OFFSHORE OUTSOURCING SERVICE TRENDS

A Malaysian Perspective

Produced for

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SPECIAL STUDY

Offshore Outsourcing Service Trends - A Malaysian Perspective

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IDC OPINION

The market for off-shore-based Financial and Accounting (F&A) services is improving despite a very challenging economic environment. With the increased acceptance of off-shoring as options for BPO services, particularly as off-shore providers invest in offering higher-value services (e.g., business analytics), local capabilities, and higher-level skills (e.g., business consulting), the market opportunities for the off-shore providers continue to increase and that these providers will increasingly pose greater threats to "onshore" providers and challenge the metrics for shared service delivery models.

On the BPO players side it should be noted that the decision to off-shore, outsource either through a shared services or third party model is a strategic sourcing decision taken mostly at the board room. Hence, in order to address the shared services services market by offering third-party BPO services, the vendors need to be at the top of the game. Here it will be crucial to offer deep vertical expertise backed by strong IP and analytical capabilities.

Furthermore the competition in such engagements will be the tier-1 global players which have decades of outsourcing expertise from a BPO and ITO perspective and have the financial strength to compete through innovative pricing models and leveraging their process automation tools. Hence, identifying a niche to focus on and targeting a focused section of the market from a vertical perspective will be a prudent strategy.

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Executive Summary

In context of the "new normal", one that is characterized by global economic and business uncertainty, businesses are faced with a slew of challenges ranging from controlling costs, competing more effectively, extending reach into new markets and being quicker in introducing new products and services into the market. Undertaking multiple initiatives to address these challenges is a daunting task and as such key on the C-Suite agenda is to build a globally successful and sustainable organization with a culture that is intrinsically based on innovation and customer centricity. Simultaneously, there is a need to enhance share holder value by clocking in robust financial results which not only shows continuous increase in top-line growth but higher profits and improved customer relevance. Addressing this the C-Suite is increasingly looking to build a robust global delivery and sourcing network which enables businesses to gain access to top talent and de-risk delivery capabilities.

Whilst building out this framework, the C-Suite does explore options to either outsource to third-party or build in-house shared service outsourcing (SSO) centers and then evaluate if these delivery centers should be on-shore, near-shore or off-shore. Influencing this decision there are further factors such as the organizational culture, type of work which can be consolidated and optimized, the delivery network itself i.e. mix of regional and global hubs and the internal charge-back models, to name a few.

As such most organizations in North America and Europe have chosen locations in Asia for setting up their global delivery network and their decision to choose a certain location is largely influenced by policies and incentives provided by governments (federal and state) in the destination country. Furthermore, access to qualified talent pool as well as data and intellectual property norms are also crucial for selecting destination locations. In the Asia/Pacific region, excluding Japan and South Korea most countries have been witness to MNCs and third party service providers' setting up Off-shore Shared Services and Outsourcing centers. As such these firms walk in with substantial FDI (Foreign Direct Investment) for the host country and significantly boost employment levels as well. With most countries competing for a pie of this large off-shore market there are several incentives out there in the offering from various governments – and therefore this is the most crucial decision making criteria.

However, the study reveals that the decision to off-shore or outsource back-end processes specifically the F&A processes is more of a strategic decision as opposed to a simple cost metric based one. Therefore, should a location align with the strategic direction of the company, and then only will a firm decide to setup operations – either as off-shore shared services or with a third-party service provider.

SITUATION OVERVIEW

Services Taxonomy

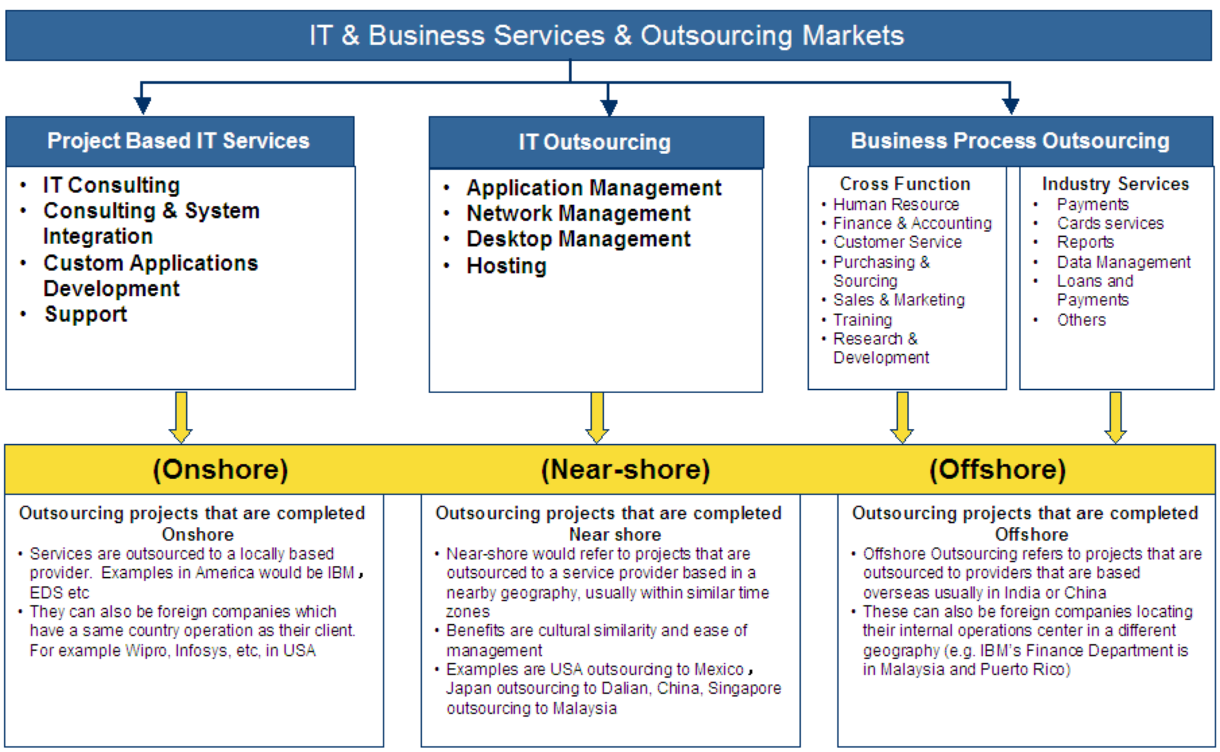
To provide context for the rest of the paper, IDC has provided description as to the definitions utilized worldwide when referring to the services industry.

IDC's services taxonomy serves as the basis for IDC services research studies, trackers and forecasts worldwide. It is a detailed view that groups individual markets within three macro market segments; project based, outsourcing and support & training. For the purpose of this document, IDC will be mainly discussing services that fall under the following; a) Project Based IT Services, b) IT Outsourcing (ITO), and c) Business Process Outsourcing (BPO).

Figure 1 below describes the breakdown of IDC's Worldwide Services Taxonomy.

FIGURE 1

IDC's Worldwide Services Taxonomy



Source: IDC, 2009

Project Based IT Services: IDC's definition of Project Based IT Services macro market is the engagement of service providers to consult/design, integrate/implement and/or provide reactive-based (e.g. maintenance/support) services. The customer maintains responsibility for the ongoing management of their own infrastructure, applications and business processes.

IT Outsourcing: IDC's definition of IT Outsourcing macro market is an engagement that transfers the responsibility for the ongoing management and execution of an IT activity, process or functional area to an external service provider to gain efficiencies, and improve performance.

Business Process Outsourcing: IDC's definition of Business Process Outsourcing macro market is an engagement that transfers responsibility for ongoing management and execution of a business activity, process, or functional area to an external service provider to gain efficiencies, and improve performance.

Global Off-shore Outsourcing Services Trends

Globally, the worldwide BPO services will grow from US$147.2 billion in 2010 to US$191.02 in 2015. The worldwide Finance and Accounting (F&A) services market will grow from US$27 billion in 2010 to $38.45 billion in 2015.

Following are the key global drivers for BPO Services and its impact on the Enterprises.

- **Price and costs**: Enterprises will continue to want predictability in costs, while minimizing risks, when using BPO as reflected by the need for "fixed" fee pricing, whether transaction oriented or done by fixed payments. This need for "fixed" pricing will place challenges on providers looking to bundle more advisory services as part of BPO offerings, which customers are increasingly looking for with business analytics services.

- **Value-add:** Enterprises are indicating a need to procure business analytics services as part of BPO services to get access to information to help optimize business performance (which would support companies' need to align IT with business processes). However, this will place increasing pressure on BPO providers to build consultative capabilities to help grow and retain customers. Further, customers are increasingly looking to providers for higher value-added services such as tax management.

- **Consolidation:** Enterprises' need to consolidate the supplier base, which is likely driven by issues such as minimizing overall costs and gaining access to scale (e.g., geographic), will place pressure on BPO providers to ensure that they have scale, though with the right set of skills and geographic footprint.

- **Social networks and mobility:** Enterprises' use of social networks will increasingly place pressure on BPO providers to find ways of incorporating these capabilities in order to drive value-added services, and to build more flexible service delivery models to support customer (end user) means of interacting with providers. Additional capabilities that providers need to include involve mobility and such offerings as location-based services.

- **Linkages between IT and business processes**. BPO providers need to provide IT capabilities (or partner with IT services firms) to support customers' ability to link IT with business processes as creating such linkages often requires changes in IT.

- **New models of delivery (cloud):** The use and interest in Business Process as a Service (BPaaS) will place increasing pressure on BPO providers, particularly BPO providers that utilize traditional technology platforms and labor-centric service delivery, to invest more heavily in what is referred to as "cloud" models.

In addition to these BPO-specific needs, and based on recent discussions with users and buyers of outsourced services, customer expectations are changing dramatically. Fundamentally, customers are looking for providers and outsourcers that have a long-term clear strategy that can support customers' need to make changes in their business more quickly and enable access to services that are reliable anywhere in the world and do so at lower costs. Interestingly, these needs extend from the largest of buyers to even start-ups — the smallest of buyers.

However, there is slowing demand in Europe mainly as a result of the economic downturn and the subsequent bouts of economic and political uncertainty in Europe, particularly in Western Europe. This uncertainty fed into lower business and consumer confidence, which in turn made many organizations less likely to outsource key business processes. The current economic environment is pushing BPO down the agenda of many organizations as they become more conservative and risk averse in what they see as a more uncertain, risky, and cash-strapped environment than previously expected. For instance, discussions with Western European organizations to rate top 10 key project priorities; BPO was the lowest-rated indicating that clearly, BPO is on the back burner for many European organizations.

However, it is interesting to note (as has been the case throughout the current downturn) that those organizations that have already outsourced a business process are more likely to say that the current economic environment makes them more likely to adopt BPO. In other words, those organizations with the track record and experience of implementing BPO are more likely to be interested in expanding their use of BPO as a result of the downturn, probably because they have the confidence, skills, and track record (and thus CXO-level approval of BPO) they need to "sell" the idea to the CFO, CEO, or line-of-business manager. This is the case across all five key horizontal business process segments. Yet, what is important to note, however, is a continuing preference among most European organizations for onshore and near-shore delivery. Discussions have shown that while organizations are becoming increasingly location agnostic (and after discussions with the supplier, they become willing to leave the delivery location decision to the supplier) - off-shore delivery is not something that organizations proactively ask for.

Asia Pacific Off-shore Outsourcing Service Trends

In contrast, the rapid growth in Asia/Pacific outsourcing market is due to three reasons. First, the need to consider alternate locations for delivery for the service providers and businesses alike, second, marked increase in acceptance of off-shore delivery and third, the need to have access to volume of skill sets which are scarce in certain markets. As such the market for off-shore outsourced IT services in the region is expected to grow from US$867.5 million in 2010 to US$2.11 billion by 2015; and the Off-shore BPO market from US$187.4 million in 2010 to US$ 745.9 million by 2015.

The off-shore services market in Asia is at a pivotal stage with businesses re-evaluating their global delivery models. This is largely due to the need for speed to enter new markets, launch new products and services and build stronger competitive differentiators. As part of the drive to be more competitive, adoption of analytics, collaboration and mobility is high on the agenda for C-Suite executives. This in turn will lead to opportunity at two levels.

1. First, the C-Suite will be more focused on driving business outcomes and enabling transformation initiatives. As such this will necessitate a change in the construct of the delivery organization.

2. Secondly, the need to enable enterprise mobility, leverage social media and analytics will require services from third party service providers and a large chunk of this will be through off shore locations where businesses can scale up or down based on business requirements and without the hassle to build and invest on test beds in-house.

From a country market perspective (i.e., demand side) Australia, New Zealand, Singapore and Hong Kong have been traditionally open to off-shoring. However, increasing interest and intent is seen in Japan, South Korea and in certain verticals (such as Oil and Gas, Financial Services and Manufacturing) as well as in the Southeast Asian region. But, the drivers are different. For Japan and South Korea the move is largely led by the need to control costs as well as support their expansion plans into the broader Asian market. As a result, Japanese and Korean service providers are looking to build their off-shore delivery presence across the region to support both Asian and Japanese operations of their clients. As such, the emergence of China as a viable near-shore destination has also facilitated this transition. As a result Japanese and Korean service providers are looking at acquisition targets across the region, more, especially in India and Malaysia.

A key factor to note is that global players such as IBM, Accenture, HP, Capgemini and others have significant off-shore delivery capabilities in the region. Therefore, it is seen that the competitive strength that Indian IT majors possessed is under threat. In view of these trends, the following market developments need to be taken into account when making a decision to select the ideal location over the forecast period.

- **Japanese service providers to acquire ITO and BPO players:** The list of acquisition targets for Japanese players will extend beyond local players, rather they will turn to acquire more established larger service providers that have a global footprint, presence and reach across key markets (such as India, China, Malaysia, Singapore, Vietnam, and Thailand). A key evaluation criterion for this will be the level of intellectual property the acquired entity can bring to the organization.

- **South Korean service providers to enter into partnerships:** Given the chaebol structure in Korea it is rather difficult for vendors as well as the customer to off off-shore services. As a result, the in-house service providers for large conglomerates will look for partnerships with established global or regional players to take advantage of cost arbitrage for service delivery.

- **Regional shared services centres will be asked to fend for themselves:** In view of the global economic environment, the study indicates that regional shared services operations (ITO and BPO) will be asked to operate as independent entities and as such look to gain their own business. While this will increase the competitive pressure in some verticals, over the long term these players will be high on the acquisition radar.

- **Data sovereignty norms will mature**: Currently, data sovereignty concerns are a key road-block for off shoring services. However, as these policies and laws mature, there is high probability that new standards and government treaties will permit off shoring (limited as it maybe) for data intensive IT processes.

Given these changes, service providers that continue to offer the cost arbitrage proposition will not succeed over the forecast period as increasing cost of delivery and price pressures from clients will slowly eliminate margins to an unsustainable level.

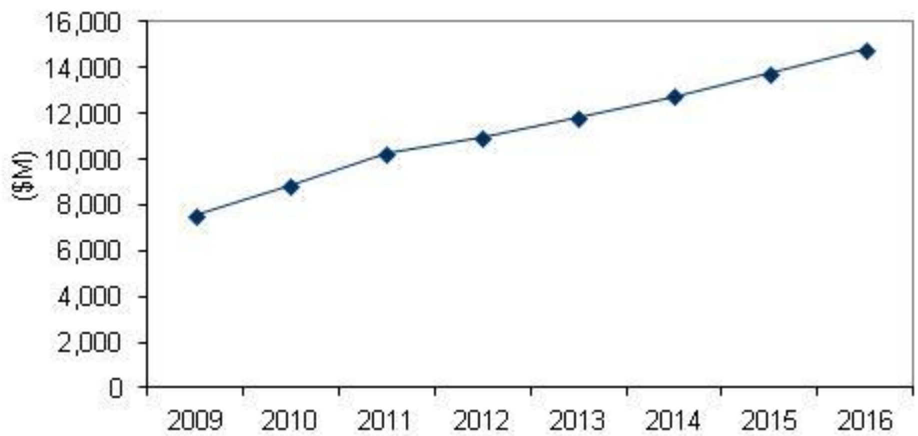
Based on the study findings, Malaysian service providers are looking at positioning their IP assets, build collaborative delivery models, and strengthen their industry specific capabilities to offer more business aligned pricing models. Beyond off shore or on shore delivery it also entails maintaining a high touch with the clients business and thereby builds a sustainable engagement model. These fundamental changes are highlighting a shift in the customer view of outsourcing from one that has traditionally been technology centric to one that is increasingly SLA-driven and business centric.

Finance and Accounting (BFSI) Services Outsourcing in Asia/Pacific Region

The F&A services market in the Asia/Pacific region is expected to grow from US$ 10.2 Billion in 2011 to US$ 14.7 Billion in 2016 with a CAGR of 7.9% over the forecast period.

FIGURE 2

Asia Pacific F&A BPO Services Market Forecast (2009-2016), US$ Million

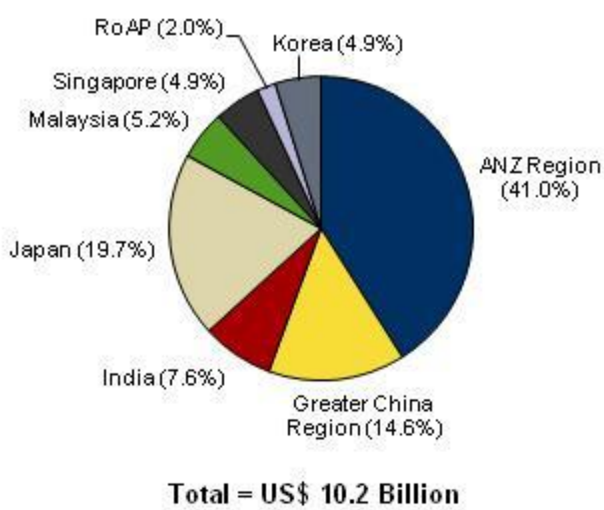


Source: IDC Asia Pacific Services Tracker, 2H2011

Figure 2 shows the market presence enjoyed by Malaysia for F&A services as compared to Asia/Pacific region.

FIGURE 3

Malaysia F&A BPO Services Market as compared to Asia/Pacific Region, 2011



Source: IDC Asia Pacific Services Tracker, 2H2011

While choosing a location for shared services or third-party engagement for F&A services businesses look to study the following factors beyond labor based cost arbitrage:

- **Security and Privacy:** One of the key facets the C-Suite looks to evaluate when they want to setup F&A shared services operations is the level of data security and intellectual property protection they can sustain. Data is the new front of corporate differentiation and as such businesses are increasingly scrutinizing their definition of business relevant data, how it is captured, stored, retrieved and cached or oven terminated over the business cycle. From an IP perspective, the legal team within businesses are highly concerned on how their trade secrets a.k.a. IP is maintained and retained as a competitive differentiator. Should any location not provide this capability then either the firm rejects the location from its off-shore list or significantly scales down its off-shore plans. In the case of partnering with a third-party service provider businesses look to sign iron-clad contracts on data security with significant liability clauses in documentation to act as deterrents for failure to meet SLAs. As such businesses will offer F&A contracts only those firms with whom they have implicit trust with internal information for the company. This is increasingly relevant when businesses undertake conversations for order to cash (such as cash applications, return management) engagements.

- **Compliance environment:** Another key facet businesses look to evaluate is the compliance environment in a country and existing F&A standards. Should the destination location have similar F&A compliance norms for domestic businesses as the firms' host country then there is greater recognition that the headcount at source location will appreciate the nuances of financial reporting. Third-party service providers have to showcase their certifications and process adherence in terms of global best practices for security, data protection as well as financial reporting such as, SOX, HIPAA, US GAAP and IFRS.

- **Proximity to financial centers**: Firms that are looking to outsource/off-shore the F&A operations for Asia/Pacific region are more inclined to choose centers that are closer to financial markets. This is more in line with the perception that closer proximity will enable better review and control for the F&A process. While this maybe selectively applicable for MNCs it is paramount for Asian businesses.

As such Malaysia addresses several of the requirements that businesses have both from a shared services operations center as well as from the perspective of engaging with third party service providers.

Malaysia F&A BPO Services Market

The F&A BPO services market in Malaysia is expected to grow from US$ 537.78 Million in 2011 to US$ 997.39 Million in 2016 with a CAGR of 13.1% over the forecast period. In the Asia Pacific region, the market share for Malaysia is expected to increase from 5% in 2011 to 7% in 2016 making it one of the fastest growing markets in the region for F&A services. In addition, in 2011 F&A services accounted for 54% of total BPO services spending in Malaysia, and is expected to continue maintaining similar levels through till 2016.

Figure 3 shows the composition of BPO Services in Malaysia.

FIGURE 4

Malaysia BPO Services Market, 2011

Source: IDC Asia Pacific Services Tracker, 2H2011

In Malaysia most of the F&A BPO services work loads are related to operational processing elements of the finance organization such as accounts receivables, payment processing, financial reporting, and administrative processes such as claims management, travel management and operational reporting. However, the shared services setups are engaging in more high-end work related to treasury, financial risk analytics, forecasting and management level analysis/advisory. Hence, there is a clear demarcation in the manner in which shared services conduct F&A operations in Malaysia as compared to services being offered by third party F&A players.

Off-shore Shared Services Market in Malaysia

Many global financial institutions like AIA, HSBC, OCBC, Prudential and Standard Charted have established an off-shore shared services centre within Malaysia; and non-financial MNCs like AMD, BASF, BMW, BHP, BP Group, DHL, Ericsson, HP, IBM, Microsoft, Royal Dutch Shell Group have also set up operations to support their F&A activities. In 2011, there were more than 200 SSO companies (roughly 140 foreign and 50 local) within the country, performing various activities ranging from BPO, ITO to KPO (but not limited to F&A only).

Part of this study was to size up the off-shore shared services market in Malaysia. 10 prominent global off-shoring entities in Malaysia were interviewed to obtain a gauge on the operational costs of their shared services centers specifically for F&A under the Banking, Financial Services and Insurance (BFSI) operations. From the interviews, an indicative figure US$540 million was attained, of which an arbitrary 30% "top-up" is required on the figure to adequately represent the Shared Services "revenue size" in Malaysia. The study estimates that the indicative figure stands at circa US$702 million for shared services center F&A "market size".

The study also anticipates many of these shared services centers operate on the basis of a service level agreement (SLA) with a cost charge out on the activities carried out. Shared services centers are only able to contain costs through continued growth and having attained critical mass. Prior to achieving that, the centers would be operating at a "loss". Some of the enterprises in the study are still growing aggressively to achieve critical mass. When the shared services model have evolved to be perceived as "strategic" part of the enterprise, the ongoing growth for shared services centre will contribute to higher value added work. Understandably, costs will then be higher than median – a "premium" the enterprises will be willing to pay in the medium term.

It is noted that in essence, shared services centre need to constantly evaluate their service portfolio in relation to the value-economic efficiency trade off. They need not only concentrate on service delivery but become the conduits through services delivered to the parent enterprise.

Assess Current Situation for F&A Shared services centre

In this section, the study addresses some of the questions which will help identify the key reasons why businesses continue to operate their off-shore F&A processes under SSO models, their challenges, and opinion of third party service providers. To assess the current situation in Malaysia for shared services operations vis-à-vis third party operations, shared services setups in the country were consulted. They comprised representatives from the financial services, technology, consumer goods and Oil & Gas industries. The revenue or billing from these shared service centers ranged from US$ 3 million to US$ 150 million.

Why do businesses prefer shared services setups for F&A operations?

The study observed that shared services operators expect to continue to be relevant to their global business and as such increase their revenue generating (or internal billing) capability over a period of 12 months. This was mostly with expectations that they will be able to operate at an increased scale to address other business units from a geographic perspective as well as move in-house some of the outsourced work given to third party service providers. This is deduced based on the following reasons:

1. Off-shoring and outsourcing discussions are rather strategic in nature and as such it really depends on the organizational culture, its business environment and financial goals to firm on whether or not the business decides to outsource or otherwise. F&A are considered to be core to business from an operational as well as strategic perspective.

2. For organizations that have not traditionally outsourced, it is an increasingly challenging decision to make after taking into account the current political and social issues at hand – this is more so for western businesses.

Furthermore, from an internal organizational perspective, off-shore shared services setups have traditionally had the ability to offer better control of business operations and as such culturally aligned to the business at large. This is always a challenge with outsourcing as the transition process is not only a significant skills transfer challenge but also challenging from an organizational change-management perspective.

However, this is changing. Increasingly, third party service providers have been building their vertical expertise and as such through interaction with various client organizations are better placed to take forward global best practices to their clientele. Furthermore, with the ability to invest in training resources coupled with global delivery capabilities, they are better placed to address the need to cost optimize and de-risk global delivery model which can be scaled based on business requirements.

Why do businesses choose Malaysia as an operational center?

The key reasons cited for using Malaysia as a regional hub for consolidating F&A operations were the government incentives and policies, access to modern infrastructure, the talent pool and the ICT skills and resources (hardware, software, services) readily available. The study also noted that while cost is still a key evaluation metric for Malaysia, other parameters were cited as increasingly relevant for selection as an outsourced destination. This is mainly because organizations that look to setup F&A SSOs centers do understand that the cost of labor will be higher for comparative processes under the BPO arena (such as procurement, human resource outsourcing or customer contact centers). This is mainly because the level of skill sets required for undertaking the task is rather high.

So, the move to Asia/Pacific, particularly Malaysia was more to do with the availability of talent rather than just cost arbitrage. The talent pool and the number of shared services centers created an ecosystem which ensured a consistent growth in terms of value of services and the maturity and capability of individuals which are delivering the services.

FIGURE 5

Key Reasons for Selecting Malaysia as Preferred Off-shore Location

Source: IDC, 2012

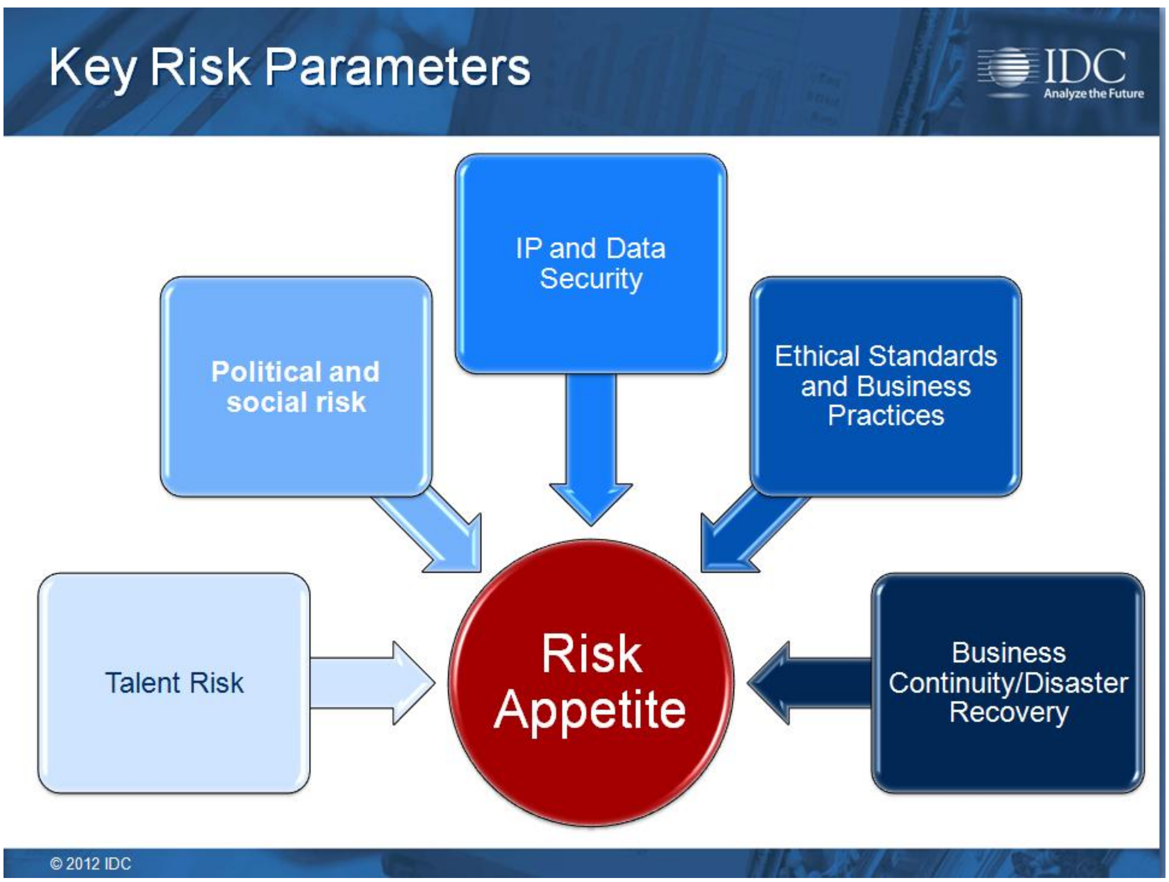
However, it was cited that Malaysia does offer lower cost points for setting up operations as compared to Australia, Hong Kong, Macau and Singapore. Interestingly, it was observed earlier that organizations prefer to setup their F&A operations near a financial hub. In the region, Singapore is considered to be one of the major financial hubs and Malaysia's proximity to Singapore is one of the potential reasons why F&A processes at comparatively lower costs do make it attractive for western businesses. From a government policy perspective respondents cited the tax benefits and financial incentives as the key reason for selecting Malaysia. In addition, lower cost and speed of implementation go a long way in positioning Malaysia as preferred location. Speed of implementation is a key element for organizations today and any ability offered by off-shore destinations to enable fast setup of business will be viewed positively. Another key facet is the multilingual skilled workforce that Malaysia offers to address Asian markets. As such it is implicitly viewed that Malaysia does offer an alternate delivery location to the Industry giants such as India and China.

What are the key risks evaluated?

Among the other key factors that businesses took into consideration when evaluating the selection of an off-shore location are the political and social risks. As such businesses prefer to operate from a country where there is low political risk, uniformity in incentives provided to businesses and strong economic policies. Equally important is the intellectual property protection and data security which is provided by the off-shore location. While setting up off-shore operations it was rather important to ensure that their internal as well as external customer data is secure and the business IP was not diluted. The study believes this is also one of the key reasons why F&A processes are not offered to third party service providers that easily. Although there are talents readily available for employment, it is noted that the attrition rate of an average of 25% in the shared services operations may pose as a speed bump to daily operations. Many cited the concern of attracting more players into the industry which may increase attrition rate when the employees have more options to choose from. Addressing possible talent shortage in the near future will be one of the keys to attract foreign players.

FIGURE 6

Key Risk Parameters



Source: IDC, 2012

What are the addressable areas and their scale?

It has been observed that most of the shared services setups in the region and specifically those based in Malaysia are for addressing the regional operations of the company. As such the businesses have consolidated their back end processes for in-country operations in Asia/Pacific to a regional level control so as to better monitor and manage their costs. Whilst doing so they are also able to offer a single, standardized view to the regional management which can be leveraged for financial reporting. From a service perspective it was found that most elements were related to operational metrics. The table below shows the services being delivered from the SSOs in Malaysia.

TABLE 1

Key F&A Services Being Delivered

F&A Services

	Tax and compliance	
	Accounts receivables, payables	
	Fixed asset accounting and general ledger	
	Financial and management reporting	
	Planning and analysis	
	Expense management (corporate travel)	
Vertical Specific Offerings		
	Insurance	
		Insurance operations
		Investment accounting
	Banking	Retail and Corporate Banking process support
Supporting IT operations		
	Application	
		SAP maintenance and management
	Infrastructure	
		Datacenter Infrastructure
	Operations	
		Back-end IT operations for operations and change management

TABLE 1

Key F&A Services Being Delivered

F&A Services

	Tax and compliance	
Other BPO Services (Non F&A)		
	Customer Support	
		Multi-lingual in-bound operations
	Supply Chain	
		Distribution schedule management
	Contracting and procurement	
		Vendor management
	Human Resource	
		Payroll

Source: IDC, 2012

Discussions during the study with off-shore shared services operations of MNCs in Malaysia proved that it was evident that control of operations coupled with lack of certainty on the ability of third party service providers to meet internal SLA (Service Level Agreement) guidelines was the key reasons why businesses have continued to operate shared services units in Malaysia.

Which are the realized benefits and key challenges for SSO?

Most respondents to the study, failed to articulate a direct cost-to-cost benefit for setting up of shared services operations. Industry norms articulate that anything below 35-40% in savings is non-starter for off shoring processes. Given that the overall sentiment was that of satisfaction with the cost-benefits it can be inferred that most businesses were able to gain the above stated cost advantage. However, in comparison industry estimates do indicate and overall expense saving of over 50% in some cases if the processes are offloaded to a third party for off-shore delivery.

From a non-cost benefit standpoint, shared services centre have indicated that they have experienced benefits from continuous process improvement streamlining and standardization of workflows across business functions, better turnaround time, and improved efficiency in the workplace through enhanced productivity. As such shared services operators have cited their ability to scale up operations as another key benefit observed. In certain cases it was observed that shared services setups were placed to provide better operational outcomes as compared to a third party service provider as they had intrinsically better knowledge of the company and its processes.

One of the key reasons (also cited as benefit) is the control of overall operations with the company and thereby balancing the operational risk of working with a third party service provider.

However, the main challenge observed is headcount retention and wage inflation. Only a few shared services centre have robust internal training and career development structures in place for assisting their workforce to upskill and therefore retain them. While organic wage inflation was not an often cited area of concern, it was evident that loss of headcount to competition (i.e. other shared services centre) was a key area of concern. The study indicates, this is best addressed by third party service providers who can leverage their multi-skilled, multi-lingual workforce to drive retention levels and as such offer a more diverse career path.

Another challenge faced by shared services operators is the process in growing their scale of operations. Evidently to offer optimal cost savings a shared services setup needs to attain critical mass of operations. In instances where this is not achieved then the entire operations for shared services is at risk and mostly divested through to a third party service provider. Furthermore, should the head of shared services operations want to further grow the business of internal delivery then there have to be significant internal sales efforts to various business unit heads. This continues to be the practice in most shared services centre with the exception of the few firms that have a board level mandate to leverage off-shore operations. However, few large organizations with large scale operations stated that pricing models offered by service providers that were transaction oriented made it unattractive to partner with a third party service provider and as such they were able to internally offer better cost metrics.

However, over the long term these metrics of comparison become redundant businesses continue to measure KPIs with previous years and as such can potentially lose out on driving innovation and industry best practices. As such lowering operational expense by 10% year-on year is going to be difficult for any off-shore operations if that's the only metric of evaluation.

What is the learning from failed third party engagements?

Poor experiences with third party service providers are a major reason why businesses setup their own operational centers. First is the effort and hand holding required with third party service providers and the lack of ability viewed by certain by businesses on part of their service provider to offer 100% SLAs. As such poor experience on delivery and effort needed to work with a third party service provider are the key reasons why businesses continue to prefer working with shared services centers. Furthermore, large scale outsourcing engagements require a rather high-touch from service providers to their clients. High attrition levels in the service provider realm are also a reality in certain markets which leads to disconnect and thereby discontent in service experience.

As a result several businesses that have outsourced their contact center (in-bound or outbound) operations are looking to bring them in-house as they believe to have developed the confidence in operations to run large scale centers on their own. As such this will leave only commodity workflows for third party service providers, whilst more critical work is carried out internally.

This assumption is largely based on failed experiences and is not a reflection of the BPO services industry at large. There have been several instances of large scale businesses benefitting from partnering with a third party service provider and leveraging the global delivery model to sustainably drive business improvement.

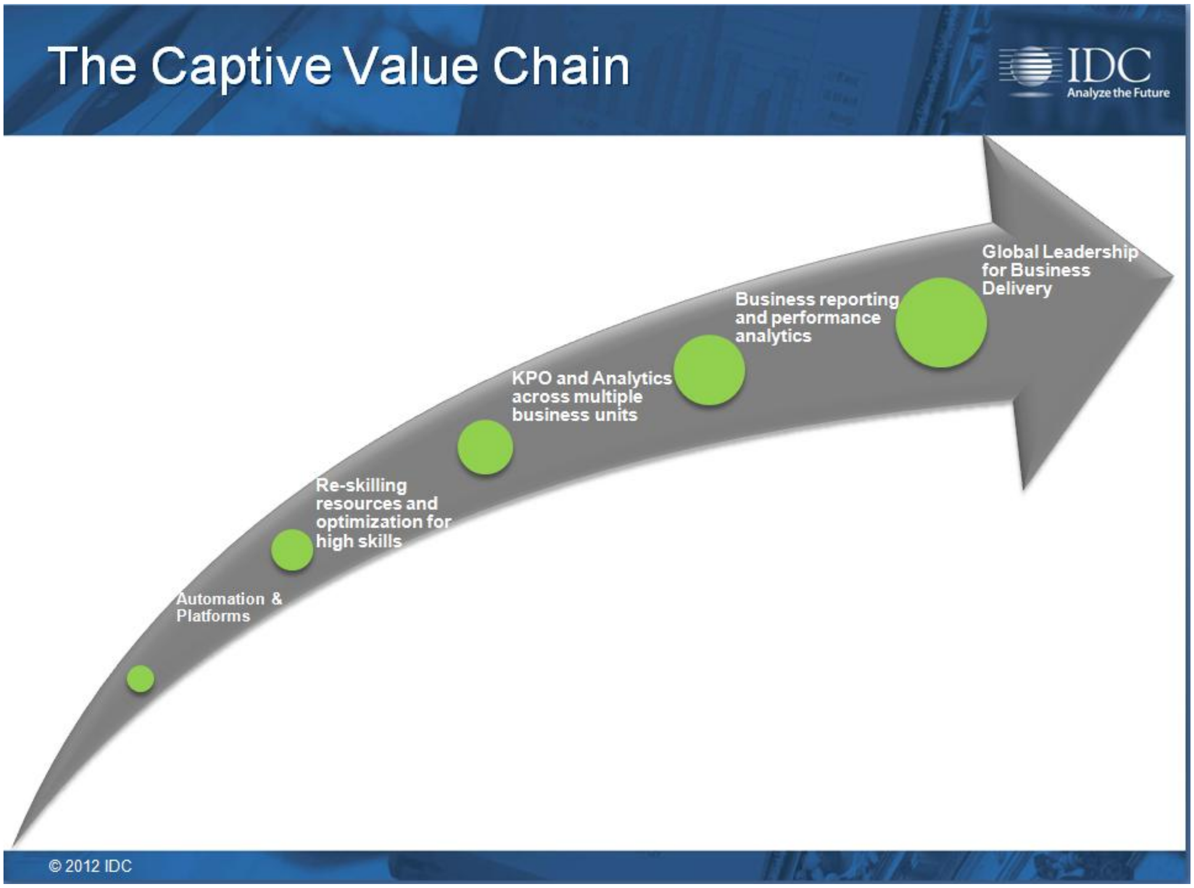
How do SSOs view themselves in the future?

Whilst discussing with shared services centers on their future direction it was evident that they will continue to focus on expanding operations. As such one of the key areas highlighted was their move to climb up the value chain offering more data intensive KPO and analytics based services to their business units. Here, the ability to keep the data "within the family" is cited as a crucial facilitator for taking advantage of low cost destinations whilst offering high-end services.

Figure 7 shows the ramp-up plan for shared services centre in Malaysia

FIGURE 7

Path to Moving Up the Value Chain for Shared Services Centre



Source: IDC, 2012

From the growth path articulated by SSO operators it is evident that their ability to grow will be significantly limited by their access to skills on tap. Progressing from a operational service based delivery organization to one that truly drives innovation is a daunting task. Internally skilling resources to move up the value chain as such will provide difficult and help from consulting majors will be crucial towards driving any level of success to pursue this strategy.

FUTURE OUTLOOK

The future outlook for the F&A shared services and third party BPO services industry needs to be viewed from three different angles – the customer, the players and the industry model at large for shared services centre.

The Changing Customer

In times of economic uncertainty as currently experienced globally, the core strategy for businesses is the same old formula of controlling expenses and improving process efficiency. The study reveals CFOs responded by articulating that conserving cash and lowering CapEx as well as OpEx were the key areas of focus for them in 2012. As such administrative expenses are high on the agenda and outsourcing non-core functions is a key target on the CFOs radar.

FIGURE 8

Top Issues on CFOs Agenda in 2012

Source: IDC, 2012

As such this would sound well for shared services operations as they would expect to have increased access to funds for expanding their shared services operations. However, also high on the agenda for the CFOs is the outsourcing of non-core functions.

The impact will extend beyond F&A outsourcing and as such the CFOs office will look for service providers that can offer end to end service delivery capabilities. Specifically with the objective to lower collection periods the market opportunity for accounts receivable/collections services will be high which will drive the business opportunity for third party service providers in Malaysia as is for other key outsourcing destinations.

FIGURE 9

Key Actions That CFOs Will Undertake in 2012

Source: IDC, 2012

This move to outsource non-core functions will benefit third party service providers as they can offer better short-term cost savings as compared to shared services operations in low cost destinations. However, this short term strategy will necessitate very careful vendor scrutiny and it will be paramount for service providers to showcase their vertical specific skills and talent resource pools.

By analyzing the results above, CFOs are increasingly focused on day-to-day operations and as such financial control is their key performance metric. However, as the economic environment matures and becomes more stable or predictable we will witness the advent of the "transformative" CFOs – one who is involved in more strategic engagements (such as M&A, new market entry, product innovation). This new CFOs' *avatar* will leave the day-to-day execution of operational environment to the Financial Controller and demonstrate that the move to outsource the noncore F&A functions will be more apparent.

The Changing Competitor

From a competitive perspective, global majors, such as India as well as other emerging regional players are extending their regional delivery presence across the region. As part of this extending presence, Malaysia is a core component as it acts as viable alternative to India and China, as well as providing access to the emerging businesses in the SE Asian market.

From a service delivery standpoint, the lines are well set. Cost reduction and operational efficiency improvement are table stakes and as such if a BPO player can't bring through any vertical specific IP then businesses would rather prefer to move towards the shared services route as compared to partnering with a third party service provider.

Furthermore, consulting capabilities are a key component of the delivery arsenal. This is increasingly relevant for engagement with large global firms that are looking to undertake transformative engagements and as part of that are exploring BPO or SSO setups.

Increasingly, deals for BPO engagements come with applications and infrastructure management elements. As such there is now a core delivery requirement from third party service providers. Line of Business managers, expect the service providers to be equipped with the required capabilities for running an end to end service delivery environment.

As a result the pricing models are changing. There is an increased level of expectation that service providers will be able to display their skin in the game by offering outcome based, SLA aligned pricing models. Here there is still not an increased level of acceptance for risk-rewards models, yet surely for business outcomes based.

A key facet driving the change element from a competitive perspective is the impact of cloud solutions. As such it is expected for emerging new players to have traditional service delivery expertise and able to launch their platform based cloud solutions for back end processes and as part of that F&A services for taxation and accounting will be key components. Evidently, this is a long term trend yet the evidence of the market model moving in this direction is already bearing fruit.

The Shared services Lifecycle

In the long term, it is forecasted that there will be businesses that will continue to run on-shore operations outside a SSO model (albeit in minority), there will be increased setting up of SSOs, increasingly more outsource engagements for F&A based BPO services, and furthermore organizations that will opt for cloud based BPO services (mainly SMBs). This is mainly because each organization will firm on its sourcing strategy based on their scale of operations and requirements from a strategic perspective.

As such the decision to opt any of the routes mentioned will be based on business case at hand.

For off-shore shared services in particular, the key consideration for both the setting up of and the divestiture of shared services centre is the balance between security of processes and cost and it is this assessment which determines a business' risk appetite for outsourcing. Typically at the set up stage off-shore shared services centres are “lower” cost solutions with minimum value add services. As the life cycle progresses, more value add services are incorporated and best practices are built. At maturity, when there is no more value addition; and with the increasing pressure of the economic downturn spin offs will be considered.

Furthermore, lack of growth opportunities do defeat the business case especially when off-shore shared services centers reach maturity in terms of processes and value add services that can be developed internally to improve organizational processes.

Simultaneously, at the broader business level there is need for influx of cash; and sales of the center will cash in much needed economic climate, that could potentially be tied in to support the liabilities of the shared services center.

Moreover, the management focuses on core competencies and availability of services: from mature third party providers who are able to offer the necessary people, processes and technology to suit the organizations’ needs at the same or lower cost. Simultaneously, the need for multi functional outsourcing will act as another driver especially in case of transformative engagements.

The study disclosed that a number of off-shore shared services centres in the region branched out to establish themselves as third party service providers. This has been evidenced in the financial services space, consumer goods as well as oil and gas verticals. Most of these shared services setups that moved to establish themselves as a third party BPO service providers have experienced initial success. However, in several cases they are under stress as their operational margins declined and their client base were targeted by traditional BPO service providers.

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Definitions

The study defines off-shore-based service providers as companies headquartered, or with primary operations, in regions with historically low labor costs that offer BPO services from their home regions to customers in the previously outlined onshore regions. The regions, which in this document are referred to as "exporting regions," in which these providers are primarily located are: India, China, The Philippines, Malaysia, Latin America, Parts of CEE, Middle East and Africa (MEA)

Examples of off-shore-based BPO service providers based in these regions include: 24/7 Customer, Aegis BPO, ExlService Holdings, Genpact, HCL, Firstsource, Infosys, Wipro, WNS, Tata.

Business process outsourcing. Business process outsourcing involves the transfer of management and execution of one or more complete business activities, business processes, or entire business functions by a customer to an external outsourcing or off-shoring services provider. The BPO vendor is part of the decision-making structure surrounding the outsourced process or functional area, and performance metrics are primarily tied to customer service and strategic business value. Strategic business value is recognized through results such as increased productivity, new business opportunities, new revenue generation, cost reduction, business transformation, and shareholder value improvement.

Processing services. Processing services involve the transfer of management and execution of activities or single business processes that tend to be high volume and automated to an external service provider. Performance metrics for processing services are primarily tied to cost control/reduction, accuracy, timeliness, and efficiency of high-volume service capabilities. Processing services are typically standardized and involve little or no customization.

Note: The forecast in this study does not include a breakout between BPO and processing services; customer expenditures represented will be for the combined BPO and processing services expenditures as captured by the term BPO.

Finance and Accounting Business Process Outsourcing Services

- The study defines finance and accounting BPO services as those associated with a company's need to manage the flow of money into, within, and out of the organization. These may include accounts payable, accounts receivable, general ledger reconciliation, budgeting and forecasting, cost accounting, property accounting, and tax filing. F&A BPO services can involve the transfer of single or multiple processes. The F&A outsourcing market can be segmented along five key sub-processes:

  - Transaction management. Transaction management includes activities such as accounts payable, accounts receivable, credit and collections, and billing/invoicing.

- Finance. Finance includes activities such as investing, funds raising, financial and performance analysis and reporting, capital planning, and budgeting and forecasting.

- General accounting. General accounting includes activities such as fixed asset management, general ledger, account reconciliation, banking relations, management accounting, financial statements preparation, project accounting, and inventory accounting.

- Treasury and risk management. Treasury and risk management includes activities such as cash management and planning, bank account reconciliation, funding, insurance, foreign exchange, internal audit, compliance, internal controls, and risk management strategy.

- Tax management. Tax management includes activities such as tax planning, tax filing, and tax processing.

Exceptions and Exclusions: IDC's definition of F&A services does not include standalone external audit, payroll, benefits processing, travel and expense processing, or discrete document management services.

Synopsis

IDC believes that in the broader context of BPO and Global Delivery, Malaysia and Malaysian BPO are at a pivotal stage of growth. Over the past five years the country has emerged as a challenger to the tried and tested off-shoring destinations in Asia/Pacific region – largely backed by government incentives as well as policies to foster ICT growth in the country. Taking advantage of the same, MNCs have chosen Malaysia as a delivery hub for their BPO process with emphasis on F&A.

Malaysian BPO players have been beneficiaries of a world class infrastructure environment and have done well to establish their presence in the region. According to Mayur Sahni, Senior Analyst for Business and IT Services – "Moving forward it will be crucial for the BPO players to up-skill their delivery capabilities, enhance their ability to undertake complex engagements and build depth in IP to take on global as well as players from India. Any lack of ability to do so will lead them to being mere commodity players in an ever competitive BPO landscape".

According to Chin Chin Wong, Senior Analyst, Consulting Research "Businesses with existing shared services operations in Malaysia are rather content with their current success with SSO set-up in the country. Government incentives, infrastructure availability and access to local talents are the key reasons they believe sustaining existing operations and further expanding them would be successful."