

GUARDIANS OF GROWTH

TREASURY CAN PLAY A CRUCIAL ROLE IN MANAGING COUNTERPARTY RISK DURING GLOBAL EXPANSION, SAY MATTHEW DAVIES AND IRFAN BUTT

In their quest for growth, companies are increasingly expanding into new geographic markets. Necessarily, new operations potentially create new risks. In the post-crisis environment, how companies assess and mitigate those risks should differ from how they might have approached them before 2008. Specifically, treasury must be at the heart of any expansion if the company is to achieve its business potential while effectively managing the associated risks.

In the past, treasury's role in managing risk and facilitating geographical expansion was limited to traditional treasury activities, such as establishing bank accounts, ensuring sufficient funding for local operations, and establishing cash management structures that take into account regulations and currency restrictions.

Today, companies entering new markets face additional challenges, such as local business regulations and the risks associated with working with new and unfamiliar customers or suppliers. Treasury can play a role in mitigating such risks.

For example, when a company begins working with new customers and suppliers, treasury can help to assess their credit risk and the impact it will have on the group's supply chain stability

and efficiency. Necessarily, the sales department will form client relationships while the procurement department will identify new sources of supply. Both of these sectors should engage treasury at an early stage, however, to ensure risks are managed effectively.

In the post-crisis world, it is essential for treasury to be engaged early. In the past, a company would only have been concerned about its own liquidity, but now, access to credit can be difficult for smaller companies. Moreover, in a competitive market, small suppliers may risk overstressing themselves by offering favourable terms to buyers to win business. And unless treasury is involved in

assessing the stability of the counterparties and their access to funding, the corporate is exposing itself to unnecessary supply chain risk.

A holistic view

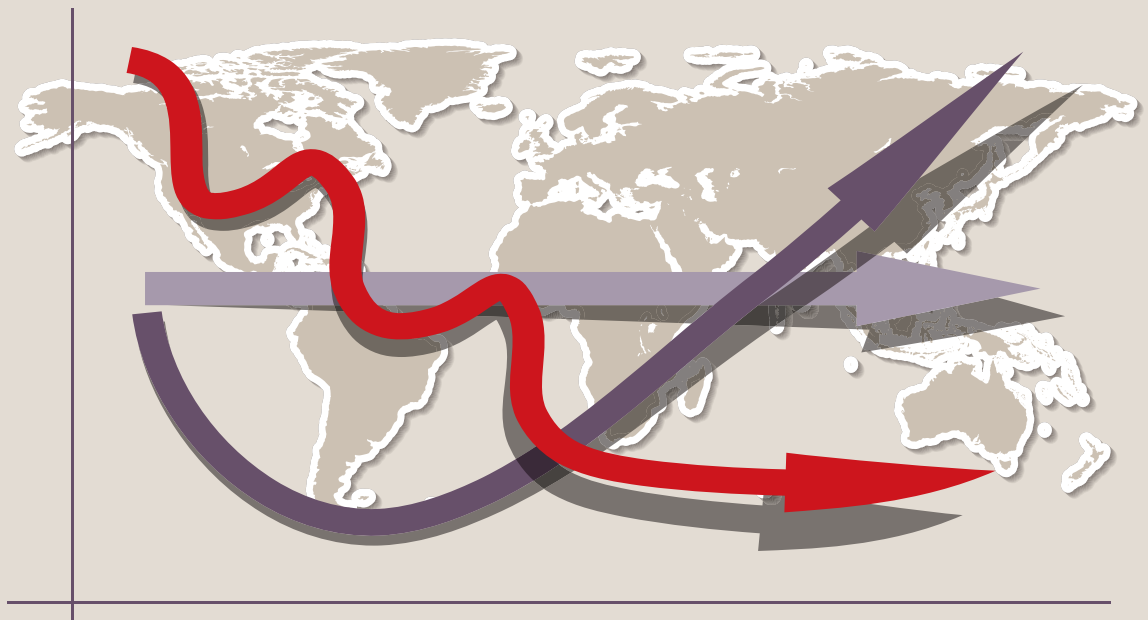
The act of entering new markets is a potential risk mitigation tool because it improves diversification and broadens a corporate's revenue streams. Yet, within a company, treasury alone has the ability to assess and balance the benefits of overseas expansion against various types of risk, including counterparty, country, credit, currency and operational.

Effective risk management requires the treasury team to have a holistic view of

the company's customers, vendors and banking partners. It is necessary not only to understand their credit risk, but also to analyse their interdependences. Every process where counterparties interact with the company or each other must be assessed so that potential risks can be understood and managed.

It is important to consider how counterparty risk should be monitored and which key performance indicators (KPIs) are appropriate. For example, for monitoring banks, companies have historically tracked their credit default swap spreads in order to gauge the market's estimation of banks' credit risk. Treasury should use multiple measures to determine safe levels for distribution of business, however. Similar KPIs and controls need to be set up for customers, suppliers and even technology vendors. The more sophisticated the measures used, the more effectively treasury can communicate the company's risk management strategy to the board.

Given the uncertain market environment, it is important that there is flexibility in



USING INFORMATION WISELY

◆ In order to balance risks across the company, it is necessary to understand them. Therefore, IT and data play a central role in understanding and mitigating counterparty risk. Technological integration with partners – including banks, customers and suppliers – facilitates effective risk management and therefore enables sustainable growth.

◆ For example, if the sales department reaches a credit limit with a customer, it must stop doing business with them. With treasury involved, it may be possible to improve reconciliation to free up limits and resume sales. Treasury does not have to own or manage systems that deliver such information, but it must have oversight of them. Because of its unique role that stretches across the organisation, treasury is well positioned to speed up the flow of information to facilitate better decision making.

◆ Treasury is also in a prime position to make connections between different parts of the company's activities that no other department can make. For example, treasury could overcome the problems caused by

reaching sales limits for a particular customer. Using its relationships with banks, treasury can determine which banks have an appetite for exposure to those customers to implement a receivables discounting structure. This could create a win-win situation for the corporate, its customers and its banks. Such an arrangement is impossible, however, unless the treasury is aware of the problems faced by sales. So, accurate and timely information is critical.

◆ Information also plays an important role in supply chain finance, where the exchange of transaction data between counterparties underpins the entire process. Suppliers, given their small size, often have limited technology that may hamper their ability to sell. Being part of a supply chain finance programme can therefore improve suppliers' ability to conduct their business. When buyers post approved invoice details onto a supply chain finance platform, suppliers can use that information to plan and forecast more accurately. As a result, suppliers may be able to improve their funding arrangements and the supply chain can be strengthened.

how risks are tracked. For example, if the risk of bank counterparties is assessed solely on the basis of credit ratings, a company could be left with no viable banking partners if there is a simultaneous downgrade of multiple banks (as happened during the credit crisis). Treasury must regularly update its governance and improve its flexibility so that it can respond faster – and be able to make business decisions – during uncertain times.

Balance is crucial

By mitigating one risk, however, a corporate may be exposed to another. Only treasury has the ability to balance multiple risks because no other department sees and acts across the company

and can manage risk in a cohesive way.

Previously, the role of treasury focused on financial risks related to liquidity, funding and exposure. Now treasury's role is much broader. Depending on the company, treasury may be engaged with the commercial team to bring stability to the supply chain (possibly using supply chain finance). Moreover, its unique position and visibility may enable treasury to further reduce risk by considering a wide range of mitigating tools available to it.

Treasury must be fully embedded across the organisation so that it is involved in all decisions that change the company's risk profile. Risk management decisions made in isolation

cannot be effective. Only by considering the balance of risks across the business can the company fine-tune its risk/reward profile and ensure that it remains competitive while making informed decisions about which risks it is prepared to accept as the price of being in business.

Driving growth

Treasury is doing more across the company and it has greater influence than ever before. To fulfil its role effectively, it must become more sophisticated in the technology and strategies it employs. It must build relationships across the organisation so that it can help the business make informed decisions that will drive commercial growth. Only treasury can ensure

that growth is pursued in a way that takes account of interactions across multiple counterparties so that risks are fully considered.

Gaining visibility of the complex processes across an organisation – and designing strategies to use that information effectively – can be challenging. Treasury does not have to do everything itself, however. A company's bank can be an important contributor of technology, expertise and data. Banks can offer enriched information, as well as advisory solutions that make it easier to measure and manage risks wherever they occur within the company. By making use of this support, treasury can act as a guardian of business growth.

Ultimately, the treasurer's role is to achieve the right equilibrium within a company. The need for efficiency must be balanced against the corporate objective to grow the organisation. At the same time, multiple risks across the business must be measured, evaluated and balanced to ensure an optimum risk and business profile. As the risk lens is continually shifting, and new challenges constantly appear on the horizon, treasurers have to remain alert and flexible if the company is to achieve its business potential while effectively managing the associated risks. ♡



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