NOTES ON CORPORATE CRASHES

HIGH-PROFILE BUSINESS FAILURES ALWAYS ATTRACT ATTENTION. WHAT INSIGHTS CAN STRATEGIC TREASURERS ADD ON FINANCIAL RISK? GARY SLAWTHER OFFERS SOME THOUGHTS

With corporate crashes such as Carillion, Northern Rock, BHS or Lehman Brothers comes an inevitable outpouring of judgements against the senior management. Accusations of corporate greed, management excess, arrogance or being asleep at the wheel are bandied about with alacrity. Commentators luxuriate in the 'told you so' world of the broadsheets and the 'fat cat' indignation of the tabloids.

However, such failures are rarely, if ever, due to one immediate cause or catastrophic failure. Historians, when explaining events, will often refer to three phases: long-term, cumulative and trigger factors.

Ingrained corporate cultures that later managements struggle to change and weak governance structures that permit poor decision-making are long-term factors. Entry into wrong markets or geographies become cumulative factors and a slowdown in receipts or emergence of a large liability can be the triggers to failure.

The strategic treasurer emerges

So, what in all this is the role of the treasurer? The one thing we know as treasurers is that we can't change things once the risk has happened. When interest rates go up or exchange rates move, if we haven't already anticipated the risk and taken the business actions or put in cover, then it's too late.

Treasurers use the methodologies learnt throughout the syllabus and systematically apply them. It's not rocket science, just logical thinking, understanding the business and its risks, and applying appropriate risk management tools.

Applying these principles to businesses that are under pressure is far from easy. In fact, it requires commercial understanding and robustness of character to see things through. This is where the notion of the strategic treasurer emerges.

The strategic treasurer is the one who is involved in the strategic decision-making process and whose role it is to see financial risk in that strategy and recommend how to manage it. It is not our role to be a naysayer, but to be the person who sets out the financial risks along with an assessment of how they can be managed through contractual, commercial or market hedge means. One caveat here: if the risks simply can't be offset through these means, then it is our place to say 'no'.

There will be those who suggest that this would be usurping the role of the CFO. But that's far from the intention. Providing solid risk management assessments is a way of proving our worth to the CFO, showing how we can provide support on corporate strategy so that the CFO is properly prepared to critique and manage that strategy. With the backing of a strategically and commercially minded treasurer, the CFO can operate even more effectively at board level.

The hard work element

One fatal error that people make is assuming that discussions on strategy mean 'taking a 50,000ft view', 'seeing the bigger picture' or 'not getting bogged down in the detail'. No, those are just excuses for laziness both in thinking and doing. Of course, we need to understand the overall objective and idea, but businesses usually don't fail due to lack of strategy; they fail due to paucity of execution.

The best CEOs and CFOs I have worked with are those who not only have a strategic vision of how everything should be, but also a detailed and analytical understanding of how to deliver on the ground. Whether it's a logistics CEO who's been a transport operator and knows the layouts of depots and the number of empty legs, or the construction CEO who's a civil engineer and has been a project manager and knows what makes a successful contract delivery; these kinds of leaders know and understand their business.

It is the same for the treasurer. We cannot manage risk if we do not know and understand the business and see how and from where financial risk occurs.

Take the example of the industry I currently work in and where the most recent high-profile collapse has occurred – construction.

Construction is not the highest value-add business in the world. Margins are generally low and technical innovation isn't too fast-paced. This is a low-capital-intensity business: all the plant can be hired, specialist requirements such as mechanical, electrical and plumbing subcontracted and so forth. But it is a people business. The labour must know what it's doing (both in terms of technical skills and, critically, health and safety training) and, very importantly, management at all levels must know what it's doing.

So, applying our knowledge as treasurers: industries that are low margin, low on capital intensity and highly reliant on supply-chain businesses are likely to have financial risk concentrated in liquidity.

Construction industry treasurers therefore need a deep understanding of liquidity. That is the issue by which the strategy will succeed or fail.

So, what drives liquidity in construction? The basis is the underlying contracts. Even before a contract is signed, the treasurer must ensure that it does not contain more risk than is acceptable: what is the frequency of application? What is the period from application to certification? Over what period is the advance payment recovered? What is the level of retention and can that be covered by a retention bond rather than a cash deduction?

In a larger group, we can't review every contract, but we need to press for good corporate governance so that we review any contract that doesn't fit usual operating parameters.

For ongoing contracts, we need to ensure that we have cash-flow forecasts that compare actuals and current forecasts to the tender S-curve. Are we on or off target? Further, what are the levels of associated payables and receivables? Do we have work being done for which we're bearing cost, but not being paid? Is cash looking OK at the moment, but only because we're not paying subcontractors?

It is all of the above rather prosaic stuff that we then take and apply when reviewing strategy.

Remember the CEO who's been a project manager? That CEO will structure strategy with the same gimlet eye that the treasurer should apply, the same concerns of: 'Does this market provide margin? What type of work do we want to do and what do we not want to do? Are there potential clients we should pursue? Are there potential clients we should avoid because they are poor payers or because margins are weak?'

Of course, as treasurers, we will also factor in FX and interest rate risk, and consider our funding structure. But the key financial risk in this industry is liquidity, so the focus remains on the key risk.

How to be a strategic treasurer

Well, it all starts with hard work. You have to know your business, understand how it works, its risks, what makes it go wrong and what achieves success.

You then need to know how to have the business understand and meet your requirements – the contract vetting, the cash-flow forecasts, the contract profitabilities, the levels of receivables and payables. Information, information, information. Most importantly, you need to demonstrate to the business that you know and understand the drivers, and can make sense of them in terms that can be understood.

None of this is easy and – at the extreme – you may find yourself fighting against a corporate culture that does not welcome your analysis or a board that does not share your views on governance. This then becomes a different issue where your ethics and personal decisions around 'fight or flight' come into play.

In industries such as construction, being the strategic treasurer is not about fancy derivative structures or intricate funding instruments, it's about the most basic requirement for financial risk management – know your business.

Could a strong, strategic treasurer have saved Carillion or Northern Rock or Lehman or Barings? No, I don't think so – and I do not know of any blame or fault in any way being attached or attributed to treasurers of these organisations.

However, I do believe that for every corporate failure there are many more organisations out there with treasurers fulfilling this role and ensuring that these spectacular corporate collapses are, thankfully, relatively few and far between. We now need to ensure that we have more of them in the profession.

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