Performance Measurement in Treasury

Corporate Treasury Consulting

J.P.Morgan

Key Performance Indicators (KPIs)

KPIs help companies measure the extent and effectiveness to which companies meet objectives against a defined target. Performance can be tracked for processes, employees or systems.

Every business has a unique set of challenges and opportunities when defining relevant KPIs. Here are some general examples – for a comprehensive review please reach out to your relationship manager.

Types of KPIs

- *Quantitative:* measurement based on numeric values.
- *Qualitative:* measurement based on interpretation *Event-driven:* measurement based on a pre-defined event.

Best Practices for Setting KPIs

- Use **SMART** goals to design target values and KPIs — **S**pecific, **M**easurable, **A**chievable, **R**elevant and **T**imely
- Collaborate on performance measurement across departments to avoid competing KPIs
- Ensure measurement is feasible and does not exceed budget (if applicable)
- Implement a process to regularly review target values and adjust as needed
- Examine all KPI incentives to prevent undesired behavior

5 Key Treasury KPIs and Their Objectives

1. **Cash and liquidity management**
   The business has the cash it needs at the right place and time.
2. **Funding and investment management**
   Funding is available and financial assets are optimized.
3. **Market risk exposure management**
   Future cash flows and earnings are protected against market volatility.
4. **Treasury operations and accounting**
   Controlled, transparent and efficient transaction life cycle management is enforced.
5. **Risk management and policy compliance**
   Financial risks are monitored.

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KPI 1: Cash and Liquidity Management

To ensure that the business has the cash it needs at the right place and time, consider the following indicators:

Effectiveness and Accuracy

- Cash visibility
  - Percentages and amounts of balances outside cash concentration structure and/or core banking group (i.e. “external liquidity”)
  - Number of times and percent in certain period of inaccurate cash position revealed on T+1 (time since previous forecast)
- Cash forecasting error:
  - Percentage forecast error by business unit
  - Accuracy:
    - Deviation in percentage: $\frac{\text{Actual–forecast}}{\text{Forecasted cash balance}}$
    - Number of times exceeding X% threshold

Timeliness, Speed

- Percentage of account balances reported on time
- Cash forecasting error:
  - Number of times reporting deadlines have been missed

Process Efficiency

- Percentage of balances reported automatically vs. manually
- Cash visibility
  - Trend analysis of percentage of restricted (and/or trapped) cash vs. total cash over the past number of months
  - Trend analysis of days cash available: total available cash/average daily disbursement
- Cash forecasting:
  - Trend analysis of percentage forecast error by business unit over the past number of months

Visibility, Control and Oversight

- Percentage and volume of accounts vs. all accounts for which balances are regularly being reported
- Cash visibility
  - Minimum/maximum cash balances, amounts and percentage
  - Percentage of restricted (and/or trapped) cash vs. total cash
  - Days cash available = $\frac{\text{total available cash}}{\text{average daily disbursement}}$
- Cash forecasting error:
  - Internal competition: 3 most accurate business units per month/period

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KPI 2: Funding and Investment Management

To ensure available funding and optimized use of financial assets, consider the following indicators:

Effectiveness, Accuracy

- Return on investment, planned vs. actual
- Accuracy of interest expense forecast:

$$\frac{\text{Actual} - \text{forecast}}{\text{forecast interest expense}}$$

- Interest rate on debt instruments vs. benchmark

Timeliness, Speed

- Funding buffer: Number of times below threshold and exceeded amount percentage against threshold amount
- Number of ad hoc funding requests after request deadline (e.g. T+2)

Process Efficiency

- Asset/liability mismatch (currency, interest, maturity)
- Funding buffer: volume
- Cost of funds performance (cost/debt issued per tranche/annualized/ across full program)
- Weighted average of credit rating of investments/issuers vs. investment policy

Visibility, control, oversight

- Investment portfolio liquidity ratios (current, quick, debt/liquidity, debt/assets)
- Percentage of non-interest-bearing cash vs. total cash
- Segmentation/concentration of investment portfolio by maturity, issuer, instrument type, credit rating
- Cash flow to debt ratio
- Available credit: total principal value of drawn credit/total principal value of all credit facilities
- Fixed/floating interest rate mix
- Percentage of committed credit facilities vs. all facilities
- Debt mix: short/long term vs. total outstanding debt
- Debt covenants (e.g. debt/EBITDA, interest coverage, debt/equity, debt/assets, total assets, dividend payout ratio)

KPI 3: Market Risk Exposure Management

To ensure that the value of future cash flows and earnings is protected against market volatility, consider the following indicators:

Effectiveness, Accuracy

- Hedge ratio:
  - Underlying transactions (i.e. exposure) vs. hedges in place for respective periods and currencies
  - Hedge ratio actual vs. outlined policy (% hedged deviating from allotted limit)
- Accuracy of reported exposure vs. actual
- Accuracy of communication with counterparties
- Hedge Accounting: retrospective hedge effectiveness

Timeliness, Speed

- Time taken to confirm transactions
- Execution speed: time between exposure identification by business unit/ subsidiary, reporting to Treasury headquarters and hedge execution
- Unconverted balances held beyond time frame set in policy

Process Efficiency

- Number and volume of trade errors, i.e. buy/sell wrong side, wrong currency pair
- Market rate conformity check:
  - Number of times transaction rate is outside of range laid out in policy—total, per staff member, per banking partner
  - Total of (estimated) commission paid over number of trades—by currency, banking partner
  - Trend analysis of number and volume of trades per banking partner

Visibility, Control and oversight

- Counterparty limit utilization
- Hedge ratio breaches
- Currency balances held unconverted in a currency account exceeding internal threshold

KPI 4: Treasury Operations and Accounting

To ensure controlled, transparent and efficient transaction lifecycle management, consider the following indicators:

Effectiveness, Accuracy

- Actual bank fees vs. budgeted bank fees
- Working capital (DPO, DSO, CCC)

Timeliness, Speed

- Delay time of trade-related settlements
- Number of days for cash transactions to hit the general ledger
- Time to determine daily cash position
- Percentage of payments released on time

Process Efficiency

- Number of late trade-related settlements
- Percentage of payments succeeding first time/STP
  - Percentage of auto-reconciliation in ERP of daily transactions on bank account
  - Percentage of payments released on online platform vs. host-to-host
  - Number of system-generated payments (from ERP/TMS) vs. manual
  - Number and amounts of ad hoc payments outside of regular payment runs of BU
- Number and percentage of repaired/rejected payments compared to total payments

Visibility, Control and oversight

- Percentage of trade-related payments not using default settlement instructions
- Number of payments authorized by signer not registered with Treasury headquarters payments authorized

KPI 5: Risk management and policy compliance

To ensure that financial risks are monitored, consider the following indicators:

Effectiveness, Accuracy

- Accuracy of staff reported for roles defined in policies (e.g. currency manager) vs. recorded in systems

Timeliness, Speed

- Time since last account signer reconfirmation

Process Efficiency

- Number of accounts with full details (i.e. signers, purpose) reported to headquarters.
- Number of times update from subsidiary to HQ exceeded allowed time frame

Visibility, Control and oversight

- Net exposure to each counterparty across credit ratings (long- and short-term)
- Total value/cash flow/earnings at risk
- External audit of treasury processes passed/minor findings
- Risk analysis:
  - Impact of significant change in interest rates onto investments
  - Value at Risk (VAR)
- Number of bank accounts with core and noncore banks

Data as the Backbone of KPI Measurement—and Beyond

A fragmented and often rudimentary system landscape can limit companies' opportunities to collect and analyze data to offer insights into strategic drivers of the business.

What Can Data Do for You?

Data builds **better customer and vendor relationships,** including:

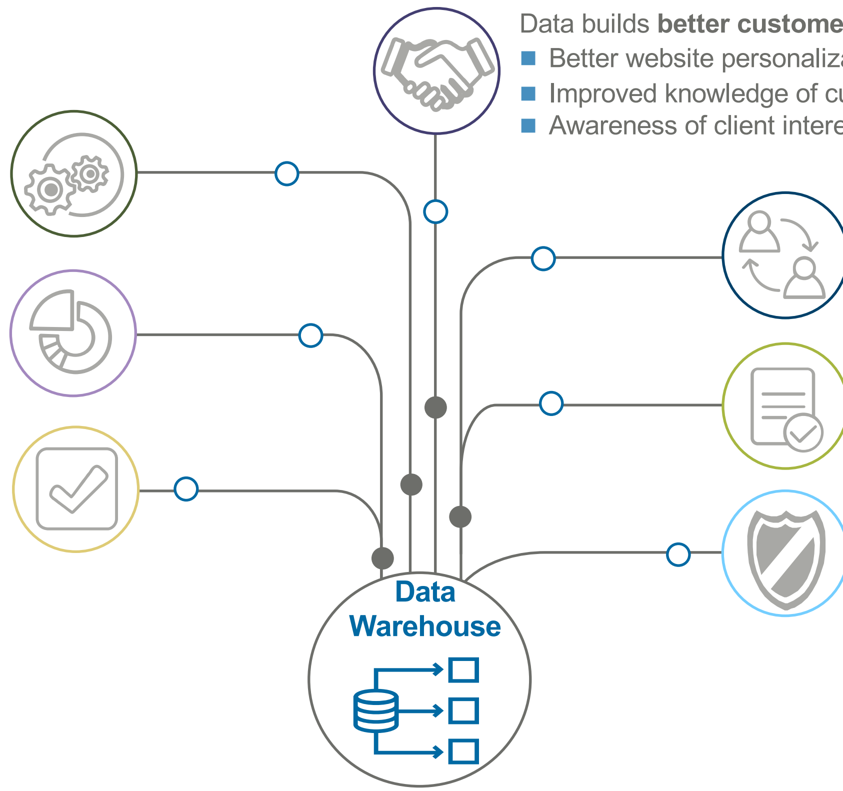
- Better website personalization and user experience
- Improved knowledge of customer and vendor communication preferences
- Awareness of client interests

Data enables **optimization**

- Meaningful data is necessary to support making changes

Create **stronger strategies** based on data with an active approach

Data is **indisputable**—actionable analytics and insights take subjectiveness from the equation



Data strengthens internal teams' ability to focus on what matters

Data **quantifies the purpose** of your work, letting the numbers speak for themselves

Use data as **your shield**—be prepared for audit requests

Considerations for Your Data Path

- Put a data management team in charge (e.g., single source, single extractor)
- Identify critical and relevant data (e.g., what type, in which format, what is needed, what is nice to have)
- Decide on method of data collection (e.g., data origin, availability, accessibility)

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