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Society of Certified Management Accountants of Sri Lanka

**Professional II Stage
March 2007 Examination
Case Study-CAS**

Instructions to candidates:

The Case Study (CAS) of March 2007 Examination comprises of two scenarios, **scenario I** and **scenario II** and the **Question** paper.

Scenario I is provided in this booklet and has information about the company and industry, on which the question paper will be based.

This booklet is **not** allowed in the examination hall.

Scenario II is a continuation of **Scenario I** and **Scenario I** together with **Scenario II** will be provided with the **Question paper**, at the **Examination**.

Question paper will be of **3 hours** duration and will have **one** question based on **Scenarios I** and **II**.

The Answers are tested on knowledge gained at all areas of CMA Syllabus and work experience.

Can-Do Office

Scenario I

Business Process Outsourcing (BPO) Industry

Outsourcing is contracting with another company or person to do a particular function. Almost every organization outsource in some way. Typically, the function being outsourced is considered non-core to the business. The outside firms that are providing the outsourcing services are third-party providers, or as they are more commonly called, service providers.

Although outsourcing has been around as long as work specialization has existed, in recent history, companies began employing the outsourcing model to carry out narrow functions, such as payroll, billing and data entry. Those processes could be done more efficiently and therefore more cost-effectively, by other companies with specialized tools and facilities and specially trained personnel.

Currently, outsourcing takes many forms. Organizations still hire service providers to handle distinct business processes which benefits management. But some organizations outsource whole operations. The most common forms are information technology outsourcing (ITO) and business process outsourcing (BPO).

Ever since the process reengineering wave of the 1990s, businesses have been looking at their core operations with an eye to cutting costs. Companies typically have three options: Consolidate and standardize operating processes via a shared-services strategy; upgrade the level of automation to reduce labour costs and boost productivity; or outsource the process to a third party that can offer economies of scale, global sourcing economics and access to more focused management.

Because organizational change is complex and often painful, automation can be a challenge. Hence a lot of companies have elected to jump straight to the last option and adopt a "business process outsourcing" approach. This can be a very successful strategy with the right partner—one who understands what you need, has an established capability to do the work, and can offer improved levels of service at a reduced cost. With some care over contract terms, you can have built in insurance against fluctuations in demand—both up and down—and turn a fixed cost into a variable. You may also be able to take capital assets off the balance sheet and replace them with a predictable operating cost related to business volume.

Although it doesn't make sense for everything, BPO works well for "undifferentiated" processes such as IT, contact-center operations, human resources, financial accounting, sourcing and even manufacturing. The best BPO providers can get more productivity out of your processes (and often your people) by better design and standardization, higher levels of automation, and better training and supervision. BPO providers also have access to a global labour pool that can take advantage of the best combination of labour rates, infrastructure and capital availability. Perhaps most important, if BPO is all a service provider does, it can build expertise in running a BPO operation on a local or global scale. That's not going to happen in the typical company, where nonessential, back-office functions will not get the most talented managers.

Business process outsourcing encompasses call center outsourcing, human resources outsourcing (HRO), finance and accounting outsourcing, and claims processing outsourcing. These outsourcing deals involve multi-year contracts that can run into hundreds of millions of dollars. Frequently, the people performing the work internally for the client firm are transferred and become employees for the service provider.

Some nimble companies that are short on time and money, such as start-up software publishers, apply multisourcing, using both internal and service provider staff, in order to speed up the time to launch. They hire a multitude of outsourcing service providers to handle almost all aspects of a new project, from product design, to software coding, to testing, to localization, and even to marketing and sales.

The process of outsourcing generally encompasses four stages: 1) strategic thinking, to develop the organization's philosophy about the role of outsourcing in its activities; 2) evaluation and selection, to decide on the appropriate outsourcing projects and potential locations for the work to be done and service providers to do it; 3) contract development, to work out the legal, pricing and service level agreement (SLA) terms; and 4) outsourcing management or governance, to refine the ongoing working relationship between the client and outsourcing service providers.

In all cases, outsourcing success depends on three factors: executive-level support in the client organization for the outsourcing mission; ample communication to affected employees; and the client's ability to manage its service providers. The outsourcing professionals in charge of the work on both the client and provider sides need a combination of skills in such areas as negotiation, communication, project management, the ability to understand the terms and conditions of the contracts and service level agreements (SLAs), and, above all, the willingness to be flexible as business needs change.

Today, Sri Lanka is one of the hottest destinations for any company which wants to outsource its business processes. Attractiveness of Sri Lanka can be

contributed to three basic factors - Cost, People and Environment. Sri Lanka is among a host of desirable nations in terms of cost (which includes employee cost, infrastructure cost, management cost and the tax structure). It beats most of its competitors on the people front as well. The people factor is evaluated on the lines of size of the job market, workforce education level, language barriers, past outsourcing experience and employee retention. When it comes to environment (which includes country risk, infrastructure, cultural compatibility, proximity etc.), however, Sri Lanka lags behind countries like Canada, Australia and Ireland.

The scenario however, is not as rosy as it looks, for this sector with enormous potential. Like any other industry during its growth phase, this industry is also going through its share of turbulence. The fact that the growth has been very sharp has added to its problems. However, all these ups and downs would help the industry in stabilizing and maturing. At least that's what experts and past experiences say.

The challenges of growth

Major challenges being faced by the BPO industry can be classified into internal and external challenges. The internal challenges include shortage of competent managers for the middle and senior management and the high attrition rates. The external challenge is in the form of opposition from the US politicians and the UK labor unions against shifting of the BPO operations by local companies to low wage economies. The threat of real competition from other players like India, Philippines also exists.

The fact that this industry is still in its nascent stage in Sri Lanka has led to the dearth of experienced middle management level team leaders and senior managers. Entry-level recruitment and employment has not been a problem with so many fresh graduates with good language skills, available readily in the job market.

The problem is more intense for the third-party outsourcing companies which have just ventured into this business. They cannot even invest in training, given their financial and other constraints. Captive BPOs like GE, HSBC and American Express, which are established players in the business, have no such problems. They in fact invest substantially in training their managers. However, they have been facing a problem of a different kind. Their middle and senior level managers are being poached by the new entrants to the industry. Reports say that large and established players face an attrition rate of 45% against the industry average of 24%. Everyone agrees that hiring from competition is a cyclical process and will not help the industry grow, but with very few options available, they resort to the easiest solution - poaching.

That brings us to the next issue - high attrition rates. Attrition means not only loss

of talent, but also includes the cost of training the new recruits. The attrition rate in the industry has been hovering around 24%, which is quite high for any industry.

An average South Asian call center employee works with a company for 11 months, where as an average UK call center employee stays in a company for 3 years. It is expected that the attrition rates would come down once the growth stabilizes. Steep growth is one of the reasons for the high attrition rates, according to many in the industry.

According to a survey by People-One Consulting, an employee leaving the organization happens typically in the first couple of weeks of joining. The reasons are many -- high stress levels, monotonous nature of the job, demand-supply disparity and lack of career growth potential on the professional front, loss of identity, mismatch with normal cycle, complete change of life style and lack of comfort on the personal front. Add to this, the 'poaching' strategy being adopted by the players in the industry.

To tackle the above problems, BPOs have been offering excellent infrastructure facilities in the form of ergonomically designed work stations and spacious, air-conditioned offices. They have been offering industry specific benefits like 24/7 cafeterias and home pick-up and drop facilities apart from regular benefits like loans at low interest rates. They have been arranging special weekend parties and offering incentives like tickets to exclusive music shows and dance parties. Some players are also sponsoring higher education of their employees. This is one of the best ways of retaining a skilled employee for 2-3 years within a company. The industry has been quite benevolent on the compensation front as well. All this really goes well with a typical employee, who is in his early twenties, fresh out of college and unmarried.

Another important area of concern is the limited growth potential for an employee in this industry. Organizations should concentrate on individual career growth of employees and succession planning in the organization. Planning for growth both vertically and horizontally can bring reprieve to the employees. Horizontal growth can be in the form of promoting the employee from simple to more complex processes within the organization. This will enhance the learning of the employee and make him "feel-good".

BPO industry is focusing on the process of brand building with a view to create respect and awareness of the job among the people.

Competition from India

At the turn of the millennium, India has numerous reasons to smile about. The economy is no longer passive and redundant. On the contrary it is one that is being steered by the winds of social and economic changes. During the past few years, the country has seen phenomenal developments in its political, social and economic infrastructure, accelerated by the strong forces of globalization and Information Technology. A country with a resurgent, progressive economy, India can be rightly called the foster-child of globalization

The booming Information Technology (IT) segment comprising ITES (IT-enabled services), BPO (Business Process Outsourcing) are the core sectors that have driven the country into the epicenter of change. The liberalization of the Indian Telecom sector in 1994 gave an unexpected boost to the ITES/BPO industry. In no time, India has turned into a hot destination for global offshore outsourcing companies. The expansion in this sector can be attributed to the leading IT giants, captive players and third party service providers, who dominate the Indian ITES/BPO market. While the countries around the world are vying for a fair share of the cake, India has grabbed the pie as the preferred destination for offshore outsourcing.

India became familiar with 'Business Process Outsourcing' only in the early and mid 1990's, but now the entire country seems to be quivering with the 'BPO fever'. The foreign direct investment (FDI) in the country owes a lot to this sector, which is progressing at a break-neck speed. The different kinds of services offered by BPO's include Customer Support, Technical Support, Telemarketing, Insurance Processing, Data Processing, Internet / Online / Web Research and so on. The cheap labour costs and the pool of skilled, English-speaking Indians have always been the two foremost factors contributing to the BPO boom in the country. As the National Association of Software Services and Companies (NASSCOM) points out, the other equally motivating factors include strong quality orientation among players, ability to offer round-the-clock services based on the country's unique geographic location, positive policy environment which encourages investments and a friendly tax structure, which places the ITES/BPO industry on almost equal footing with IT services companies.

The studies conducted by NASSCOM and the global consultants McKinsey & Co. brought to light certain amazing facts on the Indian BPO segment. According to a NASSCOM study, the country's flourishing ITES - BPO sector is estimated to have achieved a 54 per cent growth in revenue in 2003-04. A key employment - generating sector in the country, the BPO segment created job opportunities for around 74,400 additional personnel in India in the same year. By the year 2008, the ITES- BPO sector is expected to employ over 1.1 million Indians, with its sales expected to touch an amazing 21\$ to 24 \$ dollars.

Global BPO

Another major threat to the Sri Lankan Industry in future is from China, which has made English mandatory in schools and colleges. In another four to five years, China could pose a challenge in non-voice businesses, if not, voice based operations. Philippines understand US market better and have low attrition. But it has a small talent pool and more expensive than Sri Lanka. South Africa has a similar time zone to Europe, but there is a shortage of skilled staff. Mexico is 30% cheaper than US and has Spanish skills. But it is good only for low end jobs.

Can-Do Office

Can-Do Office Pvt Ltd was incorporated in Sri Lanka in 2003 by Ken Ukwatte and Aditya Rajaratnam. Ken was the Chief Operating Officer at a leading BPO company in Canada for 5 years, prior to starting this venture, Can-Do. Aditya was the Finance Director of the Sri Lankan Operations of a leading multinational company in FMCG sector. Can-Do started their operations with 10 employees and their initial project was to manage the back-office finance work of the Australian subsidiary of a Japanese Automobile company. Within two months of successful operations they managed to win another two contracts from UK.

Can-Do is specializing in financial accounting, management accounting, Tax planning, accounts receivable management and managing accounts payable.

As at end 2006, they have ten clients from Australia, UK, USA and Canada. They presently employ over 200 employees. Most of the employees are between the age group of twenty to thirty. 70% of the employees are students of CMA, CIMA, ACCA and ICASL. It has been observed that 50% of the employees leave after completion of their exams. Ken and Aditya are very concerned about this situation and are unable to take any steps to retain their employees.

Ken is the Chairman and CEO of the company, while Aditya is the CFO. Aditya manages Finance, HR, Admin and IT and Ken manages the Marketing and Operations. There are two eminent academics in the board, who are Professors or in Management at a local University. Capital financing is provided by a Development bank, who has nominated two non executive directors to the board.

Sanath Algama is the Vice President – Operations and supervises all on going projects. He was employed at another BPO company in Sri Lanka, as the Assistant Vice President prior to joining Can-Do. He maintains a close relationship with the operational staff. There are five Senior Managers who report to Sanath. Clients are grouped, based on Industry and each Senior Manager is handling a different industry.

Dave Kannangara is the Vice President Marketing and is involved in canvassing new accounts. He has just returned to Sri Lanka after 10 years of experience at

an Outsourcing Company in USA. He joined Can-Do in 2005 and manage to win three new large accounts within one year. He has a MBA from Stanford.

George Lankatilleke is the Human Resource Manager and joined Can-Do in June 2006. He is the fourth HRM of the company and the previous HRMs have left for better perks elsewhere.

Kumar Yarallagada is the IT manager of the company. He has been hired from India to manage the new ERP system introduced in the company. Can-Do is running on a Oracle based JD Edwards ERP system. In the recent past they are under pressure from their client to shift to SAP, as most of their clients run on SAP. He has four executives working under him and they work on shift basis. Can-Do operates on 24/7 basis and need to have an experienced in-house IT staff to troubleshoot any problems.

New Office

Can-Do was initially housed in a small office at World Trade Centre and as their operations expanded they have now moved to their own three storey building at Malabe. They managed to get a 10 acre crown land on lease hold basis from the Government and put up a large office complex. The new office complex includes a swimming pool, gymnasium, basket ball court, large cafeteria and library. They also have three buses for staff transport. Unlike other BPOs Can-Do offers better working environment with conformable rooms, furniture and fittings.

Training

They do send employees on overseas training, where the employees will be placed with the overseas clients for a period of one month. They will be exposed to world class business practices during their training. Only employees who have completed 3 years with the company are eligible for overseas training. Selection of staff is at the discretion of the management depending on the commitment, attitude, and efficiency of the employees. However the management has reduced the overseas training during 2006, as two of the employees sent on training to USA in 2005 have not returned back to the country. This has resulted in Visa problems for the company with the American Embassy in Colombo.

Can-do is also tied up with an Outbound training company and they train an average of 20 employees per month. They have been trained on confidence building, mutual trust, team working, stress relief and implanting the core values of the company. This training was really effective and improved the staff motivation.

Sexual Harassments

In the recent past female employees who work on night shifts have complained to the senior management that they have been sexually harassed by their supervisors and other male colleagues. As a result female employees are

reluctant to work on night shift and Can-Do is facing a problem in replacing their skilled female employees.

New Entrant

One of the Senior Managers, Krish Roche has resigned from the company in October 2006 and started his own BPO operations. He has also taken with him one of the largest client of Can-Do and five skilled employees. Employees have been offered 50% higher salary than what they were getting at Can-Do. Ken and Aditya were shocked about this issue and had a meeting with Roche requesting him to join back Can-Do and they will promote him as a Vice president with better perks. Roche has requested two weeks time to decide on the offer made.

SoftLine

Aditya called for an urgent meeting on 20th November 2006 and submitted a new proposal to acquire SoftLine. SoftLine is a BPO based in Chennai and has over 300 employees. Through a friend of his, he has got to know that the shareholders of this company are looking for opportunities to sell their shares and exit from the business. They are specializing in outsourcing Payroll and HR services to 15 companies in four European countries. They have a turnover of over USD 10 Million with a net margin of 3%.

Financing

DFCC Bank has financed Rs 100 Million at the interest rate of 13% for construction of the new office building at Malabe. Repayment of capital starts in 2007. Their working capital is financed by Standard Chartered at a floating rate of 2% over SLIBOR.

PE ratio of the BPO industry is at 12 and cost of equity of Can-Do is 15%. Treasury bill rate in India is 40% lower than Sri Lanka. Can-Do uses an exchange rate of 1 USD = Rs 103 for foreign currency translation.

Shareholding

Can-Do remained as an unlisted company and its shareholdings as at 31st December 2005 is as follows;

	In Rs. Million
Ken Ukwatte	10.0
Aditya Rajaratnam	7.5
Nihal Fernando	15.0
Employees	<u>2.5</u>
Total	<u>35.0</u>

Nihal Fernando is a strategic investor of the project and he is the father-in law of Ken. He is a multi-billionaire and has substantial investments in trading, transportation and export businesses. He is planning to retire from all his

businesses and transferring all his investments to his son, who is presently studying at Wharton School of Business, USA.

Pay-per-Job

Dave came out with a new project, 'Pay-per-Job', in the last board meeting. Under this project Can-Do need not employ any staff permanently. All what they need to do is develop a network with few skilled people, to whom specific tasks will be assigned and payment will be based on the hours spent in the project. Time allocation is based on a standard time frame set by Can-Do, based on the size of the job. This 'home –working' system works well in many countries mainly among housewives who prefer to work from home. They are not demanding like other employees and may work at 40% lower wage than the permanent employees of the company. There are many undergraduates who may also like this job. They will be getting experience, earn money and apply their theoretical knowledge through this 'pay-per-job' scheme.

Appendix 1

Can-Do Office Ltd's Profit and Loss account

	Year ended 31/12/05 (In Rs Million)	Year ended 31/12/04 (in Rs Million)
Turnover	1,500	1,300
Operating cost	<u>1,000</u>	<u>900</u>
Gross margin	500	400
Overhead	200	180
Interest	20	8
Tax	<u>98</u>	<u>74</u>
Net Profit	182	138
Dividends	<u>100</u>	<u>100</u>
	<u>82</u>	<u>38</u>

Balance Sheet

	As at 31.12.05 (In Rs Million)	As at 31.12.04 (in Rs Million)
Fixed Assets	150	60
Current assets:		
Debtors	272	185
Cash	<u>25</u>	<u>10</u>
Total	<u>257</u>	<u>160</u>
Total assets	<u>447</u>	<u>255</u>
Share Capital	35	35
Retained Profit	247	165
Long term Loan	100	
Current Liabilities:		
Accruals & creditors	25	20
Bank OD	40	35
Total liabilities	<u>447</u>	<u>255</u>

End of Scenario I