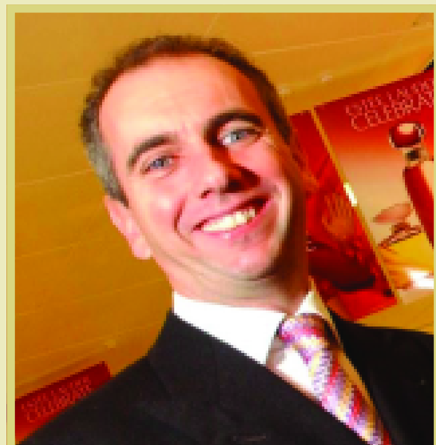

WITH A UNIQUE SKILLS SET WHICH ENABLES THEM TO CONTRIBUTE IN MANY AREAS OF CORPORATE STRATEGY, TREASURERS SHOULD SEIZE EVERY OPPORTUNITY TO GET INVOLVED IN WORK OUTSIDE THE TREASURY-RELATED ARENA, SAYS **HOWARD DODD** OF BOOTS.

MORE THAN JUST A TREASURER?

The role of the treasurer in the management of a company's financial risks and cashflows is well recognised, but a wider, more strategic role is not always so well-developed and understood. Treasurers' involvement in their organisations' corporate and financial strategy could be greater and their seniors should encourage them to look beyond their formal responsibilities.

THE DAY-TO-DAY ROLE OF A TREASURER

FINANCIAL STRATEGY. A treasurer's formal responsibilities include any number of the areas shown below, depending on the company and the experience of the treasurer:

- financing;
- financial risk management;
- tax/Insurance;
- legal entity structure;
- business risk management;
- pensions; and
- investor relations.

In addition, the company's financial strategy, setting its overall financial risk profile, dividend policy, funding sources, bank relationships and balance sheet gearing is at the centre of the treasurer's domain. The evaluation and determination of the optimum strategy requires the core skills of a treasurer.

It is critical that the determination of financial strategy follows seamlessly from the corporate business strategy. If this does not happen, the business will be inefficient. The treasurer must have a firm grasp of the business strategy, its risks and ensure the company's financial brand is consistent with its overall brand or reputation. For example, a company whose licence to operate is based on trust, needs a reputation for trust in the financial world. This will provide a useful touchstone in all the treasurer's dealings. The implementation of the financial brand with banks, rating agencies and in the capital markets, will involve the treasurer as representative of the brand. Hence, the treasurer should own the strategy and not leave it to the CFO or the board. This is a great opportunity for the treasurer to work closely with the executive directors and the board.

CORPORATE BUSINESS STRATEGY. Although many treasurers will get the opportunity to develop and implement financial strategy, their involvement in corporate strategy can be less clear. Unless they have specific responsibility for this area, they are unlikely to figure heavily in the creation or formulation of strategy. But a good treasurer has valuable skills that add value to corporate strategy. These go beyond skills in financing, cash and currency management, financial risk management and sometimes tax and insurance. Clearly, where a corporate strategy calls on these abilities, the treasurer will be a key player. But, of equal importance are the skills that are often in short supply in companies, which include:

- A profound understanding of the cashflow drivers of a business;
- skills in financial modelling way beyond the norm; and
- the ability to understand, quantify and articulate risk and the commensurate returns required.

WHERE CAN A TREASURER'S ANCILLARY SKILLS SUPPORT CORPORATE STRATEGY?

From my experience, there are three major areas that can be exploited:

AS A THINKER AND SENSE CHECKER. A treasurer's understanding of cashflow drivers and ability to construct simple but realistic financial models aids the middle of a strategy process. These skills, combined with the fact that the treasurer is not at the centre of the process and can apply a more objective mind to it, provides important input in strategy development.

IN DRIVING INVESTMENT PERFORMANCE. Successful implementation of corporate strategy is based on ensuring that investment activity focuses on the right projects yielding appropriate returns with manageable risk. Capital allocation between projects is critical to business success. Since it is often determined in practice at the 'operating level' below the 'strategic level', it can easily undermine the strategy itself. Investment appraisal criteria must translate high-level financial and strategic objectives into simple, consistent financial measures that can be used for project evaluation and drive the right activities. These rules and methods embed within the business culture and drive the micro decisions involved in investment decisions which impacts a company's performance for years. The case study shows how investment criteria was driving Boots' decisions and how a change has had a major impact on strategy over the last two years.

Translating financial objectives into investment criteria requires an understanding of cost of capital and corporate finance. It also requires the ability to 'map' this onto the business model(s) within a company so each type of project has appropriate measures. A treasurer, with his/her knowledge of corporate finance and business models (particularly cashflow related), is uniquely placed to do this.

AS A RISK AND RETURN PRACTITIONER. It is easy for non-finance colleagues to treat risk as from a negative angle and seek to eradicate all aspects of it. However, shareholders invest to take risk and it would be inappropriate to eliminate it. The treasurer has a great understanding of explaining it from his interaction with currency and interest rate markets, option-pricing models and insurance. Although not necessarily directly transferable, the thinking that the treasurer can impart on many business situations is helpful in evaluating and solving a business issue. This is particularly the case where different types of business are being evaluated against each other. For example, the development of new products versus the routine extension of existing lines, or the movement into new business areas versus organic growth of the core business.

The classical approach to this problem would be to increase the discount factor used in the new product or new business discounted cashflow, but this does not add much value or insight to the business analysis. A more methodical and consultative approach is required to support the thinking of the business in an area where there will usually be no clear-cut solution. In each case, the first step will usually be to identify and understand the risks involved in a project. Consideration of whether, irrespective of potential returns generated, the amount of risk might be acceptable, or can be mitigated or transferred, will need to made at an early stage. An understanding of the scale of existing business and financial risks, what might be acceptable to equity and debt markets, and what headroom there might be remaining is clearly important here and something the treasurer can provide.

Assuming the risks can be managed, a method is required to evaluate whether adequate returns are being obtained for the risk being taken. The method used depends very much on the risk profile.

> 'THE EVALUATION AND DETERMINATION OF THE OPTIMUM STRATEGY REQUIRES THE CORE SKILLS OF A TREASURER'

For risks with a simple normal distribution around a mean, the use of an 'expected' discounted cashflows or a modified cost of capital might well be appropriate. However, for risks with high-value remote events, – for example in the healthcare business where there might be a remote risk of unforeseen serious medical issues giving rise to high-cost litigation – then an actuarial or insurance-based approach might be required. Equally, for risks with only a few outcomes, an option-based approach could be used. In each case the treasurer, by using his/her knowledge of risk and how to manage and evaluate it in the financial markets, can support and lead business colleagues through the thinking required to make a rational decision.

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Investment appraisal at Boots

During the late 1990s Boots used a *Managing For Value* philosophy, a concept of maximising Net Present Value (NPV). Whilst the basis for this would be supported by most companies, and it had appropriately directed investments in some cases, it was understood in a way that led project champions to focus on NPV.

The consequences of this were that many projects with high NPVs, but long paybacks and poor short-term returns were accepted. These included expansion of retail operations overseas and also non-core business activities, which had large potential value but high risk.

There was under-investment in the core retailing business since returns were deemed to be low in comparison with other projects.

In 2002, Boots reassessed its investment criteria, starting from first principles, and developed a new approach that blended cash-based valuation with accounting performance measures. A range of measures were adopted to assess the quality of earnings, cashflow, and the risk. They included internal rate return (IRR), payback, return on capital employed (ROCE), and return on sales (ROS).

These led to a much better understanding of the risk and returns of a project. One immediate consequence of implementing the new system was that it focused capital allocation back to the core retailing business. It also enabled difficult decisions to be made in ceasing some non-core activities, e.g. Pure Beauty stores. However, its importance is more long-term, since it will lead to a steady improvement in decision-making which will enable sustainable growth in the business.