The Evolution of Finance and Accounting Outsourcing (FAO)

The Finance and Accounting Outsourcing (FAO) industry is undergoing tremendous change driven primarily by customer demand from the CFO/Controller (or head of the Shared Services Center) for more “value”, or more appropriately, “permanent general and administrative cost reduction”, from the service providers in this industry. This drive for permanent cost reduction by the CFO/ Controller is a fundamental disconnect with the value proposition offered by the large Business Process Outsourcing (BPO) Service Providers who promote “labor” savings via “labor arbitrage” through “off-shoring” of finance and accounting jobs to perform the FAO processes in a cheaper cost of labor geographic region like India or China. A large FAO contract is still costing the CFO/Controller a significant amount of money, albeit less than what the organization was paying for predominately United States labor rates for accounting personnel.

The FAO market has evolved into 3 versions; Version 1 basically leaves the process “as is” and reduces cost by moving accounting related labor off-shore; Version 2 adds consulting to fix the processes and then move the labor off-shore; and Version 3 is “platform led” BPO that adds automation of processes to maximize cost reductions by instituting best practices and permanently reducing labor requirements.

FAO Version 1, which is still the dominate model sold and implemented today by the major service providers in FAO, is geared around the historical “Lift and Shift” transition approach whereby F&A transactional processes such as Accounts Payable and Accounts Receivable are lifted and shifted (“as is”) to a lower labor cost geographical location (GEO) for delivery. In most instances, the lowest cost GEO for FAO Version 1 delivery resources is still the country of India because of cheap labor. Large BPO Service Providers have invested millions of dollars in the creation of “off-shore” delivery centers in each of the major India metro cities including Mumbai, Chennai, Delhi, Bangalore, etc. Other GEOs have emerged around the globe to compete with India as the dominate GEO for off-shoring FAO personnel. The “Lift and Shift” model was adopted and promoted primarily because these countries, with the investments made by the Service Providers, had access to virtually unlimited educated accounting personnel with adequate English speaking skills. This access to cheap, well trained accounting labor was, and has been, the primarily value proposition of FAO Version 1.

The inherent “weaknesses” in FAO Version 1, however, is the amount of money spent on “transitioning” the processes and the work tasks to the off-shore “delivery centers” provided by the service providers and the lack of focus on driving permanent cost reduction initiatives such as reduction in FTEs to perform the process for the customer. In most cases, the more “broken” and/or manual the finance and accounting process from the customer (CFO/Controller), the better for the service provider.

These service providers do not engage in major process reengineering initiatives on behalf of the customer, nor is there any emphasis on standardization of processes. In addition, there is virtually no consolidation of accounting systems. Often the large service providers' sole competitive differentiator is the large numbers of FTEs they have under contract in their delivery centers and access to cheap labor. Sourcing advisors that are hired by CFOs/Controllers to lead an FAO initiative typically evaluate FAO service providers on the number of FTE's they have under contract and the number of delivery centers the service providers have around the globe. In the case of FAO Version 1, bigger is portrayed as better, however, it is fundamentally flawed and there is a major disconnect in the CFO/Controller goal for permanent cost reduction.

Most CFOs/Controllers, and leading edge Sourcing Advisors, believe FAO Version 1, is rapidly becoming obsolete and not focused on the customer's requirement of permanent cost reduction. Given the recent relatively high degree of turnover of labor resources in these delivery centers (and the creation of "middle class" jobs in India which has led to "job hopping"), it is making FAO Version 1 an increasingly risky proposition for CFOs/Controllers. In addition, the high degree of political focus on job creation and keeping jobs in the USA has led many CFOs/Controllers to become increasingly sensitive to the public relations backlash of "off-shoring" of jobs. As "first generation" FAO Version 1 contracts are now coming up for renewal, CFOs/Controllers are demanding something radically different then FAO Version 1 with a key requirement of permanent cost reduction. They want and need the benefits of outsourcing (and in particular with "on-shoring"), but are becoming reluctant to commit to or continue "off-shoring".

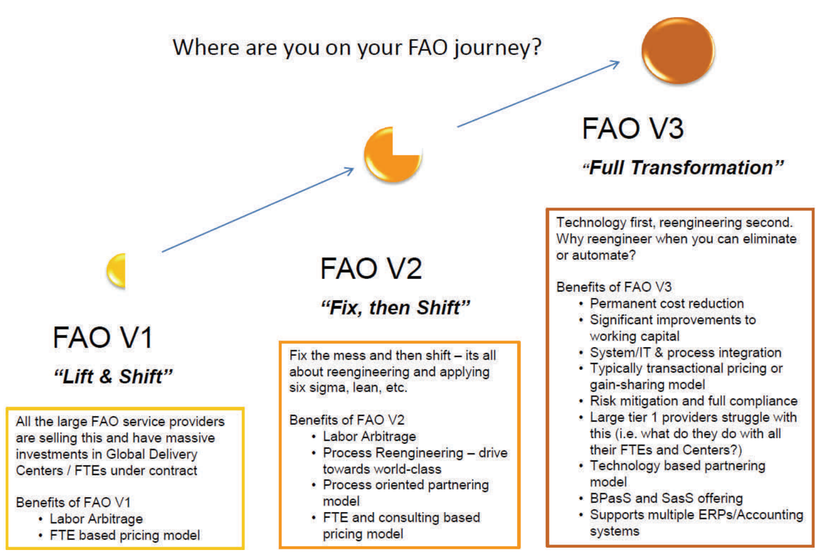
FAO Version 2 has been championed by some of the large FAO service providers in direct response to CFOs/Controllers who initially wanted more benefits of FAO then labor arbitrage alone. Thus, some of these service providers have developed consulting capabilities and domain knowledge around finance and accounting "process reengineering" and to a lesser extent, some degree of "process automation" of existing "as is" processes prior to "lift and shift" of labor to a cheaper labor based GEO like India. The value proposition sold by these service providers is typically around "Fix" the processes and then "Shift" the remaining processes (labor) to a lower cost labor delivery GEO. Some of these providers will sell the need for finance and accounting process "benchmarking" around world-class F&A metrics. The primary sales proposition is that not only will the service provider reengineer existing finance and accounting processes (typically for a consulting fee), but they will commit to year over year productivity improvements once you have outsourced transactional processes to their cheap labor delivery GEO. These service providers will sell their "lean and six sigma process methodologies" and their black belt consulting services to customers.

The inherent weaknesses of FAO Version 2 are the primary value proposition is still heavily reliant on labor arbitrage. The service providers selling FAO Version 2 have made the same investments in large "off-shore" delivery centers with access to cheap accounting labor. In some cases the cost of the FAO contract may actually cost more than a FAO Version 1 contract given the amount of money CFOs/Controllers will spend on major process reengineering initiatives which may include Enterprise Resource Planning (ERP) consolidations(s), Shared Services Center(s) consolidations, and other related consulting projects.

As is the case with FAO Version 1, FAO Version 2 is becoming increasingly more difficult to sell and sustain and once again runs counter to the permanent cost reduction mantra of the CFO/Controller. The service providers selling FAO Version 2 have also now invested heavily in consulting capabilities and in their delivery centers. The service providers are now in a quandary as to how to offer permanent cost reduction solutions to CFOs/Controllers because they know all too well that they have made massive investments in personnel that is rapidly becoming redundant, obsolete and unnecessary.

FAO Version 3 is the ultimate solution CFOs/Controllers need and desire with a focus on the requirement of permanent cost reduction. FAO Version 3 has been referred to in the industry as “Platform Led BPO” or “Full FAO Transformation”. FAO Version 3 is the next generation of FAO that is “outcome based” around permanent cost reduction requirements from CFOs/Controllers and is achieved by the use of technology and technology enabled solutions to greatly reduce and or eliminate finance and accounting (General and Administrative) transactional labor and implement best practices. This of course, has created great angst and unrest amongst the FAO service providers who have not adopted FAO Version 3 as an offering because it effectively “cannibalizes” their investment of millions (if not billions of USD) in delivery centers filled with cheap labor resources as well as large, resource heavy (and expensive), finance and accounting consulting/process reengineering resources. Stated differently, FAO Version 2, like FAO Version 1, has a fundamental disconnect between the customers (CFOs/Controllers) requirements and the service provider(s) offerings (see Figure 1):

Figure 1: Finance and Accounting Outsourcing Evolution to Version 3



Over the last decade, API Outsourcing Inc. (API) has invested in the creation of a FAO technology stack known as the "Automation Platform" to deliver permanent cost reduction and best practices to CFOs/Controllers. The API automation platform is fully FAO Version 3 compliant. Our platform led FAO offering, is primarily focused on the key F&A processes of Procure to Pay (P2P) and Order to Cash (O2C) with technology interfaces and workflow automation to enhance the Record to Report (R2R) processes. The history and heritage of API is deeply rooted in information technology, process automation, and document management led by CEO, Gary Halleen. Gary was also a visionary in establishing API's USA based "on-shore" delivery centers focused primarily on the conversion and digitization of paper based documents to electronic documents.

API has always believed that technology is the disruptive force of permanent change and also the key lever in delivering "permanent cost reduction" through process automation and/or process elimination. API has partnered with key strategic technology partners to "build" and "deliver" robust end-to-end FAO solutions in O2C and P2P. API has also developed a technology platform to provide a workflow based central repository for all information associated with a transaction or back office process. The platform supports rapid interfacing to the multiplicity of ERP systems. API offers a robust end-to-end FAO solution (people, process, technology) or a solution by process or even a sub-set of the super process. API is delivering radically new, highly automated (with enhanced compliance controls and risk mitigation), processes (and sub-processes) for our clients in a Business Process as a Service (BPaaS) model while also leveraging "the cloud" by offering our solutions via Software as a Service (SaaS). The API automation platform insures that customers can go to one repository for all information and is linked and instantly available for any transaction or relationship.

Besides permanent cost reductions, other tangible and significant benefits API provides:

P2P: we are helping our customers better manage and control Days Payable Outstanding (DPO) resulting in improvements to working capital.

O2C: we are helping our customers significantly reduce Days Sales Outstanding (DSO) which is providing a dramatic improvement on working capital.

R2R: we are helping our customers achieve real-time visibility and complete control over their month end reconciliations as well as reducing their accounting month-end close process, time, and audit requirements.

API's Automation Platform seamlessly interfaces with all ERPs or legacy accounting systems through file inter-changes. This can be accomplished in real-time or batch mode. All of our partners' technologies equally interface seamlessly with multiple ERPs or legacy accounting systems through API's automation platform eliminating the need for the customer to integrate with multiple systems for a complete solution.

In addition to our technology partners, API is committed to the accounting firms who currently service a large number of clients through their staffing or "Finance and Accounting Outsourcing" services. API recognizes that automation can eliminate some processes and enhance others. However, there is still a need for accounting "judgmental" expertise and analysis in working with financial reporting, business intelligence and dispute management. There is also the continued need for audit and tax work. Therefore API is working with several accounting firms to incorporate these services into the total FAO solution using a joint partnership model. Accounting firms already understand the core transactional processes (and judgmental F&A processes) of the client but lack the automation and technology capabilities. The accounting firms, in essence, are an extension to the "on-shore" outsourcing strategy championed by API by being able to bring qualified/certified accounting personnel to their clients in their local USA GEO.

Summary

API's competitors, in particular the large FAO "off-shore" service providers, have invested millions in infrastructure, delivery centers, and of course cheap labor resources. This investment heavily influences their desire for their customers to maintain in efficient and ineffective processes thus requiring FTEs to perform these transactional processes. If transactional F&A processes are automated and/or eliminated, thus leaving only judgmental finance and accounting processes, what does our competition propose to do with all their delivery (labor) resources? The FAO Version 1, "Lift and Shift" philosophy is to keep FTE hours the same but at a lower price. This is fraught with long term risk as labor costs, in offshore countries, are continuing to increase year over year. FAO Version 2 "Consult" or "Fix" and then "Shift" is equally flawed since the automation of processes in FAO Version 3 eliminates many of the processes that consultants are paid to reengineer and fix.

The new FAO Version 3 compliant strategy from API will deliver the following benefits to CFOs/Controllers:

- Permanent cost reduction and eliminate the need for labor (regardless of GEO)
- Eliminate underperforming processes and need to hire reengineering consultants
- Implement best practices
- Differentiate API from competitor offerings who are heavily invested in FAO Version 1 and 2 thereby creating an inherent conflict of interest with customers

If you would like to learn more, please contact Randy Mueller at 612-702-2001 or randy.mueller@apifao.com. Thank you for reading this white paper.

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Innovate To Transform

Randy Mueller

Randy is currently serving as the Vice President of Business Partner Sales at API Outsourcing, Inc. Randy has over 30+ years of professional experiences and has worked as a Business Advisor, Executive, and Management Consultant most noteworthy at IBM, Accenture, Deloitte Consulting, Tata Consultancy Services (TCS), and HCL Technologies. Randy is an industry thought leader and experienced in Finance & Accounting (F&A) systems (ERP) and tools, F&A processes including Record to Report (R2R), Procure to Pay (P2P), and Order to Cash (O2C), and F&A Outsourcing (FAO). Randy has sold, led, and advised numerous clients on FAO engagements involving numerous ERPs (multiple General Ledgers), Shared Services Center (SSC) development, and strategic sourcing. Randy's consultative sales and advisory approach to client CFOs/Controllers is focused on eliminating redundancies and process costs through automation, industry benchmarking, risk mitigation, enhancing internal and external reporting, improved liquidity and working capital, and enhanced cash management.

About API Outsourcing

API Outsourcing, Inc., is a leading onshore Finance and Accounting Outsourcing (FAO) provider of innovative state-of-the-art document management, Procure to Pay (P2P), Order to Cash (O2C), and accounting services headquartered in St. Paul, MN. API is ranked as the #1 global accounts payable service provider in the Black Book of Outsourcing's State of the Global Finance and Accounting Outsourcing Industry published in December 2010. API transforms manual paper-dependent payables and billing processes through its imaging, bill delivery and workflow systems to minimize the labor intensive work associated with back-office processing and enable customers to focus on their core business. Outsourcing benefits include improved cash flow through improved DSO and controlled DPO. This combined with reduced processing costs, increased business intelligence and improved customer/vendor relationships provides the ultimate value proposition around permanent cost reduction. API currently processes over one hundred million transactions annually, delivers world-class quality, provides exceptional customer satisfaction, utilizes Six Sigma practices and performs a SAS 70 Type II Audit annually. For more information, please call, (651) 675-2600 or visit www.apifao.com.