

# Shared Service Centers and motives for entering the Central European market

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## **Abstract**

*Foreign direct investments (FDI) have a great importance for the development and progress of smaller countries. Foreign investors are motivated by individual properties that result from the basic characteristics of the country. The article is focused on defining shared service centres (SSCs) and motives that lead to companies to build centres in the central Europe and determining the dependence between selected factors and FDI inflows in the services sector in examined countries. In the first part of the article, SSCs are defined, and we also mention basic factors that lead to the building the SSCs in Central Europe. In the next part of the article, the dependence between selected factors and FDI is examined. The subject of this article is the examination of three factors, including the amount of workforce in countries, level of education and last but not least, the cost of the labor force in the countries under consideration. At the end are confirmed / refutable hypotheses on mutual dependence and defined facts that could affect research results.*

## **Key words**

*Shared service centres, motives, central Europe, dependance*

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## **Introduction**

The benefits of using Shared Service Centers (next 'SSCs') have been implemented in their strategy by a number of transnational corporations around the world. There are several factors that motivate companies to use them. These motives have evolved over time. The factors in the countries have changed in quantitative or qualitative terms, and corporations have also changed the interests they have pursued by placing SSCs in those countries. Today, corporations are looking for target countries that provide the most benefits for the placement of SSCs while being efficient in terms of the company's operations.

The countries of Central Europe, which have several characteristics, play an important role in this regard. These characteristics can be considered as incentives for foreign investors. The amount of foreign direct investment (FDI) is directed to regions in various areas, with the service sector, of which SSCs are a part, playing an important role. Many world-famous companies such as DELL, IBM, COVESTRO, Deutsche Telekom, AT&T, KPMG, and many others have their SSCs in the region. The aim of the article is to identify the dependencies between FDI flowing into the service sector and selected factors, defined as the motives for building SSCs in Central Europe. To meet this goal, it is first

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necessary to define SSCs and the motives for implementing SSCs in the business strategy of transnational corporations.

## **1 Methodology**

The article focuses on defining the basic factors that motivate foreign investors to build SSCs in the region of Central Europe and examines their impact on the amount of FDI that flows into the service sector in the countries. From the theoretical definition of SSCs according to several authors in terms of time, through the introduction of basic motives leading transnational corporations to implement SSCs in their business strategy and identification of motives for building SSCs in a given region, we move to the practical part in which we examine the dependence between FDI in the service sector and several selected factors.

The article uses several scientific research methods. Collection, processing, and compilation of theoretical sources of literature is the basis for processing the first part of the article, in which SSCs are defined by various authors from a chronological point of view. Using the method of meta-analysis of available literature sources and comparisons, it was possible to compare the statements of selected authors on SSCs and factors that are typical for the region.

The clarity of the data is ensured by the use of tables, where the results of the statistical survey are systematically displayed. Using graphs, we demonstrate the findings and illustrate the findings on development or dependence.

The mathematical-statistical method is the basis for processing the empirical part of the article. Using a quantitative method and using the gretl system, we examined the relationship between FDI flowing into the service sector in the countries studied and selected factors. In order to ensure a higher informative value of the research, we have extended the countries of Central Europe (Slovakia, Hungary, Poland, the Czech Republic), which form the basis of our research, to other countries of the European Union. Thus, our survey was based on a statistical sample of 22 countries (several EU countries do not provide any of the necessary indicators in the publicly available OECD database and are therefore not part of our research). The length of the time series was a minimum of 3 years and a maximum of 6 years (depending on data available in the OECD database). We worked with 81 observations.

The dependent variable was the amount of FDI flowing into the service sector in each country and the independent variable was represented by three selected factors: labor costs, the number of university-educated population and the amount of labor in each country. A detailed description of the investigated factors is given in the next part of the article. We always examined the impact of individual independent variables on FDI with the annual difference between the indicators. We expect investors to take some time to respond to changing conditions in individual countries.

Using the logarithm function, we provided well-structured data for our research. The dependent variable as well as the individual independent variables were expressed in different units and reached different values. We determined the dependence between the dependent variable and the independent variables by means of a correlation matrix

and subsequently by means of a model with fixed effects. Our sample of countries does not represent randomly selected statistical units, we assume that the estimated coefficients will not change across statistical units and at the same time the constants will be specific to each statistical unit. Mathematically, this model can be expressed as follows:

$$y_{it} = \alpha_i + \beta_1 x_{it1} + \beta_2 x_{it2} + \dots + \beta_k x_{itk} + u_{it}$$

Last but not least, the analytical-synthetic method was used. We first examined the individual dependencies using the method of analysis and then, using the method of synthesis, we presented and justified the individual results of research and predictions towards the future.

## 2 Results and discussion

In this part of the article, we will focus on defining the SSCs themselves, or the motives that lead companies to use SSCs, with special attention to the factors that are typical of Central European countries. We will then examine the relationship between FDI flowing into the service sector in the countries surveyed and the factors we have selected.

### 2.1 Theoretical background of SSCs and motives for entering the markets

Many authors from all over the world deal with the issue of SSCs. Their statements and opinions on the researched issue can be divided from several points of view (according to the regions and countries in which SSCs research, according to the functional areas of the company and their focus, in terms of time and others). In Table 1, we list several of our selected authors who defined SSCs, ranking the definitions chronologically.

**Tab. 1** Theoretical definition of SSCs from a chronological point of view

	Author	Definition of SSCs
90s	Ulrich 1995	`...are government units providing support services (human resources, information and communication technologies, accommodation, facilities, communications, finance, audit and procurement) to more than one ministry, agency or general government sub-sector'.
	Moller 1997	`...are an independent organizational entity that provides well-defined services to more than one entity (which can be a division or business unit) within an organization. SSC is responsible for managing its costs and the quality and timeliness of the services it provides to its internal customers. It has its own specialized resources and will usually have informal or formal contractual arrangements, often called service level agreements, with its customers'.

	Forst 1997	`...they become an essential part of the global and regional strategy of multinational companies`.
	Ulbrich 2003	`...they differ from centralized models and outsourcing models`.
2000 - 2010	Schuppan 2009	`...are an independent organizational units that bring cross-border services to several internal customers, leading to the provision of network services`.
	Gospel, Sako 2010	`...are organizational units that combine company resources (eg human capital, organizational structure and IT systems) to perform support tasks and provide services to internal customers`.
	Brenner, Schultz 2010	„...is a partially autonomous business unit that operates consolidated support activities such as accounting and human resources and provides services to internal clients”.
2011 - 2021	Froud et al. 2016	„...service functions - previously dispersed within the organization - were centralized into one department, which subsequently became an internal service provider”.
	Richter, Bruhl 2019	„...are a new paradigm of companies to increase the efficiency and effectiveness of business support activities”.
	Schuppan 2019	„...they are a special form of centralization of sub-functions in which the roles of different bodies merge or merge. In particular, positive economies of scale are expected, which should (should) result from a favorable division of labor”.

Source: processed by the author

Based on the above definitions, it can be stated that the sharing of services and SSCs can be implemented in both the private and public sectors, while the main goal of their implementation is to streamline the activities of the company. Based on the above definitions, SSCs can be characterized as organizational units that provide selected services to companies (national companies as well as multinational corporations) around the world in order to reduce costs, increase quality, ensure added value, or increase competitiveness. They provide services more efficiently than they would if the companies provided these services on their own.

In addition to cost savings, the company's leading motives for using SSCs include several others. These are mainly (Paagman et al., 2015):

- access to external resources,
- increasing efficiency,
- increasing the quality of services,
- the possibility of concentrating on core activities,
- increasing control,
- the possibility of increasing innovation,
- increasing customer orientation,
- eliminating risk.

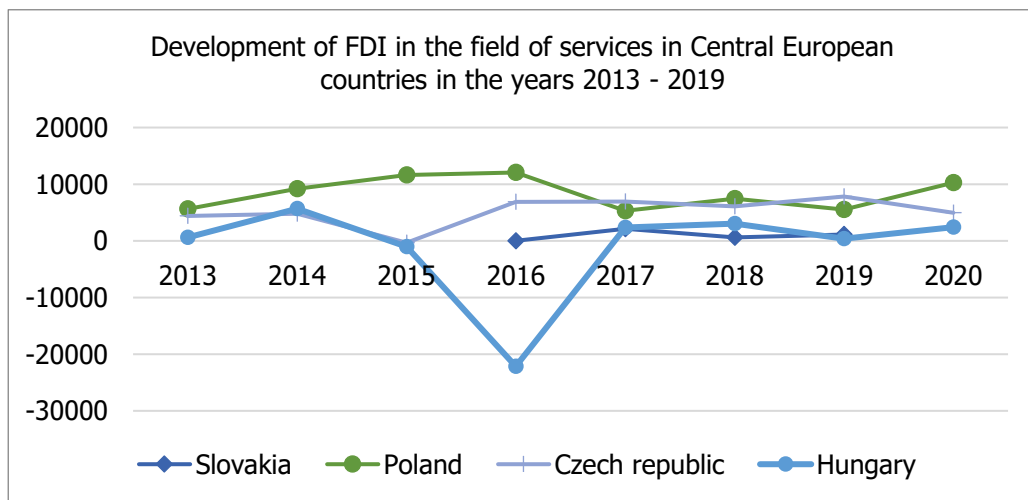
Countries and regions in the world have various factors that represent the motives for building foreign SSCs for foreign investors. The authors, as well as the organizations that operate in the countries of Central Europe, have defined several facts that have a positive effect on foreign investors when deciding on the allocation of FDI. They can therefore be considered as motives for entering the given markets.

One of the basic factors is cheap and skilled labor. The region has a sufficient workforce, which is trained and highly skilled. It can provide quality services in several languages. SSCs are thus able to adapt to the requirements of customers from all over the world. The most widely used foreign languages are English, German, French, Russian and Spanish (SARIO, 2020).

However, the workforce is more expensive than India, which is a global leader in this field. Labor costs in India account for a quarter of labor costs in Western Europe and half of labor costs in Central and Eastern Europe (Marciniak, 2014).

Another important factor that motivates foreign investors to build SSCs in this region is the geographical location, which represents proximity to the countries of Western Europe. The geographical location of the region is also advantageous in terms of time zones. The centers can provide US services in the afternoon and evening, or Asian countries in the early morning. They are therefore able to meet the requirements and respond promptly to the requirements of clients from all over the world, even in hours when this would be possible in a given country only in a limited form. Culture in the countries of middle and east Europe is basically not different from the one in western Europe together with India the culture of this region is more similar to USA (Slusarczyk, 2013).

**Graph 1** FDI inflow into services in 2013 - 2019 (in mil. of USD)



Source: processed by the author on the basis of OECD data (2021)

Last but not least, the countries in the region have a well-developed information technology infrastructure. All countries in the region create attractive offers and incentives for foreign investors. Strategies for industry and the framework are designed to help attract and retain investment in the region (Marciniak, 2014).

The building of SSCs is reflected in the total amount of FDI that flows to individual countries in the field of services. The development of the amount of FDI flowing into services to Central European countries is shown in the following chart.

Based on data available in the OECD database, 2021 we can observe the development of FDI in the field of services in the years 2013 - 2019 to three countries: Hungary, Poland, and the Czech Republic. In the case of Slovakia, these data were available only for the period 2016 - 2018. In the years 2016 - 2018, FDI flowing into the area of services in the monitored countries ranged differently. Hungary has invested more in other countries in services than it has accepted. In the case of the other three countries of the region, a higher FDI income in services can be observed than their investment in the given area in other countries. In 2017 and 2018, the least FDI went to the area in Slovakia. On the other hand, most FDI in services flowed alternately to the Czech Republic and Poland in the mentioned years, while the Czech Republic was the largest recipient of FDI in services also in 2019. In the following years 2020 and 2021, the COVID-19 pandemic came to the fore, which affected all areas of society. There have also been some changes in the SSCs, but these have been mainly changes in the organization of the work of the SSCs and therefore we do not anticipate major changes in this area due to the nature of the work of the SSCs. The impact of the FDI pandemic on the services sector in the countries under review will be examined in the following article.

## **2.2 Interdependence between FDI in the services sector and selected market entry motives**

In the empirical part of the article, we focus on examining the dependence between FDI flowing into the services sector and selected factors, which several authors cite as motives for building SSCs in countries.

'FDI is defined as an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy (foreign affiliate)' (UNCTAD, 2019).

From the OECD data, the amount of FDI can be defined according to individual sectors of the national economy. They record the value of cross-border investments received by the reporting economy during the reference period (OECD, 2021). From the point of view of the researched issue, it is important to distinguish the individual areas to which FDI is directed. In practice, we distinguish several: industrial production, construction, wholesale, retail, transport, services and more. It is the latter area that is the subject of this article.

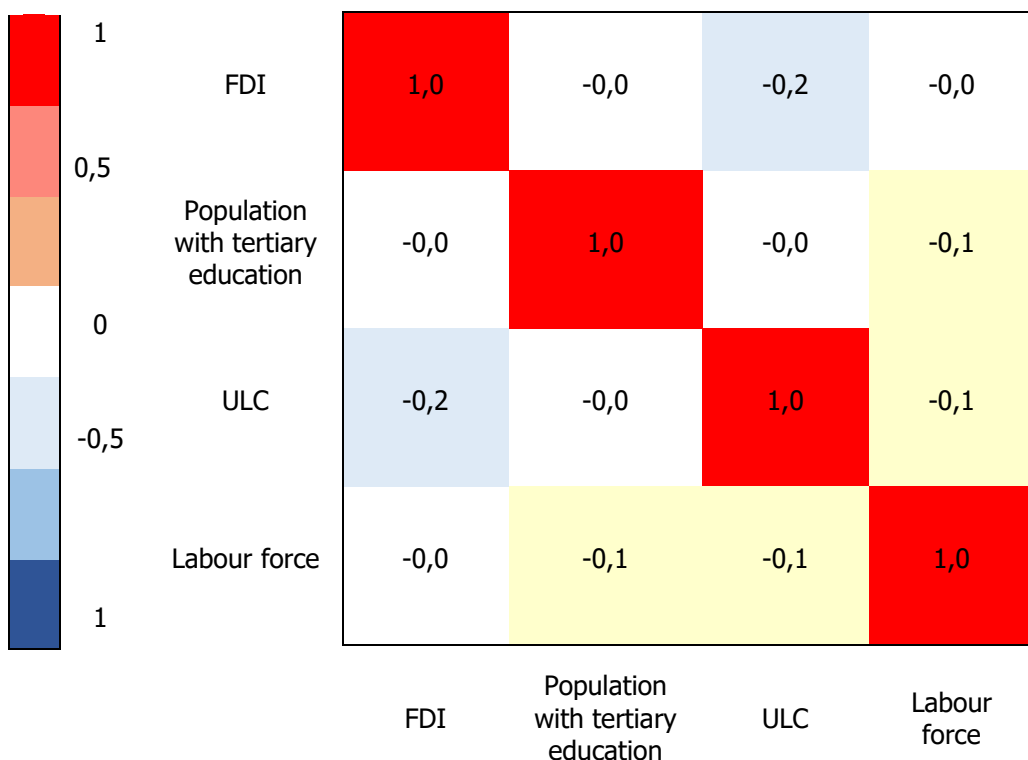
The first step was to use a correlation matrix to determine the dependence between individual factors and FDI flowing into the service sector in the given countries. We specified and examined the dependence between FDI flowing into the services sector and the 3 factors related to the following text.

**Educational level of the population** was defined on the basis of the percentage of university-educated inhabitants in individual countries, aged 25-34 years, in the total population in a given age category. The university-educated population is defined as the

population with the highest level of education. This education includes theoretical programs leading to further research or highly qualified professions, e. g. medicine, etc. The given indicator is measured by the percentage of the population of the same age. As a result of globalization and scientific and technological progress, the need for markets around the world is transforming, resulting in a growing demand for employees with a broader knowledge base but also specialized skills (OECD, 2021). SSCs are characterized by a workforce ranging in age from 25-35 years, and these employees have completed at least a first degree of higher education (Marciniak, 2014).

**Labour costs** were defined by the unit labour costs (ULC). ULCs are considered a broad measure of the country's international price competitiveness. They can be defined as the average labor cost per unit of output produced. They can be expressed as the ratio of total labour compensation per hour worked to output per hour worked—which is the labour productivity. The indicator is expressed as a percentage change in the reference years' (OECD, 2021).

**Graph 2** Correlation Matrix



Source:processed by the author, based on OECD data (2021) in the years 2013 – 2019

**Labour force**, which includes the employed as well as the unemployed, who are actively looking for a job. We consider the working population to be a working popula-

tion, resp. all persons who meet the requirements for being classified as employed (including civilian and armed forces) or unemployed. Employees include those parts of the population who work for a salary or profit of at least one hour a week, or who do not work temporarily due to illness, vacation, or protest. The unemployed are considered to be those who are currently unemployed but are actively seeking employment and able to work (OECD, 2021).

Based on the correlation analysis, it can be stated that there is a dependence between FDI flowing into the service sector in the monitored countries and selected factors. In the case of independent variables - the university-educated population and the workforce in the country, a positive dependence can be observed in relation to FDI flowing into the services sector. On the contrary, in the case of rising labor costs, a negative development in FDI flowing into the services sector can be expected. The table also shows that there is a dependence between some independent variables and each other. In this article, we focus on the dependence of FDI flowing into the services sector and selected factors, and thus the dependence that arose from the correlation matrix between the independent variables is not the subject of this article.

The specific values defining the dependence between the dependent variable and the independent variables are given in Table 2.

**Tab. 2** Correlation dependence

<b>FDI (in mil. USD)</b>	<b>Population with tertiary education (24-35 years old) (in %)</b>	<b>ULC (yearly change in %)</b>	<b>Labour force (in thousands of population)</b>	
1,0000	-0,0129	-0,1607	-0,0117	<b>FDI (in mil. USD)</b>
	1,0000	-0,0261	-0,0517	<b>Population with tertiary education (24-35 years old) (in %)</b>
		1,0000	-0,1244	<b>ULC</b>
			1,0000	<b>Labour force</b>

Source: processed by the author, based on OECD data (2021) in the years 2013 – 2019

Due to the fact that the subjects of our research are several factors and their impact on the dependent variable in selected countries, over several time periods, we will examine the dependence between selected factors and FDI in services in the following text through panel regression. In the case of proving the dependence (based on the p-value) between the dependent variable FDI and the given independent variable, we will further determine the specific influence of the given indicator on the dependent variable.



We set these following hypotheses for the solution of this subject using panel analyses based on the theory defined in the first part of this article:

**H1:** The amount of FDI flowing into countries in the services sector is growing depending on the growth of the population aged 25-34 with a university degree.

**H2:** As labor costs rise year on year, the amount of FDI flowing into the services sector decreases.

**H3:** As the working age population increases, so does the amount of FDI flowing into the service sector in individual countries.

**Tab. 3** Fixed effects model (FEM)

	coefficient	Standard error	T-statistics	p-value
const	-34,8350	22,4987	2,021	0,1272
Population with tertiary education in 25-34 years	<b>7,1016</b>	2,5366	-2,241	<b>0,0070**</b>
ULC	-0,0061	0,1380	-2,012	0,9646
Labour force	2,0394	2,5193	-0,05563	0,4216

Source: processed by the author based on OECD data (2021)

In the given model, it is statistically significant at the 95% significance level to determine the dependence between the dependent variable represented by FDI in the field of services in individual countries and the independent variable defined as the number of inhabitants with a university degree aged 25-35. Here, the positive relationship defined by the correlation matrix was confirmed, and thus, as the population with a university degree in the country grows, so does the amount of FDI flowing into the service sector.

We accept the first hypotheses. With the increase in population (aged 24 -25 years) with university education (in %) by one percentage point we expect the increase in foreign direct investments to service sector in the followed countries by 7,10 %.

We cannot accept or disconfirm the second and third hypotheses. Even though in the correlation matrix the dependency of foreign direct investments and to the service sector in the followed countries and independent variables – change in the costs of the labor and the quantity of workforce in the given countries was proven, in the model with fixed effects the interdependency is not statistically significant.

## Conclusion

SSCs represent an opportunity for larger but also smaller corporations to conduct their business more efficiently, thus with lower costs and more qualified. In order to implement the benefits of using SSCs in their business strategy, they must consider

where to build the center. The authors define several reasons that may influence their decision. In this article, we examined the dependence between three selected motives: the educational level of the population in the country, labor costs, the amount of labor and their impact on FDI flowing into the service sector. When examining the dependence through the correlation matrix, the dependence of FDI flowing into the service sector on selected factors was confirmed. Through a panel regression, using the FEM model, only the dependence between FDI flowing into the services sector and the number of the population aged 25-34 with a university degree was subsequently confirmed.

The growth of the educational level of the population has a positive effect on FDI flowing into the country in the service sector. SSCs operating in the Central European region focus primarily on the provision of services in the areas of finance, accounting, information and communication technologies, human resources, digitization, research and development and many other areas. According to a survey by the SARIO agency, SSCs are mainly young people, whose age is around 30 years. Thus, the FEM model can confirm the positive dependence between FDI flowing into the service sector and the number of people with a university degree at a given age level. However, our claim does not apply to the number of people with a different level of completed education and its impact on FDI in the service sector in a given country. A skilled workforce is therefore one of the basic factors that investors examine when deciding on the location of their SSCs.

Another factor that was defined in theory as the entry motive and market of Central Europe was the low labor costs. When examining the dependence between the amount of FDI flowing into the service sector in the countries surveyed and the labor costs in the country, the dependence between them did not prove to be statistically significant. However, a number of multinational corporations state this factor as one of the key ones in deciding on the allocation of their funds in the form of FDI, resp. building SSCs. As labor costs rise, the country loses its competitive advantage of cheap labor. Foreign investors are not interested in investing in this country. In this context, however, it must be borne in mind that circumstances such as the growing educational or economic level may distort this competitive advantage in the future.

It is also not statistically significant to monitor the relationship between the amount of labor in a given country and FDI flowing into the service sector in that country. In our opinion, the decision to allocate funds in the country is influenced by several other factors at the same time. As we stated in the article, in addition to the factors we examined, there are several others that motivate investors to inflow FDI into the country. Such factors include, for example, a favorable tax environment, the political situation or the currency used in the country. Some of them cannot be quantified statistically, so we cannot determine the clear dependence of FDI in the services sector on these factors. We believe that, although there has been evidence of dependence between some selected factors and FDI flowing into the services sector in the countries concerned, these factors need to be looked at comprehensively. Thus, a particular country must be considered as a whole that offers several advantages but also disadvantages, all of which simultaneously influence the decision of large transnational corporations to invest their funds in the form of FDI and build SSCs in different countries.

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