

*The Three C's of Outsourcing Accounts Payable;  
Cost, Control, and Complexity*

What you need to know about the impacts outsourcing has each of these factors.

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Tighter budgets and cost increases in virtually every aspect of business operations are forcing financial executives to seek out new and creative ways to save money. While the concept of reducing operating cost is not a new, outsourcing financial functions as a means of reducing cost is a new approach to this old dilemma. However, many financial functions performed in an organization are highly specialized and are strategic in nature such as reporting, budgeting, and tax strategy. Outsourcing these functions is complex and the cost/benefit of doing so is questionable. The best processes to outsource are typically those that are transactional in nature and based on high levels of repetitive, routine, and manual tasks. These functions are generally not strategic in nature and are not a part of the firms core business.

Accounts payable is one such area within the Finance & Accounting (F&A) umbrella that lends itself very well to outsourcing. The realization of how much it actually cost to process a payables invoice makes Outsourcing the A/P process even more attractive. Add to that the availability of enabling imaging and web-based workflow technologies and A/P Outsourcing becomes the “low-hanging fruit” in the F&A space.

Two of the most important subjects to any financial executive are money coming in and money going out. The decision to turn over a business function that impact either of these should be made only after a thorough study of the process and how outsourcing it will affect that process. To thoroughly understand the impact of Outsourcing A/P you must examine three vital aspect of the process: Cost, Control and Complexity.

### ***Costs of Accounts Payable***

Cost reduction is *the* primary reason for outsourcing. Other advantages include access to expertise and technology, and to free up existing resources to focus on more strategic tasks. Regardless of which study or report you read these are usually the top three reasons. Because cost is the primary driver we will discuss it first.

A good A/P outsourcing provider can typically save 20% to 70% on total costs related to paying invoices. To put that into perspective, the Institute of Management & Administration (IOMA), a management and A/P benchmarking organization, concluded that the average cost to pay an invoice is \$14.97 in 2003 with a median processing cost of \$6.41.

Multiplied by the number of invoices a firm processes per year a 20%-70% savings can add up to millions added directly to the bottom line. Just to get an idea of the size and expense of A/P, The Hackett group estimates that in 2003 \$.55 of every \$1000 in revenue went towards A/P.

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***“The inherent risks of using offshore labor should be carefully considered as the costs and exposure may significantly outweigh any benefits”***

These costs are derived not only by direct labor savings, but also the indirect components of A/P costs such as software, real estate, management, mailroom support, and time spent for non-A/P employees resolving and approving invoices. Some estimate that direct labor costs account for 30%-40% of total invoice processing costs. The rest, and more expensive variable, is the overhead and indirect costs.

An A/P outsourcing provider can achieve savings by various methods. These include:

- Inexpensive offshore labor
- Automated systems and imaging
- Economies of scale of a large A/P service center

Although much of the technology used by outsourcing providers is available to others it is still difficult to achieve the levels of savings possible by outsourcing just by simply implementing a new A/P system. The reasons for this are two-fold. First, it is expensive to buy or build and to implement the software. It is not uncommon for outsourcing firms to custom build their own software designed specifically for the way they work. This type of technology may not be available to everyone or may be patented. Second, inefficiencies within A/P may exist because of the personnel and processes. The introduction of new technology rarely solves these problems.

A discussion of outsourcing is not complete without addressing the issue of offshore labor. Unfortunately these two concepts are often used interchangeably. Many functions, not just F&A, have been outsourced without the use of offshore labor for years. Payroll is a prime example. Current trade laws and the availability of low paid workers in countries such as India, Mexico, China, and other parts of Asia make it possible for outsourcing providers to reduce direct labor costs. This is an easy solution and is utilized by many outsourcing providers because it saves money without the need to improve systems and processes. The inherent risks of using offshore labor should be carefully considered as the costs and exposure may significantly outweigh any benefits.

Things to consider before engaging an offshore outsource provider:

**Negative press** – Even though most companies who use offshore labor do not report it directly to the media, it is generally leaked by disgruntled employees

**Low morale** – Outsourcing any positions can lower morale. Expect morale to be a bigger problem when jobs are being sent overseas. This can be particularly difficult when current employees are asked to train their foreign replacements.

**Longevity and Legality of Solution** – As of this writing (Feb, 2004) there are 13 pieces of federal legislation active in the government aimed at reducing the off shoring of jobs.

It's a popular topic for the media and a popular target for the under employed. When you add the volatile mix of politics in a Presidential election year it is reasonable to expect more and more will be done to prevent or reduce sending jobs overseas. Relying on an outsourcing provider whose sole cost reduction strategy is the use of cheap labor is risky at best.

**Data Security** – American businesses are extremely careful about data security. This security takes many forms including physical and electronic access control. The low cost nature of many offshore labor providers usually does not permit them to enforce the same level of security a U.S. firm would if they were managing the process themselves. Building access, data availability access (email and floppy drives), and sub-standard data backup and encryption routines can make your data vulnerable.

This is not to say that off shoring is a recipe for failure. Many firms are doing it and only time will tell if it is successful. What is important to realize is that there are no other advantages to using offshore labor than costs. The people employed off shore are generally well educated. However they lack U.S. business experience, they must work during the U.S. business day, which is the middle of the night for them, and sometimes take on new, “Americanized” personas. These factors have the potential to make them less productive than U.S. employees. What these countries do have is a large supply of cheap labor. However, history has taught us that “throwing people at a problem” rarely works.

The alternative to reducing costs via offshore labor is to engage a provider that leverages technology to increase productivity. This approach is less risky and can meet or exceed cost savings by offshoring. Specialized technology such as imaging; OCR, workflow, and automated business rules can replace hundreds of workers. One of the greatest expenses in A/P is data entry and handling hardcopy invoices. Modern technology can solve this problem without the use of foreign labor. Although this technology is generally available to anyone, it is expensive to buy, implement, and maintain. An A/P outsourcing provider is able to spread those costs over many customers thus reducing total per invoice processing costs. This economy of scale is something that is almost impossible to achieve without the use of outsourcing.

In short, AP Outsourcing providers employ different approaches to cost savings. In order to make an informed decision you must understand your provider's strategy for cost reduction and the associated risks. You must also be willing to accept these risks when and if the business climate changes. Outsourcing agreements tend to last for 3-5 years. A lot can change in that period and what looks like a good deal today may turn out to be not so good down the road.

***“One alternative to off-shore labor is to engage an A/P provider that achieves it's savings through technology”***

## Keeping Control

Cost savings is a major reason for outsourcing. Control is a major objection. Fear of losing control over the process and, more importantly, cash outflow is a primary reason cited for not outsourcing payables. Ironically, companies have been outsourcing their biggest cash outflow operations, payroll, for years. Other significant objections include the loss of internal process knowledge, data security, and the costs of outsourcing will exceed expectation. This section will address those concerns those concerns and break them down into key components when making outsourcing decisions.

There are three categories of tasks in A/P:

Repetitive	Value Added	Specialized
<ul style="list-style-type: none"> <li>• Data Entry</li> <li>• Mail Sorting</li> <li>• Filing</li> </ul>	<ul style="list-style-type: none"> <li>• Processing</li> <li>• Resolution</li> <li>• Customer Service</li> <li>• Vendor Management</li> </ul>	<ul style="list-style-type: none"> <li>• Setting and Enforcing policy</li> <li>• Disbursement</li> <li>• Reporting</li> <li>• Compliance and Audit</li> </ul>

Repetitive tasks are those that generally do not require any special knowledge but constitute a large percentage of labor. They are tasks that are not a high control priority for most financial executives. Coupled with the fact that these tasks require little special knowledge they become prime candidates for outsourcing.

Value added tasks require specialized knowledge of the organization and are usually non-routine. Because of this and the fact that personnel performing value added tasks generally interface with vendors and customers, value added tasks are a higher control priority. Before one can successfully outsource a function, that function has to be fully understood and communicated. It is at this point financial executives often realize how little control they may actually have over the value added A/P tasks. The breakdowns include:

- No formal policies regarding processing rules
- Processing rules are not documented and may reside in a persons head
- Key personnel that may create business continuity problems should something happen to them
- Lax controls to prevent fraud and duplicate payments

***“Fear of losing control over the process is a primary reason for not outsourcing”***

***“An A/P outsourcing provider should be able to provide tools, training, and technology to increase control”***

Control over A/P is generally delegated to an A/P manager who may or may not have the tools needed to establish auditable, enforceable controls. Even though this person reports to the controller or other financial executive the actual control over value added tasks would remain in question until tools and processes are put in place to manage them. In the quest for technology expenditures it may be apparent that the needs of A/P are usually very far down on the list of priorities from an enterprise perspective.

An A/P outsourcing provider should be able to provide tools, training, and technology to increase control. Technology such as imaging, business rule repositories, reporting, and workflow are key to making the A/P function a documented, auditable, and controllable function. Giving up control to save money is a losing value proposition and only stands to increase risks beyond the benefits of the cost reduction.

The final set of tasks are the Specialized tasks. These tasks are related to setting and enforcing direction and measuring performance. Additionally, and most importantly to a financial executive, disbursements fall into this category. This group of tasks can directly affect the cash flow of the organization.

Before discussing disbursement, it's important to talk about policies and performance feedback as they relate to outsourcing. A reason that many cite for outsourcing is to drive change within an organization. Corporate culture, employee tenure, and competing priorities can be barriers to change. Some view outsourcing as a way to start with a blank slate and utilize efficient processes immediately without the long, painful periods required for internal reengineering. It is usually the case that the outsourcing provider has the experience and the people to bring best practices to bear at the onset of the project. This means bringing best-in-breed A/P and technology practices to the table quickly. A good outsourcing provider will take into consideration your existing policies and procedures, document them, and blend them with their practices to create new guidelines specific to your organization.

A word of caution: Many providers use their own particular A/P packages such as SAP, Oracle, and PeopleSoft. While these packages are complex and powerful they may not provide the best match for your business. An outsourcer who is married to their A/P package may not provide the best value.

A/P performance feedback is an area where many corporations may be lacking. At the very least, an A/P provider should provide better feedback than your existing mechanisms. Even if a financial decision maker has the data they require, they are usually unaware of the difficulty and expense required to capture and report that data. Although there are no concrete metrics available on the subject it is not uncommon for large A/P departments (12 or more employees)

***“Some view outsourcing as a way to start with a blank slate”***

to have at least one person dedicated to producing management reports. An outsourcing provider should have real-time “canned” reports as well as provide an ad-hoc reporting tool that can be used by non-technical end users. A web dashboard or scorecard that provides real-time snapshots of A/P performance is a big plus.

The ultimate control issue comes down to disbursements and cash-flow management. Financial executives do not want to interject anything, particularly a third-party, into their cash-flow management cycle. There are two steps to ensure the safety and control of the cash flow management cycle. First, when outsourcing A/P it is a good idea to retain certain key people from you're A/P department to act as your eyes and ears. Second, utilize spend management tools.

The person retained in A/P will have many functions and will work to ensure that the vendor is acting in your best interests at all times. This includes, but is not limited to;

- Managing the outsourcing relationship
- Being a coordinator for certain resolution issues
- Auditing the quality and activities of the outsourcing vendor

A reputable A/P outsourcer will provide spend management tools and workflow that puts you in control of the disbursement process. These tools can give internal personnel authority to release payments and to ensure that no payment is released without consent from your organization. They can also provide spend management analysis to help analyze and optimize spend patterns. These tools are another example of how an outsourcing provider should offer more benefits than simply cost savings.

Today it wouldn't be proper to exclude Sarbanes-Oxley from a discussion about financial controls. For publicly held companies this legislation has taken center stage. For private companies the practices outlined in the act can still be beneficial when addressing control issues.

There are two camps when discussing Sarbanes-Oxley and outsourcing. One-side feels the need to control more processes in order to better comply with the act. The other believes that utilizing a separate, non-related party to manage transactions greatly increases their transparency and reduces the chance for fraudulent activities. The latter is more prevalent and more accurate when describing the relationship between outsourcing and Sarbanes-Oxley. Specifically, areas where outsourcing can improve Sarbanes-Oxley efforts include:

***“For publicly held companies Sarbanes-Oxley has taken center stage. Privately held companies can also benefit from the recommendations of the act”***

***“Losing some control can be a good thing”***

***“The fact is, all firms are different but they almost all have the same issues driving complexity”***

**Process documentation** – The first step to compliance is documenting internal processes. This is the first step performed by an outsourcing provider

**Audit trails** – Throughout the Invoice processing and disbursement cycles electronic audit trails are maintained by a third-party.

**IT Vulnerability** – Sending payment information via email can be dangerous. A secured web based workflow system diminishes the possibility of information falling into the wrong hands

**Real time fraud detection** – A sophisticated A/P outsourcing provider should be able to monitor all transactions in real time and detect patterns of fraud, duplicate payments, and questionable transactions.

The separation of duties between an organization and an outsourcer serves to strengthen compliance and demonstrate to auditors and investigative entities the reduced possibility of fraudulent activities.

Losing some control is a good thing. Today’s financial executive is required to play a bigger part in overall firm strategy. To be effective at this one must divest themselves of the routine, transaction oriented task activities such as Accounts Payable. By turning over the day-to-day tasks of paying invoices to a capable provider a CFO no longer has to be concerned with A/P personnel issues, detailed A/P budgets, technology issues, and compliance activities. By outsourcing payroll, HR executives have been able to be more valuable to their firms from a strategic perspective. Financial executives can achieve this as well.

***“We’re Too Complex to Outsource”***

This statement, and others like it (“we’re a company of exceptions. No one could possibly do our jobs”) are heard by almost all outsourcing providers. However, many very large, very complex firms such as General Motors and BP Amoco have successfully outsourced their A/P departments. This is not to say it was easy to do, but is a testament to the fact that there are no organization that are too complex to outsource.

The fact is, all firms are different but they almost all have the same issues driving complexity:

- Disparate systems
- Many business and processing rules
- Informal relationships, policies, and communication practices

Broken down to the basic tasks A/P is not overly complicated. It only becomes complicated when informal procedures and routines begin to develop and when systems are used in ways they were not intended. Many A/P clerks are left to create their own informal work routines and their own methods of business rule management and enforcement. The presence of this situation does not prevent outsourcing. This is a popular characteristic of companies of all sizes and industries. A good outsourcing provider will always begin with documenting existing procedures and “formalizing” the business rules in a central repository. Once the processes are documented a full knowledge transfer is possible. Coupled with a rules engine whereby all processing rules can be controlled by the organization, an efficient transition to A/P outsourcing can occur.

In many cases systems are at the heart of complexity. It is very possible that older systems are the source of inefficiency. If there are routines that are performed in the A/P department that are only done because of system limitations there is a good possibility that substantial savings can be achieved by outsourcing.

The workflow in all payables is basically the same. The unique needs of a company are documented at the beginning of the outsourcing arrangement and remain up-to-date during the contract term. Once put in writing the complexity of A/P will be much more manageable.

***“The functions that bubble up as the least risky and have the greatest savings potential are the manually intensive activities such as Accounts***

### ***Conclusion***

Payables are viewed by almost all organization as a necessary cost of doing business and are usually the last in line when it comes to technology and process improvement priorities. Many firms of all sizes are discovering the advantages of getting out of the A/P business all together. What appears at first to be a highly complex, specialized function is rarely more than routine processing with certain business rules applied. Once this function is shed financial executives can focus more of their resources on more strategic and critical tasks.

Most financial executives are being asked to investigate outsourcing as a possible means of cost savings and enterprise efficiency. The functions that bubble up as the least risky and have the potential for the biggest impact are those manually intensive transaction based activities such as Accounts Payable. The metrics and measurability associated with A/P makes it a prime candidate to prove the concepts of outsourcing as a valid cost reduction vehicle.

### ***About the Author***

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