A STEP IN THE RIGHT DIRECTION

MARK WYLLIE OF CENTRAL EUROPEAN MEDIA ENTERPRISES GROUP IS ALL FOR OUTSOURCING. HERE HE EXPLAINS THE CHOICE OF ROYAL BANK OF SCOTLAND TO MANAGE ITS TREASURY OPERATIONS.

Corporate treasury outsourcing first became popular in the late 1980s and has become a key strategic issue that every company, no matter their size, should consider to improve their competitiveness. This article looks at Central European Media Enterprises (CME) and why it recently chose to partner with The Royal Bank of Scotland's Agency Treasury Services (ATS) in managing its treasury operations. The main focus is on three areas: liquidity management (cash management and the investment of surplus funds); risk management (working to pre-agreed credit, liquidity, foreign exchange and interest rate risk management parameters); and administration (the processing, reporting and management of transactions).

COST BENEFITS. In its early days, treasury outsourcing mostly concentrated on the operational cost savings that could be provided by a bank to a company. Large financial service providers could invest in state-of-the-art technologies and, by spreading the costs over a large client base, make these systems available to companies that could not afford them by themselves. Although the cost benefits remain with respect to the technological and human expenditure, outsourcing has developed from a pure cost savings exercise into a treasury management partnership that allows a company to fully benefit from the market expertise of its outsourcing partner. Therefore, treasury outsourcing can now provide significant benefits to many medium-sized companies and is no longer solely the domain of the large multinationals.

It is also important to note what treasury outsourcing is not. Specifically, it is not a situation where the firm outsources its main financial management and strategic responsibilities. The CFO, finance director and treasurer remain fully involved with all their strategic and management responsibilities and simply document these decisions in a service level agreement (SLA), allowing their bank to implement these decisions on an operational level.

WHAT IS CME? CME is a pioneering international television broadcasting company operating terrestrial stations across Central and Eastern Europe. Launched in 1994, CME's stations now reach more than 70 million viewers. The company's business strategy is based on working closely with local partners and placing an emphasis of broadcasting locally produced programming. Registered in Bermuda, with executive offices in London, CME is headed by Ronald Lauder, founder and non-Executive Chairman of the Board of Directors. It employs more than 2,000 people. But at its London headquarters, the staff totals just 19, a mix of qualified lawyers, accountants and other management and administrative staff.

WHAT MADE CME DECIDE TO OUTSOURCE? When CME started its activities in 1994, it went through a rapid expansion. By 1999, the company found itself financially stretched and turned to a course of consolidation. When I joined as CFO in September 2000, the London headquarters had been downsized from a staff of 76 to 16. There was one individual focused on the treasury side and most of his time was spent on cashflow projections. Money was rolled over on an overnight basis and there had been no time to devise a hedging strategy. As CME had substantial deposits and liabilities in dollars, euros and, to a lesser extent, sterling at the corporate level, and a much greater currency exposure at the subsidiary level, clearly some changes had to be made.

We took a hard look at what was needed to properly staff and manage the office's treasury requirements. It was felt that, given the various countries in which CME operated in were out of the mainstream, a minimum of three persons with a high level of expertise would be required. This was clearly too costly a proposal at the time, so I searched for alternatives. The concept of outsourcing with its well-documented benefits of cost savings, internal efficiencies and effective risk management was attractive to us.

CME already used The Royal Bank of Scotland (RBS) for its payroll, so we decided to approach our relationship manager to get some ideas about how the bank could help optimise CME's treasury operations. Another bank we had spoken with declined to consider treasury outsourcing as our deposit base (then $35m) was considered too small. However, the RBS approach was less focused on high volume processing and more on the overall relationship that could be provided, on an outsourced basis. With the comfort of a track record in this field, we decided to work with RBS as our outsourcing partner, to look at the full balance sheet of CME from a treasury risk management perspective. At the time, CME had $160m in fixed rate debt, with a high coupon. Working with RBS, the fixed to floating mix of our debt profile was changed to reflect our future plans and market conditions, generating significant interest savings for us. This was the catalyst for broadening the relationship.

The SLA (or Treasury Management Agreement) covered all the key areas of treasury outsourcing at the corporate level: liquidity management, risk management (credit, interest rate and foreign exchange) and treasury administration and support. In addition to detailing the operational responsibilities, it provided for:

- Counterparty list and credit limits – the bank suggested to us 30 highly rated global banks. We selected 20 as our counterparties, with each having the same credit limit.
- Permitted deposit instruments – this could have included bank deposits, commercial paper, money funds and various others. We started solely with bank term deposits and certificates of deposit (CDs), simply to keep our counterparty list to a minimum.
- Term limits – our previous 'overnight only' deposit limit was materially extended to better match our cashflow projections.
- Authorised signatures – in the past, only one signature was required at CME for treasury transactions. Now, given the broader parameters put in place, we have started a dual signature requirement for all transactions.
- Frequency and format of reports – we opted for a comprehensive monthly report with confirmations for each transaction.
- Performance benchmark – we agreed to a publicly quoted deposit benchmark that the weighted average funds for the month would be judged against.

We found completing the documentation went smoothly and RBS was flexible in the way the document reflected both parties requirements. The service is provided to CME for a fixed monthly fee and will be reviewed on an annual basis. The treasury relationship also forced us to fully document all our risk and operating procedures for the first time (before, the in-house procedures were simple yet not documented). Now, both parties have clearly defined all respective responsibilities and liabilities in the SLA. Although the bank has some discretion in its day-to-day activities (for example, which three banks to call for a competitive deposit), everything must strictly adhere to these signed-off policies and limits.

Damian McCready, our business analyst, carried out much of the work implementing the relationship. The treasury relationship took him just over two months from the signing of the SLA to implement and is now fully up and running. There was little disruption to existing procedures, as the time spent creating the policies and procedures for the SLA made each party's responsibilities very clear. The bank provides a detailed monthly report as follows:

- monthly and year-to-date interest income compared to interest income at the benchmark level;
- weighted average return of funds for the month compared with the benchmark;
- average maturity of funds across the portfolio and per counterparty;
- proportional split of funds across approved instruments;
- proportional split of funds across approved counterparties; and
- economic commentary relevant to the client's financial strategy.

There is an ad hoc report generated for each new transaction with all details. As our company's dedicated treasury staff is minimal, we had no large systems that had to be integrated. Rather, the bank had all the systems and we just chose the type of information we wanted and how we wanted to receive it. As the relationship is new Damian finds himself speaking to ATS almost daily for a brief period of time. A typical day's routine for the bank would be as follows:

- to confirm CME's start of day cleared funds position;
- access CME's cashflow forecast showing anticipated inflows and outflows;
- determine the appropriate maturity for deposits;
- examine counterparty exposure to determine the amount of funds that can be placed with each;
- call a sample of approved banks for prices in the desired maturities recording the offered rates to monitor competitiveness;
- agree rates and place funds (attend to all confirmations); and
- handle all fund transfers.

As the relationship matures, each party will instinctively know each other's preferences better. However, at this initial stage, it is reassuring to us to have this highly interactive relationship. Since retaining an outsourcing partner for our treasury activities, our risk tolerance has changed with a more active style of risk management in place. Since most of the time and burden of the operational sides of the business have been removed, Damian and I have more free time to look at new strategies and instruments. This is reflected in the usage of a wider range of risk management instruments without increasing risk levels above a level at which we are comfortable. Also, since the bank monitors CME's risk parameters closely, CME feels comfortable with this small additional amount of risk.

WHAT HAS CME ACHIEVED? To date, CME is getting very real benefits from outsourcing the treasury function including:

- superior investment returns – the wholesale competitive tender has achieved an additional 50-75bps more than what we could have achieved for similar maturity deposits as a corporate;
- a treasury risk management solution that manages our ongoing exposures – now both the bank and ourselves are monitoring our risk limits continuously;
- all processing, settlement and reporting functions managed by our outsourcing partner – this has saved us from having to hire further staff and invest in additional treasury systems which we estimated might have cost three times the annual fee we currently pay; and
- proactive risk management from a sophisticated treasury group that has, to date, provided us with significant value.

The treasury outsourcing relationship is solely at the corporate level. The next decision for us is whether to apply this relationship to our five subsidiaries throughout Central Europe. However, in the short term, we believe more benefits can be obtained from the current arrangement before we move the relationship forward to the next step, particularly further tapping our outsourcing partner's expertise in interest rate and foreign currency hedging. However, for now, the treasury outsourcing arrangement is providing us with a good return for our shareholders' money – what any good business decision is supposed to do.

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