Why outsourcing makes good sense for treasurers

Ian Talbot of JPMorgan explains how outsourcing can leave treasurers with more time to focus on strategy and risk management – and save money in the process.

If you haven't been thinking about outsourcing in the past, now is an excellent time to start. The concept of outsourcing of significant elements of the treasury function is becoming an increasingly feasible option for companies. But by not considering outsourcing options, treasurers may be in danger of missing out.

First, let's consider the data. The ACT's UK Cash Management Survey 2000 (in association with JPMorgan) and the 1999 European Cash Management survey (conducted by JPMorgan) asked questions in relation to treasury outsourcing. Respondents from a variety of countries completed the 1999 survey at the EuroFinance Conference in Lisbon. In response to the question "are you considering reorganising your treasury management over the next 12 months, including outsourcing?", a significant 49% said "yes".

The 2000 survey was conducted among UK treasurers only. A disappointing 84% of respondents indicated that they were not considering outsourcing specific areas of their treasury function within the next 12 months. Clearly, this is a concept that has gained greater credibility outside the UK and yet there are some impressive examples of UK groups which have successfully outsourced aspects of their treasury.

Core competency?

Perhaps some of this reluctance arises from some confusion over whether treasury processing is a core competency. Clearly, if a function is not a core competence then today's view is that this should be a target area for investigation. A three-question test for identifying core competencies is as follows:

- if you were starting out today, would you do this yourself?;
- would other companies pay you to do this for them?; and

> Recruitment, training, development, supervision, career planning, annual appraisals, these all become a thing of the past

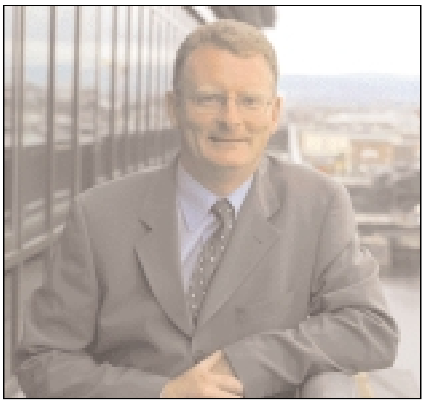
- will your future CEO come from here?

Obviously, interpretation is everything – if your answer to all three is 'yes', then the function is a core competence. Any other combination of answers suggests that further analysis may be merited.

Reasons to outsource

To follow is a quick checklist of other reasons to outsource.

- **Cost saving –** The 2000 survey found that 77% of respondents considered themselves to be a cost centre. Outsourcing is an established method of providing the most up to date services at a cost-effective price.
- **Technology changes –** technology moves ever forward and if your treasury processing is performed in-house, you are constantly having to keep up with the latest developments, how they impact your business, what the cost/benefit mechanics are, and how long (and how much) it will take to install and implement. The group which outsourced this function do not have to worry about this any more.
- **Growth –** capacity planning for growth becomes the responsibility of the outsourcing provider. This is particularly attractive when that next big merger happens.
- **Business continuity –** have you still got the February 2001 edition of *The Treasurer* sitting in your in-tray, waiting to get time to read that Spotlight section again and prepare yourself to begin the gap analysis with your existing plan? Treasurers who outsourced their treasury processes have the time to read this but don't need to because it is the concern of their outsourcing provider.
- **Staffing –** recruitment, training, development, supervision, career planning, annual appraisals, these are all areas that become a thing of the past.
- **Control environment –** the greater scale of an outsourcing provider can bring enhanced controls in areas such as segregation of duties, holiday cover and so on.



Ian Talbot

Where is it performed?

Treasury outsourcing providers have been evolving for more than 10 years. The reasons for that evolution are slightly different in different regions. In Europe, one of the biggest concentrations is in Ireland, where a large number of international and local banks and some independent entities offer services. The initial driving force was tax based, after the Irish Government extended its favourable

10% tax rate in 1990 to cover profits from inter-company finance vehicles, whether staffed by a company itself or by a service provider on its behalf.

Over a period of time, the service providers built up the range of skills and experience necessary to run treasury operations from end to end, and now many provide these services independently of Irish legal entity structures. A number of these providers have also invested heavily in treasury management systems such as SunGard Treasury Systems and Trema Treasury Management and effectively provide the straight-through processing capabilities of those systems to their clients as part of the service.

Usually, these providers are remunerated by an agreed administration fee reflecting the service provided. Therefore, as a sweeping generalisation they are providing services the company could perform itself given the resources and investment, in a more cost-effective manner.

Another area of concentration is in South Africa. This market appears to have evolved largely through a lack of skills available in the country's expanding economy and is dominated by independent service providers, rather than banks. The market is also categorised by remuneration made up of a combination of administration fees and performance-related fees for improving returns, reflecting the dearth of skills as the main driver, rather than expense efficiency.

Treasury outsourcing operations are also now developing in Asia and the US. In Asia, the currency crisis of 1997 and subsequent liquidity constraints have forced many companies to create better structures around their regional treasury needs. Outsourcing represents a great opportunity to avail of an infrastructure to administer new treasury tasks arising as a result, although the variety of regulations in the region can be a constraint. US companies are extensive users of treasury outsourcing services for their European operations and are now also looking at opportunities for outsourcing domestic tasks. Equally, non-US groups are looking at US outsourcing providers to run their treasury processes in the US.

But what is the best option? To outsource treasury functions to a bank or a non-bank entity? The biggest arguments in favour of banks are scale, size of balance sheet and availability of funds for investment in technology. Non-banks argue that their advantage is the objectivity their independence brings in processes such as competitive bidding of foreign exchange on behalf of a client. A bank provider also provides independence but based on internal 'Chinese Walls' policies.

Case Study – Avecia Limited

Avecia is a leading global fine and specialty chemicals company focused on delivering innovative technology and service excellence to clients across a range of high technology industries. Formerly Zeneca Specialties, Avecia was created in June 1999 following the chemical industry's biggest ever private investment buyout. The challenge facing Peter Whyte, the Treasurer of Avecia, in May 1999 was that as the only member of the Zeneca treasury team who would be moving to the new group, he had only six weeks to create a treasury operation. That operation needed to be able to service in excess of 60 active subsidiaries, each of which were used to having a central treasury function co-ordinating the group's inter-company loan portfolio, foreign exchange transactions, multilateral netting and daily cash management processes. "It would probably have been impossible to build a robust operation internally in the time available to us," says Whyte. "However, by using a treasury outsourcing provider with a pre-existing infrastructure and systems, we were able to replicate the entire infrastructure required in time for the first day of the demerger. JPMorgan continues to provide the infrastructure required to carry out all these processes, which have evolved and expanded to meet the new group's developing needs. This has left me with the time available for exposure risk management and strategy development without the administrative efforts involved in running day-to-day operations. We are now looking to apply a similar model to our expanding Asian operations." ■

Typical processes outsourced

The following are typical treasury administration processes which are commonly outsourced:

- intra-company loan portfolios;
- in-house banks;
- commercial paper programmes;
- funding and investment requirements;
- foreign exchange and hedging requirements;
- pooling/cash concentration structures and other daily cash management processes; and
- multilateral payment netting process.

The typical activities undertaken to deliver these services are as follows:

- information collation;
- deal execution within pre-agreed parameters, including competitive bidding;
- confirmation, settlement, reconciliation and monitoring;
- investigation and escalation;
- documentation; and
- reporting and accounting.

Potential dangers

Critical to a successful implementation is that the processes to be outsourced are clearly defined, understood and documented. The group subsidiaries also need to understand the rationale and how outsourcing will impact their interaction with treasury. In many cases, they may feel threatened by a perceived loss of control or influence. But good communication and discipline will help to manage this. There is also a danger that a group may become overly dependent on their provider. Maintaining a close working relationship and partnership approach, and working with a robust creditworthy provider, can reduce the likelihood of being left high and dry.

Looking increasingly to outsource

Treasury outsourcing will undoubtedly experience significant growth over the next two years, with web-based technology being a significant driver and enabler. The treasurer's role will continue to exist to retain overall responsibility and ownership, to identify and set strategies appropriate for the risks and exposures of individual groups and to perform other tasks such as bank relationship management. But the processes created to implement those strategies will increasingly be outsourced. ■

Ian Talbot is head of JPMorgan Global Agency Treasury.
Ian.talbot@jpmorgan.com
www.jpmorgan.com