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By Gillian Law

Picture the first finance department you ever saw. Depending on your age, your mental image will differ enormously – but most of us will remember a day when everything 'financial' was done in the finance department. From sending off invoices to paying people's wages, it was all managed by company staff.

The advent of outsourcing has changed all that. Bit by bit, the finance function is being split up and divided among companies who specialise in payroll, on cheque processing, and so on. What – if anything – is left? Will there still be a finance department in your organisation in 10 years time?

Payroll was the first to go, says David Blundell, chief operating officer of Netstore, which specialises in outsourced financial IT systems.

"Payroll must be the most outsourced aspect of business beyond cleaning the toilets," he says. "It's got what accountants call the 'buggeration factor', in that it's got to be right, the emotional impact of getting it wrong is high, and yet it's not really a core activity. You don't want your professional staff spending lots of their time on it."

There are huge numbers of companies established as payroll bureaux now and it's quite unusual for an organisation to run payroll in-house, these days, he says. "It costs you less, it lets you reassign your professional people, and it works," says Blundell.

But what about other aspects of finance?

"The next area that I've seen gathering momentum is in running financial IT applications," Blundell says.

"If you look at large companies, a lot of them have one or two IT staff who are specifically dedicated just to keeping the finance applications running. That's an unnecessary cost. And also, the financial director gets cheesed off, because finance isn't seen as a priority IT area – it's not like logistics, or procurement, but it's important to the director. So outsourcing it makes the financial director happy, and it's a great relief for the IT manager too. Running financial systems takes a lot of work, what with legislative changes and so on – and, fundamentally, it's just not seen as a 'sexy' IT area," he says.

Once the core IT functions have been outsourced, Blundell encourages financial directors to look an ancillary tasks such as automatic invoice handling, and any other processes and procedures that the client wants to automate.

"Local Authorities, for example, often have very manual systems – they often still input invoices by hand, for instance," he says.

"So we offer to scan them, show how they can be input faster. We'd do a 'health check' on all the processes they run to see what we can do – cheque printing, BACS transfers, inter-bank transfers, we can facilitate all of those for them," he says.

So how far should you go? Are there areas that have to stay in-house, or can you just close up the finance department completely?

David Rankin, managing director of Vantis Outsource, regularly stirs controversy by suggesting there's no need for a company to have a finance department – or indeed a finance director, at all. Outsource the lot, he says. Indeed, he has said in the past that “it seems unlikely that many companies, particularly SMEs, will still have an internal finance function within a decade.”

In person, he laughs when asked about this radical vision.

“It depends on the size of the business, really. For small business, yes, you probably could outsource the lot – the processing, the reporting, the decision making, everything. As you get higher up the scale, the strategic decision making becomes a day to day thing and so probably it’s best just to outsource the processing parts of those businesses,” he says.

“As for the question of whether you really need a financial director – well, I’m just trying to change the mindset that everything has to be in-house, with the computer under the financial director’s desk and him looking up the general ledger every morning …there’s an element of control, of empire building, and a lack of recognition that technology has moved on, and things are different now,” he says.

Things may have changed, but there will always be a need for in-house expertise, argues Blundell.

“I think people are your most important aspect of the financial function, and that’s where your flexibility and ability to change comes from,” he says.

“Organisations change, and you need the agility and ability to change with it – we don’t buy into the idea of taking over the whole finance department. That’s not a good move – you lose control. So no, don’t outsource your staff – people matter,” he says.

The most important part of any outsourcing move is getting the right partnership, and making sure the contract is right from the start.

“Most people have had their fingers burnt by some sort of outsourcing in the past,” says Blundell.

“They’ve lost control of the process, maybe seen performance start to go down – and found there’s little they can do about it,” he says.

The first step to a worthwhile outsourced relationship is negotiating right contract, he says.

“It has to be good, and it has to be fair – that’s important. If the buyer is too aggressive you can lose all the goodwill, and for a long term relationship goodwill is essential. We see this sometimes with large contracts, where every last thing is down as a chargeable item. That can be quite unhealthy. If you’re looking at a five to seven year contract, then having to get a purchase order for every little thing just slows the process down, and it’s not good emotionally for either side,” he says.

Instead, Blundell suggests that good Service Level Agreements are put in place right from the start – and with financial penalties if they’re not met, rather than just ‘service credits. “Who wants more bad service? If we mess up, there’s a cheque on the financial director’s desk and that’s that,” he says.

The SLAs must reflect your business, and what your priorities are – whether that’s information for investors, or paying staff, or any other key area of the business. These will be monitored day to day, with an annual overhaul to make sure they're still in line with requirements.

Most outsourcing contracts are in the five to seven year bracket, so it's important to get them right. "It can take up to nine months to negotiate a deal, and then as long to migrate systems across, so it has to be for a substantial length of time," he says.

Back at Vantis, Rankin agrees on the importance of SLAs to a successful partnership. "We can have up to 52 deliverables a week under SLAs for our clients. If we get a cheque we know we have to bank it in a certain time, match it against the invoice in a set amount of time – that's down in the SLA," he says.

"Our fee is paid in two elements. The first covers the cost of what we do, and the second is our profit. We have an agreement with our larger customers that, if we don't meet the SLAs, we don't take all the profit. That puts us in a position where we make sure we deliver!" he says.

Targeting owner-managed SMEs, Rankin says that contracts for this market tend to be shorter, perhaps one year, or up to three years for larger businesses where the migration is more complex. "With larger companies it can be a bit of a rollercoaster to start with, as you create the relationship with them and get to know their culture. We manage that process very tightly, with weekly meetings and milestones to reach."

A survey by Accenture in June 2004 brought out some interesting perceptions. Among those companies that didn't already outsource their financial functions, there was a concern about the legal implications. With growing legislation in place regarding governance and direct control of a company's finances, many respondents felt they were safer to keep things in-house.

When Accenture spoke to businesses that had already made the move to outsource, however, things were seen quite differently. Outsourcing had improved their position, if anything, compared to in-house processes that had evolved over years, the respondents felt that outsourced processes were usually better defined and documented.

One other issue that is always raised when it comes to outsourcing is, of course, the move to use overseas companies and staff.

Increasingly, companies are either setting up their own offices overseas or using outsource consultants to find companies that can help them

While India remains the most common country for outsourced agreements, Central and Middle European countries and China are all increasingly popular. A recent survey by sourcing advisory firm TPI found that 81 percent of large UK companies plan to increase their overseas outsourcing over the next two to three years.

However, an increasing number of these plan to do so through wholly owned subsidiaries, or 'captives' as they become more confident in working with staff overseas – an apparent reversal of the outsourcing concept.

Most overseas financial is limited to simple processing, according to Simon Tarsh, a partner within TPI.

"Accounts payable is the largest area, followed by the likes of accounts receivable, and travel and expense processing," he says. There is a slow move into areas like fixed asset accounting, Tarsh says, but the majority of the work is basic processing.

The main reason, of course, for going overseas is that it is cheaper. "It costs about 40 to 50 per cent less than to do it in the UK," he says.

TPI works with UK companies to find them outsourcing suppliers, and help in the initial stages of the relationship, before leaving them to work together. As has been said of UK-based contracts, he again stresses the need to get things in place right from the beginning.

"You need to get a statement of work, and SLAs with a sufficient level of detail that there's no ambiguity," he says.

Clients also have to take time to gain an understanding of the cultures they are working with, he says. In India, for instance, there is a tendency to say 'yes' when someone doesn't know an answer, or even means no, and it's important to learn to read the signs, he says.