Non-tax factors in treasury centre location decisions

Aengus Murphy of FTI considers the implications for multinationals of setting up a new treasury centre or centralising an existing treasury operation in Europe.

This year, we have begun to see a big shift in the factors influencing treasury centre location decisions in Europe. The reason for this is that there are three fundamental changes in the motivation for setting up treasury centres and the nature of the operations being established. This article looks at the issues involved from the perspective of a multinational company (MNC) setting up a new centralised operation or centralising existing treasury operations in Europe.

The first fundamental change is that MNCs are setting up genuinely substantive operations to meet treasury service needs of the European subsidiaries of the group – instead of the minimal activity tax-driven structures that were the norm up to the recent past. These needs have been generated mainly as a result of the business globalisation trend underway for the past five years or so. Globalisation has led to the formation of new European groups or sub-groups of previously unrelated entities, where now a structured and effective treasury management solution is needed.

The second change, which to a large extent results from the first, is that MNCs are now tending to separate tax structure/location decisions from operational treasury centre location decisions. The reason for this is that it is too difficult to simultaneously satisfy the requirements of a substantive treasury function and those of the tax department.

The solution is too complex and too slow to deliver. Some international tax advisers are now beginning to advise the following:

- to set up a simple and effective tax structure in such a way as to deliver the required tax result, a tax-driven decision; and
- to set up the treasury operation in a way that meets the service needs in the best way.

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MNCs are now actually doing this. But some corporations can and do still satisfy both dimensions with the one solution.

The third change is that, in line with the general business trend, treasury operations are now frequently outsourced – particularly regional treasury centre operations set up by MNCs outside of the home territory, these centres acting as satellites of the group or HQ treasury. MNCs are finding that it is no longer practical to set up one, two or three-person treasury operations in Europe – it is difficult to recruit specialist experts; too difficult to retain them; difficult to manage them from a distant HQ treasury; and too difficult to manage the performance needed. Hence the trend towards outsourced solutions.

Aengus Murphy

I have set out these points by way of background, but they represent key developments that CFOs/treasurers should be aware of in making treasury location or structure decisions.

Non-tax factors

What are the non-tax factors that should be considered in making treasury centre location decisions? I am ignoring all tax aspects – corporate tax rate, withholding tax, tax treaty issues and the like. But it is worth noting that companies will often not locate in the 'best tax' location in Europe if the balance of the other non-tax factors do not favour that location. For example, Hungary may provide a 'best tax' solution, but at present many treasurers would be slow to establish their European treasury centre there.

Also it is worth noting that of the six treasury functions set up/to be set up by FTI this year, only one had a specific tax dimension, although obviously the overall tax environment and longer term tax horizon in Ireland is favourable should a tax requirement arise in the future. Also, all six functions opted for the outsourced solution.

The non-tax factors that generally, in my judgment, would be prioritised are as follows below.

Cost

This is still a main influence, especially since cost items tend to be expensive in these solutions – people, premises, IT and telecomms. There is also a wide variation in costs from one location/country to another. While not all locations are covered by the information available to me, the comparative bar charts in *Figures 1*, *2* and *3* demonstrate this.

FIGURE 1

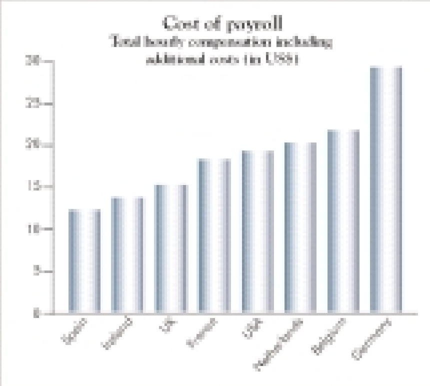


FIGURE 2

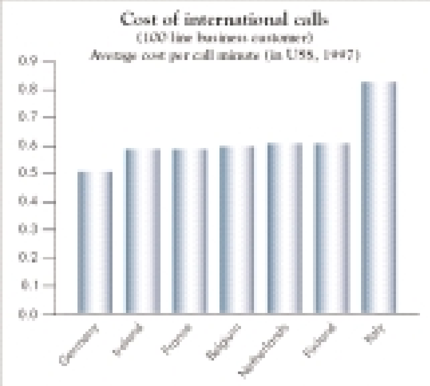
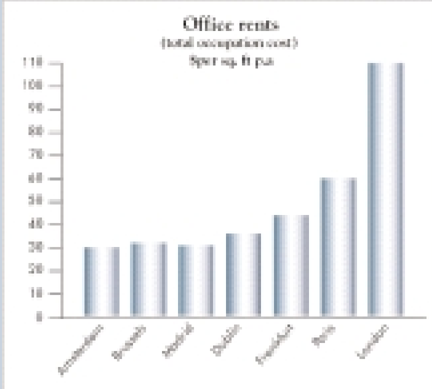


FIGURE 3



Outsourced option availability
Vying with cost in priority, the availability of an outsourced solution these days is a major influencing factor. This has been discussed above. To my knowledge, IFSC in Dublin ('Dublin Docks') is the only location from the 'recognised' list, where an extensive and professional infrastructure is available for outsourced solutions.

The reason is that many of the specific structures allowed by the Irish authorities in the IFSC had to be outsourced – hence the infrastructure of solutions, business models, people, know-how, and systems emerged over the past 12 years.

Location of other operations
Often companies will locate their treasury operation within or close to another key business operation. This is to reduce cost – utilising the facilities and resources of the other operation – and to have a reasonable treasury control framework. Hence, we find treasury operations in Germany, France and the UK where the full range of factors would not be favourable.

Having said this, sometimes treasury operations are set up in 'neutral territory' when political or 'turf' issues arise. Again, of the six operations being established by my company this year, four have no other operations in Ireland.

Centres of expertise
High quality treasury expertise is scarce. Getting access to an expert resource pool is a significant influence on location decisions. Most of the 'recognised' list of centres have built up an expert resource pool by now. But the tight labour market in these locations and for these specialists makes resourcing an issue. Outsourcing can resolve this issue to a large extent.

FIGURE 4

'Recognised' location list
Holland (BVs)
Belgium (BCCs)
IFSC, Dublin
Luxembourg Switzerland 'Lux/Swiss' Channel Islands and some Mediterranean Islands (specific operations)
UK (to some extent)

Control
Increasingly more directors, CEOs and CFOs are taking a direct interest in control on treasury activities. In many of the treasury centre operations my firm manages, the primary motivation has been to achieve best practice control standards – often there will not be a strong financial justification for setting up the centre. Where control is the key requirement, then the centre will be established where a control framework can exist.

This will tend to be where outsourcing is available or where other sizeable group business operations exist. The aim is to achieve, or replicate, as far as possible, the front, mid and back office model.

This requires a sufficient number of knowledgeable persons, which as mentioned before, cannot be achieved in a one or two-person operation.

Figure 5 sets out the control framework for outsourced treasury operations which operates in my firm.

FIGURE 5

Control framework for FTI

Control framework

- **Audits**
  Statutory audit
  Group internal audit
- **Authorities/limits**
  Documents enforced
- **Back and mid office**
  Suite of effective and independent checks and controls
- **Board/parent**
  Approves plans, policies, strategies, control framework
  Reviews performance
- **Front office**
  Professional staff
  Operating policies, controls and procedures
  Transaction security and taping
- **FTI financial controller**
  Compliance officer
  Internal control
- **Managing director**
  Active management role
- **Regulation**
  Continuous by central bank
- **Reporting**
  To internal management
  To board
  To client control personnel
- **Senior staff**
  Independent
  Authorisation
- **Systems**
  Modern
  Control and security conscious

The euro

Many companies will look to set up their treasury centre in euro-land, to simplify FX issues in the solution, either from a transactional or a translation perspective. This is an issue for the UK, Switzerland and most Scandinavian countries at present as locations.

Banking system and regulation

CFOs and treasurers prefer to site their treasury operations in locations where modern banking is available and where regulation is strong. This is for security and 'comfort' reasons. Most of the recognised centres have robust banking and regulation environments, although some are more reassuring than others.

Language

English is the predominant financial language. For some MNCs this is an important factor, especially where the HQ and many of the European subsidiaries, or the finance executives within, are English speaking.

Name recognition

This is a tendency to stay with the tried and tested, hence the 'recognised' list. No treasurer will put any part of their anatomy on the line by taking a risk with a new or aggressive solution. CFOs and treasurers are risk minimisers!

So, new locations such as Hungary or some of the Mediterranean Islands have a long way to go to establish themselves as treasury centre locations – tax location being a different matter, as discussed.

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So, these are the non-tax factors. In trying to come to a conclusion amid all the factors, it is now common practice to use a disciplined score-card approach, comparing the location options.

The score-card may address treasury-only factors or treasury and tax factors, whichever is relevant. A simple matrix with location across the top, factor down the side, a weighting for each factor – depending on what is priority for any one MNC, and a score computation to help guide the decision. ■

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