CHAPTER 1

The Finance Outsourcing Landscape

TRANSFORMING THE FINANCE FUNCTION THROUGH OUTSOURCING

Alan Eilles, Vice President Group Financial Infrastructure
BP

BP plc is one of the largest oil companies in the world. The company first outsourced its European upstream accounting services 15 years ago in a groundbreaking contract worth $20m a year. By 2002, the outsourcing of finance and accounting (F&A) had been extended to other businesses in the group and elsewhere in the world – and the value of the contracts had risen to $1.5bn. The BP deal is the largest and most enduring F&A outsourcing arrangement ever. Undoubtedly, one of the biggest successes BP has achieved has been the smooth integration of five major acquisitions into its outsourcing arrangements. Alan Eilles credits BP's usage of outsourcing and its outsourcing suppliers with contributing to this success.

Alan Eilles is responsible for managing F&A outsourcing contracts across the BP Group. He has also been involved in the global restructuring of many F&A deals as they matured and in renegotiating outsourcing scope as circumstances changed. He comments:

'As we demonstrated success through outsourcing and became confident in other service providers, these relationships broadened across BP. Initially, this was

seen as a financial transaction for accounting outsourcing. Now, it encompasses a broad spectrum of services including: systems, technology, tax, property management, HR services, construction, and procurement.

'Clearly we've received benefits over the past several years that were only aspirational when we first began outsourcing. If you only partially outsource, you can never completely access the potential economies of scale. We have seen cost reductions every year for each of the 13 years of our outsourcing experience. In fact, in the first seven years, the volume of work in the outsourcing centers doubled, due to taking on new oil fields, but our F&A costs were halved.'

When BP merged with Amoco, its scale of operations radically changed overnight. Alan Eilles says:

'Consolidation of acquisitions was the key agenda point – in accounting, we wanted to up the level of materiality and bring down the clerical workload! The business case for outsourcing was revitalized by our acquisitions. Our new scale made it even more compelling.'

Based on BP's size and the complexity of its various businesses as well as the immaturity of the outsourcing market in 1998, BP decided to minimize the risks involved by dividing upstream and downstream F&A operations between two outsourcing partners, Accenture and IBM. Alan comments:

'Today, we have two very engaged and serious firms. After much deliberation, we decided to go with a two-supplier model because we wanted to encourage a competitive dynamic and reduce risk. We split upstream and downstream between Accenture and IBM in both Europe and North America to ensure that we had resilience across the board.'

BP's suppliers have outsourcing F&A centers in Houston, Tulsa, and Alaska in the United States, and Calgary in Canada. In Europe, the F&A outsourcing centers are in Aberdeen, Rotterdam, and Lisbon. Recently, both BP outsource partners have chosen to migrate and consolidate a portion of the F&A operations in low-cost locations, such as Bangalore in India, and Krakow in Poland. As Alan notes:

'The main benefit of moving location is labor arbitrage; however, we have found benefits in both labor quality and embedded process improvement skills. How critical is location? Well, the move to India and offshoring generally in F&A outsourcing will drive change, as companies in the western world shift from considering the "which city" issue and look deeper into collaborative practices. We need to turn our

attention toward moving our business processes from being oil-centric to being cross-industry to gain further scale globally. This means that we don't necessarily want to own the process; ultimately the supplier should.' While location is important and feeds change into the equation, transition management is also critical to success. Eilles says:

'You want things to happen smoothly and peacefully. Otherwise, the relationship gets off to a bad start from which it is tough to recover. I am delighted to say that our outsource partners have done a good job in transition management.' BP's initial strategy was to get key employees to transfer to the outsourcer because their knowledge, skills, and corporate history go with them.

'But we also want a balance,' notes Eilles. 'We also bring in people from the outside in order to help create a new culture and do things differently. With transition to new geographies the old paradigm of moving existing employees had to be broken. Of course, this places even greater importance on transition management. Where and how do you cut the process for outsourcing? Our practice at BP is to retain in-house matters of judgment, policy, and interpretation.'

The company F&A services now being outsourced include general accounting, joint venture accounting, retail site accounting, hydrocarbon accounting, inventory accounting, accounts payable, and in some cases preparation of financial management information. While BP has pushed the envelope on what has been outsourced it still believes in its original premise that transactional services should be outsourced, and analysis and decision-making remain BP internal activities.

Drawing from experience, Alan notes that any business will change over time. Accordingly, outsourcing deals need to change. In one outsourcing location, BP has been through multiple contract renewals. It started as a fixed price deal, and then became open book, and finally cycled back to fixed. Alan says he would not be surprised if it moved back to open book again. He comments:

'Structuring involves many variables, including the preferences of the individuals managing the deal. Sometimes it is about achieving the next level of benefits. The first round gives you the low-hanging fruit; later, it's about change and realignment. You have to focus your people on continuous improvement. We still have not yet achieved lights-out back-office processing for accounting. We'll get there, but it's a few years away. With all our acquisitions, we are still consolidating and standardizing. For example, we are implementing a SAP platform in North America and Europe

to simplify and standardize our infrastructure.' Eilles advises companies considering an outsourcing initiative for the first time:

'You should invest serious time and energy in developing and maintaining the relationship. Both parties must be treated fairly. There will always be changes and difficult times, but at the end of the day, the quality of the partnership and the relationship will have a significant impact on the financial success of the deal.

'The original outsourcing scope was the North Sea story. The challenge by John Browne, the chief executive of BP, was: "I want you to provide a more holistic approach." This didn't mean that the outsourcers had to do more work for BP around the world. Rather, he wanted them to understand BP's business at the strategic level and to focus their offer where they could add value.' In keeping with the vision of the CEO for the organization as a whole, BP's first outsourcing initiative was a truly forward-thinking arrangement. Alan explains:

'Creating an internal shared service center would not have driven internal transparency. People at BP were used to spending significant effort on internal allocations. Outsourcing allowed BP to gain a complete understanding of its accounting costs. Now we have an open book on cost, quality, and metrics. I can honestly say we have never looked back!' Alan continues:

'This deal was perceived as innovative and years ahead of its time. It was courageous and it took strong, committed leadership to actually make it successful. For me personally, one of the biggest challenges was making sure that the transitions to our service provider's new outsourcing centers were managed successfully.'

In this initial outsourcing arrangement, BP centralized the organization into a single location in Aberdeen; it brought together accounting people from Glasgow, from accounting centers in England, and from two offices in Aberdeen. So essentially, it combined some 6 accounting groups from these locations. Alan points out:

'In terms of cost reductions, we had a target of at least 30%. We've delivered more than 50%, a very solid performance. In terms of being a catalyst for BP and for the industry, we have evolved from a single-service center into a multiclient site in Aberdeen. Part of our initial vision was the availability of industry-wide accounting services in the North Sea. And we are very pleased that the outsourcer and other oil companies have come together. They can learn and quickly transfer ideas from one company to another. Today the service provider owns the people, processes, and

SAP systems technology. This has created what I would call a community of value. Alan Eilles summarizes:

'Would we ever bring this back in-house? My answer would be no! First, we are finally seeing the outsourcing market mature. The advancement of multiclient centers will create new value. Second, as new low cost centers spring up around the world I want to have easy access to these opportunities. If BP were to insource now we would be doing so at the wrong time. You do need the full and continuing support of the CEO. It took us several years to build up the necessary experience and confidence. In the longer term we seek robustness, with centers that provide service on a rolling basis through time zones around the world. We want the ability to shift services across locations to reduce the risk of service disruption and to take beneficial economies. This flexibility will be a significant benefit of increased outsourcing scale.'

BP has the largest F&A outsourcing program in the world. They see outsourcing as a fundamentally new way of doing business. In their view, outsourcing has offered benefits that extend far beyond the enormous cost savings they have reaped. BP's outsourcing relationships have had a transforming effect, not only on accounting practices, but also on the managerial style of the company itself. By outsourcing financial operations and increasing control – the heart of every business – John Browne and Alan Eilles believe that the enterprise as a whole has been encouraged to be more innovative.

BP's experience underscores three powerful advantages that outsourcing offers:

- **Radical transformation:** Outsourcing is not just a tactical weapon, but a strategic one. BP has successfully deployed its outsourcing model to stimulate broad structural change. Outsourcing has been key to creating value without compromising corporate objectives.
- **Growth through business partnering:** Outsourcing is about partnering, not merely service provision. BP, for example, has worked vigorously to develop long-term strategic relationships with suppliers who are prepared to invest both expertise and resources in BP's business.

- **Increased innovation:** By moving priority non-differential processes (whether they be deemed to be core or non-core) and activities outside the enterprise, BP has released internal resources to focus on its strategic agenda – *a key source of competitive advantage*. Deploying its outsourcing model on a global scale has helped BP to fast track this shift of internal resources from operations to innovation.

Most of the executives we interviewed for this book have not had the benefit of BP's experience. Among the advantages that BP has reaped from outsourcing are: powerful economies of scale, standardized processes, advanced technology, and continuing investment in the back-office. As more and more companies of all shapes and sizes consider the outsourcing continuum that BP has pioneered, CFOs and their finance team members have many questions:

- How does a sophisticated, successful enterprise with all its complexity and global spread achieve tangible results from finance business process outsourcing (BPO)?
- How do you ensure you're working with the right outsourcing partner to achieve a step-change, sustainable improvements, and a good cultural fit over the longer term?
- How relevant is the BP experience to other companies?

In this chapter, we look at the *evolutionary shift of the finance function* from the late 1990s trend towards in-house shared services to the current phenomenon of finance BPO. We survey *who is doing what*. We capture current thinking and describe the new business model that is emerging, powered in part by innovative outsourcing techniques. We go on to examine the drivers behind this trend and the value proposition they deliver.

THE IMPACT OF FINANCE BPO ON THE CORPORATE AGENDA

The overwhelming finding of our research is that the outsourcing promise is both tantalizing and tangible. Outsourcing suppliers pledge to perform front- and back-office functions, including F&A, far more cheaply and efficiently than companies can do on their own. Our research shows that outsourcing delivers powerful economies of scale by using standardized processes and leading-edge technology. It also makes continuing investment in back-office improvements affordable for companies of all shapes and sizes. This adds a completely new dimension to the traditional outsourcing model: an intriguing market dynamic in which minnows can compete on the same terms as industry giants.

Higher quality service at ever-lower prices is irresistible, particularly when outsourcing allows companies to focus on the true competitive core of their businesses. The logic is simple: If someone else can perform mission-critical processes cheaper, faster, and better while ensuring the highest standards of security, integrity, and control – then why not make the leap into outsourcing?

Sophisticated technologies that automate routine tasks and connect far-flung corporations via a single platform are fuelling an unstoppable trend. Furthermore, locations are emerging that can provide highly skilled workforces at very low cost. Prime examples are Bangalore in India, Prague in eastern Europe, Shanghai in China, Curitiba and Sao Paulo in South America. A mature network of multilingual service delivery centers linked across the globe is now a reality. Many of the CFOs we interviewed expressed both surprise and shock at the speed with which this industry has come into being.

Business process outsourcing – contracting with an external organization to take responsibility for providing part or all of a business process or function – is not new in F&A. Companies have a long history of buying standard, discrete processes such as payroll, credit checking, debt factoring, check printing, and regulatory reporting from external service providers.

During our wide-ranging discussions with senior finance executives, we discovered an obsessive interest in the broader role that outsourcing is assuming. But why – and why now? Simply because operating costs are too high, huge investments are being made in undifferentiated, non-competitive areas, and everyone is still searching for the Holy Grail: the ability to out-compete everyone else. Restoring growth in profits is an absolute necessity, but we have found that this is sustainable only if it is based on a *radical* transformation of the current business model.

Senior finance executives have continued to ask a number of common, recurring questions:

> *'We have read that company XYZ is deep into outsourcing; what's the story? They have a reputation for being in the upper quartile for efficiency; what contribution has outsourcing made and where does it fit in?'*

> *'We hear others are outsourcing accounting; can they be serious? With tighter and tighter regulation, isn't there a control risk? Will we lose control and won't it be more difficult to achieve regulatory compliance? I cannot reconcile this with the fact that so many are going into outsourcing; what's the story?'*
>
> *'What's this I hear about shared services centers that are located in Costa Rica, Shanghai, and Manila? I know another company that's moving its finance function to India. What should we be doing? Why are companies doing this?'*

In the wake of explosive business scandals and the erosion of public confidence, a new corporate agenda is emerging. Investors, the media, regulators, and governments insist on transparency, honesty, and trust. The stock market now has unprecedented access to more accurate data underlying the drivers of corporate performance. Finance and industry analysts regularly meet with CEOs and CFOs. The result? More realistic and meaningful investment information that regulators such as the SEC are scrutinizing constantly with a stream of new regulations in the pipeline that are intended to make decision-making more transparent. CFOs do not work in isolation. They, together with their boardroom colleagues, are addressing the challenges posed by new market dynamics and accountability demands:

- **Growing interconnectedness**, through global capital flows, geographically transferable technology, and increased transnational trade – all supported by international treaties and protocols
- **Increased organizational scale and complexity**, with wider asset deployment, ever-more complex reporting structures, and tensions between control and flexibility
- **Pervasive low-cost technology**, creating the opportunity for a technology environment that is always on, always active, always aware, always changing
- **Increased scrutiny from financial markets**, regulatory bodies, and the public – magnifying every aspect of an enterprise's financial and operating performance
- **New roles for knowledge and intangible assets** – drivers of today's economy, in which brand, intellectual property, reputation, loyalty

and, perhaps most important, a commitment to innovation, have become key competitive weapons

- **Changing workforces**, with new capability development, motivation, and retention issues raised by diverse employee populations.

Our research confirms the fierce competitive battle being waged for scarce investment resources to pay off corporate debt and recapitalize balance sheets to fund the next phase of growth. It also reveals a radical rethinking of conventional business wisdom. As described in Chapter 2, a process of strategic renewal and innovation is now under way that will produce a new operating model – lean in asset consumption and heavy on growth in revenues and cash margins.

In the past, companies sought pure cost reduction from outsourcing; better service at lower cost was the goal. Today, forward-looking companies are moving beyond this. We have discovered numerous examples of strategically focused outsourcing partnerships based on long-term commitments between service provider and client companies that have produced radical new business models. Such alliances commonly pool the very best assets and capabilities of both partners to create new sources of competitive advantage and spur step-changes in economic performance. Similar in their impact to disruptive technology, such arrangements promise to reshape whole industries. Although cost reduction remains a key objective in today's climate, for most companies, the real prize is rapid transformation of the business model leading to higher market valuation.

Once a company's top-level team has selected the operating model that will shift its business into a higher shareholder-value creating gear, it then faces the next serious challenge: acquiring the capabilities needed to implement the changes required. This is where transformation and BPO (distinct from pure commodity-based outsourcing) come in.

THE CFO AND FINANCE TRANSFORMATION

Recently, the finance function has undergone major changes in response to two distinct, but converging forces:

1. **Transparency**: Finance has never been under so much scrutiny – or faced so much pressure for change. Although adherence to proper accounting principles and disciplines is part of the answer, it is not

the entire picture. Communicating to stakeholders the economic *value* of the business is still important, but conveying how this *value* is *changing and why* is equally so. Finance must broadcast this not just internally, but externally, to investors and other stakeholders.

2 **Technology:** Most companies have invested heavily in ERP. Many CFOs tell us that they have no choice but to continue with their programs of simplifying and standardizing business processes; but there remains much to do. In addition, CFOs now wish to beef up their *decision support capabilities, but they can only do this is if they free up time from the routine daily grind of transaction processing and bookkeeping.* Their problem? The explosive growth of technology has created what we call *systems spaghetti*.[1] The only way to cut through this is to simplify and streamline unnecessarily complex business processes, systems, and structures.

Propelled by these two forces, the role of the CFO is changing from scorekeeper to strategist. Finance, accounting, corporate strategy, and economics have all converged as never before. As Figure 1.1 demonstrates,

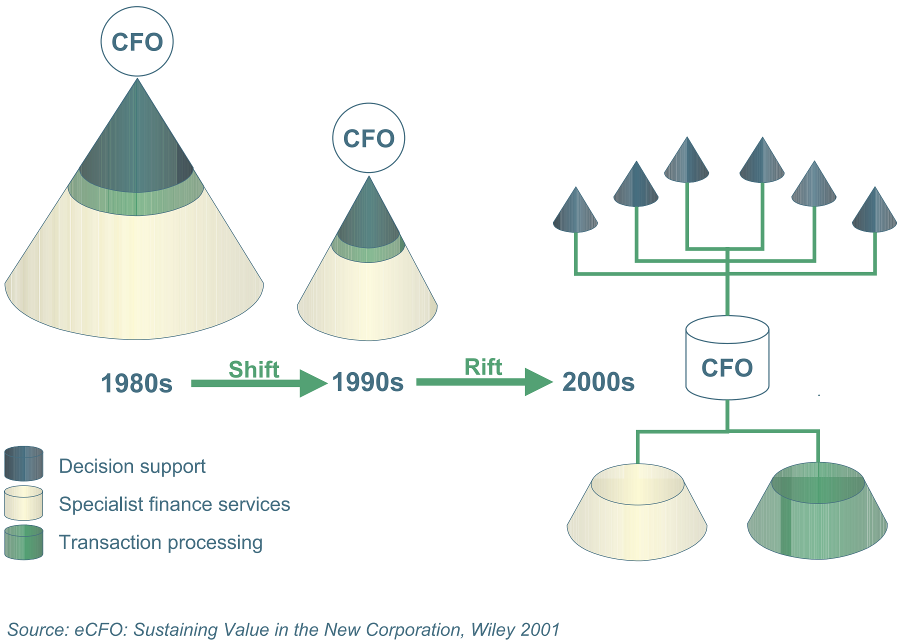


Figure 1.1 *The changing shape of finance*

today's CFOs are shaping the futures of their finance functions at an accelerated pace.

In Figure 1.1, the finance function of the 1980s is portrayed as a relatively fat pyramid, emphasizing transaction processing and lightly promoting decision support. In the 1990s, finance leveraged ERP systems and became more compact, with a leaner transaction processing operation and greater focus on performance management. By the late 1990s, the Internet had made its mark. As explored in the book, *eCFO: Sustaining Value in the New Corporation*,[2] the CFO became the center of a web of relationships managing the value of the extended enterprise. The finance function was fragmented, with transaction processing operated remotely in shared services or possibly outsourced. Decision support was embedded in business units. Today, the success of this more fragmented model depends on the CFO's ability to maintain the integrity of processes and systems.

WHY MOVE TO SHARED SERVICES?

Effective shared service centers (SSCs) are not about maintaining the status quo of the in-country, federated business model; they are about unremitting innovation. They need to be supported by strong corporate commitment to investment in leading-edge solutions. Our research and interviews with hundreds of organizations worldwide have led us to conclude that the decision to enter into outsourcing arrangements rather than adopting the in-house shared service option is motivated by six factors:

1 **Efficiency:** Multiple business units operating with independent support organizations and systems are being closely scrutinized for cost-effectiveness

2 **Growth:** Intent on growing through acquisitions/joint ventures, companies are concerned about efficiently absorbing acquisitions

3 **Scale:** Large transaction volumes and/or above-average processing costs are pressuring large companies to improve operating performance, while small- and medium-sized businesses want access to economies of scale

4 **Location:** Companies are seeking new geographic opportunities to cut costs without compromising skills

5 **Capability:** Outdated legacy processes/systems and the need for change are tempered by concern over previous failures to build new capabilities

6 **Reputation:** Internal and external pressures are mounting to increase the finance function's service and value, and to improve controls and transparency.

As companies fine-tune their approaches, feedback about what works and what doesn't is rapidly accumulating. Some distinct shared service trends are evident:

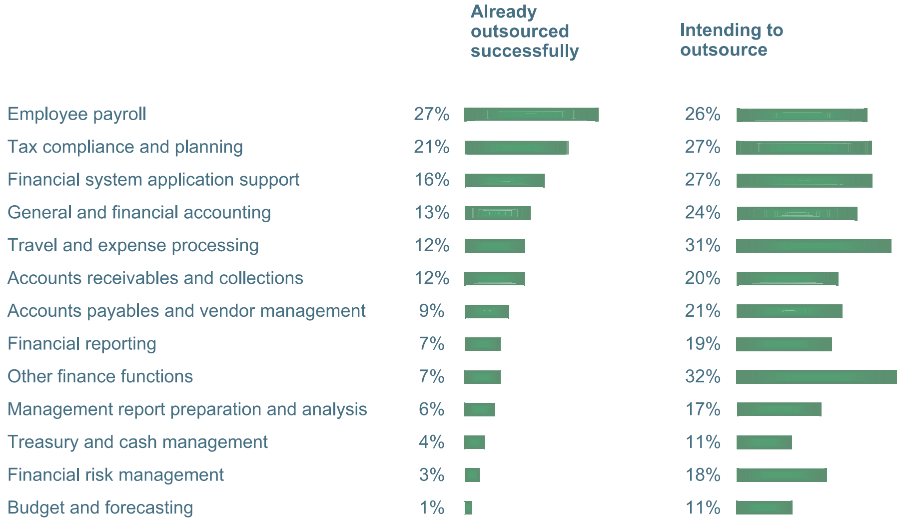
- **They are expanding in scope ...** Economies of scale are being achieved by bringing more countries and business units into the fold. More processes are included, such as IT, finance, human resource management, procurement, and customer relationship management (CRM).
- **They are becoming more and more automated ...** Better technology, less human intervention, and greater speed are close to making 'lights-out processing' a reality.
- **They are increasingly serving more than one client ...** Mega players, such as BP, who have used large, dedicated regional centers for the past decade are being joined by agile, fast-growing smaller companies. The age of multiclient service centers has arrived, giving small- and medium-sized companies access, for the first time, to scale economies that only their larger brethren have been able to enjoy.
- **Businesses are being pushed towards greater flexibility ...** Companies are being driven to decide more quickly whether to perform services internally or to outsource them. Why? Mainly because they must move faster than ever before to absorb new acquisitions, handle disposals, and manage corporate restructurings.
- **Businesses are working hard to drive down investment and operating costs ...** They are using new technology to process transactions in lowest-cost locations, wherever they might be. They are partnering with suppliers, customers, and competitors – and, in some cases, they are sharing non-strategic support services. The leading outsource providers continue to invest in next-generation, high-performance technologies, freeing client companies to redirect their investment programs to spur innovation and create competitive advantage.

OUTSOURCING: WHO IS DOING WHAT?

Despite the growing attractions of outsourcing, finance remains a function that executives handle with care. There is far greater interest in outsourcing low-risk, routine tasks than the more analytical, value-added ones. 'If you have a high-volume, repetitive transaction, you are leveraging economies of scale and it works well,' says one executive. 'You can't outsource thinking, but you can outsource brute force,' quips another. 'We keep the role of the orchestra conductor and outsource the rest,' explains a European finance director.

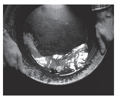
Consider the results[3] shown in Figure 1.2 of a survey in which more than two hundred senior finance executives were asked which processes they were already outsourcing and which ones they intend to in the future.

The first outsourcing candidates are typically 'commodity' processes, such as payroll. Such processes require limited company knowledge and do not add competitive advantage. Some pioneers are moving beyond basic service provision to include performance reporting and business analytics. Other companies plan to broaden their programs down the road



Source: Accenture and Economist Intelligence Unit Research, 2003

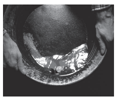
Figure 1.2 *What companies outsource now and plan to outsource in the future* as they gain experience. One chemicals company, for example, intends to expand its outsourcing program from accounts payable and receivable to general accounting and treasury. Companies tend to retain in-house finance policy formulation and management judgment.



CASE STUDY
Thames Water

Thames Water is a typical example. Its director of finance and support services describes the company's finance function as a pyramid with four tiers. The first tier at the bottom covers transactional activities, such as payroll and accounts payable; the second handles financial and management accounting; the third covers finance decision-making; the fourth is responsible for strategy and policy. Tiers one and two account for 80% of Thames Water's finance headcount. Most of the first tier is outsourced, while second-tier activities – cash management, reconciliation of cash, statutory reporting, and management accounts – are run through a shared service center. The CFO of Thames Water would consider outsourcing the second tier as well, but he draws a line there. 'When you look to outsource management judgment,' he says, 'you cannot hold the business manager responsible.'

Jones Lang LaSalle (JLL) is well acquainted with the complex issues involved in choosing how far to commit corporate resources to the care of outside suppliers. It has a dual involvement in outsourcing. As a service provider, it offers property-outsourcing services to its far-flung clients around the world. As a user of external suppliers, the company has gradually expanded into outsourcing. Along the way, it has learned first-hand some major lessons about managing and negotiating outsourcing programs.



CASE STUDY
Moving from IT to F&A outsourcing

Jones Lang LaSalle is one of the world's leading global real estate services and investment management firms, managing 735 million sq. ft. of real estate properties and facilities, with $20.5bn in real estate investment under management, and 7000 *professionals. It provides strategic advice to major companies owning, occupying, and investing in property around the world.*

The company was formed as a result of a recent merger between a leading partnership in London (Jones Lang Wootton) and one in Chicago (LaSalle). These partnerships were merged and floated on the NYSE (JLL) in the late 1990s. Lauralee Martin, the company's global CFO, says:

'The transition from two country-based partnerships, albeit with multinational coverage, into one global publicly listed company, has provided us with strategic advantage. But the transition has also confronted us with many internal management challenges. Although we are a global corporation, we still recognize the importance of the partnership ethos in our management culture – in pursuit of excellent client service, we encourage entrepreneurial flair and incentivize our best people. Although we wish to be fully aligned globally, we do not believe in standardization for standardization's sake.' JLL sees its strengths today as:

- *Global reach, with consistent culture and service*
- *Global best practices and infrastructure*
- *Investment in technology and research.*

As Lauralee Martin notes, 'We are an outsource service provider ourselves because we offer property outsourcing services to our clients.'

DRIVING IMPROVED PROFITABILITY

In its drive to improve profitability, JLL is creating new revenue opportunities by capitalizing on the outsourcing trend. Its recent most prestigious outsourcing win was Procter & Gamble, which has outsourced global facilities management to JLL. This involved the transfer of over 600 people from P&G to the JLL property service, with over 40 million square feet of property under management.

Stakeholder management is probably the single most important factor in ensuring the success of an outsourcing deal the size and complexity of P&G's. Security of employment for those employees being transferred from one organization to another – their compensation and incentives, and their alignment with business objectives are all high on the early transition agenda.

Having experienced outsourcing as a supplier, Lauralee comments on some of the learning points gathered from her company's recent P&G success:

'We believe P&G chose us above our competitors for the quality of our people – their temperament, their attitude, their deep experience, and excellent references – which combined to produce a good cultural fit. P&G's challenge was to secure a positive reaction from its in-house property staff to the outsourced deal. In return, we had to provide the senior level of management we have taken on from P&G with even more attractive career opportunities.'

JLL sees the skills and sequencing required for outsourcing deals the same way it sees any M&A (merger and acquisition) transaction. First, due diligence; second, post-acquisition planning, and third, deal negotiation. Governance of the ensuing contracts is high on the agenda. Lauralee comments:

'You have to connect responsibilities for decision-making with accountabilities for results. How decisions are made, who's responsible for delivery – these issues all need formalizing and documenting. Our experience shows that if you have to revert to detailed change control evidence and the contract itself to resolve disputes, then governance can become a nightmare. What you need is a sound set of business and governing principles that allow for flexibility and relationship-based dialogue. Confronting the difficult issues face to face is much better than resorting to legal documentation and data.'

The drive for improved operating efficiency at JLL has led them to focus on cost management and streamlining their back-office. JLL also decided to take some of its own medicine and experiment with outsourcing some of its own administrative infrastructure.

INFRASTRUCTURE OUTSOURCING

The company has adopted a 'tactical, evolutionary' approach to outsourcing its own infrastructure rather than going down the 'big-bang' route. Soon after its merger, JLL had some early challenges with IT in terms of the need to connect its huge new global platform. Lauralee comments:

'We thought that by outsourcing IT we were going to solve many of our internal management process problems following our merger; our outsourcers were encouraging us to believe in a vision, a dream, rather than reality. IT outsourcing was only part of the solution; we also needed to streamline and standardize our systems and processes. We also underestimated the workload for us internally. Outsourcing places more, not less, demand on your internal management to manage both the *outsource supplier as well as the transition. My experience shows that you have to work twice as hard when working with an outsourcing consultant through the transition phase, but it pays off in the end.' JLL's IT outsource contract has had to be re-negotiated twice, but is now delivering results.*

The complexities of the company's business processes in Europe provided the next greatest opportunity for savings.

OUTSOURCING PROCUREMENT

JLL believes in establishing a solid base line for service management on outsourcing contracts. Service contracts are based on two key monitoring principles:

1. *Metrics – where possible work outputs are quantified and measures established.*
2. *Judgment – even with the most precise measures, subjective judgment is still required to evaluate performance and, as such, strong current relationships and well-documented performance review dialogues are essential.*

The key to success in any outsourcing deal for JLL is to bring these two principles together in a way that improves both service quality and efficiency. As Lauralee points out:

'In the USA, we have already outsourced some of our back-office processes, such as travel and expenses (T&E), HR and benefits, and IT support for desktops. We retain inside our organization customer-related activities, including client accounting. However, in Europe, we are starting our outsourcing program with indirect procurement. This evolutionary approach is aimed at picking the low-hanging fruit first – activities with relatively low risk – for example, procurement savings in stationery of 30% of spend are already being achieved. We are starting with the UK and working through, country by country. As our confidence grows, we shall then potentially expand the scope from indirect procurement to client-related property spend (direct) and to other related finance processes such as accounts payable.' The outsourcer on this contract is incentivized for a basic service level with a base fee, supplemented with a success fee based on savings achieved. A scorecard monitoring key performance indicators (KPIs) monthly has been developed to manage the contract as a whole; quarterly contract performance reviews are carried out during the year.

DEFINING PRIORITY F&A PROCESSES TO OUTSOURCE

This CFO defines the following non-core finance activities as suitable for outsourcing:

- *Payroll and benefits*
- *Procurement, payables and T&E*
- *Fixed assets*
- *Credit vetting, debtors and collections.*

Lauralee does not believe that activities such as budgeting and forecasting, and contact activities related to client contracts, should be outsourced since they require judgment and JLL core skills. She says:

'We wish to retain in-house those activities that require our specialist knowledge and where we run the risk of making business-critical errors or exposure to regulatory risk. The Sarbanes-Oxley regulations should be good for the outsourcing business, since both processes and risks will have to be fully documented. In a good outsourcing contract, you should map your processes, document your decision rights, define your service management framework, and insist on regular internal control audits. However, before I move significantly up the food chain in outsourcing my finance function, I would like to know more about what works well for other companies in outsourcing finance and what the benefits would be if we were to do things differently. I would also like to know more about outsourcing situations that haven't gone so well and the lessons learnt.'

More and more companies are choosing to source corporate functions with external business partners. An Accenture report developed in collaboration with the Economist Intelligence Unit, *Outside Upside: Finding focus through finance outsourcing*, draws these main conclusions:

- **Finance outsourcing is gathering momentum:** Of the survey respondents, 71% expect finance outsourcing to increase over the next three years, 30% are currently outsourcing their F&A function – and a majority of these think the arrangement has been very successful (8%) or successful (57%).

- **Outsourcing reduces costs:** Companies with metrics in place report significant savings from outsourcing their F&A functions. For example, Rhodia, the French specialty chemicals company, reduced spending by 30% in two years. Overall, 66% of survey respondents saw 'lower costs' as outsourcing's major benefit.

- **Outsourcing supports core competencies:** Reduced costs are not the only – or always the most significant – benefit. Outsourcing relieves finance managers of repetitive or generic business tasks, letting them concentrate on high-level, value-added activities. By enabling companies to review and reshape entire business processes with an outsider's discipline, outsourcing can help companies execute ambitious transformation plans. Some 55% of survey respondents saw a sharper focus on core competencies and 32%, increased business productivity, as outsourcing benefits.

- **Awareness of potential risks is high:** Outsourcing is often *perceived* as risky. Many executives worry that it involves surrendering control over vital business functions. More recent surveys undertaken by IDC and others show that most executives actually report increased control having entered into outsourcing arrangements.

- **'Commodity' tasks are first in line:** Executives are keener to outsource repetitive, generic finance processes than they are to hand off operations requiring higher analytical capability. Payroll is a common starting point. It is the activity outsourced by the single greatest proportion (27%) of survey respondents. Niche and specialist areas, such as tax planning and compliance, are other natural outsourcing candidates.

- **Precise deliverables are essential:** To keep outsourcing arrangements on track, contracts should detail both client needs and outsource provider responsibilities. Fees should be performance-based and incentives structured to ensure continuous improvement. Metrics should be unambiguous. Alarmingly, 82% of survey respondents had no system to measure outsourcing benefits. Faith in providers may offer an explanation: 71% of respondents cited mutual trust as key to successful finance outsourcing.

- **Outsourcing can cause discord:** Even if F&A staff are transferred to the outsourcing provider, short-term upheaval is inevitable. Resistance is to be expected from employees and departments whose jobs are transformed or eliminated; only firm management will ensure that outsourcing providers receive information for the processes inherited. Explicit timetables and well-designed severance packages help.

- **Sustained management is crucial to success:** Two of the main barriers to outsourcing cited by survey respondents were 1) cultural resistance (50%) and 2) vested interest in defending jobs, budgets, and power (40%). Company leaders must remain committed and involved to overcome such obstacles as they arise.

- **Outsourcing reinforces transparency:** A surprising 73% of survey respondents felt that finance outsourcing could improve disclosure by creating a healthy separation between managers trying to achieve performance and accountants charged with measuring it.

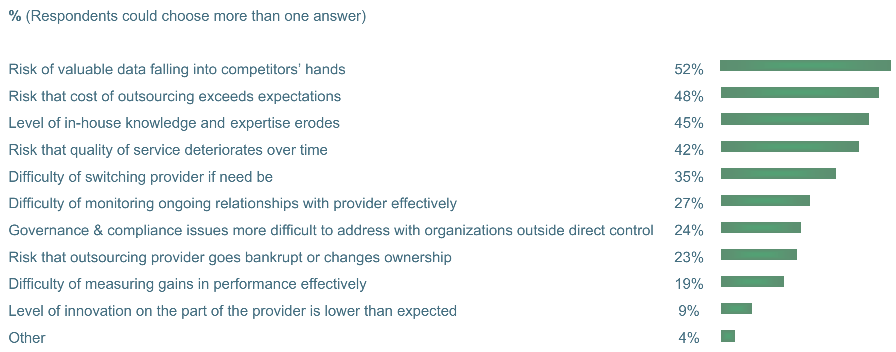
- **Shared services can be the first step:** By standardizing and centralizing F&A operations – and integrating disparate IT systems onto a single platform – SSCs can help reduce headcount and consolidate regional or country back-offices operations. SSCs are tricky, time-consuming, and often costly to set up. Yet they can ease the integration of acquisitions, speed change, and promote cost-saving innovation. Many companies that pioneered SSCs are now leading the way in finance outsourcing.

Despite the accelerating trend towards F&A outsourcing, there are still some doubters. Some executives worry about losing control over sensitive financial operations. But by examining the outsourcing proposition more closely, such executives will quickly discover that they have more control rather than less.

CFO CONCERNS

Some of the concerns that CFOs raise on this issue are shown in Figure 1.3.

The risk of proprietary data falling into competitors' hands was a potential outsourcing drawback cited by more than half of survey respondents. Nurturing in-house knowledge and expertise is another concern. Still other companies feel that they are too big to use outsourcing. A disinclination to standardize is another obstacle cited by those surveyed.



Source: Accenture and Economist Intelligence Unit Research, 2003

Figure 1.3 *Survey response – primary drawbacks of finance outsourcing*

Proponents of outsourcing are quick to counter that many of the reservations cited above dwell on perceptions rather than on the track record of outsourced projects. Veterans of successful arrangements stress that outsourcing does not entail loss of control, but offers an enhanced form of control. 'It's very difficult to convince people that they are actually gaining control because outsourcing will free up valuable resources and time to really focus on the things they want to focus on,' explains Peter Salerno, Ingersoll-Rand's enterprise-program and BPO-relationship manager.

Confidentiality is another worry that outsourcing advocates are eager to lay to rest, arguing that outsourcing providers offer the same levels of professionalism and confidentiality as banks, with which most companies share sensitive internal financial data. There are also good examples of competitive companies that share a common outsourcing platform yet maintain confidential results. As shown in Figure 1.4, the overwhelming majority of companies that have tried finance outsourcing are satisfied with the benefits they receive.

Only 7% called the experience unsuccessful or extremely unsuccessful, while 65% were satisfied. These upbeat results suggest that perceived risks are less daunting than many executives imagine. The list of complaints about suppliers from dissatisfied survey respondents included insufficient expertise, high costs, and poor service! If nothing else, the skeptics provide a helpful catalogue of doubts that must be overcome to win a green light for outsourcing.

Source: Accenture and Economist Intelligence Unit Research, 2003

Figure 1.4 *How successful has your experience been with F&A outsourcing?*

While some doubt, others do! In Figure 1.5, we list the wide range of companies that have signed F&A outsource contracts between 2001 and 2003 (publicly announced).

While the list is long, remember that there are at least as many companies again who have signed F&A outsourcing contracts in this period who choose not to publicly disclose the fact.

Company*	Provider	Company (cont.)	Provider (cont.)
Outokumpu Oyj.	Accenture	Slovnaft	Accenture
Northern Arizona Healthcare	Perot Systems	GrafTech	CGI
Olivetti Tecnost	Accenture	BC Hydro	Accenture
East Sussex County	ITNet	Regions Bank	Fiserv
General Motors Europe	ACS	BT	Xansa
Gateway	ACS	Ingersoll-Rand	ACS
Mount Sinai	Perot Systems	University of Phoenix	Andersen (now ACS)
Allegheny Technologies	ACS	Resort Condominium International	Accenture
Dairy Farm	CGE&Y	Airgas	Accenture
La Rinascente	Accenture	Thomas Cook	Accenture
AT&T	Accenture	Metromedia Restaurant	ACS
NetStar	Vsource	HP EMEA	Equitant
Visanet	EDS	DTI	Amey
Fortis Commercial Finance	EDS	Cable & Wireless	Accenture
Magnet	Liberata	Comcast Cable Com.	Unisys
O2	Xansa	BP	Accenture
Lucent Technologies	Equitant	U.S. Navy	CSC
Neptune Orient Lines	Accenture	MOL	Accenture
Air France	ACS	BP	PwC (now IBM)
Exel	Accenture		

Source: Accenture Analysis, 2004
** In date order, most recent first*

Figure 1.5 *Publicly announced F&A outsourcing contracts 2001 through 2003*

Here are some salient facts and figures drawn from a recent analysis of leading outsource contracts in 2003:

- The average contract value is $217mn
- The average contract length is 6 years
- F&A and HR continue to be most commonly outsourced.

The scale and breadth of the largest contracts signed in 2003 is typified by BC Hydro in Canada who signed a single outsourcing contract covering customer billing services, IT, HR, purchasing, financials, and property management. This contract is worth $1bn ($1.45bn CDN) over 10 years.

We interview the CFOs of BC Hydro later in this book to garner insight into their business cases and the value they have created by enhancing capabilities through the innovative use of outsourcing.

The F&A market – including administration and payment services – is rapidly growing. Today, when taken together, this represents a $33bn market[4] that is expected to increase at approximately 10% annually until 2005, as some outsource providers offer processes with significantly higher content skill and customer interaction. Services such as multiple process back-office transaction processing, management reporting, planning and forecasting, and decision-support analysis are also being provided. This total F&A market has three major segments:

1. **Payment services:** check clearing, credit card authorizations and clearing, electronic funds transfers.
2. **Compliance services:** tax reporting, financial statements, regulatory reporting, and transaction processing.
3. **Analytic services:** corporate payables, receivables & collections, general accounting, payroll, claim, order & customer administration, management reporting, performance reporting, and risk management.

The F&A outsourcing market is currently fragmented and service providers come from different backgrounds and build on different platforms of strength. The market includes traditional IT outsource players, pure-play BPO providers, vertical solution providers, and process specialists. Offshore service providers are entering the market by aggressively leveraging IT and call center capabilities to cross-sell F&A services.

Executives can choose from a variety of BPO providers that either focus on a number of different processes, or that present themselves as multi-process suppliers. In some instances, these vendors can execute globally, while others are focused solely on niche or regional markets. The competitive landscape has changed dramatically due to the Sarbanes-Oxley Act, which bars audit firms from providing BPO services to their clients.

Later, in Chapter 3, we deal with the issue of how to choose the service provider that is right for you.

THE OUTSOURCING PROMISE

CFOs tell us that they are keen to use outsourcing as a vehicle for achieving cost reductions so they can make capability improvements elsewhere in the business. They are attracted to transformational outsourcing because it is faster, requires less capital, and offers reduced risk than the alternatives. So what is the value proposition? There are several aspects to business process outsourcing's appeal:

- **Financial control and visibility:** Companies with distributed systems, processes, and infrastructures can move to consistent, well-defined best practice models with increased transparency of information and process controls. This is crucial as companies pursue new operating models in order to increase their competitive capabilities.
- **Speed to market:** Companies interested in rapidly building new business capabilities, expanding into new geographic markets or changing internal systems and processes to support new business models can exploit BPO services to enhance the speed of delivering business benefits. For example, Thomas Cook is leveraging outsourcing capabilities to create a world-class finance organization and implement new ERP technologies to stimulate transformational change across the enterprise.
- **Competitive capabilities:** Outsourcing service providers can improve a company's competitive position. Highly effective organizations like BP and Exel have used long-established service providers to achieve superior capabilities through standardization, centralization, and technology enhancements.
- **Operating cost savings:** Every company is interested in lowering operating costs by improving process efficiencies, accessing lower wage rates, and leveraging technology to increase automation and enhance decision-making. In many cases, they can achieve these results more quickly and with less risk by accessing external consulting skills, intellectual property, assets, and service delivery networks. F&A BPO contracts typically generate from 20% to 40% in operating cost savings (across all industries).
- **Financing & fiscal cost reductions:** BPO contracts can help companies slash costs, such as working capital, eliminate bad-debt expense, improve tax efficiency, and lower financing costs. One telecommunications company received $90m in cash-flow improvements within four months of outsourcing its receivables management service.

Multiple outsourcing models exist to support the CFO in striving for radical change and increased value. Outlined here are three types of outsourcing relationships:

- **Conventional outsourcing:** This entails using a niche outsource supplier to provide a narrow set of services through a contractual relationship. Most frequently, companies use the outsourcer's own standard processes to minimize costs. They may or may not transfer people and assets to the outsourcer.
- **Collaborative outsourcing:** This involves a cooperative, flexible relationship with outsource providers that offer a broader scope of services. The company and its outsourcing partner frequently define these services jointly. Again, the company may or may not transfer people and assets to the outsourcer.
- **Business transformation outsourcing:** This high pay-off outsourcing initiative involves a deep commitment between the firm and its outsourcing partner to radically transform the firm's enterprise-level performance and outcomes. The two companies jointly define a broad range of processes they will use and may also share in a joint venture that manages assets and employees.

Figure 1.6 covers the outsource delivery models available in the market today. These range from conventional consulting and outsourcing, to forms of collaborative outsourcing (such as co-sourcing and global sourcing), through to transformational models.

Organizations have a better chance of success with process outsourcing when they craft a relationship that specifically meets their needs. In

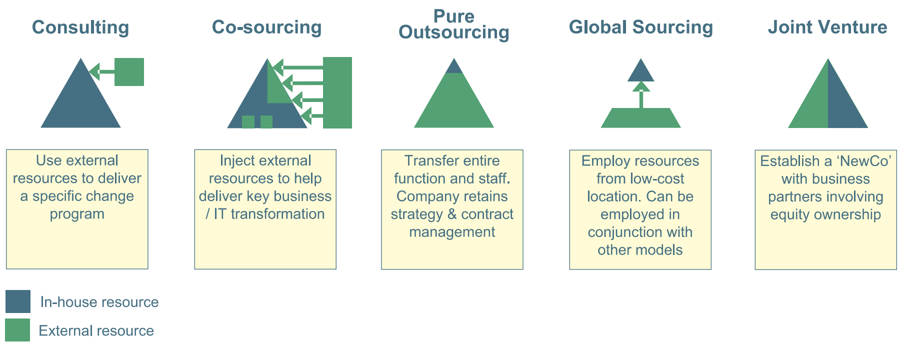


Figure 1.6 *Spectrum of outsourcing delivery models*

fact, we have found that there is no 'one-size-fits-all' approach that guarantees good results. A variety of initiatives are equally valid. We provide a table[5] here for evaluating different approaches to process outsourcing.

Outsourcing Models			
	Conventional	Collaborative	Business Transformation
Objective	Hand off support to specialist provider to cut costs and focus managers on core issues	Upgrade non-core processes to cut expenses and provide flexibility to respond to changing business needs	Transform the way a business works to achieve dramatic, sustainable enterprise-level performance improvement
Partner Role	Run support function	Re-engineer and run non-core processes	Collaborate to transform the business
Approach	Standardized services Transaction-based fee for service pricing Narrow scale and scope of services	Flexible, tailored services Output-based, gain-share pricing Services scaled to meet changing business needs	Integrated services to radically change business Outcome-based, risk-share financial structure Accelerated delivery
Typical Benefits			
Inputs	20–50% cost savings Access to best practices Improved career opportunities Improved management focus	50% cost savings Access to competitive skills Improved career opportunities Improved management focus	50% cost savings Access to critical skills Improved career opportunities Improved management focus
Outputs	Same, consistent service level Shared financial risk	Higher, consistent service level Improved flexibility, speed Shared operating risk	Higher, consistent service level Improved flexibility, speed Shared strategic risk
Outcomes			50% Market-increase Revenue doubled Basis of competition changed

There are major additional benefits to be reaped from collaborative and business transformation outsourcing. The most valuable are greater cost savings, increased flexibility and speed, and higher service levels. Consider the following advantages that more sophisticated outsourcing relationships can provide:

- **By turning an existing asset over to an outsourcer, an organization can turn fixed costs and capital into variable expenses.** This applies to people, too. The organization no longer has to invest in recruiting, training, motivating, and managing the people who staff these operations.
- **Outsourcers can share assets among multiple clients to improve cost and handle capacity fluctuations.** Sharing common application platforms, staff, and facilities spreads fixed cost. For example, in four years, one high-tech firm achieved a 35% cost saving in its call center, despite a fluctuating workload. This was possible largely because its outsource provider had the flexibility to shift staff to other clients when the high-tech firm's call volumes changed.
- **The need for integration can override other considerations.** One oil company, for example, outsources F&A to a shared service provider. However, it maintains ownership of its own software to avoid potential integration problems. The outsourcing provider performs standardized financial processes through a direct link to the oil company's SAP financials module.

This chapter has served as an overview of outsourcing trends and provided an overview of 'who is doing what?' The rest of this book is intended to serve as a guide to outsourcing for the CFO, senior finance executive, and the C-level team. It is based on real case studies and first-hand experience.

In Chapter 2, we analyze the characteristics of high-performing businesses and examine the impact of *changing business models* on the case for business transformation through outsourcing. Chapter 3 explores in detail the *outsourcing supply market* and how to choose between suppliers.

Chapter 4 deals with *scoping* – what to outsource to maximize benefits, infuse new skills, build core capabilities, and streamline business processes. The issue of scoping is fundamental to long-term success. In the two subsequent chapters (5 and 6), we cover the issues vital to *global sourcing* and *shaping the deal*.

Chapter 7 focuses on *stakeholders* – how to achieve buy-in and motivate your people through the transition. Chapter 8 provides frontline advice on how to manage *change and implementation*. It conveys the issues of transition timing, culture, communication, and building a robust service management framework.

Chapter 9 explores the full range of *risks inherent in outsourcing* and the governance structures necessary to manage the route to success. In Chapter 10, we look at how to *keep the deal working* and how to secure continuous improvement.

In the final chapter, we *fast forward* to explore where the outsourcing phenomenon is leading – envisioning a new world where physical organizational boundaries cease to be relevant; where companies in the same industry share a common infrastructure for non-strategic functions; where an outsourcing industry has transcended national boundaries on a global basis; and where technology has made business transactions truly virtual. The competitive landscape is changing rapidly and the dynamics that are driving this are permanent!

Here are some insights that other finance executives have shared with us.

CFO INSIGHTS

- CFOs are becoming more and more comfortable with the outsourcing of routine, transactional processing; they are more concerned about outsourcing complex responsibilities – including matters of principle, judgment, and decision support.
- The BPO model has matured around interconnected global service delivery, rather than any single country or region. Outsource providers should be given process ownership to create cross-industry capabilities.
- Companies are increasingly adopting process outsourcing to help drive strategic transformational change – for example, leveraging post-acquisition synergies.
- Finance BPO provides CFOs with more control, not less; creates greater transparency, not less; and compliance with new statutes like Sarbanes-Oxley is easier and cheaper to achieve than the alternative in-house option.

- Outsourcing finance shared services is a more attractive option than the in-house option – it is lower cost, enables scarce investment to be redirected towards core innovation and provides superior scale benefits.
- An outsourcing arrangement should be viewed as a long-term partnership, with shared risks and rewards – and should include well-structured mechanisms to keep the deal fresh.

FROM INSIGHT TO ACTION

ARTICULATE YOUR BUSINESS MODEL OF THE FUTURE

Outsourcing can be a powerful enabler. Analyze your value drivers. Identify those components of your business that create value and those that destroy value. Decide to retain only those core competencies that make you truly distinctive and provide real competitive advantage.

CONSIDER THE OUTSOURCING SERVICE DELIVERY OPTIONS AVAILABLE TO YOU

Decide between conventional outsourcing, a collaborative joint venture, or the potential benefits of major transformation. Do your research thoroughly to identify the best external partner for what will be a major corporate transaction. Cultural fit will be key. Establish a strong foundation for trust – you shouldn't have to resort to contract struggles later down the line.

DEFINE SCOPE CLEARLY

Consider carefully how and when you should release one or more business functions. Are the trade-offs between integration and segregation well understood? Negotiate service-level agreements that meet baseline requirements and then use incentives to drive improved performance.

CREATE NEW CAPABILITIES!

Don't see outsourcing as a situation where you are relinquishing assets, but rather as an opportunity to build new capabilities to transform your competitive position. This is the chance to revolutionize your operating model. Seize it!

SHAPE THE DEAL TO SUIT YOU

With your chosen outsource partner, develop a robust and mutually beneficial value proposition. Align your goals with those of your outsource supplier to motivate optimum performance and maximize shareholder value. Work with your supplier as a strategic business partner – you will be surprised at how much you can achieve together.

UNDERSTAND YOUR STAKEHOLDERS' NEEDS AND ASPIRATIONS

Be honest. Communicate clearly a well-argued business case and involve the right people in the transition. Be decisive! Achieving buy-in means being bold.

DON'T UNDERESTIMATE THE CHANGE MANAGEMENT REQUIRED

Is the timing right for an outsourcing deal, in terms of both your company's business cycle and changes within your industry? Take steps to minimize the potential for cultural trauma. Avoid the mistakes of others; learn from the past!

TAKE THE RISKS INVOLVED SERIOUSLY

Analyze the downside and build structural flexibility into your outsource contract. Clearly define your method for adjusting existing arrangements. But also treat risk as an opportunity. For example, acquisitions may provide you with opportunities to achieve valuable leverage and scale economies.

TREAT OUTSOURCING AS AN M&A TRANSACTION

Do your due diligence in a specific timeframe. But don't drag your organization through a long period of uncertainty. And don't allow 'scope creep' to unnecessarily prolong the negotiation process and delay benefits.

KEEP THE DEAL WORKING!

As you start on the outsourcing journey, think of the future. There will always be new and better ways of operating. Renew, and if necessary, re-negotiate your outsourcing contract as your business strategy evolves. Look to refresh the deal: Take advantage of step-changes and major advances in technology, labor cost arbitrage, and the structure of your industry.

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