



KNOW YOUR OPTIONS

ORGANISATIONS DON'T NEED TO TAKE AN ALL-OR-NOTHING APPROACH WHEN OUTSOURCING TREASURY OPERATIONS. GAUTAM DHILLON EXPLAINS WHY

Over the past 20 years, there has been a global boom in outsourcing. Initially, organisations started to outsource low-value activities, such as catering and payroll. But during the past decade, increased competition has caused organisations' attitudes towards outsourcing to shift, resulting in more knowledge-intensive activities – such as manufacturing, HR and accounting – being outsourced. These changes have, in turn, given rise to the business process outsourcing (BPO) market.

BPO can be applied to processes that are fundamental to all organisations. The growth in the BPO market is largely down to organisations examining their business processes in more detail and identifying more opportunities for strategic outsourcing. BPO enables

organisations to transform their operating models to focus on core activities while handing non-core activities to specialist providers.

Increased functionality and reduced technology costs are driving growth in the BPO sector since they make it economically viable for smaller companies to adopt outsourcing solutions. Put simply, the costs and complexities of outsourcing have reduced, meaning that outsourcing companies are now able to target SME clients. This makes BPO available to a far larger audience.

Outsourcing treasury

There has been much discussion around the potential for treasury outsourcing over the past 20 years. Except for a few large banks that offer an outsourcing solution, the predicted growth

in this market has never materialised. This is because there was a mismatch in:

- ◆ The offering (it was often seen as an all or nothing);
- ◆ The pricing; and
- ◆ The appetite of organisations to outsource this vital function.

With that in mind, which parts of treasury operations should be outsourced?

In my experience, the one function that an organisation should never outsource is the strategic evaluation of its financial risk. Once risk parameters have been defined and documented, it could be practical to outsource the tactical and operational aspects involved in meeting these objectives, in accordance with the organisation's defined treasury policy. So, all activities that revolve around the business-as-usual (BAU) aspects of a treasury's operation could very easily be outsourced. This means that the back office (deal confirmation, netting and settlements) and the middle office (treasury accounting and risk management) would be the natural places to start. Parts of the front office (deal execution and recording) could also be viewed as a BAU process because the bulk of deal executions are routine transactions.

In an attempt to overcome the all-or-nothing approach, the front, middle and back office functions can be segmented into discrete, yet interconnecting,

hubs of activity. Each one of the segments is designed to match an organisation's outsourcing aspirations; organisations can choose to outsource their entire operation or discrete parts of their operations. The table (below, left) is an illustration of the segmentation.

Advantages of treasury outsourcing

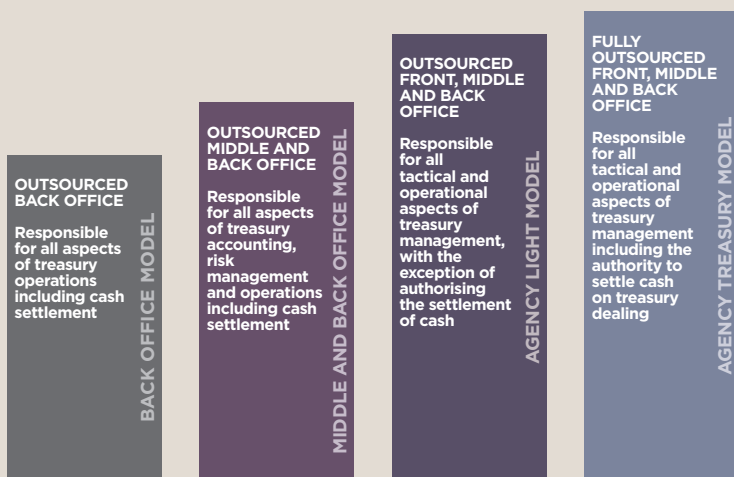
All organisations should know the importance of their treasury teams, but few are aware of the advantages of outsourcing the function. For an organisation, the advantages of treasury outsourcing include being able to quickly access world-class operational capabilities and eased capital expenditure (ie when setting up a centralised treasury or implementing a treasury management system (TMS)). While reducing cost is perhaps the most immediately appreciated benefit, other benefits include:

Strategic focus. The group treasurer is removed from day-to-day operations, which gives them more time to focus on strategy.

Personnel and systems. The organisation has specialist and experienced treasury professionals using a dedicated TMS to manage its treasury operations.

Economies of scale. Organisations that can't justify the capital expenditure of having a centralised treasury function can quickly access world-class

OUTSOURCING TREASURY OPERATIONS MODELS



capabilities with little or no upfront costs.

Segregation of duties. The outsourcing company will have a team of people to ensure segregation of duties, which may not exist in smaller treasuries.

Market knowledge. Since the outsourcing company is close to the market, it will have a much clearer picture on pricing and will see potential problems – for example, a bank getting into trouble – before its customers do.

Disaster recovery. The outsourcing company will have a disaster recovery arrangement in place to ensure that it can carry on operating without any loss in functionality.

Treasury manual. The client will get constant feedback on the performance of the tactical and operational aspects of the treasury manual and potential weakness will be identified before any breach events occur.

Target operating models

The aim of the target operating model (TOM) is to describe the tactical and operational processes an organisation is going to employ in future (using its human, IT and other resources) to meet its strategic objectives. For the TOM to be successful, it must factor in the following considerations:

Strategic vision. A clear vision defining the role and mandate of the outsourcing company.

Technology. Extensive use of technology to ensure straight-through processing.

Effective resourcing.

Appropriate staffing and resources to achieve its targeted objectives.

Segregation of duties. A strong control culture that has segregation of duties built into all aspects of its being.

Plug and play. The migration process off the client's systems and onto the systems of the outsourcing company has to be an efficient and a (relatively) painless process.

Key performance indicators.

Accurate and regular reporting on KPIs to the client.

Audit and compliance.

Regular independent audit of the outsourcing company to check adherence to the client's treasury policy.

The four TOMs are agency treasury; agency-treasury light; middle and back office; and back office.

1. Agency treasury TOM
Under this model, the outsourcing company manages the entire front, middle and back office operations based on the client's treasury policy. It sits between the client and the client's relationship banks.

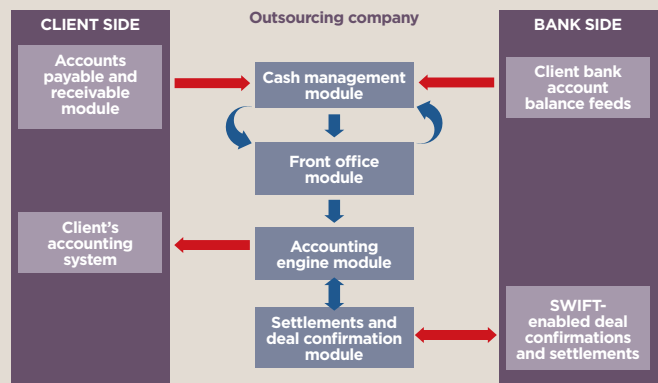
In order for the system element of the TOM to work, the outsourcing company's TMS has to be integrated with the client's banking and accounting systems, since the cash management module of the TMS requires timely and accurate data for the front office staff to perform their daily cash management activities. Feeds from the client's accounts payable and receivable module will help to give greater visibility on cash movement.

This, coupled with feeds from the client's banking system, will help to give a consolidated view on the organisation's daily cash position, forecasted liquidity and FX exposure.

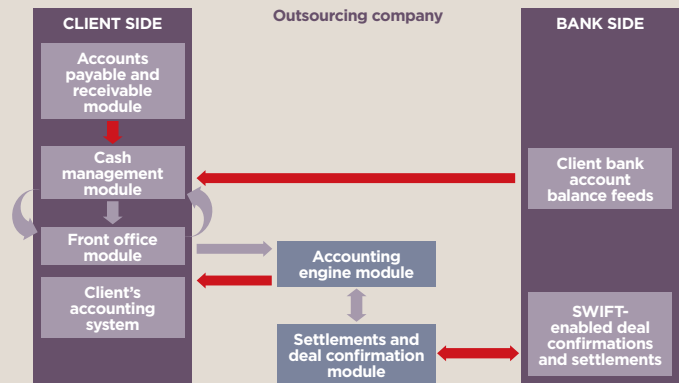
The middle office staff (via the accounting engine module of the TMS) performs daily accounting on the treasury's activities and the results are fed straight into the client's accounting system. This process is also used to produce daily management information. At the same time, the middle office performs all risk monitoring and hedge accounting activities.

The back office (via the settlements and deal confirmation module of the TMS) has access to the client's bank account. Once all of the treasury deals have been approved by at least two people, and confirmed with the counterparty bank, the

AGENCY TREASURY MODEL



MIDDLE AND BACK OFFICE MODEL



back office releases the cash from the settlements module of the TMS.

2. Agency-treasury light TOM

This is exactly the same as the agency treasury model, but with two key differences. The client is kept closer to the daily dealing decisions and the client has sole and exclusive privileges (via the TMS) to release cash payments.

3. Middle and back office TOM

The third model deals with outsourcing the middle and back office functions only. The activities undertaken by the middle and back office functions will be exactly the same as under the agency treasury model and all deal confirmations and cash settlements will be performed by the outsourcing company because it aids segregation of duties.

4. Back office TOM

This model is the same as the middle and back office offering, but with the middle office activities removed.

Strategic objective

The objective of outsourcing is to help organisations focus on one word: 'core'. The barriers to outsourcing treasury activities are being lowered so smaller and mid-cap organisations can access all of the benefits of a centralised treasury function and more established treasury operations can outsource tactical and operational aspects of their work. ♦



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