Corporate Treasury Outsourcing – A Function Best Left to the Experts?
An Analysis of Corporate Treasuries in Sweden

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Abstract

As corporations attempt to streamline their operations to keep pace with a competitive global market place, the range of activities that are seen to be part of the core competencies is becoming narrower. Corporations are beginning to outsource activities that are closer and closer to their core competencies and the treasury department is one of these. The purpose of this thesis is to analyse how a third-party provider provides outsourced treasury services to corporations and how would this differ for different companies. Multiple-case studies are used as our chosen method where Skandia Capital (SCAP) is our case study for a treasury outsourcing services provider. Corporations’ treasuries will be examined to determine how they could benefit from treasury outsourcing to SCAP. The findings suggest that from a provider’s perspective, different solutions will be required for different corporations. A successful outsourcing relationship will need to evolve with time where the provider and corporation are partners in risk management rather than just a buyer and seller of a service.

Keywords: Risk Management; Core Competencies; Outsourcing; Outsourced Treasury Services; Third-Party-Provider; Centralisation; Organisational Change
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Alphabetical Index of Important Terms used in the Study

Application Service Provider: A company that offers and manages outsourcing application services to organisations via the Internet.

Centralisation: The act of consolidating power under a central control.

Competitive Advantage: The ability of a firm to add more value to a given good/service than a competitor.

Core Activities: The set of activities of an organisation which are likely to yield a competitive advantage compared to other activities.

Core Competence: A firm’s distinctive capability; what a firm does best.

Critical Mass: The minimum amount (of something) required to start or maintain a venture.

In-house: Within the organisational boundaries of the company in question.

Internal Control: (for a treasury department), internal control is a process effected by an entity’s board of directors, management and other personnel, designed to achieve the objectives of having effective and efficient treasury operations.

Multinational: A company whose operations are not restricted to one country.

Outsourcing: The fundamental decision to reject the internalisation of an activity.

Real Time: (in programming) in relation to computer systems that update information at the same rate they receive information.

Rogue trader: A trader who acts independently of others - and, typically, recklessly - usually to the detriment of both the clients and the institution that employs him or her. In most cases this type of trading is high risk and can create huge losses.
List of Abbreviations

ASP: Application Service Provider
BOD: Board of Directors
CEO: Chief Executive Officer
CFO: Chief Financial Officer
HKD: Hong Kong Dollars
IAS: International Accounting Standards
NKR: Norwegian Kroner
SCAP: Skandia Capital Aktiebolag
SEK: Swedish Kroner
SICL: Skandia Insurance Company Ltd
SSE: Stockholm Stock Exchange
TMS: Treasury Management System
USD: United States Dollars
CHAPTER 1 - Introduction

In this section, the background to the research is given and the reason why we have decided to embark on this research is identified. This section also lists the series of research questions for the study. This is reflective of the fact that the problem is not just one problem but a series of problems.

1.1 Background

In 1994 a rogue trader by the name of Nick Leeson brought down Barings, which was Britain’s oldest merchant bank. More recently in 2003, a rogue foreign exchange trading episode at a major Australian bank caused losses of $360m USD (Clerkin, 2004). Both of these cases are of financial risk management gone wrong. They have brought the attention to inherent operational risks in treasury operations and called for the need for internal control. Leeson was in charge not only of the execution of trades in the front office of the treasury department but he was also the head of the back office where he oversaw reconciliations and the verifications of the trades were completed. Senior management at Barings did not realise the danger of such overlapping of responsibilities within their treasury department.

Corporate treasury departments depend entirely on the underlying business and its associated market risks (Hall and Andersen, 2000). They are seen as a support unit for the organisation and although it is not a core function it is seen as a critical function for the rest of the business. The objective of the treasury is to reduce the risk for the organisation by executing hedging strategies. The treasury department is costly to run and is normally structured as a cost centre (Hall and Andersen). Laker (2005) stresses the core competence of a treasury department should be that of risk management, not of a short-term profit making unit.
The treasury-services industry has faced a major change in recent years due to the increasing level of regulation on risk management and the need for internal control. A fundamental level of control in the area of risk management is required irrespective of the type of business a company is involved, to ensure the company does not face financial loss (Moore, 2005). New technology with regards to treasury management systems (TMSs) has also provided significant advances in functionality, improving communications and connectivity to financial data.

Associated costs required to develop and maintain a ‘sophisticated treasury’ - an otherwise fully equipped department for risk management - include recruiting and retaining high calibre staff, maintaining the right number of staff to ensure internal control and investment in technology and systems. Such costs have led senior management of corporations to question the value that is added to the business from incurring them (Hall and Andersen, 2000).

The need for treasury services arises due to the business the company is in as well as the way in which senior management chooses to manage the risks it faces. The larger multinationals tend to have higher risk exposures and trading volumes to warrant the implementation, support and maintenance costs that are attached to having a full in-house sophisticated treasury system. Treasuries in small and mid-sized multinationals do not always have the sufficient trading volumes like larger multinationals (Celsing, 2005). The size and scope of a business therefore can determine the sophistication of its treasury.

The situation has prompted senior management to consider treasury outsourcing as an alternative solution to the treasury and risk management of the corporation, especially for the mid-size multinationals. Treasury outsourcing is contracting a specialist third-party provider to undertake part of the treasury function on its behalf, rather than undertaking all of that function in-house (Murphy and Fogarty, 2004). For a fee, a third-party provider will do the same job for a corporation, however on a more effective
level as third-party providers of outsourcing can take advantage of their economies of scale and their dedicated and qualified resources and ideally can offer the service for less money (Hall and Andersen, 2000).

Outsourcing of treasury services began in the late 1980s in Dublin when the Irish government decided to attract the city as a tax haven for corporations\(^1\). Outsourcing became common because some of the corporate treasury structures were only permitted on the basis they were outsourced by the Irish authorities (Murphy, 2003). Treasury services include the risk management and management of financial transactions within a firm.

Banks and other financial institutions are gaining an interest in this market to offer their services to companies who want to outsource their treasury functions. Acting as third party providers in this outsourcing relationship, banks can utilise their core competence in risk management and their economies of scale to offer treasury services to corporations. Treasury activities and functions depend on the underlying business of the corporation. Therefore outsourcing treasury services will differ with each corporation.

The topic of treasury outsourcing was introduced to us by Skandia Capital (SCAP), a subsidiary of Skandia Group (SICL), which is the group’s treasury department and internal bank. The purpose of the research is to study SCAP as a provider of treasury outsourcing services and the characteristics of their current client as a corporation who has outsourced their treasury. This will give us insights into the range of services on offer from SCAP and how they are actually implemented, which subsequently allows us to ascertain whether there is a matching of the services with the needs of other mid-size corporations in Sweden. We plan to examine the

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\(^1\) The International Financial Services Centre (IFSC) was set up with a special 10% corporate tax rate for certified companies setting up in the IFSC from 1987. From the end of 2002, this 10 percent rate ceased to apply to financial services companies, except for those operations that were set up before July 1998, which will continue to avail of the 10% rate until the end of 2005. All other operations are now subject to the standard corporate tax rate of 12.5 % on income (IFSC website).
characteristics of potential clients, in terms of both the financial risks they face and the characteristics of their treasuries. The aim is to determine the most suitable companies that SCAP should look for as potential customers—that is, the companies whose characteristics and needs best match the services that SCAP can provide.

1.2 Research Background

In this section we will discuss the topic areas and issues relating to corporate treasury which led us to our research questions. The purpose of this section is to offer further background to the research questions and how we came to formulate them for this study. An introduction to Skandia Capital (SCAP) is provided, as they are the provider of the treasury outsourcing service. We will also present the criteria for selecting the most suitable clients.

1.2.1 Financial Institutions as Outsourced Treasury Service Providers

Financial institutions such as banks are one type of treasury outsourcing provider in the treasury outsourcing market. The development of corporate treasury services is an extension of the relationship banks already play with companies. Firstly they supply the operations and secondly they are assisting with risk management (Lind, 2003). Banks are also in the position to offer treasurers more sophisticated techniques for hedging.

Banks that are outsourcing their treasury services are generally very large and therefore have the resources and infrastructure to have a state-of-the-art treasury department. Large banks have the expertise, technology and critical mass to be an outsourced treasury service provider (Imeson, 2004). They are faced with a large volume of transactions and financial exposures which warrant the costs of having a sophisticated in-house treasury department. For corporations the treasury management is a critical function since its role involves controlling and monitoring the financial flows that go in to and out
of a company. However the treasury management does not form part of the company’s core competencies, whereas for banks risk management is part of its core business.

The outsourcing service provided by banks is usually payable by a fixed fee with a yearly renewal (Large, 2003). For the company this can be an issue, to invest the money to build a real treasury or to pay a fee yearly to the bank for treasury services. The company must be able to justify the cost and the fee payable must match their service requirements and expectations (Murphy and Fogarty, 2004). The outsourcing relationship must also be long term between both parties since both have made an investment of time and money in the solution. Some providers no longer accept outsourcing of a single function (for example the back office or administrative tasks) unless there is an agreement that if successful then this will lead to the company outsourcing more (Murphy and Fogarty).

1.2.2 Skandia Capital as an Outsourced Treasury Service Provider
SCAP has been a provider of outsourced treasury services for a company in Sweden since 2001. Their current client is Rottneros, a paper and pulp company based in Sweden. SCAP had not been a provider of outsourced treasury services before entering into the relationship with Rottneros. The arrangement between the two parties has been regarded as fruitful and SCAP is keen to develop their corporate treasury outsourcing services. Rottneros will be the model for one type of client SCAP would like to cater for in Sweden.

1.2.2.1 Skandia Group
SCAP’s parent company Skandia Group (SICL) was founded in 1855 and is an independent provider of long-term savings and pensions. They are situated in over 20 countries with the largest markets being the UK and Sweden. The group’s head quarters are in Stockholm, Sweden. They have
£51 billion under management and they have an A rating from Standard & Poors and from Moody’s an A/3 stable rating.

1.2.2.2 Skandia Group’s Risk Management
Skandia Group’s risk management is decentralised which means there is a separate entity called the Risk Control function which does the group risk aggregation and the reporting. Each business unit and corporate function at Skandia group is responsible for managing their own risk within the constraints set out by the Board in their policies. They are also responsible for their own risk assessments and submitting risk reports to the Risk Control unit. It is the responsibility of the Board to set the framework for risk management.

SCAP is a corporate function within the group, and it is responsible for the Group’s subsidiaries financial transactions. SCAP’s risk-taking limits are set by the Skandia group’s board of directors and are also specified in their Finance Policy. It is the responsibility of the head of SCAP to manage the risk for the department and send the risk reports to the Risk Control Unit.

1.2.2.3 Skandia Capital’s Services
As mentioned previously, it is up to the individual business unit to take care of their risks. For financial risk exposures, the subsidiaries of Skandia go through SCAP with all their financial hedging. As at 2005, all subsidiaries’ financial transactions are handled by SCAP (Skandia Annual Report, 2004). SCAP also does the administration for the deals which they have been asked to transact and risk reporting for the portfolios.

Table 1 summarises the services provided by SCAP to Rottneros. For Rottneros, SCAP also offers financial advice on the development of the company’s financial policy and which banks are best to deal with. SCAP has contacts with approximately 15 to 20 different banks when they do a deal. Their daily dealings with the various banks have given them the experience of how the individual banks function, their products and prices. A debt
management consultancy service is also provided for Rottneros, which is an area SCAP are looking into for new clients as well.

Table 1: Summary of SCAP services to Skandia Group and Rottneros

<table>
<thead>
<tr>
<th>Services</th>
<th>Service Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency Management</td>
<td>Currency Hedge</td>
<td>Passive currency hedge</td>
</tr>
<tr>
<td></td>
<td>Currency Exchange</td>
<td>Execution of currency exchange</td>
</tr>
<tr>
<td></td>
<td>Currency Overlay</td>
<td>Active risk taking through given mandate</td>
</tr>
<tr>
<td>Liquidity Management</td>
<td>Liquidity Planning</td>
<td>Short-term liquidity planning</td>
</tr>
<tr>
<td></td>
<td>Liquidity Administration</td>
<td>Depositing of short term surplus liquidity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Active administration of long-term surplus liquidity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Borrowing for coverage of negative currency movements</td>
</tr>
<tr>
<td>Treasury Administration</td>
<td>Treasury management</td>
<td>Management of business deals taking place using the TWIN business system.</td>
</tr>
<tr>
<td></td>
<td>Risk reporting</td>
<td>Risk reports are produced on a regular basis using the TWIN system</td>
</tr>
<tr>
<td>Financial Advice (Consultancy)</td>
<td>Development of the financial policy</td>
<td>Contribute to the development of financial policy including: Currency risk management Liquidity risk management Interest rate risk management</td>
</tr>
<tr>
<td></td>
<td>Relationship with banks</td>
<td>Advisory services in business dealings with banks</td>
</tr>
</tbody>
</table>

Source: Adapted from interviews with SCAP

1.2.3 Skandia’s Client Selection Criteria

SCAP would like their clients to have at least 500m SEK per annum in one of cash, interest-bearing debts or net foreign exchange exposures. An organisation will need to meet one of these financial characteristics in order for outsourcing to be a worthwhile arrangement, both for SCAP and for the client. SCAP could cater for corporations who have lower exposures if the service needed is required but their fee structure for offering treasury services is above 0.5m SEK per annum. This means it would be more of a question of if the client thinks it is worth paying the fee when they have a fairly small exposure (Celsing, 2005).
A corporation should show certain weaknesses in their treasury to be a potential client for treasury outsourcing. A company with a weak treasury would not have a TMS in place. The number of treasury officers is not adequate for internal control due to overlapping of responsibilities and to cover one another should a person be sick or go on holiday. The treasury is also not split into at least front and back offices. It can also be that some companies do not have a treasury function in the corporation or a treasurer, in place (Celsing, 2005). Since the characteristics for corporate treasuries are case by case, some treasury criteria are marked ‘in question’ in Table 2 below, meaning further investigation would be needed to answer whether the corporation would be suitable for outsourcing or not. The criteria which are marked ‘in question’ do not need to be met by a company for them to be a worthwhile potential client for SCAP.

The client should also be a mid-sized multinational (like Rottneros) which is listed on the O-List of the Stockholm stock exchange. SCAP has suggested that the top tier of the A-List (the most heavily traded companies) would have professional treasury department set-ups in their organisations to deal with their very large financial risk exposures. A professional treasury department would be in line with the operations of SCAP and therefore would not be interested in outsourcing. Potential mid-sized companies would be on the O-List and A-List övriga (Celsing, 2005). In summary, Table 2 lists the criteria for a potential client for SCAP treasury outsourcing services.
Table 2: Skandia Capital’s client-selection criteria

<table>
<thead>
<tr>
<th>Financial Criteria</th>
<th>Requirements (to meet one of the criteria)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cash</td>
<td>At least 500m SEK</td>
</tr>
<tr>
<td>2. Debt (interest-bearing)</td>
<td>At least 500m SEK</td>
</tr>
<tr>
<td>3. Foreign Currency Exposures</td>
<td>At least 500m SEK</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Treasury Characteristics</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury management system</td>
<td>No</td>
</tr>
<tr>
<td>Treasury department</td>
<td>In question*</td>
</tr>
<tr>
<td>Adequate number of people working in the treasury</td>
<td>In question*</td>
</tr>
<tr>
<td>Split into front, middle and back</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Size of the Company</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mid-Size Company</td>
<td>Company should be listed on the O- List or the A-List övriga</td>
</tr>
</tbody>
</table>

* These criteria will need to be further investigated

Source: Adapted from interviews with SCAP

1.3 Problem Formulation

The three activities that have been identified as being the core competencies of SCAP are: 1) liquidity management, 2) foreign currency risk management, and 3) debt management. In addition, they have the adequate treasury infrastructure – the necessary technology systems and the expert personnel - to provide advanced risk management services. The access to the infrastructure at SCAP and the provision of those activities that SCAP have a core competence in are the services that SCAP have on offer as a treasury outsourcing provider.

There are many different solutions to treasury services outsourcing. Each corporation varies in its treasury structure and the choice of which function or activities to outsource differs with different companies. Furthermore, there are some features of a treasury that need to be examined in more detail to determine whether their existence or lack there of, point to that company being suitable for the provision of outsourced treasury services. These features are: whether there is a treasurer or not, whether there is in fact a treasury department or not and whether there is the adequate number of employees or not.
The existing client Rottneros represents one type of potential customer for SCAP because of their treasury characteristics and financial risk management needs. It follows that finding other potential clients and how SCAP can offer their services to match the needs of the companies will also depend on the characteristics of these companies, in regards to both their treasuries and the financial risks they face.

1.4 Problem Definition

The discussion above leads us to the formulation of the following two main research questions, which we aim to answer in our thesis:

1. How do the treasury outsourcing services offered by SCAP match the needs of the potential clients?

2. What are the treasury characteristics of the potential clients?

The treasury characteristics of the potential clients will determine the type of service they need from SCAP. Our aim is to describe how SCAP’s services could differ for different potential clients based on the financial risks these companies face and the degree of weakness in their treasuries. We want to determine the extent to which the services offered by SCAP can match the needs of mid-sized corporations in Sweden and to ascertain those features that make one potential client more suitable than another.

The above two questions can be answered by also looking into the relationship SCAP has with the existing client, Rottneros, leading us to the following sub question:

3. How do the treasury outsourcing services offered by SCAP match the needs of the current client Rottneros?
Through analysing the outsourcing relationship between SCAP and Rottneros, we hope to find out the following: the reasons behind Rottneros’ decision to outsource their treasury to SCAP; how the relationship developed over time, and; the benefits and issues that arose from the decision to outsource for both sides. This will enable us to gain insights into what makes a company like Rottneros a suitable client and will subsequently aid us in finding out how SCAP deliver and match their services to potential clients.

1.5 Purpose

The purpose of our thesis is to find the potential customers for SCAP based on the client-selection criteria as described. We would like to explore the treasury characteristics of these potential clients and describe how SCAP’s products can meet the treasury needs of these companies. As we have noted that risk management and treasury needs differ with each corporation and that the treasury depends on the underlying core business of the company, we wish to provide recommendations to SCAP on the type of potential clients who would and would not be suitable for the treasury outsourcing products they have on offer.
1.6 Outline of the Thesis

Chapter 1 – Introduction
The background to the research is given along with the problem discussion, research questions and purpose.

Chapter 2 - Methodology
This chapter will describe the steps we took to answer our research questions. We will explain the research design and choices in the methods of collecting the data.

Chapter 3 – Overview of Financial Risks & Treasury Management
Chapter 3 and chapter 4 provide the theoretical framework for the thesis. In this section, the risk management activities in a treasury will be described. The aim is to provide a background to the core competencies of SCAP and the products they can provide as a treasury outsourcing provider.

Chapter 4 – Theoretical Framework
This chapter will provide the theories we have used to discuss our analysis of the potential customers.

Chapter 5 – The Skandia Capital & Rotternos Outsourcing Relationship
This chapter will provide an in-depth description of SCAP as a treasury outsourcing provider and Rotternos as one type of company who has benefited from outsourcing their treasury to SCAP.

Chapter 6 – Characteristics of the Potential Customers
Here we will present the different treasury characteristics of the potential customers. This information is then used to analyse the suitability of the potential customers for the provision of treasury services.

Chapter 7 – The Corporate Treasuries of Three Potential Customers
Three of the potential clients are presented in more detail, with regards to their core business, their treasury set up and their risk management which we will analyse in the next chapter based on their suitability as a potential client for SCAP.

Chapter 8 – Matching of Needs of the Corporate Treasuries with the Services of Skandia Capital
In this chapter, we will use the findings in chapter 7 to determine how the treasury and risk management needs of the potential clients can be matched with the services on offer at SCAP.

Chapter 9 – Conclusions and Recommendations
The conclusions and discussion regarding our research questions will be presented in this chapter. We will recommend to SCAP which type of customers will be best suited for their products.
CHAPTER 2 – Methodology

The methodology section will describe the steps we have taken in this study to collect our data. The purpose of this section will be to provide a link between our objectives and the methodological issues of collecting data. We will explain the research design and give a critical review of our research model.

2.1 Research Strategy

2.1.1 Qualitative vs Quantitative

The research strategy depends on the nature of the problem investigated. According to Yin (1994), a research design is a logical sequence that connects the empirical data to a study’s initial research questions and ultimately to its conclusions. When the research questions attempt to answer the questions of “why” and “how” then this type of study is qualitative (Yin). Qualitative research is different to a quantitative study because the latter deals with how an issue can be measured and seeks to answer the questions of “how much” and “how many”.

Taylor (2000) states that qualitative research methods are designed to give real and stimulating meaning to the phenomenon studied. Often a qualitative study is undertaken because there is a lack of theory, or existing theory fails to explain a phenomenon (Merriam, 1998). The data collected in this qualitative research is used to develop concepts and theories that help us to understand corporate treasury outsourcing. This is an inductive approach to the development of theory. In contrast, the deductive researchers test theories which already have been proposed by hoping to find the data to match the theory (Merriam). In line with our research questions our research method is based on a qualitative approach, which allows for us understand
and become more experienced with the phenomenon we are interested in. That is to say, it aims to help us to understand the treasury outsourcing world and how a financial institution can fulfil a corporation’s treasury needs and take over the treasury unit.

Sekaran (2003) states that quantitative studies deal with numbers and provide hard empirical statistical results. However a qualitative study is not represented by numbers but rather it focuses on the meaning and the involvement of the researcher in the process (Taylor, 2000). In qualitative research, data are mediated through a human researcher who is the primary instrument for data collection and analysis. This would usually involve field work where the researcher must physically go to the people, setting, and site to observe behaviour in a natural setting (Merriam, 1998). To get a direct experience of how a provider of treasury outsourced services works and to gain an understanding of their products we went to Stockholm to the office of SCAP to speak to the people behind the process and observed how they worked.

2.1.2 Qualitative Analysis and Interpretation

As mentioned previously the primary methods of scientific investigation are the inductive or the deductive process. The inductive approach is when you observe specific events and arrive at conclusions based on these facts (Sekaran, 2003). In contrast a deductive approach is when you approach the problem with a set of hypotheses that form a theory which may or may not be an explanation for the particular problem. However there is also the abductive approach which is a combination of the two. Patton (2002) cites the work of Denzin (1978b) who explained abductive in qualitative research as using both inductive and deductive thinking with logical underpinnings. Abductive analysis is about interpretation of the facts and drawing on what the data could possibly mean. It is about making that world or in this case an organisation understandable by asking a set of questions and then working
back in time to reconstruct the events (causes) that produced the event (consequence) in question (Patton).

Levin-Rozalis (2004) describes abduction as a process of doing research from scratch with no a priori hypotheses, no presuppositions and no theorising in advance. Both Levin-Rozalis and Patton (2002) mention that one must act like a detective who has to be free of pre-imposed theories and open to all possibilities and information that the investigated subject offers.

To understand about outsourcing of corporate treasury and how the relationship between SCAP and Rottneros developed and evolved, we needed facts. We collected our information by conducting interviews with SCAP and their current client. Through abduction we could develop the best explanation for our research questions by explaining the facts and then organising them into the framework set out in theory.

We also looked at our findings and interpreted what we had found and compared it to what we had read on the topic. It was obvious to us that Rottneros’ relationship with SCAP offers the characteristics of only one type of potential client. We decided from here that our main research question should be how treasury outsourcing would work for different companies, focusing on the matching of SCAP’s services to the needs of different companies.

2.1.3 Multiple Case-Study Design

The form of qualitative research we have chosen is a case study method. The case study is a research strategy which focuses on understanding the dynamics present within single settings (Eisenhardt, 1989). Case study research is an in-depth study of a single entity such as a person, an organisation, institution or event. According to Yin (1994), a case study investigates a contemporary phenomenon within its real-life context, especially when the boundaries between the phenomenon and context are
not clearly observed. In other words, it involves contextual analyses of similar situations in other organisations where the nature of the problem happens to be the same as experienced in the current situation (Sekaran, 2003).

In a case study, a researcher can converse and interview the participants in depth to gain an insight into a certain phenomenon (Taylor, 2000). The purpose is to describe the particular case hence the results of the case can not be generalised to similar cases.

Case studies may concentrate on one particular entity or it can be layered and nested within the primary case study approach when there is more than one object included in the fieldwork (Patton, 2002). According to Yin (1994), when a case study contains more than one single case it is referred to as the multiple case study approach. The cases must be selected carefully before the investigation. Eisenhardt (1989) states that in case study research, the research questions are identified at first but it must be realised that these are tentative. That is, if the cases turn out as predicted then they would provide support to the initial propositions. On the contrary, if they are not as predicted then the theory must be modified (Yin). The focus of the study should emerge once the data collection phrase has begun (Eisenhardt).

Our research follows a multiple case study approach where the SCAP and Rottneros case represents the relationship for treasury outsourcing between a financial institution and a corporation in our research. We wanted to capture the similarities and uniqueness of the treasury departments of would be potential clients to SCAP and their outsourcing decisions.

We also chose three companies\(^2\) to analyse as potential customers for SCAP. The companies needed to meet at least one of the financial criteria and they indicated that they might have a weak treasury. We selected the companies

\(^2\) The three companies are Companies E, F and P which will be presented in Chapter 7.
through discussions with our key informant at Skandia and also because the companies are based in Göteborg, making it easier for us to meet with them and interview them. They each had a different treasury set up and therefore they were chosen because they were predicted to offer us contrasting results. Rottneros and these three companies allow us to answer our research question of how SCAP’s expertises and services will match different corporations who are potentially in need of their products.

2.2. Data Collection

Merriam (1998) notes that in case study research, data collection involves all three strategies of interviewing, observing and analysing documents. The data for this study have been gathered from both primary and secondary sources which are described below.

2.2.1 Primary Data

2.2.1.1 Interviews

In case studies, we can not directly observe a person’s thoughts, feelings and intentions hence we need to ask those people questions about these things. The purpose of the interviewing is to allow the researcher insights into the other person’s perspective (Patton, 2002). Our primary data is collected through interviews both face to face and on the telephone to get a broad overview of SCAP, how they work, and how the relationship between them and Rottneros works.

Before we constructed our interview questions we researched into treasury outsourcing to guide us with the issues that needed to be explored. We had a list of questions but we did not stick to any particular order of the questions or state the exact wordings of the questions which we had prepared beforehand. We followed this approach as suggested by Merriam (1998)
which is referred to as a semi-structured type of interview.\textsuperscript{3} We had questions where specific information from the respondents was desired but other questions were quite flexible for us to work around to respond to the situation at hand. Since there were two of us doing the interviews having a set of questions was a great way to guide both on where the other is heading in his/her line of questioning. We would also pause briefly during the sessions to discuss which issue to question next as new ideas on the topic would emerge and this was an effective way to let each other know how to respond.

We wanted to understand how a treasury office functions from the perspective of SCAP. We have gathered from our reading that treasury offices are divided into the front, middle and back offices. We requested an interview with a representative from each of these units to help us to understand the individual responsibilities of the offices and also how the overall information flows between departments.

The focus was also on what services SCAP is providing to their client and how the relationship was formed and developed over the years. The same questions were asked to both SCAP and Rottneros about their relationship, the services outsourced and the benefits of outsourcing. We asked mirrored questions to gain both perspectives on the issues and also because we were the neutral observers. The interview with the current client of SCAP was conducted over the telephone as this was more convenient for the company. We emailed the interview questions to Rottneros’ CFO before the interview was conducted. In this sense it was more structured than the interview we had with SCAP because the person interviewed knew the questions before hand. However, we were still able to probe and ask further questions to aid our understanding according to the responses given.

\textsuperscript{3} A semi-structured interview contains a mix of more or less structured questions.
Given our understanding that treasury characteristics differ with different companies we decided it was more effective to have interviews with potential clients face to face and in a semi-structured way. We interviewed treasurers or group treasurers of each company. We had questions which we asked all the companies. We had guidelines for other areas we wanted to touch upon such as the objectives of the treasurer on how they would improve their treasury unit or their thoughts on the issue of treasury outsourcing. For these areas, we relied on probing and going along with what we could sense would be the main issues facing the treasurer. Overall, the interviews that were conducted were between 30 and 45 minutes and they were recorded.

To make our interview questions effective we followed the advice from Merriam (1998). We wanted our informants to give explanations or their thoughts so we did not have any yes or no questions. We ensured that they had no multiple questions to avoid confusion. To illicit an unbiased response we did not have leading questions. We reviewed our questions carefully together and discussed how we would answer the questions if we were asked them and whether we would feel comfortable to answer them.

The interviews with SCAP were recorded which gave us a chance to listen well and not have to be disrupted with constant note taking. Before we began we also asked how much time we had with each person to allow for us to plan what questions we wanted to ask in the session and which could be asked later if we ran out of time. All in all we had over an hour with each participant. We transcribed our interviews after each session to allow for an easier way of access and analyses of our data. Also, we wanted to avoid bias in the data by relying on our own notes and recollection of the events. We went through the interview responses together and the questions we had asked and noted any areas which needed further follow up and any questions which were not asked. Follow up interviews were conducted by the telephone or if the questions were more structured then emails were used.
The telephone interview with Rottneros was not recorded but both researchers were able to listen and speak to the CFO and both took detailed notes. We then pooled together our notes and double checked that both of us understood the responses in the same way directly after the interview.

2.2.1.2 **Questionnaires**

Referring to the client selection criteria of SCAP (presented in Chapter 1), to gather the financial characteristics of the potential clients we examined the most recent Annual Reports\(^4\) of all the companies listed on the O-List (both the Attract 40 and the O Listan Övriga) and the A-List Övriga, firstly to determine their cash and debt positions\(^5\) and secondly to determine whether a company would meet the third financial criterion relating to foreign exchange exposure. Net foreign exchange exposure is often not explicitly mentioned in Annual Reports so a proxy value was used. It was reasoned that sales revenue would be a good proxy, because if a company does not have more than 500m SEK in sales then it is very unlikely that it will have a net foreign exchange exposure of 500m SEK. This allowed us to narrow down the listed companies to 61 companies that either met one of the cash or debt criteria, or had a chance of meeting the foreign exchange exposure criteria. However, we still needed to collect more accurate data on the company’s foreign exchange exposure as well as their treasury characteristics.

These were the objectives of the questionnaire, to gather the information we could not find publicly available to meet the selection criteria. We also used the data collected via the questionnaires to analyse the question of how a treasury is unique to that particular firm. Data from the questionnaires also formed the basis for us to choose the three companies for our multiple-case studies analysis for research question 1. The questionnaire can be referred to in Appendix 1. We emailed the 61 companies we short listed and 22

\(^4\) Either the 2004 financial year or for some companies the 2004/05 financial year.

\(^5\) We looked at ‘cash & cash equivalents’ for Cash, though some companies had only specified ‘liquid funds’ on their Balance Sheets. For Debt, we looked for both long and short term interest-bearing debt.
companies responded to our questionnaire. We will only be looking at those 22 companies who have answered our questionnaires.

We wanted to follow SCAP’s client selection criteria with regards to finding out more about a company’s treasury characteristics. We wanted to know if the company has a treasury department and if they do then how it is structured. That is, if it has a front, middle and back office. In the case that the company does not have a treasury department, we asked how many people are involved in treasury activities and the positions of those people.

To make it easier for respondents to respond, we posted the questionnaire on the internet and provided the link in emails. We sent emails to the CFO of the company. We also suggested that the email can be forwarded to the Treasurer or Group Treasurer of the company. The name and email address of the CFO we obtained via information provided in the annual report of the company or through the company’s website.

The average completion time was approximately five minutes per reply. We used reminders in the form of a follow up email and we also called the company to enquire if there is a treasury department and a treasurer. In these cases, the new email with the link to the questionnaire was then sent to the treasurer of the company. We found that the response rate increased when we approached the Treasurer of the company, rather than the CFO. We also noted in the email that we would call and offered to complete the questionnaire with the respondent over the phone. We realised that the information we asked is deemed sensitive information and we gave the option for the company to be anonymous in the questionnaire.

2.2.2 Secondary Data
Data which have not been collected first hand by the researcher are called secondary data. They are relevant to provide a starting point in a research study on the background of the topic area and to give a broad overview.
Treasury outsourcing is quite a new topic which has not been researched extensively in the academic world. We did not find any previous studies related to this topic in journals nor books directly. We based our reading on magazine and newspaper articles mostly sourced from the internet. We went on websites of banks and independent treasury outsourcing providers to understand the products and services and nature of the business.

Since treasury outsourcing borrowed the same concepts as outsourcing in other fields such as Information Technology and logistics, we referred to previous research into these areas to build our understanding on the general topic of outsourcing. We read books on the organisational change and financial risks of a company to understand the perspective of the client of treasury outsourcing services. SCAP also provided us with their company’s annual report and prospectus on what they do for the group as further background.

We relied heavily on annual reports and information from the company’s website for background and financial characteristics of the company.

2.3 Quality of Research

Validity and reliability are two distinct though interdependent tests to judge the quality of the research design. It is important to be able to trust the research results which mean accounting for their validity and reliability. Yin (1994) has described four tests to judge the quality of the research for case studies which are described below.

2.3.1 Construct Validity

Qualitative studies have been criticised as having a lack of quantitative measures, explicit control for various validity threats and the formal testing of hypotheses (Huberman & Miles, 1994). In addition, subjective
judgements are used to collect the data (Yin, 1994). Construct validity is the establishment of correct operational measures for the concepts being studied (Yin).

As recommended by Yin (1994), to improve construct validity a researcher must use multiple sources of evidence to develop a convergence line of inquiry. A process of combining multiple data collection techniques and analysis is referred to as the process of triangulation. Studies that rely on one method are more vulnerable to errors linked to that particular method (Patton, 2002). Combinations of interviewing, observations and document analyses can strengthen the results because the different types of data can be cross checked for consistency (Patton). Yin suggests that with triangulation, multiple sources of evidence can provide multiple measures of the same phenomenon hence addressing construct validity.

To increase construct validity in our research various resources were used. We interviewed both the provider of outsourcing and the client using the treasury services on offer and asked the same questions to attain consistency in the issues we wanted to explore. We also made sure we liaised regularly with our informants at SCAP at each step of the research, taking what information that we have gathered to ensure plausibility.

2.3.2 Internal Validity
Qualitative research using the abductive approach deals with the interpreting of the facts. Internal validity is the question of how does a researcher assess the validity of those observations, that is how research findings match reality (Merriam 1998). According to Yin (1994), internal validity in case studies is the problem of making inferences. When an event can not be observed, it involves the researcher to ‘infer’ that particular event from earlier occurrences based on sources collected from interviews or documents.
To improve internal validity in our research we actually asked the same questions more than once to make sure they are consistent and correct. It was a way for us to confirm the data we were collecting.

### 2.3.3 External Validity

The third test deals with the problem of whether our findings can be generalised to other studies (Yin, 1994 and Merriam, 1998). That is, our study deals with treasury outsourcing services at SCAP and their potential customers, can the results be applied to other treasury outsourcing services providers.

External validity is enhanced in multiple case-studies through analytic generalisation. Through discussions with our key informants, the cases were chosen to give replicated results which if they turned out correctly, then generalisation can be made to other clients who would use treasury outsourcing services at SCAP. The use of multi-case studies allowed the results to be applied to a wider range of situations, in this case a wider range of clients for SCAP. We also aimed to provide detailed descriptions of our findings to allow the readers to determine if the research findings are close to their situations.

### 2.3.4 Reliability

Reliability of a study means the ability for other researchers to follow exactly the same procedures which you have described and do it all over again, obtaining the same results and conclusions (Yin, 1994). Reliability can be handled by providing detailed documentation of the procedures of the study. However Merriam (1998) argues that reliability would be problematic when one is dealing with human behaviour. Instead, it was noted that instead of demanding how one can get the same results, one should think of whether the data collected makes sense or is consistent with previous studies.
To have dependable results we dated and documented all our data at all stages of the research to follow the changes we made. This process also allows for easier backtracking for future references. We also used triangulation to strengthen the data collected by using different sources to clarify a topic.

Merriam (1998) suggests that to ensure results are trustworthy in qualitative research the study must be conducted in an ethical manner. Taking a neutral stance improves the reliability of our data because it was important for us not to change the opinions and thoughts of the person being interviewed.

2.4 Analysis of Data

Qualitative data collection involves a vast amount of data which are not particularly uniformed or structured. To have a constructive result, the data we collected through the interview process and secondary sources was sorted, selected and presented in a coherent manner.

We took it upon ourselves to plan ahead to think about how the evidence will be analysed to guide us in what was to be collected and how it would be collected. Merriam (1998) suggests analysing the data simultaneously with the data collection. This is also suggested by Eisenhardt (1989) who notes that overlapping data collection analysis allows the researcher to take advantage of emergent themes and unique case features. When we constructed our interview questions we grouped the questions in themes and topics. The data gathered would then help us in the way we presented and analyzed the data. Analysis was done after each interview session noting the important issues which we would use as leads for subsequent interviews.

Brainstorming was welcomed by both researchers as we kept notes individually on issues we wanted to explore and discuss with each other. Our thoughts, discussions with our supervisor and each other were written
down and dated to aid us as part of the aggregate data analysis. When we had questions which we could not answer ourselves and had new proposals we wanted to test out we also asked our informant for feedback.

Analysing our data as we went also helped us to better construct our research questions. As we analysed the interviews which were conducted we realised that the treasury of each company is unique to that company. Rottneros is one type of client that would be suitable for SCAP. However a company could have high levels of risk but not have the same treasury characteristics as Rottneros did before outsourcing, which could still make them a potential client. We realised during our data collection that each particular treasury could be weak to a different extent. Following on from this we decided our focus was on exploring how treasury outsourcing patterns could differ with different corporations.

The topic of treasury outsourcing is broad but we decided to narrow the study down to concentrate on SCAP as the provider of treasury outsourcing services and the type of clients they would like to pursue.

2.5 Critical Review

Data collection and analysis can be an ongoing process; however we were working within a limited time frame. We only looked at companies which are listed on the Stockholm Stock Exchange (SSE) to search for potential clients. It would have been interesting to investigate financial institutions like pension funds and non-listed firms and investigate their financial risk exposures and treasury characteristics. We would then be able to answer whether our findings can only be generalised to listed firms or to other organisational types.

The data for a company’s cash and interest-bearing debt was found in the company’s annual reports for 2004 or the latest interim reports. We had to
settle on the most up-to-date and accurate data that we could access at that point in time, while attempting to maintain consistency when the companies have financial reporting periods that end at different times of the year. The financial criteria were used purely to weigh-up whether it was worthwhile for the company to pay a fee to outsource treasury services to SCAP. We decided to focus on the weaknesses of treasury departments in terms of their structure and operations and how outsourcing would be a solution for them.

The researchers both have English as their first language; although both can speak and understand Swedish at an intermediate level, interviews and correspondence were conducted in English. Patton (2002) mentions that data from interviews are words and words can take on a different meaning in different cultures. The language factor in our case was not a large issue as most senior managers in Swedish companies are multi-lingual. However a high level of competency in English does add to the way the person can communicate their opinions and viewpoints to us.

SCAP and our key informant are located in Stockholm, and it would have been easier if the researchers were also from the same city. Greater opportunities for face to face meetings and discussions would have helped, given the time frame for the study. Stockholm, being a capital city, means that more companies have their head quarters there, which would have allowed us to go and conduct more face to face interviews for our research.

Treasury decision-making is high level, making access to the Group Treasurers or CFO difficult. We would have liked to ask further questions and to observe how more treasuries work to enhance our results, however, treasury processes are highly sensitive, making this virtually impossible.
2.6 Conclusion

In summary, we prescribed multiple methods to answer our research questions. In answering how do the treasury outsourcing services by SCAP meet the needs of potential clients and Rottneros (research questions 1 and 3), we applied the case study approach. When we had to look for the treasury characteristics of potential clients (research question 2), we relied on the use of the questionnaires to collect the information.
CHAPTER 3 – Overview of Financial Risks & Treasury Management

In this section, we will present the risk management activities that are the general functions of the treasury. Liquidity management, foreign currency risk management and debt management have been identified as the core competencies of SCAP.

3.1 Introduction

The primary role for a treasury department is to manage the financial risks of the company. Treasury management is a critical function within a company because it involves controlling and monitoring the financial flows that come in and out of the company (Stanwick and Stanwick, 2000). Effective treasury management can optimise cash flow and ensure that the required funds are available to drive corporate activity and growth (Chesney, 1999).

This section is split into three parts: 1) liquidity management, 2) foreign currency risk management, and 3) debt management. These three activities have been identified by SCAP as being their core competencies (Celsing, 2005). It is provided to give the reader an understanding of what functions a treasury performs and so therefore the services an outsourcing service provider – SCAP in this case – could offer to prospective clients. It is not intended to be a completely comprehensive coverage; rather it is intended to give the reader an understanding of the key topics and concepts that will be used later in the analysis of what SCAP can provide to the potential clients.
3.2 Liquidity Management

Liquidity risk for a treasury comes in two forms – funding liquidity risk and market liquidity risk (Lepus, 2005). Funding liquidity risk is the risk of not having enough financial resources to meet the day-to-day fluctuations in working capital and cash flow (Cooper, 2004 and Lepus). Market liquidity risk is the risk that market transactions will be difficult to transact due to market disruptions or inadequate market depth (Lepus). The treasury department is involved in the liquidity management of the company, where it has to ensure that appropriate measures are taken to enhance the returns of cash or short-term deposits subject to the pre-agreed operating balance in the company’s working accounts. The pre-agreed operating balance is to ensure access is available to adequate amounts of liquid funds.

Liquidity management is generally seen to involve cash management, the investment of surplus funds and short term borrowing (Phillips, 1997). Effective liquidity management requires that the management of cash involve appropriate collection and disbursement methods, investment of any excess cash in short term instruments and borrowing where needed for anticipated shortages. According to Chesney (1999), the monitoring of cash flows, the development and management of banking relationships, along with staying on the cutting edge of technological innovations are the key areas of cash management. Figure 1 below is developed by the authors to illustrate the break down of liquidity management in to its component activities, according to the definitions given by Phillips and Chesney.
3.2.1 Cash Management

The following discussion of cash management is based on the breakdown in to its key components as suggested by Chesney (1999).

3.2.1.1 Monitoring of cash flows

To enable efficient cash flow monitoring, bank balances must be checked and reported at the start of each day, in order to ensure adequate funds are available for the day’s activities. This ensures that the right amount of cash is available in the right currency, at the right place and at the right time (Mulligan, 2001). Monitoring cash flows is aided substantially by the development of close working relationships between the treasury department and departments such as accounts payable and accounts receivable, thereby facilitating accurate forecasting of cash flows (Chesney, 1999).

Cash pooling is a common service offered by banks which allows for centralised management of cash through the netting of individual bank account balances to a dummy bank account, thereby allowing for interest to be received or paid on the net balance. One type of cash pooling is concentrating funds from dispersed operations into one central bank account.
(Chesney, 1999). This enables expense payments from one central account which is much easier to monitor and control, and has the added benefit of increased returns. There are variations on how cash can be concentrated into one account, with one example being zero balancing. In this case, the total cleared balance from each account is transferred automatically to a central account (Ross, Clark and Taiyeb, 1997).

The netting of cash flows is an additional technique and it has numerous benefits, including lower bank charges and more competitive spreads due to larger denominations of foreign currency transactions (see Mulligan, 2001 for a full list). These are just a few cash management techniques of a large range of products and services that are on offer from banks.

3.2.1.2 Banking Relationships
Selection of a company’s bank or banks and establishing good banking relationships are of vital importance to the treasury department. Banks provide key services such as cash concentration and disbursement services and short-term financing (Phillips, 1997). Due to the competition amongst banks, most major banks are able to provide for most of the needs of a company (Ross et al, 1997). However, the stronger the relationship and the more open the communication, the more willing the bank is to support the company when problems arise and the speedier the development of new facilities when needed (Ross et al). Furthermore, the better the relationship with the bank(s), the greater the ability of the company to negotiate lower fees, lower interest rates on borrowings, gain greater access to technological innovations and better all round quality of service. For these reasons, the management of banking relationships is a task that is of significant strategic importance for most treasuries.

3.2.1.3 Technological Innovations
Having access to the most up-to-date innovations in payment systems and web-enabled access to bank accounts worldwide, is a key component of

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6 The location of which is often motivated by tax or interest rate reasons.
effective cash management. Different systems are available for a treasury department to ease cash management and monitor cash flows. They are often part of a TMS package.

3.2.2 Investing and Borrowing

Companies at different points in time may find that they have either excess liquidity or a shortage of liquidity for their day to day working capital and general cash flow requirements. This will mean that a company may be in the position to invest this excess (or borrow to cover a shortage) on a short term basis. A sign of poor liquidity management is the situation where a company has both excess liquidity invested in short term instruments and short term borrowings simultaneously (Cooper, 2004). Instead of using the excess liquidity to reduce borrowings, it is invested elsewhere, leaving the company to pay interest on its borrowings and earn a lower rate of interest on its investments.

A company should establish clear guidelines for investment and borrowing practices, and the treasury department should be held accountable for staying within those guidelines (Chesney, 1999). Guidelines for investments should specify the minimum credit rating of any financial short term instrument the treasury is authorised to purchase, the minimum credit rating of financial institutions that cash may be deposited with, the maximum that can be held with any one financial institution and the maximum amount of financial instruments issued by one institution that can be held (Cooper, 2004). In addition, specification of what instruments can or cannot be invested in should also be a part of treasury policy. Table 3 gives an example of the guidelines for a company’s policy for the investment of short term liquidity.
Table 3: Example of treasury report relating ratings to permitted investment

<table>
<thead>
<tr>
<th>Rating</th>
<th>Maximum investment</th>
<th>Maximum period</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA/ Aaa</td>
<td>US$ 50 million</td>
<td>6 months</td>
</tr>
<tr>
<td>AA/ Aa or above</td>
<td>US$ 25 million</td>
<td>3 months</td>
</tr>
<tr>
<td>A/ a or above</td>
<td>US$ 20 million</td>
<td>1 month</td>
</tr>
</tbody>
</table>

Source: Cooper (2004)

When funds are only in temporary surplus, Ross et al (1997) suggest that the usual investment criterion of optimising risk and reward does not apply. Rather, the objective is simply to generate the best risk-free after-tax return, subject to the constraints that the cash is freely available when needed and that the principal sum is maintained through the avoidance of risk. Treasury bills and certificates of deposit are probably the most common short term investments.

When managing a company’s borrowing, treasury has a wide range of issues to take into consideration. Debt levels in a company can play a significant part in the success or failure of that company. Treasury policies must be established to determine the level of financial gearing, the duration of loans, the fixed/floating interest rate mix, the interest rate exposure and the currency mix (Ross et al, 1997). When managing short-term debt, Ross et al define two key principles which a treasurer should follow:

1. Ensure that adequate borrowing facilities are available for all foreseen needs as well as a reasonable margin for contingencies, and
2. Borrow at the lowest overall cost after tax.

3.3 Foreign Currency Risk Management

According to Kenyon (1981), foreign currency risk can be grouped into two distinct groups: economic currency risk and financial currency risk. Economic currency risk is a risk faced by any company, regardless of whether the company trades in foreign currencies or whether it has foreign
operations. It is the risk of a sustained real rise of a currency causing a company to face a decline in its competitive position, due to it facing increased input costs relative to international competitors. This kind of risk is difficult to identify in the financial statements, since the most prominent effect is likely to be a decline in sales (Kenyon). However, Ross et al (1997) propose that this does not imply that it cannot be hedged.

Financial currency risk covers those risks that can be measured in terms of their effects on the financial statements. Kenyon (1981) breaks down financial risks into trading risks and balance sheet risks, though it is more common in the literature to refer to these risks as respectively transaction risks and translation risks (see Hagelin and Pramborg, 2004, Mulligan, Cooper and Ross et al). Hagelin and Pramborg provide definitions of transaction risk and translation risk, which seem to be in agreement with the rest of the literature on the topic. Transaction risks refer to “potential changes in the value of future cash flows as a result of unexpected changes in the exchange rate”. Translation risks on the other hand arise due to “the conversion of financial accounting statements of subsidiaries into the currency of the parent company”. Cooper (2004) puts it more precisely, it is the risk of domestic currency book value of assets and liabilities denominated in a foreign currency changing due to a movement in the exchange rate.

It is important to clarify another key term here in relation to the measurement of foreign currency risks. Kenyon (1981) gives a simple and concise explanation of net foreign currency exposure. He states, “A company which finds itself with receivables and payables in some foreign currency, takes the net amount, (and) thinks of this as the exposure.”

It is the role of the treasury department to hedge against unexpected foreign currency movements. Many companies hedge against translation risks through taking out loans in the same currency in which their overseas assets are denominated in (Cooper, 2004). This is referred to as on-balance sheet
hedging (see Saunders and Cornett, 2004). Therefore, any fluctuations in the foreign currency will result in a change in value of both the assets and the liabilities that are held in that currency. The gains (losses) in the value of assets are matched by gains (losses) in the value of liabilities. According to Hagelin and Pramborg (2004), the general consensus of the finance literature is that hedging of translation risks is unnecessary. This is for two reasons; (i) translation gains (losses) tend to be unrealised and have little or no direct impact on a company’s cash flow, and (ii) translation gains (losses) are poor estimators of a company’s change in real value. Despite this, in practice translation exposure is actively managed, at least this was the case in 1989 when a study by Soenen and Aggarwal (1989) found that 10% of companies in the UK, Belgium and the Netherlands focus on translation exposure alone when managing their foreign exchange risks.

The explosion of financial derivative instruments that has occurred over the last two decades has significantly enhanced the ability of treasurers to hedge foreign currency risks, transaction risks in particular. They have a substantial range of derivative instruments, available via the internet with a simple click of the mouse. Instruments are available through both market exchanges (such as foreign currency futures, options on currency futures) and over the counter (such as currency swaps and forwards). The various instruments have their strengths and weaknesses, and some are more suitable for particular situations and others less suitable.

### 3.4 Debt Management

Companies which have substantial borrowings or deposits will have their borrowing costs and deposit returns affected by movements in the interest rate (Cooper, 2004). This is known as a company’s interest rate risk exposure. This is a substantial risk for companies with large amounts of debt. The extent of the impact on the earnings of a company through movements in interest rates is influenced by the mix between fixed and
floating rate loans in the company’s debt portfolio. Table 4 offers a simple summary of how movements in interest rates affect the different loan types.

<table>
<thead>
<tr>
<th>Type of Loan</th>
<th>Direction of movements in the interest rate for which the loan type should be hedged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Rate</td>
<td>Downwards</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>Upwards</td>
</tr>
</tbody>
</table>

To minimise the impact of interest rate movements companies can apply financial instruments such as interest rate swaps. For instance, if a treasurer has a floating rate loan and he/she believes that interest rates will increase, then the treasurer can fix the loan repayments by entering into a swap agreement where the floating rate loan payments are swapped with fixed rate loan payments. This is a swap of payment streams and not the principal amount.

The treasurer is also responsible for ensuring that the maturity profile of the company’s debt portfolio means that the company is able to make all loan repayments on time (Ross et al, 1997). The treasurer must make certain that an excessive amount of debt does not fall due within any one given year. This is achieved through obtaining the right mix of short-term, medium-term and long term loans.

The concept of duration is important as it allows a treasurer to discern how much a change in interest rates will affect the value of a financial instrument. Duration is the weighted-average time to maturity on a financial security using the relative present values of the cash flows as weights (Saunders and Cornett, 2004). Duration can also be given an economic interpretation as the interest rate elasticity, or sensitivity, of a financial security’s price to small interest rate changes. For any given change in
interest rates, long duration debt securities suffer a larger capital loss (or higher capital gain) should interest rates rise (fall) than do shorter duration securities (Saunders and Cornett). Duration analysis is often applied by financial institutions as a means for measuring interest rate exposure and the same applies to non-financial companies who have large quantities of debt.

The duration concept is useful for this thesis as it allows a treasury outsourcing provider to determine what kind of debt management tasks it can offer to potential customers. If the potential customers have long durations on their loans, then the treasury outsourcing provider can offer a greater scope of debt management options than they could offer for companies with durations that are shorter term. In the case of a company with no debt at all, then it is obvious that a treasury outsourcing provider can offer no debt management services.
CHAPTER 4 - Theoretical Framework

For this chapter, we will present the theories which we will use to discuss our findings. We will describe the set up of a treasury and the operational processes and controls which are required in a treasury. The theory of the core competence of a corporation will then be presented, which is often associated with that part of the corporation that should not be outsourced. This is a good starting point for the discussion of the theory of outsourcing, for which we focus on the different definitions, the situations in which it is suitable, the benefits and costs involved as well as discussing a framework of the issues that need to be considered when developing an outsourcing relationship.

4.1 Introduction

In this chapter the development of the theories will be presented in three main areas which we will use to analyse the questionnaires and case studies we have chosen. Firstly, we will discuss the set up of a treasury appropriate for internal control. Secondly we will discuss the operational risk which is an inherent risk element in a company’s businesses and support activities. We will describe the controls and processes a treasury should have in place to decrease operational risk. There is not one model for all companies to follow since every company has different needs of its treasury. Laker (2005) has noted that the risk taking that occurs in a treasury department should be done in a controlled environment. This is supported by Moore (2005) who states that it is up to each individual company to identify the risks they face and to decide on the appropriate controls used in measuring and managing those risks. However both authors have pointed out that there are some controls which should be in place for a treasury in every company.
And lastly, the theories of outsourcing will be presented in general and also in the context of treasury. The theory of outsourcing is discussed as this will allow us to analyse the relationship between an outsource provider and the company (client) in later stages.

4.2 The set up of a Treasury

The front office describes the trading and sales staff in a treasury office and it forms the hub of an institution’s buying and selling operations. They are responsible for the results and performance of the deals on the clients’ behalf (Celsing, 2005). The front office has access to real time news and price data to enable them to trade quickly and easily. Data distribution systems such as Reuters and Bloomberg are used to deliver the market data in real time as well as for risk management requirements. The traders need to have sophisticated systems to monitor and manage their positions.

The back office is responsible for processing of the transactions made by the front office and other administrative tasks. They verify the dealings made by the front office, these checks are performed on the same day as the trades and the main purpose is to prevent unauthorised trading and minimise the potential for error or fraud.

The purpose of the middle office is to enforce the policies set forth by the board to ensure that all traders act in the best interest of the company. The middle office has the unique task of being the independent bureau responsible for overseeing the traders. To monitor the company’s risk exposures the middle office is the controller for the front and the back office although the back office is responsible for the checking and confirmation of the front office trades (Pettersson, 2005).

There is also an additional unit in a treasury department where the accounting and finance for the treasury group is completed; Laker (2005)
refers to this as the *finance area*. The finance area should calculate profit and loss for trading activities and compare the figures with traders’ estimates on a daily basis. The differences should be investigated and reconciled quickly.

Figure 2 conceptualises how a treasury department should look from the description above which we gathered through our reading and interviews with the sources. The information from the trade flows from the front office to the back where it is verified. The internal control does the accounting and book work for the deals which have been completed. The middle office controls the front, back and finance area to ensure that everything goes according to the policies which have been set by senior management. They also send regular reports to the Board.
4.3 Operating Risks Inherent in Treasury

According to the Basel’s current definition of operational risk, it is the ‘risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events’ (Harmantzis, 2005). Operational risk is unique in the financial world because unlike market and credit risk which can be observed and even summarised in Bloomberg or Reuters, it occurs away from the public eye. Operational risk can be managed by having set processes and controls in place. In a treasury such controls relate to the segregation of duties and system security.

4.3.1 Segregation of duties

The separation of the treasury into front, middle and back offices is to maintain a clear and strong set of responsibilities between the units for the purpose of internal control. Some companies may justify that they are not big enough or there is not enough work for the segregation of duties (Moore, 2005). Treasury operations of a mid-sized firm are often not split into front, middle and back, however for internal control purposes the responsibilities should be segregated so that no two consequential steps are undertaken by the same person throughout a deal (Moore). According to Moore it is important for the people who perform the respective duties of front office and back office have different reporting lines.

Moore (2005) suggests that it is common for the front office and its staff to be separated from the other areas within the treasury department. Due to the aggressive, competitive and at certain times frenzied environment of the dealing room, it is best to have the dealing room and traders apart from the middle and back office (Laker, 2005). For dealing, Laker notes that the front office must strive for professionalism and trade responsibly within their mandate.
One of the roles of the back office is to provide the front office with information on the liquidity of the customers’ bank accounts. The bank balances of the clients’ banks are checked every morning and reported to the traders. Back office officers do the following ups and queries on the flows of a client’s bank account to understand where the money is going. Queries regarding the transactions are made with the front office and queries regarding balances are made with the client themselves (Borg, 2005a). The back office should be on alert for large or unusual trades as well as unusual amendments to trades and/or frequent cancellation of trades. Further notice should be taken around key reporting periods and at the end of the trading day (Laker, 2005).

In addition Moore (2005) believes that competitive quotes in the relevant financial instrument, credit worthiness and limit availability should be sought by traders as this is market practice. Moore suggests for internal control, the back office should maintain records of the banks contacted and rates quoted, along with the fees and charges charged by these banks. This ensures that traders act in the best interest of the company or the company’s client, the best returns are being achieved and that no one bank or broker is favoured over another (Moore).

When limits for risk taking are exceeded, it is the middle office’s duty to investigate the issue and address it to management’s attention. The middle office puts together a monthly report detailing the risks and results to be sent to the CFO as part of its reporting process to the board. This is usually done via the company’s TMS.

4.3.2 System Security
The need for internal control requires the right system to keep track of the information in a treasury. Treasurers need to have a strong system control framework to keep track of the rich and ever changing market information with the organisation’s cash flow, global cash concentration and the
investment options as described in the company’s policy according to its profile for liquidity, risk and return (Lepus, 2005). Information is also easily available via the internet and other electronic sources like Reuters and Bloomberg allowing companies to access real time, which means as soon as the deal is inputted the system information feeds from real time sources and will automatically update reports and cash flow immediately (Stanwick and Stanwick, 2000). Traders in a treasury work under a fast paced environment where up to the minute information is required on a deal. The wider range of treasury functions has meant the increasing transaction volumes and complexity for the corporate treasurer (Thirion, 1999).

Laker (2005) recommends that traders should have access to the use of systems on the front desk for pricing and processing deals and for monitoring limits. The use of technology to aid treasury management is in the form of a Treasury Management System (TMS), which is a software program that consolidates the financial relationships of a company. Treasury activities can be automated through the use of a TMS, rather than relying on the manual and semi-automated systems that require greater human input (Thirion, 1999).

A modern TMS can be structured according to the specific needs of each company’s treasury, such as the number of employees who will be using the system, the financial instruments used and the risk limits of the company. Valuations of hedges can be effectively done through a TMS where feeds from Reuters or Bloomberg are automatically linked to the exposure and hedge transaction. Deals are inputted into the TMS for recording purposes and confirmations can be generated to be matched with counterparty records. The TMS can also provide an audit of each transaction (Borg, 2005b).

Without the use of a TMS, organisations run their treasury on spreadsheets which they have designed themselves. They switch between individual systems provided by their banks for cash and liquidity management. Foreign exchange deals are done over the phone with the banks and confirmation and
checks are done manually by back office staff with statements faxed to them by the banks.

Moore (2005) notes that systems should be password protected and all authorised users should be assigned a unique login name and personal password. If a computer is left unattended, it should have a time out function where password is prompted to prevent unauthorised access. Many of these operating controls can be configured automatically via a TMS.

Borg (2005b) notes that a lot of treasurers still use Excel even when they have a TMS. This happens when treasurers feel that there is a certain process they can not do in the TMS and therefore turn to Excel. This would be regarded as a loss of control because processes done outside of the TMS can not be observed and monitored. Processes which have been built into the system are considered ‘best practice’ based on compliance with regulations and also the limits and risk exposures of the company. Although it may be easier or faster to use Excel for certain processes, it is not considered best practice (Borg, 2005b).

Treasurers should not rely on spreadsheets for financial decision-making and reporting. Spreadsheets are prone to error and are difficult to check and are usually only understood by one or two individuals (Treasury Today, 2005). The term spreadsheet risk has been coined where the use of spreadsheets lead to an increase in operational risk.

The aim of having a TMS is to allow senior management to have more control of the activities of the treasury. Treasurers must work within the mandates and risk reports are sent to the Board to ensure this is occurring. Through a TMS, detailed information can be reported back to the Board which otherwise can not usually be observed. A TMS offers tight control as it allows senior management to see who has entered a deal, who has verified it and who has administered it (Borg, 2005b).
4.4 Core Competence of a Corporation

It is not easy to find a concise definition of a core competence and the confusing definitions that are presented in the literature reflect the general haziness associated with the theory (Domberger, 1998 and Jenster and Pederson, 2000). Alexander and Young (in Domberger) state that a core activity, is “an activity traditionally performed in-house.” That is, core activities are traditionally produced within the organisation; everything that is traditionally produced within the organisation is a core activity. The other definitions offered by Alexander and Young are more enlightening. They propose the core activities for a company as being:

• “activities critical to business performance,
• activities creating current or potential competitive advantage, and
• activities that will drive future growth, innovation, or rejuvenation”

These definitions allude to the idea that a core activity or competence is the central activity (or activities) of a company that it can perform extremely effectively and in a unique way, thus enabling it to attain a competitive advantage over its rivals. Of these definitions, it is the last two that coincide with the definition put forward by Prahalad and Hamel (1990).

Prahalad and Hamel (1990) define a core competence as being “the collective learning in the organization, especially how to co-ordinate diverse production skills and integrate multiple streams of technologies.” Quinn and Hilmer (1995) put it simply by stating that “managers need to think in terms of the specific skills the company must have to create unique value for customers.” Core competencies are essentially the activities within a company that when combined with the learning and experience of employees and the environment that is specific to the company, result in a

7 Core activities and core competencies can be used interchangeably since they are essentially the same idea.
product that enables a company to achieve a competitive advantage and to thereby aid its prospects of survival.

Jenster and Pederson (2000) discuss the trend of outsourcing activities that are becoming increasingly closer to the core activities of a company. They point out that it is no longer just peripheral activities that are being outsourced. Figure 3 represents the different competencies in an organisation; superfluous, ancillary, essential and core. The arrow indicates the trend over time of the activities being outsourced moving closer to the core. Hall and Anderson (2000) propose that the company be thought of as an onion, with the layers of skin representing the different activities that occur within an organisation. At the centre would be the core competencies (for example; building engines, selling clothing) and immediately surrounding the core is the support services - the essential activities in Figure 3 - that enable the core to keep functioning (such as treasury and product design). The next layers out are where the support services and functions (such as product assembly, IT and human resources) are found that provide support to the support functions that are closer to the core. These would be the ancillary and superfluous activities.

Figure 3: The Outsourcing Trend over Time

Source: Adapted from Jenster and Pederson (2000)

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8 Activities that are of less strategic importance to a company.
The trend is for companies to offload virtually all activities to third parties, with the exception of those activities that are most essential and unique, that give the company an advantage over its competitors. Companies are becoming much leaner and more flexible. An example is that of Nike, who has outsourced virtually all of its manufacturing after realising that its core competencies lie in design, marketing and brand management. Richard Branson offers another example. He believes that the Virgin brand name is core and everything else is a candidate for outsourcing (Timmins, 2000).

4.4.1  Is Treasury a Core Competence?

Treasury functions are not exempt from the trend in businesses to streamline their operations. Treasury is an essential activity, but in the past it was considered too important to outsource. However, this attitude is changing as more and more CFOs and treasurers realise the benefits of corporate treasury outsourcing and take the outsourcing plunge (Large, 2003). Some people now suggest that the efficient business model is to outsource everything that is not part of the core competence (Murphy, 2003).

Prahalad and Hamel (1990) suggest three tests to determine whether an activity is a core competence or not. These are:

1. Does it provide potential access for a wide variety of markets?
2. Does it make a significant contribution to the perceived customer benefits of the end product?
3. Is it difficult to imitate?

The treasury function is a support function in every company, at least to some extent, and merely having a treasury function in the company does not give a company any better access to markets. The treasury function does not pass the second test either as it does not contribute at all to the customer benefits of the end product. The actions of a treasury go unseen by the customer. This is because the treasury has nothing to do with production or design of a product. It ensures the funding was there in the first place for the
research, development and the production of the product. However, this does not count as a contribution since the funding could have come from anywhere. Lastly the treasury function is not difficult to imitate, rather it is too costly to imitate. Thus, based on these simple tests it can be stated that the treasury function is not a core component of most companies.

However, there are companies for which treasury is a core competence, and some of these companies are using their expertise and technology to gain a competitive advantage on their rivals. These companies are invariably banks and other financial institutions. There are also other independent (i.e. non-bank) providers and Application Service Providers (ASPs) who have the TMS technology as their core competence, but these are not the focus of this thesis.

To see that the banks that provide outsourced treasury services actually have the treasury function as a core competence, Prahalad and Hamel’s (1990) tests for core competence can be applied. The treasury function does indeed provide access to a wide variety of markets as witnessed by the various types of firms that have outsourced their treasuries. For instance, there are some companies that outsource regional treasury centres as well as other companies who outsource their head office (Large, 2003). Furthermore, each company faces different types of financial risk, which would therefore mean that a different range of products is offered to different companies. Thus, there are a variety of markets and they are differentiated in two spectrums: 1) the type of customer, and 2) the product offered.

The perceived customer benefits of the end product are presented below, but they are in summary the specialisation that is gained through outsourcing, the flexibility gained through the company becoming more streamlined and the cost savings.

Imitation of outsourced treasury service provision is possible as witnessed by the range of large commercial banks that operate in the market. This
includes the Royal Bank of Scotland, Citibank, The Bank of Ireland and JP Morgan. However it takes a bank with a good reputation, the expertise to be able to trade in the different financial markets and good relationships with other banks in the required geographical markets. These factors all take a long time to establish, so it can therefore be considered difficult to imitate. Based on these arguments it can be seen that the treasury function is a core competence of a bank operating as a treasury outsourcing service provider.

The core competence theory can be applied to the treasury function itself. That is, there are aspects of a treasury department that could be considered to be core competencies. The core competencies would be translated into which activities are strategic and which are non-strategic (Guest, 2004). The non-strategic activities and therefore the non-core activities are those activities which can be outsourced without: 1) giving away too much sensitive information, 2) requiring too much judgement and 3) increasing costs (Hall and Anderson, 2000). Thus for most companies this would relate to the technology of the treasury department and for some it would relate to the administration of trades. Alternatively, for others, it could even mean the entire treasury function. The point is, though the treasury function is not a core competence for many companies, some companies will recognise that there are actually parts of the treasury function - usually the strategic aspects - that could be considered their core competence within the function.

4.5 Outsourcing

4.5.1 The Definition of Outsourcing

Outsourcing in itself is not a new area in strategic business management. As such, many definitions of the term have been developed over the years. We provide a few of the definitions below, all of which have the common theme of outsourcing being essentially the contracting out of work.
Outsourcing was originally used to explain the contracting out of work from one company to another, usually with one of the companies being located overseas (Palm, 2001). This definition of outsourcing is however rather narrow in the sense that it is not necessary for one of the parties in the contract relationship to be located overseas. Rather, it simply involves one of the parties being located outside of the organisational boundaries of the other.

Jenster and Pederson (2000) give a broader definition of outsourcing, as “the process of externalising tasks and services previously performed in-house to outside vendors.” Quinn and Hilmer (1995) use a similar definition; they consider outsourcing as “the strategic use of outside resources to perform activities handled traditionally by internal staff, using internal resources.” These definitions suggest that for a task or service to be outsourced, it must have at some stage been produced or performed in-house.

Rasheed and Gilley (2005) prefer to seek the middle ground in giving a definition that is not too narrow and not too broad. They see outsourcing as “the fundamental decision to reject the internalisation of an activity.” This could imply either substituting an internal value-creating activity with a market transaction, or alternatively, simply deciding not to engage in an activity even though it is well within the organisation’s means. Since this definition seems to sum up more accurately the process of outsourcing, it is the definition that we will use in our study.

The range of definitions reflects the fact that there exist various types of outsourcing relationship. According to Kakabadse and Kakabadse (2000), the various outsourcing arrangements range from transaction-based contracts which are usually short-term and tightly defined, to partnership arrangements which have shared responsibilities and risks and even shared source relationships, such as joint ventures. Augustsson and Bergstedt Sten
(in Andersson and Thoresson, 2003) provide a useful breakdown of outsourcing relationships into three basic forms:

“Outsourcing as externalising of existing activities”. This is in alignment with the definitions of Jenster and Pederson (2000) and Quinn and Hilmer (1995) presented above, and it basically represents the decision to allow an external provider to provide tasks or services that were previously performed internally. The following figure illustrates this concept.

![Diagram](attachment:image.png)

Company Supplier

“Outsourcing as purchasing.” This reflects the decision to use the market to procure a good or service. This does not necessarily mean that a market transaction is completely replacing the internal production of a good or service. The good or service may be produced internally as well as externally, thus giving management a means of ensuring the internally produced products meet the quality standards of those products produced by external suppliers. Purchasing contracts are generally short term and tightly defined, and have cost advantages due to the fact that the company can base their decision on supplier by who offers the provision of goods or services at the lowest cost and/or the highest quality. The figure below illustrates this concept.

![Diagram](attachment:image.png)

Company Supplier
“Outsourcing as a relationship.” This reflects the type of relationship as alluded to by Kakabadse and Kakabadse (2000) which is more along the lines of a partnership or alliance between the company and supplier. These relationships can involve close interaction, with regular exchange of information between the company and supplier. They are generally longer term and may evolve over time. The figure below illustrates this concept.

![Diagram of company and supplier relationship](image)

This latter type of outsourcing relationship is the kind that will be under focus in this thesis. Though the outsourcing relationships presented above are somewhat simplified, they provide the reader with an understanding of the key types of relationship that are the basis of all outsourcing relationships.

### 4.5.2 When Would Treasury Outsourcing be Suitable?

There are some instances where the outsourcing of treasury services would be a very suitable option. Murphy (2003) provides a good rundown of these situations in one of his articles. As Rayberg (2003) suggests, the decision to outsource treasury service occurs less frequently as a strategic decision, and more frequently as a reaction to events. Some events include:

- A business spinning off from a larger business group, with the new entity being left with no treasury function.
- A merger or acquisition resulting in the current treasury function being insufficient to manage the new business situation.
- International expansion, where a company may move into a new market and require a local treasury function for that market.
• Business and financial restructuring, leading to a different requirement from the treasury function.
• A major change in a company’s financial position, such as a company moving from having large amounts of surplus cash to becoming a major borrower.

4.5.3 Benefits of Outsourcing
As can be expected, the benefits of outsourcing of treasury services are closely linked to the reasons for outsourcing. We have grouped the benefits of outsourcing into three broad categories; specialisation, flexibility and cost savings.

4.5.3.1 Specialisation
Having other enterprises specialist in the production and provision of supporting goods and services allows the host organisation to concentrate on those activities in which it can establish distinctive ‘core competence’ (Hamal and Prahalad (1994) taken from Kakabadse and Kakabadse, 2000). As Timmins (2000) puts it, companies should “stick to the knitting”. That is, outsourcing permits the company to redirect its resources from non-essential activities towards those essential activities that generate the greater rewards (Quinn and Hilmer, 1995). The expertise required to manage a treasury function is most often very different from the core activities of a company (the exception being financial institutions). Companies should therefore focus on what they do best, and let others that have the treasury function as a core activity provide those vital but non-core, treasury services.

Based on the tests proposed by Prahalad and Hamal (1990), the treasury function is not one of the core competencies that enable a company to obtain a competitive advantage. In fact, according to Hall and Anderson (2000), treasury is a support function, albeit a very important support functions. By outsourcing the treasury function, a company can allow a third party
specialist to provide a function that is one of their core activities. At the same time, the company itself is freeing up resources which can be invested in the development of core activities. Therefore, a company benefits from the specialisation achieved through the outsourcing of treasury in two ways; (i) they allow a third-party provider who is a specialist in treasury activities to do the job for them, and (ii) they can in turn specialise purely on those activities that are their core competencies.

4.5.3.2 Flexibility:
Flexibility in a company allows the company to respond more quickly to changes in demand. Through outsourcing those activities that are not at the core of a company, a company is left streamlined and therefore much better equipped to increase or decrease production volumes based upon the whims of market demand. This is a trend of contemporary companies, especially dot-com companies, whom tend to have a central mission and then use outsourcing for facilities, inventories and many related services (Palm, 2001). A company can avoid committing to a specific type of technology because it can simply switch suppliers when new, more cost-effective technologies become available (Jenster and Pederson, 2000). In the context of treasury outsourcing, the infrastructure required for running a modern-day treasury is very expensive. If a company needed to update their treasury department either as a response to regulations or an expansion of operations, then it would be simpler to place greater demands on the outsourcing service provider rather than investing in an updated treasury management system or hiring new personnel.

4.5.3.3 Cost savings:
Cost advantages often provide the initial motivation for outsourcing (Rasheed and Gilley, 2005). As Hall and Anderson (2000) and Wechsler (2002) suggest the treasury function is an expensive operation, especially when one considers the high costs of recruiting and retaining qualified staff as well as the installation and maintenance of sophisticated trading systems. Furthermore, the benefits attained from having an efficient and effective
treasury are not so easily observable or quantifiable (reduced risk and better cash management for example). This gives companies an obvious motivation for considering outsourcing, especially the smaller multinationals that do not have the resources to support such expensive infrastructure in-house.

As mentioned above, the decision to outsource is often driven by the perceived cost advantages. As far as the outsourcing of treasury is concerned, Murphy (2003) points out that the start-up or initial investment costs of an in-house solution is up to four and a half times greater than those of an outsourced solution. Furthermore, the ongoing operational costs if the treasury function were to continue being carried out in-house would be 16% greater than if they were outsourced. Even though the accuracy of these figures may be questionable, Murphy (2003) is not alone in citing the cost savings as an advantage of treasury outsourcing.

Wechsler (2002) and Wyllie (2002) among others, elaborate on the cost savings that can be attained. If an outsourcing treasury services provider makes the investment in the state-of-the-art treasury management system as well as keeping the expert personal that are required for risk management, then these costs can be spread over all their large client base, meaning that only a small percentage of the costs would fall on any one client. Companies which normally could not afford to have a TMS by themselves can have access to sophisticated system by outsourcing. Outsourcing allows companies access to these sophisticated systems at a much lower cost (Wechsler).

Outsourcing providers must make sure they continually deliver state-of-the-edge technologies as TMS management is party of their core competence, otherwise they face the risk of losing customers to competitors (Guest, 2004).
4.5.4 Potential Issues and Concerns

The most common concern that has been identified in the literature is that treasury is too complex or strategically important to be outsourced (Murphy, 2003). There is a common misconception that to be able to manage the risks of a company one must have a sound understanding of the specific risks that that company faces. However, recent evidence suggests that there are activities of a treasury that can be commoditised. There are risks that are to a greater or lesser extent faced by every company, such as foreign exchange risk, interest rate risk and liquidity risk. This is witnessed by the emergence of Dublin as a centre for outsourced treasury solutions. Furthermore, there are the administrative tasks that go in-hand with the management of risks that are of operational rather than of strategic concern.

There is also the loss of control, which occurs in every outsourcing relationship. Companies want to be able to have total control over strategically important tasks. This can be resolved in the initial stages of an outsourcing relationship by ensuring adequate mechanisms for monitoring the quality and performance of the outsourcing service provider are in place and by defining the duties and responsibilities clearly (Murphy, 2003).

A further issue is the fee payable. Firstly there is the explicit cost in the form of the fees that must be paid to the outsourcing service provider. The evidence suggests however, that this fee would be lower than the costs of installing and maintaining the necessary infrastructure and hiring the expert personnel. There are other implicit costs as well. Domberger (1998) mentions several of these; the costs of searching and selecting a vendor, and monitoring costs. No expense should be spared when it comes to searching for and selecting the right vendor as the relationship with the vendor would be best described as a partnership - long term to say the least. Monitoring could be handled by keeping someone in-house (such as the CFO) who is responsible for setting the guidelines within which the outsourcing service provider is allowed to act and through maintaining a constant line of communication.
The human factor comes into it as well. Unlike other forms of outsourcing where staff can be transferred to the outsourced provider, the outsourcing of treasury services is a strategic decision to replace an existing arrangement, resulting in staff not being rehired in the contracting company (Murphy and Fogarty, 2004).

4.5.5 Criteria for Outsourcing Agreements

The decision to outsource can be a complicated one where many issues must be considered to ensure that the relationship between the corporation and the third-party provider will be beneficial. We will borrow from Pichaud’s (2005) framework for identifying, creating and engaging in strategic sourcing relationships for technology and apply it to treasury. Pichaud has noted eight criteria which should be considered prior to entering into any sourcing agreement. The framework is illustrated below in Figure 4.

Figure 4: Criteria for Treasury Outsourcing Agreements

Compatibility – For the company and the third-party provider to work together, it is imperative that there be some degree of cultural fit and compatibility between the parties. As noted by Pichaud (2005), this would be whether the third-party provider fulfils the necessary requirements of the
contracting company. Differences in culture and operational styles are likely to emerge once the parties enter the relationship. It is important to identify and resolve any differences in culture and operating styles at the onset.

**Technology** - As discussed previously, the importance of technology must be considered in treasury with the use of a TMS. The question a company must pose is how important is the use of technology to the firm’s treasury? Within a corporate treasury the emphasis is on streamlining and automating financial processes to allow for treasurers to focus on the more strategic aspects of the treasury (Guest, 2004). The treasury environment has also grown more regulated where it is demanded that processes are made transparent. It is therefore important for corporate treasuries to have access to a TMS.

An issue with regards to outsourcing of treasury technology is that the corporation must choose an outsourced provider with an advanced TMS in place where the processes of a company’s treasury can be transferred and inputted through the provider’s system.

**Expertise** - As part of the evaluation process it is recommended by Pichaud (2005) to identify individuals who will take leadership responsibility, perform analysis and make the decisions. In the context of treasury outsourcing, it is the group treasurer and/or the CFO who should be included in the team that make the outsourcing decision. It is constructive to have individuals who are experienced with the financial needs of the company and the processes behind the treasury activities.

**Objectives** – Outsourcing must be conducted carefully, systematically and with explicit goals (Pichaud, 2005). Outsourcing is often regarded as a short term solution – a quick fix - that is not going to succeed in solving the cost and competitiveness problems of a company, nor will it enable the development of the required skills of personnel to enhance and sustain product leadership (see Rasheed and Gilley, 2000 and Prahalad and Hamel,
1990). The decision to outsource the treasury function should fit into the overall business strategy and be made to conform to future changes in the organisation’s environment (Pichaud).

**Human Resources** – Outsourcing the treasury function could mean job losses to treasury employees. Pichaud (2005) recommends it is important to execute changes without threatening the security of the employees. However, should this be the case then it is important to keep staff informed of the outsourcing process.

**Costs** – Achieving a low cost is consistent with most business strategy. For instance, the investment in a TMS is often very costly. The amount of trading that takes place in the treasury may not be sufficient enough to warrant having the number of personnel that are required for internal control purposes. Guest (2004) notes that the ongoing costs of having a TMS in-house include internal maintenance, upgrading costs and development of requirements due to changes to both internal and external environments.

In treasury outsourcing, the contracting company is able to benefit from a superior set of drivers such as economies of scale, better margins and fees as well as the cost of updated and advance systems all of which are readily available from the provider.

**Capabilities** – This is an important factor to consider because it tests the feasibility of the prospective partnership. A test can be performed on both the provider and the company itself to examine the ability of both parties to meet the requirements of the prospective alliance (Pichaud, 2005). It is important for the provider of treasury outsourcing to understand the ramifications of entering into the partnership agreement, including the costs and benefits the partnership could bring.

**Mandates** – Management and the provider must agree to clear instructions with regards to outsourcing of treasury activities and what should be done
and what should not be done. Mandates should provide traders with clear information of who are their dealing authorities and the names of the employees who are authorised to give instructions to the bank and what the instructions should be. Mandates should also specify the products and currency position limits at the end of the day (Moore, 2005 and Laker, 2005). It must specify how the two parties should communicate including the frequency of reporting, what it should contain, frequency of meetings and the steps to take the necessary remedial action (Pichaud, 2005).

4.6 Applying the Theoretical Framework to the Analysis

The theories presented in this chapter equipped us with the necessary toolkit to allow us to move on to the next stage of the thesis – the analysis of our findings. The optimal set up of a treasury along with those features which ensure that operational risks are minimised (segregation of duties and system security) were presented, which are the features that we subsequently looked out for when analysing the treasury departments of mid-sized corporations for signs of weaknesses. We also presented the theory of the core competencies of a company, which are the critical capabilities of a company that are likely to give it a competitive advantage. We suggested that based on the available literature and the empirical evidence of the last 15 years, that the financial institutions that are providing outsourced treasury services have the treasury function as their core competence. Since this is not our own findings, we have included it in this section of the thesis. The theory of outsourcing was subsequently presented, which allows us to determine those factors that could lead to a firm making the decision to outsource. Finally, Pichaud’s framework for identifying, creating and engaging in strategic sourcing relationships was adjusted to suit the case of treasury outsourcing relationships, and therefore made in to a tool to be used in the analysis of the case studies.
CHAPTER 5 – The Skandia Capital & Rottneros Outsourcing Relationship

In this section, we will present our findings and analysis of the case of Rottneros outsourcing their treasury to SCAP. The main focus will be on the reasons behind the decision to outsource, how the outsourcing relationship developed over time and the benefits and issues that arose for both sides.

5.1 Introduction

In this section, the arrangement of the treasury outsourcing relationship will be described between SCAP and Rottneros. We will start with describing the structure of the treasury at SCAP. This will help us to understand why they have the necessary infrastructure to be an outsourced provider of treasury services. We will then describe the treasury of Rottneros before outsourcing, and how Rottneros’ treasury needs can be provided by the competencies of SCAP. The purpose of our study of Rottneros is to understand the characteristics of one type of client for SCAP which we will use in the later chapters to identify similar potential clients for them.

5.1.1 Operational Structure of SCAP

Skandia Capital’s treasury department is segregated into four areas which are; front office, middle office, back office and the fourth unit which they refer to as the financial control unit. The four units are interlinked with each other however each unit has their own set of responsibilities for the different activities during the deal life cycle. SCAP also has a treasury management system which is a part of the operation of running treasury processes.

There are four people working in the front office at SCAP. The front office is in its own room that is physically separated from the rest of the
department. There are three people working in the middle office and four people in the back office. There is one person who does the financial accounting for the department and that person is in the financial control unit. SCAP believe they have enough staff to cover one another should someone be sick or take leave and still maintain the segregation of duties.

The front office’s role in the group is to set the hedging strategies. They also monitor situations, for example to ensure the clients’ bank accounts do not exceed a certain credit limit (Celsing, 2005). If the limit does get exceeded then the client will be in contact and an appropriate action is taken. They are also consultants to their internal clients and Rottneros and advise them on how to manage their financial risks.

It is the responsibility of the middle office to carry out the policies set forth by the Board and ensures limits are not reached by the traders in the front office. They are responsible for the risks within the Treasury but not the risks that apply to the Skandia Group (Pettersson, 2005). An example of the processes carried out by the middle office includes the set up of new counterparties and new portfolios in which old users are deleted from the system and current users have the correct access profile (Pettersson).

The TMS carries SCAP’s official record of the trades. It is the back office task to settle the trade with the bank (the counterparty) and confirm that what is in the TMS is correct with the bank’s system (Borg, 2005a). The TMS is also used for monitoring deals and also for the financial accounting (Pettersson, 2005). The middle office does the majority of their work through the TMS system. The middle office uses the system to monitor the risks the department faces (Pettersson).

### Table 5: Summary of the Operational Structure at SCAP

<table>
<thead>
<tr>
<th>Operational Structure of SCAP</th>
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<tbody>
<tr>
<td>Split into Front, Middle and Back</td>
<td>Yes</td>
</tr>
<tr>
<td>Adequate Number of Staff</td>
<td>Yes</td>
</tr>
<tr>
<td>Treasury Management System</td>
<td>Yes</td>
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5.1.2 SCAP’s and Rottneros’ Core Competencies

In assessing why SCAP has become an outsourced provider in treasury services, we will begin by analysing their core business. We will then follow with assessing the core business of Rottneros and why outsourcing was a good option for them with regards to their treasury.

Core competencies are the company’s skills, knowledge and infrastructure that create a competitive business advantage and a higher performance than average. The core competencies at SCAP are their ability to manage financial risks. They are the support function to Skandia Group, a large financial institution whose core business is in the management of ‘money’ where they offer insurance, savings and pension funds.

SCAP’s core business is to offer support to their parent company by continuously monitoring and controlling the group’s large portfolios of funds where they monitor risks and also trade on the financial markets. Skandia Capital have been in the business for a long time and built up a stable and confident relationship with the financial markets. The Group has a high rating from rating agencies for senior debt. SCAP’s infrastructure as a business unit has been invested in to enhance their core competencies. They have invested in staff, systems and processes and reports to focus on the financial institution market place and risk management. The investment in an advanced treasury like SCAP is also due to the fact that compared to Rottneros they experience a higher volume of transactions and exposures. Internally, SCAP has been a provider of treasury services for the group’s business functions. They are an experienced third-party provider of risk management.

Rottneros’ core business is in the paper and pulp industry where they are one of the largest suppliers of market pulp in the world. Producing and marketing pulp is their core business. As a mid-size multinational they are exposed to a high amount of foreign currency exposure because they produce pulp in Sweden and Spain but sell their products to other parts of
the world. Active risk management is therefore required for the well being of the company. However risk management is not a core competence of the company.

In the context of treasury activities, core competence would be translated into which activities would be considered strategic and non-strategic. By outsourcing the risk management to SCAP, Rottneros is able to streamline and automate their financial processes. The company’s treasurer or CFO can focus on the more strategic decision making and the core business of the company.

Based on the theory of core competency and in the context of treasury and financial risk management then we can conclude that SCAP would have the competitive advantage in this area. In risk management there are a lot of financial instruments, different ways of producing reports and a lot of ways to hedge and manage financial risks. A corporation would also need to comply with international accounting regulations such as IFRS, in particular IAS 39 which deals with the establishment and maintenance of internal control and procedures for financial reporting. SCAP has the technology and employment of experienced staff for risk management as well as the internal controls to comply with the regulated treasury environment.

5.1.3 Rottneros’s Operational Structure Before and After Outsourcing

Rottneros’s treasury was in Karlstad and the company had one treasurer with the CFO also being involved in treasury activities. There was no middle or back office and deals were inputted and administered in Excel (Byström, 2005). Deals were done manually over the telephone with the company’s relationship bank. Confirmation would then be faxed through by the bank to the company (Byström). Refer to Table 6.
Table 6: Rottneros' Treasury Characteristics before Outsourcing

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<th>Treasury Structure</th>
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<td>Middle</td>
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<td>Back</td>
<td>No</td>
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<tr>
<td>Finance Department</td>
<td>No</td>
</tr>
<tr>
<td>Segregation of duties</td>
<td>No</td>
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<tr>
<td>Treasury Management System</td>
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Operational risk was high as there was only one person, the treasurer, in the treasury. There were a total of two people involved in the strategic decision making for the treasury, the CFO and the treasurer. For the purpose of internal control, no two sequential steps on a trade can be performed by the same person. Rottneros did not have enough human resources to ensure the segregation of duties. Rottneros’ operational risk was increased by their use of spreadsheets to record their deals. Having one staff meant that there was no need to split the treasury physically into the front, middle and back offices.

Although they are not a large multinational which would warrant having their own internal bank with a larger number of personnel, and a TMS, having one treasurer was sufficient for the risk management activities they were conducting at that time. However Rottneros’ treasury before outsourcing did not have the internal control which is required by regulation today.

Outsourcing has forced Rottneros to describe and document their processes. When treasury functions are performed internally, then the processes stay inside the people’s heads. The outsourcing experience required the passing of this knowledge from Rottneros over to SCAP therefore it was required for Rottneros to describe the processes thoroughly. Previously, when Rottneros did not outsource their treasury functions to SCAP, the company did not have up-to-the-minute documentation of treasury processes as they have
now. The process map has increased the efficiency of treasury operations at Rottneros and decreased their operational risk.

Rottneros’ treasury is now functioning through the people, knowledge, system and structure at SCAP. Should we base our analysis on an advanced treasury as having a separated front, middle, back and financial reporting unit where segregation of duties is assured and a TMS is in place, then SCAP has the necessary infrastructure which also reflects back to Rottneros’ infrastructure. Rottneros’ treasury has now met the needs for internal control and regulation requirements.

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<td>Treasury Management System</td>
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**Table 7: Rottneros' Treasury Characteristics after Outsourcing**

5.2 **Decision to Outsource**

There are specific business situations which tend to cause companies to consider outsourcing (Murphy, 2003). For Rottneros, the event that prompted them to outsource to SCAP was the move of their head quarters from Karlstad to Stockholm and the treasurer opting not to follow. The company needed to set up a new treasury office quickly (Byström, 2005). In agreement with Murphy (2003), the reason to outsource could be interpreted as both a strategic decision as well as a reaction to an event.

The CFO of Rottneros did consider the treasury needs of the company and weighed the pros and cons of setting up an in-house treasury or outsourcing. Rottneros wanted an advanced treasury where three or four people would be
needed to work in the department in addition to purchasing a TMS. The goal for the new treasury was to have both a sophisticated treasury to manage their risks as well as to comply with regulations regarding internal control. They would need three to four people in the treasury to ensure the segregation of duties which are important for internal control (Byström, 2005).

Rottneros also had some experience with outsourcing in the past when they outsourced their cash management and accounting processes to In Group, a partly owned subsidiary of Skandia back in 2001. In Group was the cash management group of Skandia and provided cash management and accounting services to Rottneros (Pettersson, 2005). Rottneros also outsourced hedge transactions and executions to another company (Byström, 2005).

5.3 Development of the Outsourcing Relationship

Rottneros approached the then head treasurer of SCAP in 2001 to discuss what was needed to be done and what SCAP could do for the company. Rottneros believed that SCAP had the adequate resources to help them with financial risk management (Byström, 2005).

SCAP had a mutual interest being the provider of treasury services for Rottneros and both parties agreed that they should give the arrangement a trial period of six months (Celsing, 2005 and Byström, 2005). The arrangement would involve a fee-payable, where if successful after the first six months, the fee would be fixed and reviewed annually.10

From the perspective of SCAP, during the trial period they wanted to test how much resources would be needed to provide that type of service. They

10 The authors were not informed of the fixed fee payable by Rottneros. However as mentioned previously costs will not be considered in this study.
had an internal time control system to see how many hours Rottneros was taking up. This would also help them to analyse their marginal costs and determine how much capacity they have to accommodate other clients (Celsing, 2005).

SCAP presented to Rottneros what they could offer for them which were mainly the management of financial risks. Rottneros also presented them with the risk management they needed for their business, which included the management of commodity risks such as pulp prices and electricity prices. Both parties also discussed what type of activities could be added to SCAP’s system and came to an agreement on what could be outsourced to SCAP and what should be kept in-house.

In the beginning, the main outsourced activity was cash management. SCAP managed the surplus cash for Rottneros by using the company’s surplus cash to purchase instruments such as T-bills and certificates of deposit. Further activities were outsourced to SCAP in the line of foreign exchange exposure management, using derivatives such as forwards and options (Celsing, 2005).

The relationship between SCAP and Rottneros intensified with time to cater for the changing needs of the company. SCAP took on the role of the company’s advisor for their financial needs. For example, the company experienced financing needs in the second year which meant an added treasury activity was required for the company. SCAP advised the company on how they should manage their loans (Celsing, 2005).

Presently, Rottneros has outsourced all of its back office to SCAP, including cash pooling activities and the handling of currency exposures relative to IAS 39 (International Accounting Standards) full documentation. The head of SCAP has been given a consultancy role with the company where he is also a member of the company’s Finance Committee (Byström, 2005). The Finance Committee is a strategic group involving the CEO, CFO and the
Chairman of the Board where exposures and hedging are discussed and strategies are determined. SCAP has a competitive edge in the financial markets and it makes sense to have a senior member of SCAP involved in the policy setting for Rottneros (Celsing, 2005).

Rottneros could not outsource electricity and pulp price hedging to SCAP as this is not part of SCAP’s core competencies. Rottneros has instead outsourced electricity price hedging to another party who specialises in this type of risk management. The pulp price hedging is kept in-house where the CFO maintains the centralisation of the transactions for the pulp hedging (Byström, 2005).

The implementation for outsourcing took approximately three months. To transfer the knowledge over to SCAP, Rottneros and SCAP developed a detailed process map noting the processes at Rottneros. The process map detailed the activities which must be performed, noting who performs which activities and who are behind the decisions for those activities.

The decision to outsource has meant a new management duty for the CFO at Rottneros. The CFO must make sure that the mandate is followed and SCAP is aware of the needs of the company (Byström, 2005). The difference between having an in-house treasury and an outsourced function is no daily face to face contact with the treasurer. The CFO believes that it is his responsibility to bridge the gap of communication between SCAP and the needs of the company.

5.4 Costs and Savings of Outsourcing

The cost of outsourcing varies with the type of situation and the solution in terms of the fee charged by SCAP to the company. Rottneros was only dealing with one bank prior to their relationship with SCAP. They believed they were charged with too much interest and too high fees (Byström, 2005).
Rottneros have kept key decision-making processes in-house with regards to treasury activities and have outsourced the back and middle office and also the financial accounting. Key treasury processes which have been kept in-house include building and managing relationships with the banks. The CFO of Rottneros would meet with the banks and view how they work and what they can do for the company. He would then involve SCAP to establish how the three parties, that is the bank, SCAP as the third-party provider and Rottneros, would all work together. Other key processes include establishing the mandate and policies for the company.

The decision to have either an in-house set up or to outsource was primarily about cost. Rottneros felt that it was expensive and difficult to attract the right people with the right expertise for the advanced hedging which the company needs. For a company like Rottneros whom we have identified as a mid-sized corporation, to attract and maintain the people and to purchase a TMS would be very expensive considering the exposures they have. However to meet internal control requirements it is necessary to have more people in the treasury and to have a separated front and back office at least.

The cost savings does not stop at the technology and internal staff needed to manage the TMS. The CFO of Rottneros mentioned that before they outsourced they believed they had too high fees and interest charges with their house bank. Previously fees charged were in the form of an increased spread in foreign exchange transactions with their bank, which is difficult to identify. Given SCAP’s expertise in the financial markets, they believe that they are getting a much lower spread for their client than they previously were given.

SCAP can keep costs down because they have the infrastructure to manage Rottneros’ financial risks. Previously, Rottneros did not have the time and human resources to review fees and charges. This is a significant saving for Rottneros but it is difficult to measure the exact figure as we do not know
how much the spread was on previous foreign exchange transactions. SCAP believed they had the capacity to accommodate Rottneros and it is quite a profitable relationship for SCAP given the low marginal costs of catering for a new client.

The second driver for outsourcing for Rottneros was time. The CFO did not have the time to search and interview the right candidates for the new treasury. It would also have been time consuming to select the appropriate TMS vendor to implement such a system, as well as the actual implementation itself. According to Rottneros, the new accounting rule IAS 39 requires a very comprehensive treasury system. Skandia Capital has the right infrastructure to cater for large exposures and high volumes of transactions.

Should a company like Rottneros set up a full in-house treasury where more people are employed in order to have segregation of duties and if a TMS is purchased, the full employment of both the human and system resources would not be achieved given the level of transactions they have. That is, the costs of investment for an in-house treasury would not be justified by the volume of transactions the company makes. The decision to outsource was to have access to an advanced treasury department such as that of SCAP which includes both the system and the personnel with cost and time savings being the main drivers.

5.5 Key components for Outsourcing Agreements

The relationship is seen as beneficial for both parties. In this section we will apply the framework to Rottneros and SCAP that we have adapted from Pichaud (2005) to analyse the factors behind the success of the relationship. Part of this analysis will also be exploring the issues and concerns which we have noted in our theoretical framework.
Compatibility – Compatibility was tested and tried initially for 6 months between SCAP and Rottneros. There was a mutual interest for both parties to test out treasury outsourcing. The trial period also lent a hand in determining the differences in culture and operating styles that could emerge and would need to be resolved before agreements were to be set at the end of the 6 months. The compatibility would be narrowed down to the CFO of Rottneros and the head of SCAP since they are the representatives for both sides in implementing the relationship.

Technology – Rottneros’ CFO wanted to have a sophisticated treasury with a TMS. Rottneros understood regulation has called for the need to have internal control and this means that technology is important to the company’s treasury.

Expertise – The CFO took the responsibility for making the decision to outsource. The previous treasurer decided not to follow the move to Stockholm therefore it was only the CFO who is experienced with the financial needs of the company and the processes behind the treasury activities. The CFO was also the contact person for the company.

Objectives – The CFO made the decision to outsource as both a strategic decision and as a solution to the need of setting up a new treasury as part of a move of their head quarters. The objective was to improve on the internal control of the previous treasury and also to have expert knowledge on hedging techniques. The CFO made his decision to outsource based on two drivers, cost and time. His responsibilities have not changed with regards to managing the treasury and how it is operating.

The decision to outsource was not considered to be a short term solution for either party. The mutual objective was to have a long-term relationship. SCAP believed they have invested the time and effort to get to know the processes and the everyday business of Rottneros. It would not be profitable to have a short-term partner.
The responsibility of the management at Rottneros has not changed by having an external party taking care of their risk management. The CFO is still responsible for making sure that mandates are followed and the needs of the company are identified and met.

**Human Resources** – The decision to outsource the treasury for Rottneros did not result in any loss of jobs in their treasury department. This is due to their unique situation of having to set up a new treasury office from scratch.

**Costs** – The cost of employing experienced treasury staff and implementing a TMS was considered to be too expensive and unaffordable for Rottneros. They also believed that the initial investment and the number of staff required to ensure internal control would not justify the volume of transactions a mid-size company like them have. In other words, the three to four treasury staff would comply with the segregation of duties and decrease the operational risk in the treasury but there would not be enough work to go around.

By outsourcing, Rottneros is able to access the complete package of a sophisticated treasury through the structure, knowledge, people and processes of SCAP.

**Capabilities** – SCAP wanted to see if they were capable of providing what was required by Rottneros. SCAP and Rottneros met and discussed what they could do for each other and what they could not do. For example, hedging electricity and pulp prices are not part of the core competencies of SCAP and therefore they were not outsourced. SCAP wanted to know how much resources would be required to add a new client to their current system. Also, Rottneros wanted to test the relationship, to ensure that SCAP was aware of the company’s needs. Both parties decided the best way to test the capabilities was to have a six-month trial period before setting the treasury management agreement (mandates).
Mandates – A process map was developed to map the responsibilities at Rottneros. It was important to define what SCAP will do and the roles of the people who will be involved. The mandates are also not necessarily set permanently, when new regulations such as IAS 39 were introduced, the processes involved were also discussed and documented and added to the mandates. As part of the mandates, SCAP has also been instructed to act proactively where they have to give the company’s competitive rates for example. If there are issues when there might be a need to go outside of the mandates then this is discussed with the CFO of Rottneros.

Risk reports are sent to the company every month. Rottneros believes that the quality of the communication between the two parties means that there was no loss of control from the decision to outsource to SCAP. This was aided by placing a senior member of SCAP on the Finance Committee at Rottneros. It was important to have someone from SCAP to be up to date with the company’s needs.

5.6 Conclusion

SCAP’s competencies in risk management coupled with their well-trained staff and treasury infrastructure match the needs of Rottneros. Rottneros is able to have the advance hedging they require for their financial risks and access to a sophisticated treasury to have the internal control as required by regulation. The decision to outsource was to have access to a sophisticated and advanced treasury set up without the high cost of the initial investment nor the time and effort needed to attract the right people and find the right system.

SCAP sees Rottneros as representing one type of client that would match with the products SCAP is selling. Rottneros has outsourced its entire treasury to SCAP, who has handled all of its financial risks since the
inception of the relationship. Based on Rottneros, this type of client would have no treasurer, treasury department and no TMS. They would also need to have a high exposure to foreign exchange and high levels of debt and cash to be suitable clients for SCAP. The characteristics of potential clients which have the same needs as Rottneros would mean an opportunity for SCAP to offer a total package solution to the client. That is for the client to outsource the back to front offices to SCAP and also for SCAP to be part of the decision making of the risk management mandates to be set.
CHAPTER 6 – Characteristics of the Potential Customers

The following section presents the findings and analysis from the questionnaires. We obtained vital information about the treasury functions of the potential customers, such as whether the companies actually had treasury departments, and if so, how they were structured and how many people worked in them. Information regarding who is responsible for making strategic decisions and setting treasury policy within each company was also obtained. We will then use this information to analyse how this effects their suitability as potential targets for outsourcing. Finally, the companies that responded to the questionnaire are grouped into different segments, with each segment ascertained as being suitable for different types of outsourcing solution.

6.1 Introduction

The questionnaire was aimed at determining both the characteristics of the treasury function in the companies sent the questionnaire and whether they reach the third of the financial criteria which was for foreign exchange exposures of over 500m SEK. We knew from our review of the literature that the treasuries of the companies had to be lacking a certain level of sophistication if outsourcing would be a viable option for them.

The content of the questions allows the findings and analysis to be split into two topics; (1) financial characteristics, and (2) treasury characteristics.

6.2 Financial Characteristics

Of the 22 companies who responded to the survey, 19 of them have at least 500 million SEK in cash, debt or foreign exchange exposure. This is in
accordance with the financial criteria set out in Table 2 (see Chapter 1). As mentioned previously, SCAP believes a corporation who lacks the treasury infrastructure could benefit from treasury outsourcing.

Table 8 refers to the 22 companies we have surveyed. We will not use the real names of the companies in accordance with their wishes to remain anonymous. There are 4 companies who have over 500m SEK in cash and bank balances, 16 companies with over 500m SEK in debt and 6 companies with over 500m SEK in net foreign exchange exposure.

<table>
<thead>
<tr>
<th>Company</th>
<th>Cash Criteria</th>
<th>Debt Criteria</th>
<th>FX Criteria</th>
<th>Potential Client</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Below 500</td>
<td>No</td>
</tr>
<tr>
<td>B</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Over 500</td>
<td>Yes</td>
</tr>
<tr>
<td>C</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>D</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>E</td>
<td>Below 500</td>
<td>Over 500</td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>F</td>
<td>Over 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>G</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Yes</td>
</tr>
<tr>
<td>H</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>I</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Yes</td>
</tr>
<tr>
<td>J</td>
<td>Over 500</td>
<td>Over 500</td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>K</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Below 500</td>
<td>No</td>
</tr>
<tr>
<td>L</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>M</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Over 500</td>
<td>Yes</td>
</tr>
<tr>
<td>N</td>
<td>Over 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>O</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>P</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Yes</td>
</tr>
<tr>
<td>Q</td>
<td>Below 500</td>
<td>Below 500</td>
<td>Below 500</td>
<td>No</td>
</tr>
<tr>
<td>R</td>
<td>Over 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>S</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>T</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>U</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
<tr>
<td>V</td>
<td>Below 500</td>
<td>Over 500</td>
<td>Below 500</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Companies A, K and Q did not meet any of the financial criteria. The responses of these three companies will not be included in the findings set out below.
6.3 Treasury Characteristics

Treasury functions are unique to every company and therefore have different structures. However, we can say that a company should have a treasury department, which has an adequate number of staff, and it must be split into at least front and back offices - if not a middle office as well. This ensures that there is the appropriate segregation of duties to help minimise the operational risks of a treasury.

Question 1: Does the company have a treasury department?
Of the 19 companies that make the criteria, 12 have a treasury department and 7 have no treasury department. This means that almost 37% of the companies that responded do not have any sort of treasury department. If this figure is reflective of the entire population of mid-sized firms, then it would suggest that there is a large range of clients that SCAP could target. If a company has no treasury department, then this would be the ideal situation to consider outsourcing, given the high initial start-up costs of setting up a treasury department and the time required before the treasury is up and running. For some companies the needs placed on a treasury may not be that substantial, but considering that the companies in this analysis all met at least one of the financial criteria, then there would be some weight to the argument that at least some sort of treasury department is required.

For the 12 companies who have a treasury department the following questions were directed at them:

Question 2: How many people work in the treasury department?
The number of people working in the treasury departments of the respondent companies ranged between 0.5 to 7 people. As Table 9 below illustrates, a majority of respondents that had treasury departments had either two or three people in the treasury department. Only a couple of respondents had a sizeable treasury department, with seven people in it. It is interesting to note that Company L answered that they have 2.5 people in their treasury
department, which would suggest they have one person spending 50% of their time on treasury activities and two people working full time. The same would apply for Company M who has 1.5 people, except they would have only one person employed full time.

Table 9: Number of People in the Treasury Department

<table>
<thead>
<tr>
<th>Company</th>
<th>How many people work in the treasury department?</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>7</td>
</tr>
<tr>
<td>F</td>
<td>2</td>
</tr>
<tr>
<td>G</td>
<td>3</td>
</tr>
<tr>
<td>H</td>
<td>3</td>
</tr>
<tr>
<td>J</td>
<td>2</td>
</tr>
<tr>
<td>L</td>
<td>2.5</td>
</tr>
<tr>
<td>M</td>
<td>1.5</td>
</tr>
<tr>
<td>N</td>
<td>3</td>
</tr>
<tr>
<td>P</td>
<td>3</td>
</tr>
<tr>
<td>R</td>
<td>7</td>
</tr>
<tr>
<td>S</td>
<td>1</td>
</tr>
<tr>
<td>T</td>
<td>3</td>
</tr>
</tbody>
</table>

Specifying how many people are considered to be adequate is a difficult task. Three people employed in a treasury would be the absolute minimum to fulfil the three tasks of front, middle and back office. But different companies have different needs, and few companies that were surveyed actually structured their treasuries with a front, middle and back office. Thus, for some companies, two would suffice and it is the minimum to ensure that no two sequential steps are undertaken by the same person throughout a deal.

By this rational we can see that companies S and M create unnecessary operational risks through having respectively 1 and 1.5 people employed in their treasury departments. This would suggest that there is not the sufficient segregation of duties that is necessary. All other companies have sufficient numbers of people employed in their treasury departments to have segregation of at least the trading and confirmation of trade duties because they have at least two people in their treasuries.
Question 3: How is the treasury department structured?
We gave the option of the treasury being split into front, middle and back and not split into front, middle and back. The respondent could also state how their treasury is structured if it is not split into front, middle and back.

Out of the 12 companies who do have a treasury department, 5 have said they have front and back and no middle office. Two have said they have front, middle and back. The rest of the companies (5 companies) selected the option that their treasury is not split into the front, middle or back (see Table 10).

<table>
<thead>
<tr>
<th>Treasury Structure</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Split into Front, Middle and Back</td>
<td>2</td>
</tr>
<tr>
<td>Split into Front and Back</td>
<td>5</td>
</tr>
<tr>
<td>Not Split into Front, Middle and Back</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
</tr>
</tbody>
</table>

Separation of the treasury into front, middle and back offices is needed to ensure adequate definition in the different responsibilities of those that are in the treasury department for internal control purposes. Though we recognise that not all mid-size companies will have the critical mass required for operating a middle office, as a minimum there should be the definition between front and back office. This subsequently means that the five companies who do not split their treasury departments into front and back offices are unlikely to have the segregation of duties that is needed for internal control.

The following questions were asked to all companies, with a treasury department and without.

Question 4: How many people are involved in treasury activities?
For the companies with a treasury department, for this question we wanted to know if there are other people besides those who work in the treasury department who are involved in treasury activities. For the companies who said they did not have a treasury department, we wanted a gauge of how large a treasury function is for those respondents.

For those companies who have a treasury department, a majority have more people involved in treasury activities than they have stated work in their treasury department - 7 of the 12 companies had more people involved (see Table 11). Four of the remaining companies had the same number of people involved in treasury activities as there are in the treasury department. For Company B, they said they have 7 people working in the treasury department but only 4 people involved in the treasury activities. Company B may have misinterpreted the question which would explain their response.

### Table 11: Summary of Companies with no Treasury Departments

<table>
<thead>
<tr>
<th>Company</th>
<th>1. Treasury Department</th>
<th>2. How many people work in this department?</th>
<th>4. How many people are involved in treasury activities?</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>Yes</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>F</td>
<td>Yes</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>G</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>H</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>J</td>
<td>Yes</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>L</td>
<td>Yes</td>
<td>2.5</td>
<td>3</td>
</tr>
<tr>
<td>M</td>
<td>Yes</td>
<td>1.5</td>
<td>3</td>
</tr>
<tr>
<td>N</td>
<td>Yes</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>P</td>
<td>Yes</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>R</td>
<td>Yes</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>S</td>
<td>Yes</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>T</td>
<td>Yes</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

The responses to this question reflect that there are often people outside the treasury department that have some part to play in a company’s treasury activities.
For those companies with no treasury departments, the number of people who are involved in treasuries range from 0.75 to 8 people (see Table 12). Five of the 7 companies had 2 or more people involved in treasury activities, indicating that these companies may have the necessary staff to ensure some sort of segregation of duties when it comes to making trades. It could also mean that one person may be responsible for setting policy, while the other person is responsible for trading, confirming the trade, reconciling the trade with the company’s bank and then doing the reporting for the trade. This situation naturally represents a substantial operational risk.

**Table 12: Summary of Companies with no Treasury Departments**

<table>
<thead>
<tr>
<th>Company</th>
<th>1. Treasury Department</th>
<th>2. How many people work in this department?</th>
<th>4. How many people are involved in treasury activities?</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>No</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>D</td>
<td>No</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td>E</td>
<td>No</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>I</td>
<td>No</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>O</td>
<td>No</td>
<td>-</td>
<td>0.75</td>
</tr>
<tr>
<td>U</td>
<td>No</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>V</td>
<td>No</td>
<td>-</td>
<td>2</td>
</tr>
</tbody>
</table>

**Question 5: What are the positions held by the people involved in treasury activities?**

For this question we wanted to know the positions of the people who are involved in the treasury activities. We have assumed that the treasurer and the treasurer’s assistants are part of the treasury department. From our reading, we also knew that there are people who are involved in the decision making for the treasury, though they are not actually part of the treasury staff, for example the CFO or CEO.

The people actually involved in treasury activities are most frequently the treasurer and the CFO, with 15 respondents saying the treasurer is involved and 14 for the CFO. The involvement of the CFO in the treasury activities of
a company gives some indication of the importance of the decisions that are made in the treasury. The CEO is involved in treasury activities in 4 of the surveyed companies too. Other positions mentioned include financial managers, treasury co-workers, accountants, economists and assistants. Table 13 below illustrates all the responses.

<table>
<thead>
<tr>
<th>Position</th>
<th>Number of Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasurer</td>
<td>15</td>
</tr>
<tr>
<td>CFO</td>
<td>14</td>
</tr>
<tr>
<td>CEO</td>
<td>3</td>
</tr>
<tr>
<td>Treasury Manager</td>
<td>1</td>
</tr>
<tr>
<td>Financial Managers</td>
<td>1</td>
</tr>
<tr>
<td>Accountants</td>
<td>2</td>
</tr>
<tr>
<td>Economists</td>
<td>1</td>
</tr>
<tr>
<td>Assistants</td>
<td>4</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
</tr>
</tbody>
</table>

In the companies that are lacking a well-developed treasury, it is often the CFO that performs the duties that would normally be performed by the treasurer. In fact 4 of the 7 companies with no treasury department had no treasurer either. It is generally the responsibility of the CFO and the CEO in conjunction with the Board as well as the treasurer to set the policy for the treasury function, which gives them the guidelines within which they should operate.

**Question 6: What do you use to manage your trades?**

The respondents were given the option of choosing between excel and a TMS. Out of 19 companies, 11 companies use Excel to manage their treasury trades. The other 8 companies use a TMS to manage their trades.

If a company has a TMS, then it is deemed that outsourcing would not be an option for such a company. As mentioned in the theoretical framework, the investment in a TMS is substantial, so therefore the company must have the high risk exposures to warrant the large investment. The installation of a
TMS is very time consuming. It requires internal treasury personnel to learn the transaction processes necessary for all the different types of instruments used as well as defining the different roles and responsibilities to determine who should have access to specific pages and reports, among other things. Furthermore, the TMS provides the internal control that a treasury needs to comply with regulations.

Once a company has made this investment of time and money, it would be pointless for them to consider outsourcing. Our findings reveal that still a large number of companies have not made the investment into a TMS, and are subsequently still relying on excel. Excel spreadsheets offer a much lower level of security in comparison to a TMS. Given the need for internal control, the question seems to be not if a company will purchase a TMS but rather when.

6.4 Segmenting the Potential Customers

The survey results enabled us to determine the potential clients for SCAP amongst those companies that responded to the survey. More importantly, we were able to determine several particular types of companies - based on the financial criteria and the characteristics of the treasury - for which the outsourcing of treasury activities would either not be suitable, be partly suitable or would be very suitable. For outsourcing of treasury activities to be a viable option for a company, it was determined that the company must:

1. Meet at least one of the financial criteria set out by SCAP.
2. Not have a TMS.
3. Not have a well structured treasury.

The companies that responded to the survey have been grouped in to different segments based on their responses to the survey. Three of the twenty two companies did not meet at least one of the three financial criteria
which mean that these companies can be disregarded as potential customers for SCAP (companies A, K and Q).

The companies can be divided up into three different types of companies as illustrated in Table 14:

Table 14: The Potential Clients Formed into Different Segments

<table>
<thead>
<tr>
<th>Criteria</th>
<th>SEGMENT 1 (not suitable)</th>
<th>SEGMENT 2 (partly suitable)</th>
<th>SEGMENT 3 (suitable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lacking a TMS</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Structure of the Treasury Department:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Lacking a Treasury Department</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>2. Inadequate no. of people working in the department</td>
<td>No</td>
<td>Maybe</td>
<td>Yes</td>
</tr>
<tr>
<td>3. Not split in to Front and Back Offices</td>
<td>Maybe</td>
<td>Maybe</td>
<td>Yes</td>
</tr>
<tr>
<td>Analysis: What can a treasury services vendor (such as SCAP) do for each type of company?</td>
<td>Treasury department is already established. This type of client is not likely to outsource on a full scale like Rottneros, nor is it likely to outsource administration. <em>Maybe</em> it could obtain advisory services from a third party.</td>
<td>This case is special and requires further analysis. There is maybe an adequate no. of people working in the department but the right system is not in place. They could benefit from some sort of outsourcing arrangement (eg. Outsource the mid and back office functions, or the systems), but not the whole treasury function.</td>
<td>Treasury department is not set up from the perspective of SCAP. This is the type of client which could be modelled on SCAP’s relationship with Rottneros and is the most suitable potential client for outsourcing.</td>
</tr>
</tbody>
</table>

**SEGMENT 1**: Companies with a TMS, which have a treasury department, an adequate number of people working in the treasury department and a front and back office structure (at least). Some exceptions for this profile of
a company that still fit into this segment are companies M and J, who have 1.5 employees and 2 employees respectively. They still fit into this segment though due to the fact that they have a TMS.

**SEGMENT 2:** Companies without a TMS, which have a treasury department but not necessarily adequate numbers of people and it is not necessarily structured into a front and back office. These companies all have a minimum of 2 people in the treasury department. These companies need to be examined individually and in more detail, which we proceed to do in the following section of the thesis, where we focus on companies F and P. These companies are less likely to outsource on a full scale, at least not straight away. One of the reasons for this is that it would mean the personnel in the treasury department would be laid off - something that most companies would be reluctant to do.

**SEGMENT 3:** Companies without a TMS, which do not have a treasury department, nor do they have adequate numbers of employees or the front and back office structure. Companies C, D, I and V do not have someone employed specifically in the role of treasurer. Though these companies may not have the large numbers of transactions or the large risks to warrant having a well developed treasury, they all meet at least one of the financial criteria and therefore should be analysed thoroughly in order to ascertain whether they would be suitable clients for the provision of outsourced services or not. Rottneros would have fallen into this group prior to its decision to outsource. We selected Company E from this group for a more in-depth analysis.

### 6.5 Conclusion

The responses to the questionnaire enabled us to determine the suitability of particular types of companies for the provision of outsourced treasury services. Those companies which fall in to Segment 3 would be the best
candidates for pursuing a long term, partnership type of relationship. They do not have a TMS nor do they have an adequate treasury structure to meet internal control requirements. Those companies that fall into Segment 2 could also benefit from outsourcing, though a different type of service would have to be offered to them. A starting point could be to offer administrative type services or possibly the middle office and back office functions. Companies that fall into Segment 1 would not be suitable targets as they have already made the investment into a TMS.
CHAPTER 7 – The Corporate Treasuries of Three Potential Customers

The following section presents the findings from the three companies that were selected for the case studies. Background information is provided for each company, as well as the set-up of their treasuries, the risk characteristics and how they are managed and the opinions and thoughts on outsourcing of the Treasurers.

7.1 Introduction

Based on the segmentation of the previous chapter, three companies were selected that would fall into either the second or third segments for a more in-depth analysis. The companies are presented here, and respecting their wishes for anonymity they will keep the names that were given to them in the previous chapters. The three companies are Company E, Company F and Company P.

7.2 Company F

7.2.1 Background

Company F is one of the leading private healthcare companies in Europe. It has operations in Sweden, Norway, Denmark, Finland, the UK, France, Switzerland and Spain. It was founded in 1993 and through organic growth and strategic acquisitions it has developed to become the leading private care provider in Sweden, Norway and Spain, while it has a very strong market position in France and the UK.

In the 2004 financial year net sales for the firm amounted to 8,800m SEK. This yielded earnings after tax of 674m SEK. This is a significant increase
on the last couple of years and the CEO suggests that the increase stems from improvements in efficiency. One downside for the year was that the organic growth rate dipped below the company target. The consolidation and focus on improved profitability contributed towards this.

7.2.2 The Operating Characteristics of the Treasury
The following characteristics of the treasury at Company F (see Table 15 below) were obtained from an interview with a member of the treasury department.

Table 15: The Operating Characteristics of the Treasury at Company F

<table>
<thead>
<tr>
<th>Treasury Department</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury Management System</td>
<td>No. Considering purchase of one.</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>2</td>
</tr>
</tbody>
</table>
| Positions Held by Employees | • Treasury Manager  
• Treasury Assistant |
| Positions of Other People Involved in Treasury Decisions: | • President/CEO  
• CFO |
| Structure | • Not really a definite distinction between front and back but the Treasury Manager generally completes the tasks of a front office and the Assistant completes the tasks of the back office.  
• Duties are segregated. |
| Centralised or Decentralised | • Treasury activities are centralised with the exception of some local loans.  
• Payments are not centralised. They are made in shared service centres. |

Source: Adapted from Interview

7.2.3 Risk Management
Company F is in the process of going through a period of rapid growth. The company has an annual target rate for organic growth of 10%. The company has also an acquisition program. In the coming years the aim is to become a health care provider for the whole of Europe, which subsequently means that the company does not only want to expand in those markets it already has a
position, but it wants to also expand into new markets, with Germany and Italy being high up on the agenda.

As a consequence of this rapid growth, the company’s risk exposure is rapidly changing. Transactional foreign currency risks are virtually non-existent due to the fact that expenses are in the same currency denomination as revenues. Furthermore, loans are made in the foreign currency which investments are made in, thereby limiting the translation risk exposure. However, the interest rate risk exposure is substantial due to the quantities of loans made, the high face value of loans and the long term to maturity. Loans to fund property investments and acquisitions are naturally long term. In addition, short term loans are made regularly for smaller operational type investments, when the cash is not available. Credit agreements and overdraft facilities are common forms of financing. Table 16 below sets out the financial risks, the amount of the exposures and how they are managed.

### Table 16: The Financial Risks and how they are Managed

<table>
<thead>
<tr>
<th>Financial Risks</th>
<th>Key Points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liquidity Risk</strong></td>
<td></td>
</tr>
</tbody>
</table>
  - Liquid Funds: 542.7m SEK  
  - Surplus cash is managed centrally. Subsidiaries place surplus cash in cash pools which is then invested by the parent company in low risk instruments, such as T bills.  
  - A certain proportion of sales revenue always held in liquid assets.  
  - Credit facilities established with the groups’ banks.  
  - Lacking the system for accurate liquidity forecasting. |
| **Interest Rate Risk** |  
  - Interest bearing liabilities: 3,508.3m SEK  
  - Smaller investments are funded with cash where possible.  
  - Properties are owned in the UK and France so loans are naturally long. This is not the case in Sweden where properties are not owned.  
  - Duration analysis is the principle technique used for risk measurement.  
  - Loans are generally medium term and are most often from banks. On average they have a maturity of 5-6 years.  
  - Duration of loans for core operations is less than 4 years.  
  - Duration of loans for property exceed 15 years. This is almost
entirely due to an outstanding loan to the value of 3,006m SEK for property operations in the UK.

**Currency Risk**

- Net foreign exchange exposure: Very low.
- Transaction risks are limited due to subsidiaries having both revenues and expenses in local currencies.
- Translation risks are minimal due to loan financing being undertaken in the currency in which the asset is expressed.
- Otherwise translation risks are not normally hedged.
- Occasional use of FX swaps (approximately one a quarter).

**Source:** Adapted from Interview

### 7.2.4 Outsourcing as a Solution?

The company is contemplating outsourcing as an option for the handling of treasury activities, though possibly not for the present point in time. Due to the growth the company has achieved since its foundation, the company is now at a stage where the current treasury is lacking the necessary resources to continue performing its operations with the efficiency it has done up until the present. The purchase of a TMS has already been seriously considered, and is likely to happen in the near future. Furthermore, it has been recognised that staff numbers are probably not adequate to meet the needs that will arise in the not too distant future.

The main requirements of the treasury at present are to ensure funding needs are met to enable further expansion. This is a key task of treasury, and one for the moment Company F would prefer to keep in-house. In saying that, Company F has not ruled out outsourcing of the more strategic functions as an option for the future. The more routine tasks of a treasury (such as confirmations and payments) could be outsourced, with the Treasury Manager suggesting that the Company could either further centralise their payments or alternatively, outsource them.

When asked what characteristics they would look for in an outsourcing service provider, the answer was simply, “price and quality.” The Treasury Manager recognised that due to the nature of such an outsourcing
relationship, they would require that: “…this (outsourcing) partner would need to be there for quite a while and has to have a good reputation.”

The only concern that was voiced in regards to outsourcing was the potential loss of control. According to the Treasury Manager, whenever anything is outsourced, no matter how menial the task (such as cleaning or catering), there is a degree of control lost. Treasury is no different, and due to the importance of the tasks of a treasury, it would be important to have full control of its operations, especially at such a critical point in the Company’s business life cycle.

7.3 Company P

7.3.1 Background

Company P is one of the leading fashion chains in northern Europe, with stores in Sweden, Norway, Finland, Germany and Estonia. The aim of the company is to provide quality women and children’s fashion at an affordable price. The first store was opened in 1954 and the company has now expanded to a point where 330 stores are spread over northern Europe.

From sales in the 2004/05 financial year of 5,202m SEK, operating profits reached 391m SEK, a substantial improvement on the previous year. This is largely attributed to the improvement in gross margin, which reached 57.5% from 53.2% the previous year. The company intends to expand its operations in the coming year, with new stores scheduled for opening in the Baltic countries and Germany.
7.3.2 The Operating Characteristics of the Treasury

Table 17: The Operating Characteristics of the Treasury at Company P

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury Department</td>
<td>Yes</td>
</tr>
<tr>
<td>Treasury Management System</td>
<td>No. Considering purchase of one.</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>3</td>
</tr>
<tr>
<td>Positions Held by Employees</td>
<td>• Group Treasurer&lt;br&gt; • Treasury Assistants</td>
</tr>
<tr>
<td>Positions of Other People Involved in Treasury Decisions:</td>
<td>• CEO&lt;br&gt; • CFO</td>
</tr>
<tr>
<td>Structure</td>
<td>• The Group Treasurer generally completes the front office tasks.</td>
</tr>
<tr>
<td></td>
<td>• The 2 assistants complete the back office tasks.</td>
</tr>
<tr>
<td>Centralised or Decentralised</td>
<td>• Treasury is centralised. All financial risk management, handling of the payments and handling of the accounts is completed centrally.</td>
</tr>
<tr>
<td></td>
<td>• Invoicing, which is an input to treasury is done from an office in Shanghai.</td>
</tr>
</tbody>
</table>

Source: Adapted from Interview

7.3.3 Risk Management

Company P is well established in its Nordic markets but plans have been set for further cautious expansion in Germany and the Baltic region. Funding for Company P generally comes from either equity or any surplus liquidity, thus limiting their reliance on debt and consequently virtually eliminating their interest rate risk exposure. When loans are made, they are short term and with floating interest rates.

Company P has substantial exposures to foreign currency fluctuations, particularly the USD, as a large portion of their purchases are either in USD or USD linked currencies such as the HKD. Sales on the other hand are either in SEK, NKR and Euros. This means that the company faces
substantial transaction risk exposure. The company attempts to match inflows with expenses in Euros, but for the USD and USD linked currency exposures it must hedge using derivatives. The policy guidelines within which the treasury must operate, state that 70% of contracted foreign currency flows must be hedged. Translation risks are limited due to the fact that the company has low levels of equity in its foreign subsidiaries, which is generally not hedged. Table 18 below sets out the financial risks, the amount of the exposures and how they are managed.

Table 18: The Financial Risks and how they are managed

<table>
<thead>
<tr>
<th>Financial Risks</th>
<th>Key Points</th>
</tr>
</thead>
</table>
| **Liquidity Risk**  | • Liquid Funds: 384m SEK  
                     • Liquid funds are invested solely in liquid instruments with a low credit risk.  
                     • Company attempts to avoid the situation where it has both surplus liquidity invested and long term loans at the same time. |
| **Interest Rate Risk** | • Interest bearing liabilities: 9.5m SEK  
                           • Limited due to short interest rate periods on loans and investments. |
| **Currency Risk**    | • Net foreign exchange exposure: Approx. 1,000m SEK  
                     • Faces high transaction risk exposure due to a large portion of the company’s product purchases being made in USD and USD-linked currencies.  
                     • Product purchases are normally contracted three to six months prior to delivery.  
                     • Income is denominated in SEK, other currencies from the Nordic region and Euros.  
                     • According to the company’s financial policy, at least 70% of contracted flows should be hedged.  
                     • Sensitivity analysis is used to determine how much a +/- 5% fluctuation in the value of the USD will effect company profits.  
                     • Foreign exchange exposure is mainly hedged through forward contracts and options.  
                     • Book value of the foreign subsidiaries’ net assets amounted to 252m SEK as of the end of the 2004/05 financial year. This translation risk is not hedged.  
                     • Translation risks also arise when results of the foreign subsidiaries are converted back to SEK. This too is not hedged.  
                     • Economic exposure is not deemed to be a substantial problem due to the fact that competitors of Company P generally have a similar currency position. |

Source: Adapted from Interview
7.3.4 Outsourcing as a Solution?

The purchase of a TMS has been high on the agenda in the past and is once again being considered. The Group Treasurer believes the introduction of a TMS is the solution to the problems at the treasury of Company P. The main objective of introducing a TMS is to obtain better security than that permitted by the current technique of managing and confirming trades through Excel. Another stated objective is to improve the accuracy of forecasting of liquidity for liquidity planning purposes, a weakness of the current treasury function. In addition, it would ease the handling of back office tasks.

Outsourcing has not been considered as an option for treasury activities at Company P. The preference for Company P at present is to complete all treasury tasks in-house, especially those related to the managing of risks. The Group Treasurer is of the opinion that treasury is a cost function, so thereby whoever can perform the tasks at the lowest possible cost should be performing the tasks. The Group Treasurer believes that at present no one else could do the job at a lower cost than that with which it is being completed in-house. Outsourcing of more routine tasks such as administration would only be considered if it meant that fewer personnel would be needed internally. The Group Treasurer states: “If we could have one person less in Company P and have someone else outside the company then we would consider it.” However, since two people are needed internally for control purposes, then with the current set up it would be impossible to outsource even the administration. The Group treasurer cites the situation where if the person that was working in-house was sick or on holidays, then no payments could be made in the company.

7.4 Company E

7.4.1 Background

Company E is in the shipping and logistics industry, with a primary focus on industrial tanker shipping and marine services. The company has an
ambitious annual growth target of 20% over a three year period. It would like to achieve these targets through increasing contract volumes, developing new markets and through the acquisition of companies.

Like other companies in the shipping and logistics industry, the financial performance of Company E is dependent to some extent on the value of the USD. The USD declined substantially throughout the 2004 financial year, but the effects on profits were in part offset by a strong freight market. Net sales remained relatively stable from 2003 to 2004, with the 2004 figure reaching 3,207m SEK. This resulted in operating profits of 377m SEK.

7.4.2 The Operating Characteristics of the Treasury

Table 19: The Operating Characteristics of the Treasury at Company E

<table>
<thead>
<tr>
<th>Treasury Department</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury Management System</td>
<td>No.</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>3</td>
</tr>
</tbody>
</table>
| Positions Held by Employees | • Group Treasurer.  
• Treasury Co-worker  
• Treasurer in subsidiary. |
| Positions of Other People Involved in Treasury Decisions: | • Managing Director |
| Structure | • No distinct front office/back office structure.  
• Group Treasurer responsible for currency trading, setting of policy and cash management.  
• Co-worker responsible for loan administration and cash management tasks as well.  
• Treasurer in subsidiary responsible for managing loan agreements and currency for the operations of the subsidiary. |
| Centralised or Decentralised | • Decentralised.  
• Trading of currency takes place locally at the subsidiaries.  
• Loan administration for the subsidiaries takes place locally. |

Source: Adapted from Interview
7.4.3 Risk Management

Company E is in the shipping industry so consequently faces risks that are quite specific to that industry. Loans are of a specific nature, with several banks having developed specialised loans to meet the risk and maturity needs for investments into vessels. Loans are long term with a majority of loans maturing in more than 5 years. Furthermore, the company policy of having at least 50% of loans of a maturity of greater than one year having a fixed interest rate suggests that the company is quite exposed to interest rate movements.

Company E is by and large a USD company, though it is listed on the SSE, consequently financial reporting is in SEK. It is thereby exposed to fluctuations in the USD, since most of its revenue is in dollars, but this is hedged either through matching USD-denominated expenses with the revenues (and thereby limiting the transactional foreign exchange risk) or by active currency hedging. Due to the fact that several of its subsidiaries are located elsewhere in Europe, the company faces some translation risks. Investments made in these foreign subsidiaries are however not hedged. Table 20 below sets out the financial risks, the amount of the exposures and how they are managed.
### Table 20: The Financial Risks and how they are Managed

<table>
<thead>
<tr>
<th>Financial Risks</th>
<th>Key Points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liquidity Risk</strong></td>
<td>• Liquid funds: 295.9m SEK (this figure corresponds to cash and bank balances. Company E also has 659m SEK in short term investments, including money market investments and bank deposits.)</td>
</tr>
</tbody>
</table>
| **Interest Rate Risk** | • Interest bearing liabilities: 3079.1m SEK  
• Adjustments of fixed interest rates for the various loans are staggered over time.  
• Aim is for at least 50% of net debt should be at fixed rates of interest for terms of longer than one year.  
• 1,893.7m SEK of liabilities have a maturity of greater than 5 years.  
• Duration of loans is approximately 15 years. The long term loans reflect the nature of the investments required in the shipping industry. |
| **Currency Risk**    | • Net foreign exchange exposure: Limited – not definable.  
• The shipping industry operates to a large extent in USD. Company attempts to match the in-flows in USD with USD-denominated expenses. Company also uses currency hedging measures to hedge transaction risk exposure where necessary.  
• The company hedges with options or alternatively through spot market trades.  
• A majority of loans are denominated in USD (2,187m SEK which is 71%). Vessel values are expressed primarily in USD. Any change in value of the USD causes a change in value of the vessels but this is compensated by a change in value of the loans.  
• Liquids assets are primarily in USD.  
• Translation risks caused by the foreign subsidiaries are generally not hedged. |

Source: Adapted from Interview

### 7.4.4 Outsourcing as a Solution?

Company E would like to see improvements in its treasury activities, though not through purchasing a TMS or hiring more staff. The resources available at present for Company E are adequate for managing their risks. The improvements they would like to see would come about through the improvement of the administration of their loans, possibly through the introduction of a loan administration system. Alternatively, another method could be to minimise the number of loans through using one loan for three vessels instead of one.
Outsourcing of treasury activities has not been considered as an option for Company E. This is in part because the volume of trading is relatively low, and is easily handled with the current facilities and the current set-up. Furthermore, the treasury function is somewhat decentralised, with currency hedging deals taking place locally at some of the subsidiaries. The company has taken a step towards centralisation of treasury activities through concentrating surplus cash into one bank account, though no further moves have been planned.

The adoption of the IFRS is seen as one driver that will affect the way a treasury operates. At the moment, the company uses the USD as the functional currency, though reporting is still carried out in SEK. This is seen as simply creating more work for the company. If this were to change, then the reporting process would be simplified.

7.5 Conclusion

Having now seen how the treasury function is set up in each of the three companies and the risks that they face; it is now possible to move on to analyse how the companies could benefit from outsourcing and how a possible outsourcing relationship could develop. It is also possible too see how the range of products that SCAP could offer would differ for each company based on their risk characteristics.
CHAPTER 8 – Matching the Needs of the Corporate Treasuries with the Services of Skandia Capital

In the following section, we will analyse the three companies with the aim of determining how suitable each is for the outsourcing of treasury services to SCAP. The analysis will be based on the characteristics of the treasury of each company, the financial risks each company faces and how this can be matched by the services offered by SCAP and the attitudes of the treasurers in each company towards outsourcing.

8.1 Introduction

The empirical findings illustrate how treasury departments differ for different companies. The findings make it possible to determine the suitability of outsourcing for different companies. Outsourcing of treasury activities is obviously not the solution for everybody, though some companies would benefit from it more than others.

Each of the companies will be analysed separately in order to ascertain whether outsourcing would be a suitable option for their treasury departments. Firstly, an analysis of the operating characteristics of the treasury departments will be presented to establish the deficiencies in the treasury functions of the three companies. This will be followed by an analysis of the risk management objectives of the company to determine whether the needs of the companies are matched by the services that can be provided by SCAP. Finally, the suitability of outsourcing as a solution for the treasury functions of the companies will be presented based on Pichaud’s framework for outsourcing agreements.
8.2 Company F

8.2.1 The Operating Characteristics of the Treasury

Company F is looking to improve on its treasury function and believes that the purchase of a TMS is a method of attaining the improvements that are required. The treasurer cited the need for improved liquidity forecasting and management as key factors driving the need to purchase a TMS. If a company is considering the purchase of a TMS then this means that the window of opportunity is there for a treasury outsourcing vendor, though it may be closing fast. As soon as the decision to purchase is made, then there would be little conceivable chance of a company then choosing to outsource.

The company is growing rapidly at the moment so efficient liquidity management is essential, though it is made difficult by the numerous acquisitions that the company is partaking in. The Treasury Manager has the task of “getting the (acquired) companies in line” through setting up the necessary cash pools for them and negotiating loan agreements for the purchase of them.

Company F has some sort of distinction between the front and the back offices. It is a distinction of the different duties and responsibilities completed by the different personnel rather than an actual or physically defined boundary. It is up to the Treasury Manager to execute the deals and the assistant then makes the confirmation which is then approved by a superior. The CFO also has the authority to execute deals. There exists a separate finance group as well, so if necessary they can confirm deals. With such a set up it is ensured that there is always the appropriate segregation of duties for internal control purposes. However, without the TMS, the appropriate system security levels are lacking, with nothing to prevent unauthorised personnel from accessing spreadsheets. This also yields the problem of spreadsheet risk.
The company has recognised that there are not sufficient personnel to meet the demands that the company will face of its treasury in the coming years. Though at present there are the personnel to meet the internal control requirements.

Company F has a relatively centralised treasury, which means that it has the advantage of gaining economies of scale and it has given itself the best chance of achieving critical mass. However, due to the few deals that the treasury undertakes, critical mass is unlikely. The company is attempting to achieve critical mass on payments through centralising all payments to a shared service centre\textsuperscript{11} in each country where subsidiaries are located. This could be even further centralised to the head office, or alternatively it could be outsourced.

Company F has a well-structured, centralised treasury, but a lack in the number of personnel to meet future requirements of a growing company. Furthermore, the purchase of a TMS is planned for the not-too-distant future. This combination of factors would suggest that Company F would be a suitable candidate for the provision of treasury services from an outsourcing service provider.

8.2.2 Risk Management for Company F

Company F is a relatively new comer and therefore faces a changing risk environment. It is undergoing rapid expansion through acquisitions and organic growth, and has consequently the management of debts and the management of liquidity as the central focus of the treasury. It must ensure that access to adequate funding is possible at all times, which requires active debt management and liquidity management for shorter-term borrowing and investments.

\textsuperscript{11} A business unit that performs administrative transactions for numerous divisions or subsidiaries of the same company, rather than having those transactions conducted in every division or subsidiary (www.invest.uktradeinvest.gov.uk)
SCAP could provide their expertise to the liquidity management and planning of Company F, an aspect cited as a weakness of that treasury. Cash pooling has already been implemented by Company F, so this would ease the task of SCAP. Surplus liquidity is invested based on the guidelines set by the Board but SCAP could possibly attain a better rate of return since those making the investment at SCAP have continual access to real time market information and possibly more experience in managing short-term investments. Better forecasting of liquidity needs could also be achieved through using the specialists that are employed within SCAP. SCAP has also expressed interest in the management of debt portfolios; something that would benefit Company F. Company F raises much of the financing for property investments in the UK and France denominated in the local currencies. This would not serve as a problem for SCAP, since the Skandia Group has large operations in the UK and mainland Europe. Little could be offered in the form of foreign exchange risk management due to the limited transactional exposures of Company F. Translational exposures, though limited through matching, may be further limited through longer term derivative hedging.

8.2.3 Outsourcing as a Solution?

Of the Treasurers that were interviewed, only one of the three seems open to the idea of outsourcing of treasury services, and has actually considered it as an option for their company. That is the Treasury Manager of Company F.

The current operating position of the companies examined plays a large part in influencing the attitudes of Treasurers towards outsourcing. Though all companies are aiming to expand into new markets, Company F is undergoing the most rapid expansion, and this is planned to continue over the coming years. The strategy for Company F is to grow three times larger in the next five years, Company E has an average annual growth target of 20% over a three year period and Company P has no target rate but a general strategy for growth and expansion into new markets. This subsequently impacts the outlook of the treasurers. The Treasurer of Company F
recognises that the treasury department would not be adequate if it remained as it is if the planned growth is achieved. Therefore, a new solution must be found, of which outsourcing is an option. This reflects the findings of the literature – that is, it is often a particular event that leads to the decision to outsource, rather than a strategic decision.

8.3 Company P

8.3.1 The Operating Characteristics of the Treasury

Like Company F, Company P also is looking to improve its treasury through the purchase of a TMS and it has the same motivation of trying to achieve better liquidity forecasting and management. Company P also posits that a TMS would aid in attaining the internal control that is essential for the operation of its treasury. As mentioned above, there is a window of opportunity but it is closing fast.

Company P is well established in terms of having a strong market position, which is also reflected in the treasury department which is centralised and is adequately staffed. They have three people in the treasury department, which is one more than Company F and the same as Company E. The greater risk exposures of Company P no doubt demand more personnel to manage the greater amount of trading for risk management purposes and the subsequent administration of the trades.

The treasury is entirely centralised to the head office, with all risk handling and payments coming from there. The centralisation process reflects the need of the company to gain critical mass in its treasury activities, particularly administration and IT. If a company has a fully centralised treasury and it still does not obtain critical mass then outsourcing could be an option for them.

Company P has adequate distinction between the front and the back offices, through defining the different duties and responsibilities completed by the
different personnel. The segregation of duties is achieved, but the appropriate system security is not available to meet all internal control requirements.

Company P has possibly the most established, well-structured and adequately staffed treasury, which would seemingly point to it being the least suitable for outsourcing. However, this is not the case as improvements are still being sought after when it comes to the management of liquidity, therefore it could still be considered as a possible candidate for the provision of outsourced treasury services.

8.3.2 Risk Management for Company P

Company P has the advantage that they are already firmly established in local markets. At the same time, they have stated in their company objectives that expansion into new markets is a goal, which may mean that their risk profile may change in the future. Unlike the other two companies, Company P has little or no debt at all. Its risk management almost entirely revolves around the management of its foreign exchange exposures, in particular the USD.

SCAP could provide similar kinds of liquidity services to Company P as those mentioned for Company F. This could be the starting point of an outsourcing relationship, since Company P has expressed interest in improving this aspect of their treasury function and it is one of the core competencies of SCAP. Debt management would not be a major aspect of any possible outsourcing relationship, though foreign exchange risk management definitely could be. With the substantial transactional risk exposure Company P faces, SCAP could apply its expertise to provide the best hedging strategies and techniques available. SCAP has a large front office, which has as one of its key responsibilities the management of the forward books for foreign exchange risk for the Skandia group. They have constant real time access to foreign exchange markets, which subsequently
means they could attain better exchange rates and lower spreads on trades. Thus, SCAP could definitely offer more expertise.

8.3.3 Outsourcing as a Solution?
Company P has not considered outsourcing as a solution to the weaknesses in its treasury, though it has not been completely eliminated as an option, especially in relation to administrative tasks. SCAP would be well equipped to provide administrative support through their established back office and their sophisticated systems; this would not be the area where the most value could be added. However, at present this could be a good starting point for an outsourcing relationship, and we can see from the case with Rottneros that it is not necessary to start with outsourcing the full range of services at once. Rather the relationship can develop over time.

The value added tasks revolve around risk management, an aspect that Company P is opposed to outsourcing. It is arguable whether SCAP could actually provide administrative tasks to Company P at a cost advantage to how they operate at present – a prerequisite of Company P before they would consider outsourcing.

8.4 Company E
8.4.1 The Operating Characteristics of the Treasury
Company E believes that it has the sufficient resources in its treasury to manage the risks it faces. It does not have the trading volumes to warrant the investment of a TMS, nor is there a demand for more staff.

Company E has the separation of tasks to an extent, though some tasks, such as cash management, are shared. When it comes to managing deals, there exists the segregation of duties, but not the system security.
Company E has only two personnel in its head office treasury. This is adequate for managing their current position, which entails limited risk exposure. It is largely debt management and loan administration that is handled in the treasury.

Company E still has some risk management tasks decentralised. This would suggest that Company E is not taking advantages of the economies of scale achieved through centralisation. However, this could also be in part due to the nature of the business E is involved in, as well as the culture within the business.

Company E has the weakest treasury function of the three companies. It has the minimum amount of segregation of tasks and it is decentralised in some of its activities. The treasury is established in both the parent company and one of the subsidiaries. Outsourcing would not be a conceivable solution due to the reluctance within the treasury to change the way things are done at present.

8.4.2 Risk Management for Company E

Company E has very specific risks to manage, particularly relating to the USD exposures it has and the specialised loans that it uses for its investment in new vessels.

Company E could benefit from an outsourcing relationship with SCAP through making use of the expertise of SCAP in managing foreign exchange risks. Though Company E does not hedge their foreign exchange risks as actively using derivatives as Company P, they could still achieve some cost benefits due to SCAP regular involvement in foreign exchange markets. Most transactional foreign currency risks are eliminated through matching of revenues in foreign currency with expenses in the same currency. But when there are net in-flows or out-flows, these are hedged with derivatives. This is where the expertise of SCAP would be most beneficial for Company E.
Company E’s translational foreign exchange exposures are managed where possible, on the balance sheet. This is seen through the larger portion of its loans being USD denominated. This limits the services SCAP can offer to Company E.

The management of debt would be more difficult to outsource due to the need of specific types of loans. It would require someone within SCAP to have a thorough understanding of the shipping industry - something which would take time to develop. This is a skill that those working in Company E already have - one of their core competencies - so they may be reluctant to let someone else, who has less experience in the area, get involved.

8.4.3 Outsourcing as a Solution?
Company E was the most reluctant of the three companies to consider outsourcing. For the most part, the Treasurer was satisfied with how the treasury was currently functioning and it seemed the resources were sufficient to meet the demands on the treasury. The purchase of a TMS is not on the agenda - though improvements in loan administration would be one aspect the treasury would focus on. Furthermore, the company is well established in its current markets and though it is expanding, it is not expanding at a rate that would enforce major structural changes or significant changes in its financial position. This, combined with the relatively narrow range of risk management tasks that match those areas which SCAP has a core competence, suggests that Company E is the least suitable company for outsourcing.

8.5 Key components for Outsourcing Agreements for Companies F, P and E

In this section the framework for identifying the critical success factors for creating and engaging in a strategic sourcing relationship will be applied to
all three companies we have chosen as our case studies. We will analyse the factors SCAP should consider for these companies as potential clients if outsourcing relationships are considered. We will also compare the issues that surround these companies as potential clients to SCAP’s current client Rottneros.

Compatibility – Rottneros has given SCAP a different type of client than the ones they look after within the Skandia Group due to their underlying business which is in pulp and paper. Both SCAP and Rottneros thought it was best to have a trial before deciding on any agreements. Taking in other corporate clients such as Companies F, P and E who differ in their treasury characteristics as well as underlying businesses will mean they too will offer SCAP a different corporate culture that SCAP will need to adapt to in order for the relationship to work.

Technology – All three companies we have analysed do not have a TMS and rely on spreadsheets to document and manage their trades. They have stated the importance of having a TMS for internal control as well as to improve aspects of their treasury. Like Rottneros, all three companies do not have the high volume of transactions to justify having the technology needed for internal control to ensure segregation of duties for staff and system security. Segregation of duties could mean more staff should be hired where there might not be enough work to go around.

SCAP has the adequate number of employees in their treasury and also the system control. SCAP’s business depends on having advanced technology which is part of their core competencies. The high cost and deployment of a TMS is high on the agenda for two of the companies we have interviewed (Companies F and P). Given that a TMS is highly expensive to implement and maintain, it is possible that treasurers will turn to outsourcing providers for access to sophisticated technology and the expert personnel who run it.
Expertise – The companies we have analysed have a treasury in place and a treasurer. The treasurer and possibly the CFO would be the experts from the company to steer the outsourcing relationship.

Objectives – Referring to SCAP’s relationship with Rottneros, the decision to outsource was not considered to be a quick-fix solution. Rottneros started with outsourcing just their cash management but decided to tap their outsourcing partner’s expertise in interest rate risk and currency risk management as the relationship moved forward.

If the objective for SCAP is to take on a client where there will be a promise of expanding their responsibilities and to have a long-term partnership, then this will affect the issues of human resources and cost which are two other factors in this framework.

Human Resources – Unlike Rottneros where there was a need to set up a new treasury, the three companies we have studied all have in place a treasury, a treasurer and also assistants. Treasury outsourcing allows companies to streamline processes where normally the routine and administrative tasks are outsourced which will allow the corporations to concentrate on the strategic tasks. If people are a crucial component of the outsourcing decision for these companies then SCAP will have difficulty in achieving the same intensity of the partnership they currently have with Rottneros. Company F is the one company that has recognised that the treasury is not adequately staffed to deal with the increased amount of risk management that will be demanded of them in the future. This means that they could possibly attain a similar kind of relationship that SCAP has with Rottneros, though the one treasury assistant may have to be laid off. Company P has more human resources that would have to be laid off (that is, two treasury assistants) if the same sort of relationship were to be developed and the same applies for Company E.
**Costs** – Through outsourcing to SCAP a company would be able to benefit from a superior set of cost drivers that are possible given the economies of scale, the knowledge and the TMS which SCAP have. As a result, outsourcing could significantly reduce a company’s operational costs. For companies F, P and E the issue to consider would be that they already have in place a staffed treasury. The issue that will need to be solved is whether they will benefit from paying a fee to SCAP on top of the operational costs they have so far by outsourcing aspects such as technology or the routine tasks to SCAP.

**Capabilities** – The ability of SCAP to meet risk management requirements of the three companies at this present time in relation to their risk exposures can be satisfied for companies F and P. For company E, since they are in the shipping business and require special knowledge about shipping loans, this type of client must be assessed further.

**Mandates** – Different companies would need different mandates on how they would like to hedge and report their risks. Each company would have a different way of wanting to implement their risk management on an operational level. SCAP would need to know how many clients they can cater for with their current resources.

In applying the framework to Rottneros and SCAP’s relationship we found that some of the criteria are interrelated with each other. Rottneros did not have any human resources which aided them with entering into a long-term arrangement with SCAP where there was no need to question whether staff will be threatened. Different mandates with each new client SCAP can take on will also affect SCAP’s capabilities to meet the requirements of their clients as some clients would need more time than others.
CHAPTER 9 – Conclusions and Recommendations

In this chapter we will present our discussion and conclusions to our research questions based on the results and findings. This will be followed by the recommendations for Skandia Capital and suggestions for further study.

9.1 SCAP as a Treasury Services Outsourcing Provider

In this study we have concentrated on SCAP as the treasury services outsourcing provider. Outsourcing of treasury services allows other corporations to have access to the treasury of SCAP - its system, staff and expertise in the management of financial risks. The treasury of SCAP is set up to be in line with the regulation to have internal control. They have an advanced TMS and adequate number of staff to manage the large trading volumes of its parent company whose core business is in the management of money. SCAP also meets the requirements of regulation that there is segregation of duties within the treasury and there is also the appropriate security control, to minimise the operational risks.

The set up of a sophisticated treasury is expensive for mid-sized corporations have high financial risks. These corporations do not have the sufficient trading volumes to warrant the complete set up adequate for internal control and regulatory measures. For these corporations the services offered by SCAP could be appropriate. That is, outsourcing of treasury services could be a solution.
9.2 Treasury Characteristics of the Potential Clients & Rottneros

In addition to meeting at least one of the financial criteria, the types of clients SCAP can provide for will depend on the treasury characteristics of the corporations as described in Table 2 (refer to Chapter 1). If the corporation does not have a TMS and is not split into front, middle and back offices it is likely the treasury of the corporation lacks the internal control as required by regulation. It was questionable how a company with (or without) a treasury department and whether it has an adequate number of people working in the treasury will affect the suitability of the company as a potential client for SCAP. The research therefore developed on the treasury criteria by segmenting the potential clients into three types.

Companies that fit into Segment 1 would be the least suitable for developing an outsourcing relationship due to the advanced treasury they already have in place (see Table 21). They have a treasury department that is set up to meet regulatory requirements for internal control.

<table>
<thead>
<tr>
<th>Treasury Characteristics</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lacking a Treasury Management System</td>
<td>No</td>
</tr>
<tr>
<td>Lacking a Treasury Department</td>
<td>No</td>
</tr>
<tr>
<td>Inadequate number of people working in the treasury</td>
<td>No</td>
</tr>
<tr>
<td>Not Split into front, middle and back</td>
<td>No</td>
</tr>
</tbody>
</table>

Companies that fit into Segment 2 already have a treasury in place but not the complete set-up to meet regulatory requirements (see Table 22). That is, these companies do have a treasury department, though they have signalled that they possibly do not have the adequate personnel. They also may not have the front office/ back office structure.
Table 222: Treasury Characteristics of Clients in Segment 2

<table>
<thead>
<tr>
<th>Treasury Characteristics</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lacking a Treasury Management System</td>
<td>Yes</td>
</tr>
<tr>
<td>Lacking a Treasury Department</td>
<td>No</td>
</tr>
<tr>
<td>Inadequate number of people working in the treasury</td>
<td>Yes</td>
</tr>
<tr>
<td>Not Split into front, middle and back</td>
<td>No</td>
</tr>
</tbody>
</table>

Companies that fit into Segment 3 are those companies that have no TMS, no treasury department and not sufficient people involved in treasury activities to ensure the segregation of duties for internal control (see Table 23). These companies have the weakest treasury infrastructure or rather no treasury infrastructure at all.

Table 233: Treasury Characteristics of Clients in Segment 3

<table>
<thead>
<tr>
<th>Treasury Characteristics</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lacking a Treasury Management System</td>
<td>Yes</td>
</tr>
<tr>
<td>Lacking a Treasury Department</td>
<td>Yes</td>
</tr>
<tr>
<td>Inadequate number of people working in the treasury</td>
<td>Yes</td>
</tr>
<tr>
<td>Not Split into front, middle and back</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Clients that have the same treasury characteristics as Rottneros belong to Segment 3. The relationship between Rottneros and SCAP was a key stepping stone in understanding the products on offer at SCAP and a weak corporate treasury department of a mid-size firm. Rottneros needed to set up a new treasury department and therefore did not meet any of the treasury characteristics set in the client-selection criteria. Rottneros over time has outsourced its entire treasury to SCAP with regards to the management of its financial risks.

9.3 The Matching of Services on Offer by SCAP with Potential Clients

SCAP can offer a greater range of services to the companies in Segment 3 than Segment 2, because the companies in Segment 3 have a greater need for the treasury infrastructure and the risk management capability of SCAP. The
companies that fit into Segment 3 would be the most suitable targets for SCAP to seek an outsourcing relationship similar to that they have established with Rottneros, a client that belongs to this segment. Segment 2 companies do not have the same needs at present since they already have some sort of treasury department in place. Therefore, they would not need to outsource on the same scale as Segment 3. The matching of SCAP’s products to these companies would be limited. As for clients in Segment 1, they already have a treasury set up in house and would be least likely to outsource any aspects of their treasury for the given minimum fixed fee per year of 0.5m SEK.

The segmentation allows SCAP to have an initial understanding of the treasury department of the client based on the company’s treasury characteristics. If the company has a weak treasury department then outsourcing to SCAP and accessing their advance treasury could be a solution. However, in addition to looking at the segmentation of the potential clients, SCAP will also need to determine how they can provide for the needs of the company regarding their financial risks. That is how they would match their core competencies - liquidity management, foreign exchange risk management and debt management - with the needs of the three potential clients. This we have concluded will be on a case by case basis as the financial risks face by the company will depend on the underlying business it is in.

Three companies were selected for this purpose, two from Segment 2 and one from Segment 3 for closer examination – Companies F, P and E.

Company F fits into Segment 2, and has the best match with the services on offer. Firstly, they have the insufficient resources currently on hand in the treasury – with respect to the personnel and the technology systems. Secondly, they planned to expand their business rapidly over the next 3 years which would lead to greater demands placed on the current treasury infrastructure with which it would not be able to cope. Thirdly, the company
is in need of improved liquidity management and more efficient management of their debt - that is likely to escalate as the company expands. This company has the greatest demand for the services on offer at SCAP.

Company P also fits into Segment 2, though there is a weaker match between what is on offer at SCAP and its present needs, making Company P less suitable for developing an outsourcing relationship. The treasury set up is more advanced which subsequently means that its risk management capabilities are well developed, though the company also cited a need to improve its liquidity management.

Company E fits in to Segment 3, a segment in which Rottneros belongs too and indicates the client has the weakest treasury, yet it is the least suitable for outsourcing due to the nature of its financial risks being very specific to the shipping industry. There is not a good match between the services on offer at SCAP and the needs of that company’s treasury as shipping loans are not part of SCAP’s core competencies.

9.4 Conclusions to our Main Research Questions

The treasury characteristics of the potential customers have been grouped into three segments where Segment 1 clients have the most adequate treasury and Segment 3 have the least adequate. Segment 2 clients are also inadequate in the set up of their treasuries, they fall in between Segments 1 and 3.

How SCAP will match their core competencies with potential clients will be firstly indicated by which segment the client belongs to and also on other various factors which are unique to the company’s underlying business. In this respect there is a need for SCAP to examine the potential client on a case by case basis to test if they are suitable or not.
9.5 Recommendations

We would recommend SCAP to target the companies that are in Segment 3 first as these companies have no treasury infrastructure, followed by clients in Segment 2. Like Rottneros, Segment 3 clients would have the potential to outsource its entire treasury hence providing an opportunity for SCAP to offer more of a total-package solution. It would also mean a chance for SCAP to develop a partnership along the lines of what they currently have with Rottneros.

Segment 2 clients could also be targeted although not with the full range of products. Should SCAP wish to develop the same kind of relationship as that with which they could with a company from Segment 3, they would need to take into account the issue of the staff that exist in the current treasury department of that company. Alternatively, SCAP could offer a package of the standardised products, such as the administration services of the middle and back offices, which are functions that these treasuries may be lacking in, in order to improve their internal control.

9.6 Suggestions for Further Study

Treasury services outsourcing is a relatively new concept in Sweden. A suggestion for further study would be to research an established treasury outsourcing services provider and analyse how they match their products on offer with the needs of their client base. It would be interesting to see if our recommendations and findings are in line with how an established treasury service provider actually acts.

Another suggestion would be to study non-listed firms as potential clients for SCAP. A cost-benefit analysis would also be interesting to conduct in the case of Rottneros and SCAP to determine quantitatively how outsourcing has saved Rottneros on treasury costs and how SCAP benefits from the relationship.
REFERENCES

Books


Articles


**Personal Interviews**


Websites

http://www.ifsconline.ie/

www.invest.uktradeinvest.gov.uk

http://www.di.se/Nyheter/
APPENDIX 1 - Questionnaire

Below is the questionnaire that was posted on a website and the link was sent to the treasurers and CFOs of the companies that were thought could make the financial criteria as set by SCAP. Note that only the first half of the questionnaire was used in the thesis due to the lack of useful information obtained by the answers to questions 7, 9, 10 and 11.

We are attempting to determine the treasury characteristics of mid sized firms in the Swedish market. In addition, we are gathering thoughts and opinions about treasury outsourcing. Please help us in our research by answering the following questions.

Company Name (Please fill in this, even if you want to remain anonymous it would help us to determine who has responded and who hasn’t responded)

Would you like to remain anonymous?
Yes No

1. Do you have a treasury department at your company?
Yes No

If you answered no, please skip ahead to question 4 and continue from there.

2. If you have a treasury department, how many people work in this department?

3. How is the treasury department structured? Is it:

   Split into Front, Middle and Back offices
   Not split into Front, Middle and Back offices
   Other arrangements

Can you give a brief description of your treasury department if you have chosen “other arrangements”?

Please skip ahead to question 6 and continue.

No Treasury Department

4. How many people are involved in treasury activities?

5. What are the positions these people hold?

   Chairman   CEO   CFO   Other
If your answer was “other” please state: …………………………………………………………………………

6. What do you use to manage your trades?
   Treasury Management System (eg. Trema, Twin, Sunguard)
   Excel

7. How many banks do you deal with? ……………………………………………………………………………

8. What is your estimated foreign currency exposure for this year? (in millions of SEK)
   None at all   0-300   300-500   500-1000   1000+

9. Are you interested in improving your treasury operations? (For example, would you like to lower the costs of your treasury?)
   Yes   No

10. Do you think outsourcing treasury activities could be a method of improving your company’s treasury department?
    Yes   No

11. Would you consider outsourcing a part or all of your treasury department?
    Yes   No