

Treasury Outsourcing

**Aengus Murphy & Eddie Fogarty,
FTI.**

E-mail and web:
amurphy@fti.ie
efogarty@fti.ie
www.fti.ie

Outsourcing in the Treasury Context

Outsourcing involves a company contracting a specialist third-party provider to undertake part of a business function on its behalf, rather than undertaking all of that function in-house. For a number of years - and currently to an increasing extent - outsourcing is being applied to the treasury function.

Background

While treasury outsourcing has been in use for some 10 years or more, much of it in early days related to tax-based structures. Outsourcing to meet real treasury needs is a more recent phenomenon, and has gained momentum over the last three years or so. As such, treasury outsourcing is in its infancy. Growth has been steady rather than dramatic. Recent experience and surveys suggest that outsourcing solutions are increasingly being employed to meet specific treasury needs.

What activity is Outsourced?

There are different views as to what aspects of the treasury function can be or should be outsourced. The norm is to keep critical decision-making and key relationship management in-house. Rarely, if ever, is treasury totally outsourced and best practice would dictate that a company would not become totally reliant on an outsourced provider. Subject to that, it is case-by-case and the different approaches are set out below. The most important issue is the control framework within which the outsourced relationship operates and the scope of the decision-making responsibility allowed to the service provider.

1. By Strategic Importance

Outsourced	In-house
<i>Operational</i>	<i>Strategic</i>
~ Transaction Execution ~ Confirmation & Settlement ~ Reconciliations ~ Reporting ~ Accounting ~ Systems/IT	~ Funding ~ Risk Management ~ Banking Relationships

2. By Functions

Outsourced	In-house
<i>Mid & Back Office & Systems</i>	<i>Management & Front Office</i>
~ Confirmations & Settlement ~ Reconciliations ~ Reporting ~ Accounting Systems	~ Funding ~ Deal Execution ~ Risk Management ~ Interface with Group entities

OR

3. By Activity

OR

Outsourced	In-house
~ Cash Management	~ Funding
~ Surplus Cash Investment	~ Commodity Price Management
~ FX Hedging	

4. By Geography

OR

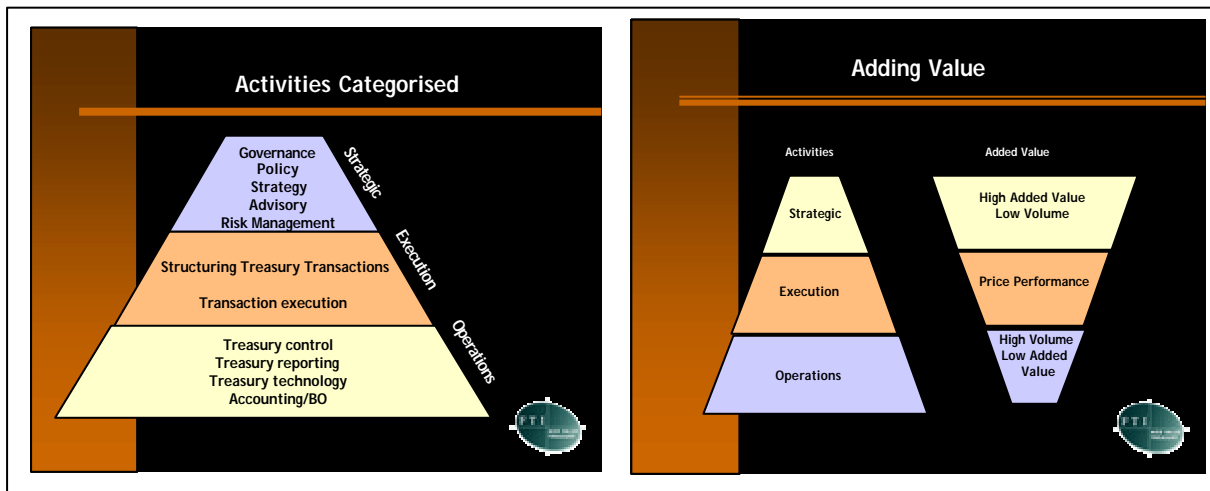
Outsourced	In-house
~ Europe	~ North America
~ Middle East	~ South America
~ Asia/Pacific	

OR

The impetus to seek an outsourced solution can come from different sources. Many would be event driven – a situation arises in the company’s business that, for whatever reason, makes the current treasury arrangements inadequate and outsourcing a possible solution. Events such as acquisition, demerger, a major corporate financing transaction, an important change in treasury policy at Board level - events such as these can prompt the search for an outsourced solution. Generally, it is not just a cost-cutting mission but more broadly business based.

In structuring an outsourcing solution, the treasurer needs to decide on whether to outsource just routine, administrative tasks or to go further and avail of the capabilities of the outsourced provider to contribute to performance. Treasury is by its nature a value-adding function and the outsourced solution can be structured to be part of this process.

The schematics below set out a conceptual framework for considering where along the value chain the solution should be pitched.



Different service providers have different value propositions and the various offerings reflect their specialisation; some focus on the operational aspects, others on the more strategic and some on a mix of the two. Some providers’ business model is what they term ‘VxP’ based (volume by price), where they aim for volume processing. Others aim to replicate a corporate treasury operation, much as would exist in-house in a company.

Potential Benefits Of Treasury Outsourcing

The potential benefits to a company from adopting an outsourced solution are as follows:

- Overall, a more effective treasury function supported by a wider pool of treasury expertise,
- Clearly defined objectives, responsibilities and service levels for key tasks,
- With the additional support and resourcing, the treasurer can focus on the most important issues,
- Access to best practice systems, controls and business recovery,
- Streamlining of processes for efficiency,
- Better support and treasury service to subsidiaries,
- The avoided costs, direct and indirect, of systems and treasury IT.

An important overall benefit is flexibility. A company can have an up-and-running treasury very quickly without having to build and commit over a period of time.

Apart from the corporate benefits, there is also the human dimension. There is a view that outsourcing presents a threat to the treasurer and the treasury function in a company. This view was stronger in the early years, when the concept and its scope were not fully defined. Experience has shown that this view is misplaced and, like many things, outsourcing can be a threat or an opportunity depending on how it is approached. It certainly can be taken as an opportunity to streamline treasury and focus on the kernel of the job, buying in the required service and expertise to enable this happen.

Potential Issues And Concerns

From direct experience of structuring solutions and also from surveys of treasurers, a number of issues or concerns can be identified.

One of the most common has been that treasury is too complex or strategically important to be outsourced. This concern was more an issue in the past when the concept was new to treasury and its application was not fully understood. As already explained, treasury is hardly ever fully outsourced and concerns about this are misplaced.

Another area of concern is loss of control. In practice, a properly structured outsourced solution actually increases control. The company buys into a strong control environment, with strong systems and defined reporting. Decision-making, roles and responsibilities are fully agreed. In fact, the treasurer can have more effective control than in many in-house treasuries.

An issue for both the service provider and the company will be the fee payable. For the company, this can be an issue when in reality a proper treasury is being provided where previously no real treasury existed. Justifying an additional cost in these situations is an obvious barrier. For the service provider, it must match the fee to the service requirements and expectations of the client.

Of course, as in any significant commercial arrangement there are a number of issues to address e.g. defining liability, confidentiality, service levels etc. Through practice, standards are emerging in relation to these issues, but it is difficult to envisage an industry standard.

Apart from the legal provisions, the core elements of the commercial arrangement must be made clear. These would include:

- The detailed specification of the services agreed to be provided.
- The system for monitoring service quality and performance.
- The fee arrangement now and the basis for it going forward.
- The treasurer's fall back situation, in the event that the arrangement does not work out.

One important contractual issue is term of contract. Neither the treasurer nor the outsourced provider will wish to have a short term contract, since both will have made a lot of investment in the solution. Nevertheless, both will want termination rights and these are a matter for negotiation.

Experience shows that perhaps the biggest issue for the treasurer is to envisage how the arrangement will work in practice. For this reason, treasurers would normally need to take time to go into the detail and seek a full understanding of how it will work. This means that the decision-making stage of putting an outsourced arrangement in place takes time to complete. Thereafter, implementation is actually smooth and relatively short for the reason that the issues have been well addressed in the earlier phases.

Unlike other general outsourced solutions, where some staff may transfer to the outsourced provider, this is not a feature of treasury outsourcing, possibly because:

- Outsourcing solutions to date have mainly been in response to events creating resource shortage, rather than a strategic decision to replace an existing arrangement.
- The corporate treasury area is not one of high resource numbers in any event, so the usual HR dimension is not so significant.

Infrastructure To Support Outsourcing

One of the key drivers to justify the outsourced solution is that a company can access best practice corporate treasury infrastructure. In selecting an outsourced service partner, the treasurer should engage in a thorough due diligence exercise to establish the quality of this infrastructure. The key components are:

- Skilled and experienced professional corporate treasury team - the front, mid and back office specialists, with adequate back up, to provide the service needed.
- The internal management process to ensure a quality secure service.

- A formal framework to facilitate the client company in effectively managing the service it is receiving.
- Best practice systems, integrated to achieve as much straight-through-processing as possible, including market information systems, pricing tools, e-dealing facility, accounting system, EB or SWIFT systems, deal confirmation matching system - all interfaced with a robust treasury management system (TMS).
- A clearly documented control framework that conforms to best practice.
- A formal and well-developed SLA/Service Agreement to provide safeguards to the client company.

Choosing A Provider

Or rather choosing a business partner, because that is what is being done. The success or otherwise of the outsourcing experience will depend on the performance on this business partner - obvious, but not always the basis for the selection. It is key that an objective and independent decision is made in the selection of the outsourced service provider. Otherwise, the relationship is set up on the wrong premise, with the treasurer's leverage reduced thereafter.

There are now a dozen or more established service providers. They fall into two main categories:

- Bank service providers, and
- Bank-independent, specialist companies.

These two categories are obviously quite different and the treasurer has a fundamental decision to make in choosing which route to take. In making the selection, credit risk is generally not an issue in relation to the independent service provider; being a non-bank, no transactions are undertaken with that entity. All transactions are in the company's name with its nominated relationship banks.

In making the choice between a bank service provider and an independent specialist, the main considerations include:

- the basic philosophy of the company and its desire for bank independence,
- the nature of what is being outsourced and likely future requirements eg bank service providers are more focused on services that match their core competencies in the areas of transaction processing, payments and so on,
- the need to customise the service; the specialist providers by definition can more readily tailor a solution to meet specific requirements.

Whereas in the early days of treasury outsourcing, a decision to select a bank meant that the lion's share of transactions went to that bank and that clearly raised questions of conflict of interest. Today, the treasurer can insist that business is more widely spread in line with the company's preferences. Nevertheless, there are concerns in this area for treasurers contemplating the bank service provider option.

Most evaluations would include at least one from each category ie an independent and a bank. Generally short lists would be kept to three, sometimes two in reality with a third 'just in case' but not fully considered. It really is not feasible to manage a longer short list; the amount of discussion and due diligence on the precise offering is quite high.

The acid tests in choosing an outsourced partner are:

- Are your business circumstances fully understood and appreciated by the service provider company, and does it proactively work with you to devise the solution which is best fit for you?
- Are your precise needs being met, including those non-routine higher end needs, such as policy and strategy support and advisory support for group entities, if these are required?
- Have you absolute comfort with the partner's service philosophy, its ability to deliver and its control and security arrangements?
- Have you met the staff that will actually work on your behalf? What is their level of experience and expertise?
- Do existing reference clients testify that, in their experience, your expectations will be met by the provider partner?
- Track record and commitment to your needs and to the long-term relationship.

Looking ahead

Outsourcing is not a universal solution for all but it is now proven to meet the needs of certain companies in specific circumstances. As further successful examples of outsourced solutions are put in place, more companies will begin to consider outsourcing as a strategic alternative to existing arrangements. Recent surveys indicate that many treasurers envisage outsourcing being an issue for them in the near future. Allied to this growing level of comfort, we can expect that a wider range of treasury activities will be outsourced in the future, including those higher up the value chain.