Everest Group
RESEARCH

The Paradox of FAO Adoption in SMBs

BPaaS Emerging as the Answer

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Introduction

As the Finance and Accounting Outsourcing (FAO) market continues to grow and mature, untapped client segments are starting to emerge. Small and Medium Businesses (SMBs[1]) is one such segment.

Unlike large enterprises, cost reduction is not the primary driver for SMBs to outsource Finance and Accounting (F&A). They seek a broader value proposition from FAO – access to expertise and technology, implementation of best practices models that drive process excellence, ability to place greater focus on core activities, and the expertise to create flexible, scalable operations that can support growth.

However, most SMBs have not leveraged FAO as a vehicle to get access to new talent pools, world-class processes, and best-in-class technologies. This has resulted in a paradoxical situation where, despite a strong value proposition, adoption of FAO by SMBs continues to be low.

The emergence of F&A Business Process as a Service (BPaaS) that neatly packages both technology and process services in a standardized solution promises to help SMBs take full advantage of the FAO value proposition and more.

This research paper focuses on FAO adoption in the SMB segment and explains why emergence of BPaaS will enable more adoption. The paper discusses:

- The paradox of FAO in SMB – strong value proposition, yet weak adoption
- Reasons behind low adoption of FAO by SMBs
- Five factors indicating that BPaaS could be a potential answer for SMBs
- Profile of an emerging BPaaS solution targeting SMBs – Sutherland's CLARITY es
- Best practices and pitfalls to avoid in adopting BPaaS

1 Organizations with revenue less than US$1 billion

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The Paradox of FAO in SMB – Strong Value Proposition Yet Weak Adoption

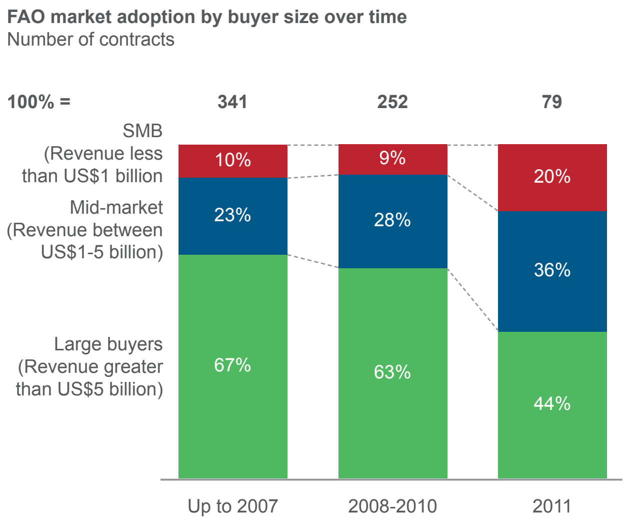
The global finance and accounting outsourcing (FAO) market is one of the fastest growing BPO segments. In 2011, the multi-process[2] FAO market grew at a healthy rate of 12% and reached nearly US$4 billion in terms of annualized contract value (ACV). The FAO value proposition and solution elements are now well-established and competitive intensity is at an all-time high.

FAO was pioneered by the global 100 companies. It quickly expanded to global 500 and more recently to the mid-market segment (organizations with less than US$5 billion in revenue). As the FAO market continues to grow and mature, adoption in the SMB segment (organizations with less than US$1 billion in revenue) is also starting to increase. In 2011, SMBs accounted for 20% of all new contracts signed as compared to ~10% in the past (see **Exhibit 1**).

EXHIBIT 1

FAO adoption by SMBs is starting to increase

Source: Everest Group



Outsourcing F&A is an attractive value proposition for the SMB segment, given the quagmire of issues that the CFO of a SMB organization faces. Firstly, in the current uncertain economic environment, SMBs are facing the twin pressure of revenue growth and cost reduction. Most SMBs face an unpredictable operational environment - both in terms of costs and service quality. Secondly, cash flow problems are exacerbated in the absence of any decision support, given the lack of data visibility and compliance. Thirdly, the overall maturity of F&A in most SMBs is also low and most SMBs suffer from manual, broken processes. They also lack a robust underlying F&A technology infrastructure. Finally, F&A leadership in SMBs is, more often than not, fire-fighting day-to-day issues as opposed to focusing on strategy and planning, given resource constraints in both recruitment and retention.

2 FAO contract with a minimum of two F&A processes, over US$1 million in ACV, and a minimum contract term of three years

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As outlined in Exhibit 2 below, FAO offers a compelling value proposition to SMBs to step up their game to compete with the best and the biggest and stay ahead in the marketplace.

EXHIBIT 2

FAO offers a compelling value proposition for SMBs

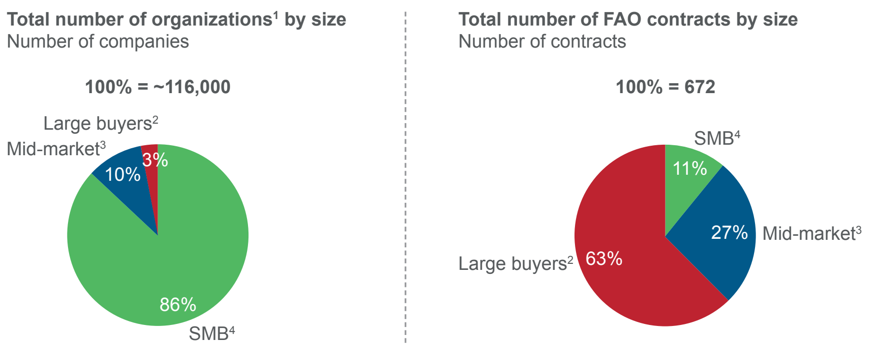
Typical F&A related challenges faced by SMBs	How FAO helps?
Twin pressures of revenue growth and cost reduction	Flexible, scalable, and low cost option
Low F&A maturity; fragmented and broken processes	Best practice F&A process with built-in productivity gains
Unpredictable operational environment both in terms of costs and service quality	Stable F&A operational environment with structured pricing, contracted service levels and KPIs
Cash flow issues combined with low levels of data visibility and compliance resulting in unfavorable business outcomes (sub-optimal DSO, EPD, and closing of books)	Decision-making support leveraging the power of analytics. Potential to create positive business and cash flow impact
Manual processes with lack of robust technology	Access to best-in-class F&A tools and technology with minimal upfront costs
Resource constraints in both recruitment and retention. F&A leadership involved in operational F&A	Access to new talent pools and greater ability to focus on core areas of business

Unlike larger enterprises, the FAO value proposition for SMBs is not driven by cost reduction. It is important but not the primary driver for SMBs as they seek a broader value proposition from FAO – access to expertise and technology, implementation of the best-practices models that drive process excellence, ability to place greater focus on core activities, and the expertise to create flexible, scalable operations that can support growth.

However, despite the attractive value proposition that FAO offers, the adoption of FAO in the SMB segment has been limited. While SMBs account for 85% of all the organizations across the globe, the contribution of SMBs to the global FAO market is only 10% in terms of the number of contracts signed till date (see Exhibit 3).

EXHIBIT 3

Nearly 85% percent of all organizations across the globe are SMBs yet they account for only 10% of all FAO deals



1 Companies with revenue greater than ~US$100 million, subsidiaries in other businesses and countries have been considered as separate companie
2 Revenue greater than US$5 billion
3 Revenue between US$1 billion and US$5 billion
4 Revenue less than US$1 billion

This is the inherent paradox regarding SMB adoption in the FAO market. Let us try and peel the layers to try and find the reasons behind this.

Reasons Behind Low FAO Adoption by SMBs

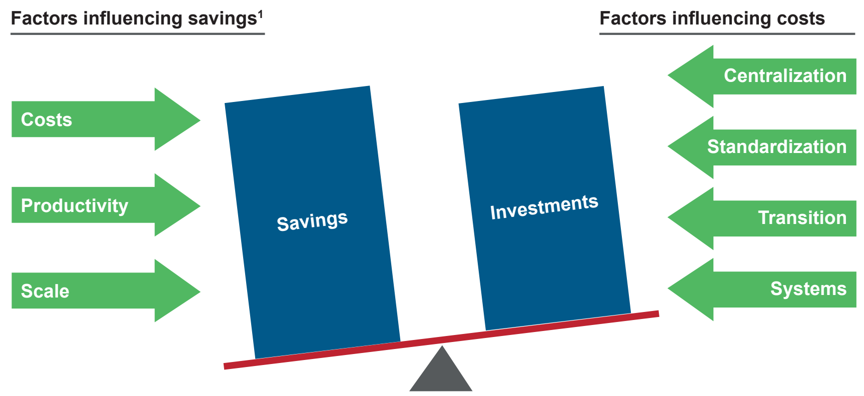
The biggest reason behind the paradoxical situation that exists around FAO adoption for SMBs is lack of scale economies.

Traditional FAO solutions are centered around the number of FTEs transitioned from the client to the service provider. It is typified by labor arbitrage – similar skills at lower costs mostly achieved through global sourcing. This makes a robust business case for a large enterprise that has a scale that runs into hundreds of FTEs. Consequently the FAO market has flourished and grown substantially over the last decade in the large enterprise space. However, SMBs do not have such scale and cannot build a positive business case based purely on economies of scale.

For the traditional FAO solution to work, the savings generated by outsourcing need to outweigh the investments to produce an attractive Return on Investment (RoI) with an acceptable payback period. **Exhibit 4** explains this concept.

EXHIBIT 4

The right balance between savings and investments is a major challenge in SMB



1 Assumes no constraints on use of off-shore solutions

In the case of SMBs, arbitrage and productivity savings reduce proportionately with scale, but transition and other upfront costs are not reduced proportionately due to high fragmentation, partial FTEs, lack of standardization and systems, and the other inherent characteristics described earlier. Thus, there is an imbalance between savings and transition costs, which often results in a poor RoI and a long payback period.

Beyond this, client acquisition and cost of sales for a service provider are also relatively high for SMBs as compared to large clients. FAO pursuits are complex and 6 to12 month sales cycles from first contact to proposal, to potential closing are not atypical for both SMBs and large enterprises. Now, would a service provider be more likely to invest in pursuing a 100 FTE FAO deal from a large client, or a 10 FTE deal from an SMB – especially when they already know that the SMB business case will not be easy? The answer is obvious, and this is where we see the opportunity for an SMB-targeted solution to be successful.

SMBs have also had limited experience with BPO. They often lack the expertise and maturity required for successful transition and change management that is readily found in large enterprises. Lack of publicized and proven success stories also makes SMBs wary of FAO adoption.

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The good news is that a number of these challenges are now being addressed. FAO providers have built a solid base of enterprise F&A clients, and they are well-positioned to down-scale their solution for smaller clients. Additionally, the share of the top three service providers in the FAO market has declined from 65% to 50% in the last five years, resulting in increased competitive intensity in the FAO market. This is pushing service providers to search for new buyer segments and invest in building solutions that offer a cost + value proposition.

However, there is a need to adopt a radically different approach to make FAO attractive for the hugely untapped SMB market. The emergence of BPaaS promises to offer that alternative – so let us look at BPaaS in a little more detail.

Five Reasons Why BPaaS Will be a Potential Answer to the Paradox of FAO Adoption in SMBs

BPaaS is the new avatar of Software as a Service (SaaS) where buyers receive standardized business process services by accessing a shared set of resources at each delivery level (people, application, infrastructure) from a single service provider. BPaaS is fundamentally different from traditional FAO and even the IT+FAO model. (See **Exhibit 5**)

EXHIBIT 5

Differences between various F&A models

Areas of comparison	In-house F&A	Traditional FAO	ITO+FAO	F&A BPaaS
Application ownership	Buyer	Buyer	Buyer	Service provider
Infrastructure ownership	Buyer	Buyer	Buyer	Service provider
Application implementation, support, and maintenance	Buyer	Buyer	Service provider	Service provider
Infrastructure implementation, support, and maintenance	Buyer	Buyer	Service provider	Service provider
Business process operations	Buyer	Service provider	Service provider	Service provider
Degree of standardization	Typically low for SMBs	Low	Moderate	High
Multi-tenancy	No	No	No	Yes

Source: Everest Group

There are five key reasons why F&A BPaaS offerings hold a lot of potential, especially for SMBs.

1. **Between 40-55% lower Total Cost of Ownership (TCO) as compared to in-house F&A for SMBs:** BPaaS solutions provide access to state-of-the-art technology that would otherwise be expensive to implement for SMBs. Further, it minimizes the ongoing support, maintenance, and software upgrade costs. Additionally, it allows SMBs to enter into an FAO relationship that would not have made sense on stand-alone basis due to lack of scale. Consequently, SMBs can now achieve operational cost reduction due to the combination of centralization and labor arbitrage levers previously only available to large enterprises.

   Based on Everest Group's TCO estimates, the BPaaS model substantially reduces TCO (includes all costs related to F&A service delivery, technology application, and underlying infrastructure) by 30-40% when compared to traditional FAO model and by 40-55% when compared to an in-house F&A model for SMBs (see **Exhibit 6**).

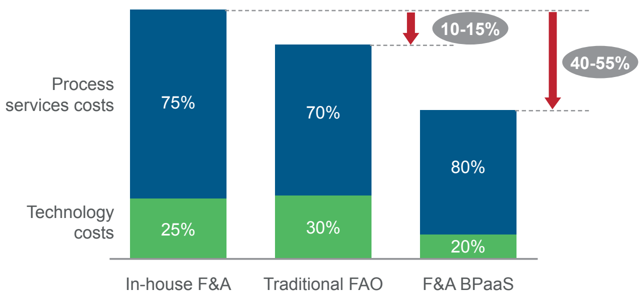
2. **Faster payback period:** As the BPaaS solution offers a highly standardized solution to SMBs, the deployment time for both technology and process services is reduced significantly when compared to traditional FTE-driven models. The BPaaS solution ensures that SMBs start realizing benefits quickly, thereby minimizing the return-on-investment (ROI) period. This is becoming increasingly relevant in the current economic situation where SMBs do not want to have a long-term commitment, need faster payback, and quicker ROI to support rapid growth and to remain competitive.

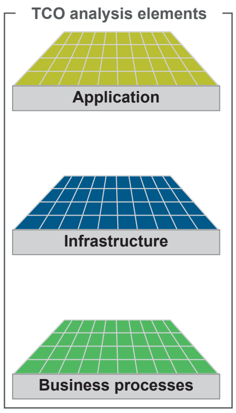
EXHIBIT 6

BPaaS offers a 40-55% reduction in TCO over traditional FAO for SMBs

Source: Everest Group

TCO comparison between In-house F&A, traditional FAO, and F&A BPaaS model for SMBs





TCO analysis elements	In-house F&A model	Traditional FAO model	F&A BPaaS model
Application	• 100% of the F&A functions in-house • Dedicated FTEs • No offshoring	• ~50% of the F&A functions outsourced • Dedicated FTEs • ~30% offshoring	• ~50% of the F&A functions outsourced • Mix of shared and dedicated FTEs • ~50% offshoring (higher offshoring given more standardization)
Infrastructure	• Ownership is with buyer • Implements ERP solutions such as SAP, Oracle	• Ownership is with buyer • Implements ERP solutions such as SAP, Oracle	• Ownership is with service provider • Service provider partners with ERP provider and enriches the existing solution to meet buyer needs
Business processes	• Ownership is with buyer • Servers are on-premise	• Ownership is with buyer • Servers are on-premise	• Ownership is with service provider • Leverage cloud and virtualize servers to the full extent

3. **Flexibility:** The BPaaS model is based on a pay-as-you-go model where the price is driven by volume rather than by FTEs. This allows SMBs the flexibility to scale up or down based on the changing business needs, thereby, paying only for the services used. This model minimizes capital expense (CAPEX) and makes operational expense (OPEX) proportional to business volumes. This makes FAO more flexible and easier to consume for SMBs. Further, the flexible delivery structure of the BPaaS model enables SMBs to accommodate rapid growth, both planned and unplanned, and also proactively manage downturns. BPaaS helps prepare buyers for mergers and acquisitions, assimilation of new product lines, and compliance with new regulatory requirements and standards.

4. **Access to best practices:** The BPaaS model offers a standardized solution by packaging best-in-class process services with best-in-class technology solutions that were previously difficult and expensive for SMBs to access.

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5. **Single throat to choke:** BPaaS reduces the governance and integration effort of a buyer because there is a single provider delivering both IT and BPO services. The buyer does not manage the underlying ERP system, the infrastructure supporting it, or any upgrades to the software. The entire burden lies with the service provider. In fact, there is only one touch-point for the entire process delivery, which is perfect for SMBs that do not have sufficient scale to manage and regulate the ERP system and BPO services. Additionally, the integrated approach enables SMBs to redeploy their resources to more critical and core activities, focusing their leadership on strategic issues, rather than on tactical ones.

BPaaS offerings for F&A are still being pioneered but hold a lot of promise, particularly, for SMBs. A recent example of one such BPaaS solutions targeting SMBs is Sutherland Global Service's CLARITY es, an enterprise solution combining best in class BPO services with a state-of- the-art ERP system from Microsoft (see **Exhibit 7**).

EXHIBIT 7

Sutherland Global Services's CLARITY *es* BPaaS offering for SMBs

Overview

- Launched in 2012, CLARITY *es* is a cloud-hosted enterprise solution combining Sutherland's BPO services and the Microsoft Dynamics AX ERP platform
- All ERP modules including financial management, human capital management (HR & payroll), procurement & sourcing, sales & marketing, supply chain management, project management & accounting, production/manufacturing, and business intelligence & reporting are available
- F&A process scope includes the entire F&A value chain from accounts receivable & payable, to general ledger, bank management, budgetary control, compliance management, and regulatory reporting

Solution highlights

- Targeted to SMBs
- BPO services by Sutherland Global Services
- Powered by Microsoft Dynamics AX
- Flexible deployment options – both cloud hosted and on-premise
- Modular deployment – all-in versus phased
- Pre-built industry-specific functionalities
- Customizable dashboards and reports
- Embedded business intelligence and analytics
- Web-access with 97.99% uptime
- Dedicated environment (not multi-tenant)
- SSAE 16 (formerly SAS 70 Type II) compliant
- Pre-configured add-on tools and RapidOn deployment
- Familiar and intuitive look-and-feel to user interface

Value proposition	Types of business impact	Examples
Strategic impact	• Platform for rapid growth, preparation for M&A • Shifts risk to supplier • Redeployment of human assets to critical strategic activities • Improved agility to deliver core competencies	• Zero cost of delivery disruption • Increased Employee Value Add (EVA)
Process/ business impact	• Process efficiency translates into increased working capital • Access to highly-skilled labor pool • Integration of multiple financial platforms into one global standard • Real time visibility into critical business data • Service delivery with guaranteed metrics	• 10% to 25% savings due to higher productivity/ accuracy • Time/Error reductions due to single point of data entry/import/ export
Direct-cost impact	• Labor arbitrage • Reduced training costs • Ongoing operational efficiencies/cost reduction • Lower TCO than on-premise Oracle/SAP implementation • Faster deployment	• Offshore : 25-30% / Onshore: 10-15% • Y-o-Y 3% to 5% reduction • Lower upfront costs and implementation time

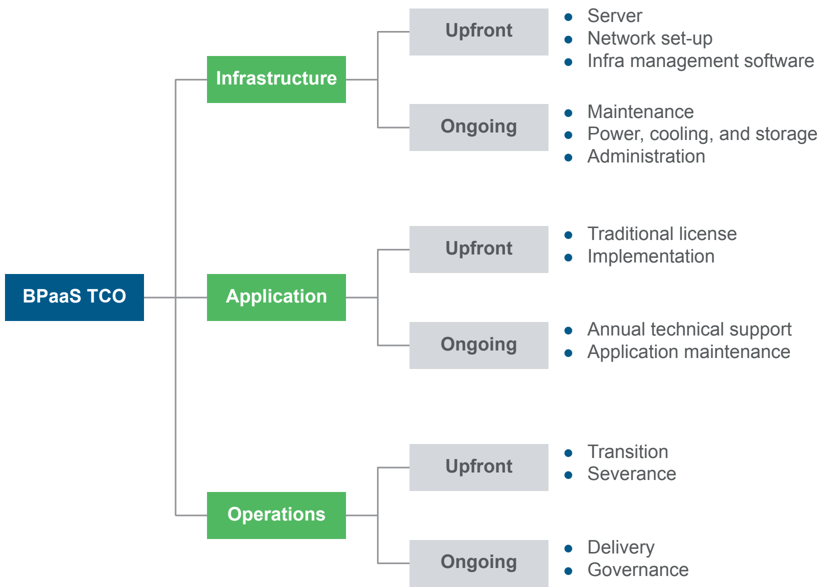
F&A BPaaS Adoption – Pitfalls and Best Practices

Given that BPaaS is fundamentally different from traditional FAO solutions, the approach to the adoption of BPaaS also needs to be different. Following are some of the best practices, and potential pitfalls to avoid while considering a BPaaS solution for F&A:

- **Build a TCO-based business case.** The TCO analysis should be based on a holistic framework that includes all three layers of BPaaS service delivery, including infrastructure, application and operations (see **Exhibit 8**).

EXHIBIT 8

Layers of BPaaS service delivery



A true BPaaS model is based on a shared resources construct at each service delivery layer, so this model should always yield a lower TCO than traditional FAO. However, the magnitude of savings depends on multiple factors. Organizations that are under-invested in technology will find BPaaS more appealing than organizations that undertook technology investments recently. And the pay-as-you-go nature of BPaaS makes it more appealing to businesses that often experience volume fluctuations.

- **Consider the trade-off between potential TCO reduction and available service delivery flexibility.** The BPaaS model does impose some constraints on the service delivery flexibility because of the standardized nature of the solution. BPaaS solutions are typically configured for a base-case that is common for the majority of SMBs ready for the next level of BPO and ERP sophistication, and do not include any client- or industry-specific customization, so it is important for organizations to understand the limitations of standardized solutions. BPaaS solutions for SMBs are designed for rapid implementation, with little customization, though these solutions can often be customized to meet specific needs, at an additional cost. SMBs requiring an ERP system that is highly configurable and customizable may still benefit from BPaaS solutions, and should bear in mind that these requirements will increase the price of the service and lengthen the implementation timeline.

- **Evaluate the BPaaS solution provider in a holistic manner.** The BPaaS service provider needs to be evaluated across each BPaaS component individually, as well as collectively, to make the right decision. The individual assessment for each component can be done on a stand-alone basis with appropriate nuances. Some of the key things to consider when selecting a BPaaS provider include:
  - The decision on the underlying software application (Oracle versus SAP versus MS Dynamics versus others) should not only be based on features and functionalities but also on configurability because customization and specialized configuration to the ERP system may result in additional costs.
  - Beyond the core technology, consideration should also be given to work flows and application wrappers, and other system integrators and add-on tools that the BPaaS provider brings to the table.
  - The look-and-feel of the solution is also important, as it helps improve internal adoption.
  - The ability of the service provider to create a seamless BPaaS solution across all layers of the BPaaS solution is critical (see **Exhibit 8**).
  - The provider's experience in BPaaS, their commitment to the BPaaS market, and their overall financial viability are more important given that BPaaS is a relatively nascent offering, and both BPO services and the ERP technology are delivered by a single provider.

- **Readiness for change and realistic expectations.** The BPaaS model requires significant changes at both the technology and operational levels. Organizations that are resistant to change may find challenges in BPaaS adoption. Here are some of the key risks and challenges that organizations face:
  - **Loss of control** given that the ownership of each layer (infrastructure, application, and operations) rests with the BPaaS service provider.
  - **Security issues** given the multi-tenant nature of BPaaS solutions.
  - **Lack of flexibility** given that BPaaS solutions by definition are standardized, and client-specific customization and configuration typically result in increased implementation costs.

BPaaS implementations require a very strong governance process, with strong stakeholder alignment, top-management buy-in, and focus on change management. It is important to include all major stakeholders, right from the planning stage, to ensure smooth implementation and go-live. F&A service providers have also invested in building tools and methodologies to help their clients manage some of these risks and challenges. It is important to work towards building a partnership-based trusted relationship with the service provider to leverage their learnings and experiences in working with other enterprises that have gone through a similar journey.

Conclusion

BPaaS solutions are tailor-made for SMBs. They provide a standardized and integrated package of people, process, and technology that lowers TCO by 30-40% when compared to traditional FAO models for SMBs. Like their counterparts in the Fortune 1000s, finance leadership in SMBs also needs to focus on decision making and strategy planning as opposed to day-to-day operational fire fighting. BPaaS solutions can help free up significant time by providing access to best-practices and best-in-class technology in an easy to consume environment that is both scalable and cost-effective.

As the FAO market matures and competition intensifies, innovative solutions and value propositions are emerging that are more attractive to SMBs than traditional offerings. Everest Group recommends SMBs to seriously evaluate BPaaS solutions as a vehicle to optimize their F&A operations.

About Everest Group

Everest Group is an advisor to business leaders on next generation global services with a worldwide reputation for helping Global 1000 firms dramatically improve their performance by optimizing their back- and middle-office business services. With a fact-based approach driving outcomes, Everest Group counsels organizations with complex challenges related to the use and delivery of global services in their pursuits to balance short-term needs with long-term goals. Through its practical consulting, original research and industry resource services, Everest Group helps clients maximize value from delivery strategies, talent and sourcing models, technologies and management approaches. Established in 1991, Everest Group serves users of global services, providers of services, country organizations, and private equity firms, in six continents across all industry categories. For more information, please visit www.everestgrp.com and research.everestgrp.com.

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