WHEELS OF CHANGE

Finance and accounting outsourcing has already had a major impact on finance business partnering and analytics, but as we broaden our understanding of the issues, FAO itself is growing more complex. CIMA’s Martin Fahy and Chris Fuller look at how market leaders are ushering in a second wave of FAO, and gradually moving towards a new paradigm: knowledge process outsourcing

By Chris Fuller and Martin Fahy

It is now 15 years since BP in Aberdeen signed the first finance and accounting outsourcing (FAO) deal with what was then Andersen Consulting (now Accenture). Since then, FAO has grown to become an established part of the finance transformation landscape and an increasingly widely adopted component of finance restructuring in large multinational organisations. In the last 12 months, Unilever, Cadbury Schweppes, Lindt, Diageo, GSK and other large multinational firms have all embarked on FAO projects.

To date, FAO has been viewed as a mechanism to reduce finance transaction processing costs by moving structured operational tasks, such as accounts payable and other lower-skill activities, to lower-cost offshore locations.

While the move towards FAO has been driven by labour arbitrage around low-skilled processes such as purchase to pay, order to cash and fixed assets, our research suggests that FAO is rapidly moving up the finance value chain, and leading firms are now moving beyond traditional FAO towards knowledge process outsourcing (KPO).

Under this approach firms are leveraging the substantial pools of highly educated business graduates in countries such as India, Malaysia, Central Eastern Europe and China to move value-added finance business partnering type activities to lower-cost and, crucially, more effective locations.

This is a significant departure from the buy-side market perception that only structured operational transaction processing can be moved to FAO delivery centres. The growing confidence in vendor domain expertise goes some way to exhausting the arguments of those who believe that FAO is a passing fad. The experience of a small group of leading firms suggests that firms will outsource higher-level analytical and finance business partnering roles to FAO delivery centres in near- and offshore locations.

During 2006 we conducted structured interviews with FAO analysts, business process outsourcing (BPO) vendors and 25 senior finance professionals from large organisations that have entered FAO agreements or were in the process of moving to FAO. This research, along with previous work, provides the basis for examining the role FAO has played in facilitating finance transformation and its emerging position in support of effective business partnering.

From captive shared service centres to transactional FAO
Finance functions are faced with the dual challenge of meeting an increasing compliance burden and reducing finance costs to the world-class benchmark of less than 0.75% of revenues. While single-instance enterprise resource planning, single global processes and captive shared service centres have played an important role in achieving these conflicting objectives, CFOs are increasingly looking to a small number of global finance and accounting outsourcing vendors to provide a quicker route to the necessary efficiencies and associated cost savings.

The earliest attempts at reducing finance costs consisted of captive finance and accounting (F&A) delivery centres, where firms established regional and or global service delivery centres, which they operated themselves (see Figure 1).

Typically, these centres focused on purchase to pay, finance and accounting, travel and expenses, and general ledger processing.

Within a relatively short period of time, large multinationals began to look to (non-captive) vendors such as Accenture, IBM, Genpact, Capgemini and WNS to take responsibility for the core F&A transaction activities. These vendors quickly established a global network of multi-shore delivery centres in cities from Chennai to Krakow to Dalian.

The adoption of FAO was motivated by wider finance transformation objectives, which, according to outsourcing advisory company Equaterra, included:

- guaranteed operational cost savings through economies of scale and scope and access to low-cost global labour, with savings typically stated at 20–40% on a seven to ten-year basis
- improved quality of service delivery
- improved cash flow/working capital savings
- avoidance of the capital expenditure required to make individual, company
process-based improvements and technology upgrades

• accelerated transformation to best in class service delivery through access to service providers’ intellectual capital, best practices and competencies
• accelerated ongoing improvement
• improved performance management and measurement of services with increased visibility and clarity across companies
• increased controls and accountability, and process and cost structure adaptability to changing business conditions
• enhanced ability to focus on core businesses and processes.

Accepted wisdom suggested that firms should move sequentially from a geographically distributed finance operation into shared services and selective FAO. By 2005, a number of firms were willing to trade the savings captured from the intermediate step into shared services for the quick wins provided by FAO providers. The move directly to FAO was driven by a number of considerations, including:

• the lack of resources and focus for taking internal improvement to the next level of performance
• competitive pressures driving overall margins down, particularly when faced with the threat of private equity investors
• a lack of capital to renew or extend enterprise resource planning (ERP) and other technology investments
• wider organisational changes in the form of mergers and acquisitions, divestitures, contraction and growth

• the need to focus on value-added business partner activities in the face of increasing regulatory pressures.

In assessing their suitability for outsourcing, firms divided F&A processes and activities into the following categories (see Figure 2):

• pure transactional, first-level customer service and issue-resolution processes that can be leveraged across the company, offering the best opportunity for outsourcing
• processes that involve higher-level issue resolution and escalation are fringe candidates for outsourcing and often depend on the degree of standardisation and systemisation
• governance, policy-setting and high-end strategy and planning processes (rarely outsourced).

From transactional FAO to value-added analytics

With the march towards FAO gaining momentum, it is important to address the question of how much of the finance function we can conceivably outsource. While the vast majority of FAO deals to date have focused on low-skilled processes, more innovative firms are embracing outsourcing across a much wider range of finance activities and processes. Our research indicates that a small number of leading firms have already moved beyond the transactional focus to higher-level analytics and activities traditionally viewed as too strategic or complex to outsource.

Our investigations show that successful experience of FAO has encouraged firms to extend the scope of FAO contracts into the KPO space and include F&A processes or activities which have traditionally fallen under the business
partnering heading. We are now seeing the transfer of management accounting activities such as variance analysis, costing and other reporting to non-captive FAO delivery centres. The WNS/Aviva case study on pg 10 is a good example of how this is happening.

While KPO remains the exception rather than the rule, the experience with FAO in the past suggests that the trend towards outsourcing more value-added finance and accounting activities is likely to become mainstream within five years.

The key features of this second wave of FAO are as follows:

1. Data cleansing/data scrubbing in support of analytics is often the starting point for KPO.

Many organisations find themselves data-rich but information-poor. Our study supports the notion that the single biggest constraint on improved financial analysis is the lack of clean reliable data. Multiple enterprise resource planning instances and poor data capture have led to a situation where much of the effort in business partnering by finance staff is directed not at analysis but in manually extracting and scrubbing data from underlying operational systems. Discussions with finance professionals indicate that in future they will look to outsource this cleansing to BPO providers who have already taken over the transactional activities associated with the data. Using this model, self-service access to clean data for financial analysts and others in
the business units will be met by teams from BPO providers who will prepare data cubes and decks which the business units can then analyse. With this approach, shortcomings in data and systems delivery can be overcome using labour cost arbitrage.

2. **KPO is initially targeting structured institutionalised analytics and reporting.**

In cases where the analysis to be carried out is highly specifiable, firms are willing to transfer the production of this analysis and reporting to BPO/KPO providers. Examples of this type of work include costing, inventory accounting, pro forma scorecard production, cost budgets and other forms of traditional management accounting. The burden of extracting information from ERP applications, using data marts and business warehouses, is transferred to BPO teams who have in-depth knowledge of the technology and data architectures. The data to desktop reporting process is then enabled using web-based portal reporting.

3. **KPO is driving harmonisation of management accounting and business analytics.**

As firms seek to exploit the service of BPO/KPO providers, there is a strong economic argument for the global harmonisation of management accounting and reporting/analysis processes. Fixed-price, volume-based charging for these services encourages firms to stop, simplify and standardise much of their reporting and management accounting activities.

4. **KPO providers bring the discipline of process improvement to the business partnering space.**

Just as they have used Six Sigma and process redesign to achieve breakthroughs in process improvement, BPO/KPO providers are now applying these techniques to the analytics space. This is leading to an industrialisation of many extraction, classification, filtering and reporting activities that make up business partnering. In time, we are likely to see world-class business partnering processes being embedded in the emerging corporate performance management and business intelligence technologies.

5. **KPO is unlikely to deliver context-specific analytics close to the market.**

While BPO/KPO providers will have a cost and size advantage in the areas outlined, it is unlikely that this will extend to context-specific and unstructured ad hoc analytics associated with optimising and configuring the business model. In the case of analytics to support brand and marketing effectiveness, strategy and product introduction, the highly contextualised nature of the knowledge needed to support these decisions will erode any labour arbitrage. As global firms have discovered in the war for talent, world-class business analysts come with a world-class price tag, regardless of where they originated.

**Key challenges for CFOs**

CFOs will need to take proactive steps to ensure that their organisation can capitalise on the emerging second wave of FAO. They will also need to ensure that they have the capability to put in place agreements that go beyond the traditional transactional scope that has defined FAO to date. The specific challenges which CFOs need to address in building that capability include:
• developing a knowledge and understanding of the role of FAO in the emerging regional and global finance architectures which firms are seeking to put in place

• understanding which finance processes are appropriate for second-wave FAO and which activities will need to remain embedded in the business

• having a comprehensive understanding of the different offerings available from FAO vendors and the value proposition under which these vendors operate

• having the sourcing, contracting and negotiating skills to put in place collaborative agreements that are sustainable and flexible for both the firm and the vendor

• devising effective risk management approaches to ensure that FAO does not undermine the firm’s compliance, performance and corporate social responsibility obligations

• developing governance and relationship management frameworks, including service level agreements, key performance indicators and performance management incentives, that drive value for both the firm and the vendor

• focusing on creating viable long-term relationships with the vendor that reduce adversarial behaviour and encourage sharing of information and efficiency gains

• working with specialist outsourcing and legal advisers who understand the intricate details of outsourcing contracts, statements of work, due diligence and the other elements needed to put in place a working agreement.

**FAO trend set to continue**

It is clear that second-wave FAO will continue the trend towards smaller business unit finance teams as more business partnering activities are outsourced to FAO providers. While the majority of firms will move slowly towards FAO for finance transaction processing, leading firms will leap ahead to exploit the extensive educational talent available from offshore delivery centres.

As labour arbitrage on transaction processing is eliminated, FAO providers will, through the deployment of technology and process improvement, seek to divert the increasingly expensive labour resources to higher valued-added analytical work. In doing so, finance will follow the established KPO model of other professions.

In the long term, culture and the other barriers to effective outsourcing of analytical tasks will be overcome and firms will seek to source finance business partnering from a network of global delivery centres.

**The changing face of FAO**

• **Cost savings** continue to be the main motive for global sourcing strategies. Quality and flexibility are increasingly important drivers.

• **Simple labour arbitrage** is no longer sufficient to sustain outsourcing. There has been a move towards skills, capabilities and availability of resources.

• **Experience on both the buy and sell side** is now allowing for greater sophistication and clarity of sourcing decisions and contract management.

• **Decision-making** and understanding and managing the operational risk of
outsourcing and offshoring, are beginning to reach maturity, allowing firms to trade off the expense of outsourcing and offshoring against the superior skills and lower costs available offshore and from third parties.

- **Core and non-core processes** are being componentised. Financial services firms are beginning to use componentisation to simplify complex business processes – the act of deconstructing complexity allows activities to be performed by individuals with specialist skills. Componentising a process minimises investment in knowledge transfer and training, and lends itself to multiple sourcing options.

- **Lean manufacturing** concepts are being adopted to identify efficiencies.

- **The process of componentisation** is enabling firms to adopt a global services sourcing model, establishing competency-based centres optimising cost, quality and skills offered by selected geographies.

- **Market commodification** is forcing firms to evaluate their operational models, leading to a shift away from product-focused towards process-focused strategies.

- **Supplier experience** has grown with the marketplace, allowing suppliers to produce better offerings. The result is lowered risk to buyers and suppliers adding more value through new tools and technology.

- It is interesting to note that **Sarbanes-Oxley** concerns are no longer an issue. In 2002 companies were worried about sending work offshore and meeting the reporting requirements of the Sarbanes-Oxley Act. Company executives, who faced jail-time if they could not certify their financial results, were not eager to outsource these functions.

- Many US companies took a waiting brief towards FAO. By the end of 2004 the marketplace had resolved these issues, with outsourcing now viewed as offering the potential to improve control and reporting, making it easier to comply with the requirements of Section 404 and other provisions.

- **The variety of sourcing options** available to companies today is in stark contrast to the scope of contracts negotiated ten years ago; experience gained by both buy and sell sides is now allowing for greater sophistication and clarity of sourcing decisions and contract management (see Figure 3 on page 8).

**WNS & AVIVA: second-wave FAO in action**

Aviva is the world’s fifth largest insurance group and the largest insurance services provider in the UK. It has premium income and investment sales of £36 billion and £332 billion of assets under management, a presence in more than 25 countries and 35 million customers.

Aviva has embraced outsourcing and offshoring as a means of addressing the competitive pressures it faces. By the end of 2007 it will have offshored 7,800 roles across five locations. As part of its global BPO capability, it has established, in
partnership with WNS, an offshoring centre in Colombo, Sri Lanka for its F&A activities. This centre was established in 2003 and will be managed by WNS until July 2007 when the staff and operation are due to be transferred back to Aviva.

The operation began as a traditional first-wave FAO centre with a focus on transaction processing. Early on, management acted to bring more value-added, analytical activities into the centre. By 2005 100 staff were supporting management accounting, planning and forecasting, project analysis and related activities; by 2006 this had extended to the preparation of full statutory accounts and business partnering across the group.

Outsourcing: glossary of terms

Business process outsourcing (BPO)

BPO can be seen as a process in which a company delegates some of its in-house operations or processes to a third party.

Business warehouse

A business warehouse is a packaged, comprehensive business intelligence product centred on a data warehouse. Like most data warehouses, a business warehouse is a combination of databases and database management tools that are used to support management decision-making.
Component business modelling (CBM)
CBM simplifies the way firms look at their operations; it allows executives to escape the process rut and helps them get at the real sources of value that drive their firms. Viewing business activities as autonomously managed components helps decision-makers to cut through the historical boundaries that build up along organisational, product, channel, customer, geographical and informational lines.

Data cubes
A data cube is a multidimensional representation of data which provides fast retrieval and drill down facilities.

Data marts
A data mart is a repository of data gathered from operational data and other sources that is designed to serve a particular community of knowledge workers. The emphasis of a data mart is on meeting the specific demands of a particular group of knowledge users in terms of analysis, content, presentation and ease of use.

Domain expertise
Domain expertise is knowledge and experience that has been acquired through a thorough track record that comes to represent the core competencies of the organisation.

Enterprise resource planning (ERP)
ERP attempts to integrate all data and processes of an organisation into a unified system. A typical ERP system will use multiple components of computer software and hardware to achieve the integration. A key ingredient of most ERP systems is the use of a unified database to store data for the various system modules.

Finance and accounting outsourcing (FAO)
Many companies are now choosing to outsource elements of their finance and accounting processes to third-party vendors. The basic premise is that by outsourcing these operations companies will achieve cost savings and be able to focus more on their core competencies.

Knowledge process outsourcing (KPO)
KPO is a form of outsourcing that sits at a higher level on the intellectual value chain than BPO. KPO involves processes that demand advanced information research, analytical, interpretation and technical skills, as well as some judgment and decision-making.

Lean manufacturing
Lean manufacturing is a management philosophy focusing on reduction of wastes with attention focused on transportation, inventory, motion, waiting time, over production, over processing and defective product. By eliminating waste, quality is improved and production time and costs are reduced.

Market commodification
Commodification is a process that transforms the market for a unique, branded product into a market based on undifferentiated price competition.

Sarbanes-Oxley section 404
Section 404 requires that companies subject to the reporting requirements of the Securities Exchange Act of 1934, other than registered investment companies, include in their annual reports a report of management on the company’s internal control over financial reporting.
Web-based portal reporting

Web-based reporting tools enable enterprise-wide reporting, information delivery, analysis and decision-making. Some applications support distribution of reports within departments, across enterprises and may also be integrated within web-based applications to deliver back-end core reporting information and front-end information analysis.

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He has written extensively on the areas of shared service, ERP systems and emerging issues in finance. His most recent books include Beyond Governance, ERP: Levering the Benefits (a joint venture with CIMA and PWC), Strategic Enterprise Management Systems and Shared Services: an executive briefing (co-authored with Andrew Kris).