5.4.2 Outsourcing Treasury Exercise Answer

Unit: Unit 1 – Treasury Strategy

Module: Module 5 – Treasury structure

Date: 1 March 2012

Summary: Answer to exercise requiring views on the feasibility of outsourcing some or all of a company's treasury functions.

Answer 1

Motivations

- Fill a resource or skills gap: Unlikely here, unless Bradley was to expand into new markets, products or sourcing which required skills which existing treasury doesn't possess.
- Free up scarce resource to focus on critical or strategic aspects of treasury: This would be a motivation for Bradley. Treasury needs to free up time to investigate innovative and value adding solutions to support the business. Treasury is also likely to need to use more effort in supporting operating units – partly to ensure that they use financial resources efficiently but also because of the impact of existing outsourcing or cost (people) reduction initiatives.
- Achieve more value: This will be a motivation – Treasury needs to obtain as much value as it can from the assets (and arguably the liabilities) under its control, and outsourcing specific activities may represent positive NPV.
- Have better control of the high-risk treasury activity: another motivation – with enhanced control should come decreased risk and hence decreased cost.
- Get access to better systems solutions: This is an alternative aspect of the prior point. Bradley needs efficient systems – an ASP solution for Bradley's Treasury Management System (for instance) should save the costs of database administration, backups, upgrade installation and testing and so on.

Benefits

- cost savings through sharing the supplier's economies of scale
- efficiency benefits through higher technology investment by the outsourcing supplier compared to what Bradley can afford
- free up resource for value-added activity
- hedge against technology/market changes
- more flexibility to grow (or downsize)
- buy in process and markets expertise
- enhanced control through contractual service level agreements (SLAs)

Drawbacks:

- loss of control, flexibility and commitment, despite terms of SLA
- inflexibility should major changes affect Bradley, e.g. acquisitions, divestments
- possibly difficult to enjoy improvements in technology (as dependent on provider)

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- outsourcing strategic activity exposes Bradley to the risk that the relationship with the outsource provider sours, and that Bradley cannot easily bring the activity back in-house or reallocate it to another provider.
- The provider still needs management and time devoted to it from Bradley management to ensure that it is performing well and to review its output.
- de-skilling of treasury function, with consequent loss of efficiency as treasury no longer has the expertise to question outsource provider's results or performance.
- business managers deprived of 'organisational learning'
- need to develop expertise in managing service suppliers

Answer 2

For all current and expected treasury activity, if the activity is not core or value adding, Bradley should review the possibility of outsourcing; otherwise it should look to automate the activity in-house. In addition to differentiating core/non-core, the decision is likely to depend on:

- cost saving versus fee to pay (hence an NPV evaluation)
- ease of specifying the task
- ease of measuring performance

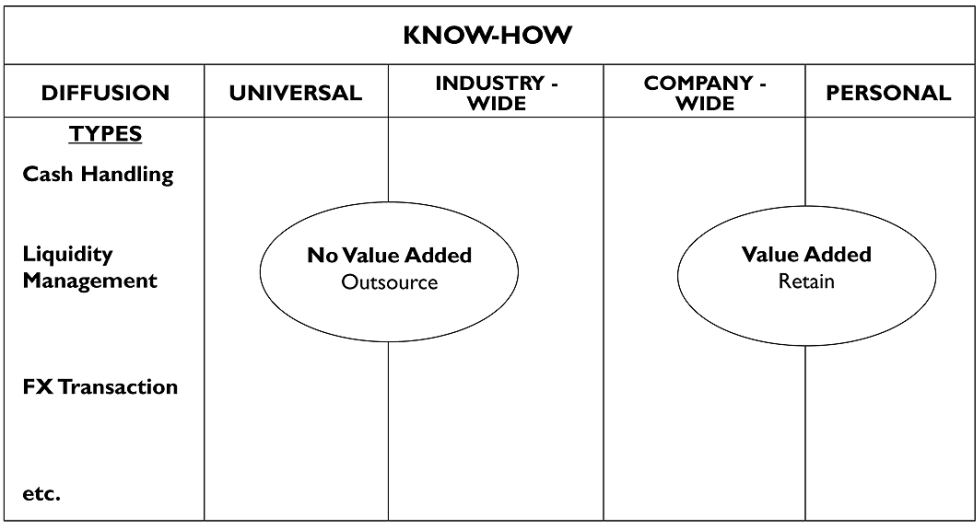
Note the following points:

- Almost anything can be outsourced if need be.
- Possible splits of activity include strategic/operational: front / middle / back offices: by activity: by geography.

Bradley therefore needs to consider the possible splits and evaluate outsourced solutions accordingly. Note that providers' expertise may vary with these splits, so Bradley might (say) outsource its US cash management activity because it is a straightforward process and the US provider has a good name in the market; but keep European cash management in house because Bradley can't find a counterparty who will meet Bradley's requirements (including an agreement) at a price Bradley is willing to pay.

An alternative way to differentiate treasury activities is to classify them in terms of the underlying knowledge and skills (know-how) necessary for their execution, for example, how diffuse is the know-how and how is it embodied:

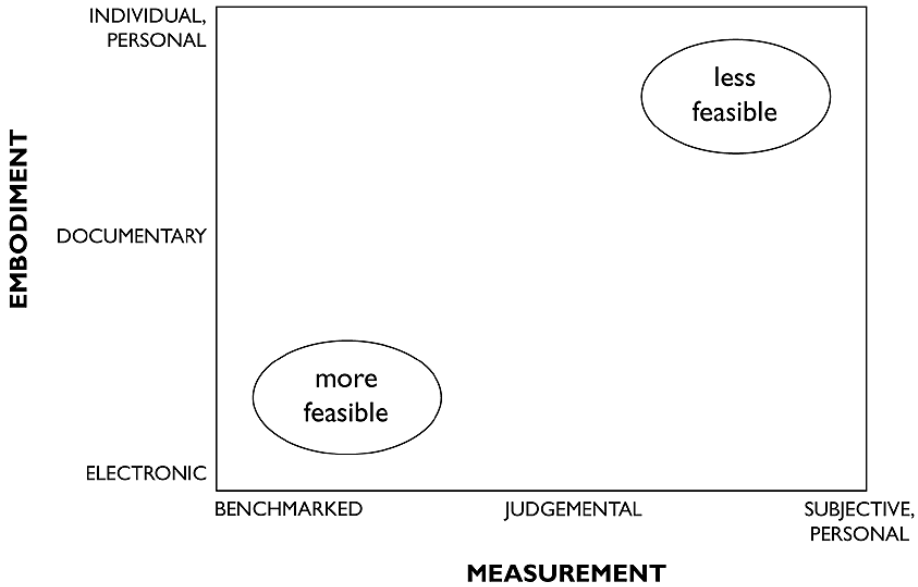
Exhibit 1: Knowledge and skills



Know-how which is less diffuse and company/individual specific is more likely to be value-added and less likely to be outsourced.

The embodiment of the know-how and the objective of measuring performance will have a dominant impact on feasibility.

Exhibit 2: Feasibility



- pooling/cash concentration structures and other daily cash management processes (this may be part of a bank offering for the transactional business)
- a multilateral payment netting process
- commercial paper programme maintenance
- intra-group loan portfolios and maintenance
- mechanistic funding and investment requirements
- foreign exchange and hedging requirements, and advice & forecasts regarding levels in the market
- an in-house bank

Answer 3

- Feasibility of control is one of the overall feasibility criteria; control is a key element of any outsourcing model.
- In addition Bradley must:
  - ensure it retains management of the outsourced process
  - does not fall into the trap of “out of sight, out of mind”
  - clearly specify and document the service(s)
  - devise a service level agreement setting out roles and responsibilities of each party
  - impose benchmark measures of performance
  - build in provision to “ditch and switch” suppliers if need be
  - make the outsourced activity subject to internal audit
  - ensure the outsourced activity is included in external audit
  - re-tender at intervals, e.g. triennially – note that this implies a willingness and ability for Bradley to move the business if need be

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