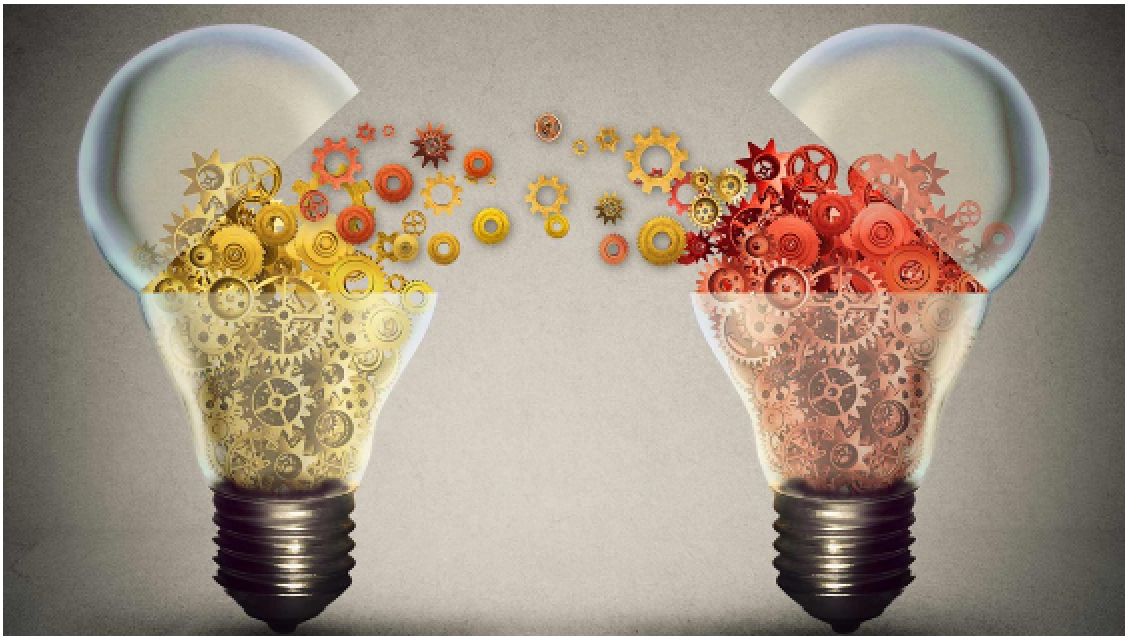
treasurytoday group
research | insight | analysis

Risk Management

Is outsourcing a cop out?

Published: May 2023

In a cost-cutting environment, treasurers are under pressure to consider outsourcing. But very few have yet taken the step towards outsourcing core treasury functions. For now, it is non-core activities such as data management that are being handed over to third parties.



As inflation and borrowing costs rise, treasurers are under pressure to cut expenditure as much as possible. Some believe that outsourcing – whereby selected activities are handed over to third-parties to operate – is the answer, but is it? Damian Glendinning, Chairman of the Advisory Board of research company CompleXCountries and former Group Treasurer of Lenovo, says many treasurers are under pressure to outsource but he is not aware that any treasurer has outsourced a core treasury function.

While it makes sense to outsource functions that are not core skills, particularly where those skills are difficult and expensive to acquire, outsourcing core treasury functions carries the risk that control will be lost over such functions, he says.

"The first question to ask if you are thinking of outsourcing is what is pushing you to consider it and why and what do you hope to achieve?" he says. "Typically, the main reason is cost savings, but treasurers have to be careful they aren't penny wise and pound foolish."

Outsourcing service providers will argue that rooms full of people undertaking daily, repetitive tasks are ripe for handing over to a third party. However, Glendinning says any treasury that has a big team doing repetitive tasks every day "has a problem". In many cases, the problem resides in the systems and processes. Sort these out, he adds, and the need for such people – and outsourcing the tasks they are doing – disappears.

Alastair McGill, General Manager, Data Control at Broadridge Corporate, agrees that treasury operations are under the same pressures as other corporate functions and face the "inevitable challenge" of delivering more for less each year. "Any aspect of their operation that can be performed more efficiently outside of their direct control is worthy of consideration for outsourcing," he says. "The acceptance and trust that Cloud service providers have established means that from core treasury applications to cash and liquidity management systems, critical treasury systems are now seen as targets for outsourcing from a technology perspective."

Justin Callaghan, CEO of Dublin-based treasury services and advisory company FTI Treasury, says when it comes to outsourcing, the company's clients retain strategic treasury functions such as front office trading. Two principal areas are outsourced: the management of inhouse bank (IHB) structures, and back and middle office services and systems. "Outsourcing the IHB structure, which includes daily cash management, is very popular particularly with North American multinational companies that wish to have their international FX and cash management handled for them," he says.

Callaghan says there has been a narrowing in the field of processes that are being outsourced. "People realise that outsourcing works well for particular processes. What has also changed is that treasury systems have come on in leaps and bounds, which has improved the level of direct integration we have with our clients' systems, enabling us to provide reports directly into their ERP systems, for example," says Callaghan.

Andy Schmidt, Global Industry Lead – Banking, CGI, says corporate treasurers are looking to outsource non-core functions that require "specialised capabilities or do not provide a competitive advantage. Common examples include payments, liquidity management, cash flow forecasting, and receivables management where connectivity to payment networks can be key," he says.

Nadeem Shamim, Global Head of Cash and Liquidity Management at software and services company SmartStream, points out that bank treasuries do not outsource any of their treasury functions "because they are heavily regulated and any problems would have a direct impact on their liquidity buffers".

Operational and regulatory risk are the main obstacles to outsourcing bank treasury functions. "Outsourcing services providers cannot be bespoke to everyone – one size does not fit all. It is likely that outsourcing companies will not necessarily have the updated information on legal requirements that a bank is obliged to have," he says.

What is typically outsourced in bank treasury departments, however, are reconciliation processes, he adds. "Reconciling cash and liquidity at the end of the day appeals to treasurers because it is not a time-sensitive task," he says. "SmartStream also provides stress testing of previous liquidity with different scenarios, based on data provided by the bank."

Regulatory reporting for the Basel III capital adequacy requirements is also ideal for outsourcing, he adds. "There is an opportunity for banks to outsource the effort of gathering the data, putting the results in the right format and delivering them to the regulator."

Reconciliation processes are "designed for outsourcing" because of their staff-intensive nature, says Shamim. "Many reconciliation systems and processes are antiquated and use a lot of manpower. By outsourcing these processes, a treasury can reduce the size of its teams and redeploy those people to run something else."

Glendinning, however, believes that the manpower intensive nature of reconciliations is more due to "the junk that is going through" the systems than the process itself. "Treasurers should be asking themselves why such an intensive workload is being created. Much of the time it is because of wrong inputs. A key part of all administrative functions of finance is that when things go wrong, you need to understand why and what are the issues that are taking place in the company. If you outsource those processes you will never know – the knowledge acquired by the person at the outsourcing provider is not held within your organisation."

> *Treasurers have to be careful they aren't penny wise and pound foolish.*
>
> **Damian Glendinning, Chairman of the Advisory, Board CompleXcountries**

Loss of control is an issue for treasurers when considering outsourcing. McGill notes: "Any time a process moves outside of your direct control there's a risk – which is why it is important to have the same level of control over your outsourced provider as you would have done had you kept the process inside the organisation." Broadridge ensures it remains certified on all relevant certifications, performing its own audits and bringing in external auditors to review processes. Clients are also able to audit the company's operations.

Callaghan agrees that control is a critical issue, particularly when it comes to risk. However, he feels that rather than a treasury department losing control by outsourcing "it is directly the opposite. We spend a lot of time agreeing with our clients the parameters in which to operate. Treasury has absolute control but doesn't have the administration and expense of the process," he says. The parameters are reviewed quarterly and the FTI team contacts clients on a daily basis. "We operate as part of a client's treasury team. It is an 'old school view' that outsourcing is separate."

The key task for treasurers, he adds, is to identify an outsourcing services provider partner that will control the operating environment and expenses. "They should ask how well controlled the outsourced environment is and how much experience the people who will be running processes have. I would add to that the need for independent auditing every year and evidence that the outsourcer is providing services to companies in your peer group."

McGill agrees, noting that there is a risk in outsourcing of "passing over your operations to a third party that doesn't apply the same level of controls that you would have taken internally. You need to be confident that the outsourcer can demonstrate a control system that is proven to meet your requirements and the requirements of any regulatory body." In outsourcing, he says, corporate communication takes place externally, which results in an increased communication effort. "Outsourcing therefore requires clearly defined communication channels and regular exchange."

Advances made in "less visible but equally critical services" such as monitoring and alerting technologies that provide essential control over critical operations have also helped to address concerns about loss of control, adds McGill. These services deliver early insight into unexpected events that could disrupt payment services. "There have also been advances in automated deployments and testing, making it easier for providers to keep clients' environments up to date with the latest patches, with minimum disruption. It is not just the infrastructure though; it is also the people and the services that are wrapped around that technology that are just as important."

Outsourcing has "inherent risks", says Schmidt, and these risks are frequently changing. "The challenge is being aware of the changes and understanding how these changes can impact your business. For example, privacy and security are risks that are well-known, and are common topics of conversation in any outsourcing relationship. At the same time, emerging risks including pending regulations such as the Digital Operational Resilience Act in the EU and climate change – or more accurately, climate resilience – are increasingly part of the outsourcing conversation and are also important topics."

Callaghan says outsourcing is "very suited" to day-to-day operational treasury tasks that ensure the smooth running of the department. These include daily cash management, management of zero balances, notional pooling, administration of intercompany loan portfolios, multinational netting management and implementation of FX hedging strategies. Some processes, he says, are not appropriate to outsource. "The more non-transactional treasury activities, which rely heavily on a treasurer's or CFO's relationship with banks, are not suitable to outsource."

Treasurers should define what they want to outsource, says Callaghan, and understand the difference between daily operational elements and the more strategic elements within a treasury. "I would recommend treasurers ask three questions of an outsourcing service provider: do you currently provide services to other clients in my peer group; do you have any third-party accreditation in your control environment; and can we speak with some of your clients?"

Outsourcing such activities, argues Glendinning, is not the right answer. "The correct solution is to improve the systems that are being used. The key factor for outsourcing to work is that everything has to fit into a predetermined set of transactions, with no exceptions. Those operating the systems have no autonomy. These people won't take the initiative or make a judgement, they will just follow a recipe. Weak finance teams would rather outsource activities to another company so it is not them saying 'no' to a client."

While Glendinning believes outsourcing amounts to something of a 'cop out' on the part of a treasury team, Shamim argues otherwise. "For many treasury teams the decision to outsource is based on the fact that they have a problem they just don't know how to resolve. An outsourcing service provider will deliver reports and feedback on their processes and how they can be improved. A treasury team can spend a lot of time and effort in trying to fix internal issues, or they can move that process out and focus on their unique selling point, which is not reconciliations," he says.

Callaghan also argues against the idea that outsourcing is a cop out. “We are bringing to the table knowledge in terms of processes,” he says. “We manage around 30 in-house banks and we can see what works well. I advocate outsourcing those activities that are the day-to-day activities that do not add strategic value but need to be done. If I were a group treasurer, I would prefer to have a small team of experts doing the high value treasury projects such as managing bank relationships, rather than a large team of people that are consolidating data and acting upon it, for example.”