Uncertain future

As treasurers, we are in the business of (among other things) managing risks. Management of these risks requires us to identify not only their nature and size but also the current and possible future costs of eliminating or mitigating them – and then to implement strategies to achieve our objectives. Forecasting of cash and currency flows and hedging exposures in accordance with policies are typical activities in all corporate treasuries but, Oceanus wonders, do all corporates really understand the risks they face and are their hedging policies always appropriate?

How many corporates look at risk in a structured way when they formulate their treasury policies? Ideally, these policies would be the outcome of a process that identifies all of the risks – from exotic items like adverse weather conditions and political instability, through fire and fraud, to the more familiar currency and interest rate volatility – assesses the likelihood of a risk event occurring and the impact on the business if it did, and then factors in the availability and costs of risk management tools (eg insurance, passing the risk to customers and suppliers, hedging). Too often, however, hedging policy is based on emotion and not an objective analysis of all the risks faced by the company.

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How does the company identify the risks in the business and is past experience any guide as to what the future will bring? Usually, when we forecast, our starting point is an actual position and our projection consists of reasonable assumptions built upon it. These assumptions, however, can only reflect what we know of the world, and our business, today. The man who forecast in the 1870s that London would be buried under horse manure by 1920 if traffic growth continued at its current rate could not have foreseen the advent of the motor vehicle. The designer of the 'airliner of the future' in a boys' comic of the 1920s gave it ten propellers – how was he to know that the jet engine would be invented? So often, forecasts are rendered invalid by unforeseen events that fundamentally change the rules of the game. In the corporate context, a major acquisition or divestment can rewrite cashflow forecast and currency exposures overnight and render outstanding hedging actions superfluous.

And what of exchange rates and interest rates? Two years ago who would have predicted today's rates for the dollar, sterling and euro? And where will those rates be in two years time? Oceanus would hesitate to guess how the US Presidential election, the introduction of euro notes and coins, Middle East oil price influences, economic fundamentals and random events might affect the markets – except to say that if one bloc strengthens another will weaken.

All this doom and gloom about uncertainty in the future is not an argument for not forecasting. On the basis that what you don't forecast you can't manage, Oceanus believes that any kind of forecast, as long as it is based on reasonable and measurable assumptions is better than no forecast. It can always be adjusted in the light of unfolding events. Yes, it will turn out to be wrong but at least you will know how and why you were wrong. The feeble light of a burning match could prevent you walking off a cliff in the dark, even if it doesn't show you how much of a drop there is. ■

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