OUTSOURCING THE FINANCE FUNCTION

Alexa Michael analyses the most important factors to consider when making decisions on farming out your firm's accounting processes.

The use of finance and accounting outsourcing (FAO) by organisations of all sizes is increasing across the world and especially in Europe. The number of large contracts (those involving at least five processes and/or valued at more than £25m) has grown by more than 45 per cent since 2005 and the global FAO market will exceed £24bn this year, according to an estimate by the Interactive Data Corporation.

Companies use FAO in order to gain at least one of the following benefits: reduced costs; superior expertise; fewer labour shortages; access to better technology; improved processes and productivity; and the chance to move existing staff to work of higher value. Yet despite the growth of FAO and its supposed advantages, buyers have expressed surprisingly high levels of dissatisfaction with their arrangements. A survey of global chief financial officers by CFO Research Services in 2006 found that 54 per cent thought that FAO didn't deliver its promised benefits. But 73 per cent still declared that they were interested in outsourcing some, if not all, accounting processes. Such contradictory findings suggest that FAO offers valuable opportunities, along with risks and challenges. They also imply that a large number of outsourcing contracts have been mismanaged.

Finance and accounting professionals should be interested in exploring FAO, but they are also the ones who must manage the pitfalls that often accompany it. This is why CIMA has published a new Management Accounting Guideline called "Outsourcing the finance and accounting functions". This focuses on the outsourcing process and is intended to help CIMA members choose the right outsourcing provider and monitor and manage the benefits of FAO.

There are three stages in the FAO process: making the decision; selecting the provider; and managing the relationship. Managing the relationship begins during the selection process when you make a request for proposal (RFP) and start communicating with the provider. This tends to be the most problematic aspect of outsourcing.

Making the decision

At this stage an organisation should conduct four separate but overlapping evaluations (*see diagram, opposite page*). First, you need

Full circle: the Gateway-ACS experience

PC manufacturer Gateway terminated its £200m, seven-year FAO deal with outsourcing supplier Affiliated Computer Services (ACS) after only one year when it embarked on a downsizing project. The resulting changes, including store closures and job cuts, made the deal unprofitable for ACS and the two parties agreed to end the contract.

The Gateway HR manager in charge of the repatriation worked on it almost full time. He described the process as "outsourcing in reverse" because it used almost the same schedules and milestones as the initial outsourcing project.

The first task was to identify the scope of the task, making an inventory of the processes, technology and people that would return to Gateway. This needed collaboration among finance, IT and corporate communications. Effective communication was one of the most important factors – senior managers had to understand the business case for repatriation and the rest of the workforce had to know how incoming processes would be performed and how it would affect them.

Gateway re-hired several key employees who had been outsourced to ACS and reassigned some internal jobs, so it recruited only a few new employees. Effective management of outsourcing selection and transition meant that the processes had generally functioned well at ACS before they were returned to Gateway.

to identify the strategic drivers. Why are you considering outsourcing, and do those reasons support your strategic objectives, directions and plans?

Second, you must evaluate the full range of options. Should you leave the processes in their current state, improve existing internal processes (for example, by adopting a different model such as shared services), or opt for FAO? You must consider carefully the advantages and disadvantages of each.

Third, you should assess your company's internal capabilities in terms of essential employees and business expertise. Will the organisation be able to manage the transition to the outsourcing provider? Do you have the expertise and staff to monitor and manage the contract from start to finish (or renewal)?

Lastly, you need to agree the scope and logic of any outsourcing arrangement. This involves finalising the FAO business case and choosing which processes to outsource.

Selecting the provider

If an organisation decides to outsource, it must seek providers to match its needs. Selectors must understand and compare the merits of each provider's proposal and ensure that they are comparing like with like. You should consider the size of the provider and be aware of any likely changes in ownership, since management upheavals might affect service levels. You should also be sure that the partner has a high output standard.

Managing the relationship

According to research quoted in the *Wall Street Journal* ("Behind outsourcing: promise and pitfalls", February 26, 2007), a third of selection teams decided to keep their processes in-house, despite spending time and money considering FAO. They chose not to outsource because they thought that their organisations couldn't cope with the degree of change that it would demand.

One common mistake is to underestimate the amount of time, energy and resources necessary to make outsourcing relationships successful. The purpose of outsourcing finance and accountancy processes, particularly transactional activities, is to perform them more efficiently. By definition, the outsourcing provider will do things differently. This means that your company's staff need to interact with the outsourced processes (and the provider's staff) in different ways. They must be able to change. Your success at dealing with the need to change depends largely on the outsourcing relationship's parameters, including change management. These are laid down during the negotiations for the contract and will remain in place for its duration.

At the outset you should negotiate a contract and service-level agreement (SLA) with your outsourcing provider that should describe the services to be provided. This part of the contract will also state which processes need to change to meet the provider's standards and which will remain unchanged. When it comes to SLAs, it is important to include qualitative and quantitative measures to monitor and manage the relationship – particularly regarding vendor performance.

Pricing is a key element of any FAO agreement and must be considered as part of the SLA. A detailed pricing model should be drawn up at this stage. In *Multisourcing: Moving Beyond Outsourcing to Achieve Growth and Agility* (Harvard Business Press, 2005), Linda Cohen and Allie Young identify and describe different pricing frameworks according to their efficiency, risk to buyer,

The FAO process

	Making the decision	Selecting the provider	Managing the relationship
Key steps in the process	Identify strategic drivers Evaluate the full range of options Assess internal capabilities Determine scope and logic	Create the project team Link buyer's needs to provider marketplace Consider outside help Develop request for proposal (RFP) Establish an RFP evaluation process Conduct due diligence	Negotiate contract and service-level agreement Transfer process and knowledge Monitor and manage performance Renew, renegotiate or terminate

"One common mistake is to underestimate the amount of time, energy and resources needed to make outsourcing successful"

FAO pricing models

Model	Description	Efficient?	Buyer risk	Provider risk
Cost-plus	Buyer pays provider's cost, plus a percentage	Yes	Medium	Low
Fee for service	Variable pricing set according to amount and/or quality of service delivered	Yes	Medium	Medium
Fixed price	Price set to specific service level and does not vary	Yes	Low	High
Shared-risk-reward pricing	Flat rate pricing with potential for additional payments tied to specific outcomes	No	High	High
Business outcome achievement	Provider does not receive payment unless predefined outcome is achieved	No	Medium	High

risk to provider and other factors. The table above is adapted from their analysis.

As FAO has matured, pricing systems have changed to ensure that they encourage the right relationship between buyer and provider. There has been a shift away from traditional pricing models such as cost-plus, fixed price and fee for service, and a move to more variable pricing mechanisms and "shared-risk-reward" pricing arrangements so that both parties can potentially profit. For example, for debt collection processes a provider can recover debts that are too small for large companies to collect efficiently on their own. A share of the extra revenue recovered can go to the provider.

The SLA should also stipulate how changes relating to the execution of processes during the outsourcing agreement will affect pricing. A change in delivery may affect the scope of the contract – eg, new processes may be added or existing ones deleted from a multi-process arrangement if the buyer decides to take them back in-house.

Similarly, a change in the volume of the work to be transacted would affect the price, as could ownership changes to either the buyer or the outsourcing company. External changes, such as new regulations that affect how a process is performed, will also have cost implications. The SLA will need to include the potential for change which may occur during the FAO agreement.

It is important to state all the terms and conditions at this stage. The outsourcing contract will need to be terminated if the service is poor, if changes make it uneconomical or, unless you renegotiate a new one beforehand, when it expires. Another key part of managing the relationship involves transferring your processes and knowledge to the provider. This depends on effective project management to clarify roles and responsibilities and to establish a project method. The project team should:

- Establish a project plan, milestones and roles for individuals and teams.
- Create a communication plan to reach everybody involved in the outsourcing process, including employees whose roles will be changed or eliminated.
- Transfer employees to the outsourcer or terminate their employment and redeploy staff to alternative roles.
- Address potential negative reactions from employees who lose their jobs.
- Identify and provide training and communications to end users.

The ongoing management of the FAO process once it's established tends to be an operational matter, so it will benefit from an operational, rather than a project management, mentality. The FAO relationship can be more effective if the following management and monitoring steps are taken:

- Select people with the necessary authority on both sides to manage the relationship for the duration of the contract.
- Track qualitative and quantitative measures as stated in the SLA to monitor the outsourcer's performance.
- Set up formal processes for meetings with the provider.
- Establish formal troubleshooting processes so that problems are tackled as they occur.
- Visit the FAO provider's workplace at least once every other year during the contract.
- Agree a process for changing the contract. This should include adding or deleting processes from the original contract, amending performance objectives and adjusting prices.
- Use qualitative and quantitative performance monitoring as the basis of any decision to renew, renegotiate or terminate the contract.

Plans to end an FAO contact should be made nine to 18 months before the actual termination. Moving processes back in-house or to another provider is time-consuming, especially if several activities are involved or they have changed significantly since the contract began.

The three options at the end of an FAO contract are: renew the contract with the current provider, seek another provider or bring the processes back in-house. An outsourcing agreement can last up to ten years, so vendors, services and prices are likely to change. You could ask your provider to present analysis of the current market in FAO to help you make the decision.

FAO offers exciting opportunities and there is an important role for finance professionals to ensure that it is done correctly.

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Further information

This article is based on "Outsourcing the finance and accounting functions", a Management Accounting Guideline by Eric Krell, published by CIMA, the American Institute of Certified Public Accountants and the Society of Management Accountants of Canada. CIMA members can access the full version at www.cimaglobal.com/cpdcentre.

Outsourcing your finance function SMEs can also make great business and commercial sense. There are without doubt cost advantages but the other benefits around innovation, ease of management and time to focus on the strategic direction of your business also make the consideration of outsourcing finance a compelling proposition.Â The consideration around financial outsourcing are usually driven by a business event â€œtriggerâ€. A review of the finance function for security and effectiveness, difficulties in recruiting high quality personnel, emergency accounting support required due to leavers, sick leave, maternity etc. or the potential sale of a business. Each of these events can bring about a need to review the way your finance function operates now and in the future. Offshoring, outsourcing, and centralization have been the bread and butter of improving the finance functionâ€™s productivity for decades. As the pharmacoâ€™s experience shows, tech-savvy CFOs are now considering automation to propel a new wave of efficiency and performance.Â Financial-planning and -analysis professionals could be retasked to support the business. Tax specialists could be refocused to maximize after-tax income. But, especially in transactional functions, the hard reality is that automationâ€”if implemented effectivelyâ€”will inevitably lead to changes in organizational structures, redefined roles, and layoffs. At one global financial institution, the CFO is on pace to release a quarter of the companyâ€™s 20,000-person shared-services organization over the next 24 months.