Under pressure

Becoming a value-adding entity has become ever more important to treasury departments. As the role of treasury has grown and changed, so the wider business has upped its demands and requirements of the department.

To dig a little deeper into how and where treasury adds value and what impact this has on other departments and shareholders, PricewaterhouseCoopers carried out a survey of 182 respondents in 166 companies across Europe.

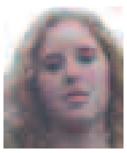
The survey uncovered some interesting facts about adding value and the usefulness of key performance indicators (KPIs). In summary, the survey highlights the pressure that treasury is under to demonstrate the value it provides to the wider business, while at the same time reducing costs and increasing transparency and control standards.

The survey – which asked European treasurers for their views and their perceptions of shareholders' views – looked at the nature of value-added treasury. It addresses how treasury adds value and how performance can best be measured and communicated, both within the business and towards the ultimate beneficiaries of value – the shareholders.

Tom Gunson, Partner of Treasury Solutions, Performance Improving Consulting at PwC, argues that it is part of the treasurer's responsibility to get through to shareholders and demonstrate where the department is adding value.

"I think a key issue is the communication to the market and to the rest of the business," says Gunson. "It's about getting through to shareholders that treasurers are focusing on things that are important to them and to the company."

SURPRISING DIVERGENCE The survey also highlighted a surprising divergence in the perceived views on value-adding activities between treasurers and shareholders. Treasurers see their value as coming in particular from bank relationship management and decision support and business supporting activities. However, they believe shareholders have a different view on the topic and see treasury risk management as the key value-adding activity.



JULIA BERRIS LOOKS AT HOW TREASURERS ACROSS EUROPE ARE COPING WITH INCREASING DEMANDS TO PROVIDE BETTER VALUE FOR MONEY.

Executive summary

- Adding value is no easy task for anyone, but evidence from a recent survey suggests treasurers are increasingly being asked to add value to treasury and prove they have done so. Treasurers may not like key performance indicators but they may have to get used to them as the pressure to communicate mounts.

The survey argues that this difference in opinion or perspective can be attributed to the recent focus of treasury on financial reporting for risk management activities and on internal controls.

Could this also mean that treasurers are getting it wrong and putting emphasis on the wrong area? Is there a lack of communication between shareholders and treasurers?

Gunson says: "Initially, when we looked at the results we wondered why treasurers were saying that these were the most important elements of their role while they believed shareholders saw other areas, such as treasury risk management, as more important.

"It could be misconstrued as treasurers not focusing on risk management. They are, but they are not communicating where they are adding value effectively."

This discrepancy between shareholders and treasurers highlighted in the survey could be a natural part of the progression and evolution of the treasury role, explains Group Treasurer at Tesco, Nick Mourant.

"Treasurers are seen as custodians of risk management in a number of corporates," Mourant says. "Typically, this is financial rather than operational risk.

"What we are seeing is that the treasury function is expanding into different remits – for example, pensions and strategic risk. The value-add comes from the experience of analysing situations given the tools to mitigate risk. This falls squarely into where treasurers' experience and thinking lies."

The need to add value has evolved from an environment in which cost reduction and a drive for efficiency has pervaded all business activities. However, the number of treasury departments which place themselves in the cost centre category, at 43%, is higher for this 2006 survey than previous surveys.

Mourant argues that the discrepancy is due to so many aspects of business being included into the treasurers' remit, resulting in many more parts of treasury having the opportunity to add value to the organisation.

BETTER COMMUNICATION NETWORK Adding value and demonstrating that value is not an easy thing for any department in a company to do. Because many treasury departments have operated in a very isolated and insular way until recent years, demonstrating value-add has not been a real concern.

Gunson explains why treasurers must now employ a better communication network with the rest of the company to aid and encourage value-adding.

He says: "Previously, treasury added value around pricing and executing transactions to hedge risk, so they could very much sit in their ivory tower and still add significant value for the business.

"Those days are gone due to changes in the market. With increased liquidity and competition in the banking world, the value that treasury adds by, for example, having a bank of dealers solely focused on getting the best price is gone. Treasury has been forced out of its ivory tower to find out what is going on in the rest of the business."

Indeed, the survey shows that areas cited as critical for the future of treasury and how it can strive to add value are beyond the boundaries of traditional treasury. Over the next five years, respondents expect to focus on areas ranging from working capital management, capital structure and customer financing to IT integration and commodity risk management.

Mourant says: "What we are seeing is the treasurer's role moving from just cash management and FX to a more strategic role. The business may pull the expertise out – such as for pensions and risk mitigation. Treasurers are increasingly being seen as generalists but with specific expertise that can be used to help manage. It is definitely becoming more integrated with the rest of the company."

INTEGRATION A POSITIVE MOVE Mourant sees integration with the rest of the company as a positive move for treasury. He explains: "I think it adds intellectual rigour to how businesses do their planning and their understanding of the risks they are running. The only way you can do that effectively is by being part of the decision-making process."

The survey shows that most respondents who support treasury as a value-adding mechanism see greater integration as a pivotal part of the process. The areas top of the survey's list for value-add are very much related to making treasury a more integral part of the underlying business and linking it to the broader finance function: in-house banking, straight-through processing (STP), payment factories, shared service centres and global banking.

This top five was followed by more risk-related and financial areas, including increased knowledge and understanding of risk and

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innovative financial solutions.

Connecting and integrating a treasury department into the rest of the company is a difficult task. The way you achieve this integration depends on the culture and nature of the business.

Gunson views integration as logical in today's climate and thinks it is simply another part of the path to modernisation, which treasury has been following for some time now.

He says: "When you look at it in the context of the business and its flows, the potential value-add becomes much more significant because you are dealing with the flows of the whole of the organisation. It gives you much bigger scope and much bigger numbers. This needs to be done because treasury is being accused of not adding value."

So how can you measure whether a treasury department is adding value?

Many respondents (75%) use KPIs to manage treasury activities, but 25% do not use any performance measures at all. Many treasurers argue that performance measures or KPIs are not suitable for treasury. The survey supports this view: the 25% not using KPIs cite difficulty in defining measures, uncertainty as to what benchmarks to use, and a lack of appropriate tools.

Using KPIs effectively can be a difficult task in which it is vital to put the right measurement methods in place. Treasurers who do use KPIs have to dedicate a lot of time and effort to using KPIs which suit their treasury function and the business as a whole.

Mourant says: "We use KPIs at Tesco. I have a particular viewpoint that encourages me to think that if something is measured then it ends up getting managed properly. You can't manage something in a vacuum, so the use of KPIs helps to inform the debate and lead to proper action being taken. I think KPIs are about trying to understand the business and exactly what it is looking for."

Few treasurers have clear performance measures in place to assess the relationship between treasury and the business units. Over a quarter (26%) do not measure their performance in servicing business units, and only 23% use objective financial measures.

TREASURY CULTURE Gunson suggests that the reticence to use KPIs in treasury could be the result of the culture of treasury as an entity isolated from the rest of the company.

He says: "I don't believe it is hard to use performance indicators. The problem is that treasurers aren't used to quantifying the value they add nor proactively communicating it. Because of this they are very reluctant to put measures in around their performance.

"However, if treasurers make sure they don't overcomplicate things, they can come up with ways of analysing how treasury is adding value."

Working with a treasury department with a very effective use of KPIs in a variety of different areas, Mourant fully supports them and explains how they work well for him and his department.

Mourant says: "One thing that Tesco looks for from me is a known maximum interest cost over a five-year time horizon. This KPI then forms part of our long-term planning and feeds into our budgeting. We can then plan for it in our capital structure and P&L, given that it results in a target for me."

The difficulty with KPIs is getting the exact right benchmark and being sure that using these benchmarks will be the best method of measuring how treasury adds value.

Gunson says: "I think we need to be careful with the distinction between a measure and a benchmark. A measure is an element of what you are doing that you want to track. The issue is about the right benchmark because if you get the benchmark wrong you are in danger of looking like you haven't added value.

"Some treasurers have managed to successfully establish measures that have helped and been healthy for the department, so it can be effective."

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