Building
Tomorrow's Enterprise

Case Study

BPO Case Study:

Infosys: transforming Philips' shared service centers

Summary

This F&A BPO case study illustrates a number of aspects. It shows that:

- Infosys, then an emerging Indian FAO player, has been successful in competing with leading FAO providers to win a major FAO contract with a large continental European manufacturing company, Philips. For Infosys, this is by far the largest BPO contract to date, giving it a major multi-process F&A client reference and propelling it into the premier league of F&A services providers. The contract involved the acquisition of three near- and offshore shared service centers. The challenge for Infosys is to continually improve the performance of these centers and eventually generate further FAO business to ensure utilization of the centers to full capacity.
- These captive SSCs were expected to encounter future problems with staff retention and motivation. Infosys' approach to this is to better manage attrition e.g. through improved recruiting and training measures. A remaining challenge is to improve knowledge management and knowledge transfer. Higher levels of standardization reduce the effort for this because less process steps need to be documented and trained.
- Efficiency improvements can only be achieved if the client, Philips, accepts and adheres to higher levels of standardization for processing work. It is shown that this can be achieved more easily if a clear documentation for process pricing is available.
- Philips is not prepared to outsource customer-facing F&A services but, in parallel, is building an internal SSC with front-office activities in its countries of operation. These front offices form an interface between internal/external customers and Infosys.

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Background

Royal Philips Electronics ('Philips') is a global manufacturer of healthcare, lighting and consumer lifestyle products. Headquartered in the Netherlands, Philips has approximately 116,000 employees in more than 60 countries worldwide and generated revenues of €26bn in 2008. Within the group, Philips has 800 operating units.

In 2002, Philips had c. 6,000 F&A personnel and conducted a benchmark on the efficiency of its financial processes. The benchmark found that performance was good but comparatively expensive. The company then decided to develop a shared service center operating model.

Three captive SSC were launched in late 2002 and early 2003:

- Lodz, Poland, for European finance operations
- Chennai, India, for U.S. operations
- Bangkok, Thailand, for Asian operations

These centers were built from scratch. The personnel recruited for the SSCs work-shadowed and documented the process work over period of 1-2 years. By early 2006, all three centers were fully operational.

Philips separated blocks of finance processes and decided for each of those if they should be transferred to the SSCs or not, based on their suitability for offshoring. Only back-office processes (without customer contact) were to be conducted in the SSCs with the following shares transferred to the SSCs:

- 85% of accounts payables
- 65% of general ledger
- 25% of accounts receivables

The strategy was to reduce the cost of service in two steps: initially through labor arbitrage and in a second step, once the centers were up and running, through harmonization and optimization of processes and organization structure. As part of this strategy, Philips had created a detailed Process Charter: a statement of work describing key process steps and the responsibility for each of the process steps, between the SSC and the Philips sites.

Business Challenge

In 2007, Philips realized that a maximum number of processes that it considered suitable for near- or offshoring had been transferred to the SSCs, as follows.

- R2R: nearly all processes done in SSCs, except statutory accounting, statutory reporting and specific accruals
- O2C: partly in SSC, but a lot of work done onshore because was considered sensitive especially with regard to language (e.g. collections)
- P2P: almost fully conducted in SSC
- Inter-company accounting: almost fully done in SSC

Philips perceived that the cost savings to be gained from labor arbitrage had been achieved. Overall cost had been reduced by 20-30% for finance operations.

The focus was then to increase the level of automation and standardization to generate ongoing cost savings. Philips had tracked performance per process and found that the cost of its F&A services were still 38% higher than those of other global companies. While R2R and P2P costs where nearly in line with global benchmarks, O2C cost was high due to only 25% of processes having been moved to offshore. Moreover, Philips was encountering a number of problems:

- Career prospects for SSC personnel were limited and Philips experienced growing attrition. Initially, attrition was low at 3-5% but by 2006/7 had risen to 15%
- As a result of attrition, internal customers were increasingly unhappy with the services provided by the SSC. This was due to experienced personnel leaving and new recruits unable to service specific requirements
- Philips did not want to make a significant additional investment into the SSCs to bring those to the next level of development.

These reasons, together with an increasing pressure generally on the organization to reduce the cost for administrative tasks, led to Philips considering the sell-off of its SSCs to an external F&A service provider. Outsourcing its F&A operations had been considered a possible scenario already in 2002, however, at that time it was decided against for three main reasons:

- An outsourcing approach was considered too complex and risky
- The F&A outsourcing market was considered immature and Philips did not feel external service providers could match its requirements
- There was high internal resistance to outsourcing primarily due to a perceived loss of control over the F&A function
- Philips wanted to benefit itself from the cost savings achieved through labor arbitrage. 20-30% of cost savings have been achieved.

In 2007, Philips perceived that the risk of selling the SSCs to an external provider was limited and manageable because with the existing SSCs already in place and separated from the internal organization, Philips could assess and specify exactly what would be sold and which processes would be outsourced. Moreover, Philips considered the BPO market to be more mature, with references from comparable outsourcing initiatives available. Philips perceived that it would be able to find a vendor that could reliably take on its SSCs and provide an adequate service quality to Philips.

Supplier Selection

Once the decision had been taken to transfer the SSCs to an external service provider, Philip's M&A group dealt, helped by a third-party advisor, with the vendor selection, since this was treated similar to a divestment.

Initially, Philips invited 9 vendors to bid, including Capgemini, Accenture, Atos Origin, IBM and others. Selection criteria for the shortlisting of vendors included strategic fit, value offered, technology deployed, operational excellence, HR fit, cultural fit. In a second step, a shortlist of three vendors was drawn up, with Infosys the only Indian provider.

Philips then used 5 key selection criteria to assess the shortlisted vendors:

1. Process capability (e.g. technology background, client experience, potential for expanding the scope of F&A processes outsourced throughout the contract duration)
2. Strategic fit (e.g. corporate values, expected synergies, suitability of vendor location footprint for scope expansion)
3. Relationship (benefits of the deal as perceived by the vendor; flexibility of the vendor towards changing business requirements of Philips)
4. Deal structure (gain sharing arrangements, acquisition price, which aspects are in-scope/out of scope)
5. Financial strength (overall financial situation of the vendor, capability of the management team to sustain the company, experience with other large customers)

Philips selected Infosys for a number of reasons, which included Infosys'

- Strong IT background, especially for automation,
- Willingness to think about future set-up, e.g. develop an F&A platform
- Strong interest in the Poland delivery center with a clear plan of retaining the center and expanding it to a multi-client delivery center through moving lower level processes to India to generate further labor cost savings and thus freeing up space to service further clients from Poland. To alleviate Philips' concerns about service quality, Infosys offered to conduct this transfer of work to India under Philips' close supervision over a period of 2 years from contract start.
- Openness about the Infosys business case for this deal, illustrating that Infosys would benefit as well in that it could expand its F&A footprint and visibility significantly
- Strong experience in delivering services from India, which Philips considers a key location for future delivery
- Existing client references (with companies Philips considered as their 'peers') and the opportunity for Philips to speak to reference clients
- Agreement to Philips' request that Infosys could not change key staff (e.g. head of center, lead of innovation) in the centers without Philips' approval

Although:

- Philips had held some concerns about the cultural differences between a European company and an Indian service provider
- Philips had no prior relationship with Infosys, and,
- Another (Western) competitor could fulfill the criteria requested by Philips,

Philips selected Infosys for this large-scale contract.

The key reason for this was that Philips perceived a great eagerness at Infosys to close the deal. This gave Philips the impression that Infosys would give this deal great attention and that it would do its utmost to ensure that the partnership would be a success. Philips states that the price paid for the SSCs was not a decisive factor, but that the perception of a strong partnership approach was key to the decision to outsource to Infosys.

Transition

On 1 October 2007, the following numbers of Philips personnel was transferred to Infosys:

- 760 in the Lodz center
- 445 in the Chennai center
- 190 in the Bangkok center

F&A services to be provided by Infosys include:

- Accounts payable
- Accounts receivable
- General ledger
- Equity accounting
- Cost accounting
- Transfer filing
- Travel and expense management
- SOX planning and testing.

In addition, Infosys will provide some procurement transaction processing, mainly P-card administration and processing.

In terms of process activity:

- 620 are deployed on accounts payable processing
- 130 on accounts receivable processing
- 360 on GL activities
- 90 on procurement transaction processing.

In addition, a number of personnel are engaged on IT support.

Governance model

The contract has a detailed governance structure laid out with the Executive Steering Committee and the Innovation Board being key elements in driving the strategic partnership.

- Executive Steering Committee: bi-annual meeting of 3 leaders of Infosys BPO management and 1-2 leaders of Philips SBSF management to discuss key aspects of the relationship. Potential problems are identified through the regular creation of a 'health check' document providing a satisfaction rating by each partner on 15-20 key aspects of the partnership, e.g. operational service, governance structure, cost/tariffs, execution of business plan etc.
- Innovation board: bi-annual meeting between technology leaders from Infosys and Philips to discuss IT roadmaps and automation. With Infosys still working on Philips IT systems (SAP), these meeting take place to discuss and plan how Philips applications have to be changed/adapted in line with the harmonization/automation efforts done by Infosys. The partners are also planning common IT projects such as a future move to an Infosys platform for F&A service delivery.

- Operational level: formal monthly reviews take place between the SSC operations and sites.
- Frequent informal calls and communications happen on an ongoing basis.

A further important factor in the relationship is the fact that an internal retained organization has overall responsibility for the monitoring of customer satisfaction delivered by Infosys.

At the same time as the outsourcing contract started, Philips started to create an internal SSC, the Shared Business Services Finance (SBSF) group, comprised of 50 SBSF front offices (one in each country of operation) with a total of 1,100 personnel (of which a global team of c. 15 are based in the headquarters in Eindhoven). These front offices form the interface between Infosys and internal and external customers of Philips and conducts F&A activities not transferred to the SSCs, mostly O2C-related tasks such as collections, because they require customer contact, as well as language and country-specific know-how.

The contract with Infosys was one of the reasons for this structure, because it greatly facilitates the communication, with SBSF taking full ownership of the total service delivery. SBSF, with its country organizations, can help to conduct monthly performance reviews by country with internal clients. Infosys, in turn, is responsible for monthly KPI monitoring and reporting to Philips. This includes the monitoring of Philips' SOX compliance.

Results

The key objectives for Philips of the outsourcing arrangement with Infosys were:

Cost reduction

A guaranteed cost reduction of c. 20% over the 7-year contract duration is laid down in the contract. This is to be achieved through a number of ways:

- Harmonization, automation and standardization of processing tasks (see below)
- Further labor arbitrage by moving more processing work to India. Infosys has already transferred cash applications, manual invoicing and intra-company reconciliations work to to India, which in total comprises c. 90 FTEs. More are planned but targets for this cannot be communicated due to confidentiality reasons
- Move to transaction-based pricing model with prices for each transaction fixed per center for each year of the contract. This also creates visibility of prices for Philips controllers who can thus influence behavior to keep costs down. For example, knowing that an express payment processes by Infosys costs 50% more than a regular payment, controllers are less likely to use express payments unless strictly necessary. The move to transaction-based has been achieved as of 1 January 2009.
- Gainsharing mechanisms in new projects. These are projects where Infosys, for example, implements a new tool with support from Philips. Infosys would pass back the savings generated in the centers after having recovered the initial investment made.

As of mid-2009, Philips perceives that the cost reduction targets as laid down in the contract are well on track.

Cost variability

Philips aimed to gain a higher level of flexibility for scaling F&A processing activities up and downwards. This has been achieved through the move to transaction-based pricing. Within an agreed percentage range, Philips can benefit from price flexibility for reduced or increased transaction activity volumes. Volume changes outside the agreed bandwidth (e.g. in case of mergers or divestments by Philips) would imply a renegotiation of prices with Infosys.

Scope expansion

Philips is planning to transfer additional services to Infosys to benefit from lower cost processing. With currently c. 50-55% of its overall F&A processes outsourced, Philips is aiming to increase this share to c.80 by 2010. Areas that are considered for future outsourcing include:

- Controlling activities that can be based on rules, e.g. month-end closing, reporting, cost analysis
- Master data input (supplier/vendor information)
- VAT
- Customer query management
- Statutory accounting

Service improvements and service level reporting

A key objective of using a external BPO service provider was for Philips to achieve a more formalized way of measuring the performance of F&A processing and thus improve service levels. This has been achieved through the introduction of approximately 20 KPIs that measure correctness and timeliness of the Infosys service.

These KPIs include, for example:

- Number of supplier invoices paid in line with Philips payment terms
- Month end closure done on time
- SOX controls executed on time
- Number of balance sheets analyzed and cleared on time
- Accuracy of posting invoices (% of errors)
- Accuracy of cash applications
- Customer satisfaction

The KPIs are reported on a monthly basis and are provided on a business unit and/or location basis so that specific error sources can be identified.

The contractual agreements also lay down reverse SLAs, e.g. for SAP downtime or delayed provision of information from Philips controllers when required by Infosys.

The contract also stipulates fines/penalities for Infosys for non-compliance with KPIs.

Examples of service improvements achieved by Infosys include:

KPI	October 2007	July 2009
Timeliness of invoices processed	60%	99%
Timeliness of payment of invoices	80%	95%
Accuracy of invoice postings	95%	99.9%
Customer satisfaction	6.5 (of 10)	7.8 (of 10)

Leveraging technology

Infosys has been and is continuing to implement a number of technologies to increase efficiency. Examples include:

- Development of a vendor portal in which suppliers check the status of their invoice, thus eliminating the majority of supplier queries
- Implementation of Infosys' proprietary IGLS technology for general ledger workflow automation.
- Implementation of the third-party 'Winshuttle' tool for automated booking from a journal entry email into the SAP system. This tool is able to work across different SAP instances by routing automatically to the correct SAP code
- Implementation of an internal control tool that measures the status of harmonization. This is done through assignment and tracking of a harmonization rate for each process, in each region.

In the future, Philips is interested in benefiting more strongly from Infosys' experience of providing F&A service to other clients, and to be able to gain best practice know-how. In this area, Philips sees demand for further initiatives from Infosys to:

- Establish a structure within Infosys that enables efficient knowledge sharing among Infosys FAO clients
- Establish an expert team at Infosys that works to identify best practice across clients.

Staff retention and motivation

One of the key issues Philips aimed to improve through the outsourcing arrangement was to lower attrition levels and increase staff motivation. Under Infosys management, attrition has risen to 25-30%, however, Infosys is focusing on managing (rather than fighting) attrition. Philips recognizes Infosys' strengths in its highly efficient recruitment and training mechanisms. For example, Infosys provides 1-2 months training before a new employee takes on their job. Back-up training and internal job rotation enables quick replacement for leavers.

The problem that remains, however, is that knowledge management is as yet insufficient, making it difficult to train new staff adequately to fulfill specific service tasks. The objectives for Philips have therefore changed away from the staff retention issue towards more efficient knowledge management and a higher level of harmonization and standardization of processes which also make it easier to train new recruits.

Standardization

Philips identified in early 2009 that, in a fully standardized structure it would require only 350 work instructions for Infosys to fulfill all processing tasks.

Due to the existing lack of harmonization, Philips' specific country requirements and its fragmented SAP landscape, the company currently has c. 15,000 work instructions in place. The realization of this potential for efficiency improvements and resulting cost savings has led Philips and Infosys to work closely to develop and document highly standardized processes, thus eliminating exceptions. For Philips, a key task in this is to convince Philips employees to adhere to standardization.

In this drive for harmonization, Philips sees a major benefit from working with Infosys. While the captive SSC had not been proactive in driving harmonization and reluctance to adopt standardized processes had been high in the Philips organization, the company now perceives a change.

This is due to two reasons:

- Philips is keen to further reduce costs and the provision of price lists for F&A processing provides transparency on how standardized processing can reduce costs
- Infosys has an interest in standardization to reduce its cost of service delivery which it needs to achieve in order to fulfill the cost reduction targets laid out in the contract. Also, as processes are standardized, more work can be transferred to Infosys

Overall, Philips is highly satisfied with its partnership with Infosys. Philips perceives that the following three factors have been essential in ensuring success of this outsource arrangement:

- The contract has been drawn up with a high level of detail so that there is clarity on expectations. Most importantly, the contract includes details on aspects that could not be planned at the time of contract signing, but are still to be done within an agreed time period. Examples of such aspects are business continuity planning or risk mitigation which were to be finalized within 12 months. As a result of the clear formulation of these goals and the responsibilities of each of the partners, they could be achieved.
- The partners agreed in the contract that the pricing model was to be changed from FTE-based to transaction-based pricing by January 2009. This has been achieved.
- The clearly defined governance structure, with regular reviews and discussions, has ensured ongoing satisfaction in the partnership.

Outlook

Philips is keen to expand the relationship with Infosys. In addition to the scope expansion discussed above, Philips is looking for Infosys support with IT operations, as well as to help its expansion in emerging markets, notably Latin America.

Currently, Infosys is setting up a delivery center in Brazil to provide F&A processing services for Philips' Latin American operations. The center is to be operational with c. 100 FTEs by mid-2009. Philips has asked Infosys to build this center to avoid high business taxes (c.50%) that are incurred when servicing the Brazilian market from another country.

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