

# Finding a partner to suit your company's needs

By tapping into the expertise of an outsourcing partner, the decision support function in your firm can be greatly enhanced, as Nigel Fox of ARC discovered.

With ARC's background mix of a rapidly expanding company and a highly competitive market (see box), the key operational focus for the finance team for 2001 was set on controlling the growth of the business. This meant focussing on strategic finance activities such as business performance measurement, cost analysis and strategic planning support. Decision support is an essential value-added area for the finance function and has the potential to provide a greater competitive advantage for the company.

According to research by Hackett Benchmarking & Research, however, most finance managers now spend more time on the 'grunt-work' of processing transactions and allocate less time to such value-added activities than they did in the 1990s. The average finance manager now commits nearly three-quarters of the day to routine tasks. But we were keen to avoid this situation.

A conscious decision was taken, therefore, to outsource activities we felt were not central to our team's role. These activities were liquidity management of our IPO proceeds and related foreign exchange risk management, as well as the treasury processing function.

A concern often expressed about outsourcing is one of loss of control. But we believe this does not have to be the case. It must be recognised that strategy and policy-setting rest with the firm. Only the implementation of agreed treasury policy should be outsourced. On this basis, outsourcing can provide a greater focus and offers the treasurer the opportunity to leverage their own skills and increase their profile within the company.

The efficiency and effectiveness of ARC's finance team has been greatly increased by outsourcing and we are now free to concentrate on decision support activities. Other factors behind

Most finance managers now spend more time on the 'grunt-work' of processing transactions and less on value-added activities than they did in the 1990s

our decision to outsource were:

- it has allowed us to reduce fixed and variable costs, although this did not mean a headcount reduction in the finance team, rather a reduction in the systems and processes required to support an operational treasury activity, such as monitoring, deal processing, market information services;
- we wanted to ensure optimisation of the value our treasury exposures represent by spreading credit risk between a number of well-rated banks; and
- we wanted to improve returns on the



Nigel Fox



The year 2000 was an exciting one for UK-based ARC International, a leading designer and developer of customisable high performance microprocessors and related intellectual property systems:

- turnover increased by more than 450% to £10.9m;
- its number of employees grew by more than 170% to 279 worldwide;
- global operations were expanded in France, Germany, Israel, Sweden, the US and Canada, and ARC moved to new UK headquarters in Hertfordshire;
- two software companies were acquired in the US and Canada;
- ARC International was successfully admitted to the Official List of the United Kingdom Listing Authority and to trading on the London Stock Exchange in September 2000; and
- The initial public offering (IPO) raised £126.4m and provided a platform from which to develop the business.

ARC International has three main objectives for the coming year:

- to extend technological leadership and maintain revenue growth through deeper penetration of the three main markets (telecoms, networking and consumer electronics);
- to secure more blue chip clients; and
- to build further on relationships with original equipment manufacturers (OEMs). ■

flotation funds, while still maintaining liquidity.

### Choosing a partner

In choosing an outsourcing partner, several factors were of key importance to us:

- **track record** – for a fast-growing company in a specialist market, we needed to ensure our outsourcing partner would fully understand the needs of our business, through a track record of providing outsourcing services to companies in similar situations;
- **performance benchmarking** – we also wanted to be able to track the value of our business against an industry-recognised independent benchmark;
- **resourcing** – did the outsourcing partner have the experience and resources to be able to manage competing requirements from different clients effectively?
- **expertise** – we wanted to access a dedicated source of recognised expertise to help us manage our treasury business on a continuing basis and to provide strategic input as regards balance sheet management.

We chose The Royal Bank of Scotland's Agency Treasury Services (ATS) team, led by Tom Roche. The Royal Bank was well placed to provide a tailored solution for ARC, after steadily building a presence in providing outsourcing services to the IPO market over the previous 12 months.

Following discussions, through which we were able to satisfy our checklist, we awarded our treasury outsourcing mandate to ATS in October 2000.

We have a full treasury risk management service provided on an outsourced basis which handles:

- liquidity management of the flotation funds;
- foreign exchange risk management, which involves identification, analysis and risk management of the multi-currency cashflows to, from and between overseas subsidiaries;
- treasury administration and support duties, such as payments and confirmations; and
- regular management and performance reporting against an agreed benchmark.

It is important that there is regular communication between the partners, to ensure consistency and effectiveness of treasury policy

### The risks of outsourcing

The risks associated with outsourcing can range from sub-optimal performance, which ultimately impacts the P&L, to increased workload through managing poor communication flows between the outsourcing partners. However, these risks can be managed effectively in three ways:

- **checklist** – clearly set out the key features you require of an outsourcing partner from the start. Measure competing tenders against these features to ensure they best fit with your requirements;
- **service level agreement** – clearly set out the roles and responsibilities expected of both parties. With ATS, this is done by way of a mandate that covers what services are being provided to ARC by ATS and how each service will work in practice; and
- **benchmark** – measure performance against a recognised benchmark. What benchmark is appropriate will depend on the services being provided, but this should be able to be negotiated with your outsourcing partner and reviewed on a regular basis to ensure continued appropriateness and effectiveness.

### The service in more detail

On our side, we provide ATS with cash-flow forecasts on a regular basis – weekly, monthly and quarterly. This is an important point, as the value of the service is dependent upon regular two-way flows of communication. ARC retains strategic control over policy-setting, with ATS undertaking all policy implementation and reporting. As a first step in agreeing the parameters of the

service, ATS created a model which reflected our cashflow requirements and risk/reward parameters. This model covers:

- credit limits – maximum exposure per approved counterparty;
- counterparty list – list of authorised banks/financial institutions minimum credit quality permitted;
- instruments permitted – range of authorised financial instruments, in this case, bank term deposits and certificates of deposit and approved amounts per instrument;
- time limits – maturity profile for the pool of funds; and
- authorised signatories – list of designated personnel who could approve changes to the agreed investment policy.

From here, an investment portfolio was created, which was then implemented by the ATS team acting as agent for ARC. To ensure dynamic management of our investment needs, the portfolio is constantly monitored. We approve adjustments to the portfolio as suggested to us by ATS.

These adjustments can take the form of lengthening or shortening the maturity of the investment decisions. It can also be the introduction of new instruments designed to increase the yield on our flotation funds.

To meet our requirement for spread of counterparty risk, ATS manage the proceeds of the IPO out to a pre-agreed panel of banks. A competitive tender approach is taken, to ensure competitiveness of rate. treasury administration and support duties are included in the service. Dedicated support staff handle all of the outward payments for ARC as well as confirmations to these banks.

Typical daily activities which have been outsourced include:

- accessing cashflows showing anticipated inflow and outflow of funds from transaction settlements and maturing treasury trades;
- determining appropriate maturity split for funds placement by reference to the yield curve and preferred maturity split;
- examining counterparty credit exposures to determine the amount of funds that can be placed with each bank;

- calling a sample of banks from the approved panel for prices in a variety of maturities and amounts, recording the rates offered to monitor competitiveness;
- agreeing rates and placing funds for the selected maturities;
- attending to the production of confirmations for all money market deals to counterparties;
- checking all incoming confirmations for accuracy; and
- handling payments of funds to counterparties taking funds.

From a control point of view, it was vital our service was conducted on a discrete basis.

This requirement was satisfied. Each client has their individual details configured on the ATS processing systems in a segregated area distinct from that which supports the rest of the Royal Bank's client business and to which only ATS staff have access.

**Performance rating**

ATS also report on a monthly basis on the performance of the funds under management. Following detailed discussions, a suitable performance benchmark was agreed. This is a Libor-related benchmark which clearly allows value to be measured against market performance.

By outsourcing treasury to a multinational financial group, we have received additional benefit in terms of return.

The level of expertise of your outsourcing partner, when combined with an established presence in the market, can bring the benefit of scale for a company in dealing with counterparty banks.

ATS operates a dedicated team of dealers. In the money markets, they monitor the twice-daily liquidity announcements from the Bank of England and their potential impact is considered before trades are undertaken on ARC's behalf. Hence, we have often received prices that are 'better than market'.

We receive daily trade listings from ATS plus a comprehensive monthly report which details the amount invested during the month, maturity of trades, performance against benchmark and market commentary.

The reporting format is flexible and ad hoc reports have been provided on particular market issues, for examples,

For companies at particular life cycle stages – such as flotation or acquisition – outsourcing could be seen as a way of enhancing a competitive advantage

solutions to combat the reinvestment risk arising from the shape of the yield curve in the early part of this year.

By tapping into the expertise of your outsourcing partner in such a way, the decision support function in your own company can be greatly enhanced.

**FX/interest rate risk management**

It is important foreign exchange exposures are related back to an underlying liquidity management programme, given the links between them.

For ARC International, with dollar exposures, we have been able to receive foreign exchange risk management advisory structures from ATS on an ad hoc basis.

Upon notification of a new exposure, ATS is able to analyse the exposure and provide a range of solutions to hedge the risk, based upon the parameters of a pre-agreed forex hedging policy.

As with the liquidity management service, this policy covers the products, tenors, credit limits and authorised signatories.

A company can gain significant value from having both asset and liability profiles managed as part of an outsourced service.

The outsourcing partner should be able to identify exposures across both profiles and employ interest rate risk management tools on behalf of the company, to neutralise their effect.

Therefore a strong argument exists for considering all elements as part of an integrated treasury management service to be outsourced on that basis.

**An effective management tool**

It is important to recognise that outsourcing is not a blanket solution.

Rather, it should be viewed as a strategic management tool, which can be deployed to great effect in one of several situations. It is of greatest value for:

- those companies wishing to focus on core competencies,
- those companies with no resource, time or capability to perform this function in-house;
- those seeking to strip out additional costs; and
- those businesses seeking to leverage the skills contained within their present treasury team by outsourcing operational activities; and
- for companies at particular life cycle stages – such as flotation, acquisition, merger or management buy out – outsourcing could be seen as a way of enhancing a competitive advantage.

The analyst and investment community are also likely to be very receptive to the demonstrable steps taken by a company towards the professional management of its treasury risk through a service such as outsourcing.

For an outsourcing service to work, it is important that the boundaries of the service are set from the very start and that there is regular communication between the outsourcing partners, to ensure consistency and effectiveness of treasury policy implementation. A breakdown in either of these areas will affect performance.

For ARC International, outsourcing our treasury function has proved a worthwhile exercise. Leaving aside the benefits experienced, from a purely financial position, we have received value. Since October 2000, performance has been consistently above benchmark.

This has allowed us to focus on building our business. This year we are confident that we will build upon the strong platform we have created for the company. And at this early stage, we believe we are on course to achieve our objectives. ■

*Nigel Fox is Group Financial Controller ARC International plc.*  
[nigel.fox@arccores.com](mailto:nigel.fox@arccores.com)  
[www.arccores.com](http://www.arccores.com)

*Contact at The Royal Bank of Scotland:*  
[tom.roche@rbos.com](mailto:tom.roche@rbos.com)