TREASURY TRENDS

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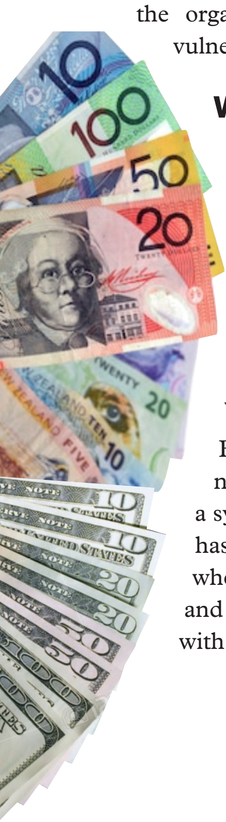
Keeping cash in focus

Most organisations face relentless pressures to use resources more efficiently, to mind costs and to maximise income. People and cash are usually an organisation's key resources.

The more glamorous aspects of treasury are often seen to be the markets, risk management and hedging. The ability to contain costs or improve income in the treasury area does not come around often. Yet many overlook the gains from applying the most basic rule of treasury risk management — understanding and managing the need to have the right amount of cash, in the right place (and currency), at the right time.

The information to apply this rule is plentiful but many fail when it comes to finding, understanding, managing and reporting it. Cashflows touch every part of an organisation and everyone in it, which means that managing it is everyone's role — whether they be in sales, procurement, production, distribution, marketing or finance. Delivering detailed forecast data with a high degree of accuracy is a never-ending challenge. There is always room for improvement. Equally, letting cashflow forecasting drift along or worse, allowing it to lapse through action or omission, will expose the organisation to unnecessary risks and increase its vulnerability to surprises and shocks.



Where is it?

Locating the source of information pertaining to an organisation's treasury exposures can be easy but getting the right information at the right time is often difficult. A direct linkage with the finance, production, procurement or sales systems and getting the buy-in of those parts of the organisation reap considerable rewards for the treasury manager and the organisation as a whole.

For routine cashflows, collating this information is not usually cumbersome or too much trouble once a system of regular requesting, cajoling or threatening has been put in place. A common breakdown occurs when the figures are repeated one month to the next and those providing them are blasé about what happens with the information.

Key points

- Understand the importance of cash to get the best out of your treasury risk management and to keep your head while those around you rush about.
- Cashflows touch every part of the organisation. Managing, understanding and reporting are everyone's joint responsibility.
- Getting the buy-in of parts of the organisation will reap considerable rewards for the organisation as a whole.
- How the cash is used will determine appropriate policies, objectives and decision-making processes.
- Make certain that reporting to management and Board is clear and relevant.
- Step back and admire the view in an honest, searching and critical manner.

Involving those responsible for forecasting exposures in the ultimate hedging and investment decision making is the best way to ensure that due consideration is put into deriving the exposure forecasts at the start. There is quite a difference between a table of numbers in a spreadsheet and the risks that they represent. To our thinking, an organisation-wide, collaborative approach to strategic thinking makes treasury work best.

What does it mean?

It is rare for an organisation not to change or evolve. It is also rare that an organisation's exposures, its risk horizons and sensitivities do not change. If a committee or a process becomes stale, it will not evolve with the organisation and its business environment, risking subsequent decisions that no longer match the organisation's risks. Asking the question 'is

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there anything new?' on a regular basis can tease out a change, or potential change, or even provide positive reinforcement for current processes or decision makers, be they committees or individuals.

Judging the validity of forecasts is the key element in the treasury risk management decision making process because it relies on information that cannot be gleaned simply from a table of figures. Despite the best and most prudent of intentions, each and every decision will be flawed if the forecasts are incorrect, more so if market expectations were a key input.

What to do with the cash?

To many organisations, cash management is about making the most efficient use of cashflows to minimise debt costs. Accurate and timely forecasts produce short term benefits by way of better forward planning of debt sources and maturities (tactical benefits) and long term benefits from greater confidence in cashflow forecasts and funding requirements (strategic benefits).

Businesses for whom cash management is about managing and maximising surplus cash have different drivers. Investing cash requires a different set of policies, objectives, disciplines and decision-making processes than reducing debt costs because the primary rule of investing is to make sure that you will get your money back when you want it back and in the form that you want. That entails assessing the creditworthiness of the investment counterparty, the timing of getting the investment back and how much reward you get for lending your cash.

Where does it go?

Once decisions have been made and implemented, and their results recorded and processed, the next step is to make certain that reporting to management and Board is clear and appropriate. Reporting to management should be sufficiently detailed to allow the decisions and their outcomes to be managed. Reporting to the Board should be less detailed but still needs to inform the Board so that it can perform its governance duties.

No matter how good an individual hedge or investment decision is, it is unlikely that the Board needs to know of that decision in isolation and in detail. Board reporting should be concise and should summarise all areas against which the policy has prescribed an objective, a specific control limit or a benchmark requirement.

A table or chart showing identified exposures along with hedging or investments undertaken compared to policy parameters is usually enough. It never hurts to provide a commentary of the environment in which risk management and investment decisions were made and a table or chart of what the proposed future profiles will be as they help to avoid future criticism from 'Hindsight Harrys' who, in the future, will possess the one piece of critical information that you lack today — what the future holds.

The most important aspect of Board reporting though is to focus on exceptions, changes, any unusual facets and benchmarks, to include reasons for breaches and to detail hedging products that are not standard or have an unidentified contingent risk attached. This seems pretty obvious and fundamental, but we have come across each of the above problems in the recent months. Yet, no one in those organisations thought it was that obvious at the time.

We encourage readers to take time to stand back, look at the wood not the trees and admire the view in an honest, searching and critical manner. If the view does not look all that clear or the last review was undertaken a long time ago, then it is timely and prudent to review your treasury landscape.

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