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The new dynamics of managing the corporate portfolio 1
As investors demand that companies actively manage their business portfolios, executives must increasingly balance investment opportunities against the capital that's available to finance them.

Living with the limitations of success 9
Once companies reach a certain size, setting realistic performance aspirations gets a bit trickier.

Getting more out of offshoring the finance function 13
Companies aren't getting the most out of their offshoring programs. Key design changes would help.

When Chinese companies go global: An interview with Lenovo's Mary Ma 18
CFO Ma describes the unique challenges awaiting Chinese companies that seek growth through international acquisitions.

Preparing for the next downturn 23
In a buoyant economy, the next recession seems far off. But managers who prepare during good times can improve their companies' chances to endure—or thrive in—the eventual downturn.

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Getting **more out of offshoring** the finance function

Companies aren't getting the most out of their offshoring programs. Key design changes would help.

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The quality of offshore providers of finance and accounting services has never been higher. Many have made significant investments in the control and monitoring mechanisms needed for high-end functions, regulatory requirements, and complex finance processes such as valuation reviews, legal-entity control, and tax preparation. Some have even hired risk-and-control officers to deal with Sarbanes-Oxley, Basel II, and SEC reporting.

More sophisticated vendors enable companies to cut their labor costs by as much as 30 to 70 percent for offshored functions, to raise productivity by at least 5 percent a year, and to improve their control and risk management. What's more, these vendors offer people-constrained finance operations flexibility—the ability to meet proliferating business needs quickly by tapping into a highly skilled workforce. Offshoring can also play an important role in even more comprehensive efforts to streamline the finance function (see sidebar, "Getting started and staying with it").

Yet very few companies have come close to capturing the full potential of offshoring finance operations. Indeed, a majority of the companies that have offshored some of them did so only in the past 24 months and are thus just getting past the start-up stage. In our experience, the problem is the faulty assumptions that companies make about what gets sent offshore to whom—and when. Rethinking key design decisions can therefore begin to deliver some of the untapped value.

And they should be rethought, because we continue to find that companies make suboptimal design choices when crafting offshoring programs. Some lack awareness of the vendors' capabilities or feel pressure to capture near-term cost benefits without thinking through a two- or three-year plan strategically. Others have preconceived notions about what they must keep close at hand. Certain design

components are unique to individual companies, of course, but a number are common to almost all offshoring efforts. These components are the cornerstones of any offshoring-enabled transformation of the finance function.

Go beyond the basics

Many finance executives limit offshoring to commodity and transactional activity. They believe that only such basic tasks can be performed remotely; everything else is strategic and critical to the business and must therefore stay local.

Some companies are thinking bigger: certain GE companies, for example, have successfully offshored as much as 35 to 40 percent of their finance activities. The offshored operations include not only typical accounts-payable and time-and-expense work but also a full range of accounting and control functions, decision support and regulatory activities (including some management reporting, 10-K and 10-Q preparation, and SEC filings), and expert functions such as tax compliance and cash management within treasury (Exhibit 1).

Furthermore, some forward-looking CFOs are moving away from piecemeal, task-level offshoring. Using offshoring as a tool for a fundamental redesign of the finance operating model, they are reconsidering which finance functions absolutely must be performed in or near headquarters. At one global high-tech company based in the United States, the CFO went so far as to offshore significant portions of all the

Exhibit 1

More than the basics

Companies can offshore a range of finance processes and activities at all levels of the organization.

[1] Generally accepted accounting principles.

Getting started and staying with it

Offshoring can be a cornerstone of a sweeping effort to transform a company's finance function. A successful effort can take years to accomplish and requires significant investments of capital and resources. Executives who attempt such efforts should pay close attention to at least three critical elements of the execution plan.

1. *CFO leadership.* Offshoring never lies easily on the organizational palate. As with any transformation effort,[1] top managers must continually reinforce their commitment to it. CFOs in particular should personally communicate their vision of offshoring as a commitment of the overall finance function and assume responsibility for staffing offshoring programs with the best internal and external talent available. Anything less is a recipe for failure. In our experience, companies that try a bottom-up approach—sending small projects offshore—never reap the full benefits of offshoring.

2. *Risk analysis.* A transformation program of the right scale and scope is not without risks: news of offshoring could increase a company's attrition rate and lower employee morale, to the detriment of service levels. Companies should meticulously assess the risks as part of their plans for offshoring—for example, the risks related to operations, political and legal developments, and threats to business continuity. This approach can help set the right expectations with onshore clients and allow the company to develop appropriate risk-mitigation plans. One leading European logistics business conducted a thorough assessment of risk for an offshoring project, for example. The assessment revealed more than 120 potential risks, including the possibility that onshore employees would leave faster than knowledge could be transferred offshore. The company then ranked these risks by their likelihood and severity and incorporated risk-mitigation plans into its overall implementation programs.[2]

3. *Governance and change management.* In any offshoring effort, it's essential to build on existing governance structures rather than add more bureaucracy. The specific issues related to offshoring, however, are often new to the finance organization. Novel governance processes must be designed, for example, to revisit regularly the scope of the activities being offshored, to assess service levels and take corrective action, to review the financial charges between onshore and offshore units, and to identify opportunities for further performance improvements in the offshore centers (through benchmarking, for instance).

[1] Carolyn B. Aiken and Scott P. Keller, "The CEO's role in leading transformation," *The McKinsey Quarterly*, Web exclusive, February 2007.

[2] Michael Bloch and Christoph Jans, "Reducing risks in offshoring projects," *The McKinsey Quarterly*, 2005 Number 3, pp. 10–1.

finance functions systematically, including procure-to-pay, order-to-cash, record-to-report, financial reporting, planning and analysis, treasury, fixed-asset management, and taxes. He believes that in his end-state model, advances in communication and work flow technologies will make it possible to locate more than 75 percent of the finance operation far from the corporate center or country headquarters. This company now sets the low benchmark for finance costs in its industry.

Ship, then fix

Too many executives believe that processes, and the underlying IT applications supporting these processes, must be optimized perfectly before they can be sent offshore. Many Fortune 500 companies that have embarked on projects to implement financial systems or commercial enterprise-resource-planning (ERP) applications, for instance, believe erroneously that it would be wrong to offshore processes and systems while such projects are under way. Some want to wait until all finance activities or processes have been completely migrated to the new ERP system, others until general ledgers have been fully integrated. This propensity to fix processes before outsourcing them—the "fix, then ship" model—is single-handedly responsible

for much of the gap between leading-edge offshorers and average ones.

In our experience, offshoring a process first and then implementing continuous-improvement efforts—the "ship, then fix" approach—typically delivers one-and-a-half to two times the net present value of the "fix, then ship" approach. Offshoring generates higher savings at a faster rate than large process-redesign and automation exercises, which often take three to four years for benefits to accrue.[1] The difference in value is especially visible in large, high-cost markets (such as Australia, Japan, and the United States), as well as some Western European markets (for instance, Scandinavia, Switzerland, and the United Kingdom). Companies in these markets typically have stable, stand-alone IT systems, are large enough to achieve scale in offshoring, and benefit from labor laws favorable to it.

Smaller companies or those in markets with restrictive labor laws[2] can still benefit from the "ship, then fix" approach. We've seen several implement significant offshoring programs without any internal job losses by aggressively reducing the use of outside contractors and temporary personnel, retraining and transferring finance personnel to other functions, and leveraging early retirements. When these methods don't apply or a market doesn't have critical mass on its own (because it has very few finance professionals or the scale of a company's business in it is small), a more gradual "fix, then ship" approach could be preferable.

Some global companies may want to strike a balance between the two approaches by simultaneously migrating businesses to new systems platforms and moving finance and accounting resources to regional or global shared-service centers. This line of attack is particularly suitable for companies that have already mastered offshoring transitions and developed clear and detailed transition methodologies.

Diversify locations

Many companies still view India as the only location for their offshoring requirements. Although it is perfectly reasonable to start by offshoring jobs to English-speaking countries, that won't suffice when companies truly seek to expand their offshore work. Some of them need offshore providers whose employees can speak languages other than English for activities such as customer service and contacts with suppliers. Others must ensure that business continues in the event of potential disruptions such as natural disasters, wars, or political unrest. Further, in India the number of employees providing offshore finance and accounting services has increased sixfold over the past six years. This dizzying pace of growth has begun to place a strain on the middle- and senior-management layers at many Indian finance-offshoring suppliers. Indeed, our analysis[3] suggests that for various business-process-outsourcing segments, including finance and other functions, India will probably face a talent shortfall of up to 500,000 full-time-equivalent employees by 2010.

Genpact, the former GE subsidiary, is a good example of a company that has carefully crafted a multilocation model. It provides GE and other clients with finance and accounting services from five countries: China, Hungary, India, Mexico, and Romania. Similarly, P&G picked Costa Rica for its shared-services center in the Americas but turned to Newcastle and Manila to serve Europe and Asia, respectively.

[1] Recent surveys by Financial Executives International and the Standish Group show that a very significant portion of large ERP programs are considered partial successes at best.

[2] Western European countries such as Belgium, France, Germany, and the Netherlands, as well as countries in Asia and Latin America.

[3] The analysis is based on the McKinsey Global Institute report, *The Emerging Global Labor Market*, available free of charge online at mckinsey.com/mgi. See also Diana Farrell, Noshir Kaka, and Sascha Stürze, "Ensuring India's offshoring future," *The McKinsey Quarterly*, 2005 special edition: Fulfilling India's promise, pp. 74–83.

Exhibit 2

A diverse set of vendors

Different types of vendors have different strengths.

Vendor type[1]	Distinct strengths	Special challenges
Former captives	• Depth and breadth of capabilities in finance and accounting (F&A) • Global presence • Track record for continuous improvement in F&A • Depth of talent in F&A	• Customer orientation • Flexibility to work with different corporate cultures and mind-sets
Global service providers	• Global presence • Strong relationships with potential clients (eg, global multinationals) and understanding of their organizations	• Process transformation, continuous improvement • Consulting rather than operations mind-set
India-based service providers	• Strategic focus on business process offshoring operations • Strong transition methodology (gain advantage from offshoring IT operations or non-F&A operations) • Long-term partnerships	• Limited F&A track record with blue-chip clients • Limited range of F&A services, in particular for higher-value processes (eg, general ledger, analytics) • More limited global presence

[1] Specific vendors have a wide range of strengths and weaknesses that do not necessarily align with these generalizations.

Making a good match

For control and compliance reasons, some companies believe that they must set up their own company-owned and -operated—that is, captive—offshore centers. For some early movers (such as British Airways and GE), captive offshore finance and accounting operations made sense because in the past there was no capable vendor community.

An analysis of public data sources, however, reveals that of 30 companies[4] that have embarked on new finance-offshoring efforts during the past two years, 26 have chosen to work with outsourcing providers. These providers offer faster service, using a more talented group of analysts at a sustainably lower cost than companies could realize by themselves. Indeed, our analysis[5] shows that, on average, the total cost of providers is 30 percent lower than that of captive operations. Indeed, only the very best captive centers achieve similar—and sometimes better—levels of performance and cost.

Companies that decide to work with an offshore vendor would be well advised to evaluate their potential partners carefully to make sure they pick one that makes the right fit—strategically, operationally, and culturally. At this point, at least three kinds of providers are investing heavily to build their capabilities: former captives, global service providers, and service providers based in India. Each type of provider brings distinct strengths but also faces unique challenges (Exhibit 2).

Offshoring can give the finance function powerful benefits that go well beyond labor cost arbitrage. The design of offshoring efforts can make all the difference in how quickly and effectively companies can reap those benefits. MoF

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[4] US or Western European Fortune Global 500 companies that publicly announced their intention of offshoring finance functions to locations in Eastern Europe and India.

[5] This analysis tests the alignment among key stakeholders—such as agents, team leaders, offshore senior management, and onshore clients—on operational focus, performance, and health along 12 key operating practices such as recruiting, talent management, process improvement, governance, and support processes. It also benchmarks the performance of service providers by key operational metrics such as cost, quality, speed, flexibility, innovation, and risk. As of this writing, we have rated more than 23 captive and third-party providers that perform more than 162 processes. Our surveys have involved more than 4,800 respondents. See the Nasscom-McKinsey report, *Operational Excellence: The Next Frontier in Offshoring*, February 2007.