

Rapid adoption of Accounting Process Outsourcing

By Michael Hart, Managing Partner, Merit Outsourcing Advisors



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Overview

In the current economic landscape, outsourcing has become a cost effective way for organizations to attain and sustain operational excellence. Delivering significant payback to a wide spectrum of organizations, the Canadian outsourcing industry has seen YOY increases in most segments of Business Process Outsourcing (BPO).

Outsourcing of a number of non-core business activities including Human Resources and Legal Processes are on the rise. Finance and Accounting (FAO) is one of the fastest growing areas of outsourcing, delivering significant payback to organizations. Within the Professional Services sector, process outsourcing in the accounting industry has also become a strategic and increasingly attractive way for organizations, accountants and accounting firms to gain expert service, scale their business capacity and benefit from cost savings on their non-strategic functions and activities. This whitepaper highlights the growth of the Canadian BPO industry and identifies the major benefits and challenges associated with Accounting Processes Outsourcing (APO) for the small, mid sized and large firms.

Part 1: Outsourcing Strategies

The economy is now recovering from the recent global financial crisis bringing with it renewed competitive pressures on organizations in most industries. In a quest to reverse the effects of the declined profit margins and sluggish growth,

organizations across the globe are looking at every possible way to:

- Optimize operations
- Improve efficiency
- Reduce cost
- Channel resources and capital towards their core competency
- Incorporate transformational elements of change to the business and increase competitiveness

Outsourcing has been an accepted service delivery model to meet these objectives.

The Centre for Outsourcing Research and Education (CORE), the leading Canadian outsourcing association, comprised of buyers of outsourcing services, service providers, lawyers and advisors provides significant insights into the Canadian outsourcing market. CORE observes that while cost savings continues to be the top reason for outsourcing, access to resources, flexibility, ability to scale and delivery quality are emerging as important factors for outsourcing decisions. However, the motivations vary somewhat for organizations in different size segments. As large companies have used their scale to exploit the labor arbitrage opportunity presented by outsourcing, small and midsized firms have successfully achieved key business objectives such as gaining new business process acumen, broadening of their global reach and drastic improvements of worker skills aimed at increasing their ability to operate more effectively.¹ Other emerging drivers of outsourcing are:

¹ Source : The "State of Outsourcing 2011" Survey, Hfs Research

- The need for flexibility of sourcing relationships to adapt as the client's business changes
- The ability to use best of breed providers and alternative delivery models such as asset-light transactions
- Cloud computing (general term for buying services on the internet and paying on a usage basis)
- Offshore delivery services (leveraging scalable delivery centres, leading processing disciplines and access to labour arbitrage)

Part 2: Outsourcing Background

The adoption of outsourcing in Canada began with Information Technology (IT) transactions, both infrastructure and application management services. Most mid to large size Canadian organizations now have adopted some levels of IT outsourcing as part of their service delivery approach. In the past 10 years, we have seen a growing number of Business Process Outsourcing (BPO) arrangements. The most common BPO transactions are in Finance & Accounting, Legal Process Outsourcing, Human Resources and Contact/Call Centre services. The Merit Outsourcing Advisors outsourcing deals listing has over \$80 billion of total contract value in force in Canada.²

After the downturn, businesses have looked to change old ways of running operations. Mid-market businesses are looking to use outsourcing “to combat fatigue from old business support models”, while the large businesses are more used to using customized sourcing approaches and shared services models that are harder to replace with outsourcing engagements.³ A 2011 study

conducted by outsourcing research firm, Horses for Sources Research group and the London School of Economics Outsourcing Unit, with a sample size of 277 buyers of outsourcing services, reveals that the cost reduction targets are being met satisfactorily for most firms. The mid market buyers have been particularly successful at achieving transformational changes in business like gaining new business process acumen or global effectiveness. Although, achieving business process acumen or improvements in the existing business processes through outsourcing have been tough, organizations do not perceive this as an immediate concern as the outsourced functions are, for the most part, considered to be non-strategic.

“Innovation”, the buzzword in the industry for a while, has been one of the most critical components of outsourcing. However, innovation is almost always associated with an amount of disruption caused by new or creative ways to achieve business value, high-risk potential or allocating more resources or capital. Clarity of expectations and decisive behaviors from both buyers and providers are important to achieve innovation.⁴

According to CORE, there is a noticeable maturity amongst buyers of outsourcing services. There is an increased focus on the health of the outsourcing relationships. Organizations are investing more time, resources and capital towards developing efficient sourcing strategies and governance models in order to realize maximum business value from an outsourcing engagement.

² Source : Merit Outsourcing Contract Database

³ Source : <http://www.horsesforsources.com> (HFS Research, 2010)

⁴ Source : Eradicating the Innovation Dearth in Business Process Outsourcing: Practical Advice on how to Achieve it (Cecil & Fersht)

Part3: Outsourcing Market in Canada

The Canadian outsourcing industry continues to grow in 2011 after an overall positive year in 2010 with growth estimated around 3.8% in 2010⁵ as compared to 2.1% in 2009⁶. Although the inertia in the market caused by an uncertain global economy had prevented some material transactions, the last quarter in 2010 saw a substantial increase in activity along with some sizable contract signings. Merit Outsourcing Advisors expects 2011 to be a good year for outsourcing in Canada with estimated increase of 4-5%.⁷

Another important trend is a shift towards multi-sourcing, where large and enterprise size organizations use multiple providers to deliver a suite of services, instead of one primary service provider. As a result, the client acts as the integrator or manager of the group of service providers. The benefits realized from multi-sourcing range from the advantages of best-in-class delivery to ease of progression from one deal to the next. The main reason, though, is cost savings, that by competitively tendering discrete pieces of technology to the competitive market lowers overall sourcing costs and enables buyers to access specialized service providers. Research reveals that by midyear 2011 most buyer organizations have made progress on developing a multi-sourcing strategy compared to December 2010, when only 20% organizations had an explicit multi-vendor delivery model.⁸

The BPO industry in Canada continues to grow in 2011 with a YOY growth of about 2.25% so

far in the year. There is a rapid adoption of back office **Financial Services BPO**, consistent with the penetration in the US & UK. 2011 shows a resurgence of BPO worldwide in 1Q 2011, with a YOY increase of 66% and activity levels near a 5 year high after the slow growth over the last five years.⁹

Globally, we are witnessing increased outsourcing of non-traditional functions such as document and imaging services, legal processing (**LPO**), “knowledge process” outsourcing (**KPO**), accounting process outsourcing (**APPO**), and logistics services. This signals an increase in both supply and demand. We are seeing many new “niche” outsourcing service providers in Canada, delivering strong value propositions to small, medium and large businesses.

As the global economic landscape slowly improved, the proportion of firms outsourcing **Human Resources (HRO)** functions increased to 46% in 2010 from 43% in 2009. According to Kelly OCG, an outsourcing consulting group, the predominant outsourced HR functions are recruitment (63% of the deals) payroll (54%), benefits (26%), training (24%), HR information system (16%), compensation (8%) and performance management (4%)¹⁰.

Multi-national companies are not only looking to gain support across borders and employ quality resources in all countries of operation, but are also looking to solve productivity issues globally rather than taking region-specific approaches. A growing number of buyers seek HRO providers having global capabilities.

According to the Human Resources Outsourcing Annual Report 2011 published by Everest

⁵ Source: CORE Outsourcing Monitor Jan 2010

⁶ Source: CORE State of Canadian Outsourcing Report 2009

⁷ Source: Merit 2011 Mid Year Outsourcing Trends Update

⁸ Source: CORE Outsourcing Monitor June 2011

⁹ Global Outsourcing Market Data and Insights First Quarter 2011. THE TPI INDEX. (TPI, 2011)

¹⁰ Global RPO Report 2010 (KellyOCG and HROA, 2010)

Group, an advisory and research firm on global services, a stronger economy brought new contract activity in the multi-process Human Resources Outsourcing (MPHRO) market and a strong rebound in mid-market adoption in 2010. Everest Group projects the MPHRO market will grow by 8-10% and reach around \$3.35 billion in 2011.

Legal Process Outsourcing (LPO) continues to be a growing segment of the outsourcing industry and is a major buzzword in Canada, US and the UK. Forrester Research, an independent research firm, predicts LPO revenues to grow from an estimated \$640 million in 2010 to more than \$4 billion by 2015. (Ramachandra & Birer, 2011). The global LPO landscape is witnessing a rapid change due to technology, globalization and commoditization where the conventional approach of providing legal services is being challenged. As technology makes law more transparent, the professional legal community become more sophisticated and demands more value from their investments. The recent years have witnessed rapid growth in the LPO sector and according to Shared Services and Outsourcing Network (SSON), Canada represents a sizeable Legal Process Outsourcing market. Merit Outsourcing Advisors observed outsourcing in all of the following service areas:

- Document Review
- Legal Research
- Litigation Support
- Intellectual Property
- Knowledge Management

Growth within **Finance and Accounting Outsourcing (FAO)** was hindered during recession as most organizations perceived outsourcing the cash management cycle as a business disruption.

However, the global FAO segment shows great promises in 2012, with 17% of 347 buyers surveyed of outsourcing services looking to outsource their finance and accounting operations for the first time¹¹. The Finance & Accounting Outsourcing Annual Report 2011, published by Everest Group states that **FAO market is expected to grow 15-20% and top \$4 billion in annual contract value in 2011**¹².

Industries like healthcare and financial services that have traditionally been reluctant to outsource their FAO operations due to the complexity of the accounting operations, are increasingly adopting outsourcing models. The growth is driven by the mid-sized businesses with increased number of smaller deals and decreased contract size due to a competitive market place and falling price points. Major providers such as IBM, Genpact and TCS have re-structured their capabilities to take on the smaller deals. A slow move towards a transactional pricing structure can be observed from the standard FTE (full time equivalent) pricing. However, outcome based pricing or gain sharing is gaining momentum as clients feel it is worth incenting the performance of the providers.

Part 4: Outsourcing in the Accounting Industry

Along with the increased adoption of most BPO segments, recent years have also seen the growth of outsourcing of accounting processes, where organizations have adopted specialized and reliable accounting services at lower delivery cost. For many years, top accounting firms worldwide have been integrating outsourcing as a strategic business growth enabler into their operations. **Accounting Process Outsourcing (APO)** becomes all the more relevant in the current competitive

¹¹Source: According to a survey conducted by HFS Research and the London School of economics. (Phil Fersht, Hfs Research, 2011)

¹² Source: F&A Outsourcing Market to Grow 15-20% in 2011 (Smriti Sharma, www.globalservicesmedia.com, 2011)

scenario as firms not only gain a cost effective approach to handle repetitive and error prone accounting services, they are also able to optimize their resources and gain valuable efficiencies on streamlining their accounting processes.

Public practice firms are benefiting from outsourcing accounting services such as taxation work, where managing the completion of corporate compilation and personal tax files can be efficiently conducted by highly trained accountants, working in specialized outsourcing entities. As these typical accounting services are time consuming, firms that outsource these processes are capturing valuable resource time and realize significantly lower production costs.

Apart from this, there is an increased emphasis on accounting process efficiencies that can significantly reduce delivery timelines while allowing firms to focus on core business activities, generally of higher value to the accountants' clients. This leads to a change in supplier landscape with the growth of providers delivering standardization and accompanying process transformation.

Technological advances have acted as a lever towards helping accounting service providers deliver impressive turn-around times for clients. One example is the increase in work volume throughput through the concurrent processing of client files. This alternative to the more traditional method of sequential file processing brings with it significant business optimization benefits. For the accounting firm, more work can be accomplished with less staff resources and with dramatically shortened timeframes. In addition, accountants at different levels and in different locations can work upon or review the same file as needed with no wait time. Organizations can add the much-needed

“green” dimension to their business by moving into an online accounting delivery model.

Businesses of different scales have benefited from APO in different ways.

By combining in-house work structure and methods with specific outsourcing service components, smaller firms have successfully created streamlined efficient business process models that yield improved cost and performance ratios. Relief from accounting responsibilities has allowed smaller firms to focus on improving turnaround times for clients rather than managing the accounting staff. Firms facing the challenge of scaling their resources up or down according to the fluctuations of their business needs find the outsourced delivery model especially beneficial and affordable.

The midsized firms, looking to grow, on the other hand have looked to lower total operational costs and utilize assets and resources efficiently, while preserving brand reputation and the overall quality of their services. Outsourcing elements of production accounting work has been proven to help mid size firms realize higher rates of productivity and yield higher returns from their existing approach to staffing. The implementation of an "in-house + outsourcing" work paradigm has demonstrated itself as both highly viable and beneficial model in the accounting industry. This strategy can yield improved cost and performance ratios, along with impressive operational and performance improvements.

The large accounting firm, dealing with challenging market conditions and competitive threats needs to move towards economical business models as they look to develop and implement strategic growth plans. Bringing

capabilities and best practices to the table, accounting service providers have given large organizations the dynamics to carry the business forward while transferring transactional and burdensome accounting activities to expert talent pools.

Many of the world's top accounting firms realized years ago that outsourcing layers of non-mission-critical work offshore could result in significant business advantage and generate substantial operational and financial benefits. Widely viewed by experts as a strategic business enabler across a wide range of industries, a growing number of large accounting firms are now embedding various outsourcing strategies within their business planning, in order to increase competitive positioning and realize higher margins on their client work.

However, the benefits offered by APO do not come without challenges. Unlike the established norms that exist with the more typical engagements in the outsourcing arena, APO providers must conform and adhere to stringent regulatory mandates within the accounting industry. Of particular note are provisions ensuring that confidential data remains within the borders of the issuing country. Compliance failure can have costly consequences.

Another concern for clients is having full disclosure from service providers of overall business resources including qualified personnel and the secure facilities for completion of work.

Tapping into the public accounting sector since 2006, ABACA Solutions (www.abacasolutions.com) is a Calgary-based firm that has been gaining buyer preference in Canada. Unlike other providers who may outsource to third-party entities and

facilitate the delivery of services outside of the country, this Canadian outsourcing firm has full ownership of its offshore offices and management of its international operations. With a team of certified accountants in Canada and offshore, it has developed its process technology systems whereby all data either resides within the client premises or is securely positioned onto discreet servers located in its' Canadian data centre.

Conclusion

In an environment where global outsourcing deals are being driven by the likes of Accenture, CGI, Genpact, HP, IBM, Infosys, Wipro, etc., specialized or niche market providers are responding to the demands in the APO sector.

The relevance of accounting outsourcing can be measured by the increasing number of firms opting to outsource segments of the accounting process. What began as an approach to gain cost reduction has clearly matured into a global practice. As accounting firms step beyond the proof of concept stage to implementing an outsourcing strategy, they are quick to realize the economic and operational benefits tied to this rapidly evolving business dynamic and to gain valuable advices on business process acumen. However, "inertia" in most firms still remains the biggest challenge towards adopting an outsourced delivery model but despite cultural roadblocks, much like what is broadly occurring in other industry sectors, the value proposition is compelling enough to attract organizations of all scales to consider outsourcing accounting functions.

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