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Ask the experts:

Change creates opportunity, so grasp it with both hands

How should treasurers deal with change in a volatile world?

Matthew Hurn, Group Treasurer, Mubadala Development Company, Abu Dhabi

In essence a treasurer should not act any differently dealing with change in a volatile world as he would in a non volatile world. His, or her, role is to support the business in delivering its strategic objectives, whatever they may be, though how the business will deal with change is one for the business leaders.

It is during volatile times however that a treasurer can demonstrate to the business the skill sets and tool kit they have at their disposal to manage volatility effectively. It is worth stating at this point however that volatility should not necessarily be associated with downside risks as there are also upside possibilities available.

Human behaviour would dictate that many people would try to avoid difficulties, shy away from tough decisions and prefer to "stick their head in the sand". As treasurers, it can be said that this is the environment that you have trained for, and waited for, to demonstrate and put into practice what you have learnt and can do. My advice is, and always has been, to ensure that the fundamentals of your treasury are in place that match the business's risk appetite and approved policies etc and that you are doing the basics well.

Another key challenge that many may face is that of communication. The hectic pace of news regarding currencies hitting new highs, or lows, extreme equity market movements and predominantly negative news-flow from the banking sector are testing us all. Those involved in treasury often use jargon when talking to their peers, though this will not be effective when trying to communicate to the business leaders the impact such external events are having on your business and your competitors. We could all learn to improve the effectiveness of our communication to ensure that the right people are aware of the key issues in a manner that they can relate to. My former finance director once told me a story of his training days when his manager at the time used to say to him that the fact he didn't understand what he was saying was not his problem and that to me has held true.

I would encourage all those involved in treasury, and financial risk management, to embrace the change and possibilities whether the outside world is volatile or not. It is a great learning experience for us all, but make sure that the basics are in place to monitor, measure and report the impact such changes will have on your businesses in a clear and concise way.

During these times I'm sure you will have the opportunity to talk more frequently to your finance directors, chief executives and hopefully your chairman and non-executive directors about the impact you are seeing in treasury, but more importantly, what you are doing about it and hopefully demonstrating and satisfying them that the management of the financial risks is in safe hands!

Darrell Porter, Director, UK Corporate Coverage, Deutsche Bank

Volatile markets are ones where mistakes can be punished more harshly. To that end, it may be a prudent time to reaffirm that suitable controls are in place, duties are correctly segregated and that monitoring and accounting systems are effective.

Just as important, though, is the requirement to ensure that the company's actual and perceived liquidity is strong. In the Deutsche Bank session at last year's ACT Conference, quite correctly the risk that was voted the most important to shareholder value was "funding, liquidity and credit"...and this was before the market meltdown!

A volatile world will also present opportunities, however, and it is important that the treasury is sufficiently flexible and nimble to benefit from these.

For example, some companies with revolving credit facilities have recently switched from semi-annual interest periods on their debt to monthly rolls, overlaying same currency one-month Libor/six-month Libor basis swaps to achieve a risk free pick-up of 25bp. Others have considered monetising the fact that their credit default swap levels are at historic (unrealistic?) highs, either through swaps or financing structures. In such volatile times, tier one banks prove their worth both in terms of the strategies that they can provide and their ability to execute in difficult derivative and debt markets.

We have also seen a renewed dependence on relationship banks, as treasurers tap the significant resources that these institutions

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can bring to bear, both in terms of experience and also knowledge of the prevailing market. Such relationships are especially crucial in a credit constrained environment and it is interesting to observe the success or otherwise of the different approaches adopted, by both banks and corporates. Many lenders are feeling the pain more than perhaps they let on, especially when they are asked to provide finance at margins that are below their own funding levels, before any consideration of even capital charges or credit costs.

In summary, volatile markets mean that treasurers need to be comfortable that the basics are covered, most especially liquidity. Treasury departments also need to ensure that they are suitably flexible and nimble and that they have the relationships with the top tier banks to ensure that opportunities are identified and captured efficiently.

Robin Terry, Head of Corporate & Institutional Banking Sales, Europe, Payments & Cash Management, Global Transaction Banking, HSBC Bank

Change creates opportunity. With the right tools, structures and financial partnerships, treasurers can grasp this with both hands and work it to full advantage. In today's economic climate, corporates should be taking a hard look at their treasury and cash management activities to determine how best to maximise the new revenue streams materialising as a result of continuing business globalisation.

In Europe, for example, the Single Euro Payments Area (SEPA) offers corporates an opportunity to improve efficiency within their treasury operations. First, SEPA encourages a greater use of electronic euro payment instruments therefore progressing automation further along the financial supply chain. Second, it enables more streamlined bank account structures and centralised payment and collection processes so that treasurers can achieve easier and more accurate cash forecasting and liquidity management. Additionally, when the new SEPA direct debit scheme is implemented, customers' accounts for direct debit collection will be reachable across all the SEPA countries – and because of this, many corporates will find themselves in a better position to penetrate further into Europe.

Globally, the economic development of emerging markets such as China, India and Vietnam, opens up new opportunities for corporates ready to capitalise on this growth. However, establishing the right mechanisms to tap into these potentially rich seams of revenue can be challenging, especially considering the myriad of tax requirements and regulations surrounding trade in many of these developing countries. These expansion opportunities also mean heightened risk potential. Treasurers are therefore dealing with more and more risk management issues evolving in line with corporate strategies as well as economic conditions.

By working with financial partners that have strong global presence and advanced liquidity management products, treasurers will find they have access to the sophisticated tools necessary to achieve the greatest benefit from cash generated in emerging (as well as developed) markets while maintaining an environment conducive to strict risk management practices.

So, for treasurers to deal with change effectively, they need to be prepared. To be prepared they must look closely at their own operations, their business needs and objectives and then identify the best global banking and business partnerships that will support and help them to achieve their aims.

Jonathan Chesebrough, Senior Director, Financing & Risk Solutions, RBS Global Banking & Markets

It is not uncommon to see that a company's risk management policies are not fully aligned with their strategic objectives. Combined with market turbulence, this can result in lower shareholder value and loss of financial flexibility needed to capitalise on strategic opportunities.

As a company's strategy is built around creation of shareholder value, strategic risk management manages the risks to achieving a company's strategic goals and, therefore, to the creation of shareholder value.

While an oversimplification, strategic risk management focuses on managing financial risks that can threaten the debt capacity needed to achieve strategic objectives, as well as reducing year-on-year volatility in key financial metrics (as companies with lower volatility are considered less risky, and therefore worth more). This can be done, for example, by reducing the FX risk to metrics that are used in assessing debt capacity such as Net Debt/EBITDA, or FFO (or RCF) to Adjusted Net Debt, as well as mitigating volatility in P&L metrics.

In many cases, companies adversely impacted by the recent financial market volatility would have been in better shape with a well designed strategic risk management policy. In addition to increased volatility in results, some companies have been stretched so significantly that they have lost the debt capacity needed to capitalise on potential opportunities such as acquisitions or to fund capex, or have even found themselves in a position of financial distress, which incurs significant costs.

Examples of risk management approaches that are not aligned with a company's strategic objectives include:

- The currency of debt for a highly leveraged company (post derivative overlay) being driven by minimising interest expense or hedging net assets, instead of being aligned in the same currency proportion as operating cashflows. Companies with inadequate US dollar debt or too much euro debt have seen their credit metrics adversely impacted, contributing to a decrease in debt capacity.
- Commodity hedging done over the short term only, rather than acquiring hedging cover for a longer period, which would reduce volatility in results, as well as provide the needed time to offset commodity price increases through reduction in other costs or, to pass on price increases to consumers. A few food producers have recently been impacted in this regard.
- Foreign exchange transactional hedging based only on protecting the current year's budget, rather than using a longer and tapered hedging programme to reduce volatility and provide the time needed to recapture the losses.