In the hybrid structure, both
market elements and hierarchical elements can be found. At the basis of TCE-reasoning lies the assumption that individuals consciously and rationally choose for a certain governance structure. It is assumed that the different individuals involved have different kinds of information and knowledge, and that the governance structure should be constructed in such a manner that this information and knowledge is activated in the best way. TCE also assumes that the parties involved may act opportunistically. Opportunistic behavior is the seeking of self-interest with forms of trickery and deceit. Parties are mainly concerned about their own interest and are assumed to have the propensity to distort relevant information to their advantage. The governance structure has to compensate for such potential opportunistic behavior. Starting from the position of a market as a generic governance structure, the possibility to compensate for potential opportunism by market-based controls decreases as parties get more dependent on each other. It then may become efficient for parties to switch to a more hierarchical based governance structure.

Although TCE primarily focuses on a generic level, we more specifically draw on this theory to explain governance and control choices both within and between organizations. In the context of this paper the concepts governance structure and management control structure are used as synonyms. Both concepts refer to controlling and incentivizing managerial behaviour in order to increase the effectiveness and efficiency of the operations (Van der Meer-Kooistra & Scapens, 2008). Vosselman (2002) developed a

---

2 We agree with the choices Van der Meer-Kooistra & Scapens (2008, p. 368) make concerning the control of lateral relations. They prefer the term governance above the term management control. They perceive the term governance to be a broader term that encompasses all kinds of formal management control mechanisms and practices that are put in place by management. In turn, important in depth categorizations in management control include for instance a categorization made by Simons (1995). He makes a distinction between diagnostic control systems, beliefs systems, boundary systems, and interactive control systems. Another categorization is for instance that of Van Veen-Dirks & Wijn (2002). They use a triad of control forms: diagnostic, interactive and strategic control. In our paper, in stead of deepening the concept of management control we broaden it and for that reason we link up with Van der Meer-Kooistra and Scapens (2008).
A TCE-based model, containing a number of archetypes of management control from which decision makers can choose. Each archetype contains a distinct and identifiable group of control elements and practices (see also Spekle, 2001). The model differentiates horizontal management control archetypes from vertical management control archetypes. Horizontal management control opens up the possibility to introduce a market mechanism, while vertical management control is characterized by a hierarchical mechanism.

Horizontal management control is in fact the counterpart of vertical management control with a top-down control structure. Horizontal management control may imply internal client-supplier relationships between essentially equivalent and relatively autonomous business units. To a large extent, control over the supplying unit (such as an SSC) is then executed by the buying business units. The introduction of an SSC implies the development of such horizontal management control.

Vosselman’s original model is depicted in Table 1. It relates important choices in the governance structure of services to three critical dimensions of transactions: the characteristics of the services (standardized, customized and highly specialized), the frequency of the services and the degree of complexity of the service. In certain combinations these dimensions lead to a choice for a specific governance structure.
<table>
<thead>
<tr>
<th>Characteristics of the services</th>
<th>Frequency</th>
<th>Degree of complexity</th>
<th>Governance structure(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highly specialized</td>
<td>Recurring</td>
<td>Low to high</td>
<td>No centralization(^3) at all (decentralization)</td>
</tr>
<tr>
<td>Highly specialized</td>
<td>Occasional</td>
<td>High</td>
<td>No centralization at all (decentralization)</td>
</tr>
<tr>
<td>Highly specialized</td>
<td>Occasional</td>
<td>Low to intermediate</td>
<td>Horizontal management control with captive buying and selling</td>
</tr>
<tr>
<td>Customized</td>
<td>Recurring</td>
<td>High</td>
<td>No centralization at all (decentralization)</td>
</tr>
<tr>
<td>Customized</td>
<td>Recurring</td>
<td>Low to intermediate</td>
<td>Horizontal management control with captive buying and selling</td>
</tr>
<tr>
<td>Customized</td>
<td>Occasional</td>
<td>Low to high</td>
<td>Horizontal management control with a tendency towards captive buying and selling</td>
</tr>
<tr>
<td>Standardized</td>
<td>Occasional</td>
<td>Low to high</td>
<td>Horizontal management control with free buying and selling; external buy-out; complete outsourcing</td>
</tr>
</tbody>
</table>

Table 1. Transactional features and governance structure.\(^4\)

The management control structures or governance structures in the model range from complete decentralization, where business units conduct the services themselves, to outsourcing. Essentially, the model predicts that an organization or a business unit will keep a frequent and complex specialized service within its own boundaries and will

---

\(^3\) Vosselman (2002) does not distinguish between centralization on the one hand and an SSC on the other, as is done by Janssen & Joha (2006). In his article centralization entails combining supporting services that originally were conducted within business units. This means that centralization in Vosselman is per definition the forming of an SSC.

\(^4\) This table is based on Vosselman (2002, p.144), but the order of the table is reversed as this is more in line with the explanation of the table in the text.
exercise hierarchical control. At the other extreme, a standardized service, regardless of frequency and the degree of complexity will, according to the model, be governed by the market.

In the next section, in order to serve as a basis for the analysis of the PCM case study the model will be further tailor-designed to choices regarding SSC-related governance.

2.3. Governance structure choice and an SSC: a theoretical model
In this section, the model will be tailor-designed to choices related to the governance of services that (to some extent) are or will be concentrated in an SSC. First, the focus will be on potential governance structures that may result when the decision to implement an SSC is part of the decision making. Second, the factors that influence the choice of the governance structures (characteristics of service, frequency and complexity) will be related to the choice of the governance structure.

Governance structures
The governance structures distinguished in the model depicted in Table 1. are categorized on a scale of market-oriented governance (outsourcing), to hierarchical governance (decentralized model). This analysis focuses on organizations that already have established an SSC, or organizations who are considering to establish one. In a way, the business units within the organization are then confronted with a make or buy decision. Will they conduct the services themselves or are they going to internally or externally outsource the services? Internal outsourcing involves the divestiture of services to an SSC; external outsourcing involves the divestiture of services to a third party or third parties. This last option is of course only possible when there is no ‘captive buying or selling’: business unit management then has the opportunity to outsource to external parties. If the service is outsourced internally to an SSC, but the internal client has the possibility to switch to a third party, there is relatively much market-based control. This possibility will be experienced by the SSC-management as an exit threat, which threat is essential in a market mechanism. The pressure of external parties thus adds to more bureaucratic forms of control exercised by business unit management and to hierarchical
control exercised by senior management. The market mechanism thus enters the organization and complements more bureaucratic and hierarchical mechanisms.

Market-based controls are even stronger in governance structures that correspond with external buy-out and outsourcing. With an external buy-out, the SSC is placed outside the boundaries of the organization, thus putting less emphasis on hierarchy and more on market. In comparison with an SSC governed by buyer-supplier relationships with free buying and selling the balance further shifts from hierarchy to market. However, in case of an external buy-out a connection between the new and rather independent service organization and the mother organization will continue to exist, for example by means of long-term contracts and/or a majority of the shares. Weak forms of hierarchical control will still remain active.

The most extensive form of market-based control is connected to a complete outsourcing of the service. In this case top management of the mother organization has no control over the transactions of the supporting services anymore. By way of contracting, the business units try to ensure an adequate service level.

In practice though, the choice for a complete outsourcing of a service may be made gradually. The process may start with the introduction of an SSC, after which an external buy-out may take place. Eventually, business units may get the freedom to structurally opt for alternative suppliers. The latter resembles the free market situation (Koene & Van der Pijl, 2005).

In sum, based on Vosselman’s model the following governance structures can be distinguished (figure 2).
The governance structures within the dotted frame are governance structures that, at least partly, exercise control by market pressure.

The question now is which factors determine the choice of the governance structure, or, more specifically, which factors determine the balance between market-based controls and hierarchy-based controls?

Determining factor 1: Characteristics of the services
We claim that the classification of services in three categories (standardized, customized or highly specialized) as it was made in the original model can be simplified. Our claim rests on the assumption that the main consideration of a business unit manager will be whether the service should be tailored to its needs (customized) or whether there is a standardized service.
The distinction between a standardized and customized service is closely linked with the concept of asset specificity (Williamson, 1979; 1996). Asset specificity is the degree to which the resources for delivering the service are transaction-specific, i.e. specifically determined by the specific transactions with a specific customer. Resources for standardized services are not transaction-specific, resources for customized services are to a greater or lesser extent. If the services are mainly of a standardized nature, the likelihood of opportunistic behavior by the supplier is low, and if it occurs, it is easy for the client to switch to another supplier. In this case a horizontal governance structure containing relatively much market-based control would be efficient.

As the desired level of customization of the service increases, the business unit manager is expected to ‘keep it close to himself’. He will experience a risk of opportunistic behavior by a potential (internal) supplier, to whom he will get ‘locked in’ as a consequence of the required specific knowledge and/or required specific other investments in the relationship. Therefore, he will consider it to be more efficient to keep the service ‘in house’. As the level of customization increases, he is assumed to prefer hierarchy-based controls over market-based controls. Schematically this can be depicted as in figure 3.

![Figure 3. Customized services and governance mechanism](image-url)

We furthermore theorize that the way customized services are to be governed will depend on the degree of complexity.
Determining factor 2: Degree of complexity

We claim that a business unit would like to keep complex customized services close to her own organization. Outsourcing complex services can increase the dependency of other organizations as knowledge and skills are lost; a so called locked-in situation may emerge. In order to circumvent possible opportunistic behaviour that emerges as a consequence of such a locked-in situation, the control balance shifts into the direction of hierarchy-based controls. On the other hand, simple customized services shift the control balance into the direction of market-based controls. For example: the cleaning of office space, which is a relatively simple service, will allow for relatively much market-based control (preferably in an outsourcing relationship), whereas the cleaning of a hospital surgery room, which is a complex service that requires very specific proceedings, will ask for relatively strong hierarchical control. This step can be visualized as in figure 4.

![Complexity of the service and governance mechanism](image)

Figure 4. Complexity of the service and governance mechanism

Determining factor 3: frequency

Yet another factor influencing the governance structure of, particularly, customized services is the frequency of the services. An occasional customized service can for instance be done by the internal SSC, since such a center assumingly has more knowledge to deliver such services than the business unit itself. In case there is no SSC available, such occasional customized services might be expected to be outsourced to external parties, since the advantage of better skills and knowledge is likely to exceed the disadvantage of possible opportunistic behaviour. In contrast, recurring customized services may lead to more hierarchy, as this will prevent opportunistic behaviour from...
occurring while at the same time opportunities for economies of scale can be created. Schematically this looks like figure 5.

Figure 5. Frequency and governance structure

2.4. Summary of the model

Figure 6 links the governance structure with the type of service (customized or not), the complexity of the customized service (simple or complex) and the frequency of the customized service transaction (occasional or recurring).
Figure 6. Transactional factors and governance structure

Figure 6 shows that complex customized services may efficiently be performed by an SSC with captive buying and selling, or in the business unit itself. The choice between an SSC with captive buying and selling on the one hand and the business unit on the other hand, heavily depends on the frequency of the services. The more frequent the complex customized services are, the more reason to perform the service activities within the own business unit. High frequency of complex customized services makes it possible to efficiently acquire and use the capacity needed for the delivery of the services ‘in house’, while at the same time benefiting from short communication lines. In other words: both
economies of scale (efficient use of capacity) and transaction costs (costs of coordination of these complex services) indicate that recurring complex customized services should be done within the business unit. Incidental complex customized services on the other hand are more efficiently governed within the existing SSC since centralization of supporting services makes a better use of capacity possible. As long as this advantage is bigger than the disadvantage of higher transaction costs, a business unit manager’s choice for an SSC with captive buying and selling is an efficient one. The captiveness of transactions prevents transaction costs as a result of potential opportunism by an external party.

Relatively simple customized services needed on a regular basis can also be organized in an SSC with captive buying and selling. Concentration of those activities in a specialized service center generates economies of scale while transaction costs are relatively low. For simple customized services, the role of frequency is such that incidental transactions are better governed via the market then via an SSC with captive buying and selling.

The next section contains a description of a case study conducted at PCM. Then, the data will be confronted with the insights form the model depicted in figure 6.

3. PCM case study

3.1. Case company

PCM is a publisher of daily newspapers and books. The financial data and headcount over 2006, 2007 and 2008 are depicted in table 2.5

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales  (x €1.000)</th>
<th>Net Profit (x €1.000)</th>
<th>Employees (fte)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>670.989</td>
<td>6.369</td>
<td>2.907</td>
</tr>
<tr>
<td>2007</td>
<td>644.287</td>
<td>23.991</td>
<td>2.645</td>
</tr>
<tr>
<td>2008</td>
<td>629.499</td>
<td>(180.041)</td>
<td>2.423</td>
</tr>
</tbody>
</table>

Table 2. Data PCM Publishers

In this case study we focus on the main newspapers published by PCM, namely De Volkskrant, NRC-Handelsblad (including nrc.next; from now on we will just use the name NRC) and Trouw, and on the SSC that is responsible for the advertisements revenues, called PCM-Media. The core activities of the newspaper business units are the gathering and reporting of the news and the selling of the newspaper. The most important sources of income are therefore the revenues from selling the paper and the revenues from selling advertisement space.

3.2. Research method

Data were collected using a qualitative research method in the form of a case-study (Baarda, De Goede & Teunissen, 2005; Miles & Huberman, 1994; Silverman, 2005). The case study began in November 2007 with the aim to identify relationships and structures related to horizontal forms of management control. Ten semi-structured interviews were conducted with several persons, among others the CEO, the financial director, two successive directors of PCM Media, the publishers of the newspapers and other persons in and outside the organization who were closely involved with the change of the governance structure. In addition, relevant documents were collected, such as annual reports, service level agreements and minutes.

The interviews were centered on issues concerning changes of the governance structure (the management control structure) regarding advertisements within PCM. The open questions particularly (but not exclusively) focused on ‘in house’-activities and (internal) transactions and on the way these activities and transactions were controlled.

After we finished our case study, many things changed at PCM. The organization was taken over by the Belgian Persgroep, the newspaper Algemeen Dagblad (AD) is again fully owned by PCM and NRC and the books divisions are for sale (fd.nl 18-6-2009). PCM-Media Merged with the advertisements sales department of the Persgroep and is as of September 2009 called Persgroep Advertising. “With the newspapers AD, De Volkskrant, Trouw, NRC Handelsblad, nrc.next and Het Parool in their portfolio, the Persgroep is the largest newspaper publisher in the Nederlands” (http://www.pcm.nl/docs/bpWebsite.asp). It would be interesting to conduct a follow up study to the governance structure of this new SSC within the Persgroep.
We investigated challenges and problems and solutions regarding the (governance of) advertisements and emphasized the role of the interviewees. The data were then analyzed using the model we developed in the previous sections. The reading of relevant theoretical work, discussions with colleagues, several presentations of earlier drafts of this paper and feedback of reviewers has led to the paper in its present form. 7

3.3. Changing governance structure at PCM

During 2007 a committee consisting of selected executives prepared a plan for a new management control structure or governance structure for PCM. An important reason for this was that revenues from advertisements decreased due to increasing competition of other media such as television and internet. Business unit management was faced with a decrease in profits, and they felt dissatisfied about this. In their eyes PCM-Media (a separate department that among other activities sold advertisement space) was underperforming. Moreover, they felt that the board of PCM was failing in their responsibilities. According to the CEO:

“When I go back to the past, I see that cooperation between the newspaper business units and PCM-Media was far from optimal. I think that this partly had to do with the assignment of PCM-Media. It was able to operate independent from the business units. There wasn’t much accountability. During three years there was no accountability at all. You saw many frictions between the business units and PCM-Media, because when sales dropped they immediately blamed PCM-Media of course, but the source was the lack of well prepared plans. How much effort can I expect and at which clients? How are you going to do that and also how are you being held accountable; what was the performance in comparison with the original plans?”

The old structure can be depicted as in figure 7.

7 Among others we drew on Nicholson, et al. (2006) for the methodological approach. The main theoretical source was (Vosselman, 2002).
In this structure the newspapers operated as departments who were only responsible for making the newspaper and for consumer marketing. Other business processes such as sales, HRM and strategy were centrally controlled. Sale of advertisements was organized in a separate department (PCM-Media), but, from the point of view of the paper business units, was seen as a centrally controlled unit and not as a business partner that delivered services as an SSC would do. Based on the definition of Jansen & Joha (2006) business unit management perceived PCM-Media to be a central department as depicted in figure 1.

The main reason to change this structure into the direction of an SSC was because the executives of the newspapers were held responsible for their profits but couldn’t control the advertisements revenues and costs. PCM-Media operated very independently and cooperation with the newspapers was rather poor. The newspaper executives wanted their profits of course to be as high as possible and, therefore, aimed at an increase of their parts of the revenues of PCM-Media. For that reason, PCM-Media and the newspapers tried to make budget agreements at the beginning of the year about the revenues. In some cases, however, such agreements were not brought forward. But even when management
succeeded in making an agreement, there was no instrument for the business units to enforce the agreements. Moreover, the costs PCM-Media charged to the business units were not negotiated, but were simply calculated and allocated by the financial department of PCM. This increased the perception that PCM-Media was just a central department; there was definitely no clear client-supplier relationship between the newspaper business units and PCM-Media. Service Level Agreements (SLA’s) were made, but were of no significance to the players in the field. The director of PCM-Media commented on this, saying:

“In the past we also made SLA’s, but we didn’t do much with them. They remained in the drawer. We have the intention to change that in 2008 and onwards, and make better business agreements.”

Under the old governance structure, PCM-Media was responsible for everything that was connected to advertisements sales; from making contacts with clients to back office activities. Advertisements space was sold via media agencies, or directly to organizations. The back office was responsible for invoicing and other administrative services.

The relation between the various constituencies can be depicted as in figure 8. In this picture the word ‘agreements’ is purposively put in quotes, as it is difficult to consider them to be ‘real’ agreements.

![Figure 8. Old structure sales of advertisements](image)

On the basis of the committee’s advice a change process was started that eventually resulted in a new structure in which functional tasks were decentralized to the newspapers. This change process was not always easy. The project leader of the change process communicated about this:
“It is changing, but some time ago we hired a consulting agency and they spoke with all the big chiefs and wrote: ‘PCM bashing is a sport, even now.’”

This quote indicates that PCM had a culture of resistance to everything that came from the board of PCM. Also the phrase “the ministry of newspapers” was heard during the interviews.

Although changes are still going on, at the end of 2008 the contours of a more permanent structure became visible. The organizational layer Newspapers was removed and the newspaper units were transformed from mere departments to profit centers. The new structure is reflected in figure 9.

![Figure 9. New structure PCM](image)

In this new structure PCM is functioning as a financial holding who keeps more distance from the activities of the newspapers (business units). The business units are controlled by a two-headed management, a publisher and an editor. The publisher is responsible for the business decisions of the business unit. The relationship between the business units and PCM Media also changes. The business units are unmistakably responsible for profits and get more freedom to realize their ambitions. This opens up the possibility to start advertisements sales themselves and to start a better and more equal business relation with PCM-Media.

This eventually led to a new governance structure of advertisement sales, enabling business unit management to indeed conduct a part of the sales activities themselves. In the PCM-strategic plan for 2008 it is described as follows:
Advertisements sales will become a commercial core activity for the business units, instead of a supportive activity, and the organization has to be structured accordingly. The director/publisher is responsible for advertisements sales in a model that is based on autonomy for the separate business units.

The paper business units and PCM-Media made a classification in their advertising clients’ data base. In 2008’s SLA it was agreed that PCM-Media would stay responsible for the largest part of sales, namely the sales to the 1,500 biggest clients of PCM. It was agreed that the remaining smaller clients could also be approached by the business units. The future aim and wish of the business units is to reduce the exclusive sales rights of PCM-Media to the two hundred biggest clients. However, PCM-Media will continue to perform the back office activities for all business units. Among others, these activities include accounting, billing and page layout. The business units will establish ‘unit-sales’ teams who will approach the other small customers themselves. This will, according to business unit management, create an improved alignment between the themes in their newspapers and the interests of the clients. A business unit publisher described it as follows:

“We have our own story and are better equipped to sell that. Also towards the business market, so they understand what unique market share they purchase, because that is what counts. You reach a unique audience.”

The new structure can be depicted as follows (figure 10).
The SLA-terms include a clause that the business units are not allowed to outsource the advertisements sales to outside parties. So, at least for the short term, there is captive buying and selling. From PCM’s strategic plan it is not clear whether this will continue to be the case in the future. Quotes, such as ‘it will not be specifically forbidden’, ‘maybe in the future’ or ‘we did not look into that yet’ indicate that it is not an option at the moment. For the moment it proves that the business units have no other choice than to internally outsource the advertisements sales to big clients and back office activities. In turn, the director of PCM-Media is not free to work for other external parties.

In sum we may conclude that the governance structure of PCM changed from governing the sales of advertisements in a central department towards a structure that implies the freedom of business units to sell advertisements ‘in house’ or to internally outsource them to an SSC (PCM-Media) with captive buying and selling. The next section confronts this change with our theoretical model developed in the previous sections.

4. Analysis

4.1. Dimensions of service transactions

This section confronts the dimensions of the service transactions with the theoretical model developed in former sections.

Our interpretation of the dimensions of the services is as follows.

*Characteristics of the service*
The core question in this section is whether the services for each business unit are customized jobs, or whether the services are comparable and are thus standardized. The services PCM-Media provides include sales of advertisement space and administration (back office). A large part of the advertisements sales is corporation wide, which means that the ads can be sold for all business units, ergo for all newspapers. A smaller part is customized; for instance when advertisers have to be found for a specific theme in one of the newspapers. This is the case for special weekly newspaper sections of De Volkskrant, for instance about health or traveling. For customized ads, more knowledge is required about the contents of the theme and, therefore, more specific agreements have to be made.

The back office activities don’t need any customization per business unit and can therefore be characterized as standardized services.

**Complexity**

The degree of complexity depends on the advertisers’ demands. The more specific the advertisement has to be, the more complex it will become. As complexity increases, more internal coordination is needed regarding the advertisement strategy in specific media or campaigns.

The interviews, however, show that the sale of specific ads in themselves is not seen as very complex. It just calls for a specific focus at PCM-Media.

**Frequency**

All advertisement services needed by the business units are of a recurring nature. The corporation wide advertisements sales and back office activities are daily transactions. The specific ads sales for campaigns or weekend papers do occur less frequently, but are nevertheless recurring.

**4.2. Theory and practice compared: an analysis**

By confronting the dimensions of the service transactions with the expected choices based on the theoretical model depicted in figure 6, expectations about choices in the governance structure can be formulated. This is depicted in table 3.
<table>
<thead>
<tr>
<th>Services of PCM-Media</th>
<th>Customized</th>
<th>Complexity</th>
<th>Frequency</th>
<th>Governance structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation wide ads sales</td>
<td>No</td>
<td>N / A</td>
<td>N / A</td>
<td>Outsourcing, external buy-out or SSC with free buying and selling</td>
</tr>
<tr>
<td>Specific ads sales</td>
<td>Yes</td>
<td>Relatively simple</td>
<td>Recurring</td>
<td>SSC with captive buying and selling</td>
</tr>
<tr>
<td>Back office</td>
<td>No</td>
<td>N / A</td>
<td>N / A</td>
<td>Outsourcing, external buy-out or SSC with free buying and selling</td>
</tr>
</tbody>
</table>

Table 3. Services of PCM-Media, nature of transactions and governance structure

In the new structure the rather standardized ads are sold by an SSC (PCM-Media). Our model indicates that concentration of these services in an SSC rather than deconcentration of the sales activities in the three business units is an efficient choice. This enables a more efficient use of resources, and, thus, minimizes production costs and incurs economies of scale. It does so without incurring relatively high coordination costs and/or (opportunity) costs related to opportunism. So, the decision to opt for an SSC is consistent with our modeling. However, the decision to introduce the concept of an SSC is accompanied by a decision to maintain the captiveness between the business units and PCM-Media. In other words, there will be no free buying and selling. Yet, our model indicates that an SSC without captive buying or selling, and therefore, a further shift into the direction of market-based control, would be efficient. Abolishing captive buying and selling is efficient whenever services are standardized, because the risk of a lock-in effect is minimal and there is no ‘small number bargaining’. This would enable the business units to switch to other suppliers in case of relatively bad performance and, thus, would introduce an exit threat in the governance of services. As a consequence, business unit management would be further empowered to control the price-quality ratio of the services and, thus, would get more controllability on its economic results. On the other hand, as a
consequence of increased market control PCM-Media would be better enforced to be competitive. One business unit manager stated:

"The question is always if you have to buy services from an SSC or if you have to go to the free market [...] make it a profit centre because then you can start a commercial relationship. Otherwise you can just as well do it yourself. What is the added value of the fact that you [internally] outsource? Yes, economies of scale, but I wonder if that is really the case."

Apparently, this business unit manager (the Publisher) clearly asks for the freedom to buy from outside suppliers. This is consistent with our model.

The sales activities of specific advertisements are located within the business units themselves and are the responsibility of so called unit-teams. PCM labels this a strategy of decentralization. However, the question remains as to how specific these sales are. The interviewees state that PCM-Media eventually will only serve a few hundred of their largest clients, and that the other thousands of ‘smaller’ clients will be approached by the business units themselves. This is, however, in only a few cases a customized job, and even then it is a relatively simple job. In terms of the theoretical model, this would imply a governance structure based on an SSC with captive buying and selling, but only if the sales are really specific, i.e. customized. Otherwise the sales should be governed via a market based structure.

It makes sense to organize the specific advertisements sales in an SSC, since PCM already has an SSC running for the corporation wide ads sales. Decentralization and the freedom this entails for the business units have led to a structure incorporating both an SSC and unit-teams within the business units. A potential disadvantage of this decentralization is that diseconomies of scale might result, as different sales persons start approaching the same customers.

With regard to the back office activities a conclusion comparable with the conclusion related to the corporation wide sales can be drawn. In terms of our theoretical model the efficient governance structure would be an SSC with free buying and selling. This would
lead to the lowest production and transaction costs. However, PCM chooses to concentrate these activities in an SSC with captive buying and selling.

In the last section a reflection on these findings and an overall conclusion will be drawn.

5. Reflection and conclusion

In order to focus on the efficiency of choices in the governance structure of services, and, particularly, of services provided by an SSC, this paper extends Vosselman’s (2002) transaction cost economics based model. Next, the extended model was used to get insight in the changes of a governance structure at PCM. We focused on the different relations between business units and PCM’s SSC. The model confronts the dimensions of service transactions with the choice of a specific governance structure. This paper assesses the dimensions of the service transactions and confronts choices at PCM with the choices the model would predict. It proved that, although PCM chose a governance structure with an SSC, it did not opt for free buying and selling, as the model would predict. Moreover, in contrast with our modeling the business units chose to do a large part of the advertisements sales themselves. Our model would suggest an internal outsourcing of these services to the SSC.

These outcomes should not necessarily be interpreted as a flaw of the model, or as a failure in practitioner’s judgment. Several reasons can cause these deviations.

A limitation of the model is that the nature of the service transactions cannot objectively be determined; different persons might assess the nature of these services differently. Moreover, the model is based on strictly economic reasoning. Traditionally, outsourcing has been a viable alternative for non-core operations. However, the generation of advertisement revenues is perceived as one of the core operations of the company and outsourcing these operations may have implications for the company’s survival and growth. The governance decisions thus may also have linkages with strategy. This strategic aspect is not captured in our modeling.

Another limitation of the model is that it ignores the process of institutionalization. For example, it may take publishers a while before they find out what the most efficient way of working is in their part of the organization. Therefore, it might very well be that
in the (near) future the governance structure develops into the direction our model predicts. Future research might therefore be more process oriented. The organizational change process from a hierarchical control structure towards an SSC structure with market-based control or even complete outsourcing of the services might be a guided or a drifting process (Andon, Baxter & Chua, 2007; Quattrone & Hopper, 2001). In order to explore these change processes we would suggest to do longitudinal case studies that enable to study the changes of governance structures in the long run.

Furthermore, based on the case study we have reasons to assume that distrust toward the board of PCM and also toward PCM-Media is hindering the choice of an efficient governance structure. The publishers do not always believe that PCM-Media is working in their best interest, and they think that higher profits can be achieved by keeping the services ‘in house’. Trust is not a factor in our transaction cost theory based model. However, several authors argue that trust should play an important role in theorizing about organizational structures (De Man & Roijakkers, 2009; Nootbeoom, 2004; Van der Meer-Kooistra & Scapens, 2008; Van der Meer-Kooistra & Vosselman, 2000). It would therefore be worthwhile to make an attempt to include the construct of trust in our model. Furthermore, studying the process through which a governance structure develops can benefit from an adoption of the notion of relational signaling as studied by Lindenberg (2000) and Six & Nootbeoom (2005), as this notion can be seen as a mechanism behind interpersonal trust building.

As a final remark, we claim that our model might be used by managers to improve the economic rationality of decisions regarding the governance structure. This would enable them to consciously decide on governance structure choice and to more critically reflect on tendencies of isomorphism in practice. Organizations are inclined to ‘jump on the bandwagon’ and, in some cases, this implies a less rational decision making (1983). The use of our model therefore might improve the rationality of the decisions.
References


