Treasury 3.0

THE TREASURY DEPARTMENT IS TURNING INEXORABLY INTO THE ORGANISATION'S FINANCIAL NERVE CENTRE. **MONIE LINDSEY** EXPLAINS WHAT'S REQUIRED FROM A THIRD-GENERATION TREASURY FRAMEWORK.

The role of corporate treasury is changing. The financial crisis, economic uncertainty, heightened risks, accelerating globalisation, and board and executive management demands for real-time information and crisis assessment have placed huge demands on treasury. As a result, a new operating environment is emerging that requires a new treasury framework.

WHAT HAS CHANGED Treasury is becoming more strategic, broader in scope and more critical within the organisation. The financial crisis may have driven much of the recent change, but many of the changes were already taking place long before the crisis and were simply accelerated by it. Collectively, these changes have served to enlarge the remit of the treasurer and elevate treasury to its emerging position as the organisation's financial nerve centre.

Globalisation has brought greater political risk and greater focus on counterparty and currency exposures within unique jurisdictions such as the euro zone. Companies of all sizes continue to globalise, increasing complexity and risks in managing geographically dispersed cashflows, information flows, financial risks and counterparty risks. Expansion into emerging economies has added to the complexity.

Centralisation of treasury and related operations has consolidated competencies and improved control and visibility, moving beyond treasury and risk to incorporate working capital. Centralisation has paralleled globalisation trends, but has accelerated in recent years as a result of two main factors:

- the economic crisis, which has in turn driven the need to monitor and manage financial and counterparty risks more closely, to optimise access to and management of internal and external liquidity, and to focus more on working capital management (creating a demand for more efficient order-to-cash and purchase-to-pay cycle processes); and
- the availability of enhanced technology, in the form of enterprise-wide accounting systems, web-enabled solutions and improved bank connectivity via SWIFT, banks and third-party providers – all making it easier and more cost-effective for companies to manage both centralised and decentralised global treasury operations.

Regulation is adding to costs. Liquidity and credit exposures will become more expensive. Impending regulatory changes (Basel III) will profoundly impact financial services providers and, therefore, corporates. Banks continue to reel from the massive regulation heading their way and are evaluating changes that will need to be made to all aspects of their strategies and operating models.

It's not a question of if, but how, these changes will impact banks' corporate clients. Geographic solutions may change as banks retrench from unprofitable markets. Lending and deposit solutions may change as each bank's lending and balance sheet management changes to meet capital and solvency requirements. Target market strategies may change as banks evaluate their ability to service a particular market or segment adequately and profitably.

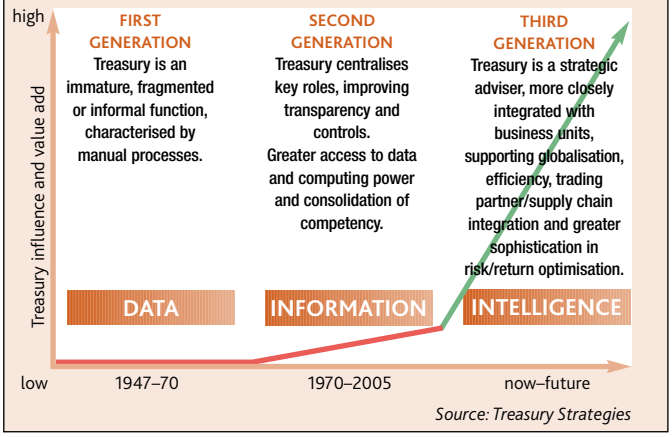
We do not believe that the fundamental nature of banking relationships will change. However, we do believe the detail of

Box 1: What treasurers say they want

- "I want to do business with providers that can get me near-real-time data, with full remittance detail and in formats that can STP into my GL and key systems."
- "I know my future needs will change – I'm getting more ad hoc requests for analyses and data, so I need to build a data architecture that is extensible and flexible. I have to get data out of my ERP in a format that I can use."
- "If I fire an employee for fraud, how quickly can I ensure they've been removed as an authorised signer or user?"
- "Do I have redundant data that is creating data latency issues or inaccuracies?"
- "How do I reconcile my business unit forecast to my legal entity forecast used for hedging?"
- "I'm constantly being asked to do more, but also to spend the same or less. How can I leverage data to create efficiency?"

Source: Treasury Strategies

Figure 1: Treasury 1.0, 2.0 and 3.0



Source: Treasury Strategies

bank/corporate relationships will evolve as banks adjust their strategies to the new regulatory environment. Corporates must evaluate the impact on their banking group and the consequences for the credit and transaction services provided.

Risk and liquidity management dominate the treasurer's agenda as never before and require far greater rigour than in the past. With access to external liquidity no longer a given, corporates are focused on working capital to optimise access to internal liquidity, building up cash levels as a buffer against future financial crises, and adding and changing credit banks to ensure maximum access to external credit. Also, treasurers now have to look at the entire settlement chain (intermediaries, custody, and so on) to understand the conditions under which funds may not be available.

Risk – whether in the form of fraud, financial or credit – has reached a magnitude unimagined even five years ago. Accelerated globalisation, entry into emerging economies and high and volatile commodity prices have raised the stakes of financial risk management. But for most treasurers, it is credit management that causes sleepless nights. Not only has treasury been tasked with greater rigour around monitoring exposure to traditional counterparties, but also the number of counterparties has grown exponentially.

EXPANDED ROLE While the treasurer's role steadily expanded prior to the crisis, the demands of the role have since catapulted the treasurer to centre-stage. Traditional roles remain, executing operational activities, investing short-term liquidity and securing short-term credit. However, these traditional roles now fade to the background. Treasurers have to be excellent at these traditional roles, but must now be more focused on ad hoc demands, monitoring the environment and interacting with business units to understand how business changes will affect liquidity, risk exposures, and so on. The role now involves:

- expanded risk responsibility for counterparty, commodity and currency, requiring more rigour and responsibility around assessment, mitigation and effective strategies;
- greater interface/influence with and in some cases responsibility for more internal stakeholders than ever, including working capital areas (payables and receivables), IT, shared service centres, business units, procurement, accounting, marketing and sales; and
- greater involvement in key internal decisions as stakeholders increasingly turn to treasury when making strategic decisions, such as assessing the impact of external events (financial, economic or political), making trade and supply chain strategy decisions, synchronising decisions involving multiple stakeholders.

WHAT DOES TREASURY NEED TO EXECUTE ITS EXPANDED REMIT EFFECTIVELY? The changes described above barely touch the surface of treasury's expanding responsibilities. What is clear, however, is that the tools, technologies, solutions and processes designed for a narrower, less critical scope of responsibilities are not sufficient to navigate, manage and execute effectively in the new environment. To meet the new challenges, treasury needs:

- real-time visibility of balances, transactions, counterparty positions, currency exposures, and so on;
- real-time or near-real-time access to accurate data;
- transparency of pricing, transactions, counterparties;
- tools and processes to assess the impact of events (financial, political, environmental) quickly;
- the ability to quickly generate ad hoc reports for board, management and other internal stakeholders who need to understand the impact of events and determine the best course of action;
- updated policies, processes, controls, metrics and governance;
- scalable, integrated solutions that will grow and change with the organisation; and
- a technology infrastructure to support the above, including treasury and risk management systems and frameworks that allow flexibility and responsiveness.

With these changes, corporate treasury is becoming the fully integrated financial nerve centre of the company. The treasury of the future will be an analytic and technology hub that provides end-to-end business intelligence to the company's board, business units, creditors, customers, suppliers, shareholders, rating agencies and regulators. It will be the third generation of treasury, Treasury 3.0, as described below and shown in Figure 1.

- **First-generation treasury**. Prior to 1970, companies borrowed almost exclusively from banks and kept ample balances with them.

Operating services were simple and free, exchange rates fixed and liquidity plentiful. Commercial paper was just developing. IT was not widely used in treasury. Portable calculators had just been invented. Banking was about relationships.

- **Second-generation treasury**. The collapse of the Bretton Woods system in 1971 dramatically changed the environment for the CFO and the treasurer. Exchange rates fluctuated. Technology advanced. Liquidity dried up. Balance levels fell. Banks began charging for services. Short-term investment markets blossomed. The treasury function changed radically. Data became information.
- **Third-generation treasury**. Ushered in by the combination of advancing technology and ERP (enterprise resource planning), globalisation, the financial crisis and the emergence of major risks in unexpected places, Treasury 3.0 leads treasury to its new role as the company's financial nerve centre. Information is no longer good enough – what's now required is intelligence.

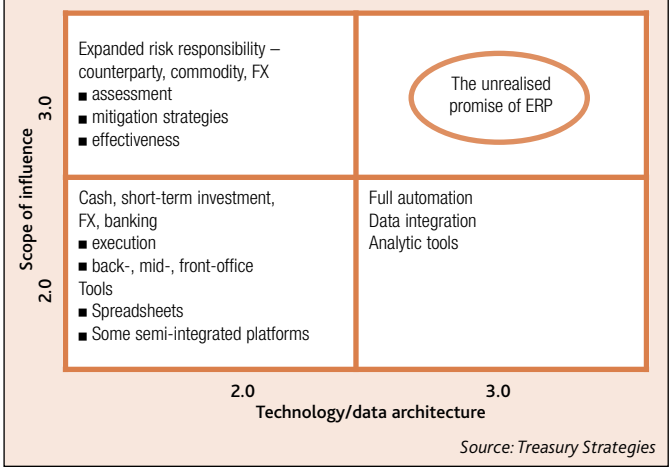
The transformation to 3.0 is not limited to corporations. The providers of financial, operating, information and risk management services are also beginning to undergo massive change or are about to do so. The entire ecosystem is impacted.

USING 3.0 AS A FRAMEWORK TO ACHIEVE YOUR TARGET STATE No company is fully operating in a Treasury 3.0 mode, but many are implementing Treasury 3.0 solutions for their most critical challenges. Assessing where your company stands along the 2.0 to 3.0 continuum for your most critical challenges can help prioritise the steps you need to take to manage and navigate the new environment optimally. Box 2 highlights key differences between a 2.0 and a 3.0 organisation across key functions.

Another way to assess where a treasury stands on the continuum is to plot its position on a graph with the following axes (see Figure 2):

- Y-axis represents the scope of influence within the organisation. Are there steps you need to take to ensure treasury is responsible for or has influence in areas that impact the company's ability to operate in a 3.0 environment? For example, do you have responsibility for optimising access to internal liquidity, but little influence over how receivables and payables are managed?
- X-axis represents technology and data architecture. Does your technology and data architecture support a Treasury 3.0 environment and your ability to execute treasury's responsibilities optimally? For example, is treasury responsible for financial and credit risk management but has limited access to data, systems and tools to monitor and analyse these risks?

Figure 2: The 2.0–3.0 continuum



Source: Treasury Strategies

Box 2: Transition to Treasury 3.0

Area	Treasury 2.0	Treasury 3.0
Risk	■ Siloed, sterile ■ Data limitations ■ Weak transparency	■ Integrated, holistic ■ More, faster data ■ Deeper analytics/tools
Investment	■ Policy-driven ■ People-executed	■ Automated, rules-driven ■ Rigorous view of liquidity ■ Supply chain as investment opportunity
Revenue cycle	■ Reactive to changes in billing, payment types ■ Operational focus ■ Fragmented	■ Strategic and opportunistic ■ Automated, intelligence-driven ■ Centralised scale and control ■ Risk mitigation during customer onboarding
Payments and suppliers	■ Superficial analysis of supplier risk ■ Siloed and static management of payment terms	■ Multi-channel ■ Integration of liquidity decisions with treasury ■ Greater integration with suppliers
Balance sheet, liquidity and funding	■ Liquidity = cash + committed credit ■ Banks as primary liquidity providers	■ Operating cash plummets ■ Broader funding sources: customers, suppliers, government, direct ■ Corporations act like banks

Source: Treasury Strategies

IN A NUTSHELL The financial crisis, globalisation and escalating risks are propelling treasury into the role of financial nerve centre of the organisation. At the same time, technology trends point to a continuous journey in which banks, vendors and corporations are getting closer to their destination. It's a destination in which treasury's broader and more strategic scope of activities is supported by technology and solutions that create faster, better, more integrated access to data, and the tools and techniques to make sense of that data.

The Treasury 3.0 journey is about the data architecture, people (a shift to more outward looking vs. internally focused), process, tools (better analytics) and change management. A Treasury 3.0 environment allows treasury to execute optimally its role not only as risk mitigator but also as creator of value.

Monie Lindsey is managing director at Treasury Strategies.
Monie_Lindsey@TreasuryStrategies.com
www.treasurystrategies.com