

SOLVING THE PROBLEMS OF GLOBALISATION

by Aengus Murphy, Chairman, FTI

IN BRIEF

Over the past five or so years, business has become truly global – mainly through a spate of mergers and acquisitions across the world. This globalisation of business has brought many management problems, not least in the finance and treasury functions of the new global groups.

In this article, Aengus Murphy describes the treasury solutions to these problems, and outlines the role of treasury centres and the key factors affecting the decision on where to locate them. The current trend of outsourcing treasury management functions is examined, and the author gives some practical advice on how to set up a successful outsourcing operation.

Mini case studies show what treasury functions have been outsourced by three recent treasury clients of his company.

FTI is an independent, specialist financial consultancy firm, with a focus on treasury management. It has four main business areas: corporate treasury consulting, systems and products; national (state) treasury management consulting, systems and products; outsourced corporate treasury management services from its base in IFSC; general financial consulting and corporate finance, systems and products.

The firm is owner managed with a permanent professional staff of 30. Web: <http://www.fti-treasury.com>

Expansion and globalisation have dramatically changed the face of business and given rise to the need for new treasury solutions for US MNCs in particular.

A MERICAN companies have expanded aggressively into Western, Central and Eastern Europe, the Middle East and the Far East. Far Eastern companies, if less aggressively, have expanded across Europe and into the US, and European companies have been vigorously expanding in both directions – east and west.

This great expansion or globalisation has dramatically changed the face of business in the US in particular. Huge US-based multinationals with extensive foreign business generated by exports, operations owned overseas, or a combination of both, are now commonplace. (See chart 1.)

Many of these new multinational groups consist of

conglomerations of domestic and international subsidiaries or sub-groups brought together through mergers and acquisitions. These groups of entities often come from very diverse backgrounds, with different controls, procedures, reporting, management processes, business models and cultures. Integrating them into one cohesive multinational group has been the major challenge for management, and achieving a consistent financial and treasury management process is at least as difficult.

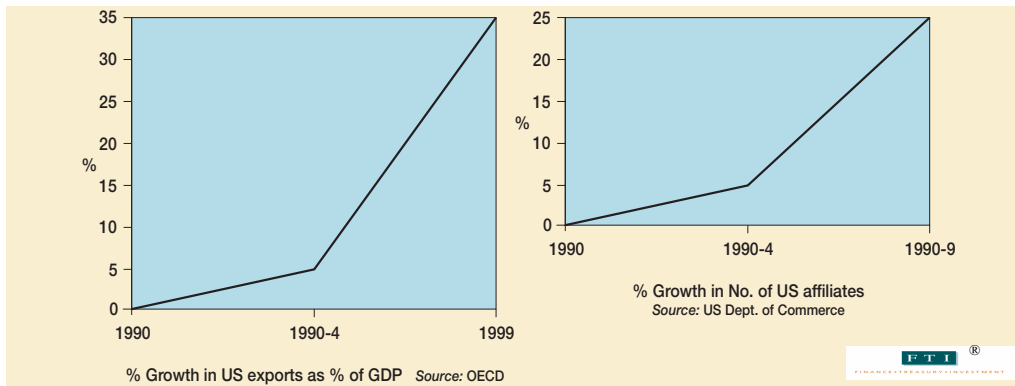
The way such groups handle their general treasury functions varies dramatically. Add general financial business activities, such as AR/AP, to the picture, and the result is often a disjointed mess.

Finding solutions

In the search for efficient and effective solutions, new financial and treasury management business models have been developed by business leaders and business consultants. However, implementing these models is no easy task.

Many multinationals have established Financial Shared Services Centres (FSSCs), usually one in each continent or major business region, and housed their treasury functions within them. Other groups have established regional treasury centres e.g. European Treasury Centres (ETCs), or Asia-Pacific Treasury Centres, or an International

1 – Growth in US exports and number of US affiliates



Treasury Centre (ITC) for all non-domestic treasury business, or where the main concern is

cash management, they have set up Cash Management Structures (CMSs).

A substantive treasury centre can deliver enhanced value and effective control

far more satisfactorily than 'scattering' treasury staff throughout the group entities.

The role of the treasury centre is usually threefold:

- To bring more value to the group from the cash flow and foreign exchange (FX) flows in the business. Often, in these disjointed subsidiary families, cash is 'sloshing around' everywhere (also, the aim is to improve liquidity and corporate and investment funding cost via a centralised approach),
- To be able to provide quality treasury services to group entities so that their business performance can be enhanced,

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- To bring consistent and effective management control to the high risk and sensitive treasury activities.
- They can achieve tax management advantages.
- They have located or plan to locate an FSSC.
- They have significant business operations.
- Costs are low.
- There is euro membership.

The model structure for a treasury centre is fairly simple – a treasury group in the US headquarters, with one or more regional or satellite treasury centres under its control. The HQ treasury sets policy throughout, and typically provides services to the North American entities. The satellite treasury centres provide services, under group policy, to the group entities located in their region. Charts 2 and 3 show variations of this model, illustrating the structures and relationships. Most satellite treasury centres can perform all of the functions and activities of any standard treasury unit, with one exception – policies are usually determined by the HQ treasury. Chart 4 illustrates the range of activities and functions that a treasury centre might handle.

Choice of location

In the past, satellite treasury structures were primarily tax driven, locating treasury activity where tax on profits generated was at a favourable rate. However, pan-national regulations and individual tax jurisdictions have limited somewhat the benefits from treasury management vehicles, although they are still quite common.

New treasury structures are primarily driven by business needs, to solve the problem identified here. If the structure can be justifiably housed in a favourable tax jurisdiction and can offer some additional value, then so much the better.

Multinational groups tend to establish their satellite treasury centres where:

- Expertise and outsourcing is available.

The locations most commonly selected in Europe are Belgium (BCCs), Luxembourg, Switzerland, The Netherlands (BVs), UK and Ireland. Dublin's IFSC has been very successful as a corporate treasury centre, with 350 major multinational treasury operations, many from the US. And with the planned move to a 12.5 per cent corporate tax rate by 2003, Ireland will become a still more attractive location. Indeed on the bases of tax, euro membership, cost, available expertise and outsourcing infrastructure, Dublin is generally regarded as the preferred European location for corporate treasury operations.

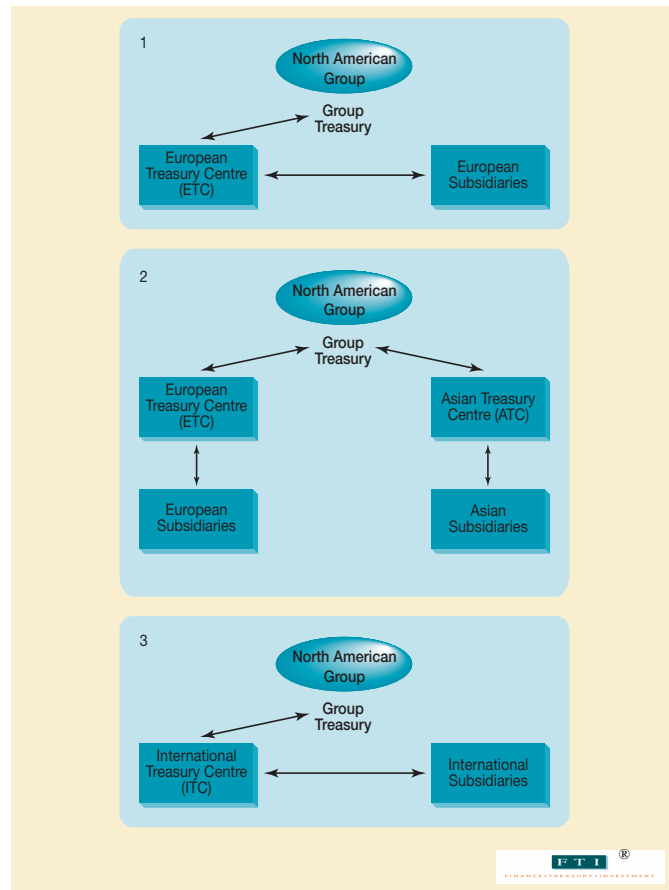
Outsourcing

Outsourcing is the second major emerging business model – after globalisation – that impacts treasury structures and solutions. Again, US multinationals led the way in this trend, developing competence in areas of core business and outsourcing as many other activities as possible. While treasury management is a critical and sensitive activity for most corporate companies, it is not a core activity.

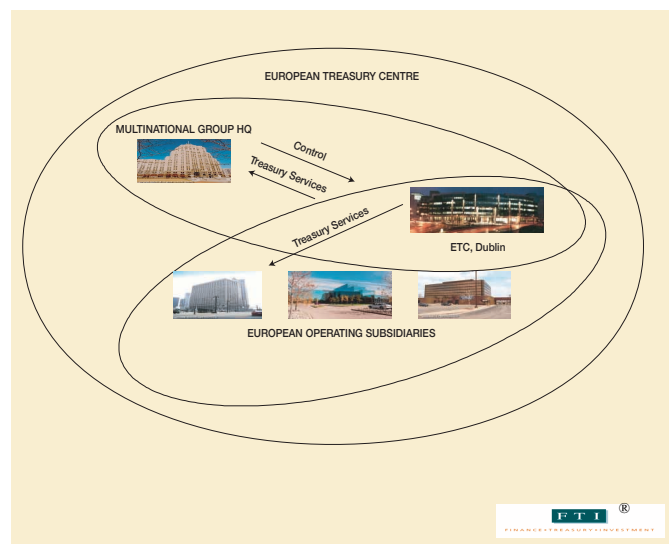
There has been a tradition of outsourcing of treasury activities for many years, certainly since the late 1980s. Of the 350 companies that have set up operations in Dublin's IFSC, over 90 per cent have been outsourced to agent managers.

Maintaining in-house treasury structures off-shore is not an easy task – particularly recruiting, retaining and managing

2 – Satellite treasury centre A



3 – Satellite treasury centre B



4 – Agency treasury centres

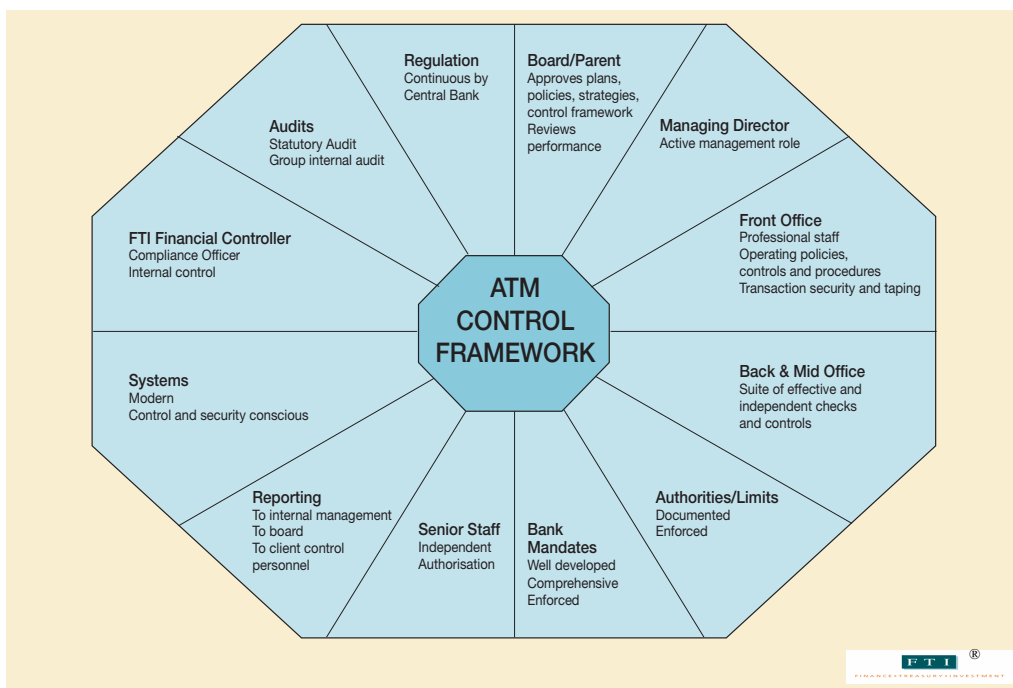


staff, and getting the level of service needed. Many US MNCs have found this to be an almost impossible task, and they therefore often tend to opt for outsourced solutions. In addition to its existing clients, FTI is at present in discussion with some 50 US MNCs regarding proposed outsourced treasury management services, an indication of the preference for the outsourced solution.

Outsourcing has a number of attractions and advantages, especially for satellite treasury and cash management structures. The main ones are:

- Access to professional expertise, since the outsourced agent manager firm will have a team of experienced treasury professionals – front, mid and back office.
- Bringing scope to add value, due to the facts that:
 - the agent manager will be working with a range of clients from many different sectors in a variety of locations and so enabling cross-fertilisation of ideas,
 - the agent manager team will be aiming to be at the leading edge in treasury terms, and the agent manager will compete by offering leading edge approaches and solutions.
- Providing flexibility, since the agent manager has responsibility for resources. Upsizing, downsizing or redirecting are much more easily achieved.
- Outsourcing should provide a cost attractive option, rather than setting up an in-house operation, since the agent manager will be able to achieve economies of scale and will have the treasury infrastructure already in place.
- Controls, which are critical in this sensitive and highly visible business area, can be much more effective where

5 – Control and security framework



satellite treasury structures are outsourced. An in-house structure is likely to be small in size for most companies, making it difficult to achieve a best practice control structure, especially division of duties.

- An outsourced solution can often overcome internal group political barriers.

Outsourcing treasury operations, especially satellite treasury and cash management structures which companies set up to match global business structures, provides an attractive and effective option for US multinational companies.

Issues to be managed

When considering outsourcing as an option, financial/treasury management in the corporate HQ should ensure that:

- The proposed agent manager has the competence to deliver – the people, the expertise, systems, communications and management, and an understanding of the client business and its requirements.
- There are no potential conflicts of interest – the agent manager is working for you and not acting in his own interest (this is a particular concern when the agent manager is also potentially the counterparty to many transactions, e.g. a bank).
- Both the client company and the agent manager see the relationship as a strategic alliance – a long-term commitment – based on full understanding, where both parties are satisfied.
- The client company has to be absolutely comfortable with the agent manager's control and security framework, since a highly sensitive

Case Study 1

Multinational corporation – outsourcing of inter company funding and deposits

Company

This MNC is an international food group with annual revenues of USD 600m.

European Treasury Centre (ETC)

In 1991, the MNC established a European Treasury Centre in IFSC, Dublin, and outsourced all the activities to FTI as its total treasury function.

Business concept:

Acting as a centre of expertise, to provide all treasury services to the group and its subsidiaries.

Activities:

Mainly:

- Group and intra group financing
- Group deposits facility
- Cash and liquidity management

Also:

- FX management
- Strategic treasury advice and projects for the group

Benefits:

- Continuous, high quality service
- Value-added contribution to group
- Effective treasury risk management
- Significant tax advantages

Case Study 2

Multinational corporation – outsourcing of investments

Company

This MNC manufactures specialist steel products for world markets with annual revenues of USD 2 bn.

European Treasury Centre (ETC)

Established a treasury centre in 1991 in Dublin and outsourced the management and operation to FTI. Operates as a satellite to parent group treasury.

Business concept:

To complement group treasury by providing independent treasury functions and benchmarks for cash investment and providing intra group financing. The outsourced treasury unit must make a positive pre-tax contribution to the group and investment performance is assessed against market based benchmarks.

Activities:

Mainly:

- Active cash investment management in USD, sterling and euro funds.

Also:

- Cash and liquidity management
- Group and intra group financing
- FX management
- Strategic treasury advice and projects

Benefits:

- Added value to the group through superior performance targets
- Complements group treasury as centre of expertise
- Significant tax advantages

Case Study 3

Multinational corporation - outsourcing of FX risk management

Company:

This MNC is a market leader in the manufacture and distribution of cans. It operates across the globe and has annual revenues of USD 2.5bn.

European Treasury Centre (ETC):

This MNC was created following a divestment by a larger industrial conglomerate. Consequently it had to develop its Treasury Centre to manage the diverse fx risks across its European subsidiaries. The Treasury Centre was set up in 2000 and was outsourced to FTI.

Business concept:

To provide the full range of operational fx treasury services to the group's European subsidiaries from a centre of expertise where continuity is assured.

Activities:

- FX dealing services
- Group netting
- Banking relationships

Benefits:

- Added value to the group through performance of expert service
- Continuity of service through professional outsourced arrangement
- Attractive cost of service
- No tax dimension to the operation

treasury activity is being passed over to a large extent to a third party. The key elements of the control and security framework are as follows:

- The outsourced manager should not have access to client funds or financial assets – these must remain in the client's accounts, in the client's name.
- The client HQ treasury should have an adequate level of control of, and involvement in the outsourced operation.
- The outsourced manager should have an effective front, mid, back office structure, i.e. best practice division of duties, critical in the treasury activity.
- A comprehensive policy, including authority and limits, should be agreed between the client and the outsourced manager.

- An effective suite of bank mandates should be in place.
- Senior, experienced staff of the outsourced manager firm should provide an independent authorisation of all transactions, and especially funds transferred.
- Effective reporting to client HQ treasury or financial management, reporting as any group subsidiary would.
- Top class systems and IT are provided by the outsourced manager.
- Independent compliance officer, audit and regulation roles apply to the outsourced manager firm.
- As a last resort, the outsourced manager should have adequate doomsday insurance cover in place.

The control and security framework which we operate in FTI is shown in chart 5 as the generic model. Of course, in any given situation, this

framework would have to be customised to meet the client's needs.

Choosing the right business model

Whether a company decides to outsource or not, managing risk at a satellite treasury centre is a major responsibility. If treasury management is outsourced, the CFO and Group Treasurer must have absolute confidence in the agent management firm. If the functions are kept in-house, they must have the staff, resources and policies in place to ensure an effective management process for the treasury activities and for the risk management process. The recent trend strongly favours outsourcing, rather than setting up in-house functions; this is what US MNCs now tend to do. □



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Aengus Murphy is Chairman of FTI, the independent specialist treasury management firm based in Dublin's International Financial Services Centre (IFSC/Dublin Docks). He has 20 years' experience as practitioner and consultant in treasury management services, and is a frequent contributor to specialist journals and conferences.

Aengus is a founder and past Chairman of the Irish Association of Corporate Treasurers (IACT), and a fellow of ACT (UK).

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