The treasurer as risk manager

The Association and its members should be doing more to advance the case for the treasurer as a leader in business management, says Judith Harris-Jones.

The risk you are taking at this precise moment is that the time you invest in reading some or all of the following paragraphs will be wasted.

In order to help you manage that risk, let me be clear that this article will *not* provide you with sophisticated probability analysis techniques, or describe the more arcane insurance and derivative products from which to build a hedge portfolio.

However, if you are interested as a businessperson, or from a career viewpoint, in debating the treasurer's role in the implementation of enterprise-wide business risk management, I suggest you read on as there have been some interesting developments in this area.

Development no.1

You may have noticed a recent risk phenomenon disturbing cashflows and shareholder values – the emergence of the dot.com businesses. While youthful management teams captured investor attention with their plans to deliver well established concepts through a revolutionary new medium, their traditional counterparts were faced with a marked weakness in shareholder support. Falls in share prices, sufficiently dramatic in some cases to remove long standing members from the FTSE 100, came as a surprise to many. After all, the companies' performance remained sound according to such previously accepted market criteria as profitability, cash generation and earnings growth.

This swing in market sentiment led to the treasurers of some of the traditional businesses facing a number of immediate problems:

- planned share issues being deferred or abandoned, leading to unplanned levels of gearing;
- covenants coming under pressure, bankers reconsidering credit status, and their willingness to lend and transact; and
- analysts, shareholders and the press re-examining the company's strategy for evidence of e-business developments – tricky for those with investor relation responsibilities.

If the change in relative status and the perceived efficiency of the traditional businesses prompts customer, supplier and business partner defection, then unanticipated volatility of cashflows may result. The day-to-day consequences for the treasurer may include mismatches between revised cash forecasts and hedge portfolios, and higher interest and derivative costs. The longer term effects may include the company's ability to remain independent, or indeed to survive at all.

Post hoc, one could argue that the dot.com bubble has burst, and some of the issues have gone away. But *post hoc* rationalisations are *not* the basis for risk management which enhances shareholder value – the periodic stock market realignments have brought many businesses to their knees in the short term, and crippled the long term reputations of others. For a while the stockmarket thought that the newcomers had more credibility than the traditional players.

Judith Harris-Jones

The type of risk represented by the stock market trends this year is called variously environmental, exogenous and economic. These are among the risks which should emerge from the more rigorous and out-of-the-box approach to business risk which the Association has been advocating.

The treasurer is often exceptionally well placed to support the board in their commercial need to constantly identify the threats and opportunities to their corporate strategy. His/her responsibility for relationships with financial institutions means a continuous monitoring of market conditions, and an appreciation of factors which trigger volatility. A company's financial counterparties (including the rating agencies) will have well informed economic and market databases – a tightening in the conditions the treasurer is seeing will provide an alert.

Daily contact with the group businesses, where changing competitive and strategic issues feed back realtime into the current and forecast cash performance, are also a valuable source of early warnings.

Development no.2

I get the impression that UK directors, as a class, have become bored with the challenge of getting to grips with risk. It has become a subset of the corporate governance farrago, a control issue, a disclosure requirement. The attitude prevails that, together with their auditors (external and/or internal) they brainstormed the risks facing their business, but it took a day out of a busy schedule last year, and have things changed materially in the meantime?

Perhaps the events referred to above will have reminded boards that:

- inattention to current exposures or failure to spot emerging competitive threats, has the potential to severely knock performance, whether that be reputation/market capitalisation, or cash flow;

- board level focus on risk is an activity, not just a regulatory requirement;
- the activity must capture *all* the threats and opportunities facing the business; and
- the performance measure to be concerned about is shareholder value-cash generation within the business, and share price performance.

If the risk management responsibility does not merit a board position of its own (an interesting discussion for which there is not room here), then the task must be delegated to a single sub-board level post; the job is to identify, understand and measure aggregate exposure and potential impact on the cashflows with which the shareholder is concerned. The overall responsibility must by definition reside in a one-off executive role.

What are the professional skills needed for the director of risk? The Association's Business of Finance publication *The Management of Corporate Risk* argues that the key skills for a successful treasurer are:

- a thorough understanding of the global business in which the treasurer operates;
- a cashflow-based view of company activities and performance measures; and
- an ability to articulate, develop and communicate the activities necessary to deliver an effective risk management programme.

I remain of the view that these are the best match for the risk director's job description, much closer than those of the insurance manager, the internal auditor or the actuary, valuable though their contributions will be. The dot.com example further illustrates the point, drawing attention to the relevance of the treasurer's internal and external relationships.

Development no.3

In the November 1999 edition of *The Treasurer*, Jeremy Wagener, a former director general of the Association, readvanced the case, that the treasurer is the right person to 'lead the [business risk management] process on behalf of the management and the board' and said that 'we have to argue more vigorously than before that we do have the right people'.

> Rather than opting for team participation the Association should stand up and shout about the strategic strengths, change management skills, the dynamic forward looking nature of its members

Sheena Boyce, Group Treasurer at Kingfisher plc, was asked in the Association's 21st anniversary publication, 'What is your prediction for treasury and treasurers in the 21st century?'

She replied 'Treasurers must learn to work closely within their businesses, or forever be pigeonholed as specialists'

Helen Ralston, Head of Corporate Finance at Bowthorpe plc, looks forward to 'a greater need and opportunities for treasurers to move out into broader business roles'.

Yet at the annual Association planning weekend, attended in February of this year by 28 of those actively involved in running the Association, it was agreed that we would no longer bid for the leadership of the business risk function. Rather, 'we had a role to play as a team member applying our financial markets experience and techniques in an effort to allow the team to have a more complete picture of the options for total risk management'.

A far cry from the conviction we held four years ago, that a business risk application of our management skills would facilitate the release of real value for our companies.

Who is to lead?

The point is that managing risk effectively is clearly a source of competitive advantage (see the excellent article by Robert Charette in the July 1999 issue of *IT Pro*). To manage it effectively is to manage it holistically. That requires leadership – if the treasurers do not wish to take on the mantle, others do. The accountants and internal auditors have it at the moment, sanctioned by Cadbury and its successors, managing it firmly as an issue primarily of control. The insurance case was put very cogently by Mark Butterworth, Chairman of The Association of Insurance Risk Managers, in the 10-part pull-out section (*Mastering Risk*), recently published in the *Financial Times*. (It is interesting to note that, as far as I am aware, the treasury profession did not feature anywhere in this 'special'). The actuaries are building up a head of steam.

Broadening horizons

If risk is to be managed holistically, will financial/treasury risk be incorporated into that picture? This is certainly the case at Microsoft. Does this mean the treasurer will take a step away from the board, and report to whichever function takes the lead?

At the first Association Evening Symposium of 2000, Paul Spencer, UK Chief Executive of Royal Sun Alliance talked about the evolving role of the treasurer. His advice was listened to avidly, for clearly, here was a treasurer who escaped the pigeon hole. He referred, among other matters, to the need for treasurers to widen their roles by taking on for example, investor relations and M&A. However, the single most arresting remark of the evening was perhaps made by Barbara Lord of the executive search firm Whitehead Mann. She said the biggest problem for treasurers who wanted to take on a wider, more senior role was to portray strategic vision and commercial acumen. While this may hold true for some individuals, most of the treasurers I know have a very good grasp of the corporate strategic and cultural issues. But Barbara's words *do* convey the received wisdom at board level and within the executive search companies.

Rather than opting to play as team participants, I would like my professional association to stand up and shout about the strategic strengths, the change management skills, the dynamic forward looking nature of the job done by its members. If we are no good at selling ourselves, let's find a top notch marketing expert to help us. Otherwise I believe the loss will not only be to ourselves as individuals, but also to the business risk management practised by UK plc.

Over to you, dear reader! ■

Judith Harris-Jones is a Fellow of the Association and a member of Council.