

TRANSFORMING AND OFFSHORING FINANCE PROCESSES: TIMING IS EVERYTHING

Hackett research shows 10-year NPV of finance process cost optimization initiatives ranges from \$366 million to \$462 million, depending on timing of initiatives

Management Issue

For Current Members of Hackett Advisory Programs Only

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EXECUTIVE SUMMARY

The “globalization” opportunity is extremely compelling for companies striving to achieve world-class performance for their finance function. But it needs to be considered in a much broader context than just taking advantage of labor arbitrage; rather, globalization represents a chance to evaluate the overall performance of the organization. Globalization should not be a substitute for strategic transformation and continuous improvement – all are needed to achieve world-class performance. However, various options do exist when it comes to execution, consisting of differences in the timing of the initiatives. Organizations with the ability and resources to execute strategic transformation programs will tend to transform more work before offshoring it, whereas resource-constrained organizations will look to move work offshore first as a means to realize a rapid payback that can be used to fund further transformation. However, because of underlying differences in finance processes, no company should follow a strict “transform first” or “globalize first” path for all processes; in practice, optimization will take place through a series of “waves” that combine transformation and globalization initiatives.

Finance process cost and shareholder value

The calculations used in this report assume a total annually recurring finance process cost-reduction opportunity of \$110.2 million for a Global 1000 company with revenues of \$22.3 billion. This number is based on Hackett data about the gap between world-class and peer-group finance process cost levels, and the labor arbitrage opportunity of offshorable FTEs in the finance function. Assuming these cost savings all add to the bottom line, at an effective tax rate of 20% and a P/E ratio of 20, this opportunity represents additional market capitalization of \$1.8 billion.

STRATEGIES TO ACHIEVE WORLD-CLASS FINANCE PROCESS COST LEVELS

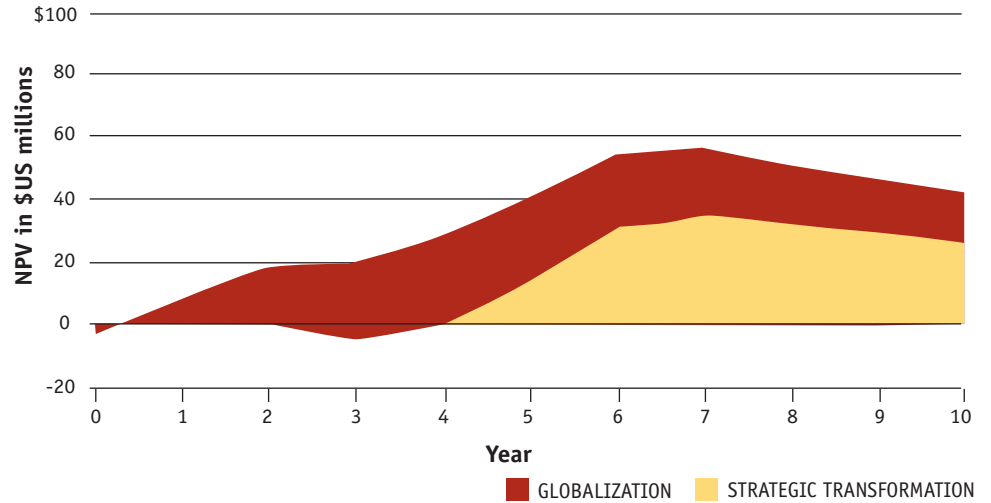
Companies can drive down finance process costs through discrete globalization and strategic transformation initiatives, as well as through continuous improvement of their finance processes. Those aspiring to achieve world-class finance performance levels do not have the luxury of selecting just one or two of these options, but need to pursue all three. However, companies can make choices about the timing and phasing of their globalization and strategic transformation initiatives. The key is in understanding the trade-offs involved.

In **Fig. 1** and **2** below, we present two scenarios for achieving world-class finance process cost levels, modeled for a typical Global 1000 company. A first observation is the very significant value opportunity at stake (between \$366 million and \$462 million over a 10-year planning horizon), which underscores that companies cannot afford to ignore SG&A process cost savings opportunities in general, and finance cost specifically.

Although the 10-year NPVs are not far apart in both scenarios, the benefits realization and risk profiles are very different. In Scenario 1, the company undertakes a “lift and shift” globalization initiative (i.e., moving processes suitable for

FIG. 1 Transform and shift scenario 1: Offshore first

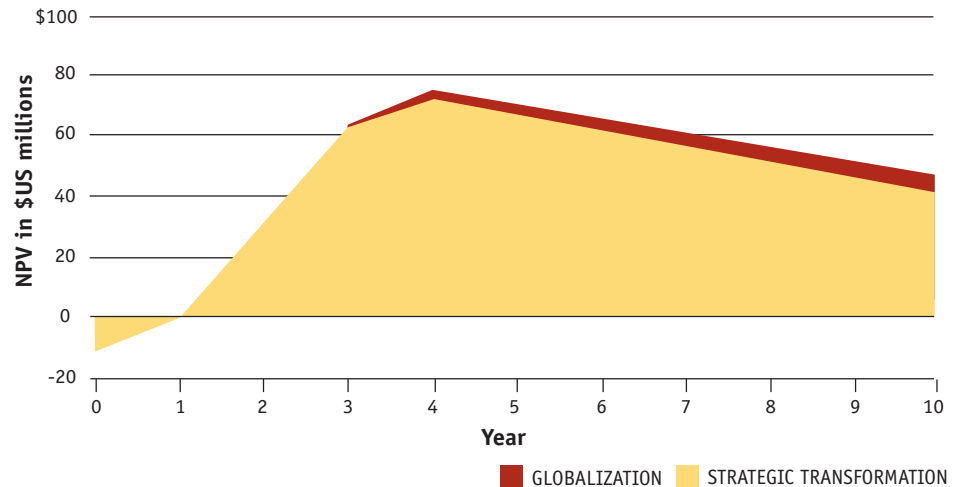
(Total cumulative 10-year NPV: \$366 million)



Source: The Hackett Group, 2007

FIG. 2 Transform and shift scenario 2: Transform first

(Total cumulative 10-year NPV: \$462 million)



Source: The Hackett Group, 2007

offshoring in their “as is” state). Process transformation is started in the fourth year into the 10-year timeline. This strategy requires low up-front investment, and benefits can start accruing in the first year or two. This scenario has the advantage of requiring a minimal initial investment and allowing the savings to pay for the additional transformation work that will be required. The strategy may be implemented through an outsourced (BPO) relationship, building of a captive offshore capability, or a mix of the two approaches. Typically, time to benefits in a BPO model will be shorter because the BPO provider may be willing to fund some of the initial investments. However, realization of subsequent continuous

improvement and strategic transformation benefits is dependent on a different set of dynamics in an outsourced model, and may be constrained by the BPO provider's capability to support strategic transformation initiatives.

In Scenario 2, the company undertakes a large strategic transformation initiative up front, substantially reducing the number of finance FTEs before moving remaining work offshore. The processes are transformed in a way that dramatically reduces the number of FTEs through automation, centralization, process reengineering and so forth. The savings are most dramatic in the years immediately after the processes transformed are put in place. It should be noted that the scenario is a reflection of opportunity across all finance processes, including those that represent a relatively small globalization opportunity and large transformation opportunity. Nevertheless, because the number of "offshorable" FTEs is drastically reduced through transformation, the globalization opportunity remaining after globalization is small relative to the opportunity of the initial transformation work.

Although the scenario is appealing, there are some very practical constraints that may preclude companies from going down this path. Transformation may be a long, costly and sometimes politically difficult process. For example, transformation assumes companies standardize processes and move to a common ERP platform. Depending on existing process and technology complexity, ERP consolidation may be a very costly proposition – the business case for "lifting and shifting" first may be more compelling. Also, the company may not have the program and change management capabilities to undertake a large-scale strategic transformation. We have observed companies postponing globalization decisions based on the argument that transformation needs to be done first. However because the company lacks transformational capabilities, nothing is done and the "transformation first" argument has in effect become an excuse to do nothing.

THE DIFFERENT RISK/REWARD PROFILES

Scenario 1 produces an evenly distributed benefits realization profile over a 10-year time frame, whereas Scenario 2 requires significant up-front investment, leading to a negative benefits stream in the first two years, and then rapidly accruing benefits, with a gradual decline in benefits in the last few years in the planning horizon. In strict financial terms, Scenario 1 has a quicker payback, and is largely self-financed, whereas Scenario 2 has a higher 10-year NPV. For resource-constrained companies, Scenario 1 is very compelling, whereas companies with deep pockets that can afford to take the long view will be biased toward Scenario 2.

The risk profiles are different in that Scenario 1 depends largely upon the company's ability to execute on a globalization operations strategy, whereas Scenario 2 requires the company to be able to execute a large transformation of its organization. Scenario 1 reduces the risk of having to project planning assumptions about key parameters of the globalization component of the business case – such as projected wage rate gaps – further out into the future.

The impact of cost and discount rates

Resource-constrained companies will typically have higher cost of capital and hence higher discount rates. The higher the discount rate, the more favorable Scenario 1 (i.e., globalize first) compares to Scenario 2, strengthening the bias toward Scenario 1 for resource-constrained companies.

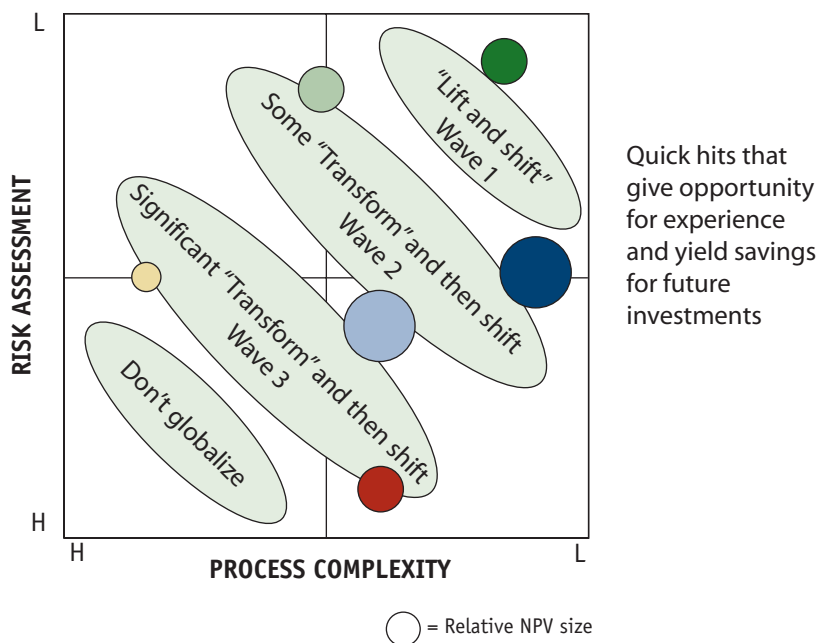
However, Scenario 2 reduces dependency of the business case on these same parameters, so whether time-shifting the globalization initiative increases or decreases risk is situation-dependent.

Another risk consideration is the strategic and competitive impact of globalization (outside the SG&A business process domain) in one's industry. In industries in which globalization has a high strategic impact, embarking on SG&A business process globalization initiatives early may pay dividends by elevating the company's general globalization capability maturity. Conversely, by postponing SG&A globalization, the company may fall behind the competition. All these considerations should be factored into the business process globalization business case as additional value and/or risk drivers.

THE REALITY: DIFFERENT RISK/REWARD PROFILES AND OPTIMIZATION IN WAVES

The globalization and transformation scenarios and opportunity numbers presented in this research represent the aggregation of a variety of underlying finance (transactional and non-transactional) processes. In planning actual transformation and globalization programs, companies need to consider how transformation/globalization decisions impact the risk/reward profile of optimization of individual (finance) processes. Because of the fundamental differences between finance processes, most companies will follow a blended scenario, strategically transforming some processes first, while offshoring and then transforming others. This strategy is consistent with Hackett's view of globalization being a five to 10-year process, with different optimal approaches for different processes (Fig. 3).

FIG. 3 Business process globalization "waves"



Source: The Hackett Group, 2007

STRATEGIC IMPLICATIONS

Although companies aspiring to be world-class have no option but to deliver continuous improvement, undertake strategic transformation and globalize, they have a great deal of discretion over how to phase these initiatives. Optimal strategies are dependent on such factors as the role of globalization in the overall business strategy, the cost of capital (reflected in discount rates), risk profile, size of the gap to world-class performance, and the scope and characteristics of the finance processes under consideration. All need to be understood and factored into the company's global service delivery strategy for the finance function. Given the size of the opportunity, ignoring the issue is not an option.

RELATED HACKETT RESEARCH

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[“One of the Biggest Decisions You Will Make for the Next 5-10 Years: How to Balance Business Process Globalization and Transformation,” May 2007](#)

[“Globalization: The New Horizon for European Finance Shared Services,” The Hackett Group 2007 Book of Numbers Research Series, Vol. 11, No. 1](#)

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Mr. Janssen is responsible for analysis, thought leadership and research activities for The Hackett Group's advisory programs. In addition, he leads the firm's efforts in advising clients on world-class sourcing and outsourcing. During a career spanning over two decades in outsourcing leadership positions, he has been a major contributor to the industry's development and designed strategies for creating effective relationships between service organizations and their clients in a wide range of industries and business processes. Prior to joining The Hackett Group, he was president of Supplier Solutions for Everest Group, a consultancy specializing in strategic, management and transactional advice to buyers and suppliers of outsourcing services, and co-founder of the Everest Research Institute. In addition, he provided strategic oversight for Everest Group's Outsourcing Center, the world's largest outsourcing community and vehicle for identifying early industry trends. Previously, he was a senior director in Gartner Group's strategic sourcing practice and held numerous management positions with EDS.

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Mr. Dorr has over 15 years of experience in the IT industry in a variety of positions. Currently, he advises Hackett Group clients on a broad range of strategic IT issues, ranging from application management to enterprise architecture and IT governance. Mr. Dorr has responsibility for the firm's IT and business process globalization research agendas. In the past, he has taken a consultative and management role in helping large organizations with enterprise system strategies and implementations. Before joining The Hackett Group, he was a research analyst and consulting director for a large IT research and consulting firm and vice president of IT at a global manufacturing company.

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