Gaining height: relocating fragmented finance functions

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When small, dispersed, and over-stretched finance teams can no longer guarantee even basic processes and compliance tasks, outsourcing the work to an external service provider is often the solution of choice. The thinking is that service providers have the human and technical resources to perform the work reliably and to a high standard. But the success of such a move is by no means guaranteed. ### We look at the risks and the options, and explain the action steps a beleaguered CFO should take to reap the rewards.

1. Introduction

The typical business case for relocating - i.e. centralizing or outsourcing - finance processes is based on the transfer of large volumes of similar, rule-based work to internal or external service providers, who can achieve efficiencies through bundling, standardization, automation, or labor cost arbitrage.

There is, however, another situation in which relocation is often considered: when small and very small, dispersed finance teams have become so weak that they can no longer carry out even basic tasks effectively and with sufficient quality. It is with this scenario that we are mainly concerned here.

In the first, typical, case, companies start from a position of strength and want to take advantage of further opportunities; in the second case, the focus is on risk avoidance: The expectation is that service providers will have the human and technical resources to handle the most demanding tasks reliably and to a high standard.

In this article, we examine the risks faced by fragmented finance functions and their organizations, we explore how relocation can help to overcome these risks, and we look at the factors influencing a relocation as well as the available options. Finally, we summarize key factors that CFOs should take into account if they want to execute a relocation successfully.

2. The risks of a fragmented finance set-up

The problem often arises when the international administrative footprint is too heavy relative to the sales and profits generated. Markets with sales of ten million Euros and average return may be able to justify a dedicated legal entity. But if either is lower, funds may not be sufficient anymore for systems investments or team quality. The result can be highly precarious: micro-teams or lone admin warriors on autopilot, relying on outdated systems and routines. At a first glance, they may seem impressively efficient, but the illusion breaks down as soon as new challenges arise and cannot be met because there has never been either the time or the resources to invest in future-proof skills and infrastructure.

Attracting new people to such constellations is tough. Long-serving employees may derive a strange kind of satisfaction from an employment relationship that is pleasurable and painful at the same time and can prove surprisingly loyal. Potential newcomers tend to take a more sober view of the prospect of never-ending over-time and understaffing. And even the most loyal incumbents may eventually find it too much to bear. A narrow knowledge base will then further erode through illness or attrition. In extreme cases, say, after the emergency recruitment of a new chief accountant who turns out to be a tyrant, the risk of total depletion looms.

But how can it come to this? Perhaps sales have fallen from a previously adequate level. Or perhaps they never reached the magnitude for which the organization was originally set up. Or an overly simplistic, blunt restructuring - staff cuts and nothing else - has further reduced already tight capacity without doing the hard work of simplifying processes and requirements. Moreover, once in place, heavy admin structures tend to set limits to simplification: transfer pricing systems don't distinguish between large and small transactions, nor do banks' KYC processes, nor do most public compliance requirements.

All of which might still be manageable if a well-resourced head office has the necessary expertise and bench strength to help out. But if skeleton subsidiaries are run by a head office that is no less emaciated itself, this route is also not available.

The risks of such scenarios are obvious and have already been mentioned in part.

Narrow, further eroding know-how sets the ball rolling: Once the necessary, often considerable, contextual knowledge of structures and processes is lost, business transactions can no longer be correctly classified and fulfilled. In extreme cases, even the most basic processes such as delivery, purchasing, and invoicing break down in the event of minor disruptions such as staff changes, illness, or even holidays.

Of course, the same applies even more to topics like customs or tax. Not only are these extremely complicated fields, they are also often highly risky in the event of inadequate compliance - a slippery slope with a steep incline, where problems can quickly accumulate. For example, group executives who are directors of subsidiaries may be personally affected, and in some countries the authorities can revoke the operating license in the event of non-compliance. If, in the past, compliance simply used to be given, the head office may not notice the breaches in its weakened subsidiaries until it is too late for an effective defense. In such cases, outsourcing to a service provider can be a lifeline.

3. Relocating to the promised land

Relocation can help to manage or avoid the risks outlined above. As long as the situation is still relaxed and the company has sufficient time for implementing either, it is possible to consider both centralization at an internal service organization - which may need to be created

first - and outsourcing to one or more external partners. If a company is already in the middle of a crisis, the speedier external option may be the only realistic option.

But service providers can do more than just help you get through a crisis. They can also be better placed to manage tasks effectively: they have a large pool of staff which the customer only needs to pay as needed. Service providers may experience staff turnover, too, but they are usually better equipped to deal with it than a struggling micro-enterprise. Expertise is a given, as are process knowledge, process discipline, and compliance. Even though the knowledge of a new client's business and organization will have to be built, these factors promise a better performance post transfer than the client can ensure on its own.

And there are further opportunities: A service provider serving several clients can achieve cost benefits through standardization and the sharing of best practices - and can pass some of these savings to the new customer. A well-utilized systems infrastructure can also be a big plus. The service provider is more likely to keep pace with, or even drive, the digitization of processes, allowing the customer to participate in technological advances, like machine learning, which might otherwise have been unattainable or unaffordable. Finally, there may be opportunities for labor cost arbitrage the customer does not have.

All in all, outsourcing does promise reliable and efficient backbone processes, as well as further opportunities, that are not available in the legacy setup.

But none of this is automatic.

To what extent these benefits can be realized in an individual case, depends crucially on the design and execution of the transfer.

4. Executing a relocation successfully

The extent and depth, as well as the success or failure, of a relocation are first and foremost driven by factors inside, and often controlled by, the client organization. The service provider and its performance during the project matter but have a lesser influence. In this section we explore some of the main factors.

Relocation out of strength or weakness? What is the reason for the relocation, and how healthy is the company looking to outsource or centralize? Is a healthy company relocating from a position of strength or are we dealing with a precariously fragmented finance organization crippled by staff shortages? In the first case, a comprehensive project plan can ensure that the outsourced processes are well integrated with the retained finance processes; that the selection of the service provider will be based on the right objectives and on sound specifications; and that close project management will be in place during the implementation.

If, on the other hand, bottlenecks, staff shortages, and external deadlines for tax returns or financial statements have added up, there might be no time for, e.g., a detailed benchmark; expectations towards the service provider may not be sufficiently elaborated; efficiency improvements or cost savings have to take a back seat; and the only concern is to somehow maintain the bare necessities. The risk with an emergency operation like this is that an incomplete and poorly managed transfer will make a tough situation worse and cause deep disappointment and dissatisfaction on both sides. But still, under some circumstances, the emergency transfer might be the only available alternative.

So, which processes should be transferred? The more standardized a process or function, the easier it is to outsource. Some processes, such as registering supplier invoices, are relatively easy to outsource: the activities involved can be well delimited and managed, for example by setting up automated controls or using written work instructions for account assignment and tax code selection.

At the same time, due to their high degree of standardization, fully automated processing can be an even better alternative for AP and similar tasks. OCR, EDI, or XML data formats, perhaps aided by machine learning algorithms, already make it possible to run such processes largely without human labor – an option potentially superior to a relocation. Unfortunately, in our crisis scenario, it is likely that neither the time nor the IT capacity required for setting-up the systems will be available.

Financial accounting as a whole? Although in most cases implemented only for sub-processes (e.g. incoming and outgoing invoices), a completely digitally automated setup is conceivable even for the entire financial accounting. However, human expertise will still be needed to record more complex transactions or for certain business models. More often, therefore, financial accounting as a whole is outsourced to internal or external service providers with only partial automation. For small and medium-sized companies, it is usually the tax advisor, while groups often use internal shared service centers to centralize financial accounting as a whole. The respective service providers, in turn, optimize their own processes through digitization and automation on as large a scale as possible.

Reporting requirements. Receiving up-to-date financial data is essential for management and controlling. Hence, the question of how quickly and how frequently figures need to be reported must be addressed before any relocation. Otherwise, management could quickly become disenchanted when, after cut-over, the required information is not provided on time.

Tax compliance. In many companies, tax compliance is outsourced to tax advisors. This is particularly true for annual tax returns (corporate or personal). Even groups with their own tax department regularly call in an external advisor for final checks and the submission. Monthly reports, such as the VAT advance return or the payroll tax return, often stay in-house. And frequently, a combination of an internal shared service center and an external tax advisor can be found. Tax advisors are familiar with the processes involved and are therefore natural points of contact for companies in urgent need of support. Going it alone without specialized expert support when deadlines have already been missed can trigger considerable risks and may, in the worst case, end in the initiation of criminal tax proceedings.

What to keep in-house. Not every function should be outsourced. Especially control and monitoring processes must be kept in-house. Failure to do so can deprive the company of internal expertise in a key management area. In extreme cases, it might become all but impossible to control the company without external help. However, centralizing financial management and control for a set of subsidiaries at HQ level can be a good option. This is often the case with sales subsidiaries that act as limited risk distributors, or with units that act as extended workbenches.

Provide for interfaces. After processes have been outsourced, the service provider must have ready access to relevant information. In addition to control and monitoring processes, interface positions must therefore be retained after the bulk of the function has been transferred.

Project management. Project management, likewise, has to remain with the client. Service providers are often great at execution but will be hard-pressed to lead a project effectively. Plus, when a company outsources project management, there is an even bigger risk of losing critical expertise. If this is compounded by staff turnover, knowledge may be lost for good, leading to excessive dependency on the service provider.

Interface effort vs transaction density. To achieve cost benefits, the relationship between interface effort and transaction density must make sense. Cost benefits will vanish if too much effort is required for interface management. The design of the interface is therefore critical and

must be considered when planning for the project. Since the effort required to control external and internal service providers is easily underestimated, planning must not be limited to the outsourced process itself. Aspects such as adherence to deadlines, clarification of queries, problem management, etc. have to be considered, too, in order to avoid expensive surprises later on.

Internal vs. external service providers. Depending on the function to be outsourced and the structure of the company, both internal and external service providers can be considered. If the necessary know-how is available in the group, internal relocation is usually the simpler and more cost-effective option. It should be noted, however, that not only the technical understanding of the accounting systems must be available, but also specialist local accounting know-how. If this cannot be guaranteed, an external partner might be preferable. Avoiding penalties for missed deadlines or interest for missed tax payments can more than compensate for their higher fees. As mentioned, the time required for relocation is also an issue: if internal service capacity needs to be built up first, this route will not be available in a crisis where rapid action is needed.

Avoid dependency. When choosing a service provider, it is important to consider whether the process in question is to be outsourced on a temporary or long-term basis. If the necessary knowledge and infrastructure is not retained within the company, a permanent dependency on the service provider may result. After the project has started, and even more so after several years of operation, changing the service provider or bringing processes back in-house will be possible only with a great deal of effort. Transmitting the process knowledge held by the service provider back to the client (or to another service provider) will be expensive. It is therefore essential that the client retains the full knowledge of the processes that were outsourced.

Information flow. The larger the group and the more decentralized the project, the greater the need for communication. For example, if the subsidiary accounting is outsourced to local tax advisors, internal and external group reporting deadlines have to be communicated and monitored. The exchange of accounting-related information, for example about structural changes, is another aspect that should not be underestimated: thus, the establishment of a new sales channel needs to be announced early on so that it can be properly reflected in the accounts and tax papers. Even in-house accounting and tax departments sometimes do not receive such information until it is too late. When these functions are outsourced, the risk of a lack of information flow increases massively.

Implicit knowledge can no longer be taken for granted. The loss of informal efficiency associated with process outsourcing needs to managed. Activities that were self-understood by the company's own employees must be explained to the service provider and included in

the job description. The company must not assume that this knowledge will simply be available or will be built up automatically.

Risk of attrition. No matter how well a relocation is designed, the changes must ultimately be supported and implemented by the employees. Internal communication is, therefore, vital and needs to be planned. Negative rumors, if persistent, can derail even the best project. If such rumors cannot be contained quickly, there is a risk of losing the most knowledgeable people, who are essential for project control and interface management.

5. The dos and don'ts

The previous sections have highlighted many of the issues that arise when relocating financial processes. Below, we have summarized the most important dos and don'ts which - in our experience - should be considered in any relocation.

Here's what you should do:

(1) Plan ahead. Consistent planning of all necessary steps is critical. Think of employee empowerment, scoping, process design, supporting systems and communication.

(2) Ensure the right skill-set. It is vital to have a team of experienced people at the out-sourcing organization who have the necessary technical skills and customer focus.

(3) Clear scoping... This includes the definition of a robust division of activities with clear rules regarding which tasks get transferred and which are retained. To avoid instability, processes should be transferred as holistically as possible. In addition, as many highly transactional processes with little external contact (especially customer contact) as possible should be transferred, as these offer the greatest bundling benefits.

(4) Digitization is an absolute must. Standardization of processes and workflows ensures that accounting operations can be carried out effectively and efficiently, provided the requisite systems are in place. Digital documents, such as invoices or bank statements, are a must. Workflow-based transaction management and the standardization of systems allow scalable automation to be built over time. At a later stage, machine learning can open up entirely new opportunities.

(5) Communicate! From the outset and throughout the transition, open and transparent communication is essential. Project objectives should be clearly articulated so that the underlying strategic goals become transparent. Involving the local organization at an early stage will create the necessary buy-in, which in turn is crucial for the success of the project.

(6) Respect the nuts and bolts of transformation. Small operations should be integrated into shared services environments only if these are sufficiently mature. Based on a clear division of labor and a migration readiness plan, complete the transition in a compact manner. The first weeks after cut-over should be closely monitored to ensure that processes are quickly stabilized. It is key to establish routines and rules for working together, including SLAs and regular exchanges at management and operational levels.

And this is what you should by all means avoid:

(1) Don't prioritize speed over quality. Too fast an implementation can reduce quality and have a lasting impact on effectiveness, as frustration and escalation can be difficult to mitigate. Corporate culture plays a big role in determining the optimal pace.

(2) Don't disregard language skills. Even if the receiving team communicates mainly with the local organization and less with customers or other external contacts, local language skills are always a help and, for some countries, a neccessity. Especially in the start-up phase with its high need for coordination, barriers can arise if language skills are lacking.

(3) Don't neglect local management. The responsibility for restructuring the local (legacy) organization must rest with local management. They need to become stakeholders at an early stage so that the project team and service provider can focus on service delivery and do not in addition have to worry about restructuring the legacy teams.

(4) Don't be too rigid. If the as-is processes are not already standardized, process variants will be needed. At least initially, standards must not be applied too rigidly. Pragmatic compromises have to be found in order to prevent the entire transformation from stalling. It is better to drive out process variations in later stages of the transformation than trying to establish standards in a hurry during the initial transition.

(5) Don't neglect data privacy and compliance. Data protection and compliance regulations have to be carefully adhered to.

6. Conclusion

We hope our discussion of the opportunities and challenges and our dos & don'ts have shown that relocation quality benefits greatly from a solid planning. An emergency move is much less likely to succeed than one that is carefully prepared. If an emergency transfer cannot be avoided, it's vital to have experienced and careful leaders at the helm of the project.

In addition to our recommendations above on how to ensure success once a relocation has become unavoidable, we therefore want to conclude with one very simple, but fundamental piece of advice: CFOs whose finance organization is spread out in small, highly stretched teams should make every effort to stabilize their function long before the situation becomes precarious and forces hasty action. Only in this way can the best options - such as establishing an internal shared service center or the comprehensive digitization of the administrative processes – remain on the table and be implemented with confidence.

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