

A Cook's tour of FX



THE EVOLUTION OF THE CORPORATE TREASURY CONTINUES UNABATED AS TREASURY DEPARTMENTS BECOME INCREASINGLY CENTRALISED AND IN-HOUSE BANKING ASSUMES GREATER PROMINENCE. DANIEL ANDRES OF XRT EXAMINES THE IMPACT OF THE CHANGING TREASURY STRUCTURE ON FOREIGN EXCHANGE (FX) OPERATIONS THROUGH THE EXPERIENCE OF TRAVEL AND FINANCIAL SERVICES GIANT, THOMAS COOK AG.

Executive summary

- Thomas Cook has restructured its business operations in response to a competitive market.
- The company has updated its treasury technology with meeting the needs of foreign exchange (FX) as a core objective.
- Thomas Cook has centralised its treasury operation and introduced an in-house bank.
- Any technology solution needs to be flexible and configurable to deal with business issues that are unknown at the time of implementation.

For Heiko Ries, Head of Group Cash Management at Thomas Cook AG, the old cliché “change is the only constant” rings true. Change has been a way of life at Thomas Cook in recent years. The company has restructured its business operations to meet the challenge of a competitive market offering wafer-thin margins. Wolfgang Beeser, Management Board Chairman of Thomas Cook AG said the company was focused on “cost discipline, clearly defined responsibilities and improved orientation to the demands of the market”.

During this period, XRT has worked closely with Thomas Cook to build a technology structure capable of meeting the escalating demands on the corporate treasury. Thomas Cook is now set to reap the benefits of a newly centralised treasury and an in-house bank

that are designed to act as a multi-faceted financial services centre for the companies within the group.

Thomas Cook is one of an increasing number of multi-nationals choosing the centralised treasury route particularly to deal with foreign exchange (FX). The combined impact of a centralised treasury and in-house bank – together with the supporting technologies – is reshaping the way in which FX activities are conducted.

THOMAS COOK'S FX As an integrated international tourism group, Thomas Cook's various companies are involved in the entire leisure travel value chain – flights, hotels, administration, sales and service agencies. With travel and financial services as its core businesses, effective management of foreign exchange (FX) is of vital importance.

With a worldwide reputation as a supplier of FX services for travellers, the consumer FX market is equally important. However, while overall FX transactions are on the up, Thomas Cook's core European consumer FX business has seen a downturn since the advent of the euro.

"There is a constant flow of FX business all of which is hedged centrally," says Ries.

"In the package holiday market prices are often set artificially low. The Thomas Cook Tour Operations business has to fix prices for publication in travel brochures that appear almost a year in advance. To come up with numbers that will result in a profit, we need fixed foreign exchange rates. That entails settling transactions in over 20 currencies, including our two main currencies GBP and the euro, all of which need to be hedged."

"The group's hotels, clubs and airplanes all require financing which needs to be hedged against fluctuations in interest rates. Then there are the four airlines owned by the company. Keeping the 65 planes airborne depends on hedging USD to buy fuel.

"There are also corporate FX requirements such as buying and selling hotels, airplanes and, as has happened in recent years, other companies. And let's not forget that for any corporate treasury, ensuring FX liquidity is a priority," says Ries.

Ries has noticed that the scope of FX activities is becoming "much bigger". For example, he points to the emergence of difficult to deal currencies like CYP, MAD, MTL, MUR or SCR (Cyprus, Madagascar, Malta, Mauritius, Seychelles).

Therefore impact of any major change or refocus in treasury operations has to be judged against its impact on the company's ability to handle FX risk.

THE IMPACT OF CENTRALISATION Ries sees the advantage of Thomas Cook's decision to centralise its FX activities. According to Ries: "Having the majority of transactions managed in one place, supported by a solid technology foundation and a clear set of tough guidelines means everything comes together that much easier."

Ries says that there has been a quantifiable reduction in costs, primarily because Thomas Cook can now process high volume, low margin FX transactions in bulk. Aside from saving time, by using technology to automate and aggregate FX transactions, corporates can negotiate favourable rates with banks.

The more complex FX transactions still require expert attention from internal specialists and banks. From a financial perspective, handling more specialised FX instruments might prove to be a means of recouping some of the revenue the banks stand to lose in other areas.

Clearly centralisation has an impact on existing employees. A number of different approaches can be taken that combine a

Offsetting inflows and outflows

- Thomas Cook is credited with the creation of the travel industry. The company's beginnings were very modest. In 1841 Cook, a former preacher and active social reformer, organised transport to carry temperance supporters to meetings across England.
- In 2001, C&N Touristic became the sole owner of Thomas Cook, positioning it as the second largest travel group in the world. The two shareholders are Deutsche Lufthansa, Germany's national carrier, and KarstadtQuelle, Germany's largest department store owners. In the same year, C&N Touristic announced a name change to Thomas Cook AG.
- Thomas Cook's business is structured into geographical market segments, including Germany/Austria, Western Europe, UK & Ireland and International Markets.
- The group controls 33 tour operators, over 3,600 travel agencies worldwide, 76,000 supervised hotel beds, a fleet of 65 aircraft and a staff of 24,600.

responsible attitude towards employees with the strategic objective to centralise. One organisation known to XRT recruited skilled members of staff for its central treasury from subsidiary offices. The company realised that the nuances of local knowledge and understanding can make a positive difference when dealing with FX problems from a remote location.

Treasury employees are showing an increased interest in training covering the more arcane aspects of FX. This seems sensible given that expertise in the more sophisticated FX instruments will always be in demand.

COMMUNICATION AND COMPLIANCE Meeting compliance requirements such as the hedge accounting and reporting complexities introduced by IAS 39 *Financial Instruments: Recognition and Measurement* comes down to two essential factors – communication and control. Time and again treasurers have found that you really cannot have one without the other.

While it is relatively easy to enforce standards in the central treasury and check that they are being followed, ensuring that subsidiary offices adhere to the corporate rules designed to ensure compliance is more of a challenge.

COMMUNICATION AND FX HEDGING Communication is important in FX hedge accounting. To identify and plan FX hedging priorities, FX specialists working in the central treasury must be certain they are working with forecasts that are close to reality. The central treasury must have accurate, timely and on-demand information from subsidiary offices.

Both compliance and hedge accounting are subject to information from, and controls in, regional or subsidiary offices. Many large corporates still use a spreadsheet based system for these operations. These systems have inherent pitfalls.

Spreadsheets are completed by relevant offices and sent at intervals to the central treasury. Often there is no set format, nor are there any directives on the information that has to be included. Then it is up to the central treasury to interpret the spreadsheets and extract what it needs.

Thomas Cook – Treasury Structure

- The treasury function is organised into a layered structure with a central treasury at its core supported by regional treasuries plus smaller treasury operations dealing with discrete cash management functions.
- There are five subordinate treasury locations including four Regional Treasury Centres (RTC) located in the UK (RTC North), Belgium (RTC West), Spain (RTC South) and Germany (RTC Middle). The RTC Middle also offers a shared service function to cater for the needs of international markets (India, Canada, Egypt, etc.) and all smaller markets which do not belong within the jurisdiction of a specific RTC.
- All RTCs report to Thomas Cook's central treasury function, the Corporate Centre, based in Oberursel, near Frankfurt, Germany. RTC West in Gent, Belgium acts as a co-ordination centre hedging currencies for Belgium, the Netherlands and France.
- The XRT Globe\$ system supports operations at the central corporate treasury in Oberursel. The system allows regional treasuries in the UK, Spain, Austria and Belgium full access to the information and functionality it provides. XRT c-Globe\$ is installed at each of the local offices.

Spreadsheets are undoubtedly a useful business tool but they're not the universal panacea that ubiquity would suggest. According to the *Managing the Spreadsheet Sprawl*, a report issued by The Butler Group in December 2004, the popularity of spreadsheets has exacerbated the latent weaknesses inherent in even the most powerful applications.

The report said: "Our reliance upon and use of spreadsheets represents one of the single greatest threats to corporate data quality and accuracy, due in the most part to the unmanaged way they tend to be used."

It is the way companies and, in particular, individuals use spreadsheets that undermines their credibility. Regardless of the credibility of the data source, quality and integrity is, as the report said: "at the mercy of the individual or individuals designing and using the spreadsheet".

Accidental errors can easily be overlooked as can deliberate manipulations by Machiavellian contributors with, perhaps, something to gain from their deceit.

And, of course, there's the compliance issue. At a time when companies are called upon to prove that they comply with an ever-widening range of regulatory regimes, spreadsheets cannot hope to match the validation, traceability and security facilities offered by an automated system.

COMMUNICATION – SEAMLESS, TIMELY AND ACCURATE By using XRT Globe\$, Thomas Cook has linked its regional and central treasuries with an automated system that provides accuracy, security and traceability.

Access to up-to-date information automates and improves the efficiency of the entire FX hedge accounting process.

Each of the treasury locations can input local financial data in accordance with standard formulae via c-Globe\$ to provide the central treasury real-time availability to the accurate, timely

information they need to make effective and informed decisions on matters like FX hedging and ensure compliance with accounting standards.

Control is another benefit of using an automated system. If any subsidiary or office is not sticking to the corporate rules, it will be visible on their reports. The central treasury can take steps to reacquaint the aberrant subsidiary with the corporate rules.

For many organisations, the implementation of an in-house bank is a catalyst for change. In-house banks impact on areas such as costs, banking relationships and control across all treasury departments including FX.

Corporate treasurers are beginning to see that in-house banks work. XRT is seeing that in-house banking is being cited as a priority by customers and in-house banking has become a factor in the buying decision.

WHAT IS SO GOOD ABOUT IN-HOUSE BANKS? In-house banks should provide cost and efficiency savings. Processing FX through an in-house bank allows organisations to consolidate FX as well as clear inter-company and cross-border payments across all subsidiaries. Corporate treasurers can also take advantage of improved cash pooling abilities to enhance FX hedging decisions.

However the primary benefit of an in-house bank is in the potential it allows for a redefinition of existing relationships with banking institutions. Many organisations are turning their backs on the multiple relationships they have maintained until now. They are choosing to rationalise and reduce banking relationships and enjoying an immediate reduction in international bank charges.

The evidence suggests that multi-national organisations tend to select a bank with a global presence so that local offices can deal with branches of the same institution used by the central treasury. Are we seeing a subtle shift in the power balance that has until now, arguably, generally worked in favour of the banks?

TECHNOLOGY – CREATOR OR ENABLER? Without technology there would not be a centralisation/in-house bank option available to corporate treasurers. Whether technology is driving the transformation of the corporate treasury environment is open to debate. Wherever the original impetus for change lies, technology is the foundation on which the corporate treasury is being rebuilt.

Working with customers in different sectors across the world, XRT has found that as the implementation proceeds, the customer's perception of what is possible in areas like FX tends to expand. Treasury technology buyers need to source a treasury solution that is flexible and configurable because it is a certainty that the scrupulously scoped business needs analysis will change in ways not considered.

Ries has advice for treasurers planning a radical restructure. "Hire an experienced professional and not an external consultant right from the start. Let that person structure the project including centralisation of the FX business. Encourage that person to establish inviolable guidelines. Check that everything is to your satisfaction and only when you can't find any more holes in the proposals – and not any earlier – give him or her the budget to put the plan into action."

Daniel Andres is General Manager of central Europe for technology supplier, XRT.

Daniel.Andres@de.xrt.com

www.xrt.com