

Can **corporate treasurers** manage **risk** at a time of increasing **uncertainty** for business?

The Informed Executive considers the role played by corporate treasurers in helping the medium scale and larger enterprise secure the funds it requires to sustain its operations

From the PR firm in Putney with its three staff, to the drinks manufacturer delivering to customers in twenty-four countries out of plants that it operates in four of them, there is an overriding factor underlying the survival of all businesses, whatever their scale or field of operation. Taking it as read that their intention is to make a profit on the revenues being generated by trading, they also have in common is an overwhelming requirement to manage their finances *effectively*.

Fail to source the cash required to finance operations, and the engine does not start turning: lose control of the cash flow, and it grinds rapidly to a halt.

At the entry level to the SME community - a broad swathe of businesses which accounts for the largest share of the Informed Executive readership by head count - responsibility for managing funds is likely to rest with the CEO or owner directly: there is probably not a dedicated financial controller or anyone formally carrying the FD mantle on what passes for a board.

Move up the SME scale and into the corporate league, and much clearer roles crystallise out in the financial corner. The Finance Director is a recognisable function on the board at this level.

Often qualified - almost all are chartered accountants in larger businesses - these key players in the management team bring to the table a combination of formal training and experience: in theory at least, they can provide the methodology if not the entrepreneurial flair to carry forward the business.

Within the FD role, or reporting to it as a separate function, is the corporate treasury.

Whether in the bailiwick of a single member of staff or of specialists drawn from across the organisation, the treasury is tasked with ensuring that the enterprise has the funds available on acceptable terms for it to carry out its day-to-day activities.

But it also has a strategic role in planning to fund the longer term objectives set by the Board which will be realised perhaps three or five years down the road.

Funding working capital

The ability to fund the company's more immediate objectives has become an increasingly complex task in the past two decades. Working capital has to be sourced, managed and applied more cost-effectively across the spectrum of its operations.

For a business trading outside its national borders, foreign exchange is an additional factor; a theme to which we return at points throughout this edition.

It requires more than a crystal ball to forecast how Sterling will move relative to the currencies in which the organisation is trading overseas.



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*John Grout, Policy & Technical Director,
the Association of Corporate Treasurers.*

What, for example, are the political and economic risks inherent in any one or more of its significant markets, which could affect the company’s ability to be paid on time and with full value?

And then there is the multiplicity of banking relationships to be *managed*; potentially a combination of loan, current and deposit accounts in each of the countries and for each of the currencies involved.

Role for a corporate treasurer

To gain a perspective on how the corporate treasury can fulfill this burgeoning portfolio of responsibilities, we turned to John Grout, the Policy and Technical Director at the Association of Corporate Treasurers (ACT), the professional body for the sector in the UK.

He confirmed that the financial crisis triggered three years ago has proved to be a major driver of change within corporate treasury. “We have seen changes in the appreciation of risk and the re-evaluation of dealings between companies, financial institutions and other players.

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The larger companies in the marketplace were already reducing dependency on banks when the problems started emerging in the financial sector.

More stringent regulation of the banking sector had been making borrowing inherently more expensive, while requirements that the banks should hold larger amounts of capital on their balance sheets relative to the size of their loan books made those institutions less willing to lend to anything but prime customers.

As a result, there has been a steady movement towards the bond markets, as Grout went on to explain. “One reason is that the purchasers of bonds are a more diverse cross section of investors than the banks are as lenders.

“As the bonds are tradable, holders can dispose of these securities at short notice, making the higher quality ‘paper’ an attractive home for funds.”

There are other considerations. Eurobond ownership is anonymous, for example, keeping investors ‘below the radar’. And for the largest companies, whose asset base and past performance allows them to offer true investment grade bonds (which are acceptable to many fund managers), the attraction of issuing bonds to raise funds is that the conditions prevailing there are less constraining than with the banks.

More flexible funding

John Grout noted that bonds involve fewer covenants than in bank lending. This allows companies to respond to a changing regulatory or financial environment more easily.

Establishing the true cost of funds is an aspect of the treasurer's responsibilities that would be served better with more qualitative information to hand. With a diversity of deals and commercial risk, there is some way to go before boards can be satisfied that the optimum position has been reached.



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Michelle Price, Deputy Policy & Technical Director, Association of Corporate Treasurers.

It can prove difficult for a company to honour covenants entered into with a bank, placing the business technically at risk of default and the opprobrium of negative press scrutiny.

A change in the accounting convention on which an enterprise produces its balance sheet, for example, could find that organisation in an unintentional breach of a covenant simply because its balance sheet is now being drawn up on a different basis and the business has assumed a different - lower - value.

The fact that the world of financial reporting may have moved past the company does little to mitigate the borrower's 'crime against humanity'.

The same banking covenants may restrict the way in which a company uses its subsidiaries as vehicles for funding operations: the terms may prevent borrowing through those businesses as this could reduce the security underlying any bank loans to the parent company.

Michelle Price (*above*), the Deputy Policy & Technical Director at ACT, took up that point. "The CEO has to keep fully on top of the situation, finding opportunities for the business. It is the role of the corporate treasurer to translate those objectives into the art of the possible, determining how much the company could afford to pay for an acquisition, for example, without damaging its credit standing."

Communicating with the Board

Fine sentiments, certainly, but are there sufficiently clear channels of communication between the global executive and financial functions within a corporate?

The reason for having a specialist treasurer is that there is a specialist who can formulate a financial strategy to present in terms which the CFO and CEO can understand and put forward to the board for adoption.

As John Grout observed, "One has to recognise that the general business strategy and the financial strategy may each need adapting so as to optimise the overall mix.

"If the CEO is formulating the funding strategy (that is part of the overall financial strategy) then the CEO is being to that extent the treasurer. That's fine, and smaller companies operate like that.

"A cash management clerk might be called 'treasurer' but that person would not be expected to develop any sort of strategy. The reason for maintaining a 'proper' treasurer is that the CEO and CFO have other things to do."

Mr Grout was able to draw on his own extensive experience in FTSE 100 companies at this point. "As corporate treasurer, I found myself talking frequently to the CEO about the financial strategy for taking the business forward.

"It necessarily involved determining which of the large acquisitions that the company had in mind could be financed, how that could be achieved, and what the constraints would be. It is a mistake to regard treasury as a 'black box' function which somehow runs independently of the strategic objectives of the business."

Potential for technology?

Whatever the political and economic changes might have been in recent years, there has been a much greater potential for collecting, analysing and distributing the information on which the corporate treasurers' advice is based.

This publication has featured in earlier editions the processes of data re-

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porting and data mining, which involve setting up automated processes to 'tap' the core data resources across an organisation, analyse the data they find against particular criteria - the cost of funds and the implicit risk, for example - and then present the results in a user-friendly format.

Broader spectrum of factors

To what extent has this generation of technology been a benefit? Does the treasurer have available the tools which can collate and manipulate the financial data into a form from which the CEO and his team formulate both short-term funding and longer-term business strategy?

Have the data tools improved the quality of decision-making or simply increased the 'noise' from which executives still have to extract the key elements? Michelle Price at the ACT again: "Much of the information being

collected and processed is accounts-oriented. Decision-making needs to take into account a broader spectrum of factors.

"When the business has an international dimension, for example, the corporate treasury role involves more pragmatic considerations such as mitigating risks from the inflation of commodity prices and forecasting when the shipment is being made to its destination country and funds can be released."

More than historical data

It is clear from the ACT Policy team that corporate treasury involves rather more than the collection, analysis and presentation of current 'book-keeping' data derived from across the footprint of the organisation.

Establishing the true cost of sourcing, delivering and maintaining funds for the business is an aspect of the treasurer's responsibilities that would be served better with more qualitative information to hand about the company's funds.

If a company operates multiple accounts in multiple currencies, that analysis will necessarily examine the costs and rewards associated with each of those accounts, posing the question whether all of the entity's funds are being used efficiently.

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Responding well to change

John Grout believes that corporate treasurers are responding well to the changing environment.

They appear to be open to new ideas and approaches. "The financial crisis has encouraged companies to override local practices, so that if an overseas subsidiary is sitting on a healthy cash balance, those funds accessed by head office even if it means that local executives appear to lose some of their financial autonomy.

"Entering what may traditionally have been an autonomous operation requires considerable sensitivity and powers of persuasion. It is often said that treasury management is as much about psychology as it is about finance." §

