Reflecting on the future

A study of global corporate treasuries
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Introduction

Treasurers are responding to a changing environment, but achieving a desired future outcome may require a very different operating model.

As “keeper of the company’s purse,” the treasury function has traditionally been involved with the general financial issues concerning the company. The financial crisis, its prolonged aftermath and the general shift to greater integration of business units (BUs) and processes, has greatly enhanced this role and the capabilities of treasurers. To understand the extent to which the treasury has been impacted by recent changes, the key challenges and where treasurers see their role in the future, we conducted a study of over one hundred treasury professionals around the globe.

Perhaps not surprisingly, liquidity has become a key area of focus with 30% of treasurers noting cash forecasting accuracy as a liquidity risk management challenge, and a further 20% expressing concern about refinancing and access to funding. These concerns are not being helped by the continued prevalence of inadequate cash forecasting mechanisms, decentralized payment arrangements and the continuing lack of transparency and access by treasury to BU cash. The irony could be that, at a time when refinancing is proving difficult, pockets of funds may exist across discrete areas of business that could be put to use as working capital by treasury.

When asked about risk management and governance in general, financial risks dominated treasurers’ top concerns, and they thought this was unlikely to change in the next two years. A quarter of respondents had not made any recent changes to their overall risk management approach, despite acknowledging the lack of maturity of that approach. Additionally, operational risk did not feature in their concerns. The last finding is perhaps surprising given the role that operational risk management can play in identifying fraudulent activity – a topic of high profile recently. Treasurers acknowledge the importance of key performance indicators (KPIs) for financial risk, but operational KPIs are still largely unused. Similarly, while a significant number of treasurers now use Credit Default Swap (CDS) spreads to measure the credit risk of their banks, credit ratings are still the preferred method. This is likely to continue. Additional work may be required to define an explicit firmwide risk appetite framework.

There are also sharp differences in the respondents’ views and their actions around technology. While the majority admits to being far from leading practice, less than half of treasurers believe that technology and data quality improvements will help them achieve their desired future operating model. The technology options available to treasurers are highly sophisticated, but our experience has demonstrated that, despite acknowledging their technology limitations, steps are rarely taken by treasurers to improve this area. Without a carefully articulated business case, the upfront investment and related upheaval of a system change can be off putting, but it can pay dividends in the medium to long term.

On the people front, the treasury is not immune to the global, industry-wide challenge of acquiring talent. Over 60% of treasurers reported difficulty in recruiting over the last two years. It may simply be a case of demand exceeding supply. However, with fewer than 30% of treasurers rating their talent development programs as mature, they may need to consider new approaches to attracting talent.
Key findings

► Talent management and development was identified as a high-priority challenge. Issues include both recruitment and training. Treasuries in the Americas found recruitment the easiest, and Asia Pacific treasuries found it hardest. Corporates may be competing with financial services for the same talent pool.

► In our study, 40% of treasurers interviewed felt that financing (including refinancing) was one of the most important issues their treasury had dealt with in the past 12 months. Over half of those rated it their highest concern of all – 27% of all respondents.

► Liquidity management was a key concern, with companies looking to diversify their funding sources. In this regard, direct use of capital market funding (such as bond issuance) is expected to become more mainstream.

► Cash forecasting was another major concern. Centralization of payments and the use of payment factories facilitate liquidity and good cash management, and investment in payment factories are examples that tend to pay off.

► Operational risk was not mentioned among risk management concerns. We found this very surprising in the light of the recent high-profile cases of fraudulent activity in bank treasury environments.

Methodology and demographics

Our study was conducted via face-to-face interviews with 101 treasurers of leading international companies, covering 14 countries and 21 industry sectors. Our respondents are the treasurers of large corporations across a range of industries.

The interviews took place over a period of four months in late 2011, by members of our global treasury advisory network. Questions and open discussion covered key areas of concern, strengths and areas for improvement.
Operational KPIs, such as percentage of confirmed deals, were not used by a high proportion of respondents.

Many treasuries rely on simple measures, such as duration and sensitivity analysis to measure financial risk rather than Cash flow at Risk (Cfar) or Value at Risk (VaR).

Despite over half of treasurers rating their risk management approach as not very mature, a quarter have not made any recent changes to their risk management approach.

Treasuries still rely on credit ratings as credit risk indicators, despite some criticism. While CDS spreads are now used by many treasuries to measure credit risk, fewer than one in five treasuries use internal financial analysis.

Almost all respondents now have a treasury management system (TMS) in place, but around a third are not fully satisfied with theirs. Use of and reliance on the TMS is hampered by under-deployment, limited vendor support and functionality issues. Budget concerns often result in the TMS being configured and installed by the vendor or the in-house IT function, with limited buy-in from treasury staff.
Future directions
Treasury is becoming much more involved in strategic financial initiatives than in the past.

What has happened so far?
In order to understand what treasurers’ priorities will be in the future, we asked them what the big issues were for them in the past year. Just under 40% mentioned refinancing, with over half of them (27% of all respondents) mentioning it as their top priority. Along with FX risk management, this is the area where treasurers felt their operations were most mature.

Among the other big issues mentioned were financial risk management (21%, including FX and commodity risks) and 11% each for capital structure and managing a technology project.

Figure 1: Largest issues dealt with by treasury in the last 12 months

Note: Unprompted, multiple responses were permitted. Other responses, such as emerging markets, company performance and lack of resources were mentioned, but not widely, and these have been omitted from the chart.

Beyond financing and refinancing concerns, treasurers are also getting more involved as active stakeholders in their companies’ strategic initiatives, such as acquisition-related activities, divestment of businesses, capital structures and general corporate strategy issues. Respondents from many companies stated that one of the key drivers of this increased strategic focus is a need to reduce debt levels and to deleverage. This has led to treasury becoming increasingly involved in capital structure, issues relating to counterparty credit and the need to improve credit quality with adequate return.

What will change going forward?
About three-quarters of the respondents believe that the scope of activities treasury is asked to perform is changing and will continue to change in the next two years. The main drivers are greater integration between the BUs and treasury, and an increased focus on liquidity and funding. One could argue that these are direct results of the economic crisis and the consequent restricted availability of credit. The two other main reasons mentioned are centralization of processes and working capital inefficiencies.

Other drivers cited as being behind expected changes include increased regulation (e.g., OTC derivatives reforms), advances in payment processing and the emergence of effective in-house bank solutions. Respondents also suggested that emerging markets would carry increased importance for most businesses. We think the increasing importance of commodity risk management will also be on the agenda for more treasurers in the future as commodity price turbulence increases.
Impact of Basel III

Despite the noise of Basel III, it does not yet appear to have impacted the activities of treasurers. Business environment-related changes, due to new regulatory regimes or new ways of allocating capital, are not high on the agenda for most treasurers. However, the increased capital requirements of Basel III are likely to require banks to look anew at their pricing across all products and especially in their trading books. Treasurers have traditionally raised financing in the cheapest markets, and swapped the funds raised into different currencies. However, the economics of such arrangements may now change. It may be necessary to re-assess the cost and benefits of transaction hedging and of current operating models.

Treasury maturity

About a quarter of the respondents do not foresee any major impact on the activities treasury is asked to perform; in many cases these respondents considered their treasury functions to be mature in most aspects.

As figure 3 shows, treasurers believe that they have leading funding and FX management practices, but that cash forecasting is far from leading practice. This is surprising given the importance and attention given to cash forecasting. One possible reason is the fact that cash forecasting depends highly on other business areas and therefore it is not entirely under treasury control.

The study identified challenges related to liquidity management. These included the availability of funding and effective ways to invest surplus cash in a secure way. The main positive implication of efficient cash management is reduced reliance on external short-term funding, yielding reduced financing costs.
Another major area where treasurers consider their operations as distant from leading practice is technology and data. Our experience suggests that this has been a growing concern in previous years, yet limited corrective action seems to have taken place to date.

**The road to leading practice**

The areas below are seen by treasurers as being the main challenges to reaching a desired operating model.

**Improvements in business unit relationships**

BU relationships are identified as the most important element of future success. Information and data needed for some treasury operations and reports emanate from BUs, and therefore it is paramount that the quality is guaranteed. In addition to providing methods and channels for data supplies from BUs to treasury, treasurers need to engage more with their counterparts within the BUs. A better relationship with BUs should also improve cash-flow forecasting, (itself an area identified as problematic). This should help ensure that there is mutual understanding and appreciation of the work done by each function and the contribution to the overall performance of the organization. Any automation of business processes to achieve a higher degree of straight-through processing (STP) by the use of better technology should greatly contribute to improve forecasting, which should in turn unlock trapped cash and ultimately improve the cash position.

**Talent development**

Talent management and development, both in terms of recruiting and training, is identified as a high-priority challenge. The demand for experienced treasury staff, due to an increase in treasury activities, growth into new markets and increasing centralization, is hard to fulfill. Good systems should provide good channels of communication, enhance STP and free up time for talented staff to do more value-adding work.
Most treasurers expect to continue investing in people through formal training and professional education.

**Improvements in technology**

Forty-four percent of treasurers believe that better use of technology is a key building block in reaching a better future state. This includes such activities as improving risk management and cash management through improved data quality. Furthermore, increased use of technologies can lead to improved techniques, such as the in-house bank and payment factory. These two techniques depend heavily on successful enterprise resource planning (ERP) system implementation; and in turn, for implementation to be successful, specialist skills need to be available.

Despite treasury technology being mature in capability, only around half of treasurers feel that their use of technology is in any way mature. Forty percent of respondents are planning a change of supplier of their TMS.

**Figure 4: Challenges to achieving the treasury objectives**

- BU cooperation or motivation
- Attract and retain quality staff
- Technology limitations/projects
- Lack of resources
- Board and management buy-in
- Company profile/performance
- Visibility of BU exposures
- Appropriate policies and processes
- Macroeconomic environment
- Lack of investment in treasury
- Cash forecasting accuracy
- Growth in emerging markets
- Regulatory changes
- Refinancing/access to funding
- Aligning to ERM
- Managing bank relationships
- Unreliable data
- Access to BU cash
- Integration of acquisitions
- Working capital management
- Borrowing costs

A study of global corporate treasuries
89% of respondents would consider external help.

External help
In order to improve their performance, almost all of the respondents would consider taking external advice. The desire to obtain knowledge on leading practices and the ability to benchmark with other companies were among the chief reasons for doing so. Despite the high importance attached to technology improvements, however, it is surprising that only 12% would seek assistance with systems projects. It appears that running systems projects alongside the day job is the preferred approach.

Figure 5: Reasons for considering external help

- Leading practice
- Benchmarking
- Ad hoc projects
- Systems projects
- Cash management
- Market and industry knowledge
- Policy
- Secondments
Treasury organization and deployment of resources
Any organization is only as strong as its weakest link, and with regulatory developments and cash squeezes in sharp focus, staff have a major role to play in keeping treasuries focused and effective. With 63% of respondents reporting difficulties recruiting, companies’ strategies to recruit, retain and create a career path for the treasurer are becoming increasingly important. We think that the main constraints may be twofold: a limited supply of qualified candidates and there being more attractive or engaging opportunities available, for example, in the financial services or consulting sectors.

The most frequently occurring number of staff for a group treasury is 5. However, the arithmetic average of 15 illustrates the significant number of large treasury teams among the respondents. It appears that these numbers are not expected to vary much in the immediate future.

Figure 6: Group Treasury HQ

The competition for talent enters new territory.
There seemed to be a lack of specialist staff available, and of those treasuries seeking to recruit, over three-quarters experienced some difficulty due to a shortage of candidates. The difficulties were most pronounced in the consumer products, industrial products, telecommunications and professional services sectors (see figure 7). This may indicate, for example, a shortage of candidates with both treasury and industry specific experience.

In terms of geography, treasuries in the US found it easiest to recruit staff, while those in the Asia Pacific region found it hardest.

While 75% of treasuries expect to increase the scope of their work in the next two years, only one in five of these see their staffing levels materially increasing.

Figure 7: Difficulty recruiting in different industries
Treasurers get involved with activities outside traditional treasury.

Treasurers sometimes perform tasks outside traditional activities such as cash and FX management. Commodity risk management, in particular, is expected to become more important in the next two years. However, there appears to be significant discrepancies between different industries and geographies in the arrangements put in place to manage these risks. For instance, the consumer products and diversified industrial products industries seem most likely to have commodity risk management in treasury.

Almost twice as many Asia Pacific companies manage commodity risk in treasury compared with American and European companies. However, for pension risk, management in treasury is far more common in the Americas than elsewhere; merely a fifth of UK treasuries handle pensions.

Figure 8: Principal non-traditional treasury activities
Liquidity
Amid the backdrop of the ongoing financial crisis, we have observed a sharp decrease in the availability of funding and corresponding concerns about liquidity risks in companies. We see that many companies do not have central payment arrangements or even visibility and control over cash in different centers. But as with some of the other issues we mention, decisive action has not always been taken.

Where is my cash?
Companies have increasingly focused on getting a better understanding of their current and future cash positions, decreasing their funding requirements and enabling a more proactive approach to managing liquidity risk. Several changes have been and are being implemented to improve liquidity risk management, as figure 9 shows.

<table>
<thead>
<tr>
<th>Change</th>
<th>Percentage</th>
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<tr>
<td>Improved forecasting</td>
<td>35%</td>
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<tr>
<td>Diversification of funding sources</td>
<td>25%</td>
</tr>
<tr>
<td>Cash pooling</td>
<td>20%</td>
</tr>
<tr>
<td>Greater focus on counterparty credit</td>
<td>15%</td>
</tr>
<tr>
<td>Higher cash reserves</td>
<td>10%</td>
</tr>
<tr>
<td>Improved working capital management</td>
<td>5%</td>
</tr>
<tr>
<td>Centralizing cash management function</td>
<td>5%</td>
</tr>
<tr>
<td>Cash repatriation</td>
<td>5%</td>
</tr>
<tr>
<td>Proactive financing</td>
<td>5%</td>
</tr>
<tr>
<td>Diversification of maturities</td>
<td>5%</td>
</tr>
<tr>
<td>Early refinancing</td>
<td>5%</td>
</tr>
<tr>
<td>Scenario analysis</td>
<td>5%</td>
</tr>
<tr>
<td>Reduction in debt levels</td>
<td>5%</td>
</tr>
<tr>
<td>Longer-term financing</td>
<td>5%</td>
</tr>
<tr>
<td>Concentrate on relationship banks</td>
<td>5%</td>
</tr>
<tr>
<td>Reduce reliance on banks</td>
<td>5%</td>
</tr>
<tr>
<td>Payment factories</td>
<td>5%</td>
</tr>
<tr>
<td>No major changes</td>
<td>5%</td>
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Intracompany netting or payment factories do not appear to be much in use, and very few companies listed a payment factory as a key future change. We would have expected this figure to be higher given the substantial cost savings that may be realized.
The principal liquidity risk management challenge respondents identified was accuracy of cash forecasts (30%). This was particularly acute in the consumer and industrial products industries. Refinancing (20%) and counterparty credit risk (17%) were also noted.

While two-fifths of respondents did not have any improvements planned regarding cash pooling, almost the same proportion planned to roll it out more widely, while one in seven envisaged an improvement in efficiency.
Only half of treasuries claim to have visibility of between 75% and 95% of daily cash.

Optimizing the cash position

There are two principles governing liquidity management: visibility (insight into all cash positions) and control over all the cash positions (being able to transfer the cash company wide, preferably on a real-time basis). Our study shows (figure 11) that only about a third of the treasury departments have visibility of more than 95% of the cash in the company on a daily basis. About half of the companies claim to have sight of 75% to 95% of the company’s cash on a daily basis. It is hardly surprising, therefore, that the majority of companies (69%) plan to further improve visibility of and control over cash.

Given that control of cash can, by definition, decrease the need for additional funding with all its attendant costs, it is noteworthy that so few companies can harness that powerful resource.

Figure 11: Percentage of company wide cash visible to treasury on a daily basis

One way of achieving better liquidity management and optimizing interest costs is to implement a cash pooling structure. Most companies strive to include all their BUs in their centrally managed or automated cash pooling structures. More than half of the companies in our study are working on implementing and rolling out cash pools to specific divisions or regions.

In practice, however, it is not always possible to include all BUs into a cash pooling structure, because of regulatory restrictions or tax-related issues in certain countries. In those circumstances, some treasurers are seeking full visibility of the cash by attempting to receive the bank account balances of these BUs. This can be achieved by either importing the balances directly into their TMS from their banking systems or by joining SWIFT and utilizing the SWIFT network and messaging system.
Cash forecasting

Cash forecasting is essential to a forward-looking and proactive approach to treasury management. Based on accurate cash forecasts, companies can make better informed decisions concerning optimized funding structures and managing liquidity and foreign currency risk.

To achieve accurate cash forecasting it is essential that treasury is provided with timely and accurate forecasts regarding the cash flows of the business. In practice, companies use a variety of methods and systems to retrieve the information from BUs. While automation has been a trend in treasury management, over half of the treasuries that receive cash forecasts still do this through spreadsheets only. Just under a third receive short-term cash forecasting data fully through their TMS. A further 14% use the TMS partially, in conjunction with spreadsheets.

Accuracy of the cash forecast

As stated earlier, cash forecasting is a major concern for many treasurers, and its importance has clearly increased due to the liquidity crunch. Nevertheless, almost half of the respondents are still frustrated with the accuracy of the cash forecasting; either they are not satisfied (15%) or see this as insufficient (34%). Only 6% of the respondents are very satisfied with the accuracy of the forecasting data.

In some instances, issues with getting reliable cash forecasts are related to the inherently uncertain nature of the business process (e.g., with a small number of very large cash flows with uncertain payment dates). However, often the reasons for not getting reliable forecasts are related to the internal processes and systems.

Initiatives to improve cash forecasting

The majority (almost 80%) of the companies in our study understand the significance of cash forecasting, and are working on further improvements in this area. The main initiatives being focused on are:

► Process improvements (56%); for example, by improving the administrative processes of the “purchase-to-pay” and “order-to-cash” cycles, the reliability of the cash forecasting data in the systems can often be significantly improved
► Systems improvements (50%); half of the companies in our study plan improvements to cash forecasting systems, e.g., by creating automated interfaces between the treasury system and ERP systems, to retrieve payables and receivables data
► Training (42%); aimed at improving the skills and knowledge of cash forecasting and the processes
► Performance measurement (25%); measuring the accuracy of the forecast can lead to a better understanding of the underlying causes for deviations, which can be discussed with the business

Interestingly, only a small percentage of companies (8%) plan to work with incentives, to motivate businesses to provide accurate cash forecasts.
Payment structure

In recent years, a significant trend in treasury management has been the centralization of payments. The main reasons are to get a better control over the payment transactions of the company and to optimize banking fees. Implementing a “payment factory” can, for instance, lead to a better negotiating position with banks (with a larger number of transactions handled by fewer banks) and allows a company to minimize the number of transactions by “netting settlements” or “routing” transactions.

Despite this general trend, the current study indicates that over half of companies still have a decentralized payment structure. This finding was somewhat unexpected, given that the majority of respondents are large international businesses. Of the rest, only about a quarter have implemented a full “payment factory,” including functionality for netting and routing payments. About a third of the companies plan to make changes in their payment structure.

Treasury departments need to present a solid business case if they wish to get approval to implement major changes to the payment structure. The study indicates that it has proved a challenge to convince company management that the benefits of a payment factory clearly outweigh the costs and potential risks of selecting and implementing a structure.

We have observed, however, that the following factors will often help to strengthen the business case. These include:

► Utilizing established communication channels with banks (such as SWIFT)
► Use of secure data warehouses for storing standard settlement instructions and payment messages
► Control of access to the payment environment
► Minimization of unnecessary manual interventions in the process
► Use of the four-eyes principle for authorization, settlement and release of payments
Figure 12: Biggest challenges in building a business case to implement major changes to payment structure

Funding
Almost 40% of treasurers considered refinancing to be one of the biggest issues their companies have faced during the last 12 months. Considering the current disruption to the financial markets, it seems reasonable to expect this trend to continue for a considerable period.

Currently, the majority of companies are directly financed through bank facilities. However, banks are themselves experiencing difficulty in obtaining funding, compounded further by Basel III and requirements to improve their capital base. Treasurers expect this trend to continue to put pressure on the availability of corporate loans, leading to higher funding costs. Treasurers are seeking alternative sources of funding, with euro capital markets the front-runner.
In the light of the difficulties mentioned above, many companies are striving to reduce their dependence on specific banks, and to diversify their funding counterparties. In addition, it is expected that “disintermediation” will increase, with corporates obtaining funding directly from capital markets. For example, about 23% of the companies are currently funded primarily through the capital markets, e.g., bond issues, and this is expected to rise to 28%.

Sales and supplier financing

While the financial crisis has caused funding issues, some large companies have identified opportunities to engage in relatively new activities, such as sales or supplier financing.

► Sales financing is the financing by a company of its client’s purchases. In certain cases, it can be a challenge for clients to obtain funding and offering some form of sales financing can then be seen as an enabler to doing business.

► Supplier financing is focused on using the company’s creditworthiness to achieve interest benefits, for both the supplier and the company itself (e.g., through “reverse factoring”).

Through sales and supplier financing initiatives, treasury can add value to the business model. Our study shows that half of the companies already have, or plan to have, some form of sales or supplier financing.
Risk identification and exposure management challenges
Operational risks are not on the radar despite some warning signs.

Risk management is more important than ever for today’s treasury, but conspicuous by its absence in this study was a lack of concern about operational risk. In light of the recent high-profile cases of fraudulent activity in bank treasury environments, we found this very surprising. Lack of operational risk management increases the possibility of errors, which can be as catastrophic as a major fraud incident.

With insolvency levels on the up, corporates are rightly taking care in screening their counterparties. However, in a large number of cases, this care extends only to checking credit ratings from the main agencies, to the detriment of other indicators such as CDS spreads, equity prices, bond valuation or internal financial analysis.

Major risk concerns

With global liquidity virtually absent during the financial crisis, obtaining external funding has become extremely difficult in the last couple of years. It is therefore no surprise that liquidity, funding and FX risks were ranked among the top three key financial risk management concerns of treasurers. Liquidity risk was top of the list with 44% of treasurers highlighting it as the biggest issue. Funding followed (19%) and FX risk (18%) was rated third.

When treasurers were asked to look into the future and rank their top financial risk management concerns over the next two years, the rankings remained almost entirely unchanged.

Figure 14: Current and future leading financial risk management concerns

![Risk Management Chart]

- Liquidity
- Funding
- FX
- Counterparty
- Commodity/energy
- Interest rate
- Inflation
- Other

0% 10% 20% 30% 40% 50%
Current  Next two years
It is interesting to find that a high percentage of the treasurers (27%) who were interviewed have not made any changes to their approach to financial risk management in the last year (figure 15). The three most prominent changes which have been made relate to policies and governance. Treasurers are ensuring that the board gets more involved in key policy decisions and increasing the extent of reporting to senior management and the board.

Operational KPIs such as settlements and confirmations are used by only a small proportion of respondents. This also suggests that operational risk is not considered as a key concern by most treasuries.
Measuring financial risk

There are a number of techniques for measuring financial risk. The most common techniques used by the respondents of this study are sensitivity analysis (required by IFRS 7) and stress testing (see figure 16). However, 20% of respondents appear to not use any method for managing risk.

It appears that some of the least used techniques are Earnings at Risk (EaR), CfaR and VaR. These techniques tend to be complex and depend on sophisticated methods often requiring the use of systems, models and data from a variety of sources. Perhaps it is this complexity, as well as the difficulty in interpreting the analysis, that makes them slightly less appealing.

Almost a third of respondents did not plan to add any additional measures, which may be seen as a concern. We would expect to see an increased use of additional measures as well as more traditional techniques, as they can provide a supplementary measurement of risk in an increasingly uncertain market.

Figure 16: Techniques for managing and measuring financial risk (multiple responses permitted)

FX risk management

The study shows that treasurers do not seek to trade exposures but take a rules-based approach to managing FX risk. From this, we deduce that certainty is the chief objective for companies.

The main challenge for treasurers is information discovery, with 40% of respondents considering that the accuracy and quality of forecasts was the greatest challenge. Seventy-seven percent of treasurers rate their FX risk management as fairly mature or better.
Are businesses over-relying on credit ratings?

Credit risk

Credit ratings from the main agencies are used by the majority of treasurers as the key indicator of credit risk (figure 17). Perhaps recognizing the weakness of reliance on a sole measure of credit risk, nearly half of respondents also use CDS spreads. This may provide an additional warning of elevated credit risk with their counterparties, but should be tempered by the knowledge that actual CDS payouts have been limited. The financial stresses in the markets have resulted in reassessment over the last two years, with nearly half of the respondents changing their credit risk policy or credit limits to adapt to the economic environment during the credit crunch.

Credit ratings are expected to remain the most popular measure of credit risk in the future. Our analysis shows that more treasurers anticipate using CDS spreads as a leading indicator of credit risk in the next two years – an increase of nine percentage points.

Figure 17: Counterparty credit indicators

![Bar chart showing credit ratings as the most popular measure of credit risk in the current and next two years.](chart-url)
Commodity risk

Commodity risk management is on the agenda for treasurers. Around 40% have some involvement, and a quarter have direct management and hedging responsibilities (figure 18). Our study also showed that an additional 10% expect to become involved in the next two years.

For those involved in managing and hedging commodity risks, it seems that the most common commodity being managed is energy (including fuel), followed by metals and soft commodities.

Given the rise in value and significant volatility of many commodities, this trend is likely to continue. Treasurers need to make sure they are part of the risk management solution.

Credit support annex

Banks increasingly require that a Credit Support Annex (CSA) forms part of the standard contract for derivatives trading. This development is also being driven by changes in financial regulation, for example the Dodd-Frank Act in the United States, Basel III and European Market Infrastructure Regulation (EMIR).

A CSA is a document that establishes the protocols surrounding the use of collateral for transactions involving derivatives. Depending on the fair value of the derivative and the thresholds established in the contract, there may be requirements to post collateral (margin) with the counterparty to mitigate the counterparty risk. In a one-sided agreement, typically only the company would be obliged to provide collateral at the bank, which would mitigate the risk of the bank. In a two-sided agreement, both parties may have the obligation to post collateral, depending on the fair value. While CSAs mitigate counterparty credit risk, these contracts can lead to a significant increase in liquidity risks. For example, companies regularly fund through combinations of floating rate notes and (payer) swaps, effectively creating a fixed rate loan. This relatively straightforward transaction can lead to the company having to come up with a significant amount of cash collateral if it is subject to a CSA.

The study suggests that banks do not yet require most companies to execute CSAs. Although CSAs are expected to become commonplace in the new regulatory landscape, it appears that banks have yet to develop their strategic business models for such arrangements. However, these results may also reflect the strong creditworthiness of corporations in this study.
Technology and integration
Concerns on systems and technology remain but few are taking remedial action.

Technology plays a fundamental role in making the job of the treasurer less stressful (visibility on risks, liquidity) and more efficient (process automation, performance improvement). The vast majority (96%) of the respondents now have a TMS. This, together with the fact that most treasurers place high or extremely high value on their system, makes the TMS one of the most important tools available to support treasury activities.

However, despite improvements in technology and IT, many businesses still do not get a high return on their investment.

There is a difference in perception of the value an investment in a TMS can add to an organization. The large majority of the respondents place a high value on their TMS (figure 19). Over a third of the respondents, however, argue that, at most, moderate value is added by their current system.
There are numerous reasons for not getting the most value out of a TMS (see figure 20), which include:

► Under-deployment of functionality, often due to implementation being done in-house to minimize costs
► Lack of vendor support
► Lack of training on the use of the system and consequent lack of expertise on how to extract the most out of it

Improving technology is therefore often stated as one of the three most important challenges to address in the future.

TMS implementation is an ever-present issue and has not improved significantly over the years. Some interviews reveal a deep-rooted belief that a system implementation is solely an IT issue to be dealt with and managed by the IT function, with little involvement from treasury. In an attempt to cut costs, treasurers admit that they rely on vendors to do the bulk of the work, often leaving treasury to pick up the pieces after the “go live” date. The result is often user dissatisfaction with the final product’s lack of functionality and knowledge transfer with consequent development of user-maintained spreadsheets and other manual workarounds.
The study confirms that a TMS cannot be a stand-alone system but needs to interface with peripheral systems for certain operations such as market data feeds, confirmations and others. Figure 21 displays the most common peripheral systems and the percentage that interface with respondents' TMSs.

Figure 21: Systems interfaced with TMSs

<table>
<thead>
<tr>
<th>System</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market data feeds</td>
<td>80%</td>
</tr>
<tr>
<td>Electronic banking for balance reporting (inc SWIFT)</td>
<td>60%</td>
</tr>
<tr>
<td>Confirmations</td>
<td>80%</td>
</tr>
<tr>
<td>Electronic banking for payments (inc SWIFT)</td>
<td>60%</td>
</tr>
<tr>
<td>Statutory reporting</td>
<td>40%</td>
</tr>
<tr>
<td>FX dealing platform</td>
<td>20%</td>
</tr>
<tr>
<td>Reporting and compliance</td>
<td>20%</td>
</tr>
<tr>
<td>Risk management</td>
<td>20%</td>
</tr>
<tr>
<td>Cash forecasting</td>
<td>0%</td>
</tr>
<tr>
<td>None</td>
<td>0%</td>
</tr>
</tbody>
</table>

Treasurers are willing to address areas for improvement and other quick wins by using technology. However, they feel frustrated by what they perceive as a lack of TMS functionality. The question that therefore arises is this: are corporates missing out on the full benefits of the TMS because of unrealistic expectations, or because of lack of internal structure and expertise to utilize the systems to their full capacity?

Whatever the answer, vendors need to listen to treasurers as they try to build product trust and reshape strong commercial relationships.
Reflecting on and achieving future vision
A study of global corporate treasuries

Every organization needs a “charter” that outlines its modus operandi – the basic principles underlying the operations of the organization.

Our study highlighted four fundamental operational issues that treasuries face with their current structures – monitoring of operational risk and lack of risk management processes, efficiency of cash management, people development and recruitment challenges, and concerns about the return on investment in systems and technology. While many treasuries are reflecting on the need to address these issues, without a clearly defined target operating model that incorporates all of these areas, significant progress for treasury and broader business is unlikely to be realized.

Working with companies, we have seen the value that a treasury target operating model (TOM) can provide in realizing such improvements, and achieving a desired future state. The TOM is defined on the basis of the functional requirements of the business, current state assessment, strategic objectives, business and funding profile and regulatory requirements. The desired outcome is a “redesign” or a new operating model which depicts how treasury can best support the organization. The key components of the TOM are: governance framework, functional capabilities, people and structure and systems and data infrastructure.

In defining a TOM, treasurers will need to consider the following questions:

► What information is required by the board of directors and executive board to meet risk management and financial management responsibilities?
► What are the functional and system capabilities to support the board mandate for treasury?
► What are the hand-offs between treasury and internal counterparts?
► Is treasury properly governed?
► Are the skills of treasury staff appropriate for the level of service expected?
► What is the “cross-border” interaction with the BUs?
► How can the work and performance of treasury be measured and benchmarked?
Our study has highlighted the specific areas that require focus from the treasurer, but with so much change unfolding, knowing how to prioritize improvements is difficult. Devising and implementing a plan of action enables the treasury to focus on their operational requirements in terms of people, processes, systems and controls and subsequently increase productivity and overall operational efficiency. This clarity allows individual operational components and relevant interdependencies to be addressed. Based on our key findings and experience, some of the benefits of this approach are highlighted below.

► Our analysis and experience has shown that, while treasurers accept the benefits of a sophisticated treasury system, many are still not implementing them effectively. Common issues include mismatch of system functionality and business requirements, and continuous reliance on in-house and, at times, technology-light skills to implement systems. The business case for the appropriate treasury management system should be clearly defined and communicated, based on all functional requirements. The result should then be an optimal system that allows for a reduction in manual processing and errors, creates more streamlined operations and enables staff to focus on value-added work.

► According to our study, treasuries may not be realizing the value of integrated risk management, as they focus more on financial risk management and less on operational risk. Implementing integrated risk management will allow treasurers to enhance their overall control of risk. This can be enhanced by creating the appropriate governance framework structures at board and committee level.

► Our study highlighted the difficulty corporate treasuries face in recruiting and retaining talent, perhaps because they are in competition with other seemingly more attractive sectors, such as financial services. In order to address this issue, treasurers may need to adopt the more developed techniques, processes and career paths used by these sectors.

► The respondents in our study acknowledge that their role will continue to change as treasury becomes more aligned with other BUs and more involved in overall business direction. Those treasurers that put in place a flexible operating model will be able to respond more effectively to strategic business objectives such as acquisitions and geographical expansions, and contribute to business growth.

Our study highlights that some fundamental issues affecting treasury functions require attention – some have been festering for some time, some have come to light more recently. We believe that if these issues are not addressed in the near future, some treasurers may find it difficult to influence not only the direction of the treasury, but also the future direction of the company.
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