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Offshoring Accounting Services: New opportunities for developing countries

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Abstract: The aim of this paper is to explore the viability of off-shoring of accounting services to foreign companies by providers of such services located in Republic of Macedonia. We have assessed the potentials of accountants in Republic of Macedonia to offer off-shored accounting services by using the criteria for assessment of outsourcing destinations in general as established by the McKinsey Institute. We have founded that there is considerable potentials for off-shoring of accounting and related services. Exploitation of these potentials would result in significant contribution to the accounting profession development and the employment of young graduates in accounting. In these terms, we offer some practical recommendations to the profession and to the policy-makers for further promotion of this business opportunity

Keywords: Accounting Services, Outsourcing, Off-shoring, Accountants

JEL codes: M14, M16, M41

1. Introduction

Companies today operate simultaneously in many countries worldwide and consequently need to employ accountants with international accounting knowledge. In addition, the off-shoring and near-shoring of selected accounting activities is becoming increasingly attractive option for many of them pursuing

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greater competitiveness. Therefore, the accounting profession worldwide is developing towards much broader interdisciplinary knowledge and towards variety of skills. The accounting information systems development, the globalization of the accounting services and the international standardization of the financial reporting are the primary factors of changes of the accounting profession that need to be adequately tackled by the formal education and by the lifelong training of the accountants.

The market for off-shore-based Financial and Accounting (F&A) services is improving despite a very challenging economic environment according to Sahni *et al.* (2012) expecting the worldwide F&A services market to grow from US\$27 billion in 2010 to \$38.45 billion in 2015.

Stark *et al.* (2011) recognized the offshore services industry as opportunity for developing countries by offering increased employment in service jobs, facilitating the entry of these countries into the knowledge economy, and providing access to new markets. Everest Group (2014) considers Central and Eastern Europe (CEE) as one of the leading delivery in Finance and Accounting because of availability of multi-lingual and highly qualified finance talent, close cultural ties with Western Europe and North America, proximity to western markets, and favourable business environment.

In the latest A.T. Kearney Global Services Location Index, nine countries from the CEE region are among the 40 top destinations for global offshoring (Appendix One). The index is made up from three categories: Financial attractiveness, Skills' availability and Respective business environment.

The McKinsey Global Institute (2012) new growth model for CEE countries identifies the outsourcing (off shoring) as one of the three major opportunities for CEE-nations to raise both the volume and the value of their export. The Report underlines the need of targeted investments in education and development to capture more high-value-added O&O work will require, as well as, engaging in international marketing efforts and sharing best practices in the industry. Outsourcing is expected to grow regionally, aided by the financial crisis in Western Europe, which is pushing companies to shift some expensive functions to the east of the continent (Cienski, 2013). The developing countries should consider this off-shoring service opportunity in their strategies for growth.

In Europe, countries such Poland, Czech Republic, Slovakia, Hungary, Romania and Bulgaria are also well-known destinations for offshoring various business services, holding app. 8% share of the global off-shoring market. In Poland, these services expansion outpaced the rest of Central Europe and grew three times faster than in India (McKinsey Institute, 2015). Aided by the financial crisis in Western Europe, outsourcing is expected to grow even further, pushing companies to shift expensive functions to the east of the continent, claims Cienski (2013). Forbs

indicated on Romania as the next most convenient destination for procurement of outsourced accounting services (Păvăloaia, 2011).

This trends provide an opportunity for developing countries like Macedonia that possess or can develop considerable competitive advantage on the global market of off-shoring accounting and related services. Macedonia, due to its economy small size, is not on the offshoring landscape and in the focus of the consultant companies' assessment of the countries where the companies may decide to locate offshore operation. Therefore, in this paper we have examined the potential of Macedonia to offer offshore services by employing the criteria established by McKinsey Institute. Cattaneo and Walkenhorst (2012) have recognized international relationships, language ability, and professional expertise, and access to a quality communications infrastructure being important factors of the level of outsourcing opportunities for accounting firms and we agree with. They have stressed the significance of the knowledge of international accounting standards and consequently the need of certification through the International Organization for Standardization, as well.

In this paper we have analysed the capacity of Macedonian accountants to provide services to clients outside the country. We apprise off-shoring of selected accounting activities as attractive option for developing countries like Macedonia. Therefore, we analyse the position of the accounting profession and its qualification to develop considerable competitive advantage on the global market of off-shoring accounting and related services and we implement our findings in a SWOT diagram. Consequently, we have offered several propositions to the profession and the policy-makers in the same line.

2. Literature review

The off-shoring is not new activity but it has become increasingly sophisticated over the last few decades, according to Kwacz *et al.* (2013). In their study they describe the evolution of off-shoring over time which has started by sending operational processes abroad, predominantly manufacturing tasks. The second wave from 1990s related primarily to contact centres and information technology support, initiating the services off-shoring stage. And the third one relies more heavily on high-value and complex tasks, such as research, product and design development, and programming. Ives (2013) have recognized even six generation of business process outsourcing evolution: starting from financial, accounting and HR services through back and middle office to everything as a service.

Gal (2014) indicates two aspects of service exports as a new channel to growth – specialization within service exports, and the sophistication of service exports. His

analysis suggests that increasing sophistication of services is positively related to growth. Blinder (2007) analyses the impact of outsourcing on a wide spectrum of jobs and predicts that it will become a major phenomenon in the oncoming decades, and even postulates that it could be on the same level as a “new industrial revolution.”

Based on the transaction cost economics, Ellram *et al.* (2007) findings confirm that low transactions volumes for offshore outsourcing of services are unattractive because of the high upfront fixed cost of the administrative and set-up costs. However, it partly supports the premise that organizations are less likely to offshore outsource services with high asset specificity and that firms are less likely to offshore outsource items when they are unsure of the requirements or when they cannot determine whether the supplier actually performed as agreed to in the contract.

Farrell *et al.* (2005) indicated on the further liberalization and on the improvements in the information technology as contributors to the decrease in the perceived risk of operating abroad and on the shortage of labour in developed countries as main factors for outsourcing to the low-wage locations, offshore. Mishra *et al.* (2012) found positive relationship between the quality of the business services in a given country and its growth performance. They stress that the increases in the sophistication of the business services provide valuable foundation for sustained economic growth. Moreover, the offshore services are recognized as potential vehicle for low and middle-income countries to participate in the global knowledge economy. These services offer attractive compensation and career development opportunities for graduate professionals in these countries. Hence, these services are important, not only for employment, but for the creation of additional demand for education, business formation and higher level of consumer services in these countries, too (Stark *et al.*, 2011). These countries additionally benefit by adopting policies that increase the value-added of these services, improve productivity, eliminate obstacles to sophistication in many related service activities and promote service export performance (Mishra *et al.*, 2012).

There is consensus among the researchers and the organizations that the developing countries, in general, should consider the introduction of offshoring accounting in their search for viable strategies for growth. The availability of appropriate human capital and adequate knowledge and skills are the key prerequisites for that, according to UNCTAD Global Services Forum (2013). However, Kwacz *et al.* (2013) added some additional factors, when ranking emerging economies as providers of offshoring services, such as their overall business acumen and the type of the leadership.

Stark *et al.* (2011) expect the established trend in offshoring to continue, explaining it by the persistence and further intensification of the labour shortages in the

developed economies, while the wage differences between the countries are likely to persist. Admittedly, the emerging economies will likely remain the most desirable sites for offshoring, because of their large, young talent pools and their lower wage costs. Greater investment in education, coupled with shortages of qualified talent in developed countries, will continue to constitute critical advantage for the emerging countries, they claim.

While studying the outsourcing in the accounting industry, Daley (2008) stated that the firms have positive experience with the new service offering due the variety of the available services and the decreased prices. Furthermore, the online “portals” which enable the outsourcing of accounting become much more secure and the workflow software has grown increasingly user-friendly, efficient, and cost effective, claims Daley (2008). Professional service firms, according to Sako (2014), are outsourcing providers and also users of outsourced services and they may to acquire a larger or a smaller segment of the market depending on the successfulness of their playing of the intermediary role.

According to Daley (2008), the phenomenon of outsourcing has engulfed the entire accounting industry and now offers wide range of services, starting from bookkeeping, accounts payable, debt collection, billing and invoicing, ending with complex tax returns preparation. Cienski (2013) considers countries of central Europe as most attractive providers, since they are in the EU and thus share common legal code, have well-educated population, fluent in many languages, while the labour costs are still less than in the case of the other countries of Europe. He argues that, while the labour rates remain significantly lower in India, China and Philippines, the European offshore destinations by sharing same culture and the time zone with the major European business centres, are still the best candidates for the higher-valued “near shoring” arrangements and investments. This is in line with Bunyaratavej *et al.* (2007) finding that differences in wages might not be the only factor that firms use to consider offshoring of their services and that the education and the cultural distance are important factors determining the location of offshore services activities.

A study of the European Union apparel sector concludes “labour costs, along with geographical and cultural proximity are the most important reasons for the original choice of a given country as a processing partner” (Baldone *et al.*, 2001). In line with this approach, distance, promptness in delivery and flexibility in organisation of production are important variables in choosing the off-shoring location (Evans and Harrigan, 2003). Sass and Fifekova (2011) consider availability of skilled labour with strong language skills, low costs, favourable business and stable political environment, well-developed infrastructure and geographical and cultural proximity to Western Europe as favourable factors for the Central and Eastern European (CEE) region to become a business service offshoring and outsourcing destination.

Despite the belief that the service industry is promising opportunity for the CEE economies, Gal (2010) states few threats concerning the region's future prospects as major offshoring centre. According to him, the size of the talent pool is still limited to the CEE region, (2) the population is limited and fragmented, (3) the providers are more attached to the local market instead of seeking out the global market and (4) the bureaucratic environment.

Stark *et al.* (2011) suggest that the policy makers in the case of the countries providers, while evaluating their workforce development policies should consider the rapid evolution and the high competitive nature of the outsourcing industry, calling for much more in-depth understanding of the workforce profiles needed for these higher-level services. Moreover, the skills and the qualification of the workforce effectively determine the point of entry and the market potential for growth of these the host nations, claim Stark at al. (2011). They also suggest combined institutional approach and collaboration between the business, public authorities and education sector in narrowing the gaps between the demand and the supply of labour able to meet the global standards of these services.

According to the McKinsey's Global Institute Report (2012) the offshore talent pool exceeds that of the high-wage countries by a factor of two. Only Russia has almost 10 times more finance and accounting professionals than Germany, for example. However, only 13% of this talent supply from the low-wage nations is suitable to work for multinational companies. The lack of appropriate language skills, the inability of the educational system to convey the needed practical skills and the lack of cultural fit and readiness for high workload and flexible working hours are the main reasons for that situation. Even so many researches indicate that the university graduates from the Eastern European countries are well suited to work for multinational companies the mentioned skills will remain to be the essential prerequisites for offshoring of the advanced business services. Even in the case of the countries in which education provides modern skills, according to Stark *et al.* (2011) the majority of the workers still need extensive on the job training to meet the high-quality standards required for serving the global market.

3. Methodology

The methodology used is based on a desk research of the documents from government agencies, independent institutions and financial agencies, universities and other educational institutions and relevant journals. We also use database of the State Statistical Agency of Macedonia for the number of the registered accountants and the amount of their salaries or declared income.

To assess the potential of the Macedonian accountants to offer offshore services we have used the criteria for evaluation of outsourcing destinations as established by

the McKinsey Institute: (i) the cost savings, (ii) talent pool, quality of providers, (iii) language skills and (iv) cultural and market proximity. We have examined the cost savings by comparing the salaries in Macedonia with those in other CEE countries. We have assessed the talent pool by reviewing the accounting educational programs and the language skills and assess the cultural “proximity” of the country. We have used the Eurostat data of Foreign language learning statistics to evaluate language skill of Macedonians. Results of the survey are presented in suitable S.W.O.T country analysis.

4. Evaluation criteria for accounting services off shoring

The institutional framework

Republic of Macedonia has accepted the International Accounting Standards for large and medium-sized companies in 2005. Since 2012, even the micro companies and the sole proprietors have to keep their accounting in accordance with the related International Standards. The institutional framework for the accounting, auditing and the reporting system in Macedonia was established when the Institute of Chartered Auditors in 2006 and the Institute for Chartered Accountants in 2012 were inaugurated. These two institutions are now authorized for certification of the auditors and accountants and for continuing training of the certified providers of these services. Other accounting professional associations that were established meanwhile are the Association of the accountants of the Republic of Macedonia and the Chamber of the Accountants.

The cost of the accounting services

In 2014, in the sector of Administrative and support service activities, there were 1,067 registered entities, with 17,769 employees, who turned app. 220-million-euro revenue. The payroll cost was 70 million euro, or each worker cost app. 4,000 euro (State Statistical Office, 2016). Comparison with the other countries shows that Republic of Macedonia would be cost competitive destination for offshoring. As it can be seen from the Table 1 in the Appendices, accountants are less paid only in Philippines and China.

The quality of providers

The Law for the Accounting Profession, adopted in 2012, imposed the basis of the development of the accounting services by regulating their licensing, examination and continuous professional training. Certification is undertaken in the interim by the Ministry of Finance, which has issued certificates to some 12,000 accountants and certified accountants, of which 9,000 are temporary certificates (World Bank, 2014). The 2012 Law on Accounting Services improves regulation and the knowledge and skills level of accountants in Macedonia. The Law on Accounting Services defines the roles of the institutions, the licensing framework (the

knowledge and skills and the examination) and the two categories of certified professionals, Accountant and Certified accountant. The Table 1 lists the Law requirements for accountant and for certified accountant professional.

Table 1. Requirements for accounting practice in Republic of Macedonia

| Requirement | Accountant | Certified Accountant |
|-----------------------------|---|--|
| Education | Four Years High School | Baccalaureate in business or economics |
| Exam Training | Required 90 hours in last three years, minimum 20 hours in last year | Required 120 hours in last three years, minimum 30 hours in last year |
| Prior work experience | No | at least three years in accounting |
| Entitlement for endorsement | Sole proprietorships, civil associations and foundations | All types of business entities |
| Legal form of operations | Sole Proprietorship | Company |
| Minimum headcount | One Accountant | One Accountant and One Certified Accountant |
| Professional insurance | 2,000 to 5,000 euro | 20,000 euro |

(Source: The authors own work based on the Law on Accounting Services)

Talent availability

Republic of Macedonia has a relatively well-established system of education. With the transition from the previous socialist system into free trade economy, Republic of Macedonia constantly upgrades the system introducing various business and entrepreneurial courses in the curricula at all levels of education and all types of schools. The high school education is compulsory. The number of enrolled high school students in 2014/15 was 83,522. The number of the university students in 2013 reached 56,094, and 9,166 graduated that year (MAKSTAT, 2016). Both private and public schools are allowed. There are several foreign high schools and universities and many students from Republic of Macedonia study abroad. The institutions of higher education (there are twenty accredited) provide various courses in accounting at undergraduate and graduate level. The universities in the country offer basic accounting course as part of economics and business administration degrees and advanced courses dedicated for accounting and auditing majors. The number of students in the business school in 2013 was 8,473, out of which 1,344 or app. 16% enrolled in accounting and auditing programs (State Statistical Office, 2014). Accounting subjects offered cover foundation, intermediate and advanced accounting, financial reporting, international accounting, managerial accounting and auditing. The syllabi incorporate key aspects of international accounting and financial reporting standards and ethics. However, the quality of the delivery varies in a very broad range with the

reputation of the school and the skill and experience of the teachers. Although, there is a new generation of educators who slowly change the paradigm, somehow the state universities still put forward and value memorizing before critical thinking. On the other hand, private universities foster new standards of teaching and emphasize skills of the students, but they are doing that by downplaying the formal knowledge of the profession.

We surveyed the publicly declared programs of the six best ranked universities in Republic of Macedonia, as merited by the Ministry of Education. We used the ratio between the accounting courses and the total load with undergraduate subjects as a proxy for the perceived “importance” of the programs in accounting. In five of the universities that load was 2/30 or 6.67% and in one 3.37%. Five of the surveyed institutions offer accounting and auditing undergraduate degree, with 30% of the total load in case of one university, 13% in case of two, and only 10% load in the other three. Information Systems for Accounting or any kind of training in computerized accounting (Quick Books or similar) are not offered by any of the surveyed institutions. However, the institution that currently does not offer such undergraduate specialization plans to offer it from the next academic year. They will collaborate and align with the requirements of the Association of Chartered Certified Accountants (ACCA) as widely recognized and reputable professional organization. We conducted several interviews with professors involved in delivery of accounting subjects. They stress that due to the so-called Bologna Process their students practically lack one full undergraduate year of schooling, which means that the Introduction in business is omitted, putting extra pressure to the professors who teach Principles of accounting. Moreover, since the intermediate accounting is also omitted students while still struggling with the basic concepts have to wrestle with the complicated issues of financial accounting. As a consequence, they tend to develop hesitation to the accounting and auditing programs and generations of business graduates in the Country are almost entirely focused on marketing, human relations and other soft skills and the pool of potential candidates for accounting and auditing graduate degrees is very limited.

However, due to the low population growth and the high emigration, Republic of Macedonia also shows depopulation and shortage of workforce. The low wages are not attracting young graduates to stay at home. Open borders drive them towards the regions of Europe that pay much more for educated workers. The emigration rate among young graduates is app. 22% or every fifth young graduate leaves the country. This issue might turn critical for the aspirations of Republic of Macedonia to offer a suitable destination for offshoring of accounting and the related services. The other critical issue is the quality of the potential providers and the common perception of their establishment and integrity as accounting professionals.

Cultural and language issues

Some of the common disadvantages of the workforce of the so-called ex-communist countries, like the lack of the proper attitude to the work and lack of internal drive, loose discipline and commitment are present in the case of the workforce in Republic of Macedonia, too. However, the lack of proficiency in foreign languages, at least in the case of English, with the young generations is practically eliminated. According to Eurostat (2016) all pupils in primary education in Macedonia learn English languages and near 55% of Macedonian students learn two or more languages in upper secondary education.

5. Presentation of the findings in S.W.O.T. Matrix

We present our findings from the evaluation of the criteria of the potential of Republic of Macedonia in offering offshored accounting services in the Table 4 in form of S.W.O.T. Matrix.

Table 3. SWOT- Analysis of the Republic of Macedonia as Outsourcing Destination

| STRENGTHS | WEAKNESSES |
|-------------------------------------|--|
| Relatively educated workforce | Weak work culture |
| Good proficiency in English | Weak professionalization |
| International standards implemented | Lack of widely recognized certifications |
| Very competitive salary ran | |
| Advanced ICT infrastructure | |
| OPPORTUNITIES | THREATS |
| Good location (time-zone) | The economic crisis in EU |
| Conducive Government Policy | Political instability in the region |
| Large diaspora worldwide | Potential shortage of work force |

6. Conclusions and recommendations

Accounting and the related services, like payroll were not traditional domain of offshoring. Only the second wave of outsourcing added advanced services based on high-value and complex tasks such as accounting. Offshoring and nearshoring today offer wide range of services from simple bookkeeping, accounts payable, debt collection, billing and invoicing, up to tax return preparation. Countries of Central Europe are attractive nearshoring destinations, since they share the common legal environment with the rest of the European Union; people are fluent in English or German, while the wages are still considerably lower. Offshoring of business services are increasingly recognized as potential vehicles for many other

low and middle-income countries interested to participate in the global knowledge economy. These services offer attractive compensation and career development opportunities for graduate professionals in these countries.

Research shows that the sophistication of the business services, including the accounting, provide valuable foundation for sustained growth. These emerging economies will likely remain desirable sites for offshoring, due to their large, young talent pools and the lower cost of the labour. Greater investment in education in the emerging countries coupled with the shortage of qualified talent in the developed countries will continue to constitute the critical advantage of the emerging countries. Consequently, the policy makers in these countries should foster creation of new generations of workforce able to cope with the challenges of these new outsourcing. The availability of the workforce will determine the ability of a given country to tap the market of outsourcing of advanced services like accounting. However, the talent pool is limited since just 13% of it in low-wage nations has appropriate language skills. The educational systems fail to convey practical skills to students and there is lack of cultural fit and readiness for high workload and flexible working hours. Having all of this in mind, Republic of Macedonia should also consider higher involvement in this growing world marketplace. The Country has accepted the International Financial Reporting Standards for all accounting entities starting from the micro companies and sole proprietors up to the companies listed at the Stock exchange.

Analysing the strengths, weaknesses, opportunities and threats we can conclude that Republic of Macedonia is relatively well located (same time zone) and has large diaspora that can serve as Agent Bridge between the providers and customers. Policy makers should comprehend the full potentials of the offshoring of accounting services. Republic of Macedonia should learn from countries like Poland that is a leader among all CEE countries in taking advantages of this trend. The country just recently started to recognize the full potential of the services in general for the employment of its higher educated workforce. The contribution of the services in the GDP reached 9.8% in 2014 (State Statistical Office, 2016). Due to the higher prices of the services relative to manufacturing, this drives up the productivity in the country. In addition, these services require much lower capital investments, do not pollute or harm the environment as the traditional industries were doing for decades. Regarding the education, only 16% of business students are enrolled in some accounting and auditing program. Only one university tries to align its program in accounting and auditing to the requirements and standards of ACCA as reputable professional organization.

Recognizing this, the recommendation to the policy makers and to the professional associations would be to include better coverage of accounting in the business schools, combined with stricter professional education and licensing, additional foreign languages, better communication and improved ICT skills and knowledge.

The accounting associations should consider introduction of some widely recognized professional designations and certifications in parallel with their national certificates. The move will add value to the national certificates and will make Republic of Macedonia recognizable destination for offshoring of accounting and other related services.

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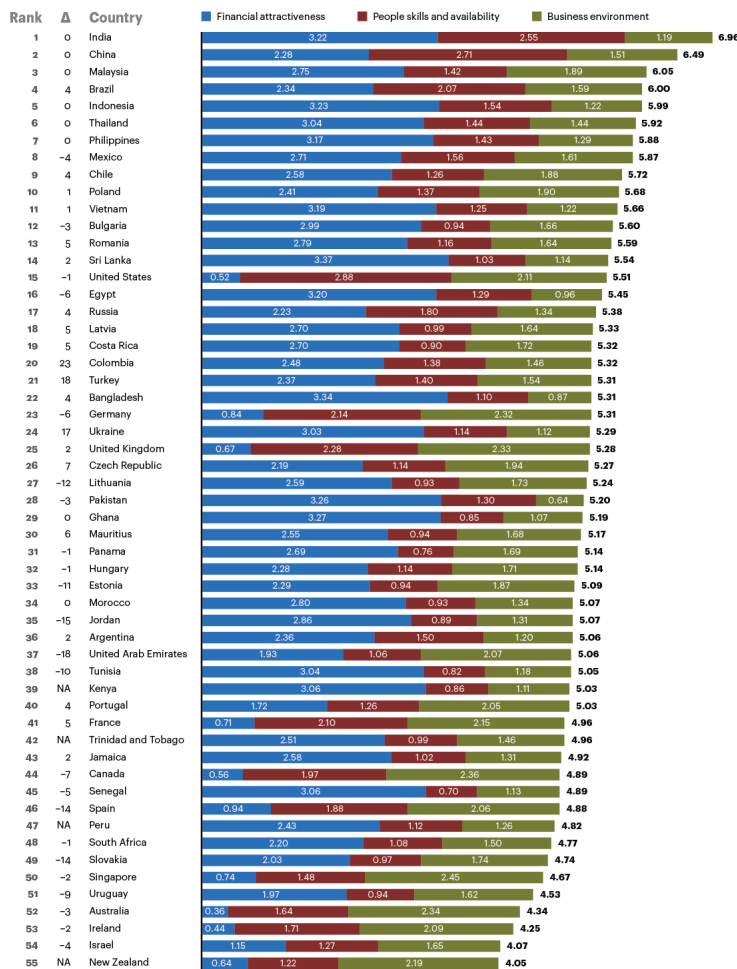
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Appendices

1. Top countries in Outsourcing in 2015



(Source: Kearney - The 2016 Global Services Location Index)

2. Average Gross and Net Salaries (Income) of Accountants

| Country | Gross | Compulsory Deductions | Net |
|----------------|-------|-----------------------|-------|
| U.S. | 3,370 | 22% | 2,629 |
| Finland | 3,308 | 38% | 2,051 |
| Germany | 2,977 | 34% | 1,965 |
| Korea | 2,789 | 14% | 2,399 |
| Italy | 2,785 | 37% | 1,755 |
| Kuwait | 2,697 | 0% | 2,697 |
| Australia | 2,578 | 20% | 2,062 |
| Canada | 2,352 | 32% | 1,599 |
| Austria | 2,179 | 36% | 1,395 |
| Singapore | 1,682 | 22% | 1,312 |
| Portugal | 1,553 | 23% | 1,196 |
| Brazil | 1,351 | 20% | 1,081 |
| Hungary | 1,136 | 45% | 625 |
| Taiwan | 1,111 | 10% | 1,000 |
| Czech Republic | 928 | 29% | 659 |
| Mexico | 831 | 15% | 706 |
| Latvia | 709 | 29% | 503 |
| Slovakia | 646 | 22% | 504 |
| Thailand | 621 | 6% | 584 |
| Poland | 617 | 35% | 401 |
| Romania | 597 | 33% | 400 |
| Lithuania | 493 | 31% | 340 |
| Macedonia | 377 | 25% | 283 |
| Philippines | 278 | 16% | 234 |
| China | 165 | 8% | 152 |

(Source: www.worldsalaries.org/accountant.shtml and makstat.gov.mk)