FINDING A WAY TO ADD TRUE VALUE

CAN OUTSOURCING REALLY DELIVER GENUINE BOTTOM LINE SAVINGS? **DECLAN LYNCH** AND **BRIAN FEIGHAN** OF JMH TREASURY FIND OUT.

Companies use different principles to guide major decisions and these principles change as market conditions change. Broadly, these principles can be captured as: reducing or containing costs; improving operations; enabling strategy; or organisational restructuring.

At any one time, a firm's focus will be aligned primarily with one of these and that focus will greatly influence its justification of any outsourcing decision. Some companies do focus on using outsourcing solely to cut costs from their operations. Many providers do not approach the market with solutions focused on cost reduction alone and here is where we have some potential disconnect.

In this article, we shall look at the extent to which costs are the key driver of outsourcing, examine some ways which treasurers can ensure that planned cost savings from outsourcing can be quantified and delivered and suggest that focusing on cost alone is really limiting the world of outsourcing opportunities available to treasurers.

DEMAND FOR VALUE. The number one driver behind the growth in outsourcing today is an increase in the number of companies that are reviewing their internal operations in an attempt to more fully understand their true core competencies, and focus on only those competencies. All other internally provided services then become candidates for examination in terms of how efficiently and effectively those services are being delivered, compared with what is available from an external service provider. The decision process often includes an evaluation of the cost of owning technology – with its associated support costs – that is not core to the company. This is leading to an increased willingness to outsource processes considered non-core, yet critical – activities such as back office processing.

For many companies the investment required in treasury technology and infrastructure is difficult to justify, expensive to maintain and, ultimately, delivers a poor return on investment. An outsourcer can manage all of those infrastructure-related functions for multiple companies – and perform those functions extremely cost-effectively.

A secondary driver of growth in this market is a desire by companies to optimise resources and maximise efficiency. Outsourcing offers companies an opportunity to do so in many cases and at the same time removes the requirement for the capital expenditure that would be necessary if the company sought to improve these internally.

The third most prominent driver of growth in this market – not surprising, given the current economic environment – is a desire by companies to extract all possible costs from within their internal operations. Any chance of decreasing transaction-processing costs frees up precious capital that can then be applied to more strategic initiatives.

The potential cost savings in treasury outsourcing will vary depending on a variety of factors, including:

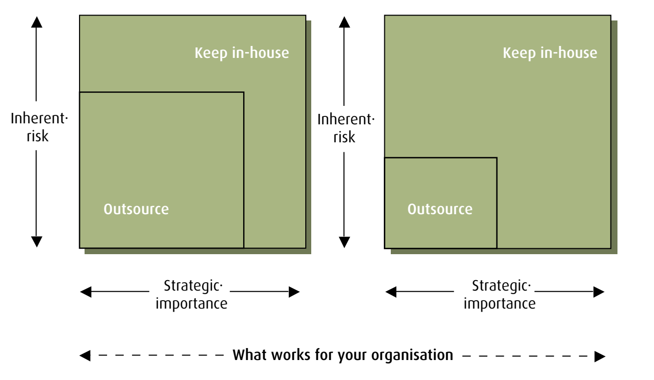
- the degree of automation in the current environment;
- the extent of centralisation of treasury activity;
- the extent of cost efficiencies in the current environment based on analysis and benchmarking;
- the existing knowledge of the all-in costs of operating treasury activities; and
- the degree of customisation required to service the specific client.

Value propositions and forecasts of potential cost savings from outsourcers naturally differ. Average costs savings will vary greatly from company to company and you must also factor in the value of some difficult to quantify benefits such as higher levels of control, more efficient processing flow and the acquisition of current technology. Current adoption rates are still relatively low and it is hard to generalise about cost savings.

There are also different types of 'outsourcing services', ranging from single business processes through to full-scale managed service arrangements. What works will vary from company to company. Where most of the action is taking place is in the back office area. What matters most is that you decide what works for you (see *Figure 1*).

In general, cost savings/benefits are similar across industries. However, treasury structures do impact the savings/benefits

FIGURE 1
SCOPE OF SOLUTION.



achievable from an outsourcing solution. In particular, the extent of centralisation of treasury activity is a key factor. Generally, the higher the degree of centralisation, the greater the cost savings/benefits achievable are. However, bear in mind that if cost is your major driver, there is only so much you can squeeze out. For the majority of companies, treasury typically does not amount to more than a couple of people and support structures are not over-extensive.

True – what is compelling about the current outsourcing models is their ability to deliver cost effective access to resources not available in-house (people, process and technology).

True – there is a range of benefits these solutions can deliver, including:

- Improved financial performance, which includes reduction in operating expenses, making better use of available capital funds, and gaining improved market pricing for financial transactions.
- Contribution to business effectiveness, which includes more focus on the business, gaining access to industry best practice, re-directing management and staff to other added-value functions and improving financial control.
- Improved internal controls effected through greater independence of reporting and valuations and effective segregation of duties.

True – these models are more suited to companies not having large, professional in-house treasury organisations. But is this only part of a bigger picture that today's treasurer should be focused on?

UNLOCKING THE REAL VALUE. Since companies discovered that they could save money and improve productivity simply by outsourcing their non-core processes, providers rushed to serve their needs. Today, many buyers would still contend that a lot of the noise being generated is still coming from the vendors and maybe they are right. It may be that the problem is that the needs being served by many of the current providers are only part of a much larger picture.

Now, as the drive to create real business value through outsourcing accelerates, two trends are emerging. It is becoming more evident that the traditional boundaries of treasury are widening and that the full working capital cycle is now within the treasurers remit. Some vendors are realising that the real value may lie beyond classic treasury.

While there are plenty of opportunities to outsource in the working capital cycle, the opportunities tend to be fragmented; only addressing certain functions within the chain (for example, accounts receivable or treasury). Combined integrated solutions are, however, starting to emerge and these have the potential to deliver greater benefits to companies.

Web-based technology is enabling enhanced visibility of data, greater flexibility and integration. The ability of service providers to extend their solutions to combine multiple offerings on a single platform would undoubtedly make the whole much more attractive than the individual parts.

A NEW MODEL? Some suppliers have already made significant investments to create combined integrated solutions. One example is the move to integrate trade receivables financing. The concept stays the same. The service provider still brings scale, access and critical mass to the market. The proposition provides even greater value.

The technology at the core of most treasury outsourcing solutions provides enterprise-wide visibility and reporting of cashflows. Extend this – using overlay technology which sits on top of existing accounting infrastructure – to provide a real-time monitoring system that tracks each invoice through its life cycle and now you have a platform that enables you to potentially tap a new source of funding. Combine this with recent technology developments that make larger transactions significantly easier to execute and that open up the market to companies rated below investment grade and you start to see where real value can be added. This is highly relevant to treasurers currently because:

- securitisation funding is often substantially cheaper than bilateral finance – savings can be millions of pounds per year;
- corporate liquidity is tightening;
- there is a general perception that corporate creditworthiness is deteriorating; and
- new banking regulations (Basel II) mean capital weightings for bilateral loans will go up (potentially to 150%) and capital weightings against structured assets (for example, a securitisation) will go down (potentially to 20%).

While various traditional flowing assets, such as mortgages, car loans and credit card receivables, have been successfully securitised on a broad scale, the securitisation of trade receivables represents less than 4% of the market size.

MOVING ON. Advances in technology and the ability of service providers to combine/integrate multiple offerings will take the treasury outsourcing market to the next level and, in our view, significantly increase the relevance of the value proposition to the treasurer.

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