FOR CORPORATE TREASURERS WHO WANT TO OUTSOURCE THEIR ORGANISATIONS' DAY-TO-DAY LIQUIDITY MANAGEMENT, THE FINAL DECISION ON WHICH SERVICE PROVIDER THEY ARE GOING TO USE IS ONE THAT MUST BE VERY CAREFULLY THOUGHT THROUGH, WARNS **PETER HAZOU**.

CASHING IN ON OUTSOURCING

Virtually every corporate activity is a candidate for outsourcing – from outsourcing core activities to the management of the outsourcing itself. In fact, the most effective business model no longer places demands on doing everything in-house. Companies are increasingly relying on partners to take care of their core and non-core activities.

The decision to outsource is always best made as part of a broader and deeper calculation of corporate goals and strategies – and the outsourcing of cash management is no exception. While there is no doubt that cost is one key motivator for outsourcing, this is, by its own very definition, a bottom-line concern which is usually most focused on the short-term. Outsourcing decisions should, however, be made with the long-term perspective in mind, and corporate treasurers must take this view when outsourcing liquidity management and/or any other elements of their treasury practice.

The investment services company Gartmore recently decided to outsource its back office as part of a broader restructuring strategy to focus management time on managing money and client services, while meeting cost and risk reduction requirements. This is part of a long-term commitment to outsourcing which began in the mid-nineties, and has led to a number of similar moves, including the outsourcing of transfer agency, custody and fund accounting. The plan now is for its banking partner to take over its London-based back office systems and transfer over 100 staff across to the bank. The outsourced contract is for transaction processing and related foreign exchange, custody, portfolio and fund accounting, and performance measurement for its European institutional and retail products.

Executive summary

- The decision to outsource should be made as part of your company's long-term strategy, not purely to reduce immediate costs.
- Treasurers are interested in outsourcing liquidity management, particularly cash pooling and management of inter-company loans.
- Outsourcing liquidity management was considered 'hot' five years ago, but is now common practice for both corporates and their banks.
- Choice of service provider is vital as reversing the outsourcing process is difficult if things go wrong.
- Questions to consider include: will outsourcing reduce staffing requirements and eliminate the need for support services such as IT, and will it eliminate high levels of spending on infrastructure?
- The levels of automation offered by your service provider are crucial.

WHAT SHOULD YOU OUTSOURCE? Today, corporate treasurers are most interested in outsourcing their day-to-day liquidity management, particularly cash pooling, and the administration of inter-company loans.

Pan-European liquidity management sees all of an organisation's liquidity from its subsidiaries across a broad geographical area pooled together and managed by a third party in one location. Considered 'hot' outsourcing as little as five years ago, this is now a routine activity for both corporates and their banks, and is available as a suite of products commonly known as Overlay Liquidity Management. The latter comprises all the tools required for the consolidation of a corporate's liquidity such as pooling and cash concentration.

Aside from liquidity management, the execution of foreign exchange swaps, investment decisions (within strict guidelines), accounting and reporting, management of payables and receivables and multi-lateral and third-party netting can also be outsourced to a third party, bringing major benefits to a treasury operation.

However, while outsourcing may appear an attractive option in many cases, certain elements of treasury practice may prove highly unsuitable. For example, policy or risk decision-making, the management of strategic external relationships and the selection of eligible counterparties for lending and investment purposes is best conducted in-house. Any type of activity that is considered fundamental to a company's core business should also remain in its own hands.

WHY OUTSOURCE LIQUIDITY MANAGEMENT? When it comes to deciding whether or not to outsource their liquidity management, corporate treasurers should always undertake a cost benefit analysis.

One of the key points to consider here is whether outsourcing will provide you with the economies of scale you want, and allow your company to focus on its core business. At the same time, resourcing issues should also be addressed – will outsourcing reduce your personnel requirements and eliminate the need for additional support services such as dedicated IT back-up? Will it also eliminate high levels of spending on the infrastructure required to manage liquidity internally?

Any downsides should also come under the microscope. If there is no clear business case to outsource liquidity management, then corporate treasurers should not be tempted to do so. Likewise, if you feel uncomfortable with the liability outsourcing presents and believe that you will lose control of vital processes – or cannot find the expertise required from outsourced services providers – you should not pursue this route. Regulatory and/or legal issues can also present a barrier to outsourcing.

EVALUATING YOUR PARTNER. Outsourcing is not a decision that is easily reversed, so extreme care and due diligence must always be taken when selecting a service provider. Payment factories are commonly outsourced – almost always to the immediate benefit of the treasurer, who suddenly finds that all payments and collections are taken off his/her desk, and consolidated at a bank that takes over all of the processing. But as your company structure evolves and your requirements change, you may want your outsourcing partner to take on other aspects of the treasury function such as management of investments. Does your partner offer the scale and resources required to offer a fuller service?

Though some elements, like your service provider's trustworthiness, character and commitment, may be hard to measure, there is a proven range of criteria for evaluating an outsourcing partner. These include:

- Does your partner have sustainable capability – without stretching – to perform the tasks required?
- Is there a robust customer service model in place?
- Does your partner have a business model that will make the arrangement profitable for both of you?
- Does your partner have the scale required to offer a sustainable service to you over your long-term?
- Will you get the built-in flexibility you will need in the future?
- Does your partner learn from its customers? And is your partner likely to be responsive to your changing needs?

Once you have made the all-important decision to outsource, it is vital that you select your provider carefully. Amongst the other key criteria that you should bear in mind are relevant experience, market share, your partner's ability to provide management information and, of course, costs and personnel.

AUTOMATION IS CRUCIAL. Another feature by which you should assess your outsourced services provider is the level of automation offered.

Why outsource?

The main reasons why a corporate treasurer should consider outsourcing are:

- **To effect a long-term corporate strategy;**
- **rebalance core and non-core activities;**
- **improve company focus;**
- **meet time-to-market and cycle-time challenges; and**
- **gain immediate expertise in a suddenly critical arena.**

'OUTSOURCING IS NOT A DECISION THAT IS EASILY REVERSED, SO EXTREME CARE AND DUE DILLIGENCE MUST BE TAKEN WHEN SELECTING A SERVICE PROVIDER'

In the past, corporate treasuries have performed an outsourcing role by gathering faxes from subsidiaries, making calculations of regional liquidity, and then deciding which banks to fund and which to defund in order to optimise regional liquidity. Today, most major banks supply these and related services on a fully-automated basis. They implement cash pooling and other services, which automatically consolidate a corporate's liquidity position in a single location.

An outsourcing agent that manages liquidity – or other types of activity – on a manual-entry basis will never be as responsive, resilient and adaptable to changes outside and inside your organisation as one that has automated processes in place.

Automation allows a solution to be scaleable, meaning that no matter how much of your liquidity management and other activities you chose to outsource, your partner will always be able to meet your needs. It can also result in a higher standard of management information that is delivered electronically to you via a direct interface with your organisation's own systems. There is little point in outsourcing your transaction processing only to have to input the same transactions manually yourself when it comes to accounting for them.

As we look to the future, it may be feasible to question if there is a normal path companies should follow when outsourcing – that is move forward from the outsourcing of a payment factory to more intricate investments?

The reality is that much of the current big-ticket outsourcing is a fairly new phenomenon, and business models have yet to be developed in such a way that they fully evolve around it.

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