Nexia International Special Report | July 2012

Financial outsourcing in the BRICS

NEXIA INTERNATIONAL

About this report

This report provides an overview of financial outsourcing in Brazil, Russia, India, China and South Africa (BRICS). It covers what a business should look out for when outsourcing its finance function in these countries, the benefits of doing so and ways to avoid potential pitfalls.

It is based on the views and experience of Nexia International member firms operating in the relevant countries.

This report is adapted from an article authored by Nexia International and published in FDi magazine in June 2012.

Contributors

We are very grateful to the Nexia International member firms that participated in writing this report and, in particular, to the following for their contributions:

Bashier Adam, SAB&T, South Africa
bashier@sab-t.co.uk
+27 12 682 8789
www.sab-t.co.za

Avnish Arora, Chaturvedi & Shah, India
avnish.a@cas.ind.in
+91 22 400 90585
www.cas.ind.in

E. Camillo Pachikoski, PP&C Auditores Independentes, Brazil
ec.pachikoski@ppc.com.br
+55 11 3883 1600
www.ppc.com.br

Sapan Parekh, SKP Group, India
sapan.parekh@skpgroup.com
+91 22 6617 8000
www.skpgroup.com

Henry Tan, Nexia TS, Singapore
henrytan@nexiats.com.sg
Tel: +65 6536 5466
www.nexiats.com.sg

Elena Yuzhakova, ICLC, Russia
yuzhakova@mkpcn.ru
+7 495 621 1015
www.iclcgroup.com

Contents

Introduction

Economic gloom in much of the world has led many businesses to look increasingly to the world's major, fast-growing economies of Brazil, Russia, India, China and South Africa – the BRICS – for growth.

Operating in the BRICS can mean dealing with complicated and unfamiliar tax and financial legislation, and bring governance challenges for the parent company. A subsidiary is usually lead by a local country head and manned by local staff. Companies need to guard themselves against improper commercial dealings that may result in fraud and may even embroil the parent in regulatory violation in the home country. A recent example is the alleged massive fraud by the former CEO of Reebok India. Under the Foreign Corrupt Practices Act (FCPA), the parent company is responsible for corrupt practices by subsidiaries. So, how does a chief financial officer ensure adequate oversight over a subsidiary?

Outsourced services

To help meet these challenges, CFOs increasingly see the benefits of outsourcing the finance function to a local firm to provide services such as payroll, bookkeeping or management accounting or to deal with the local tax authorities.

Other more specialist outsourced functions include VAT returns, pensions administration, expat tax services, transaction processing and even internal audit and risk management. In recent years, more companies have started outsourcing their invoicing to cope with high volumes. Some outsourcing firms offer general ledger management and management reporting based on business intelligence tools.

At the other extreme, some companies outsource the entire CFO function of the subsidiary. And an increasing number of service providers are able to deliver a complete accounting and compliance service, as well as control and business support functions on a par with a good CFO.

Who is outsourcing?

For small and medium-sized companies expanding into the BRICS, financial outsourcing can significantly reduce the cost and management time required to set up. Many entrepreneurs have recognised they can gain a competitive advantage by delegating financial processes through a fully outsourced solution package, allowing them to focus on the main business.

Large companies and multinational subsidiaries have tended to co-source, transferring some financial activities to external providers who liaise with the central finance function in the home country, and doing the rest with their own finance teams and technologies. But the range and extent of outsourced services to these larger players is growing, partly as a result of familiarity with the shared service centre model adopted by many multinational corporations.

Comparing the BRICS

India

India has, of course, emerged as one of the preferred locations for outsourcing globally. A large English-speaking pool of technically trained graduates makes it a formidable player in the market. The business process outsourcing industry is itself one of the most significant growth catalysts for the economy.

India also has a well-established financial outsourcing industry with more than a decade of experience in all aspects of tax, bookkeeping, payroll and financial services. It has a cost-competitive infrastructure and a favourable time zone, which provides advantages for US and European operations.

There is great demand for bookkeeping and processing of large volume transactions, such as expense claims and accounts payable, from foreign companies operating in India, while payroll, tax-return processing, pensions administration and dealing with the tax authorities are considered major 'pain points' across companies of all sizes.

Start-up Indian subsidiaries of overseas companies usually outsource their finance function and have tended to pull the finance function inside as they grow. While there are fewer instances of large companies outsourcing their finance function completely, processes such as accounts payable, accounts receivable are increasingly being outsourced.

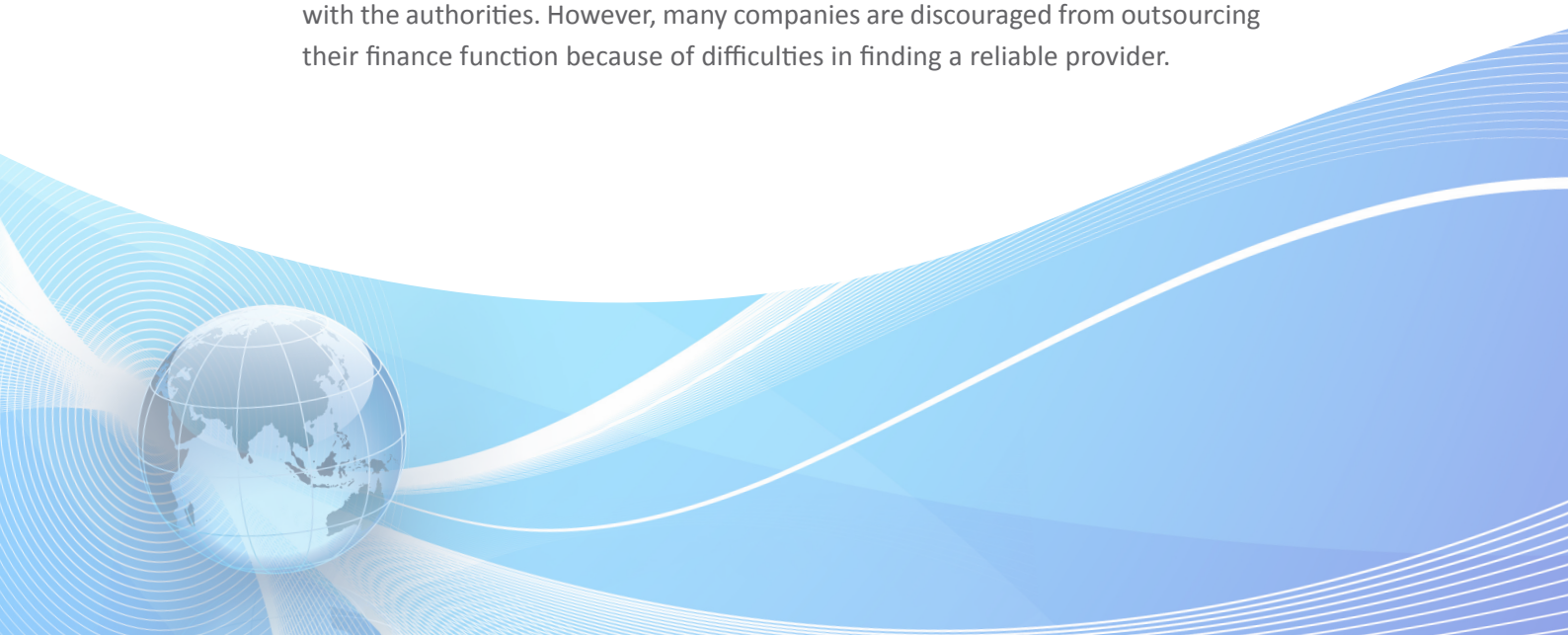
Brazil

In Brazil the market for outsourced financial services has grown significantly in the last few years, following a cultural shift in business administration. There are now numerous highly skilled service providers, whereas in the past, outsourced services were provided largely by small accounting firms lacking proper structures and specialist employees.

Brazil has some of the world's most complex tax legislation, which requires a finance function to have specialist expertise. Labour law is also complex. Professionals at these levels are rare and relatively expensive, but outsourcing companies are able to provide these experts by diluting their costs through their client base.

Russia

Outsourcing of payroll, accounting and tax support are popular with foreign companies operating in Russia, mainly to reduce costs and to avoid complications with the authorities. However, many companies are discouraged from outsourcing their finance function because of difficulties in finding a reliable provider.



China

In China, it is rarer for an overseas-owned business to outsource its entire finance function, as legislation requires businesses to have an in-house professional for tasks such as lodging documents with government authorities. However, there has been some growth in demand in the past few years, particularly by smaller start-ups and newly established subsidiaries of overseas companies.

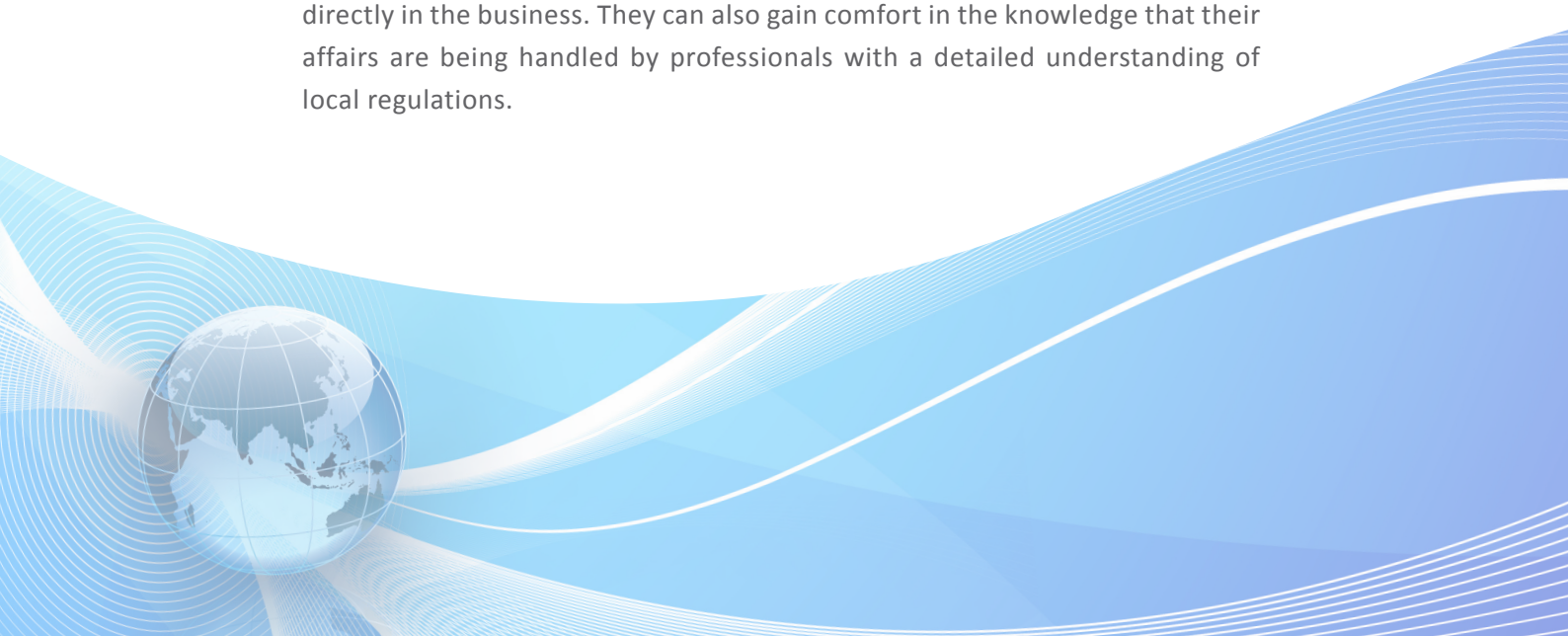
South Africa

Influenced by the recession and its stringent labour laws, South Africa has seen steady growth in the financial outsourcing sector in recent years. Outsourcing the finance function to third parties is becoming attractive to medium and large businesses, but it has long been the favoured option for SMEs for dealing with their financial compliance obligations.

South Africa is being recognised as an attractive destination for outsourcing business support services because it offers cost-advantages over destinations such as the UK, EU and US, and is thought to present a relatively high quality offering compared to some other developing economies. In particular, an increasing number of companies in the UK and Western Europe are exploring opportunities for offshoring their operations to South Africa.

Reaping the benefits of outsourcing

Many overseas companies and subsidiaries prefer to outsource their finance function due to cost-effectiveness, a shortage of well-trained financial staff available in the marketplace and insufficient internal capacity to employ people directly in the business. They can also gain comfort in the knowledge that their affairs are being handled by professionals with a detailed understanding of local regulations.



Clearly the benefits of outsourcing will depend to a large extent on the level of financial transactions undertaken by a company on a daily basis. Some companies prefer to keep rank-and-file bookkeepers on the staff, while outsourcing the functions of the chief accountant. Minor issues may be better dealt with in-house.

Focus on key issues

The main benefit of the outsourcing model is to allow the BRICS-based start-up or subsidiary to focus on key issues in its core business without the need to involve management in local accounting or tax issues. The company avoids the hassle and expense of recruiting staff and setting up and upgrading systems and software locally.

Control and business support

Beyond the obvious benefits, there are the important issues of control and business support that a good partner can bring. A key driver is quality and timeliness of management information through a combination of robust and reliable reporting platforms, relevant local knowledge and expertise. This should allow the business to be more agile and to focus on important business issues. Another key driver is the independence of the service provider and whether it sees its role as accounting and compliance or as a partner (or extension) of the parent company's finance function.

Cultural divide

Companies venturing overseas for the first time are often unprepared for the cultural differences they encounter. Working with the right local service provider can help them deal with the unfamiliar regulatory environment as well as bridge the cultural divide.

Flexibility

Some companies believe that their complex industry-specific financial accounting systems mean that outsourcing is not an option for them. But good financial outsourcing firms will offer flexibility. In a difficult situation the outsourcer may be more able to find the right expert for the job, while a company employing its own financial staff may need significantly more time. So, in addition to qualified staff well-versed in bookkeeping and accounting, the outsourced function can provide access to legal experts, tax consultants and other specialists, often drawn from an international network, who can help the company address more complex issues, anticipate upcoming issues and respond appropriately to matters that need to be addressed.

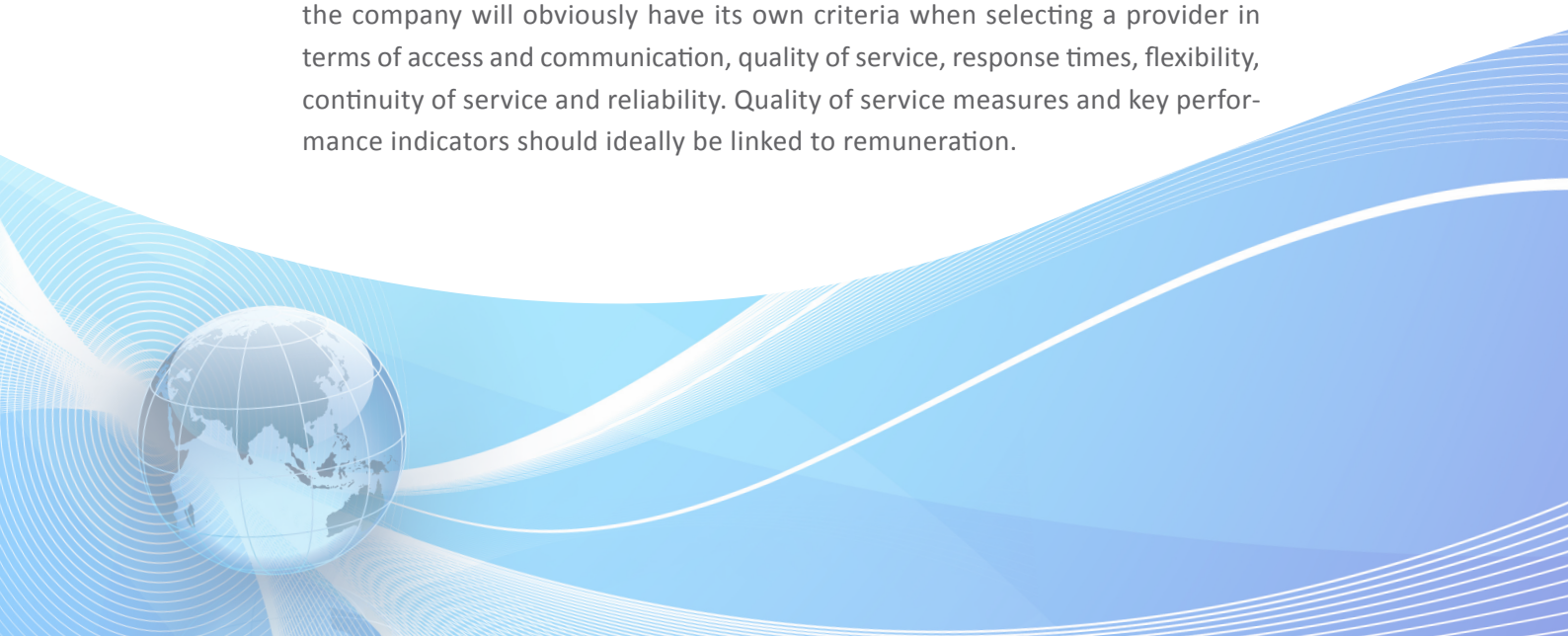
Continuous improvement

Another priority is to ensure that financial processes are continually refined and improved once they have been outsourced and that they keep pace with changing needs and new technology. Systems and software should be upgraded to take account of any regulatory or tax changes.

Choosing a provider

The fear of losing control of a company's finances to a third party is understandably often a major obstacle preventing businesses from engaging financial outsourcers. The choice of provider and senior level buy-in at the initial stage is critical and can make or break the fledgling operation in the BRICs.

To ensure that the outsourced function delivers the full benefits outlined above, the company will obviously have its own criteria when selecting a provider in terms of access and communication, quality of service, response times, flexibility, continuity of service and reliability. Quality of service measures and key performance indicators should ideally be linked to remuneration.



The parent company must pay as much attention to setting up its accounting, compliance and local CFO function as it does to sales, operations and HR. It should look for a service provider that has the maturity and character to grow into a partner rather than be driven only by price.

It's important to consider local issues, which may arise due to the country's infrastructure, cultural and language differences, and whether the outsourcing provider can clearly demonstrate that it understands the contractor's business. The provider should fully meet regulatory standards and provide evidence of compliance with relevant certificates and documents. Sharing data with outsiders always has security and confidentiality ramifications so it is crucial to look at the safeguards in place.

Always obtain references from other clients and find out about their experience of the provider's structure and the specific team who will work on the project.

Choosing an outsourcing partner – key points checklist

- Obtain senior level buy-in at the start
- Link remuneration to quality of service and KPIs
- Look for quality before cost
- Consider cultural differences
- Make sure the provider understands your business
- Obtain evidence of compliance with regulatory standards
- Consider appropriate data security safeguards
- Get references from other clients

Avoiding the pitfalls

It is critical to ensure that the local service provider is independent and has an open channel to the parent CFO. Companies will need to invest in building the relationship with the local service provider so that it can be relied upon to be the company's eyes and ears as the local operation grows.

It's essential to agree a formal contract detailing clear terms and conditions, deliverables and an extensive service level agreement. Particular attention should be paid to potential additional costs, for example, whether the services of specialists are included in the fee.

Companies should constantly evaluate the service provided, both in terms of structure and personnel, and immediately correct any problems if the provider is cutting corners. In the event of any major service issues, the provider should have contingency plans in place.

Companies should be particularly careful not to outsource a 'corrupted' process before fixing it in-house. The finance function is a dynamic process and the provider must be able to make continuous improvements once they take over and keep pace with changing needs and technology, rather than rectifying problems with existing systems.

Firms need to have measures in place to avoid becoming excessively reliant on the contractor. It is important to be wary of losing control over financial matters and be mindful of the impact on the company culture. The cost of maintaining control over the outsourced function will increase with the size and complexity of the business.

Above all, outsourcing requires careful management. All companies should continuously monitor their relationship with the outsourced function and react quickly in the event of any disagreement.

Avoiding outsourcing pitfalls – key points checklist

- Invest time in building a long-term relationship, but ensure independence
- Agree a formal contract
- Pay special attention to potential extra costs
- Regularly evaluate levels of service
- Address problems when they arise
- Fix broken processes in-house before handing over to a third party
- Ensure the provider keeps pace with changing needs and technology
- Maintain control and don't become overly reliant on the provider

About Nexia International

Nexia International is a leading worldwide network of independent accounting and consulting firms, providing a comprehensive portfolio of assurance, tax and advisory services.

With more than 570 offices in over 100 countries, we have a substantial presence in the world's major financial and economic centres. We are strategically placed to serve the diverse international requirements of our clients, ranging from globally listed entities and international subsidiaries, to owner-managed businesses and high-net-worth individuals.

Experts from around the Nexia International network work together to provide cohesive, customised services to solve cross-border business issues and advise individuals on wealth creation and preservation.

Providing a consistent quality of service, regardless of location, is fundamental to our work with anyone engaging professional advice across international borders. Through our tight knit global community, you can expect shared values, close and enduring relationships between member firms and the highest standard of professional advice – anywhere in the world.

Nexia International
4 Harley Street
London, WIG 9PB, UK
Telephone: +44 (0) 20 7436 1114

Primary contact:
Sarb Bajwa
Email: sbajwa@nexia.com

www.nexia.com

NEXIA INTERNATIONAL