

Position paper

Corporate Treasury — out of the comfort zone

What treasury can really contribute to corporate success and why it is the centre of gravity within finance



Finance & Treasury
Management

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Prologue

Question: **“What do others do?”**
 Retort: **“Why is this important?”**

Let’s travel into the past — 1996: The internet became a mass phenomenon for many users with the invention of Netscape Navigator. I still remember discussions about internet access from my company PC at my former employer and allocation of a personal email address. Such an address was not approved at the time, only one email address for the entire department, of which I became the proud administrator. Now you understand where the add-in “Please consider the environment before printing this email” comes from, which can be found at the end of many messages.

A favourite story among colleagues which has become a legend is a fireside chat with our managing director about the benefits of an intranet for internal corporate communication. The budget for this project was not approved in the first round (and also not in the second). Instead, my colleagues and I were encouraged to pick up the phone more frequently for internal communication.

What do these anecdotes tell us? They tell us that one does not always have to be an early adopter. Nevertheless, my former employer succeeded in generating enormous growth in the telecommunications sector in only three years, and the above-mentioned managing director was awarded the title ‘telecommunicator’ by the media. They also tell us that the benefit of investments has to be sustainably quantified and clearly communicated. Young and ambitious as we were then, our main focus was on ideas and visions. We would not really have been able to answer the question “What do others do?”. A lot was still in its infancy. What we could have done though was attempt to quantify these benefits. After all, no sensible businessperson would want to spend money if there is no reasonable chance of generating returns or protecting their assets with the investment concerned. Or if they do not at least

have a sense of being on the right track. Well, alright, in those days many company founders amassed millions without being able to say — and having to say! — what would come of it.

And today? Nowadays, at least at treasury, the question “What do others do?” is not really helpful. Technical developments open up unprecedented possibilities. They allow doing the right things right. They allow making risks really transparent, early on and at their source, providing a solid foundation for their management and control. They contribute to major gains in efficiency and reductions in process and transaction costs. And above all, they permit accurate cost-benefit calculations. Therefore, the right question to ask is: “What do I need to do, what can I do in treasury so that it supports the corporate strategy and objectives and adds independent value?” Only observing what others do in order to copy them cannot be a successful strategy in a globally competitive market in the long term — neither for the company in general nor treasury in particular.

Therefore, the thesis proposed in this paper is: Treasury can contribute up to 1 per cent return on sales¹. You have doubts? Read on.

1 Return on sales was chosen primarily because it is an easy-to-use, concise ratio for comparing companies within sectors and across industries. While treasury does not make a direct contribution to sales, it nevertheless influences cost and indirectly also sales via the management of individual financial risks (for example, by means of currency management). For reasons of simplicity we use gross return on sales (before tax) here, dispensing with further normalisation (by ignoring interest on borrowings, among others). While this makes the line of argument somewhat less precise, it has no significant influence on key statements.

This position paper presents my personal point of view of the matters discussed — with the exception, of course, of the maths applied for calculating added value. For that purpose, I have applied the rules that have been valid for many years. Naturally, some readers will interpret individual issues and assumptions differently. And that is a good thing, because progress can only be made by discussing facts objectively. Not to mention that there is still a lot of scope for improvement in treasury. Of course, there will also be readers who say: “This is how we have been doing things for years.” To which I can only respond: “Great. Congratulations!”, by quickly adding whether this applies to all subject areas.

Who should read this paper? First of all the treasurer, of course, and for two reasons: Firstly, to obtain ideas for better positioning treasury within the company which is also useful for promoting one’s own career, and secondly, to better prepare the treasurer for the CFO’s probing questions, which the CFO will likely have after reading these pages. And this brings us to the next intended user of this paper: the CFO.

Here it is, the spotlight, which sheds the first light on the treasury black box! Other intended users are colleagues in accounting, controlling, procurement and sales. For them, reading this paper will help better understand what treasury actually does, and also help them focus on their own connection with treasury, i. e. the effects of their activities on the performance indicators used by treasury.

I would like to take the opportunity at this point to thank my colleagues, Professor Dr Debus, Michael Baum, Mark Hill, Sven Korschinowski, Dr Andreas Liedtke, Andrea Monthofer, Bardia Nadjmabadi and Stephan Plein for their critical review of my thoughts and considerations as well as examples of value contribution and accounting.

Would you like to discuss this paper?

The author, **Carsten Jäkel**, would be very happy to do so. He can be reached by phone at +49 221 2073-1522 or email at cjaekel@kpmg.com.

2

Executive summary

You do not have time for details, but you would like to know what relevant information this paper contains? Great — here are the essentials: The quality of treasury functions has a very significant and immediate effect on corporate earnings. The following examples illustrate that 0.6 per cent return on sales is achievable overall, even based on a conservative estimate. This is the difference between an 'adequate treasury'² and a 'best-in-class treasury'³. With such potential for increased return on sales it is worthwhile paying more attention to treasury, even though the contribution of treasury is hardly evident from the balance sheet and income statement nowadays. Whatever the company's purpose: In the end, it is all about money and whether it is there or not. Not considered in this context are potential costs and risks arising from a lack of compliance or security risks. The significance of these costs should be clear to anyone who has followed the 'discussions' in the media regarding various DAX companies with the US Securities and Exchange Commission (SEC). For example, those who have read the Dodd-Frank Act in detail will know the consequences for misconduct of companies and therefore also of their managing directors and board members.

Let us have a look at the main levers: Apart from the complete and accurate determination of risk exposures for currency and commodity risk management, these primarily are transaction and process costs for payments, liquidity planning and corporate finance. Retrieving treasure requires rigorous centralisation, cross-departmental cooperation (especially between sales and procurement, but also accounting, controlling and corporate development) and adequate performance measurement. This applies on the assumption that investments are made into the required resources — personnel and IT. No one should give into the illusion that any of the benefits will come for free.

The good news: It is not rocket science. Further details can be found in the following chapters. The bad news: External pressure groups, particularly analysts, have started questioning treasury performance, especially in countries with a strong Anglo-Saxon influence. One of the reasons is the influence of currency effects on earnings per share, with the level of tolerance decreasing continuously.

- 2 An 'adequate' treasury is a treasury department that fulfils generally applicable core requirements. It may also be very well positioned in some individual subsegments. Nevertheless, there is still potential for optimisation. This is particularly well illustrated by the example of incomplete foreign exchange exposure documentation (cf. 4.2.3).
- 3 'Best in class' in this context is synonymous with 'best or leading practice' or 'best of breed' and essentially means the following: "This is how it should be; this is currently the best approach (conceptually and technically) for achieving the specific goals of an individual company."

3

The treasury black box

Before I delve into this paper's thesis, let us have a brief look behind the scenes. This is helpful for finding an answer to the inevitably emerging question as to why treasury considerations are necessary.

3.1 In the comfort zone

It is no doubt very comforting to sit in a warm spot while dark rain clouds appear on the horizon and then pass over. Cost pressures, staff cuts, performance measurement, reorganisation: No area has been spared major changes in the past two decades. No area? Not true! Little Gallic villages can also be found in companies. And one of them is treasury. Critical readers will say that treasury has in fact undergone major changes already. While this is true, the question is on what scale. Compared to what has taken place in the company as a whole, especially in production and production-related areas, the changes in treasury seem rather more like successive adjustments to dramatically changing environments. How else can it be explained that in many companies it is still not possible to automatically receive the (group's) cash position at 9am? Is there a plausible reason why a globally operating company does not know the bank accounts of subsidiaries that have been acquired over the years? However, it is not appropriate to point the finger at treasury in this context. A lack of understanding of what treasury has to achieve, can achieve and actually does achieve, has had the effect that this area has been largely overlooked for many years. It is therefore perfectly rational for a treasury organisation to only respond upon request. At the same time, many of these corporate entities have been clever enough to perpetuate the myth of non-transparency. Complex financial instruments, trading in derivatives, their valuation — all these issues are hard to comprehend for outsiders. CFOs, in particular, often depend on information provided by treasury and rarely are in a position to query it. And who would begrudge treasury the comfort zone it has managed to create for itself? Who

would enjoy confronting accounting or controlling about deviations in cash flow and liquidity planning? This is why, in the past, treasury employees in many cases more often communicated with external parties — banks (!) — than internally. However, the financial crisis has had the effect that the spotlight is now also directed at treasury (It may seem boring and unimaginative to continue referring to the financial crisis, however, it was probably the single most important turning point for treasury and is therefore still of tremendous importance, even though there are contemporaries who believe that it is long over.) A good development, as it allows treasury to make its own contribution to value more transparent to the general public. If, yes if, there weren't language barriers to be overcome first.

3.2 Language barriers. Do you speak 'Treasury'?

Also in my role as advisor, I frequently have to define terms first so that there is a common understanding of the meaning of such expressions as in-house bank, payment factory or currency exposure. However, things become really interesting when a representative of the tax department speaks to a treasury employee or the controller has a discussion with the treasury colleague responsible for liquidity planning. These language barriers — which, by the way, exist in both directions — only provide a glimpse of the insufficient understanding of the tasks and activities of treasury. This is surprising considering that the effects of decisions in other corporate entities — from sales to procurement — may have a significant effect on the performance of treasury. This is becoming very evident in the area of commodity risk management. Commodity risk is immanent to the system. It is there, even if it is not immediately evident. It is inherent to contractual arrangements for the procurement of goods and becomes apparent indirectly from fluctuations in the price of goods and services. Moreover, it cannot simply be passed on to third parties. Therefore, immediate

communication is essential between treasury on the one hand, and procurement, logistics and sales on the other. Only if those departments take care of end-to-end processes in their entirety, will a company be in a position to fully identify commodity risk. If exposure is incompletely identified and intransparent, any hedging activity by treasury is really out of the question until it has been accurately determined.

Back to the language barrier: As has been demonstrated, the treasurer needs to also speak the language of the procurement, logistics and sales employee in the same way, as they must ensure that they are properly understood. My assertion is that it is also this language and therefore communication barrier that makes treasury so reluctant to tackle the issue of commodity risk management, to give just one example.

3.3 Communication. With whom? And why?

Silence is a form of communication. It has the desired effect in some cases, but frequently also not. Let us first have a look externally: External communication (with banks) has always been the preferred terrain for treasury. This always becomes apparent when the responsibility for bank relationship management is withdrawn from decentralised entities in the course of centralisation projects. No matter how full the agenda, there is always time for lunch with the local bank's relationship manager, especially considering that this provides a perfect opportunity to confirm one's own participation in the golf tournament. A personal relationship with the bank can definitely be useful in this regard, and even be indispensable in some cases. The same applies to contact with the local representatives of the group's main banks.

The same as with any banking relationship applies: The local treasurer or controller responsible for treasury issues should know not only the company's objectives with regard to its business relationship with the bank. They should also be informed about the other party's concerns, objectives and those of the bank. They have to understand internal banking processes, must develop an understanding of the information that is decisive for setting credit margins, and — even more crucially — must know how what information is processed that leads to a positive or negative lending decision. Here, once again, the rule comes into play that expertise on treasury issues becomes more and more scant the further an entity is removed from corporate headquarters. This directly takes us to the next communication relationship: the internal one. With regard to the above example of communication with the local bank, this means

that it is necessary — also with a high degree of centralisation — to train the colleague on site for their conversations with the bank and to supply them with all the relevant information. How else can they fulfil the intended role as local trailblazer?

Within the company the question now is who to communicate with or with which department and above all why communication is necessary at all. The answer is relatively easy when looking at it from three different perspectives: first, from the point of view of the financial supply chain, second, purely in terms of the information requirements of treasury, and third from the perspective of reporting to management. The financial supply chain⁴ is dedicated to various financial aspects, ranging from the selection of a business partner — “Do I want to do business with company A and, if so, on what contractual basis?” — to concluding a transaction (acquisition of materials or sale of goods) for payment and final analysis. There are issues and decisions throughout the entire process chain that have a direct influence on the activities of treasury. The most easily comprehensible examples are currency, terms of payment and mode of payment. But the design of processes, such as purchase requisition, incoming goods and invoice control, entry and payment release, also has a significant influence on treasury.

Just to clarify: Complete and accurate information provided when placing an order can be used as a reliable source of data for planning liquidity and determining currency exposures. The raw materials purchased by procurement involve contractual arrangements (with regard to currency or price escalation clauses) that may influence commodity and currency exposure or even accounting treatment, for example, by using embedded derivatives. Arrangement of the entire order, incoming goods and invoice inspection process, in turn, influences the design of payment processes with a view to compliance and fraud prevention aspects.

4 The financial supply chain concept developed by Aberdeen Group and the expanded scope of responsibility of treasury derived therefrom goes back ten years already.

A final example, this time from the field of investments: Knowledge about the timing of cash flows (e. g. for payments tied to acceptance tests) is of tremendous importance to treasury. Surprises can increase borrowing costs significantly if they require borrowing in the short term to acquire the necessary liquidity.

These examples illustrate the importance of internal communication to treasury: It functions as a recipient of information, but above all it has an influence on strategies, procedures and processes in other corporate entities which will have an effect later on, directly or indirectly, on the costs and performance of treasury.

3.4 What is not evident from the balance sheet and income statement

Unfortunately, the balance sheet and income statement do not contain items such as 'excessive interest expenditure compared to the market' or 'unnecessary cost due to poor implementation of hedging strategy'. The performance of treasury becomes, and must be made, transparent elsewhere. And yet: There are issues that must be explainable. Among the two most important examples are currency gains and losses and balance sheet items that change due to fluctuations in exchange rate, be it operating assets or income statement items such as revenue or cost of materials.

To avoid delving further into the depths of the financial statement analysis, let me illustrate the melee of issues based on some very specific and frequently asked questions in connection with currency management: What does the item 'currency gain or loss' actually mean? What does it explain? Is it an indicator of good or bad hedging?

Some companies have made it their goal to hedge all significant cash flows in full. If, in such case, hedge accounting is applied and the effects are neatly divided into operating and financing activities, currency gains and losses should always largely balance out. Unfortunately, this is rarely the case. Quite frequently, posting logic is the cause for a very different picture. For example, in cash flow hedge accounting, amounts are reclassified from equity to profit or loss too late. Or maybe, all orders are recorded by the system with a hedging or budget rate, even though not all orders are hedged.

This also, can lead to the entry of currency effects which, in reality, never occurred. Some companies enter the bank account or bank clearing account balance not at the current rate, but at the rate for the previous month, which also results in skewed figures.

Elaborating on these considerations further while at the same time addressing the effects of translation risk would easily warrant an investigation of its own. Whenever I compare news reports with my own observations at companies, the following conclusion inevitably springs to mind: As currency gain or loss is simply a matter of 'chance'⁵ at companies without a hedging strategy, they have no problem with blaming this figure should there be any issue about corporate earnings.

What should be done? First, it would be advisable to analyse the posting logic to create transparency with respect to the cause of currency gains or losses, but it may also become necessary to adjust the posting logic or introduce hedge accounting. The next step is a detailed investigation of exposures (transaction and translation risk) and their effects on the balance sheet and income statement, for which various scenarios should be used, such as a cash flow at risk model. This serves as a basis for determining risk appetite, which then leads to the following questions: What fluctuations of which balance sheet and income statement items is the company willing to accept? Is it acceptable that operating profit fluctuates by 20 per cent due to currency effects? Once the answers have been found, the strategy, instruments to be used and their accounting treatment are immediately clear. The result: The balance sheet and income statement can be consistently explained with regard to the impact of fluctuations in exchange rate.

Another side effect is the following: It can now be explained to the capital market without any confusion what effects changes in foreign exchange rates have on operating performance, how they become evident in the balance sheet, and which of them are actually relevant to cash flows after hedging.

5 'Chance' does not mean that the effect of movements in exchange rates cannot be unambiguously or unequivocally explained.

4

1 per cent return on sales? Treasury's potential contribution

When looking at the margins for a wide variety of industries, it becomes apparent that the realised and realisable return on sales does not exactly inspire confidence across the board. It seems that every stone has been turned over at least once already. And yet, there still are areas with untapped potential — one of them is treasury.

4.1 “You have to score the big points”⁶

I know treasurers, who urgently and very objectively need additional staff to be able to appropriately fulfil their department's tasks. They then approach their management board with an inconsistent line of argument and a budget that barely covers the cost of additional resources. The treasurer can consider himself lucky if the board tells them what they think. Things become more difficult however when the board keeps their thoughts to themselves, because then all investments for treasury will be on ice for a long while and the treasurer's career will have reached its peak. What should we learn from this? In order to get a hold of other people's money — in this case the budget — clear communication is essential and should be based on the following questions: What exactly is the purpose of treasury? What are the risks that need to be controlled by treasury? What are they — quantitatively and qualitatively? What is the cost of necessary adjustments (investments, staff) and — above all — what is their benefit?

Let me give you a practical example: Liquidity planning is to be migrated from an Excel solution to an integrated IT system providing detailed actual figures automatically. What are the benefits? A frequent line of argument is optimising investment horizons. This is true, however, it describes only a small part of the benefit.

Other conceivable 'big points' include the early detection of exceeded contractual leverage limits, which would result in an increase in interest rate for the entire (!) credit volume relating to that contract. The early detection of negative deviations from an approved budget is another tremendously important point, particularly from the point of view of corporate management. Treasury is considerably faster and, above all, more accurate than controlling in this regard and can immediately elucidate the reasons for deviations. But, how can this be quantified? It does not have to be quantified, and yet, a CFO will immediately see the benefits for himself.

⁶ Boris Becker frequently seems to be associated with 'big points', which refers to the phenomenon of always doing the right thing when it counts. With regard to treasury, this means focussing on major and therefore important drivers of added value.

4.2 Corporation X — sample calculation

Is it possible to prove the hypothesis that treasury is responsible for 1 per cent return on sales by carrying out its functions? The following example has been chosen so that it is scalable, i. e. can be applied to actual companies. At the same time, these sample calculations have been deliberately simplified. I am aware that the world frequently is somewhat more complicated and that my assumptions greatly simplify these complexities. Nevertheless: The basic statements made are solid, also based on conservative assumptions. It is important in this context to point out that potentially positive tax effects are not taken into account, because this would require looking at the specific situation of a company, which a rough and simplified sample calculation (for reasons of transparency) cannot provide.

This example refers to the following areas:

- liquidity planning
- cash pooling
- currency management
- commodity risk management
- payments
- borrowing costs
- working capital management
- treasury IT.

Let us take a closer look at Corporation X:

- revenue: EUR 1 billion
- 20 locations in 10 different countries
- number of currency zones: 4
- currencies: euro (50 per cent), US dollar (25 per cent), pound sterling (15 per cent), Japanese yen (10 per cent)
- debt capital: EUR 100 million
- liquid assets: EUR 25 million
- volume of payments (p. a.): EUR 950 million
- commodities procured in the financial year: 50,000 metric tons stainless steel, 3,000 metric tons copper wire
- Corporation X is a publicly traded company.

4.2.1 Liquidity planning

If one of the central functions of treasury is to ensure solvency, then liquidity planning is the tool to achieve it. However, this does not yet resolve the issue of how to set it up. Examples of questions relating to set-up are: why liquidity planning (i. e. the motivation behind it), what level of detail (complexity) and what type of arrangement — decisions as to the currency used for planning, the most appropriate planning method (direct, indirect or cash flow analysis) or most suitable planning approach (bottom-up versus top-down or top-down/bottom-up) for this type of business. The approach chosen is highly individual and depends on the company's business. Therefore, the following contributions due to liquidity planning cannot be applied one-to-one to each company or scaled up. Nevertheless, four different possible contributions are presented here for illustration:

Contribution 1: Avoiding recurring planning inaccuracies and uncertainties

Unnecessary liquidity buffers: They have the effect that borrowings cannot be reduced by EUR 10 million. In figures: borrowing interest rate 4 per cent⁷, investment interest rate 0.5 per cent. Potential contribution to profit: EUR 350,000 or 0.035 per cent return on sales⁸.

In addition, due to insufficient local planning, excessive liquidity buffers are in place in three countries with restrictions on capital movements (India, China, Brazil). Financing could be reduced locally across all three entities by about EUR 2 million. Contribution to profit: EUR 70,000 or 0.007 per cent return on sales.

Commitment interest: The credit line amounts to EUR 100 million. A maximum of EUR 70 million is in fact required. The remaining EUR 30 million serve as security with a view to planning uncertainties. Reducing the credit line by EUR 10 million due to better planning would save commitment interest of 0.5 per cent (specific example of an MDAX company: 35 per cent interest margin, maximum of 0.6 per cent p. a., interest margin between 0.9 per cent and 2.3 per cent). Contribution to profit therefore EUR 50,000 or 0.005 per cent return on sales.

⁷ These are interest rates for a 'normal world' — i. e. the currently negative interest rates in some areas represent an extreme scenario.

⁸ This type of presentation hereafter describes the contribution of treasury to achieve the return on sales.

Contribution 2: Early detection of financing shortfalls

Detecting requirements early allows timely reaction. Borrowing costs (and refinancing risk) can so be reduced significantly. Reducing the interest on borrowings by 0.5 per cent for necessary financing of EUR 25 million results in a profit contribution of EUR 125,000 or 0.013 per cent return on sales.

Contribution 3: Personnel expenses

By automating the calculation of actual figures and simplifying planning processes (integration of the treasury management system — TMS, automated consolidation, connecting further data sources) one full-time employee can be saved or used in other areas (assumption: central calculation of actual figures as well as consolidation). Profit contribution due to cost savings: around EUR 120,000 (total cost) or 0.012 per cent return on sales

Contribution 4: Improved ratings

Ratings can be improved through transparency of movements in cash flow, proven high forecast quality and cash flow optimisation, which reduces borrowing costs. Assumption: A rating improvement by one notch reduces the borrowing interest rate by 0.25 per cent. Contribution to profit of EUR 300,000 or 0.03 per cent return on sales.

Preliminary conclusion

Liquidity planning can contribute around 0.1 per cent return on sales. In terms of monetary value, the contribution is about EUR 1 million.

4.2.2 Cash pooling

Contrary to generally held opinion, cash pooling is not one of the major value drivers in practice, based on my observations. This is caused not only by the almost indistinguishable difference between lending and deposit rates at this current time, but also by the fact that cash pooling is part of the standard repertoire these days, so that target/actual comparisons with a less than optimum starting situation have become virtually impossible. There often is potential for optimisation in an international, cross-currency context. Major restrictions are currently being lifted, particularly in China. Banks are offering solutions in this regard. But, in following the maxim that 'a little bit more is always possible', I am giving an example here that is based on conservative estimates:

Due to the lack of cash pooling (balance-free or only assumed), there are remaining local positive cash balances in some unregulated countries that cannot be used centrally. As EUR 5 million in liquidity is unused, borrowings cannot be reduced as necessary. Borrowing interest rate: 4 per cent, investment interest rate: 0.5 per cent. Potential contribution to profit: EUR 175,000 or 0.0175 per cent return on sales.

Preliminary conclusion

Optimisation of cash pooling contributes about EUR 175,000 to value — this corresponds to 0.0175 per cent return on sales.

Note: I believe that the importance of cash pooling is over-rated. From an overall strategic point of view, resulting account balances are no more than a residual figure once the equity or debt ratio for the individual entity or entities in a country has been optimised for tax and capital expenditure, from which a much greater value contribution could be derived if arrangements were optimised.

4.2.3 Currency management

The main objective of a currency management strategy usually is to stabilise currency gains or losses. It is difficult to quantify the resulting contribution to value, as the associated positive effects of control have an impact on a variety of areas (from procurement cost to communication to capital markets). The positive effects of the optimisation of currency management are obvious however:

Contribution 1: Centralised hedging

In the event of a decentralised currency management approach, risk exposures are hedged by national subsidiaries via their local banks. In that case, hedges frequently are used that have an offsetting effect from a group perspective. (For example, subsidiary 1 buys US dollars three months forward against pound sterling and subsidiary 2 sells US dollars for euros at the same terms.) Centralisation of currency exposure at central treasury usually reduces the exposure to be hedged and avoids offsetting hedging transactions, whereby it should be kept in mind that there is risk of exposure to the group's reporting currency, the euro.

If it is assumed that the currency exposures to be hedged are reduced by 20 per cent for each currency, hedging cost is reduced by about EUR 10,000 with an average bid/ask spread of 0.0001. There is further potential, particularly for exposures in currency areas with less liquidity.

Contribution 2: Reducing processing cost

Centralising currency management means that processing cost can be reduced. As this cost usually consists of personnel expenses in treasury, central implementation of currency management significantly increases efficiency, as illustrated by the following sample calculation:

At five foreign subsidiaries, local hedging transactions are processed by a total of 15 full-time employees (local treasury staff, traders and handling staff) at an average personnel expenditure of EUR 50,000 annually per employee⁹. By centralising these activities at the central group treasury, staff required for local currency management can be reduced by about 20 per cent. If it is assumed that, as a consequence, the number of staff required for currency management at group level will also decrease accordingly, the optimisation of structures will result in a profit contribution of EUR 150,000.

Contribution 3: Determination of currency exposure

The contribution to profit from currency management can take on very different dimensions very quickly. Let us assume the company miscalculates exposure — experience has shown that this happens very frequently! The reasons for inaccuracies in determining currency exposure are multifold and range from unknown covenants in supply or procurement contracts, currency exposure from the procurement of raw materials, to simple errors and inaccuracies or a lack of due diligence when entering data locally.

Let us assume, therefore, that the euro/US dollar exposure is in fact EUR 25 million or 10 per cent higher than has been officially reported. (This seems perfectly realistic based on experience.) As this exposure (US dollar long) is unknown, it is not hedged. Let us now assume that the US dollar is subject to devaluation over the course of the year from 1.32 to 1.38 against the euro. Fluctuations in exchange rate of around 5 per cent as in this example are perfectly normal, even fluctuations of 10 per cent are not unusual, not to mention fluctuations of up to 20 per cent for currencies of emerging economies. The resulting foreign exchange loss therefore is around EUR 825,000.

Depending on its origin, this foreign exchange loss is apparent neither in the balance sheet nor in the income statement and therefore is not transparent in any reporting. Believe me, I have seen many such cases, both as treasurer and advisor.

Preliminary conclusion

The potential contribution to profit is about EUR 1 million or 0.1 per cent return on sales.

There is another aspect which I need to mention even though it is hard to measure financially, if not impossible: the use of hedge accounting. Let us assume our sample corporation hedges the currency risk associated with anticipated future cash flows of USD 100 million, however, does not use hedge accounting for USD 70 million, to which this would be relevant. Consequence: Fluctuations in value of derivatives used for hedging are recognised in full in profit or loss. (USD 7 million for a fluctuation of 10 per cent would not be unusual in such a case.) There are plenty of situations in which this could be a significant problem, for example, in the case of corporate earnings reported to the capital markets or covenants in relation to existing loan agreements, to name but two possible scenarios.

4.2.4 Commodity risk management

Commodity risk management is decentralised. While the exposure of copper is reported by procurement to treasury and counter-hedged there, there is no predefined reporting procedure so far for the market risk associated with the procurement of stainless steel.

⁹ Assumption: The cost for local employees is about 50% of the cost for central treasury experts.

Contribution 1: Copper

So far, the commodity risk of copper was controlled through micro-hedging. As the price risk under these contracts relates to both sales and procurement and therefore is hedged on both sides, the volume of derivatives for LME copper far exceeds annual consumption.

A catalogue of measures to centralise commodity risk management issued by treasury ensures the coordinated transition from a micro-hedging to a macro-hedging strategy and from back-to-back hedging to exposure netting for subsidiaries at the level of treasury. This significantly reduces the volume of derivatives for commodities with an identical risk profile. Besides transaction costs, this mainly reduces contango payments. Potential contribution to profit: 2,800 metric tons x EUR 35, i. e. just under EUR 100,000 or 0.01 per cent return on sales.

Contribution 2: Stainless steel

The price risk from stainless steel has not been hedged so far. The restructuring of pricing mechanisms in the steel market has led to reconsideration in specialist departments, so that it is planned to also use hedging instruments for this purpose. As with price risks for copper, treasury assumes the responsibility of netting and subsequent external hedging via derivatives. In addition to the price for iron ore and steel, this also relates to the alloy components nickel and molybdenum as well as energy sources.

Through targeted management of commodity risk, fluctuations in profit margin and thus — in conjunction with the use of hedge accounting — also in profit can be significantly reduced. This reduces the credit spread and therefore also borrowing costs considerably in the medium term. Potential contribution to profit: around 20 basis points for a financing volume of EUR 100 million,, i. e. EUR 200,000 or 0.02 per cent return on sales.

Preliminary conclusion

The potential contribution to profit of improved commodity risk management amounts to approximately EUR 300,000 or 0.03 per cent return on sales.

4.2.5 Payments

Corporation X processes its payments locally. Each entity pays its creditors independently — both internally and externally.

Contribution 1: Payment factory

Payments are centralised in a payment factory to prevent early or late payment. Experience has shown that as much as 15 per cent of all payments occur too early (about two days on average) or too late (up to 4 per cent of all payments), resulting in loss of discounts. In assuming a volume of payments of EUR 500 million relevant in this case, by avoiding early payment this 15 per cent can be invested for a longer period of time or does not have to be raised until later, resulting in an interest gain of about EUR 17,000. EUR 417,000 can be saved by preventing the loss of discounts (discount of 2 per cent). In total, this has a profit effect of about EUR 417,000.

Contribution 2: Bank accounts

Each of the 20 locations has about ten bank accounts, with 200 accounts in total. These can be reduced to ten central and 20 local accounts group-wide through central cost management and central payment in a payment factory. (It can be assumed that each entity requires an account of its own for local purposes.) With average bank fees of EUR 30 per month and account, around EUR 61,000 could be saved. In this context, it would be opportune however to look at the overall cost for 170 accounts, for which two elements need to be considered: firstly, internal administrative cost (master data, job routines, bank confirmations, annual statements, etc.) incurring 0.5 days' expenses p. a. for each account, and secondly, daily account management as well as bank accounting, each requiring five minutes per account and day. With an assumed daily rate of EUR 400¹⁰, EUR 34,000 could be saved annually group-wide (administrative cost) and EUR 34,000 for account management and bank accounting.

¹⁰ Assumption: daily rate for cash management of EUR 400, i. e. EUR 100, less than for format adjustments by IT.

Critics may say that this approach is unrealistic and that such savings are not feasible in practice. To this I would counter that these are activities at a value well over EUR 375,000 per year, with no appreciable contribution to value.

Contribution 3: Adjustments to format

Minor format changes may be required each year due to amendment of the SEPA regulation. With a payment factory approach, these adjustments only have to be made once centrally. Entities provide payment data in the existing format. If payments are made locally via stand-alone systems, all ten entities in the SEPA region will have to invest around three days each once a year for format changes, at a daily rate of EUR 500. This compared to central changes in the payment factory system, requiring three days in total. Consequently, well over EUR 14,000 could potentially be saved each year.

Contribution 4: Increase in straight-through processing (STP)

Assumptions — average payment amount: EUR 5,000; number of payments per year: 190,000; price per transaction: EUR 0.1; cost per repair item: EUR 0.5; returns and inquiries: EUR 1. Central cash management is exercised with greater expertise, standardised processes, and thus at higher straight-through processing rates at the bank. Repair items — i. e. the cost of instances where the bank has to intervene manually — will be reduced from 10 per cent to now only 1 per cent as a result of proper delivery and processing. This will reduce transaction cost by EUR 7,000. Moreover, returns and inquiries by the bank will be reduced from 2 per cent to 0.5 per cent. This will reduce cost by about EUR 3,000. Consequently, transaction cost can be reduced by about EUR 10,000 in total annually.

Contribution 5: e-banking applications

Local entities each have an e-banking application for local and special payments, and as backup. It was assumed that these entities maintained two e-banking applications on average previously, which means that 20 applications will now no longer be required. With an average price of EUR 50 per month, EUR 12,000 will be saved. More extensive total cost analysis should be considered also in this case: If the internal cost for technical support and the operation of systems for communication with banks is added at half a day per application and month, the additional annual saving for the group is EUR 60,000 at an assumed daily rate of EUR 500.

Contribution 6: Requesting bank statements centrally

If bank statements are requested centrally, only one instead of 20 employees checks whether all bank statements have been received and calls the bank in question if a statement is missing to enquire as to its whereabouts. This does not result in savings immediately, however, in the context of more extensive total cost analysis the situation is as follows: Only one instead of 20 employees of the group checks receipt of all statements. With an assumed nine accounts on average for each entity, which are now eliminated, and ten minutes for checking, about EUR 100,000 is saved group-wide at a rate of EUR 400 per day. Once again, it needs to be pointed out that these are 'split full-time employees', which cannot be saved one-to-one; the main objective is to avoid unproductive activities.

Contribution 7: Payment transactions as a lever with banks

In view of low interest rates and the Basel III liquidity requirements, the business of payments is becoming ever more important to banks. Therefore, the central award of a (more ample) wallet of fee business to banks should also be utilized for loan negotiations. Restructuring or renewing a loan portfolio of EUR 50 million could reduce interest rates by up to ten basis points. This would reduce costs by EUR 50,000 annually.

Preliminary conclusion

The potential contribution to profit from payment transactions is EUR 475,000, or EUR 1.04 million based on total cost analysis or 'split head full-time employees', i. e. as much as 0.1 per cent return on sales.

Compliance costs are not considered, as already mentioned above. These are usually only quantifiable 'once the horse has already bolted'. However, it needs to be emphasised that it would be advisable for the executive board to show the requisite interest in secure processes and appropriate monitoring — particularly of payment transactions: It is liable for deficiencies, as demonstrated yet again in a recent court judgement.

4.2.6 Borrowing costs

Let us assume that loan capital has been provided not as a credit line but in the form of medium to long-term loans, which have been used.

The loan was made available to Corporation X by a banking syndicate. Upon signing the loan agreement, the company paid a commission of EUR 300,000; also payable is an annual agent fee to the banking syndicate coordinator of EUR 25,000. Financing was arranged for five years at the time, which is the maximum period in the current financing environment. The loan has a remaining term of two years.

Corporation X has decided to refinance the existing syndicated loans before their date of maturity:

Example 1: New syndicated loan agreement

The corporation is negotiating a new syndicated loan agreement. Due to improvement in the interest rate environment, the new interest margin is 2 per cent p. a. compared to the previous 2.5 per cent. This means annual savings of EUR 1 million. Even after deduction of the one-off arrangement fee of EUR 300,000, which is now payable once again and in fact would have to be spread over five years, EUR 700,000 could be saved already in the first year. The resulting effect on savings is EUR 700,000 or EUR 1 million, corresponding to return on sales between 0.07 per cent and 0.1 per cent p. a.

Example 2: Promissory note

As a publicly traded company, Corporation X is refinancing its syndicated loan by issuing a promissory note. Here also, a one-off arrangement fee of EUR 300,000 is charged. However, in this favourable environment for investors, the company will be able to realise an annual interest margin of 1.75 per cent. Compared to the previous syndicated loan, EUR 1.5 million will be saved a year. Accordingly, the effect on savings — once again including or excluding the one-off fee of EUR 300,000 — ranges between EUR 1.15 and 1.5 million. In relation to return on sales: between 0.11 per cent and 0.15 per cent p. a.

This example does not consider other factors reducing borrowing costs, such as subsequent collateralisation of the syndicated loan with Corporation X's assets. It is also important to include other qualitative effects in this consideration, for example, the much longer maturity intervals offered by a promissory note, which increases financing security. While this would partially offset the interest savings effect, it would potentially optimise Corporation X's risk profile. A third effect would be tranching the promissory note into a variable and a fixed interest tranche. This would generate further savings effects in connection with interest rate hedging instruments.

Preliminary conclusion

The potential contribution to profit of optimised financing could be as much as EUR 1.5 million or 0.15 per cent return on sales.

I would like to direct a few words to those potentially raising criticism also in this context: There are companies with outstanding corporate finance experts. Even though they are among the best in their field, they frequently lack insight into current markets, as they are unaware of the most recent details of transactions and terms and conditions of banks. But it is exactly that knowledge that makes the difference in negotiations with lenders. Companies in the English-speaking world use external financial advisors for that purpose far more frequently than German companies.

4.2.7 Working capital management

The focus of modern working capital management (WCM) is to reduce tied-up capital in the company in order to thus reduce the share of borrowed capital and strengthen the company's ability to finance itself.

What role can treasury play in this regard? Treasury is obviously not responsible for stocks. It is equally obvious that treasury will not interfere with corporate processes for which it is not responsible. However, treasury should assume a control function with regard to sustainable working capital management — i. e. not only when dark clouds appear on the horizon of the economy — as it will have to work with the final outcome: the liquid funds available.

The logical question to ask now would be whether controlling can assume this responsibility. It can. However, it needs to be clearly stated at this point that controlling does not usually think in terms of liquidity or contemplate the consequences of activities primarily with regard to their impact on liquidity. This is perfectly acceptable in my opinion, because it would present any organisational entity with major challenges having to determine, at one moment, what should be (budget), and at the next, to look at it from an entirely different perspective in terms of what will be (forecast).

It is therefore important to integrate working capital management more permanently into a standard process with a stronger focus on cash. Elements of this process and management model are the cash flow statement, indirect liquidity planning, liquidity forecasts as a direct planning tool, and a liquidity drivers model that makes the processes driving the company's liquidity movements more transparent.

When such a liquidity drivers model is part of the management model, treasury will be able to identify areas of potential through appropriate monitoring and make them transparent. At the same time, treasury should become actively involved itself in certain phases of the financial supply chain and, for example, discuss possibilities of optimisation with the responsible departments. However, deriving profit contributions for Corporation X from such activities would be too ambitious in my opinion, and would not be in line with the rather conservative approach taken in this study.

For the sake of completeness, it should be noted that sustainable handling of working capital potentially creates added value in the following areas:

Contribution 1: Trade receivables

Give us the money quickly — this demand is of vital interest to treasury or at least that is how it should be. Let us dismiss, for the moment, the period between provision of services and receipt of payment, which is of crucial importance to working capital management. Being able to plan incoming payments is of particular importance to treasury. This requires that the debtor is put in a position to render payment on time, i. e. by receiving a flawless invoice immediately or shortly after the provision of services.

And so we have come full circle: Once the payment terms have been established by taking into account various parameters — here also we may have conflicting goals between sales and working capital management — the focus is on timely receipt of payment and thus on internal invoicing and dunning processes that can actually be influenced.

Contribution 2: Trade payables

In this area, one frequently hears the relatively flat demand, in my opinion, for payment at the latest possible date. Much more exciting in this context are aspects such as rebates and cash discounts, because it can definitely be beneficial to use one's own good credit standing or liquidity situation to negotiate a larger cash discount in return for earlier payment. In this regard, the positive effects on purchase cost have to be weighed against the negative impact on working capital, of course. The key term here is total cost analysis or — to be more specific — close cooperation between procurement and treasury. Although this is not a direct treasury issue: Many companies forego the possibility of using cash discounts because their own invoice receipt and verification process takes too long. Or they lose interest income by paying too early because of a lack of routing control for payments — this also is a treasury issue. Mass data analysis has repeatedly confirmed that payment often occurs too early.

Contribution 3: Inventory management

This area definitely is treasury territory. The particular challenge of inventory management is to minimise the time between goods purchase, warehousing and goods issue (to production or the customer). Of particular importance in this regard is optimising days in inventory, i. e. balancing supply capacities with capital commitments, by also taking into account production planning.

More interesting, however, is the question as to the point of inventory management at which process steps or decisions should be considered that may impact treasury. I should warn against hasty decisions because the interdependencies are too complex in many cases. Which brings us back to the liquidity drivers model as an 'accelerator of transparency'.

Table 1 Liquidity effects when improving days working capital (DWC)

Improvement in DWC (days)	Effect on liquidity (EUR million)	Time value of money (EUR million)	Improvement in return on sales (per cent)
1	2.700	0.137	+0.0137
2	5.500	0.274	+0.0274
4	10.900	0.548	+0.0548
8	21.900	1.100	+0.1100

Effect on return on sales

For the sake of completeness, let me give you a simple example in addition to the above table. In the case of Corporation X, it can be assumed that liquidity is released with a reduction in average days working capital (DWC, defined as DSO + DIH — DPO)¹¹; this effect of the time value of money in turn has a positive effect on return on sales.

This is calculated as follows:

- gain in liquidity = sales revenue/365 days
- effect of the time value of money = gain in liquidity x WACC¹² [assumption: WACC = 5 per cent]

Depending on the level of professionalism of receivables, inventory and payables management, reducing days working capital between four and eight days is a realistic target in practice (see Table 1); further improvement is possible in some special cases.

Conclusion: It is a good investment to assign two or three employees to liquidity management or working capital management.

4.2.8 Treasury IT

How high are IT costs in treasury — both in absolute terms and in comparison with other companies — and how can they be reduced? Nowadays only very few treasurers can give a comprehensive answer to these simple and at once complex issues. The more treasury is involved in the entire system landscape of a company and the larger the interfaces between departments and entities, the more difficult it is to directly allocate and control individual cost pools.

It is no doubt still relatively easy to determine the license and maintenance costs of applications used exclusively in treasury. However, can directly controllable cost types be identified at all in a mix comprising allocation of overheads and cost transfers for PCs, printers, networks, computer centres and ERP systems? And how does one deal with opportunity costs arising as a result of inefficient system use in treasury, if for example interfaces between treasury and accounting are not optimised or reporting involves a high degree of manual effort?

Unfortunately, in the majority of cases, costs still are the determining factor in deciding for or against specific projects, also in treasury. Savings forecasts therefore always are based on knowledge about actual cost — even if it is often hard to get such information.

But what can treasury ultimately do to scale back its IT cost? Treasury is merely at the end of the IT chain and usually unable to influence significant decisions concerning the strategic framework of IT operations such as the selection of an outsourcing partner or hardware. The answer, instead, lies in the framework which treasury defines for the focus of IT and the associated operating costs: towards central organisational management, towards automated processes for procedures and towards a uniform platform for its architecture:

11 days working capital (DWC), days sales outstanding (DSO), days inventory held (DIH), days payables outstanding (DPO).

12 weighted average cost of capital (WACC).

Centralisation: If treasury defines a particular organisational direction for the central management of risks and payment processes, IT architecture will also have to be given the same focus. The introduction of a centralised treasury management system and bundling of interfaces and communication channels with banks and business partners inevitably make multiple tools in corporate entities and international group companies redundant and thus lead to savings in operating expenses.

Automation: Speed is key also for treasury processes. Systems in this environment function automatically to make entries, prepare reports and create cash positions. Within an up-to-date technological framework, there no longer is any reason for systems not to be perfectly coordinated, which, if lacking, requires labour-intensive manual and thus high-cost activities in this department as well as IT operations in general. In this context, treasury is responsible for identifying and itemising existing vulnerabilities, but also for turning sector-specific trends and innovations such as SWIFT or eBAM into concrete recommendations for action.

Standardisation: Creating a global platform for treasury management in particular requires the integration of numerous systems and tools, interfaces and information (reports, payment formats, etc.). As guardian of competent guidelines, treasury also needs to provide guidance for a focussed IT landscape and specify the level of permitted heterogeneity as well as the criteria for deciding to operate a centralised treasury management system or multiple partial solutions within a hybrid architecture. Implementing a project to create a uniform system landscape usually impacts operating expenses in my experience.

Savings and assessing the effect on costs are only one side of the coin however. So, what are the benefits? What fundamental contribution does IT make to the company's success and how can this contribution be expressed in meaningful figures? This issue, which does not depend on treasury in the first place, has been discussed for more than 40 years in a range of scientific theories and practical approaches, for example, in connection with calculating business cases.

So far, there is no cardinal route setting uniform and verifiable standards — even in the ratio systems upheld by many decision-makers. In the light of increasing expenses in the form of financial and human resources required for changing or enhancing treasury system landscapes, treasury must increasingly face the question as to whether the introduction of a new treasury management system or the establishment of an in-house bank with the necessary technological infrastructure (e.g. SWIFT-based bank communication) generates sufficient potential income and benefits.

The difficulty the treasurer has in answering this question stems from the fact that the use of technology does not automatically lead to cost savings; the indirect effects of IT also need to be examined:

- How does IT support the various treasury processes and how are professional requirements reflected in the system? A large number of manual activities and interim solutions is an indicator of inadequate support. However, if interfaces function smoothly and most individual activities are implemented automatically — for example, in reporting or the processing of financial transactions through exchange of electronic confirmation — the benefits of IT in treasury can be regarded considerably greater. The speed of treasury processes is another factor coming into play here.
- Can operation of the relevant systems and components be organised with sufficient efficiency? If so, this means fail-safe provision with the degree of availability and performance desired by treasury. In this regard, risk and compliance issues in the area of IT security are of great importance to operators. If, for example, the operation of a global payment factory is not ensured around the clock, foreign subsidiaries will be unable to receive support in the event of problems. The value of IT solutions in treasury should be appreciated at all times, not merely when systems fail.
- To what extent does IT fulfil its role as enabler of technical innovations? In a global treasury organisation, in particular the manner in which treasury collaborates with local departments and entities depends greatly on the technological platform.

- Global currency management can only be implemented efficiently, for example, when an adequate system landscape allows the decentralised identification of risks in international group companies and also the consolidation of exposures. An innovative compliance issue such as electronic bank account management (eBAM) also requires adequate tools and workflow support. If systems reach their limits in this regard, they are a hindrance rather than a help.

When considering these factors, priorities and decisions regarding IT investments in and for treasury inevitably may be set or made with a view to aspects that go beyond imposed regulatory requirements or a mere analysis of cost and potential income.

As part of the ongoing struggle over restrictive and tight IT budgets, treasury promotes its own interests by identifying potential innovations and gathers valid arguments in support of its plans.

Preliminary conclusion

Attributing a quantifiable contribution to treasury IT does not seem feasible necessarily at this point and would — if achievable at all — be based on so many assumptions that attempting to make a definite statement would not seem sensible. An interesting consideration however is the fact that a significant investment in Corporation X's treasury IT — of EUR 1 million or more — would by no means seem too expensive. In view of the potential contribution to value of a best-in-class treasury, such an investment should not be cause for concern to anyone.

4.2.9 What remains

Critics may say that costs are always incurred initially in connection with organisational, process or IT adjustments. This is fundamentally true. Nevertheless, these sample calculations are not meant as business scenarios, but merely serve to compare two different situations or approaches. I have also not considered extreme examples of bad treasury management, which could drive up cost dramatically or whose negative impact on performance would be significant.

Table 2 Overview of main results

Item/ example	Return on sales (per cent)
Liquidity planning	0.10
Cash pooling	0.02
Currency management	0.10
Commodity risk management	0.03
Payments	0.10
Borrowing costs	0.15
Working capital management	0.08
Total	0.58

Admittedly, the hypothesis that treasury could take credit for about 1 per cent return on sales could not be proven based on conservative estimates for Corporation X (see table above).

But, what about potentially negative tax effects due to a badly chosen location for a finance company? Or the consequences of a tax audit, in which transfer pricing for cash pooling is criticised as unsuitable? Or the amount of loss due to fraudulent payments? Or the penalties imposed by US government agencies for using bank accounts in the US for purposes of corruption?

And, finally, there is also the issue of the consequences of a worse rating or the scenario of analysts arriving at the conclusion that currency and commodity risk management is insufficient, so that they reduce the upside target for anticipated profit because of the associated increased risk. Reducing the credit margin in response to an improved rating is another lever that should not be underestimated. All these issues have deliberately not been quantified.

There is no dispute however that hedge optimisation and accounting have a positive effect on the stability of cash flows and profits and thus also on ratings. Then — and particularly in the case of a treasury with greater need for action and optimisation — that department very quickly enters dimensions that far exceed 1 per cent return on sales, however — unfortunately — in negative territory.

The total contribution to value of 0.58 per cent return on sales based on the example of Corporation X is an impressive figure, particularly when considering the returns on sales customarily achievable.

Even more impressive is the absolute amount of contribution to value with an effect on liquidity: around EUR 4.4 million excluding working capital management and EUR 5.3 million including working capital management. This illustrates what three to four full-time employees achieve at Corporation X's treasury department, which should end the discussion about adequate resources — i. e. investments in human resources and capital expenditure.

4.3 Measuring success — but how?

Sales are measured based on revenue and — with functioning control mechanisms — by also taking account of payments received. Production has its own performance indicators, in the same way as procurement and IT. And treasury? Where and how is it determined whether the performance of treasury is in line with corporate strategy and planning? The fact that treasury was not subjected to real performance measurement in the past is becoming a problem now: Its contribution to value is not visible and (what is even worse in my view), even if it is discussed, this does not mean that it is also properly understood. Let us turn to three, in my view, easily understood examples of successful performance measurement. This could be done even more accurately, of course, however only the following performance indicators are presented at this point: firstly, an unequivocal and exogenous benchmark, secondly, process and transaction costs for the prior period compared to the current period, and thirdly, the balance of interest income and expenses compared to the budget.

Example 1

The envisioned rate is achieved by means of hedging instruments, for which the target rate was calculated by taking into account existing hedges and forward rates. At the same time, more comprehensive reporting in cooperation with controlling is required that allows the presentation of deviations as to whether they are induced by volume or price — the former not being the responsibility of treasury, while the latter is if it cannot clearly be attributed to economic exposure, i. e. a volume-induced deviation that is already evident.

Example 2

A particular volume of payments of x results in total cost of y. The latter is composed of personnel expenses and cost of materials (IT, e-banking, etc.) as well as transaction costs (mainly banking fees). The objective is to reduce cost, period-on-period, through process optimisation until the best-in-class benchmark has been reached by the company.

Example 3

Business planning also includes planning interest income and expenses. To this end, interest expenses and income are determined based on liquidity planning and recognised in the budgeted financial statements, whereby it is important that it makes a difference whether a leveraged acquisition occurs sometime in the coming financial year or has been scheduled very specifically for the first quarter. With regard to the achievement of targets, a distinction has to be made as to whether the deviation is the responsibility of treasury — such as miscalculating interest rates — or not — for example when the acquisition is postponed until the fourth quarter.

5

Obstacles and the art of overcoming them

5.1 The CFO's understanding

Treasury is important! Understood. Liquidity is important! Also understood. The cash flow analysis of controlling and liquidity planning of treasury produce different results. And so they should. Really? We have foreign exchange losses despite hedging? Treasury, please explain! I admit: Treasury is complex. But not difficult to understand. And this from someone who makes his money from treasury advisory. CFOs usually only encounter symptoms within the scope of responsibility of treasury and then react to those without knowing their cause. This applies to deviations from forecasted free cash flows, unexpected foreign exchange losses or gains, liquidity shortages and difficulties with financing. They are hardly aware of the fact that a lot of what happens, or does not happen, in the company and during its operations is manifested in treasury and therefore predictable, both in terms of liquidity and currency gains or losses. Transparency is in need of improvement. An obligation to be performed by the CFO? An obligation to be fulfilled by treasury? Both, in my view. And let us be honest: What CFO takes the time to intensively study treasury issues to the same degree as accounting and controlling issues? How does the CFO contribute to making treasury and procurement aware of their joint and undivided responsibility for the management of commodity risk? And what treasurer approaches the new CFO to explain to them in detail what treasury does exactly and why? It is assumed that the CFO knows already. And they, in turn, assume, that

treasury takes care of financial risk. A joint, better understanding of the financial supply chain would, however, have many positive effects. These range from better integration of treasury into corporate processes and sound decisions on locations and investments, to improved communication with capital markets (without having to give away any more in return). The fact that the financial supply chain concept has not become a reality to this date falls back on the entire business organisation, in my view, and not only treasury.

5.2 Where does the king reside?

The following is being spread about to major international insurance companies: While the king sits at headquarters in one, there are many kings in various countries of the other as well as dukes and earls in various divisional companies. It has always been the case, unfortunately, that kingdoms in which minor kings are able to establish themselves are always exposed to quick ruin. Conclusion: There can only be one king and he must sit at headquarters. Even if we disregard governance and compliance arguments for the moment, the benefits of a central treasury function are evident not only from the perspective of risk management, but also from a quantitative point of view due to netting and economies of scale. Regardless of generally valid organisational theory and a wide variety of advisory trends — from local to central and back again — it is undeniable that treasury has undergone a consistent development to central organisation for 20 years. This was only intermittently hampered by a lack of technical possibilities until also the last bastion of decentralised treasury organisation fell two or three years ago: the payments bastion.

Since then, only the legislator — in some countries — prevents complete centralisation of the treasury function.

Location is then the next issue to be discussed: as a central function at headquarters, as part of the finance company in country A, B or C, or as an independent treasury company. This depends, in particular, on tax considerations and also control objectives. However, what all three alternatives have in common is that treasury is understood to be a central function. Pursuing none of these options would mean consciously foregoing treasury's positive contributions to profit!

And finally, there is no escaping the compliance argument: An executive board cannot sufficiently fulfil its duties with regard to financial risk — as confirmed by recent court rulings — when central treasury functions are performed locally (regardless of guidelines) or when the transparency of all financial risks is not ensured.

5.3 No special status

This position paper addresses the special status of corporate treasury. I think it is about time to put an end to this special status. Treasury should no longer shroud itself in an aura of complex duties that are hard to comprehend by outsiders and hide behind these. At the same time, it is important that other departments and also senior management gain a better understanding of what treasury can and must achieve. This can be accomplished through communication, but even more so education. In the same way as a treasurer should understand the basics of procurement, accounting or controlling, representatives of the departments mentioned as an example here need to understand the basics of financial risk management. Technical developments facilitate the required speed for making decisions as well as adaptation to new situations as a result of changes in business models. And it is now also possible, with a justifiable amount of effort, to manage the increasing complexity of financial risk arising from ever-changing correlations. All it takes is the right frame of mind, which is not difficult considering the potential contribution to corporate earnings that can be achieved.

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