Outsourcing and Consolidation Of Financial Management Operations

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Theme of this Presentation

- Outsourcing and consolidation are underway
- E-business enables and speeds up the process
- Government is on the bandwagon
Perspective

• The scope of this presentation is wide-ranging
• Its focus, however, is on government financial operations
• The tenor is on self-directed (voluntary) outsourcing — not mandated (OMB Circular A-76 in Federal parlance)
Recent News

- "ACS Net Rose 58% in 1st Quarter" (WSJ 10/23/02)
- "The Proctor & Gamble Outsourcing Soap Opera Continues" (Network World Newsletter 10/02/02)
- "President's Management Agenda Emphasizes (among other elements) Expanded E-Government and Improved Financial Management (dozens of recent publications)
- "OMB Makes First Cut on Payroll Consolidation" (FCW 9/12/02)
BP Amoco Is Set to Outsource Accounting in $1.1 Billion Deal

By Steve Liesman

Staff Reporter of The Wall Street Journal
GM strikes deal to outsource accounting

Revenue, not just savings, involved as Arthur Andersen buys its best practices

Just the Facts

GM-Andersen Partnership

- $250M over 10 years
- Arthur Andersen to take over GM's payroll, dealer billing, accounts receivable and payable, fixed asset accounting, and travel and expense transactions
- GM estimates that it processes $250B of financial transactions each year
- Both companies will market accounting services to new customers

“...activities are not rocket science, but more process-oriented. And one would think over time administrative systems such as payroll have been perfected to the point where there's no fat left.”

GM couldn't concur more. Doling out paychecks to 265,000 North American employees is an arduous task. It wants to utilize Web technologies to a significant degree going forward.

“Payroll processing has been around for donkey's years, but as the Internet gets into the middle of things, it becomes easier to do integrated billing across a bunch of services,” said Gopi Bala, an analyst at The Yankee Group in Boston.

But unlike typical outsourcing contracts, GM expects to reap revenue gains as well as save money in the deal. That's because the deal also involves revenue sharing by the two companies, as Arthur Andersen mar-
** Bethlehem Steel Meshes IT, Finance **

Bethlehem Steel's IT department will see a few changes in 2002. The group is now part of the steelmaker's business-services division, which includes transactional and technical services from accounting, human resources, and law. In addition, the previous head of IT, Thomas Conarty, will retire at the end of the month. Conarty, 51, was senior vice president and chief of procurement and information technology, and will not be replaced. His post is one of several senior positions that have been cut, a spokeswoman says.

Heading up IT is Larry Clees, director of IT who reported to Conarty. Under the new structure, he will report to VP of business services Ed Reybitz, who was previously a controller at Bethlehem and is a direct report to the company's CFO, Leonard Anthony. When Conarty was CIO, he reported to Duane Dunham, president and chief operating officer, who also retires at the end of January and will not be replaced. Bethlehem's change in management structure is no surprise, considering the possibility of near-term industry consolidation. U.S. Steel has said it may acquire Bethlehem, which has been hit hard by the steel industry's downturn and filed for Chapter 11 bankruptcy in October 2001.
Trends

- Organizations are getting out of **non-mainline operations**
- The operations—**mostly support functions**—are being outsourced
- Outsourcing may be to similar organizations or to ones which specialize in providing such services
- Electronic interfaces in large measure are the enabler/glue of the outsourcing initiative
LAST YEAR, General Motors was the world's leading travel agent—or so it would seem. The automaker sent more than 100,000 employees on the road, and that's just in the United States. Its peripatetic workforce racked up an eye-popping array of expenses for airfare, hotels, fleet transportation, entertainment, communications, and other business needs, most of them paid for via four different corporate-card accounts. The mountain of data produced by all that activity required a veritable company-within-a-company to process, flag questionable expenses, and record everything in the general ledger.

Does a company that designs and builds cars really want to devote so many internal resources to the management of corporate travel? In December 1998, GM said no, and shifted the burden to Kirkland, Washington-based Captura Software Inc.

GM is not alone in moving its noncore business processes to outsourcer service providers. Many companies are following suit, outsourcing a growing list of functions that includes purchasing and disbursement, order entry, billing and collection, human resources administration, cash and investment management, tax compliance, internal audit, payroll, and customer relations. A survey con-

EAGER TO FOCUS ON THE THINGS THEY DO BEST, COMPANIES HAVE TURNED TO BUSINESS PROCESS OUTSOURCERS FOR VIRTUALLY EVERYTHING ELSE. BY RUSS BANHAM
of reservations are made by travel arrangers.”

Nonetheless, several travel buyers envisioned a far brighter future for online booking than did their counterparts who answered the survey.

At Hewlett Packard, for example, travel supplier manager Jeff Kurn predicted a largely paperless travel booking and reimbursement system. “By the year 2002, self-booking products will be able to accurately find lowest cost travel alternatives and accurately implement corporate negotiated deals. They also will be able to handle such manual tasks as faxing hotels for available rooms when the GDS shows they are sold out. The use of paper in expense reports also will be mostly eliminated, as hotels will be able to provide folio data electronically, and the IRS will no longer require any receipts when expenses are placed on a corporate charge card.”

Kurn expected that self-service online booking will take over the work of perhaps half of H-P's travel counselors, as “90 percent of all air, car and hotel transactions that are currently going through an agency will at least be started through Internet-based booking systems by the end of 2002. Of that number, maybe 25 percent will then go direct to a supplier instead of through a GDS.”

Others had expectations of even higher usage. “Personally, I expect 50 percent of our bookings to move online by 2002,” said a travel buyer at one Fortune 500 company that rolled out a booking system this year. “Online booking is an evolving technology and if it continues to generate lower fares and begins to lower distribution costs, companies will have no choice but to adopt it. And as the Internet continues to become a vital business tool, as the workforce becomes more comfortable with it and with other technological tools, such as Palm Pilots, more and more travelers and travel arrangers will gravitate to it—no question!”

Across the pond, one European buyer described the following vision: “The keys to delivering 'best value' travel management by the end of 2001 will be a multi-local corporate travel Web site (the 'virtual travel agent,' directing travelers to make the right purchase); e-mail to communicate itineraries; consolidated global data from which to construct decision-quality management information; and a smart card to deliver ticketless travel, act as the payment mechanism, track actual spend and deliver added-value benefits to the traveler.”

The typical corporate travel site will offer direct connectivity to preferred suppliers, and focus on cutting out unnecessary travel through “an armory of business interaction
### Definitions

- **E-Government**
  - Web-enabled operations, information, and communications technology

- **Outsourcing**
  - Turning over some portion of your operations to others

- **Consolidation**
  - One organization takes responsibility for similar work formerly done by other organizations
Definitions (continued)

From the viewpoint of the organization for which selected processes are outsourced/consolidated, outsourcing/consolidation are pretty much the same—someone else does what you used to do!
Selected Elements of President's Management Agenda

• Improved financial performance
• Expanded E-government
• Budget and performance integration
Improved Financial Performance

- Clean Financial Audit Opinion
- Accurate and timely financial information
- Re-engineering reporting processes and expanding use of web-based technologies
- Quarterly financials
- Accelerated year-end financials
- Comparative financials
Financial Performance (continued)

• Integrating financial and performance information
• Using Budget & Performance Measures and outcomes
• FFMIA (Integrity Act) Compliance
• JFMIP (Joint Financial Management Improvement Program*) compliant systems that can produce financial systems

*JFMIP is a federal office involved in establishing principles for federal accounting systems.
Expanded Electronic Government

• Single point of access systems
• Reuse of data
• Sharing of data
• Automating internal processes
Budget and Performance Integration

- Performance data should be used for:
  - Program management
  - Budget submissions
  - Monitoring and rewarding staff
  - Management accountability
- Performance based budgets by 2003
- Integrated budgeting, performance, and accounting information systems
Budget and Performance Integration (continued)

- Budgets will identify **outcomes** and **measures** and integrate performance of programs with cost
- Integration of paperwork requirements
E-Government Hype Cycle

Technology Timeline

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Outsourcing Drivers

- People problems
- Others are doing it and like it
- Cost (careful!)
- Speed up modernization
- Believe another outfit can do it better
Outsourcing Drivers (continued)

• Frustration with past/recent attempts to transform internally
• A good offer
• OMB initiatives

Frequently the key driver is pain---we can't suffer any longer!
Advantages of Outsourcing

• Someone else does routine work as you focus on higher value added work
• Service reliability is someone else's responsibility
• Specialists keep current with process; e.g., state tax regulations
Advantages of Outsourcing (continued)

- Critical mass could result in low per-transaction costs
- Competition should lead to lower pricing
- Unsatisfactory service—you can leave
Disadvantages of Outsourcing

- Someone else has your stuff
- Service could be impersonal
- Cutover at outset will be resource intensive
- Standard service may not meet "unique needs"
- Changes staff composition and FTE count
Where Government Outsourcing Is Working

- Equal Employment Opportunity Commission (EEOC)
- Bureau of Indian Affairs (BIA)
- Hawaii Tax Collection
- GSA, USDA(NFC), Interior(NBC), VA Payroll
- Pennsylvania Information Management
- DFAS Retired Pay
- Grant Thornton Office Support
- Financial Management Operations at an ASP
- Battlefield Monument Commission
- Federal Emergency Regulatory Commission (FERC)
Others Said to Be Looking at Outsourcing

- IRS Overdue Collections
- Defense Security Cooperative Agency (by DFAS)
- Selective Legislative Branch Offices
- Several Grant-making Organizations
- Army Third Wave
- BIA Trust Fund accounting
Financial firms bet on outsourcing

BY ANN BEDNARZ

IBM's $5 billion, seven-year outsourcing agreement with JPMorgan Chase is the latest and most valuable in a string of multibillion-dollar deals recently forged between IT services firms and financial institutions. Financial services firms are turning to outsourcing to lessen IT costs and management burdens, free up cash, and find better ways to respond to fluctuating market conditions, analysts say. IT agility is key to financial services companies, which face economic pressure from shrinking transaction volumes yet shoulder intense computing requirements, says Tom Kucharvy, an analyst at Summit Strategies. "The need for outsourcing among those companies is clearly on the rise," he says.

The JPMorgan Chase pact announced last week calls for IBM to handle a significant portion of the firm's technology infrastructure, including its data centers and voice and data networks, as well as absorb 4,000 JPMorgan Chase employees and contractors. JPMorgan Chase will retain control of some IT functions, including application development and delivery, and desktop support.

In addition to the JPMorgan Chase deal, IBM last month inked a $2.6 billion, 10-year agreement with Deutsche Bank to manage some of its computer centers. IBM isn't the only company landing big outsourcing deals. Electronic Data Systems (EDS) landed multibillion dollar deals with financial services companies: Bank of America and ABN Amro in December.

The Bank of America contract is a 10-year, $4.5 billion outsourcing agreement whereby EDS will reengineer and manage the firm's voice and data networks.

The ABN Amro outsourcing contract — valued at $1.3 billion over five years — covers provisioning of technology services and applications development for ABN Amro's wholesale client strategic business unit.

Also in the billion-dollar club is Hewlett-Packard, which in September announced a seven-year, $1.5 billion outsourcing agreement with Canadian Imperial Bank of Commerce (CIBC) to manage much of its IT infrastructure, including desktop PCs, software and network gear.

What's significant about some of these outsourcing agreements is not only the size of the deals but the services delivery and billing methods. Financial institutions are buying into utility-based pricing models that allow them to obtain IT services such as server processing and data storage on an as-needed basis rather than buying fixed IT services with fixed prices, analysts say. "When the need for transaction processing drops, as it will in a downturned stock market, [customers] can cut back without having to lay people off or continue having to carry a lot of unproductive capital equipment like mainframes and servers," says Bruce Caldwell, principal analyst at Gartner.

The flexibility of pay-as-you-use services appeals to JPMorgan Chase, spokesman Michael Dorsman says.

Content delivery market set to soar

BY PHIL HOCHMUTH

Industry watchers expect corporate content delivery networks to take off this year as businesses exploit the technology for more than multimedia delivery and Web page caching.

In addition to using CDNs for delivering multimedia content such as e-learning and corporate communications, companies will use them for applications such as transferring sales updates or other data to remote offices and business branches, analysts say.

CDNs rely on Web caching and load-balancing technologies to efficiently deliver large amounts of data over a WAN. CDN technology gained prominence through services offered by companies such as Akamai and Inktomi that aimed to alleviate congestion at popular

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Accounting Process Outsourcing: The Right Choice for Your Company?


Understanding outsourcing

Outsourcing has been around for a long time, but is relatively new for the accounting process. Most companies have outsourced their payroll processing and many have outsourced one or more areas like IT and call centers. It is important to keep in mind that we are talking about outsourcing the process not the responsibility or control over the function itself. In the case of payroll outsourcing, you...
Caveats

- Not suggesting outsourcing for everyone
- Outsourcing/consolidation doesn't make sense for all
- Some inherently government activities aren't candidates
- Won't work without strong web-enablement
BART PERKINS

Look Before You Leap to Outsource

MOST MAJOR CORPORATIONS are considering outsourcing everything from the corporate cafeteria to IT and beyond. Outsourcing is often touted as an easy way to achieve more functionality for less money, with less aggravation.

But how do these deals allow a fair evaluation of your outsourcer equivalent to security breaches at your own company? You will be equally responsible whether your customers' data is promised, stolen or hacked at your site or the outsourcer's site. Your exposure and liabilities are significant.
Outsourcing: Buyers Still Calling the Shots (Part I)

Despite the problems at EDS, purchasers of outsourcing services are still driving hard bargains.
Alix Nyberg, CFO Magazine
February 11, 2003

Last fall, the outsourcing industry seemed poised for a tailspin. Drained by soured bets on its own stock, a drop-off in new business, and a crop of troubled existing customers (including the bankrupt U.S. Airways and WorldCom), Plano, Texas-based outsourcing giant EDS Corp. shocked Wall Street with its announcement that it would miss earnings targets.

Those troubles, combined with a credit-rating downgrade, meant it might become harder for EDS to get the cash needed to maintain operations for customers. And that prospect led some to speculate that outsourcing deals in general would no longer be as sweet as they once were.

"The market has seen what can happen when deals are unfavorable to the outsourcers, and companies will likely think long and hard about being aggressive in their negotiations," one analyst who follows EDS and other major outsourcers told CFO at the time. That EDS was renegotiating some of its worst-performing contracts, like the $6.9 billion U.S. Navy agreement, only heightened the expectation that outsourcing could get more expensive.

But a quarter later, consultants say EDS's financial problems have had little effect on the deals struck.
Web-enablement (E-government)

- Remote data entry and processing
- Smooth consolidation of several databases
- Remote user access
-Eliminates paper
- Same operation supports many users
The ABCs of ASPs

Should your financial management solution include an

By Robert Lavery

The emergence of application service providers, or ASPs, reminds me of the expression “everything old is new again.” Just as bell-bottom pants and platform shoes from the 1970s have resurfaced as fashion trends, ASPs (which grew out of the “service bureaus” of the ’70s) appear to be the latest fashion in technology.

Modern ASPs give customers Web-based software as an alternative to buying, installing, and maintaining more expensive internal systems. A few decades ago, prior to the introduction of the personal computer, hardware was expensive and software was difficult to use. Service bureaus provided access to mainframe systems and software on a time-share basis for companies that couldn’t afford to buy large computer systems.
Think ASPs Make No Sense? Think Again

BY JADE BOYD

Hype springs eternal in the Internet industry, but the negative backlash against unproven business models can be just as overstated as the initial exuberance. So it is with application service provision: Yesterday’s can’t-miss IT outsourcing model is today’s overt failure.

The arguments against application service providers are legion: They can’t adequately guarantee service levels or uptime; they can’t adequately secure a company’s application data from other ASP customers; most ASPs aren’t financially stable and may not be in business long.

Despite these valid concerns and the baggage the ASP acronym now carries, many customers are getting value from applications hosted by third parties and delivered over the Internet.

For example, although complex and company-specific manufacturing, supply chain and other enterprise applications might not fit the ASP model snugly, human resources apps such as payroll and benefits administration are flourishing in a hosted envi-
IBM readies apps on tap

Vendors adapting to evolving utility model

By Michael Vizard, Brian Fonseca, and Ed Scannell

Putting its heft behind an appetizing new business model, IBM will spend at least $4 billion over the next three years to transform itself into a first-tier player in the on-demand computer services market.

IBM executives envision a new set of Internet services that will provide access to applications under a usage-fee model more often associated with utility companies than with the computer industry.

Big Blue is not alone in its quest. The emerging market is expected to be worth $50 billion in three years, whetting the appetites of IT vendors galore, including EDS, Oracle, Sun,
Considerations

• Should your financial management shop have pain of one sort or another, look at outsourcing/consolidation

• When you get serious about it, have intense discussions with those who have "blazed the trail"—don't just listen to providers

• Once you've decided to transform, set realistic goals/schedules

• Recognize there will be frustrations
Predictable Surprises
Many disasters are preventable if you know how to spot them coming, says Michael D. Watkins, who wrote an article about the subject in this month's Harvard Business Review with Max H. Bazerman. Page 44

OPINION
Look Before You Leap to Outsource
Do your homework before signing on the dotted line, advises columnist Bart Perkins. Page 46

Breaking Outsourcing Boundaries
Forget following the conventional rules. Focus on the idiosyncrasies of your business. By Kathleen Melymuka

Continued on page 40
Forging a Partnership

But turning a large, troubled five- to 10-year outsourcing contract into a successful one requires that a client see both his and the vendor’s side of the equation. If the client can come up with an incentive for the vendor to renegotiate, such as a larger or longer contract, his chances of success are high, says Peter Bendor-Samuel, president and CEO of Everest Group Inc., a

How to renegotiate troubled relationships and live happily until a contract’s end. By Melissa Solomon

assigned to other IT work after it was outsourced, says Rideout. So he had the IT workers help draft a list of service levels and then explained that if the levels were met, those workers would need to stop complaining to both management and the outsourcer and let it. Structure’s employees do the work the way they saw fit.

Structure was pleased with the renegotiation because its contract, which was due to expire in a year, was extended for four more years, and the

OUTSOURCING Overhauls
Summary

• Outsourcing/consolidation is evolving—government financial management success stories are increasing
  • President's Management Agenda will speed it up
  • OMB initiatives are drivers—including drawing in other jurisdictions
Outsourcing Boom to Return in 2003, 2004

The slowdown in outsourcing projects in the second half of 2002 appears to have been temporary. Growth opportunities in outsourcing are expected to emerge in 2003 and 2004, according to a new report by Kennedy Information (publisher of CN.)

“The fundamental drivers that support adoption of the outsourcing model remained in place, and outsourcing is expected to outpace consulting and IT integration work by a healthy margin,” the report forecasts. The biggest driver is expected to be business process outsourcing projects.

EDS, IBM and CSC are positioned to remain the largest providers. Accenture can’t be counted out of the top pack, given that firm leaders recently said outsourcing would account for half of the firm’s revenue in a few years. Other large outsourcing providers include Affiliated Computer Services, Hewlett-Packard, Lockheed Martin, Perot Systems Corp., SAIC and Unisys.

Between 2001 and 2004, the compound annual growth of global BPO revenue is expected to be almost twice that of other IT outsourcing projects. Similarly, in the US, BPO will far outpace other IT outsourcing opportunities, according to KI’s report.
Questions?