



FINANCIAL MANAGEMENT

Outsourcing the finance function

Developments and potential trends

ADVISORY

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Foreword

KPMG is a trusted adviser to clients that operate in a wide variety of industry sectors and geographies. We continually seek to identify business trends that can directly affect these organisations' performance, productivity and shareholder value. Strategic sourcing is one such emerging trend.

We live in increasingly global marketplaces enabled by astonishing advances in technology and communications. In such an environment, organisational challenges come in many guises.

In this context we are not surprised to find that organisations are looking increasingly beyond their traditional organisational and geographic boundaries to find more efficient means of conducting business day to day. New business operating models are emerging that challenge the conventional wisdom concerning what makes an organisation successful or capable of differentiating itself in the marketplace, now and in the future. Standing still is not a viable option for those that want to thrive.

Clear vision, strong leadership and ability to manage change will always be key attributes of success. But what exactly does a leading organisation's corporate "DNA" need to look like?

Ever competitive market pressures have fuelled the need for better quality management information to satisfy the demands of stakeholders and to enable strategic decision-making. Traditionally, finance and accounting functions have been part of the core skill sets organisations retained within their own "gene pool." This inclination is changing, however, as blue chip organisations increasingly rely on third-parties to provide such services. What's more, top organisations are making these choices not just with functions that are largely rules-driven and focused on data input. Indeed, many large blue-chip firms are outsourcing higher-value functions including business-process and even knowledge-process activities.

To assess some aspects of these developments, we recently joined with the National Outsourcing Association (NOA) to assess NOA members' current circumstances and future intentions for their finance and accounting (F&A) functions. Our goal was to determine if outsourcing the finance function has been undertaken or is being considered. Where finance outsourcing has taken place we wanted to learn what parts of F&A have been affected and the benefits and challenges that have resulted. We also sought to identify key trends, such as specifics about countries that have become outsourcing hotspots.

We hope that these findings will provide valuable insights that will help you to challenge your own thinking with regard to outsourcing and the finance function.

John Machin

Head of Sourcing Advisory Services

KPMG

Approach

This review was conducted in October and November 2005 through an on-line questionnaire. The 60 NOA members who responded are outsourcing professionals from UK-based end-user companies.

The majority of the respondents are at the outsourcing management level within their organisations, with 80 percent of them responsible for outsourcing deals worth up to £500 million.

KPMG and the National Outsourcing Association (NOA) would like to thank all respondents for their participation.

A Summary of Key Findings

Finance and Accounting Functions

- 52% of respondents are continuing to or plan to outsource their F&A function.
- Payroll is by far the most popular function to outsource – 67% of respondents who already outsource F&A currently outsource their payroll.
- Over 27% of respondents outsource both their tax compliance and their tax planning, and another 31% plan to outsource tax compliance.
- Over 70% of respondents are moving towards multi-process outsourcing, due mainly to the benefits of economies of scale.
- Currently, the ultimate decision makers in outsourcing deals are the CEO, the CFO, or the entire board in equal measure (27%). However, respondents say the CFO will have the final say in many planned future deals (38%).

Outsourcing Suppliers & Destinations

- Respondents indicate good relations with their suppliers: over 60% plan to renew existing contracts. Nonetheless, over 32% of respondents plan to re-tender their F&A contracts when they come up for renewal.
- Termination clauses now feature in over 80% of contracts, and flexibility is also a key consideration as more than 70% of contracts move away from fixed-term periods.
- Results indicate that the UK remains the most popular destination for outsourcing F&A. Increasingly, however, companies are sending F&A work to India, and Eastern Europe is growing in popularity as a destination for F&A outsourcing.

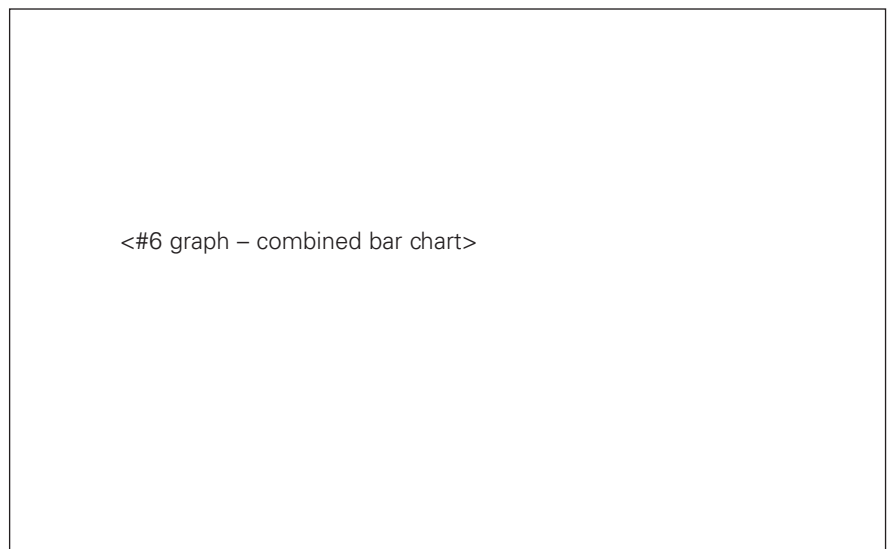
Reasons for Outsourcing

- Respondents cite “cost savings” as the main benefit of F&A outsourcing, especially payroll. However, when companies outsource processes such as accounts payable and travel and entertaining (T&E) expenses, the main benefit they cite is “better control.”
- “No business case” is the overarching reason for not considering outsourcing certain F&A functions.
- For the respondents who have yet to outsource any area of F&A, the main reason cited was “not in a position to consider any outsourcing options”.
- “Lack of board support” is identified by 71% of respondents as the most likely reason for preventing an outsourcing deal.

Finance and Accounting Functions

Payroll dominates for outsourcing

Over half of respondents are continuing to or plan to outsource their F&A function, and of these, 52% will be outsourcing their payroll function over the next five years. Payroll has long been outsourced by UK-based companies and is probably why the main area for current outsourcing is seen as the UK.



The areas cited as most likely to be outsourced in the future are tax, accounts payable (AP) and travel and entertaining (T&E) expenses. These results point to two opposing pressures to outsource: whilst AP and T&E are seen as reducing cost, the outsourcing of tax is likely to be as a result of compliance issues or the need to invest in tax experts.

No respondents currently outsourced, or were thinking of outsourcing, budgeting and forecasting – a result suggesting that in the future, the retained finance organisation will be largely involved in that area. In fact, we have seen growing interest among clients in budgeting and forecasting – an area in which analysts are often critical of companies. Respondents also indicated (somewhat less) reluctance to outsource internal audit – another result that indicates a focus on control and commercial roles for the future retained finance function.

¹ This is an example of a footnote. Lorem ipsum dolorum luvola.

<to check when data is sorted> Within a number of respondent organisations, certain functions that are transactional in nature, are currently outsourced onshore. While some of these will likely move offshore in the future, we believe the more sensitive and added value processes will likely be retained closer to home.

<#15/16 graph – combined bar chart>

Move towards multi-process outsourcing

Most respondents are moving toward multi-process outsourcing, an indication that organisations are also taking advantage of economies of scale.

74% of respondents agreed that multi-functional outsourcing was the best way to achieve economies of scale and to facilitate process improvement. This result highlights the growing tendency to view outsourcing as a key strategic business process rather than one best suited to one-off tactical functions.

CFO's influence is growing

Currently, the ultimate decision makers in outsourcing deals are the CEO, the CFO or the entire board in equal measure. However, as procurement takes a back seat, the CFO will have the final say in more future deals.

Respondents ranked the main drivers for outsourcing decisions as "cost," "control," and "quality." Our experience has shown a similar focus on cost, but we have found that organisations value "quality" over "control." This result suggests that whilst cost objectives are met and often delivered to a higher quality, there are concerns over controls. Whether this is an underlying trend or linked to a greater market awareness of control issues would be interesting to determine.

Outsourcing Suppliers & Destinations

Growing realism by suppliers

68% of respondents were happy with their current provider but had flexible contracts, whilst over 60% are planning to renew their existing contracts. However, termination clauses now feature in most contracts, and 70% of respondents believe contracts are moving away from fixed term. These responses indicate end-users' increasingly realistic view of the probable longevity of outsourcing relationships. It also shows that flexibility is a key consideration for both parties.

Most deals were small, involving 55-100 employees. This result suggests that although companies have accepted outsourcing F&A in theory, many of them are continuing to test the concept on a small scale – although our experience in working with a number of global technology companies suggests otherwise – and may be the result of the surveyed companies being smaller than £500m in general.

More respondents are considering efforts to offshore shared services rather than full-fledged offshore or onshore outsourcing. This is a trend we have also observed in the market place – that is, organisations moving towards either 1) re-implementing shared services to address compliance and efficiency issues before considering outsourcing, or 2) establishing shared service centres (SSC) where they have not previously had them.

<#10 graphical element>

Most growth in India

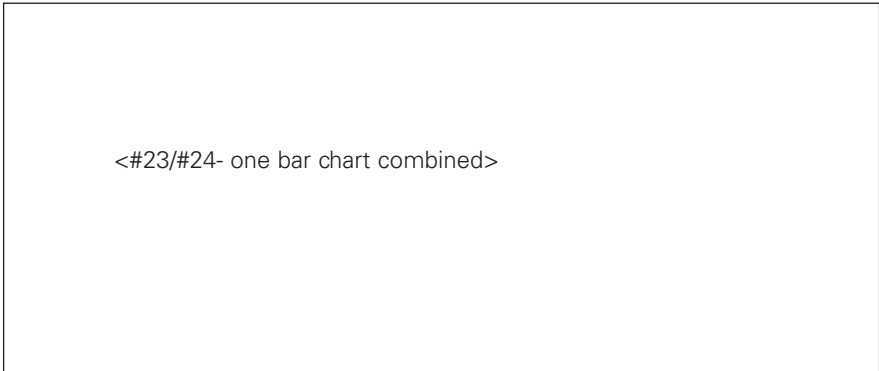
The UK is still the most popular destination for outsourcing finance. However, respondents expect more F&A work to be off-shored to India and, increasingly, locations in Eastern Europe.

<#25 – map showing most popular locations>

Reasons for Outsourcing

Cost remains the main benefit of F&A outsourcing, especially for payroll, according to respondents. They also cited other benefits including better quality of information, improved productivity, and better control. To date, respondents believe that standardised processes are a prerequisite for outsourcing. In our experience, however, companies are increasingly outsourcing value-added functions. The challenge organisations face now is to acquire the skills and expertise needed to outsource these functions effectively.

Among respondents, the underlying drivers for not outsourcing finance vary by function and thus cannot be addressed without regard for these differences. For transactional functions, “cost” and “lack of a good business case” are cited as the prime reasons for not outsourcing. For the more skilled functions, the sensitivity of information is the most important factor.



<#23/#24- one bar chart combined>

For respondents who have yet to outsource any area of their finance functions, the main reason cited was “not considering the options” – signalling their need [among outsourcers?] to raise awareness of potential benefits and opportunities especially within the Board, without the support of which an outsourcing deal becomes much less likely.

Interestingly 58% of respondents cited “technology” as a real alternative to outsourcing to achieve cost savings; comments were made about the automation of AP, single ERP, and so forth. Technology capabilities could potentially pose genuine competition to outsource providers, especially in transaction processing. The results align with a growing awareness in the marketplace about using technology as an alternative to outsourcing. We may see outsourcers change how they operate as a result of this trend.

To date, the transactional functions around cost, scale and processes have been the focus of F&A outsourcing. Respondents believe, however, that outsourcing to add value rather than merely to process data will become increasingly important over time. One respondent commented that in the future, “there will be more confidence by finance directors that outsourcing is risk free, economical and adds great value to the service they offer as Chief Value Officers rather than as pure accountants processing data and information”.

Conclusion

As organisations increasingly choose to outsource various aspects of their finance functions, they will need to develop a longer-term perspective that enables them to evaluate benefits that extend beyond cost savings. Such analysis will become important especially as they consider whether to significantly transform their finance functions – and, thus, their organisations – by outsourcing value-added activities [such as....]. Strong business cases will become increasingly critical as well the need for robust governance, control, and risk management. In such an environment, leaders will need access to the right set of skills to effectively conclude an outsourcing arrangement and then to manage it on an ongoing basis (in a 'business as usual' mode).

Possible NOA comments – TBC

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¹ The research findings are available upon request.

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