

WILL OUTSOURCING FLY?

More Asian companies plan to outsource finance. But is there enough value to be gained?

By Don Durfee

Ask Philip Chu what he thinks of outsourcing, and he doesn't hold much back. "We've tried it twice before, and the results were not good," says the CFO of Datacraft, a Singapore-based IT service provider. His first try involved human resources. "Our HR function was spread across many countries and wasn't being professionally run, so we thought, 'Let's outsource it.'" The outcome was a project that cost Datacraft more than it had been spending on HR previously and that soon became a grievous distraction for management. "We ended up devoting more effort to HR than we did originally and I was the one who had to provide the outsourcer with the data."

Later, Datacraft outsourced tax planning and preparation. It was another disappointment – a costlier function that created new problems for Chu. "At the end of the day we received penalties for things that had been done incorrectly with our taxes," says the CFO.

Given this unhappy history, it would be no surprise to hear that Chu has ruled out any chance of outsourcing his finance operation. But he hasn't. On the contrary: he predicts that one year from now he will have turned over his accounts payable and procurement functions to an outsourcing firm.

This is not to say that Chu has become a believer. He doubts that outsourcing will save him much and isn't looking for process improvements beyond what he's already achieved through a recent shared services effort. Drawing a lesson from his experiences, he vows to dedicate an internal staff member to manage the vendor relationship.

Instead, he will do it for a simpler reason: the threat of losing his best employees. "Staff turnover is my number-one problem," says Chu. "It's very hard to recruit new staff these days, and if you ask your top talent to do routine stuff like transactions, they will leave. But if I outsource it then they can spend their time on more exciting work." He will redirect his staff – he'll keep the same number of employees after outsourcing – away from three-way matches and toward analytical projects in support of business growth. There's plenty to do: Datacraft is growing 20% a year.

Like Chu, many Asian-based CFOs have mixed feelings about finance and accounting (F&A) outsourcing. They are skeptical about the advertised cost savings and wary of delegating essential – if uninteresting – finance activities to a third party. And even as their peers in North America and Europe warm to the idea of F&A outsourcing, local finance executives know that such projects will be harder for them to pull off. The business case is murky: it's hard for most Asian companies to achieve anything close to the savings available to a US company outsourcing to India. And putting finance operations – typically scattered across ten or more countries with as many languages – promises to be arduous for both vendor and client.

Yet there's rising pressure on CFOs to consider outsourcing, for reasons ranging from the workforce issues cited by Chu to an urgent need for better financial controls. Indeed, the market for such services in Asia appears to be at a turning point as providers sign on new clients here. But is F&A outsourcing right for the region?

A hard sell

Consultants and outsourcers have been preaching the benefits of F&A outsourcing for years, but beyond payroll and retirement plan administration, the practice has been slow to catch on. One of the earliest deals was a major agreement between Accenture (then

Andersen Consulting) and BP in 1991. BP handed over almost all of its North Sea finance function – from data entry to forecasting – to the consulting firm. This contract helped Accenture launch its finance outsourcing business and led to predictions that many others would soon follow. Few did.

That has started to change. As last month's story ("Going Away," June 2007) explained, big Western companies are starting to overcome their reluctance, partly because of compliance pressures and a desire for cost savings, and partly because of a feeling that the F&A outsourcing business is mature enough that signing up is no longer the gamble it once was. "Companies are much more eager now," says Bob Cecil, a managing director with EquaTerra, an outsourcing advisory firm. "Last year there was a lot of industrial tourism, but now people are signing contracts."

That eagerness has been slower to reach Asia. According to a review conducted a year ago by Everest Group, a consulting firm that advises companies on shared services and outsourcing, a mere six F&A outsourcing deals have been announced for Asian-based firms up until April 2006. Another eight had been added by March this year, a sign that the market is finally picking up steam. Another 21 have been signed elsewhere but extend to the Asian operations of multinational firms. While the outsourcing providers dream of a host of Asian-based deals emerging soon – and are investing to meet this projected demand – the current field still looks thin.

And one of the original six – an eight-year F&A contract between Singapore's Neptune Orient Lines and Accenture – is now defunct. According to Alan Wong, regional finance officer for Neptune Orient, the company opted to bring the project in-house as of November of last year, moving the work from one global center back into three regional facilities. Accenture confirms the early end to the contract, which it says was amicable.

Why has the Asian outsourcing market been so sluggish? Fundamentally, say both outsourcers and CFOs, it's harder to build a convincing business case here. These days, most – but not all – of the service providers' back office facilities are in Asia, to take advantage of cheap skilled labor. But most Asian companies already have finance employees working in low-cost environments. Shift your back office from suburban London to Bangalore and you'll easily save 30%. Move accounts payable employees to India from Indonesia, Vietnam, or Malaysia, and you could easily spend more. (Costlier Asian markets such as Japan and Australia are notable exceptions.)

It's also harder to centralize. An outsourcer taking over US finance operations for a company confronts only one language and one set of regulations. Doing the same in Asia could easily involve 15 countries and languages, and as many sets of local rules. And that means the service provider must employ in its facilities not just the usual English speakers, but workers who speak Thai, Japanese, Mandarin, Bahasa Indonesia, and Korean, just to name a few. Further, within many smaller finance operations – and local finance departments in Asia tend to be small – the finance function does more than finance. "In many countries, finance isn't just finance," says Andrew Friars, managing director for Accenture's Asian finance practice. "It's also administration, small-scale procurement and other services." As a result, a company might outsource the finance role, but find it must still keep the employee.

Finally, the Asian operations of MNCs typically employ fewer people, meaning fewer opportunities for volume-based cost reduction. For example, of the roughly 600 finance employees working for PerkinElmer, a US-based instrument maker, only 90 are in Asia. That limits the savings possible from either centralization or outsourcing, according to Robert Buckley, CFO for the company's Asian operations. Because of this, multinationals that have pursued multi-country F&A outsourcing deals have often left their Asian operations alone.

The business case hasn't been very compelling for the outsourcers, either. It costs nearly as much to bid on an Asian-based project as on a very large deal with a Fortune 500 enterprise. If the choice is a high-margin, 400-seat deal for a European company or

a difficult 100-seat project in Asia, the outsourcer will pursue the bigger deal.

There is some irony in this, says Arno Franz, Asia Pacific managing partner for TPI, another outsourcing consulting firm. "The major providers all have facilities in Asia, but not necessarily to cater to Asian companies in Asia," says Franz. "Their focus is where the big dollars are, and that's North America and Europe."

All of this would seem to suggest a market that's headed exactly nowhere. And yet F&A outsourcing, long dormant in Asia, is showing signs of life.

The view from China

The view from Capgemini's new delivery center in downtown Guangzhou is expansive, taking in not just the grayness of the city's post-war construction, but the broad Pearl River and a smattering of gleaming, half-built skyscrapers. The center occupies several floors of one of Guangzhou's new office towers, and is the service provider's third in this city (it will soon close the oldest of the three in favor of this larger office). These facilities, which will have a total of 1,500 employees, serve the Asian operations of ten local and multinational clients – mostly multinationals, including DowCorning, Syngenta, and Tetra Pak, and some Asian-based companies, too, such as Hong Kong-based Dairy Farm.

Stretching out along the windows are dozens of large cubicles, each seating four casually dressed employees, who work at flat-paneled computer terminals, processing expense forms, vendor invoices, or doing statutory accounting. There's little paper anywhere – most documents have been scanned so that the workflow moves electronically.

One flight up, the office bustles with activity, as construction workers install carpets, bolt together cubicles, and pull the plastic covers off of new desk chairs. They are getting things ready for the center's latest client, a European company that has signed on for a massive project that involves outsourcing its F&A operations from 80 countries – the Asian and Latin American operations will be served out of the Guangzhou facility, and another center in Poland will serve everywhere else. "By November, this will be full of people," says Dariusz Sus, the center's director, talking over the sound of nail guns and workers' voices.

Capgemini and other outsourcers are expanding their Asian facilities to accommodate what they say is a surge of new business serving local operations. That's especially true of Genpact, the former GE shared services operation that is now performing F&A for outside clients and is opening its fourth center in China to serve local operations. Accenture plans to add another facility soon.

"This market is consistently underestimated by the US and Europe," says Aurore Saglio-Thébeault, the Hong Kong-based CEO of Capgemini's Asian finance operation. "Our Asian contracts increased 50% last year and the value rose by 70%," referring to both F&A outsourcing and the consulting contracts that are often connected with them.

Friars of Accenture is only a little less sanguine. "It's been a slower start out here than in other parts of the world," he says. "But there's momentum. We see it in our pipelines." Accenture has recently signed an F&A deal with National Australia Bank and other local multinationals. And like Capgemini, the outsourcer has also added work serving the Asian operations of US and European companies that are now choosing to extend their outsourcing projects to Asia.

Any market growth is coming off of a very small base, of course. But Peter Barta, CEO of Everest Group Australasia, argues that Asia could eventually emerge as a major source of revenue for the outsourcing industry. "The future for finance outsourcing in

Asia will be very different from the history," he says. The firm conducted a market study that shows that while Asia only accounts for 2% of the finance outsourcing market today, that number should be far higher, given the number of large organizations here. It could eventually reach 23% of the total value.

Formidable barriers

Why the rising interest, given the formidable barriers to stitching together deals that make economic sense for client and provider alike? CFOs and vendors cite a mix of factors, including a drive to standardize finance processes globally (which in practice tends to mean getting Asia to adopt the same standards already applied elsewhere in the world) and a desire to build a platform for growth in a fast-growing region. For example Syngenta, an agrochemical company based in Switzerland, launched its 22-country outsourcing project with Capgemini as part of an effort to standardize finance and trim costs, and set the stage for further growth. Leaving Asia out of the project would have undermined the effort, says Ralph Fraundorfer, who managed the company's outsourcing project in Asia.

But two drivers predominate: CFOs' desire to make time for more valuable work and a sense that centralization and outsourcing can help avert a compliance disaster. A recent survey of 188 Asian CFOs conducted by CIMA, an association of management accountants, confirms this ordering of priorities. Among the top four challenges cited by finance executives were providing decision support, driving value, and improving compliance. Reducing costs in finance was near the bottom of the list, with only 39% of respondents choosing it.

CFOs such as Philip Chu feel pressure to help with analysis of investment proposals, and market and customer profitability analysis. They hope that outsourcing will let them shift employee efforts to these kinds of jobs.

Compliance worries are growing, too. Asia is a growing concern for CFOs, given the rapid growth and the dispersed nature of finance operations here. "In the past, you had companies decide that it wasn't important to outsource in Asia Pacific because the cost savings weren't going to be as great as elsewhere," says Capgemini's Saglio-Thébeault. "But now many of these companies are growing very quickly in China and Asia Pacific and CFOs realize that F&A has to be under control, which unfortunately, it's not. When you get to the point where 50% of your company's revenues are coming from Asia, that starts to be a really big risk."

Put finance operations all in one place and it's easier to apply a single set of controls and to keep an eye on the finance operation. Robert Buckley of PerkinElmer spends 80% of his time traveling around Asia visiting his regional finance centers, which are scattered from Korea down to Australia and across to India. He's now beginning a project to centralize those operations in a few centers. "This is about compliance – I'd feel more comfortable if these operations were in just a few places," he says.

Buckley doesn't plan to outsource, however. Indeed, at least some of the outcomes sometimes cited as benefits of outsourcing – easier compliance, for instance – come firstly from centralizing. That can be true also of cost savings and process improvements, since moving finance into shared services means agreeing on one way of handling supplier payments, for example, and getting scale benefits by having it all performed in one location.

Although new research suggests that shared services captives aren't performing as well as outsourced operations (see "Free Your Captives," page 25), many Asian companies are in fact pursuing shared services with little intention – yet – of moving to outsourcing, says TPI's Franz. "A lot of our clients have spent time on shared services and are quite content to continue down that path," he says.

How deep is your love?

Can finance outsourcing be anything more than a niche phenomenon, limited to the very biggest multinationals operating in Asia?

There is reason to doubt that it will reach many small- or mid-sized companies. “The suppliers know that the effort to do a small deal isn’t that much different from a large deal,” says Barta. “There is a threshold to get their attention.” What that threshold is isn’t clear – some analysts say outsourcers look for clients with at least US\$2 bn in revenues and others say it’s an outsourcing deal that involves at least 50 finance employees. Most companies in Asia have fewer finance employees than this.

The service providers themselves say that 50-employee deals are where a company starts to get a reasonable return, although both Accenture and Capgemini can cite deals they’ve done that have involved fewer people. Saglio-Thébeault says that the minimum is generally 30 employees, but that she’ll consider 15 to 20 if there’s a chance of more business from the company later.

Still, CFOs haven’t always encountered such flexibility. George Pan, CFO for Greater China at Sidel, a European packaging manufacturer, has been eager to outsource his Chinese finance operations, but has been told by the major Western providers that they aren’t interested in anything less than a 50-finance-employee deal. He hopes that Sidel will eventually put together a global outsourcing deal he can participate in.

Outsourcers will also need to demonstrate that they can successfully manage employee turnover. They may be doing better than company-owned captives, but attrition and wage inflation take a toll, particularly in China and India. “I worry about the vendors’ ability to deliver on their service promises,” says Martin Fahy, director of development, Asia, for CIMA. “You transfer your finance work to Dalian and after a year, one half of the employees have left. You end up with someone with 18 months experience, who is also more expensive. That inflation gets passed onto you through the contract.”

The service providers acknowledge the concern. “Attrition is endemic to the outsourcing business,” says Friars. “But we can absolutely manage it.” He cites Accenture’s practice of documenting processes at an extremely detailed level, so that a new hire can be trained and doing the work well in just a few days. Genpact – which claims to have some of the lowest attrition rates in the business – points to its rigorous employee training activities as motivators for employees to stay.

Capgemini’s delivery center in Guangzhou has also struggled with the attrition problem. “When I came to Guangzhou in 2005, turnover was really bad, 50% annually,” says Dariusz Sus. “Since then, we’ve reduced it to 18% and aim to get it to 15% this year.” The steps he took included replacing many of the original managers who had been brought from Hong Kong, and sometimes clashed with the local staff. He has also focused on offering employees chances to try different kinds of work – different client projects and different finance activities.

Service providers will also have to win the confidence of local CFOs. Jimmy Spencer, CFO of Chemtex Group, an international engineering firm based in Mumbai, rules out the idea of finance outsourcing, largely for security reasons. “Irrespective of the stature of your service provider, the people doing the work are human beings,” he says. “It is very difficult to avoid a situation where there’s a leak of information or a conflict of interest.”

Finance activities that involve interaction with customers – especially collections – will also be a tough sell. According to Friars, Neptune Orient Line’s decision to take its outsourcing project back in-house began with a change of CFO and a decision that it would be better to have customer-facing work performed in regional centers (and hence closer to customers) rather than in one central back office in China. Alan Wong of

Neptune Orient says that although the company was happy with the service it received, collections were one factor in wanting to take the project back in house. Some of the collections work has even been returned to local operations, often because of language issues.

Value proposition, revisited

There's a final hurdle for service providers: convincing CFOs that, in the absence of irresistible cost savings or a corporate mandate, a major F&A outsourcing project is worth the effort. Better compliance and a chance to move employees away from the duller aspects of finance are certainly appealing, but when companies have decided to outsource finance, the decision has typically turned on cost reduction.

The good news, says Barta, is that this challenge comes at a time when the industry is investing in new ways of making outsourcing pay. "The value proposition in the past was labor cost arbitrage, but that's not the future," he says. Instead, he sees them concentrating on new technology – software that automates finance processes, helps CFOs catch errors, or analyze their data.

Friars gives an example of how Accenture uses technology to improve accounts payable. There's an online portal that vendors can use to submit their invoices directly into the system – if they still send paper, those invoices are scanned with an optical character reader. The system automatically matches the invoice with the purchase order and with a goods-received note. The manager who needs to approve the payment will get an email asking for approval, and can respond electronically. Automation promotes efficiency: a process that might have required 20 people before now needs just five and takes half the time.

Additionally, there's technology that can check to see whether any payments are being made in accordance with the contract the company has with a supplier. For example, a company might not be taking advantage of a volume rebate that it's entitled to. Reviews of a year's worth of payments typically reveal that a company has made US\$1m to US\$3m worth of unnecessary payments for every US\$1 bn spent, says Friars.

Capgemini employs similar tools. The company also offers services such as outsourced internal audit for Sarbanes-Oxley compliance, performed out of its Indian service center – something that can save a great deal of money, given the cost of such experts in the US and Europe. Saglio-Thébeault says such add-ons are necessary to help CFOs justify their outsourcing projects. "If a CFO from Europe outsources, he saves 30% immediately," she says. "For the CFO in Asia, 30% is hard to achieve with just labor costs. We need to be smart and offer services that will make him money."

Not everyone is jumping at the chance. "I understand their argument" about process improvements and technology, says Buckley. "But the fact is, by saving the 15% margin that I would pay to an outsourcer, I can just go and hire ten to 20 more employees to do analytical work." Or a company might spend that money on technology. Fahy predicts that many of the Asian companies that don't opt for either outsourcing or shared services will buy systems such as the scanning/workflow software that Accenture provides its clients. "These tools sit on top of your existing IT platform and the cost of ownership is low," comments Fahy, who says that the payback period is as little as six to eight months.

Deciding whether finance outsourcing pays, of course, depends on what a company wants out of the effort. The list of possible benefits for an Asian operation that wants to outsource is long: it runs from cleaner processes and easier compliance to the chance to be liberated from the tedium of transactional process. And despite the skeptics, there are companies like Syngenta, for whom those have been compelling reasons. "As a result of our outsourcing project, we've been able to shift management attention to

market- and customer-facing areas of the business,” says Fraundorfer.

That’s a real benefit, to be sure. Just don’t count on saving much money. **CFO**

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Free your captives

For years, CFOs who couldn’t bring themselves to give up day-to-day control of their finance function have opted for shared services in countries like India. But according to a recent study by Forrester Research, 60% of captives (as wholly owned shared services centers are also known) on the subcontinent are failing. Among other problems, the centers suffer from rising costs and alarming attrition rates – some see turnover rates of over 100%. Those workers typically leave to join large service providers, which generally have more success recruiting and retaining staff because they offer more training, better variety, and a possible career path.

The study also found that service providers are better than captives at achieving savings. Despite the 15% margin that service providers typically charge, their loaded cost per employee is still less than for most shared services centers. The Forrester survey found that the average employee cost in a captive was US\$4,944 compared with US\$4,231 in an outsourced arrangement.

Beset by problems, some shared services outfits will simply be turned over to outsourcers, say analysts. But there are alternatives to consider – increasingly popular choices that sit somewhere between pure shared services and outsourcing. There’s the “virtual captive”, in which a vendor owns the facility and supplies the manpower, but the corporate customer supplies the management oversight. There’s the “microcaptive”, where a company either brings a service provider’s employees into its own captive facility to take over certain processes, or sends out select processes for the vendor to handle on its behalf.

Other companies, says John Halvey, an attorney with Milbank Tweed in New York, are setting up more traditional outsourcing arrangements but are securing options from the service providers to buy those facilities back at some point.

Whatever happens to the captives, says Cliff Justice, a managing director with EquaTerra in the US, one group will clearly benefit. “The problems with captives are a big opportunity for the service providers, and they know it.” – DD