

P E R S P E C T I V E

## Treasury Organisation: Picking the Right Model



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Organizations have extended debates on the kind of treasury they should have. The common themes include services that the treasury should offer, the right size or structure, and the right spread of management control. Is there one size that fits all? Is there a way to decide what model to adopt? What should be the parameters for deciding the kind of treasury to have?

There are many dimensions to the structure of a treasury organization. We focus on two key dimensions - range of services and extent of centralization of management control - and define resultant organization models. Further, we analyze the relationship between organization models and factors that influence decisions on the right model to adopt. The objective is to investigate if certain models are better suited for certain organizational situations. A word of caution: this article does not examine all possible dimensions, although it does address the factors we believe to be critical.

As the definition of treasury expands, companies must choose the treasury organization model they want to base their operations on, regardless of their underlying business.

The two most important dimensions of these choices are: the range of activities covered by the treasury, and the extent of centralization of management control.

Using these two dimensions, there are four main service models they may opt for: full service global, full service local, limited service global, and limited service local.

Companies must consider the key factors impacting these: the scale or spread of operations, the focus of the underlying business, and the complexity of treasury wanted. These factors are collated to form a decision matrix, which is a useful tool for any debate on treasury models.

### Treasury Functions

There are various definitions of the word treasury. In its strictest sense, it refers to one function: asset liability management, especially when used in the context of banks. In a wider sense, treasury includes a whole range of activities encompassing various markets.

A few significant activities are:

- Asset Liability Management:
  - Maturity Mismatch
  - Interest Rate and Type Mismatch
  - Currency Mismatch
- Sales and Trading:
  - Currency, Interest Rate, and Credit Products
  - Money market and Long-Tenure Instruments
  - Derivative products
- Risk Management
  - Back Office Processing, Settlement, and Accounting
  - Customer and Regulatory Reporting

### Organization Models: Dimensions

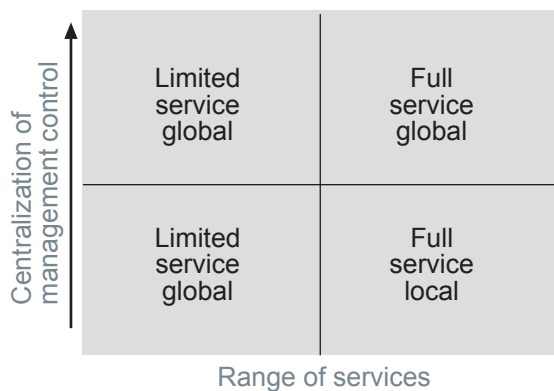
Clearly any organization can exercise its choice on the scope of the treasury functions it undertakes. In doing this, it may be governed by a variety of considerations:

- It may choose to handle only those needs driven by utilitarian motives such as liquidity support or, on the other hand, it may consider treasury as a 'core' organisational process and hence handle the full range of services
- It may choose to outsource portions of the activities required or it may choose to foster these capabilities in-house

Independently, an organization can also decide on the extent of centralization of treasury management:

- It may be efficient to centralize back office processing, while the front office may need to be decentralized to aid speedy local decision-making
- It may be important to have a common risk management strategy, while execution may be decentralized

Figure 1: Four Models of Treasury Organization



Is the underlying business a dimension to the organization model for a treasury? Every organization undertakes all treasury activities to some degree or another. The nature of the underlying business does not detract from the fact that these activities themselves need to be done. The treasury function and its structure and the choice of any treasury model are, hence, largely independent of the underlying business. A study of common practices relating to the two key influencers - the range of activities supported and the degree of centralization or decentralization - at treasury organizations globally suggests four models (see Figure 1).

#### Full Service Global

Full service refers to a treasury that undertakes most, if not all, of the activities mentioned in the previous section. Global treasury refers to one that either operates as the only treasury for all markets across the globe, or ultimately combines all regional or local treasuries (that may exist due to legal or regulatory reasons) into a central treasury for pooling risks, for policies or strategies, or for both of these. In this sense, management of the treasury function in this model is very much centralized. Although this model readily lends itself to global organizations, it could also be used by local businesses that need to access global markets.

#### Full Service Local

Here, each treasury is a self-contained local unit dictated purely by the needs of the local business. Thus, the treasury management function is, by and large, decentralized. While this sort of treasury is usually the norm for a business with a local or regional spread, it may be adopted for a global organization that operates as a collection of highly

independent business units. Again, the range of services offered is the full gamut, as described in the full service global model above.

#### Limited Service Global

This model is different from the full service global model in that the range of services offered is limited. This could largely be due to the fact that certain activities are kept outside the purview of the treasury and are handled directly by business units, if only because the scale of these activities is not large enough to warrant the attention of the central treasury. Examples are treasuries with limited or no foreign exchange trading activities, with the exposure being either managed directly by the concerned export or import department or not managed at all. For those activities that are included in the treasury in such a model, pooling is at a central level.

#### Limited Service Local

This model is akin to having virtually little or no treasury activities, beyond local cash and liquidity management. These are very small decentralized treasuries where the concerned managers may also have other responsibilities in the finance department.

Some activities such as accounting and regulatory reporting are common across all models, irrespective of whether it is done by the treasury back office or by the common functions of the organization. How to choose one from among these models of treasury organization? The section below takes a close look at the key factors that impact a decision on the right model for the treasury: scale or spread, focus, or complexity.

### Organization Models: Factors

#### Scale or Spread

While the underlying business itself does not impact the decision of the best model for a treasury, factors about the business may lend themselves as determinants to a treasury model. The first choices are the size or scale of operations and the geographic spread of the business.

Typically, the larger the scale of operations, the greater the likelihood of a full service treasury. The more the geographic dispersion, the greater the value of opting for a decentralized model.

**Figure 2: Primary Objectives and Treasury Roles of Typical Organizations**

Type of organization	Primary objectives	Treasury role
<b>Investment Companies</b>		
Mutual funds	Early collection of subscriptions; investment of short-term surplus	Maintenance
Private wealth	Assist portfolio managers in their efforts to maximize Maintenance portfolio wealth	Maintenance
Insurance companies	Early collection of premiums; short-term liquidity Management	Maintenance/ Risk management
<b>Banks</b>		
Global	Generating profits; generating return on capital employed (ROCE); asset liability management (ALM) for the bank	Active, advisory
Local or regional	Generating profits; generating ROCE; ALM; building strength in the local currency	Active, advisory
<b>Others</b>		
Development institutions	ALM; managing short-term investments	Maintenance/ Risk management
Retail finance companies	Managing receivables; managing short-term funding or investments	Active
Brokers	Managing liquidity; managing short-term funding or investments	Active
Custodians	Ensuring transactional efficiency in foreign exchange deal execution; fund movement; managing short-term investments	Maintenance
<b>Corporates</b>		
MNC or global corporations	Managing cash and risk on a global basis	Active, maintenance
Local	Managing cash and risk on a local basis	Maintenance

Figure 3: Decision Matrix – Treasuries and Organization Models

Treasury model	Full service global	Full service local	Limited service global	Limited service local
1. Primary motive	Active	Active	Maintenance/Risk management	Maintenance
<b>2. Size of organization</b>	<b>Large</b>	<b>Large</b>	<b>Medium</b>	<b>Small</b>
Size of organization	Large	Large	Small or medium	Small
Geographical spread	Wide	Wide	Wide	Narrow
<b>3. Complexity of operations</b>	<b>High</b>	<b>Medium</b>	<b>Medium</b>	<b>Low</b>
Range of services	Full or near-full range of activities	Full or near-full range of activities	Only some activities undertaken	Only some activities undertaken
Range of financial products	Wide or medium	Wide or medium	Medium	Narrow
Underlying financial markets (trading or settlement practices, regulations, experience in a market, state of infrastructure)	Diverse	Diverse	Limited	Narrow
Treasury decision making (investments, operations, technology)	Centralized	Partially decentralized	Partially decentralized	Decentralized
<b>Illustrative organizations, illustrative activities</b>	A large domestic bank, namely, a bank with a significant proportion of operations limited to one market but with reach that spans several markets, which has almost full centralization on treasury-related decision-making	A global bank, with sales and trading in a variety of instrument categories, geographies and markets, and dispersed control	A transnational manufacturing company. The treasury here may focus largely on foreign exchange exposure alone, but across markets	A local insurance company, with its treasury focus limited to cash and liquidity management

## Focus

Just as with scale or spread, another key factor that influences the choice of model is the primary demand made on the treasury by the underlying business. What is it that the organization looks for from the treasury: is it only liquidity support, or does it complement or significantly enhance the core businesses and hence has a larger role?

To illustrate primary objectives, we take a few typical organizations (see Figure 2), including both financial and a few non-financial company categories, and tag their primary objectives. We further observe that these objectives tend to group treasuries into the four categories from the perspective of their primary drivers:

- **Active:** profit-seeking
- **Maintenance:** cash and liquidity management
- **Risk management:** managing market or credit risk
- **Advisory:** as a pool of skills that helps an organization price its services, distribute products, deliver services, or even manage risk,

The primary objectives of treasury also highlight who the primary customer for the treasury is: internal or external. Where the customer is internal, the treasury tends to follow risk management, maintenance or advisory roles. For instance, manufacturing companies or fund management companies. Where the customer is external, as with a bank, the profit motive tends to dominate. Advisory is important for a treasury playing a largely supportive role to independent business units that own execution. While most treasuries follow multiple motives, it is the dominant motive that determines what category a treasury falls into.

## Complexity

A third determinant is the complexity that the organization wants its treasury to take on. It is not unreasonable to assume that the larger the number of activities covered, the more complex the operation. Centralization and decentralization add to complexity. Centralization is the task of covering multiple activities within the same location. Decentralization is the complexity of coordinating and linking activities across multiple locations. The range of financial products that the treasury is required to deal in, or the breadth of markets it is

expected to operate across, also add complexity.

## Decision Matrix

Having defined the model options and listed the major factors that determine the model best suited for a company, we have analyzed various categories of organizations for the models they adopted, and how each factor contributed to this choice. These observations are collated into a decision matrix (see Figure 3), a useful tool for any debate on treasury models. The matrix also lists illustrative participants for the model options, and lists activities that a treasury may execute in these organizations.

Note that while there is a pattern in the relationship between the various factors and the model options of the treasury, it is always possible to find deviations. Recommendations based on factors such as management policy or corporate strategy can drive the role of the treasury in an organization significantly away from its traditional role.

## Conclusion

Organizations exhibit patterns in their choice of treasury organization models. Two important dimensions for which these choices differ are the range of activities covered by the treasury and the extent of centralization of management control. Key factors that impact the choice of model adopted are the primary motive for the treasury within the organization, the scale of operations, the geographic spread of the business, and the complexity.

We believe that the above discussion will help categorize treasuries better and tie the organization of a treasury to its key performance drivers, thereby suggesting efficient theoretical models for the organization of treasury for different business categories. Once the organization model is chosen, new challenges come to the fore. Different execution models are appropriate for different strategic organization models. That is an area for further research. Identifying patterns that help choose the right operating model or the right technology model is a challenging exercise, but it can also be very rewarding.



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