CONCEPTS IN OUTSOURCING

YOU MAY BE RELUCTANT TO OUTSOURCE YOUR TREASURY, BUT OLIVIER BRISSAUD OF VOLKSWAGEN COORDINATION CENTRE IN BELGIUM BELIEVES THAT IN THE SHORT TERM, IT CAN BE A COMPANY'S SAVING GRACE.

Outsourcing aspects of your treasury is a subject you will have certainly come across in many publications recently. The idea is bound to shock the people concerned – the fact is, outsourcing results in fewer people being employed by the company. But let us take a closer look to find out about the pros and cons and begin by establishing the *raison d'être* of a corporate treasury department.

WHAT IS CORPORATE TREASURY? The task of the treasurer has always been to guard the 'treasure' – the financial resources – as is still evident in the Germanic languages which are more self-explanatory: *Schatzmeister* in German, *Penningmeester* in Dutch. On ancient pictorial representations you can see a man, generally of a mature age, keeping a watch over a heap of gold pieces, surrounded by soldiers. His role has thus always been to ensure the availability of the financial resources needed to sustain action, regardless of the circumstances. Later on, when the era of fixed exchange rates ended during the 1970s, many companies whose activities were affected by exchange rate fluctuations felt compelled to recruit qualified staff, alongside their normal treasurer, to manage that risk.

Which trader would want to lose his or her commercial margin (or even more) because of fluctuations of the currency in which the invoice is made out *vis-à-vis* their own? The modern treasurer therefore is a person who, based on full knowledge of the company's activities, objectives and environment, assesses and quantifies financial risks, suggests risk hedging strategies to the decision makers, implements adopted policies and evaluates their efficiency. There are therefore two sides to the job: a more conceptual and a more operational one. Let us find out what is hidden behind the concept of outsourcing.

WHAT IS OUTSOURCING? The basic idea is this: to be operational, a company needs a number of functions or 'functionalities', as one would say in systems language. However, the know-how required to provide these services is not always available in-house. Examples are the management of the company's car park or restaurant. Mechanics and cooks are not natural parts of a company's profile if the company happens to be a bank, for instance. Other companies, however, are specialised in these fields, which are their very *raison d'être*. Why then recruit cooks and mechanics if you can sign a contract with professional providers and get a similar or even better service? While this practice is now widely established, it has until recently only been applied to areas fairly unrelated to the company's core business. Banks have so far not entrusted third parties with the conception of their products over a longer period, and the same goes for software manufacturers who always realise their basic applications themselves. That seems obvious. But there are grey areas such as human resources (HR) management, electronic data processing (EDP) or treasury. Although everyone agrees that good HR management is key for the success of a company, increasingly more elements of this function are now covered by third-party contracts – payroll management is the most frequent example of this kind. This takes us to the question as to which aspects of corporate treasury might similarly be outsourced, and, if so, why and at what price?

WHICH ELEMENTS OF CORPORATE TREASURY ARE SUSCEPTIBLE TO OUTSOURCING, AND WHY DO IT? The idea is nourished by two converging trends. One is that the large international banks employ staff who are extremely well qualified in many fields, including corporate treasury. They wish to exploit their material infrastructure and human resources as best they can. At the same time, there is the obsession – imported from the other side of the Atlantic – to reduce the number of permanently employed people as much as possible, since personnel costs traditionally represent the lion's share of a company's costs.

Given that treasury management requires increasingly sophisticated, and therefore expensive, know-how one may well ask whether these competences must be available in-house or whether it makes more economic sense to rely on the skills of experienced bankers to fulfill this function. This is a quantum leap: so far, the tasks that were outsourced have always had a high operational content, and savings, in terms of headcount, were significant. But, as mentioned earlier, in treasury the conceptual part is essential and does not represent a large number of employees.

Fair enough, say the proponents of this technique, let us focus on the operational part – that is, processing 'routine'-type financial operations and following them through to the arrival of the bank statement in accounting. The job of a front-office and a back-office, in short. Risk hedging assessment, strategic planning and efficiency control would remain in the company. Even so, there will always be complex operations one would wish to keep confidential and which could therefore not be taken over by a third party supplier. To deal with them, the company will have to keep some basic infrastructure, front and back office. Outsourcing will result in a reduced headcount at best, but some people will have to stay on. The question therefore is whether or not the fixed costs connected with keeping the remaining staff operational (market information sources, treasury system, segregation of duties and the like) dilute the advantage sought by personnel cuts.

OTHER REASONS FOR OUTSOURCING TREASURY FUNCTIONS. As we saw earlier, the main driving force behind the approach is cost control through systematic personnel cuts. But might there be other reasons leading to the same decision? Without going too much into detail, we can easily identify two. The first may be the findings of an internal or external audit according to which the company must invest in the qualification of people or systems – the 're-engineering' of tools, systems and procedures – to attain the level of 'best practice'. The question in this case is whether it might not be dangerous to entrust to others the management of processes that are judged suboptimal on an internal basis. The other case in point may be the consequence of a severe crisis, major fraud, acquisition of a large company or business relocation to countries where sufficiently trained people capable of taking over these tasks are not available. In both cases, the company might conclude that the investments required to attain the objective are not a priority or are too costly.

OUTSOURCING: HOW, TO WHOM AND AT WHAT PRICE? The third party that is to carry out your financial operations will have to be a professional partner, and a bank obviously comes to mind; interestingly, some counterparties proclaim to be 'neutral' in terms of banking interests. You will have to draw up specifications in as much detail as possible to be able to compare different offers in full transparency and to make sure the parties know what is expected of them. This should help to facilitate the subsequent drafting of a service level agreement with the partner of your choice.

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The process still remains onerous – in particular if you wish to prevent serious misunderstandings at a later stage. Trust is of the essence, but I believe the final agreement has to be vetted by lawyers and, as everyone knows, they don't come cheap.

Last, agreement compliance and supplier's performance control must take place through well set and precise 'benchmarkings'. The duration of the agreement is just as essential – permanent outsourcing will be managed differently from tactical outsourcing where all that is needed is time to get organised. We know from experience that it takes three to six months for treasurers to conclude their outsourcing programme with suppliers.

Agreeing on the price for the service will doubtless be the most delicate phase of the process, given that the decision to resort to it will most likely be based on economic considerations. As far as I know, best practices or standard rates for this type of service contracts do not exist. Therefore, it is necessary for the cost controllers to check the relevance of the move ex post.

ADDED VALUE OR NECESSARY EVIL? If we agree that for the reasons mentioned above a company cannot totally forgo its treasury competences in-house – and this may be more true for larger than for smaller companies – the question remains nevertheless whether savings can be achieved by outsourcing parts of a parent company's treasury to a third party. I believe outsourcing can be imperative in situations of acute crises, but for no longer than the time needed to rebuild an adequate team, one or two years at most. It can also be justified if a regional treasury has to be maintained, whatever the reason. A typical target could be the European treasury of a US mid-cap.

My view is that a modern group treasury must design its processes in as precise, transparent and reliable a manner as possible. It must also make the best possible use of all technologies available on the market. Treasurers will have to master managerial skills beyond treasury if they want to be recognised as genuine interlocutors by the other corporate functions such as sales and risk management and, of course, the more related functions of accounting and controlling. If this is the case, treasury and its head will be considered a real added value to the company rather than a necessary evil to be got rid of.

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