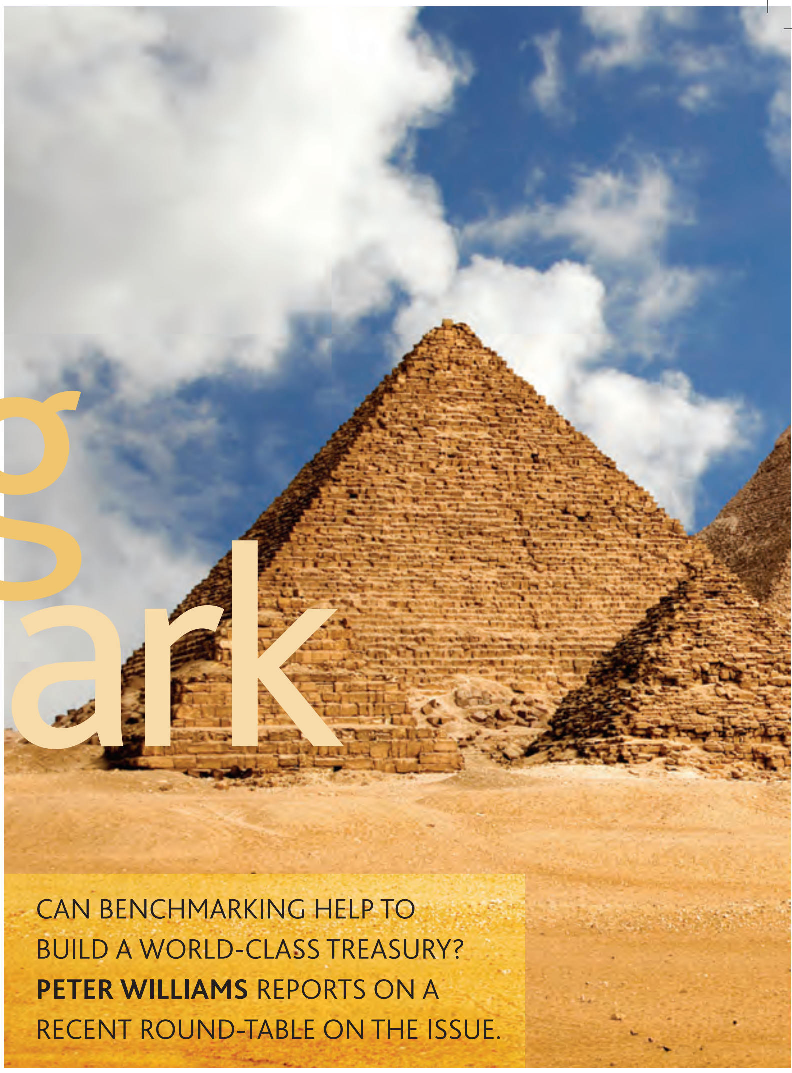
Making a mark



CAN BENCHMARKING HELP TO BUILD A WORLD-CLASS TREASURY? **PETER WILLIAMS** REPORTS ON A RECENT ROUND-TABLE ON THE ISSUE.

Executive summary

- A recent ACT round-table, which took place under the Chatham House Rule (that all information divulged can be freely used but not attributed), gave a fascinating insight into how treasury departments and treasury professionals are working to achieve world-class treasury and the challenges they have to overcome.

Corporate treasurers are set to make a huge impact on the fortunes of their companies over the next 12 months. In the corporate arena, while questions remain over whether the economy will fall into recession, it is more certain that the level of corporate bankruptcies will rise. In this environment the treasurer plays a critical role in the company, overseeing areas such as liquidity management and counterparty risk.

THE PURPOSE OF BENCHMARKING It was against this background that the ACT organised a round-table to discuss the purpose for the treasury profession and individual treasury departments of devising and maintaining systems of key performance indicators (KPIs) and benchmarking.

Experienced treasurers perform benchmarking on an intuitive basis or devise informal ways of dealing with a requirement to benchmark. They will gather information informally through networking with other financial professionals in similar situations and with others closely associated with the profession such as banks, and to a lesser extent consultancy firms.

While this ad hoc process may work reasonably well at the treasurer level it is a less satisfactory approach for chief financial officers (CFOs), finance directors (FDs) and the board. It is hard for boards to see or to be presented with reasonable evidence which indicates whether the company has a good treasury department.

For treasurers who are asked to perform some benchmarking task, it seems that the most obvious approach is to make a comparison with their peers. Treasurers will monitor other companies in the same sector or perhaps with the same credit rating.

The type of benchmarks deployed in these situations include:

- overall interest costs/rates compared; and
- terms of bond issuance in a three-month period before and after own issuance.

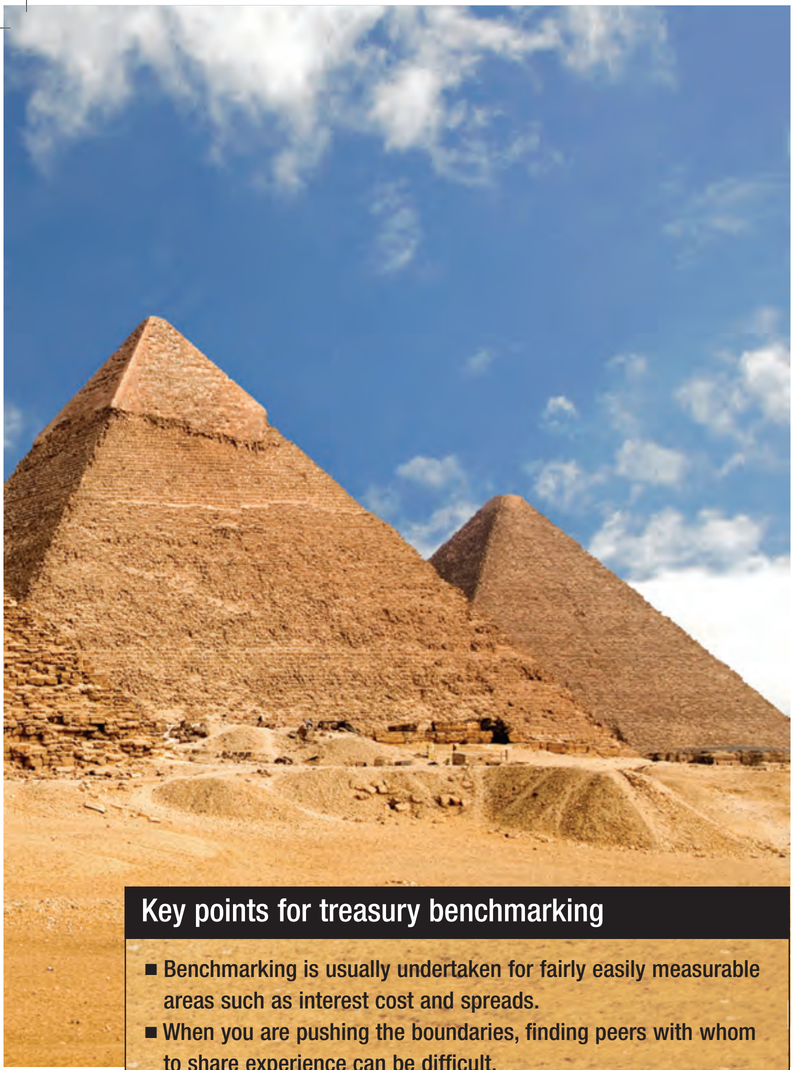
Treasurers will often have and operate treasury policies which could be interpreted as benchmarks or best practice in action. Companies running a policy of a ceiling on the cash held in operating companies are an example of this. And associated with capital market activity, treasury departments forecast interest rates and monitor the accuracy of those forecasts.

SETTING BENCHMARKS For heavily repetitive jobs, collecting external data to act as comparatives, or using internal data comparisons over time or between people and departments, can serve a purpose if the data is sufficiently like for like. Numbers of transactions per person and promptness of confirmations may be appropriate for a treasury, but at best they will add just modest value while at worst they could be misleading or even generate a counterproductive concentration on the wrong elements.

Once you get into less tangible areas such as risk management, the problem becomes one of defining the risk-neutral position to compare against. If the results are interpreted accordingly, some treasurers have found it worth inventing a base-level target and then measuring against this.

COUNTERPARTY RISK With the volatility in the financial markets, the issue of counterparty risk has been pushed up the treasurer's agenda. Do treasurers have a standard approach to measuring counterparty risk? It seems not. While it may be true to say that every corporate has different risk appetites, it is difficult to ascertain in detail how risk approaches vary and what drives them. It may be useful to understand why treasurers and corporates take different risk stances. One approach to measuring counterparty risk would be to record mark to market exposures on a weekly basis.

While treasurers may understand what they are trying to do when putting in such measures, there remains doubt over how easy it may be to educate the board, who are the ultimate decision-makers in



Key points for treasury benchmarking

- Benchmarking is usually undertaken for fairly easily measurable areas such as interest cost and spreads.
- When you are pushing the boundaries, finding peers with whom to share experience can be difficult.
- Every company's risk profile and risk appetite is different, so it can be difficult to benchmark much of the treasury function. Many of the things that are done – or the way in which they are done – may be unique to a specific company.
- Large corporates have lots of access to information and to banks, so understanding what can be done in different areas of treasury is fairly readily available. But for smaller corporates without the same level of access, best practice may be less well understood and more difficult to attain.
- To know what it is possible to achieve, treasury departments need to look outwards. Historically, treasury functions have been perceived as looking inwards and that would have to alter if the function is to learn from best practice elsewhere.
- For some corporates, the board's main focus is control and execution rather than benchmarking in the sense of how the treasury department compares with others.

terms of risk management and appetite. For instance, would it be possible for a benchmarking exercise to help explain why different companies have different attitudes to credit risk exposures? If company A has a £50m limit for AA rated loans and £25m for A rated loans, whereas company B has limits of £50m and £40m respectively, which can be regarded as more soundly based? How quickly, if at all, should limits move to take account of the changing environment, such as the seismic shift in the credit markets?

The round-table discussion also looked at whether counterparty risk comparisons were sector-specific or whether they could be looked at in a wider context. While there may be comfort in knowing other companies in the same industry are taking a similar approach, this has to be balanced against the possibility of the development of a herd mentality, where everyone ends up going in the wrong direction.

Nevertheless, asking whether you are doing anything out of line and, if so, why, can generate extremely useful information for treasurers and others. As always, the sharing of information within an industry has to be balanced against the competitive environment of the free market and the desire to steal a march on the competition.

BENCHMARKS AND POLICY Any development of benchmarks for treasury is bound to be heavily related to and dependent on the development and maintenance of good treasury policy. One of the issues is the applicability of the treasury policy for the company within the present and foreseeable environment. The questions may be straightforward (although the answers may not be):

- What is the policy?
- Why is the policy in place?; and
- How does the policy relate to the underlying risk and risk appetite of the business?

Take cash management as an example. The cash policy of the company has to be placed within the larger context of the overall liquidity management strategy of the business and that in turn is informed by the situation and overall strategy. With credit policy this could be tuned to the maximum AAA loss the company could bear without a major embarrassment and then adjusted back for AA or A based on relative probabilities of default.

One of the areas where treasurers and corporates have focused their efforts in term of good practice is auditable areas such as transactions to ensure that the process flow is mapped and that the documented procedures are followed.

The advantage of this sort of practice or benchmark is that it is binary: for each transaction the procedure is either followed or not, and therefore is right or wrong. But in so many areas of treasury there is not the luxury of right or wrong; rather, it is a judgement.

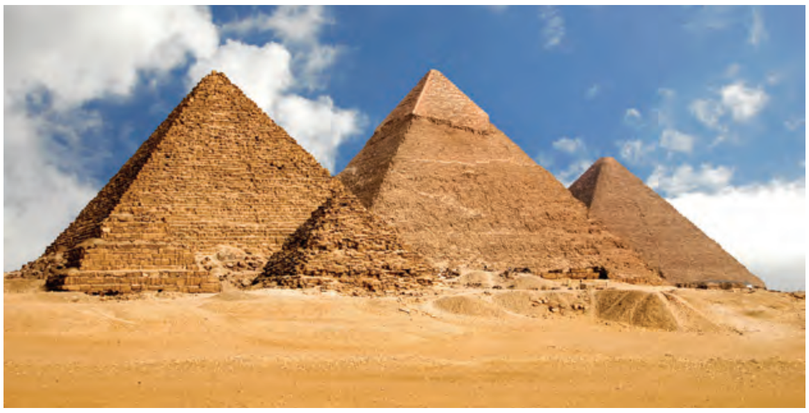
While it is important that every FX transaction, for example, is executed properly, and that can be tested, how does a corporate or a treasury department test whether it is borrowing money in line with the market and its own particular strengths?

PUSHING BOUNDARIES One of the issues that may come out of an inquiry into treasury benchmarking is the question of guidelines and standards. Would it be desirable to have treasury standards and could they be implemented in any meaningful way?

Treasurers may find the idea of treasury standards a difficult concept to apply because business models and individual circumstances vary so greatly. But in many related industries, professions and disciplines (accounting and banking are obvious examples), standards both in the form of self-regulation and external regulation have become accepted.

Professional bodies such as the ACT are pushing the principles of good practice and are already formulating treasury best practice. This is most obvious in the area of education where, for instance, the ACT's Certificate in International Cash Management (CertICM) focuses on global cash management and is establishing the required competencies for cash management.

MOVING FORWARD One of the key benefits of instituting a benchmarking system is that it will help provide assurance and comfort to the board that the treasury department is working on the right lines. If benchmarks could be instituted in key areas such as treasury, trading and pensions as part of the analysis of the control environment that is presented to the audit committee (and hence to the board), it could pre-empt many of the questions that can quite naturally arise.



Benchmarking is traditionally thought of as involving numerical comparisons, which can cause a concentration of effort on some mundane activity. Rather more crucial to leading treasurers is getting the balance right on treasury policy and strategy.

It is not possible to define a single best-practice policy applicable to all companies but the round-table thought there was significant value in understanding the spectrum of policies that different companies have adopted. From this, ideas can be gleaned to improve your own company's practices especially through understanding the rationale for particular policies appropriate to the business and its risk appetite.

In any benchmarking process, or collation of information that could be done by a professional body such as the ACT, there would need to be an awareness of the different types of organisations but also the different size and scale of organisation. The potential for gauging where your policies sit along the possible spectrum is as important to smaller companies as it is to multinationals and any guidance on benchmarking needs to reflect that range. Networking both in a formal and informal way can be facilitated so that there can be learning from all sources. In that context real-life case studies are seen as one of the best learning models where principles can be applied to real-life situations.

At the moment a framework for describing benchmarks appears to be lacking. There are some publications on treasury policies and it may be possible that these can be reviewed. The idea of benchmarking and best-practice world-class metrics could be an idea whose time has come.

Peter Williams is editor of *The Treasurer*.
editor@treasurers.org

The ACT will be using the views and reactions gleaned from the round-table to help it decide whether there is a useful role for the ACT in collating information on good practice from a variety of companies to help members refine or improve their own practices.

The ACT would like to thank the following companies who participated in the round-table: Associated British Foods, AstraZeneca, Deloitte, Diageo, EMC, Experian, National Grid, Nokia, Shell and Vodafone.

If you have any comments or input on benchmarking, please email Martin O'Donovan at modonovan@treasurers.org.