Treasury & Cash Management

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Risks and Rewards

Having survived one of the worst recessions on record, companies understand better than ever that treasury management is important for improved efficiency, whether through tightening their accounts-receivable or accounts-payable processes to unlock working capital or limiting the impact of FX, interest rate and other risks on their balance sheet. Now more than ever treasurers have the ear of the CEO, but in a number of companies they are still required to do more with less. Most corporate treasury management teams comprise a small number of people who have responsibility for optimizing cash and liquidity across a number of subsidiaries. Centralizing treasury operations is not a new theme, but what was once the preserve of large multinationals is now filtering down to tier-two and -three companies. These smaller firms are looking for greater levels of transparency and visibility over their own cash and liquidity as well as their subsidiaries' operations and local bank accounts—without compromising or challenging the hegemony enjoyed by those staff running operations in outer reaches of the company.

As part of that centralization initiative, corporate treasury is also moving away from proprietary banking interfaces and wanting to manage relationships with its banks globally via a single platform so they can have a single view of their bank accounts across multiple providers without having to log on to different banking systems. To achieve this aim, Swift Corporate Connectivity is becoming an increasingly popular choice among a broader range of companies.

Risk management is uppermost in the minds of most treasurers these days, with events of the past 24 months having tested systems, policies and procedures that were put in place to preserve working capital. FX volatility is on the increase, with the sovereign debt crisis still weighing heavily on currencies and companies that did not have policies or frameworks in place for managing their FX exposures. As currencies remain fragile and more companies get to grips with the challenges of doing business in an increasingly globalized world that exposes them to more exotic currencies, more companies are putting frameworks in place quantifying the maximum exposure they are able to withstand without doing too much damage to the balance sheet. They are also trying to move away from spreadsheets and proactively manage their FX exposures using the latest software solutions.

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Shared Value

There are many options for how to set up and roll out a shared service center, providing an approach for every budget and corporate structure.

By Denise Bedell

As the recession thaws and purse strings again begin to open for slightly larger-scale projects with a longer-term return on investment, shared service centers (SSC) are in central focus for CFOs and treasurers eager to reduce costs and centralize processes. Dwayne Prosko, director in KPMG's shared services and outsourcing advisory group, notes that centralizing transactional activities frees up finance staff to focus on more value-added activities like decision support and business analytics that help drive the revenue growth of the business. "In short, it enables finance to be less of a numbers-checker and more of a business partner," he says.

The increasing interest in moving to shared services is being driven by the economy and the continuing need for companies to increase efficiency and reduce cost, according to Al Fish, vice-president of professional services at Basware North America. "The shared service center doesn't just bring cost savings, it provides a lot of other benefits to companies: They are able to unify processes and have better visibility into the financial activities of the company," Fish says.

"When profits get squeezed, companies look … at the internal organization to save money"

"As a result more organizations are being charged with finding ways to cut costs, and the SSC is a natural conclusion" —*Robert Cohen, Basware*

Depending on budget, corporate preferences and goals of the project, how a shared service center will be implemented can be very different from company to company. At a time when many businesses have limited available resources, some are taking a slower approach to implementation, while others are pushing forward with regional or global rollouts to garner maximum advantage. In addition, companies have very different stances on how to structure an SSC—whether to house a single function within one SSC and focus on driving costs out of that process as much as possible, or to have multifunction SSCs.

In some cases companies are looking at shared service as a deployment option for a particular function. The goal is then to implement absolute best practice within that service and function and set very specific efficiency and cost-reduction goals. Notes Fish: "With the SSC you are able to build

Prosko: Centralizing transactional activities frees up finance staff

up individuals with specialties that are able to effectively work on specific processes, making them more proficient in those specializations."

According to Craig Himmelberger, solution marketing director at software provider SAP, this approach is quite common in the US. He says: "In the American approach, they might say, 'Let's make this the best A/P [accounts payable] center we can,' and they are very focused on cost saving and metrics."

In contrast with the multifunction approach—where various functions are offered on a shared service basis—the focus is more on qualitative metrics. Says Himmelberger: "More so in Europe we see deployment of multifunction SSCs, where instead of having a center for specialty, the shared service center is built bearing a broad range of processes in mind." One advantage of the multi-function approach is that as new functions are rolled out, the SSC staff become that much faster at managing the rollout process.

Choosing How to Roll It Out

In addition to the types of function that are included in an SSC, companies also have a number of options for how to roll out a shared services center. How a company chooses to go forward with such a project will depend on a number of factors, including its project goals, budget, corporate structure—centralized versus decentralized—and corporate environment. Companies may choose to roll them out on a grand scale, centralizing and pushing an entire function or department into the SSC at one time; or they may take a slower approach, offering the service to an in-house unit to develop.

The second approach treats the SSC as a cost center that must market its service to subsidiaries and bid competitively for the business. There are a number of advantages to this approach. First, it encourages internal competitiveness and efficiency creation. Second, services can be rolled out slowly, and the costs can be extended over a longer period of time.

Finally, for a decentralized company where individual units may push back against a full rollout, this is a gentler approach. Global relocation firm Crown Worldwide is a clear example of the gradual rollout and internal marketing of shared services. The company has a shared service center in Malaysia. Alpesh Sanghavi, director of operations of the group shared service center at Crown Worldwide, says: "Given the acquisitions and expansion that Crown saw over the past ten to fifteen years, it made sense to set up a shared services center."

Because Crown expected some resistance to the shared services concept and did not want to disturb local autonomy, it chose to commence with a small operation and build gradually. Sanghavi says the goal is to be able to move things to Malaysia at a pace that is comfortable for local in-house clients and for the SSC itself. The Crown SSC went from one staff member in 2006 to its current staff of 51.

Although there are several different approaches that a company can take, one thing that is clear is the companies are once again seeing the value of moving to a shared services approach for finance and treasury functions. Robert Cohen, vice-president at Basware, says: "When things get tight and profits get squeezed, companies look more closely at the internal organization to save money. As a result more organizations are being charged with finding ways to cut costs, and the SSC is a natural conclusion." ■

An Eye On Compliance

Central to the thoughts of any CFO or treasurer today is the issue of compliance in global operations, yet that is something that is often overlooked or undermanaged in the SSC, according to David Lewis, director in business services and outsourcing at consultancy BDO. According to Lewis, compliance is seldom a primary consideration, but, if not addressed, it can create big risks and reduce performance gains of the SSC. "We have found that when companies are entering these projects, they are focused on big wins around transactions, but it is important to bear the compliance aspect in mind from the beginning," Lewis says. "Compliance is often an afterthought in these projects, and then out of the blue you end up getting a tax penalty from, for example, the Egyptian tax authorities that you did not expect," he says. "But if you think about compliance from the beginning, then you are able to avoid those surprises."

In a recent study of corporate shared service centers and compliance, BDO found four key problem areas with local compliance: poor process performance, with fragmented reporting responsibility and a lack of coordination on compliance processes; operational problems, with the need to understand a broad range of local regulations and language issues; employee issues, with high staff turnover and the need to safeguard local knowledge; and market challenges.

The study notes: "Local compliance is necessary but was not ranked a priority by our study group, and accordingly performance levels can vary dramatically, affecting corporate cost-effectiveness and process efficiency." In addition, compliance can be vital to continuity of operations: "In some countries, errors or lateness in compliance can go beyond mere penalties and lead to the closure of commercial operations," the study says.

Data Drivers

Analytics solutions pull data from disparate sources to provide a big-picture view of operations and exposures. By Denise Bedell

In the wake of the financial crisis, the job of the treasurer has increasingly focused on a few key areas—compliance and risk management, global liquidity and working capital management, and planning support. As it triggered a global near-freeze on bank lending, the crisis increased the pressure on corporate treasurers to be able to report quickly on the amount of cash held within the organization, to have a clear view of liquidity needs going forward and to understand risks facing the organization in order to protect its revenue and profitability.

Having good data and good analytics to support decision-making and help drive efficiency is key to effectively managing those tasks. Improved cross-technology integration is helping treasurers pull data from disparate sources, but strong data analytics solutions are needed to make effective use of that data and, ultimately, better manage working capital.

George Ravich, executive vice-president at banking systems provider Fundtech, says: "It is a new world in terms of the level of detail that corporates have now. They have access to real time economic and business data, and they want to know not what their balance is at end of week, but right now. This real-time access to data is now not only expected, but it is a necessity as companies deal with issues of liquidity."

Treasurers' demands go even deeper. Access to real-time data is not enough—companies must be enabled to sort through all the data at their fingertips to make use of the information. Dyfan Williams, managing director of Fundtech's financial supply chain product, notes that data is, by definition, unstructured. "On its own, it is not much good," he says. "You need to be able to put context around it, to be able to rapidly deconstruct and reconstruct it. And you need to be able to figure out in advance what questions you want answered in order to determine what data is relevant." Companies are looking for analytics systems that can slice and dice data and return it in easily digestible formats to help people make decisions and increase efficiency.

In the past, decision support systems were far from seamless. For example, companies would download, or manually enter, data for forecasting—including cash positions, historical sales figures, economic forecast data and the like—into a spreadsheet and create a forecast from that to support financial planning and analysis. "Now the goal that drives a lot of companies is how to bring decision support together more efficiently and easily, and how much more quickly you can then take action," says Craig Himmelberger, director of ERP (Enterprise Resource Planning) financials solutions marketing at SAP. "Being able to improve and increase the speed of decision-making is the highest value that can be achieved."

Improving Risk Management

There are countless examples of how solutions that pull data from various sources into advanced data analysis solutions can help treasurers to improve treasury management. One that came to the fore during the recent crisis is counterparty risk management. In early 2007, few treasurers thought twice about counterparty risk; now it is a daily consideration. But the key to effective counterparty risk management is that all the necessary data be dependably assembled.

Says Paul Higdon, chief technology officer of treasury solutions provider IT2: "The effectiveness of this exercise depends firstly on identifying all relevant exposures—which

Saric: "We provide data enrichment to help with vendor management"

Ravich: "Real-time access to data is not only expected but is a necessity"

may include bank account balances, deposits, money market instruments, bond and equity investments and FX and derivative positions." The raw data then needs to be integrated so that the complete exposure information is made available to monitoring and management functions.

"That data includes market rates, prices and volatilities [for valuation purposes], and creditworthiness indicators such as CDS [credit default swap] spreads and other sensitive market indicators such as equity and bonds prices and indices, for evaluating probability of default," notes Higdon.

On the supply-chain side, analytics systems can pull together information on enterprise-wide supplier contracts, creditworthiness and so on. Alex Saric, director of visibility solutions at Ariba, says: "We can provide data enrichment—for example OFAC (office of foreign asset control) or SDN (specially-designated nationals) information to flag if a supplier is on a US government blacklist—to help with vendor management." This is useful not only for supplier selection and to raise flags during the selection process but also for ongoing supply chain risk management—to continuously monitor vendor strength.

Consolidating and analyzing data from all types of exposure to a given counterparty and combining it with creditworthiness measurements creates a complete and accurate picture that companies can monitor to take swift action when counterparty deterioration is detected. Having such detailed information on one screen—which is now quite possible through solution providers—would have been invaluable in 2008, when the counterparty risk burst onto treasurers' radars with the fall of Lehman Brothers.

Improved Compliance and Working Capital Management

Data analytics are also proving invaluable in helping treasurers to better manage compliance and in improving efficiency of working capital. Ariba's Saric says: "Companies are a lot more interested in proactively planning and ensuring they have adequate cash on hand and their supply chain is strong." And given the continued uncertainty on the global economic scene—and concerns over the ongoing availability of liquidity—they are still looking to find more ways to reduce expenses.

One clear example of how data analytics help is in improving use of working capital in vendor management solutions. A system can retrieve contracts and payment terms with a given vendor, or set of vendors, from across the organization, determine where there is overlap in contracts or where one vendor is giving better terms, and use that to optimize payment terms across the organization. Saric adds: "For example, different parts of the company may have negotiated different contracts with the same vendor. You can consolidate those contracts and negotiate better payment terms with that vendor."

Small Investments Can Make a Difference

IT budgets have generally risen above the levels seen during the worst of the crisis; however, companies are still very much aware of how and where their IT budgets are going. Although they may look to slightly longer time periods for return on investment, they still want to clearly see that ROI—either through qualitative measures, like better compliance or improved risk management, or through quantitative measures, such as reduced days sales outstanding or reduced cost-per-check. Many companies prefer to invest in smaller steps, SAP's Himmelberger says. "People don't want to rip and replace systems that are still functioning well, so a lot of the investments we see now are incremental, and companies are investing in systems that provide high-value decision support," he explains.

David Williams, director of solution marketing for SAP BusinessObjects, adds: "One of the key drivers in the office of finance is how to improve organizational agility. The challenge is no longer capturing data but delivering it in a format that can be used by the organization to drive their business. That is why we are seeing such demand for applications that help to do that—speed or time to decision is critical." ■

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Braced For Turbulence

Currency volatility is increasing, and companies are finding that more than ever they need to have an effective FX hedging strategy in place.

By Anita Hawser

Frank Pirozzi is the assistant treasurer at Red Hat, a Raleigh, North Carolina–based company that sells open-source technology solutions to customers worldwide. It derives roughly 40% of its revenues from outside the US and has exposure to 40 different FX currency pairs, the bulk of it being in the top currency pairs, such as US dollar/euro, US dollar/yen and US dollar/sterling. Although its accounting currency in Europe is the euro, Red Hat also has non-euro-based expenses in other currencies, such as the Czech koruna. Until fairly recently, getting a grip on Red Hat's total global FX exposure was a multiday process for Pirozzi that entailed manually trawling through the company's enterprise resource planning system and keying figures into a spreadsheet. "With our ERP system there are some limitations in terms of drilling down into the weeds of our FX exposure," Pirozzi admits.

The impact of FX risk on businesses has been growing recently. A survey of FX exposure and risk practices conducted recently by treasury software vendor SunGard AvantGard found that across a broad range of industries, revenue categories and regions, FX gains or losses had had a material impact on approximately 60% of organizations, compared with a similar study conducted two years earlier, where just 40% of companies reported a material FX gain/loss. According to Wolfgang Koester, CEO of Arizona-based FX solutions provider FiREapps, volatility in the FX markets is at an all-time high, leaving those companies that do not adequately measure and manage their FX exposures in a particularly vulnerable position. "While in the past the average FX volatility was 10%, it is now 12% to 13% in the G10 currencies," he says.

Giacomo Orlandi, CFO at Ilapak, a Switzerland-based manufacturer of industrial wrapping machinery for primary packaging, says in the past 24 months there has been

"Any type of … curve ball you throw analysts, positive or negative, is bad"

"They don't want to have to worry about what FX is going to do to your earnings-per-share" —*Frank Pirozzi, Red Hat*

Koester: "CEOs and CFOs need to better understand their exposure"

a lot more volatility, especially in the euro/dollar rate, which went from 1.30 to 1.61, then reverted to 1.20. "That's a massive shift," he says pointing to the detrimental effect FX volatility can have on a company's competitive edge and efficiency if it is not managed properly. For those companies that do the bulk of their business outside of their home market, FX volatility can have a negative impact on their balance sheet and, ultimately, their earnings-per-share. Koester says he is still surprised at the large number of supposedly sophisticated companies that still use manual processes, namely spreadsheets, to manage their FX exposures, and he cites examples of companies that have lost a third of their revenues due to FX volatility. "FX risk has one of the largest financial impacts on companies, and often they don't understand that impact until it is too late," he explains. "CEOs and CFOs need to better understand their exposure and determine what is an acceptable level."

At Ilapak, Orlandi has put a framework in place that enables his company to manage its FX exposure within a maximum loss limit of 10% to 20% of forecasted net profit. "Once we have defined this amount, we set up a system of stop losses that acts as a system of triggers," he explains. Orlandi says most companies should have a framework for managing their FX exposure. When it comes to hedging their exposure, the percentage they hedge, whether it is 10%, 20% or 80%, depends on how much risk a company is willing to take. "You need to hedge something," says Orlandi, "allowing for minimum hedging of 30% or 40%. But if you only hedge the minimum, you should have a system for limiting losses." In order to diversify its currency base, Ilapak also went a step further and changed its production and value chain from being European-centric to incorporating two plants in the US and one in China. So although the company's value chain is still in dollar-based countries, if the dollar declines against its accounting currency, the euro, Orlandi is able to recover some of that money, as goods exported from its Chinese plant may be cheaper.

Companies Risk Under-hedging

Kevin Grant, CEO, IT2 Treasury Solutions, says FX hedging is tried and tested and is a systemic part of FX operations. "I haven't sold a treasury management system without there being an FX component," he says, "but just because there are tools available doesn't mean they are being used." While companies may mitigate their FX risk through hedging, according to Koester of FiREapps, companies only hedge those currencies that represent the bulk of their exposures and don't factor in the volatility of other currencies in their portfolio, leaving them with significant unmanaged risk. Some companies also appear to be struggling with accessing high-quality data in order to quantify their FX exposures. In the SunGard AvantGard study of FX risk practices, the top three FX management challenges were difficulty in quantifying FX exposure, lack of confidence in data, and obtaining timely access to data. By ignoring certain sources of currency risk and under-hedging others, Koester says it is typical for companies that actively mitigate FX risk to—consciously or unconsciously—leave approximately 10% of their FX VaR (Value at Risk) unmanaged.

Most of the data for understanding a company's FX exposure resides in ERP and accounting systems. Yet some companies can have 50–100 different ERP systems, making the task of collating all the data needed even more challenging. Instead of relying on different people within the organization to send in data on spreadsheets, FiREapps' software allows companies to pull in data from multiple systems and then provides workflow tools for defining the way a company wants to look at its exposures. Pirozzi says that using FiREapps, he is able to access FX exposure data across Red Hat's global business in an easy-to-read format, from which he can gather detailed information on currency exposure and type of account (accounts payable or accounts receivable).

"I can pool all my balances at the end of July and compare them with the previous month's balances, and sometimes that can show me an FX exposure I didn't know about," Pirozzi says, adding that he typically does this before he closes the books to make sure any FX hedges he has put in place to cover his exposures are correct. If his FX exposure is less or more than he anticipated, he then adjusts the hedges accordingly to ensure that he is not over- or under-hedged. "I can't imagine going back to the Stone Age now and having to pull everything out manually," Pirozzi says. "It is easy for spreadsheets to get corrupted or updated incorrectly."

Koester says more companies are starting to understand how currency movements affect their business, probably as a result of the sovereign debt crisis in Europe and recent volatility in the FX markets. "Those companies that are managing their FX exposures well don't have the negative impacts any more," he adds. However, for some companies hedging may be deemed time-consuming and costly, and some believe that if they don't hedge, over time they will end up in the same position they started with anyway.

But as a publicly quoted company listed on the NYSE, Red Hat is cognizant of how it is perceived by industry analysts, and by proactively managing its FX exposures, Pirozzi says, it is unlikely to create any confusion for analysts. "Any type of … curve ball you throw analysts, positive or negative, is bad," he explains. "They don't want to have to worry about what FX is going to do to your earnings-per-share." ■