

# Finance and Accounting Outsourcing – the Next Logical Step for Small Business

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## *Abstract*

*Outsourcing has evolved from those activities that are normally regarded as peripheral, such as cleaning, catering, and security to include critical areas such as payroll, accounts receivable, accounts payable. This form of outsourcing is known as Finance and Accounting Outsourcing (FAO).*

*Outsourcing is gaining popularity as a way to reduce financial and operational risks by making them easier to manage. As small businesses struggle to find bench-mark strengths among their in-house personnel, turning to a qualified, external outsourcing service provider often becomes a logical step.*

*In an age where the focus by small business is on core competencies, small businesses are increasingly outsourcing critical financial functions to the experts and for many finance and accounting service providers, accounting is their core competency and they are experts in their field.*

**Keywords:** *Business Process Reengineering, Outsourcing, Core competencies, Strategic & organisational change, Risk management*

## **Introduction**

This paper introduces the preliminary concept model developed from the literature review undertaken as part of this study and explores the connectedness of Finance and Accounting Outsourcing to the parent disciplines of Business Process Reengineering and Outsourcing. Following the preliminary concept model is the background and rationale behind the study which considers the increasing levels of Finance and Accounting outsourcing being undertaken by small business.

As the concept model indicates, Business Process Reengineering (BPR) and Outsourcing are central to the immediate discipline of Business Process Outsourcing and Finance and Accounting Outsourcing. BPR focuses on the outcomes of a task and not how the task is performed and can be best described as the radical and fundamental rethinking and redesign of

an organisations business processes in order to achieve improved measures of performance.

Outsourcing is seen by many as an alternative to the clean slate approach of BPR and although there are many definitions and interpretations of outsourcing, it can be simply stated as the assignment of an internal function or activity of a business to an external supplier or service provider.

The paper further explores the fundamental concepts of Business Process Outsourcing (BPO) and Finance and Accounting Outsourcing (FAO) and why the activity of FAO is increasing and its relevance to small business operation and performance strategies.

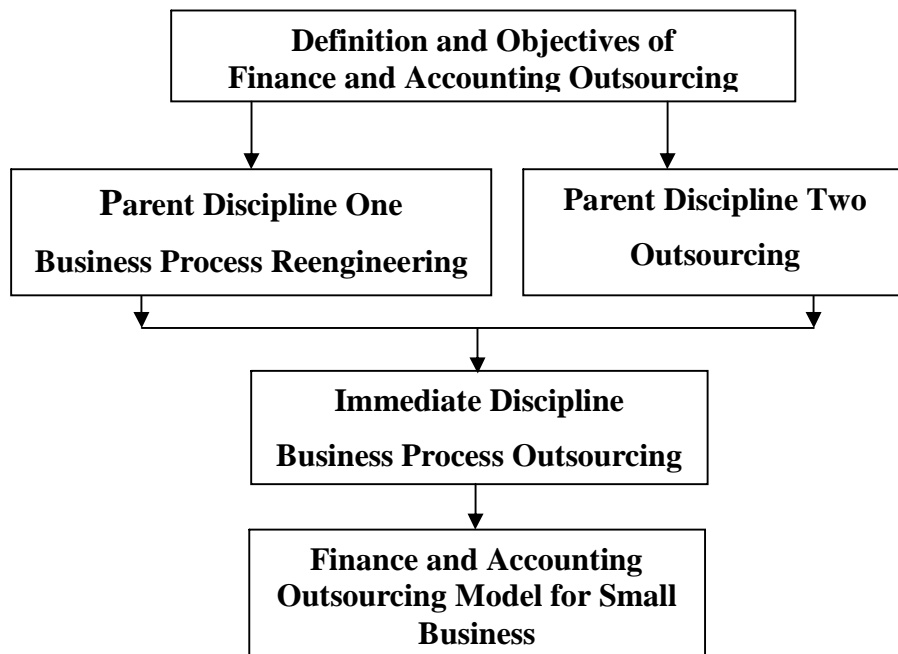
### **Preliminary Concept Model**

Based on the proposed research proposition the preliminary concept map for the literature review is shown in figure1. The definition and objectives of Finance and Accounting Outsourcing are presented to assist in setting the boundaries of the research. Next, the two parent disciplines, namely Business Process Reengineering and Outsourcing are presented. These parent disciplines are the background for the immediate discipline of Business Process Outsourcing and Finance and Accounting Outsourcing. In light of this literature search, the development of a finance and accounting outsourcing model for small business is investigated.

### **Background and rationale**

While great ideas and entrepreneurial skills are fundamental to the business start-up, good financial management can be considered critical to the business survival. The reason most small business fail is that they are not up to the challenges of effective financial management and decision-making. This is where outsourcing of the finance and accounting function comes in and is an alternative, which all small businesses should consider in order to be remain competitive.

Being a small business owner is not a full time job. It's three or four full time jobs. The roles the small business owner must play are numerous and of course require extensive knowledge of all aspects of running a successful business. Large organisations regularly outsource the tasks they choose not to handle in-house, small businesses, however are not always so financially fortunate and the small business owner is usually required to master many specialised tasks themselves, or employ someone with the necessary skills to perform the task.



**Figure1 Preliminary Concept Map of Literature Review**  
 Source: Developed for this research

Small business managers are learning that outsourcing the finance and accounting function is a sound business strategy. Successful outsourcing of the finance and accounting function may provide small businesses with a way to meet a diverse set of tactical and strategic objectives aimed at improving the decision-making activity while still saving money and allowing the organisation to focus on its core business activity.

Outsourced accounting services are increasing and many experts suggest a rapid growth in the outsourced accounting market. A report by the Dallas based Everest Group (Business Finance May 2004) described increased numbers of small businesses contracting out for finance and accounting services, with growth really beginning to accelerate in 2002 and 2003. They found accounts receivable and accounts payable to be the most commonly outsourced function with a growing number of outsourcing contracts for a full range of accounting services including payroll, management reporting and analysis. As the amount of outsourcing undertaken by small businesses increases each year, the decision as to which activity to outsource becomes increasingly more difficult.

There can be no doubt that as long as these outsourcing initiatives get closer to the organisations core and to activities that are at the centre of its future success, the risks involved will be greatly increased and the decision to outsource any small business activity is one that should be considered very carefully due to the long lasting implications.

### **Business Process Reengineering (BPR)**

Various authors have described approaches known as Business Process Reengineering (BPR); business process redesign; business process management; business process improvement and core process re-design. Their approaches have different characteristics in terms of the degree of change, the scope of the exercise, the potential risks and the potential benefits.

Hammer (1990) states, for example, that firms can only hope to achieve radical performance improvements using business process re-engineering methods, which strive to “break away from the old rules about how we organise and conduct business”. He states that ‘Re-engineering cannot be accomplished in small or cautious steps but must be viewed as an all-or-nothing proposition’.

Hammer’s intervention strategy, which he has referred to as the “neutron bomb” approach to business improvement (1993), clearly exists at one extreme of a wide spectrum of opinion regarding the most appropriate BPR strategies for firms to adopt: “We’ll leave the walls standing and we’ll nuke everything on the inside”. Indeed, an element of tension clearly exists between those who favor an incrementalist approach and those who prefer “root and branch” radicalism where business process improvement is concerned. However, Aikins (1993) adopts a much more IT-related position than Hammer, when he states that BPR is “the current popular term for examining an organisation’s business processes and recommending automation or changes to achieve strategic goals”. On the other hand, Harrington’s ideas on the subject (1992) may be said to inhabit the more incrementalist and less IT-dominated end of the BPR opinion spectrum. He defines the concept of business process improvement as “A systematic methodology developed to help an organisation make significant advances in the way in which its business processes operate”.

BPR focuses on the operational or business processes of an organisation. It takes a revolutionary view, in that it is concerned with why a process is necessary, rather than with the details of how it is done.

## **Outsourcing**

Based on the current publications, little research on the subject of outsourcing of the finance and accounting function in Australia and New Zealand has been conducted and as a result, many questions remain unanswered.

A review of current literature on outsourcing has identified differing viewpoints on what outsourcing covers. Some literature defines outsourcing as “hiring an outside company to handle all or part of an organisations data processing activities (Romney & Steinbart 2003, p 626) while other literature simply refers to outsourcing as ‘purchasing goods or services as opposed to producing them’ (Jones & Rama 2006 p 540).

Whatever the precise definition, outsourcing may be viewed as an arrangement in which one organisation provides a service or services for another organisation that chooses not to perform those services in-house.

### **Business Process Outsourcing (BPO)**

Business Process Outsourcing (BPO) is outsourcing of business functions which are generally performed in-house by white collar and clerical employees to achieve various benefits such as cost savings, better quality and ability to focus on core competencies. BPO is about specialisation, whereby each organisation focuses on the things they do best, that is their core business processes. BPO involves outsourcing processes that are not core to an organisation, however are essential for efficient operation of the organisation.

Under BPO, the organisation transfers the complete responsibility of specific non-core processes to the outsourcing service provider who guarantees certain service quality standards. BPO deals mainly with non-core processes of an organisation and may include administrative support, document processes and finance and accounting outsourcing.

As noted by (Ephraim 2005), “BPO typically covers back-office financial operations such as accounting, HR, supply chain and call centres” Ephraim (2005) goes on to say that ‘organisations realise that outsourcing allows them to focus on their core competencies while leveraging BPO’s best-practices capabilities’.

## **Finance and Accounting Outsourcing**

Outsourcing has evolved from those activities that are normally regarded as peripheral, such as cleaning, catering, and security to include critical areas such as payroll, accounts receivable, accounts payable. This form of outsourcing is known as Finance and Accounting Outsourcing (FAO).

Outsourcing is gaining popularity as a way to reduce financial and operational risks by making them easier to manage. As White (White, 2001) points out, 'improved risk management has a direct correlation with improvements in financial performance and shareholder value'. As continued pressure for improved financial performance increases, so do the levels of competency and consistency in finance and accounting functions.

All organisations need relevant, timely and accurate financial reports and analysis. Irrespective of the organisations' size, the needs are very similar and unlike the larger organisations', small businesses can generally not afford to employ an in-house accountant.

Finance and Accounting Outsourcing by small business can make a lot of sense. For many the decision to outsource is purely financial and takes into consideration whether it is more cost effective to hire in-house or to outsource these activities. As Leah Thiss says, "if you're a small to mid-size business, chances are you cannot afford to hire the breadth of expertise you may require" (Leah Thiss 2005). Thiss goes on to suggest that "with a few exceptions, outsourcing accounting can result in operating cost reductions and better strategic insight. No matter your size, your needs are constantly changing" (Leah Thiss 2005).

It is generally regarded that outsourcing finance and accounting functions by small businesses to organisations regarded as experts in the field can alleviate the burden of staying on top of frequent changes to tax codes and accounting regulations and provide increased levels of information transparency, visibility of controls and clarity of accountability.

White (White, 2001) goes on to say "continued pressure for improved financial performance requires increasing levels of competency and consistency in finance and accounting functions" which for many finance and accounting outsourcing providers, accounting is their core competency and they are experts in the field.

It is extensively claimed in the literature that cost reduction is one of the main reasons that tempts most small businesses to outsource their finance and accounting functions (Anonymous 2004) (International Accounting Bulletin, 2006). However it seems that a number of other factors like the 'access to accountants with specialised skills' and 'increased

service levels' (Anonymous 2004) can be put forward as an explanation as to what really influences the decision to outsource the finance and accounting function.

The finance and accounting (F&A) business process -- including accounts payable, accounts receivable, order management and tracking, treasury functions, financial reporting, tax consulting and internal audit services -- is expected to be one of the most widely outsourced business process categories in the near future. "One industry estimate pegs spending on F&A outsourcing services at \$65 billion by 2006, a 12.3 percent five-year compound annual growth rate. Even Dun & Bradstreet's Global Barometer for Outsourcing predicts that F&A outsourcing will represent 10 percent of the total worldwide market for outsourced services by 2005" (Anonymous 2004).

All of this data shows the growing importance of FAO and makes it one of the fastest-growing segments of the business process outsourcing (BPO) industry.

### **Conclusion**

As there is very little research on the outsourcing of the finance and accounting function by small business in Australia and New Zealand, this study is primarily based on literature sourced from other economically developed countries and while this literature provides a consensus for the adoption of FAO by small business in Australia and New Zealand it is expected that this research will provide a better and more professional understanding of the needs of small business and contribute to our general understanding of how small businesses perceive the function of outsourcing their finance and accounting needs.

As more and more countries develop economically particularly the Asian economies we will see expanded growth of BPO and FAO activities as it is hard to argue with the improvements these initiatives may provide in regard to better financial reporting, decision making and professionalism as well as lower costs compared to in-house accounting.

Further research into FAO is essential. A better understanding of the relationships between service providers and small business may provide insights to guide the development of an empirical model.

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