Treasury and Risk Management

The treasurer’s expanding role in global business is revealed in this review of cross-border concerns and techniques.

Historically, treasury’s involvement with risk management has been focused on identifying and hedging such financial exposures as foreign exchange and interest rates. The treasurer’s classical responsibilities were to establish policies for financial risk management, execute related practices and track and report the results of the program.

That was then. A recent survey by our firm revealed a considerably broader scope of concerns, as shown in the accompanying Figure 1.

These priorities are actually linked to managing an increasingly broad range of risks, financial and operational, which confront contenders for global growth in today’s complex and volatile environment. Significant issues requiring attention include: (i) liquidity maintenance; (ii) counterparty risk; (iii) operational risk; (iv) country risk; and (v) properly organizing the overall risk management program.

Our research indicates that CFOs are placing prominence on the effective measurement and management of risk. In part, this is a recognition that risk levels have increased across the board, as companies operate in an increasingly global environment. This is compelling a rapid evolution in focused corporate risk management programs, under the stewardship of the treasurer. Hallmarks of these programs include:

- integration with strategic planning for global growth of the business;
- focus on adding shareholder value to group operations; and

Ron Chakravarti, Treasury Strategies, Inc.

• continual expansion of the categories of risk exposure for which the treasurer assumes responsibility for oversight and management.

This article explores some of the principal risk-related issues with which the treasury is concerned. It also offers insights into how world-class multinational companies are successfully coping.

Special Concerns for Global Companies

When a group makes the decision to operate across borders, it enters an environment in which individual markets vary greatly. Distinctive factors include size, stability and maturity of the national infrastructure in terms of economic, political and financial progress.

Advancing from domestic to global operations implies a giant step in comprehension of “how things work.” The decision to invest or otherwise commit corporate resources across border is no longer spontaneous; it drags a “long tail,” in terms of sovereign, exchange and related risks of international business.

Old-line multinationals have come to terms with the core challenges of international business. Their incremental response to increasing levels of risk and responsibility is integrated within the overall treasury function. However, many companies are relatively new as international players; for these, a relatively higher investment of resources would be required on the international side of the ledger.

Additional Challenges for the Treasury

Expansion of international trade and investment creates new challenges for the treasury. Although these are diverse, they share a common factor of financial risk exposure that need to be incorporated in the group’s policies and practices.

Liquidity and funding: “Going international” means that the continuing treasury challenge to provide adequate liquidity and cost-effective funding to group operations is complicated by introduction of foreign exchange considerations.

The range of exposure measurements (i.e., transaction, translation and economic)—and choosing the right management technique from
the extensive toolkit available to manage them—represent a substantial additional investment of treasury effort and capital.

**Organization and management:** Usually, operating in a multinational context implies working with affiliated corporations as well as branches or divisions (in many companies, offshore operations may be grouped under an “International” business governance structure). Such a multi-corporate structure inhibits Treasury flexibility, even as it isolates individual corporate exposures.

Additional hurdles can be encountered when coming to grips with management styles and organization structures peculiar to the foreign areas in which the group is doing business; a good example would be the “management board/executive board” structure, common in northern Europe, which is completely alien to North American managers.

**Taxation:** A major exposure exists in terms of potential conflicts between tax codes of various jurisdictions in which a multinational group operates and the corresponding code of the country in which it is resident. The danger is that transactions may accidentally be structured in such a way as to attract double or punitive taxation.

Whether or not the treasury has direct responsibility for tax matters, the treasurer needs a working understanding of international taxation. This will allow the treasury to recommend liquidity management and financing structures that allow efficient use of tax credits and otherwise minimize exposure to double taxation.

**Regulatory considerations:** Regulations affecting convertibility and transfer of local currency, among other treasury-related aspects, can impede an efficient global liquidity management program. This is relatively more critical in emerging markets, where many of the perceived growth and investment opportunities exist.

Another regulatory consideration involves proliferation of disclosure, accounting and corporate governance requirements in a number of jurisdictions, following last year’s misadventures of various U.S. and offshore groups.

**Regional cash management standards:** The exhibit on this page indicates the broad range of cash management standards that apply to global treasury operations. Areas in which substantial differences can be encountered include: (i) banking and payment systems; (ii) trade collection and payments practices; and (iii) vehicles for investment and finance.

Doing business in—or among—several regions requires flexibility and ingenuity on the part of treasury staff, since a “one size fits all” approach will not adapt well to radically different environments.

**Responding to International Challenges**

The most effective response to the challenges of an international treasury function is to manage them within the context of a global, principles-oriented set of treasury and risk management policies.
Goals and Benefits of a Global Treasury Review

**Goals**
- Streamlining and automation of processes
- Improving cash forecasting and positioning
- Optimizing liquidity throughout the organization
- Simplifying bank structures
- Improving foreign exchange / and interest exposure management
- Establishing consistent global treasury management practices

**Benefits:**
- Reduced net financing cost, or improved margins on liquid asset investments
- Reduced bank fees
- Elimination of unnecessary foreign exchange transactions and improved trading margins
- Reduced internal process costs
- Significantly improved internal controls and risk management.

Start with a Global Treasury Review

The most well-organized travel arrangements are those in which both the starting and finishing points are accurately charted. This is equally true of the journey to an efficient, integrated function for international treasury and risk management.

In this context, it can be extremely helpful to engage the services of an objective treasury expert to benchmark current procedures, ascertain goals and advise regarding the measures that are necessary in order to achieve them. Some of the typical goals and benefits of a global treasury review are indicated in the accompanying Figure 2.

**Conclusion**

The treasury function within a multinational group should apply coordinated, consistent treasury and risk management practices throughout the enterprise. This can often be expedited by an objective review of the treasury, perhaps conducted by an independent expert.

Suppliers of financial services should be selected and managed on a strategic, rather than an ad hoc, basis. Indeed, all aspects of treasury and risk management will produce more value if they are integrated with the group’s forward planning.

Ron Chakravarti is a principal of Treasury Strategies, Inc., based at its New York office. Treasury Strategies is a management consulting firm that helps corporations and financial institutions attain maximum value from treasury operations. Ron’s 18-year career includes senior management positions in treasury and international banking based in the U.S., Europe and Asia/Pacific. He may be reached by e-mail at ron.chakravarti@treasurystrat.com. This article is adapted from a presentation at the 2002 New York Cash Exchange conference.