Making the case for **outsourcing** the forex process

Members of the Press were invited recently to a news conference hosted by Standard & Poors, the rating agency which had downgraded the United States by one notch in its long-term assessment of that country's prospects. The online event was to explain something of the thought processes involved in that decision and set the record straight. If reports in the popular press at the time were to have been believed, S&P was reducing the rating of US government stock to not much more than junk bond status and was about to inflict the same humiliation from an investment perspective on half the countries of Western Europe.

Even a cursory glance at the facts underlying Standard & Poors' rating adjustment would have shown that these interpretations were far from accurate and that the loss of 'half an A' (from AAA to AA+) certainly did not mark the end of the road for the US economy. The minuscule increase in perceived risk would have no impact on transatlantic trade, for example, and companies exporting to the US would get paid on the same terms as before.

The international currency market is the largest traded market. it is also the most liquid and is traded virtually 24/7. The market is driven by trade and speculation, causing wide swings in rates on an ongoing basis.

Economics and politics, demand and supply, expectations versus realities drive constant change. Businesses that trade internationally have additional factors to consider – the underlying business, pricing, shipments, world disasters, contract variances, non payment and other ongoing business risks that increase the complexity of trading across borders.

These are inherent risks that have to be managed and minimised for businesses to trade profitably internationally.

While these concerns permeate the boardrooms of FTSE 350 companies as much as they affect the smaller business, major corporates are generally better equipped to monitor and manage the risk.

Role of Corporate Treasury

The Informed Executive has already examined the role of the Corporate Treasury and found it to be a standard feature amongst large companies. One of the many functions

associated with that role is that of managing the currency risks arising from the company's overseas trading activities; mitigating a broad spectrum of risk to its stakeholders in the process.

Spurred on by the exhortations of government to export for all they are worth, the tiers of business below the major corporates are just as keen to sell their products and services overseas or purchase product for usage or onsale in the UK.

Few, however, have the intellectual insurance policy of a corporate treasurer in the business or the resources to handle a foreign exchange (forex) strategy effectively.

Managing forex carefully

Ensuring that foreign exchange for both importing and exporting businesses is correctly managed is an obvious concern – will any profit on a deal be wiped out if the converted value falls short of expectation, for example?

Add to those concerns the matter of a tortuous trail of paperwork which accompanies a consignment on its way from factory to customer or supplier to your warehouse. Incorrect or invalid documentation can delay shipments and alter delivery patterns, adding to costs, slowing down currency transactions, incurring penalties and possibly seeing the goods impounded in a foreign customs hall.

Add to that the normal risks we experience regularly of earthquakes, ash clouds, political interventions and similar world or local events. There is also the risk of business failure of a party in the chain of production.

Risks of international trade

Uncontrolled, the accumulated risk associated with international trade takes many 'sub-FTSE' businesses out of their comfort zone to the extent that they do not see the risk of international trading as being worthwhile.

For those already importing or exporting, the management time needed to ensure seamless, profitable trade may make them question the economics of the operation.

The risk is either that forex is relegated to when there is time or forex demands more time than it should: this impacts upon profitable business management.

Forex at top of risk list

Of all the issues which influence companies' willingness or ability to import or export, whatever their size, forex is consistently at the top of the list. Problem areas identified include the risk of currency rate changes, choices and ways of hedging, timing of forex purchases, managing the hedging as underlying trades change over the order cycle and the recording and reporting accurately in the books.

For such a specialised area of activity, outsourcing the entire process is arguably the most viable option unless an enterprise has a fully functioning corporate treasury team in-house and can afford the otherwise prohibitive cost of managing its forex portfolio in-house.

If the parameters of the engagement are set correctly, outsourcing should harness a knowledge base and skill set that can be accessed whenever a foray into international trade is being planned. Involving the specialist consultant at every step of the forex management process will achieve direct savings in rates and a reduction in operational costs. §

Uncontrolled, the accumulated risk associated with international trade takes many businesses out of their comfort zone so that they do not see the risk of international trading as being worthwhile.

Demand for expertise in the forex arena was the rationale for a UK-headquartered consultancy to enter the market. Valufin Ltd draws on three decades of experience and the track record of its management team in the foreign exchange consulting sector. Based near London, Valufin provides outsourced foreign exchange risk management services to companies and individuals in the UK market, the South African market and globally.

Valufin's portfolio of advisory services spans forex planning and risk mitigation for businesses and high net worth individuals internationally through to managing the processes involved in funds transfer for individuals from South Africa.

The company is a classic SME: its stakeholders had identified a UK commercial opportunity for bringing their in-depth knowledge of the forex marketplace to bear on a problem facing a broad cross-section of the business community. They evaluated the market and set up a company to achieve that goal.

The services it has to offer appear to be without geographical boundaries, as the same concerns about forex and its risks apply wherever the client is based.

Sharon Constançon, the Valufin CEO, recognised the scope for the company but voiced a note of realism: "While it does not matter where our clients are domiciled, it is part of our role to develop relationships with their bankers, and that becomes more difficult when we are not in a similar time zone."

By way of illustrating the degree of geographical independence which Valufin has already established, however, Constançon cited the example of a client in the Virgin Islands which is trading with Taiwan, Japan, India, Russia and the eastern bloc countries. "This client is dealing in major and exotic currencies around the clock, and we support them effectively working with their key banking relationships."

Strong South African links

Closer examination of Valufin's operations suggests more than a passing link with South Africa where Sharon Constançon was born and spent the first half of her professional career. The connection with South Africa is an important axis around which several aspects of the business have developed.

An associated authorised financial services company in that country provides trading and back-office services for Valufin Ltd

In addition to providing outsourced forex management services to companies trading internationally, Constançon's SA knowledge allows Valufin to provide additional bespoke services to South African individuals locally or living abroad to manage their exchange control and revenue service requirements when transferring funds out of South Africa.

"Clients could handle the process themselves, but ensuring that all the procedures have been followed correctly, and that key documents are produced for approval by the authorities, can take as long as two months. By following the process meticulously, we can reduce that time to seven days."

Managing the risk in **foreign exchange** transactions

As an SME, will Valufin be able to accommodate the expansion being projected?

"We are risk advisors so do not provide currency. We negotiate the purchase and sale for the client from their suppliers. At no time, therefore, do the clients' funds pass through our bank account or come under our instruction. Responsibility for the holding and movement of funds always remains with the client."

Investment in advanced technology

The ability to continue growing in a controlled manner is due in no small measure to the ICT systems which Sharon Constançon has specified and commissioned over the years to manage the processes involved.

All of the forex services provided by Valufin are managed through its Forex Risk Manager (FRM) system. It provides for the recording of all exposures and all hedging in such a way that the risks can be managed and the accounting is totally accurate.

FRM provides management information from board, management, accounting to operations levels. It is unique in its ability to account accurately for currency cash flows. losses and gains for each shipment or exposure.

As FRM is hosted online it enables users to access their forex portfolio and generate reports whenever they require. It allows for client's operations departments to add to, and update, international trade exposures in real time.

Software on a subscription

Offering the FRM service to clients on a software licence is one route to market when the organisations have their own expertise in-house but would benefit from the process control features that the solution delivers.

Constançon again: "This service has been introduced to assist what are essentially large corporates who have a corporate treasury but have no forex system of their own, or one which is based on legacy technology."

Licensing FRM on a Software as a Service (SaaS) basis, clients engaging with the system effectively pay a subscription for the resources they use, making it a cost-effective way of complementing existing in-house systems.

Generating a revenue stream for Valufin, FRM secures a lower level of direct engagement with its consultancy clients by key members of the Valufin team in the day-to-day management of forex. The same FRM system underpins the forex consultancy service which Valufin provides, with clients given access to its exposure input and reporting modules where appropriate.

Risks of dealing with an SME

This shorthand description of FRM inevitably raises more questions than it answers about the extent of Valufin's involvement in managing its clients' forex position.

How does the UK consultancy persuade its clients – many of them very substantial

Above: Sharon Constançon, the CEO of Valufin Ltd responding to the challenge that clients could be risking their foreign exchange with a UK SME.

Delivering the Forex Risk Manager system online where appropriate should enable Valufin to scale up the volume of its services and handle the increasing volume of business being generated.

Conventional cloud computing was not an acceptable scenario as it could mean that personal data might be routed to servers in a US jurisdiction and become subject to the requirements of the US Patriot Act. By running its systems at a 'fixed' location in a highly secure data centre in the London area, Valufin delivers the benefits of cloud operation without the issue of holding data in an inappropriate location.

corporates – that it will not default while purchasing forex on their behalf, for example?

And on the security front, what is the additional risk to the client of loading the extensive financial information required by FRM into a remotely hosted computer?

Sharon Constançon was ready with an unequivocal response on both points, arguing that the Valufin business model is as much about what it does not do as the services that it provides. "We are risk advisors so do not provide currency. We negotiate the purchase and sale for the client from their suppliers. At no time, therefore, do the clients' funds pass through our bank account or come under our instruction.

"No less important, we are never assigned powers to instruct a client's bank to transfer funds. Responsibility for the holding and movement of funds always remains with the client."

The contract between Valufin and its clients does provide for the consultancy to liaise and negotiate with the banks on their clients' behalf, however.

That role was neatly summarised: "We will handle all the tasks that would be handled by an in-house treasurer, for example, assembling all of the 'Know Your Client' evidence under the Anti-Money Laundering regulations for engagement with a new currency service provider.

"We seamlessly interface between the bank/broker and client acting as the 'validator', with documents passing through our highly secure UK-based servers."

Financial independence from client

The financial independence from the client is core to the Valufin philosophy and is carried through to the basis on which the company charges those organisations.

The model for dealing with corporate clients is to agree a retainer related to the complexity and volume of the forex involvement.

Subsequent annual retainers would normally rise in line with inflation as measured by the Consumer Prices Index, unless there was a dramatic change in the nature or value of the business being handled.

As Sharon Constançon explained, Valufin should not be influenced in its recommendations by the level of savings or volumes transacted. The core reason for trade must be that it is the best transaction for the client at that moment.

There could never be the accusation that Valufin recommended a particular course of action simply to generate or maximise its own fee income.

The exception to the retainer rule is where there is a specific trade or infrequent trades handled as unique exposures and not part of a portfolio - typical of an individual or a company with infrequent or erratic currency needs. In these circumstances the fees may be based on the size of the transaction or on the benchmarked profit.

Rigorous security procedures

On the security front in general, the procedures followed by Valufin are rigorous and appear to meet or exceed the accepted standards for the movement and storage of financial data. All data is encrypted, for example, while individual users are assigned personal profiles which allow them only to access specified features of the system.

The FRM engine could well be seen as a cloud computing application: the SaaS 'subscription' method of charging for services delivered would tend to support that view.

But with a true cloud environment comes the possibility that applications are being hosted at any location where the cloud provider could access a data centre.

This was not an acceptable scenario when it could mean that personal information might be routed to servers in a US jurisdiction and become subject to the reporting requirements of that country's Patriot Act.

"By running our systems at a 'fixed' location in a highly secure data centre in the London area, we deliver the benefits of cloud operation but without the attendant issue of holding data in an inappropriate location

"If we were to run out of capacity then we have in place the arrangements for additional hosting on an additional, specified server in the UK. And for clients who do not want to be hosted in London for any reason, we have comparable facilities in Switzerland.

"It follows that we are scalabie to support the growth of our operations, calling into play whatever processor and storage capacity may be needed to manage our client's affairs efficiently. We achieve the best of cloud computing without the concerns."

Accepting the limitations on the 'cloud computing' label applied to Valufin's ICT approach, the solution adopted bears little relation to forex systems in place in the late '80s when Sharon Constançon first migrated into this specialised field of activity.

Having worked for a mining house, she joined Blue Circle as an accountant, becoming involved in foreign exchange. It became clear that there would be benefits in centralising the group's forex management: apart from immediate cost savings, the process could be made more efficient and the relationship between the company and the banks optimised.

Constançon made the conscious decision to experience the forex scene from the banker's perspective, joining Société Générale as chief trader setting up their interbank and corporate trading desks. "Significantly, the bank did not have a corporate desk, and I was given the opportunity to set one up. It gave me a clear understanding of the services that such an institution should be able to provide for its clients. But corporates have accounts with multiple banks, and there was clearly scope for a professional service that could understand the requirements of the client and optimise those relationships."

By 1988, the time had come for Sharon Constançon to leave the comparative security of major corporations and establish an independent consultancy operation. There was clearly a demand for the facilities on offer. Ten years later, the business was still growing and had around 350 of the top organisations in South Africa outside mining, the public sector and utilities as clients. "Those businesses had their own treasury department and were accustomed to dealing internationally. The companies that we took on board were large but did not have the time, knowledge, staff or the technology required to handle forex in-house."

The business grew steadily; Constançon acquiring a partner in 1996 and pursuing an exit strategy which found the company listied on the Stock Market in South Africa two years later. Leaving the venture just before the turn of the century, the former CEO developed a portfolio of commercial interests including IT-based business efficiency, governance and compliance systems.

These covered key areas of business such as the Anti-Money Laundering, financial services, immigration and Health & Safety regulations in the UK, where failure on a company's part to comply would leave it exposed to heavy legal and financial penalties. These modules were later to provide some of the building blocks for forex process management that complement the specific FRM solution. §

Has leading edge technology given Valufin significant advantages over its competitors?

The forex risk management solution which Valufin now offers its clients is an order of magnitude more advanced than the package on offer back in late 90's. The underlying technology has advanced out of all recognition, with new software platforms and the use of the internet, complemented with faster hardware and market acceptance of online computing solutions. Perhaps the greatest advance and benefit to clients of these has been in the distributed computing environment which the Internet and secure hosting has provided.

As Sharon Constançon noted, "Clients can tap our collective knowledge of risk management 24/7. They have access to revaluation, their position and the resulting exposure at any time.

"Any delay in their seeing the most up-to-date picture is usually the result of their failing to update or notify us of primary exposures. Once advised, it is part of the portfolio which is managed 24/7 by Valufin.

"Risk management of a portfolio is more about transaction type, transaction duration (interest rate management) and cross currency management (splitting legs to the USD) combined with understanding the nature of the business and having intimate knowledge of business cycles and client risk appetite. These are far more important than responding constantly to small variations in exchange rates. The right rate quoted at the correct margin is important but yet is no more than one tenth of the profit opportunity"

Building up Valufin revenues

Valufin Ltd has been building up a portfolio of clients for its consultancy services on both the corporate and private client levels. Examination of the company's business model and its ability to take on new assignments raise the question of how Constançon and her team will market their services.

Fellow professionals – typically accountants and lawyers, and organisations such as UK Trade & Investment, complemented by word of mouth recommendations, provide perhaps the most logical route, with approaches from companies and High Net Worth individuals keen to minimise their own forex risk approaching Valufin directly.

The Valufin organisation has a very simple and direct business model. It is using current generation technology to roll out its solutions in a way that appears to be both secure and cost-effective from a delivery perspective.

It is headed by a CEO with a demonstrable track record in the management and direction of businesses: Sharon Constançon is one of a comparatively small number of Chartered Directors in the UK, a qualification provided by the Institute of Directors.

Valufin is advising clients and setting in place the instruments which assist those organisations in mitigating their risk, without increasing their exposure. On any reckoning, it is an effective lubricant in the machinery of international trade. §

This editorial assessment of Valufin Ltd is published by The Informed Executive.
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Establishing effective marketing channels will prove an important factor in rolling out the skill set which Valufin offers: recommendations and fellow professionals appear to be generating sales.