

Challenges in Finance and Accounting Outsourcing of Indian Manufacturing Industries –An Overview

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Abstract

The present paper is an attempt to understand the various challenges faced by manufacturing industries for outsourcing of Finance and Accounting services. This is basically a conceptual paper and based on the secondary sources. The objective is to visualize the various difficulties that need to be taken care in case of outsourcing of accounting and financing departmental works.

KEYWORD- Finance & Accounting, Outsourcing, Manufacturing industry

An overview

The two major issues discussed about limited scope of outsourcing is Cost burden and Skill deficit.

While cost can be managed to some extent what requires mainly to be addressed is the Skill deficit. Lack of requisite skills for accounting staff results in higher cost of replacement and training in case of high labor turn over. That's where the outsourcing firm must come to the rescue with supply of adequate man power to address the skill gap and efficient execution of process. But this is not possible due to the skill deficit of outsourcing staff. The challenges are enumerated below:

Challenge #1: Requirement specification and design

Manufacturing sector encompasses a wide variety of industries and verticals. Each process in a manufacturing organization is a combination of various complex sub processes. The nature of complexity makes accounting treatment of routine transactions complicated which is unlikely in service sector due to the fact that the processes in service sectors are more or less standardized due to fewer number of complex sub processes.

Therefore thorough in depth analysis and careful planning is required along with coordination with all departments for requirement specification and design. For instance the payment term may vary from Advance payment to complex terms like part payments against bills after performance in different stages of a process which is common in all steel and cement industries. Preparing the requirement design is very difficult in this case where a thorough study of processes and technical acumen is required apart from commercial or accounting knowledge. Moreover in large organizations they have decentralized the accounting processes to various business units. Hence taking note of these processes for each business units becomes cumbersome and delays the requirement specification process. This will result in inefficient tracking of due diligence procedures which in turn may result in perceived dissatisfaction by customer after execution of the process.

The processes need to be identified as routine processes and strategic processes. In manufacturing set up there is a thin line between routine process and strategic process. The routine processes has to be identified which needs to be outsourced and strategic processes will be retained by the client.

These routine processes need to be identified with accuracy and separated from the strategic processes.

Challenge #2: Ambiguity in ROI calculation

There is always a need for correct estimation of costs and benefits. This is an important skill set required as huge difference between perceived costs and benefits and actual costs and benefits can give wrong calculation of ROI.

Quantification of costs for redeployment of internal resources as well as extra training and development needs is often difficult to calculate. In addition of costs all perceived costs and hidden costs to be taken into account. A difficulty arises in quantification of costs and benefits for change in qualitative attributes of a team before and after outsourcing. Similarly benefits for compliance within the timeline of reports after outsourcing has to be quantified accurately.

Greater operational efficiencies may result in greater satisfaction between different stakeholders, particularly customers and vendors. The satisfaction has to be expressed in numbers for calculation of ROI. Transformation from legacy processes to a paperless system is very time consuming and often expensive. For instance scanning of all invoices and POs and storing them in central database for all branches of the plant. Outsourcing firms need to take this cost into account. Difficulty in putting numbers often results in wrong estimation of costs and benefits and ROI calculation.

Challenge #3: Accuracy in Compliance procedures

The legal and regulatory environment is fast changing for companies with incorporation of new companies act'2013 and social responsibility accounting. The increased cases of accounting frauds and inappropriate disclosures has made compliance procedures more stringent and with need for large number of statutory reports and filing.

Proper knowledge of these regulatory environment for manufacturing sector as well as assisting the customer as a partner in 100% achievement of these compliances is essential to make manufacturers take initiative for outsourcing.

Manufacturing industries have to present a lot of reports and liaison with Excise, Customs and Sale Tax Authorities. Liasioning with these Govt Bodies is an area where the manufacturers may not be ready to go for outsourcing.

Challenge #4: Lack of Initiative for Outsourcing

Often large manufacturing units are traditional set ups with employees with traditional mindsets and cultural patterns. Hence this new trend of outsourcing may not be easily digested by them. Moreover with little exposure to outsourcing the employees find hard to believe that 100% commitment can be provided by the outsourcing firm. How can they deliver timely and efficient results being an outsider is often the question asked by the client while deciding about outsourcing.

The traditional mindset of the client often perceives that outsourcing may breach confidentiality and integrity of the organization if it goes for outsourcing. The resources may be perceived to be shared by the outsourcing firm to competitors. With little evidence of its value proposition outsourcing is feared by the client.

The greatest opposition for outsourcing may come from trade unions and labor relations department who perceive outsourcing to create a chaotic environment within the organizations. With outsourcing of routine jobs workers may feel loss of job security and feel unsafe within the organization. This is the reason why most PSUs find difficult to outsource so as to prevent dissatisfaction among labor and trade unions.

Small and medium enterprises often fear to go for outsourcing due to pricing issues and perception of more costs incurred than benefits for the organization. Outsourcing firms must look into all these critical factors before implementation.

Challenge # 5: Alignment with IFRS

The Ministry of Corporate affairs has announced the implementation of road map for adoption for new Indian accounting standards. The new accounting standard is closely aligned with International Financial Reporting Standards (IFRS). Even though this may prove beneficial in the long run for India Inc. to be more acceptable among global stakeholders in the short term it will create certain complexities. A survey conducted by Grant Thornton India LLP across pan India recently on adaptability of India Inc. to new accounting standards yielded the following results:

- Level of knowledge of accounting staff was low in implementation of new accounting standards.
- Transition to new accounting standard have not yet taken place and companies are yet to conduct an analysis on adoption of new standard.

The adoption of new accounting standard will not be applicable to banking, Insurance and non-banking financial companies. Hence for outsourcing firms to implement in manufacturing sector they must train their professionals to sharpen their skills in new accounting standards in a short span of time along with ability to conduct impact analysis for companies on adoption of new accounting standard. This is really a great hurdle for outsourcing companies to venture into the manufacturing sector.

Challenge # 6: Cost Estimation and Profitability Issues

Cost Accounting is needed in all areas of business and is of much importance in the manufacturing sector. In the Manufacturing set up the costs are complex combination of Fixed, variable, Direct and Indirect costs. Proper tracking of various costs associated with Raw Materials, Work – in – process and finished goods can give a clear picture of per item cost of production under different situations so as to properly analyze the minimum price of the products. These variety of costs are to be correctly allocated and traced as they have significant impact on the profitability of the enterprise. Hence a professional from outsourcing firm must be well versed in these aspects which are unique for each sector as each sector has a complex chain of processes.

Challenge # 7: Difficulties in implementation at start ups

Startup manufacturers have already incurred heavy costs in plant set up. Hence they perceive outsourcing as a costly proposition. Lot of new processes are to be built and standardized. Many of the Startups do not have a proper network infrastructure and data security is also an issue which they fear may be lost if companies go for outsourcing. Only a fraction of small business in India is Online.

Education and awareness to be provided by outsourcing firm personnel to prove the benefits in long run and improving productivity. These Start Ups should be motivated by outsourcing firm to remain tech savvy to enjoy the benefits of outsourcing with improved technology.

Challenge # 8: Difficulties in achieving and maintaining a Learning Curve

The learning curve for the BPO Industry has highly accelerated for telecom and banking verticals with development from being as call centers to rapid growth as strategic partners in the growth story of the companies. Skilled personnel have been trained on this front to align with the global standards.

The same learning curve has not been established in the Indian manufacturing set up due to lack of exposure in this vertical due to following prime reasons:

- Lack of growth in the Manufacturing sector coupled with stalled projects
- Complex processes and sub processes difficult to standardize and require improvements in processes
- Outsourcing firm needs to be cost effective as manufacturers have already incurred heavy costs along the value chain.

The personnel of outsourcing firm needs to be trained in these aspects so as to venture into domestic outsourcing.

Challenge # 9: Necessity of Innovation

Wage arbitrage will not work in domestic outsourcing unlike global outsourcing. Hence Indian firms need to update themselves on new processes which will simplify the processes and reduce costs. Outsourcing firm personnel if can train their staff on these issues for the manufacturing sector, the firms will be more driven for outsourcing.

Challenge # 10: GST Implementation challenges

The present government is planning to implement GST to move towards a common tax base and remove the cascading effect of taxes. Such a common tax structure will impact the supply chain distribution network. Thus manufacturers will try to make the supply chain leaner and for optimizing the supply chain. This poses a great challenge for manufacturers where they have to relook the business model and redesign the supply chain.

The vendor price negotiation contracts will also change. Manufacturers may also consider to relocate the warehouses and redefine the hub and spoke model. The following areas of accounting need treatment also:

- Impact of difference between GST Levy Date and Revenue Recognition date
- GST Reconciliation and stock transfer with accounting records

- Modifications in IT and ERP systems
- Changes in MIS reports

Specialized skills are required by accounting staff to be well versed in these areas as well as assist the company in redesigning the supply chain. Impact analysis has to be done on how the organization will adapt to new GST tax regime. All these require the staff to be skilled in performing the analysis.

Conclusion

The present paper tries to highlight the various challenges the manufacturing units facing the while outsourcing the finance and accounting outsourcing. It is very much important to understand these challenges before implementing the outsourcing option in the organization. It is also important to take care the issues related to confidentiality of information related to organization before outsourcings of the services are considered. The option will be benefited only when organization can able to handle the challenges.

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