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Understanding Finance and Accounting Outsourcing Adoption among SMEs: Evidence from Bangladesh

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Abstract: The objective of this study is to explore the determinants of adopting finance and accounting outsourcing (FAO) services by small and medium enterprises (SMEs) in Bangladesh using the theoretical lenses of Transaction Cost Economics (TCE) and Resource-Based View (RBV). Data were collected through fifty semi-structured interviews with firms and their SME clients and analyzed using thematic analysis. Results suggest that cost efficiency, access to expertise, firm size, and technological readiness influence their FAO adoption. Respondents from SMEs also expressed concern regarding data privacy and firms' legal legitimacy. Therefore, economic, operational, and institutional factors combinedly determine the FAO adoption decision. This study contributes to the literature by providing contextual evidence from an emerging economy where research on FAO adoption remains limited. Therefore, this study has practical implications for firms, SMEs, and policymakers, providing insights for strengthening policy support and trust mechanisms to facilitate sustainable FAO adoption.

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INTRODUCTION

Businesses generally have internal F&A department to support resource management and performance measurement. However, in SMEs, F&A functions often remain at a basic level, generally combining cash and accrual accounting approaches (Seman et al., 2019). They face difficulties in financial management due to limited economic and institutional resources to support F&A functions internally (Kamyabi and Devi, 2011). Due to these limitations, they face hurdles in generating timely and reliable financial information for effective managerial decision-making. As a result, many SMEs are increasingly relying on specialized accounting firms to manage F&A activities (Dimitriu and Matei, 2014). This growing dependency portrays the strategic significance of outsourcing F&A functions.

In FAO, firms manage all or part of a business' F&A functions. These services include forecasting, payroll processing, billing, bookkeeping, asset management, and financial reporting etc. (Ibrahimova-

Guluzada, 2017). FAO enables SMEs to modernise operations with access to technology and professional expertise. It transforms traditional internal accounting structures into externally managed modern processes. FAO can lead to reduced operating costs, core competency focus, expert involvement, and improved financial management, but also may reduce innovation, confidentiality, and control (Egiyi, 2020; Gyamera et al., 2023). However, SMEs lacking F&A expertise are increasingly adopting FAO as a strategic managerial practice for financial management (Nyathi et al., 2018). The emergence of cloud-based technologies enables more flexible and real-time arrangements for FAO (Al-Okaily et al., 2022).

Multiple factors may stimulate SMEs to outsource their F&A function. Literature suggests that FAO adoption decision may result from complex interactions among economic, institutional, and technological factors rather than a single dominant driver. Although cost reduction remains important, core competency focus and access to expertise may also play equally significant roles (Kamyabi and Devi, 2011; Hafeez and Andersen, 2014; Asatiani et al., 2019). SMEs regard outsourcing as a strategic tool for competitive advantage rather than merely a cost saving mechanism (Kumar and Eickhoff, 2006). Additionally, the adoption of the FAO/cloud-based accounting system improves SMEs' decision-making and communication performance (Al-Okaily et al., 2022).

FAO adoption shows regional differences in adoption patterns and growth. North America and Western Europe lead in adopting FAO due to the high cost of employing accounts staff and high compliance requirements. Western European businesses adopted a hub-and-spoke model to outsource F&A functions from Eastern European centers to meet the compliance needs (Kakabadse and Kakabadse, 2002). The Asia-Pacific region has emerged as a major FAO hub due to its cost advantages. Firms in this region are initially rendering transactional services, such as bookkeeping and payroll, but are also moving toward higher-value services (Nicholson et al., 2006; Maelah et al., 2012). Studies indicate that SMEs globally are gradually adopting FAO, facilitated by cloud computing and Software as a Service (SaaS) models.

Prior studies in the international context on BPO/FAO includes Bryce and Useem (1998) on the impact of corporate outsourcing on firm value, Duganier (2005) on FAO for business control, Nicholson et al. (2006) on the control of outsourced accounting in India; Desai (2007) on the disclosure regulation recommended for FAO; Everaert et al. (2008) on transaction cost economy of accounting outsourcing; Ray (2009) on the importance and mitigation of expectation gap of FAO; Desai and McGee (2009) on the effects of SOX in FAO; Kamyabi and Devi (2011) on the resource-based view to interpret FAO adoption by SMEs; Prawitt et al., (2012) on the risk of fraud in internal audit outsourcing; Aman et al., (2012) on transaction cost economics for offshore FAO decision; Brandas et al., (2015) on the cloud approach of information systems outsourcing; Bagieńska (2016) on the key factors for FAO development in Poland; Cullinan and Zheng (2017) on FAO and audit lag; etc.

FAO adoption is largely motivated by skill shortages and cost pressures in emerging markets. However, the factors in emerging economies may also differ from developed markets (Adekoya and Ojediran, 2024; Islam and Sobhani, 2010). In the Bangladeshi context, few studies are found, which are Askari et al. (2015) examining problems and prospects of IT and IT-enabled outsourcing in Bangladesh; Islam and Sobhani (2010) on the determinants of outsourcing decisions in Bangladesh; Hossain (2017) on the prospects and challenges of outsourcing in Bangladesh (not specific to FAO), etc. However, these studies offer limited understanding of how economic, institutional, and technological factors influence FAO adoption among Bangladeshi SMEs.

The Bangladeshi context is a unique choice for this study for several reasons: (1) it ranks lowest in South Asia in the 'Ease of Doing Business Index' (World Bank, 2020); (2) SMEs in Bangladesh contribute to 99.92% of the economic units and 78% of the Employment (Mohiuddin, 2026) – however, 65% of them remains informal and 50% do not have access to computers or internet (near 100% SMEs in India, Brazil, and Vietnam) (World Bank, 2023). These challenges for SMEs in Bangladesh make the Bangladeshi context unique to study the factors contributing to FAO adoption, which requires policy support and technology. Therefore, the objective of this study is to examine the determinants of FAO adoption by SMEs in Bangladesh. To achieve this objective, the study addresses the following research question:

RQ1: What are the economic, institutional, and technological factors that influence FAO adoption decisions among Bangladeshi SMEs?

LITERATURE REVIEW

This study uses TCE and RBV to explain why businesses decide to outsource their F&A functions. These theoretical perspectives are useful in understanding the outsourcing behaviour by SMEs with limited resources and a rapidly changing environment. TCE theory was developed by Coase (1937) and further advanced by Williamson (1985). It explains business' outsourcing decisions through the lens of cost comparison of a function between internal and external arrangements.

According to TCE, businesses choose to outsource when the costs of performing a function in-house exceed the costs of externally. Costs such as negotiation, monitoring, and enforcement, along with the direct financial costs, are considered while making such a decision. Furthermore, TCE highlights the roles of asset specificity, environmental uncertainty, and transaction frequency in shaping outsourcing decisions (Williamson, 1985). SMEs with the above-mentioned attributes are more likely to adopt FAO to enhance flexibility and reduce governance complexity.

The RBV complements TCE in explaining why businesses may outsource their functions. RBV offers a capability-oriented explanation for outsourcing decisions. It explains that businesses can achieve a competitive advantage by capitalizing on valuable, rare, and inimitable resources internally (Barney, 1991). However, SMEs often face constraints in developing such resources internally. As a result, outsourcing becomes a strategic mechanism to access external professional expertise. They can also get access to advanced technologies and high governance standards that are unavailable within the firm (Barney, 1991; Hafeez and Andersen, 2014).

Outsourcing allows SMEs to focus on their core activities and delegate non-core functions, such as finance and accounting activities, to specialized firms. It enhances operational efficiency by focusing on core business activities and improves financial reporting quality to support improved strategic decisions. According to RBV, outsourcing is not only about cost efficiency but also about organizational capabilities that are difficult to develop internally. Although TCE and RBV explain outsourcing decisions from different angles, they can be used in understanding FAO adoption.

Prior studies on FAO focus on various organizational contexts. Some businesses experienced failure, and company managers also have complaints about the drawbacks of FAO. However, it reduces operating costs and enhances shareholder value. Existing literature suggests that FAO adoption improves efficiency and has strategic implications. Businesses can enjoy scalability, flexibility, and cost savings by outsourcing accounting services (Bryce and Useem, 1998). Transaction costs remain crucial while deciding whether to use offshore FAO (Aman et al., 2012). Transaction costs are minimized in the contact, contract and control stages of F&A operation if the service is outsourced (Nicholson et al., 2006).

The financial performance of SMEs is positively influenced by FAO (Gyamera et al., 2023). FAO services rarely weaken SMEs' internal control, rather improve governance and compliance quality (Duginier, 2005). Entrepreneurs often receive high-quality services, financial management consultancy, tax planning, and other additional services, which make them prefer FAO (Bagieńska, 2016). Similar factors were found by Islam and Sobhani (2010) in Bangladesh. These findings indicate that SMEs adopting FAO are driven not only by cost considerations but also by improved service quality and governance.

Beyond these benefits, prior research also examined key determinants and barriers of FAO adoption. From TCE perspective, businesses are more likely to outsource when internal production costs exceed external contracting costs (Williamson, 1985). Businesses are also influenced to adopt FAO depending on their asset holdings (Kamyabi and Devi, 2011). Businesses with higher assets are less likely to adopt FAO, and this likelihood is stimulated by industry competition, trustworthiness, and policies. Additionally, firm size, expertise, and age can be significant.

In Malaysia, SMEs are outsourcing their F&A operations due to significant cost savings and avoiding the economic burden of in-house F&A functions **(**Jayabalan et al., 2009; Barrar et al., 2002). This supports the TCE argument that outsourcing decisions are influenced by cost considerations and resource limitations. Although, findings from Tomašević et al. (2023) shows that SMEs preferred external providers for F&A even though there was a 20% increase in their prices. This indicates that factors other than cost saving may also play important roles.

SMEs in Malaysia adopt AI in F&A function when it is easy to use, receive management support and subject to legitimacy pressures (Zandi et al., 2019; Lim and Seng, 2024). The COVID-19 pandemic prompted many business firms to adopt cloud-based accounting systems. For example, SMEs in Jordan are motivated by performance expectations, social motivation, management support, organizational readiness, and suppliers' support during COVID-19 to use e-accounting (Al-Okaily et al., 2022; Saad et al., 2022). Similar factors were found to be significant by the study of Tawfik et al. (2022) in Oman, but Thottoli and Ahmed (2021) found IT costs to be insignificant in the Omani context. Rather, IT risks, IT skills, and employee knowledge emerged important. Thai SMEs were also motivated to adopt cloud-based accounting during COVID-19 due to efficiency, accessibility, accuracy, and compatibility (Sastararuji et al., 2022). Lebanese SMEs are driven to use FAO due to the competitive environment and accounting competence (Mahboub, 2021).

From an RBV perspective, SMEs often lack the financial and human resources required to maintain high-quality accounting functions. So, FAO adoption is motivated by business firms' need to access specialized knowledge and capabilities (Kamyabi and Devi, 2011). In Indonesia, SMEs rely on FAO due to asset specification, environmental uncertainty, required competence, and competition survival (Cahyaningtyas and Ningtyas, 2020). The implications of FAO on audit, compliance, and control have also received attention. Prawitt et al. (2012) mentions manageable risks even if the internal audit function is outsourced. Moreover, the external audit function is strengthened when the auditor is involved in internal audit activities. This study was an important step toward increasing the legitimacy of FAO.

However, the privacy of sensitive accounting data is an ethical issue in outsourcing decisions (Brandas et al., 2015). FAO can also result in audit lags (Cullinan and Zheng, 2017). Receiving FAO services may also drastically alter the scope and character of a company's accounting operations (Desai and McGee, 2009). The audit and compliance arrangements regarding FAO is also influenced by the Sarbanes-Oxley Act (Desai, 2007). Furthermore, the perceptions of SMEs receiving FAO services and service providers are explored in Ray (2009), which points out the possibility of an expectation gap. These findings from prior studies holistically suggest that business firms' outsourcing decisions are a combination of economic, institutional, ethical and technological considerations.

Most studies examine these factors in isolation or within specific contexts. This creates a gap in understanding how cost, capability, and technological drivers jointly influence FAO adoption, particularly in the developing economy context of Bangladesh (Hafeez and Andersen, 2014; Asatiani et al., 2019).

METHODS

Research Design

The objective of this study is to examine the determining factors influencing FAO adoption by Bangladeshi SMEs. To achieve this, an exploratory research design was adopted, suitable for developing an understanding of the complexity of decision-making process, human perception, and other contextual factors. To do that, semi-structured interviews were conducted with personnel from the specialized accounting firms and their SME clients involved in FAO in Dhaka. A qualitative approach was preferred in this study to get in-depth insights into the contexts, motivations, and practices. A semi-structured interview approach was selected to obtain deeper insights into respondents' perspectives and maintain consistency. Dhaka was selected as the study location because it is the capital and commercial hub of Bangladesh. The SMEs are scattered across the country, but the SMEs that adopted FAO and the FAO service providers are mostly concentrated in Dhaka.

Sample and Participants

A criterion-based purposive sampling approach was undertaken to identify respondents with substantial knowledge and direct experience with FAO. Managers of the firms and SMEs involved in outsourcing decisions were selected as respondents. Active engagement of firms as service providers and SMEs as active clients are the inclusion criteria for firms and SMEs, respectively. This approach enables the inclusion of respondents who can provide experience-based insights. The client SMEs were identified

using the snowball technique, as they are difficult to identify directly from a database and are typically connected through service-provider networks. A total of fifty interviews, comprising twenty-five service provider firms and twenty-five client SMEs, were conducted. The sample captures perspectives both from firms and SMEs to reflect both supply-side and demand-side dynamics. Recurring patterns across interviews suggest the thematic redundancy. Data collection continued until no major new themes were observed. A series of pre-formulated interview questions was presented to participants face-to-face and over the phone, depending on their availability. Each interview lasted approximately 20 minutes. Respondents were assured of the confidentiality of their responses and their voluntary participation.

Interview and Data Collection

The author formulated a questionnaire suitable to explore answers to the research question from the interview conversation. This study used the theoretical lenses of TCE and RBV, and the prior FAO literature, to formulate the questionnaire. The questions covered the cost, operational, and institutional attributes of the SMEs. A separate sheet was maintained for each respondent to note down their responses. Detailed notes were taken of each interview.

Data Analysis

Thematic analysis was used to identify common themes and insights. A hybrid thematic analysis approach using deductive reasoning was adopted. The deductive approach used the analytical lens from theories to identify themes. TCE supported the identification process of the cost related codes, while the RBV theory was used to focus expertise, capability, and technology. Additional issues emerging from respondents' narratives were also coded contextually. The data analysis followed a systematic process of note consolidation, coding, grouping codes, and developing themes. First, the authors carefully reviewed the interview notes to develop initial familiarity. Then, initial codes are assigned to common ideas and themes were developed using common codes. Finally, TCE and RBV were used to interpret the themes.

RESULTS AND DISCUSSION

After careful analysis of the interview responses, the results reveal that determinant factors of FAO adoption are similar to findings in prior literature. However, the findings also provide context-specific insights into how these factors function within Bangladeshi SMEs.

Economic Factors

The most significant factor behind FAO adoption by Bangladeshi SMEs is cost-effectiveness. Respondents from client SMEs unanimously mentioned that expenditures for the F&A function, ERP/AIS, materials, and HRM are significantly higher if these activities are managed in-house. In an SME, at least two to three personnel are required to manage accounts, which costs between BDT 70,000 to 100,000, whereas managers of service provider firms mentioned that they can provide the same service between BDT 25,000 to 30,000 for an SME.

A manager of Shopway, a wholesale and retail-based SME, mentioned:

> *"*Managing the finance and accounting operations in-house is a mammoth task in terms of cost and effort that we wanted to pass that on to a specialized firm. After outsourcing, we get timely services at a lower cost than managing it by ourselves."

A manager at ACE Advisory, a specialized service provider, discussed the cost-effectiveness from their perspective. His discussion involved:

> "Generally, at least two people are required to manage the finance and accounting-related activities in an SME for effective bookkeeping. Sometimes, it is even higher if other activities need to be managed. The salaries of professional accountants are high and become a burden to the SMEs. If they outsource it, we can use our human and technological resources to serve multiple businesses at the same time, which brings cost effectiveness."

Since F&A are the core operations of firms, they can manage to maintain cost effectiveness (economies of scale) while providing this service. This finding can be interpreted by the TCE theory that SMEs may arrange external arrangements of a function if they can reduce overall operational and governance costs. This finding is also consistent with prior studies that businesses can avoid high operating costs and economic burden of an in-house function if they outsource (Barrar et al., 2002; Jayabalan et al., 2009).

Along with the functional cost of F&A, participant responses focused on the transaction costs. These are the expenses incurred during the inquiry, data collection, bargaining, deciding, and law enforcement phases (Nicholson et al., 2006). According to respondents from firms, the transaction cost to avail FAO is negligible in Bangladesh. The pricing of the outsourced service is competitive and depends on the size/volume of transactions. Little bargaining is required, information on firms is readily available, and the contracting cost, monitoring, commission, banking, and legal fees are minimal. As a result, SMEs can easily and quickly outsource their F&A services.

A manager of APSIS Solutions Limited responded:

> *"*What do you need to outsource your F&A services? Information is available on firms' websites about their services and resource persons. If you can choose one, it is just a matter of a basic contract and formalities. We can make the onboarding journey easy and flexible for our clients. Besides, access to our software can make monitoring easy for clients."

Respondents from SMEs confirmed the advantages of lower transaction costs during interviews. A manager of Bunon Kutir Limited, an Argo-based SME, opined:

> "The onboarding process was easy. After we made the decision, relevant information on these firms was available. I also collected information from my peers. When I made a choice, it was just a matter of a meeting and a few paperwork."

Everaert et al. (2008) support this finding from the TCE perspective. According to them, SMEs have in-house system to support frequent F&A activities, but cares to outsource the less frequent activities, such as year-end reporting or tax return etc. The study of Nicholson et al. (2006) support the same finding of lower transaction cost.

Institutional Factors

For medium-sized companies, keeping in-house F&A operations can be cost-effective, but expertise can be a deciding factor. Managing in-house F&A operations means that SMEs need to comply with all relevant laws and regulations (GAAP, IFRS, Tax and VAT, Payroll, etc.). All these fields are specialized and require expert knowledge. Maintaining the required level of expertise for these specialized fields can be difficult for them, as they need to hire and train individuals incessantly. Firms have expert personnel for this task as this is their core operation.

A manager of Harriken, an e-commerce and tech SME, responded:

> "Finance and accounting regulations are complex. What is not there? Accounting rules, tax rules, VAT rules, and other regulatory compliances. We had medium-skilled in-house personnel before we opted for FAO. However, we could not be satisfied. Besides, we could not develop/buy accounting software. However, after the outsourcing decision, everything just fell into place. Now, we have access to software where we can see our financial standing anytime."

A manager of Enroute International Limited discussed the expertise issue from the firm's standpoint. He revealed:

> *"*Professional accounting is not the cup of tea for everyone. You can hire personnel to manage F&A activities, but expertise can be an issue. As specialized firms involved in F&A services and handling financial matters of a wide variety of clients, personnel working here become experts. Under the supervision of certified accounting professionals, they can handle the F&A activities of a firm more efficiently than anyone. SMEs can also get consultancy on tax planning and process improvement from us.

The RBV interprets this matter because, according to this theory, businesses outsource to access specialized knowledge and capabilities that are not available internally. SME entrepreneurs and managers

may not be competent in accounting rules and guidelines (Tomašević et al., 2023). Managers of client SMEs mentioned that managing a skilled in-house F&A department requires collaborative organizational efforts, which is a reason why SMEs are opting for FAO. In addition, SMEs can avail a range of services, such as financial management and tax accounting, when it is outsourced (Bagieńska, 2016). It also allows focusing on core business activities and outsourcing finance, bookkeeping, and consultancy. Therefore, the findings suggest that not only cost efficiency but also access to expertise are drivers of FAO adoption. However, firm size is also a major institutional factor, according to the respondents. Bigger companies have the tendency to keep an in-house F&A department, whereas smaller companies tend to outsource it. Similar results are found in Everaert et al. (2008) where they found higher asset specificity of bigger companies to be negatively associated with accounting outsourcing.

Respondents from client SMEs mentioned their ethical concern about confidentiality and data security, like the findings of McGee (2005) and Maelah et al. (2010). Access to financial data by outsiders is a concern for many of them about confidentiality breach and loss of competitive advantage. However, respondents form firms ensured strong ethical and legal fundamentals of professionals in this matter. Extensive regulations and penalties for misconduct are the safeguards for the clients, they ensured. However, clients necessitate the need for a 'Data Protection Act' as an added legal safeguard to mitigate the confidentiality concern. This highlights the role of perceived risk and trust in outsourcing decisions. Along with cost and expertise, institutional trust and legal environment are significant factors for clients.

Furthermore, many firms in this sector are not registered as chartered accountancy firms and skip the surveillance of the the Financial Reporting Council. Professional and regulatory bodies shall arrange for a certification to legalize and validate their presence in the market and to build a bridge of trust between these firms and clients. Annual ratings can be given to firms to categorize the quality of their service. It will improve trustworthiness and create a control mechanism. These findings suggest that institutional support and regulatory mechanisms are also important for strengthening trust and facilitating wider adoption of FAO in emerging markets.

Technological Factors

The respondents mentioned that IT infrastructure is a significant determinant for SMEs to decide whether to outsource the F&A function. It becomes difficult for SMEs to bear the cost burden of F&A function due to their relatively small revenue figure, although the nature of F&A activities can be similar. Along with size, the SMEs must have a basic IT structure to facilitate data sharing, storage, and analysis. In many instances, much of the outsourced F&A services are conducted and monitored remotely, so remote access by cloud-based storage and systems is necessary. The findings further indicate that technological readiness enables outsourcing arrangements.

A manager of Frontdesk Bangladesh Limited cited in the interview:

> "According to our experience, the propensity of outsourcing F&A services is higher in small businesses than in large companies. It is the structural nature of SMEs which probes and enables them to avail FAO. There can be a misconception that a huge investment is needed for having an IT infrastructure to outsource F&A services. However, it is a similar setup you may need for an in-house F&A department with good internet and software compatibility."

A manager of Bamboo Craft, a manufacturer of products from bamboo, shared her insights on the IT infrastructure:

> "I had an attitude that outsourcing the F&A services would cost a big investment in IT until I finally implemented it. In my experience, every Bangladeshi SME can now afford the basic IT structure required to subcontract their F&A activities to specialized firms. It is not a large amount."

CONCLUSION

This paper examines the determinants of FAO adoption among SMEs in Bangladesh. This exploratory study collected data from semi-structured interviews with firms and clients to understand the factors affecting the adoption of FAO by the SMEs in Bangladesh. The interviews conducted with the

accounting firms and their SME clients reveal several interrelated determinants that influence SMEs to outsource their F&A activities.

Firstly, keeping an internal accounts department can be a cost burden for SMEs. As a result, they are highly motivated to outsource the F&A function to attain cost efficiency. SMEs usually outsource to minimize the costs of a business function. Secondly, even if SMEs may have an internal F&A function, finding and managing experts in this field can be a material challenge. However, F&A being the core competency of firms makes their employees experts at these activities, which leads SMEs to outsource this competency. In this way, SMEs can also focus on their core business activities. Therefore, it can be deduced that SMEs in Bangladesh decide to adopt FAO by considering both cost and capability considerations.

Thirdly, finding an FAO service provider and receiving their services does not require SMEs to go through a complex and costly process in Bangladesh. The ease and availability of the services make it suitable for SMEs to seek FAO. This suggests that lower transaction costs reduce barriers to outsourcing decisions. Lastly, the size and IT structure of SMEs were found to be significant from interview responses. Size relates to cost-effectiveness, and small-sized businesses struggle with the cost burden. Along with size, the IT structure is important as a minimum level of IT structure is necessary to initiate and enable SMEs to get FAO.

Besides these determinants, the author found important insights regarding the confidentiality and legal legitimacy of firms, and respondents also called for suitable solutions to these challenges. Legal framework of the service and confidentiality are two significant factors that SMEs consider before adopting FAO. In many instances, many SMEs in Bangladesh never adopted FAO due to trust and confidentiality issues. The study also indicates that TCE and RBV are complementary to each other in explaining outsourcing behaviour among SMEs.

This study provides practical implications for all firms and SMEs involved in FAO. It provides evidence on the determinants of adopting FAO and benefits the parties involved. SMEs will be able to identify the key factors that may prepare and lead them to adopt FAO. Besides, firms will also have information on the factors to enable them to attract more SMEs adopting FAO. The study is also relevant to policymakers in developing regulatory frameworks and certification to strengthen institutional trust.

The author identifies two limitations of this study. Although the sample provided sufficient thematic insights, a larger sample could further enhance the generalizability of the findings. Furthermore, numeric data analysis is missing. Therefore, future studies can employ a larger sample size and quantitative or mixed methods to validate and extend the findings of this study.

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