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Five steps to a more effective global treasury

Demands on the corporate treasurer are changing, and many are struggling to keep up. Here's where to start.

The rapid shift of economic activity from established markets in Europe and North America to developing ones in Africa, Asia, and Latin America has many CFOs asking treasurers to improve their performance. The pace of growth and regulation has left too many of them lagging behind on even core activities in their home markets: cash management, banking, debt and funding, investments, and risk management for currencies and interest rates. Such shortcomings are only magnified as companies expand into emerging markets,[1] where even world-class treasury departments struggle to navigate varied banking protocols and diverse languages and customs—and often lack an operating model and infrastructure to connect their activities, portfolios, and risks.

The cost can be heavy. Companies pay incremental interest expenses when they overborrow as a result of inaccurate cash flow forecasting and often lose money when they don't hedge exposures for currencies and for interest rates, commodity prices, or both. They pay unnecessary taxes when cash moves needlessly through tax-heavy regions. If inadequate controls or segregated financial responsibilities lead to fraud, companies face both financial losses and reputational damage. Those that miss their financial covenants with banks or fail to meet liquidity requirements can find themselves dealing with credit-rating downgrades, a loss of credit flexibility, or even bankruptcy.

In an effort to help corporate treasurers improve their performance in core activities, we surveyed 120 of them over the past year and conducted in-person interviews with an additional 50. Those sources, as well as our experience working with treasurers, have led us to believe that companies should focus on five moves to improve their global treasury function.

1. Centralize the treasury function globally

Historically, most companies have had a treasury department at their corporate headquarters, but it was "siloed," managed only core activities, and often duplicated those of individual business units. As bank communications technology improved and treasury groups added new responsibilities, it made sense to consolidate functions that had been operating independently in different parts of the world.

Many companies did centralize treasury functions at headquarters, supported by a few part-time treasury and finance professionals in developing markets. But most treasuries retain too many decentralized components, and few are as centralized in developing markets as they are in developed ones. Our survey found, for example, that among global companies operating in over 50 countries, the average number of bank accounts held was more than 850—considerably higher than the 200 or so we've seen at the best performers. One treasurer we interviewed complained that her company didn't even know how many

[1] See, for example, Yuval Atsmon, Ari Kertesz, and Ireena Vittal, "Is your emerging-market strategy local enough?" mckinseyquarterly.com, April 2011.

bank accounts it had overseas. And at one heavy-materials company, analysis of cash balances in 300 accounts held by 25 country locations showed a daily average of over $80 million in uninvested cash over a three-month period.

The ideal model would centralize policy setting, decision making, and execution—though not necessarily personnel. Consolidating the treasury function under the global treasurer can help by giving managers an aggregate view of their cash flow and risk positions—a view they need to optimize debt and investment portfolios and to minimize taxes and financial risk. Moreover, the operating model and infrastructure that connect a company's various activities, portfolios, and risks ensure that even regional treasury groups have the quickness and rigor needed to make the most of activities in volatile markets. They can therefore take advantage of local financial opportunities and avoid unnecessary losses. Such a treasury would have to be flexible and well controlled to receive inputs from regional treasuries.

One caveat: a centralized treasury organization does come with trade-offs; for instance, it might leave a company with less information about local banking and country-specific regulations. Moreover, business units in different regions may have to cede responsibility for activities, such as currency and commodity hedging, that have historically benefitted their local profit-and-loss statements. That can generate resistance from local managers. At one of the world's largest consumer goods companies, for instance, the CFO would like to eliminate duplicate treasury functions among businesses and centralize the treasury in one location. But doing so would require a battle with strong, independent businesses that adamantly defend their own treasury infrastructures and back-office locations.

Such battles are winnable. One global company, for example, upgraded its treasury in Asia to the same level as those in established markets by designing improvements to its operating model to take effect as the treasury function matured over a five-year period. Here the emphasis was on analytical sophistication, internal-client impact, automation, and integration.

The company's treasurer organized a structured workshop, bringing everyone to a single geographical location free of operational distractions, to get buy-in from the global treasury managers and ensure that the treasury's mission and operating model were aligned with the company's mission and strategic plan. The CFO approved investments in new systems for cash management and for the front and back offices. The development of treasury policies and a treasury "dashboard" kick-started the initiative and extended the company's treasury capabilities to its regional businesses. Managers are pleased with the progress of this redesigned treasury, though the CFO reports that it's still struggling with the reporting relationships between the global treasurer and the management of regional business units.

2. Strengthen governance

Wherever there's money moving around, fraud and mismanagement are risks. That's particularly true in a company's treasury department, where funds move in real time, using complicated financial instruments—and where an erroneous transaction can affect accounting, financial reporting, and internal controls. Add regional differences in protocols, governance, and oversight norms, and the problem can be a real headache for CFOs and treasurers alike, especially as their companies expand into some developing markets where governance is often weak or nonexistent.

Strengthening treasury governance requires a thorough review of policies and processes for core activities, followed by testing to ensure that they work well in practice and by comprehensive training. One way to start is to test how processes work under stress. The treasurers we identified as most effective, for example, regularly test the business continuity plans that keep treasury operations running through unforeseeable catastrophic events, such as the recent hurricane on the US East Coast, the 2011 tsunami in Japan, or the 2001 terrorist attacks on the New York World Trade Center.

In our experience, such plans should be—but often aren't—tested regularly in all regions to highlight and correct operational-risk weaknesses. Unannounced tests are critical. The global treasurer at a US-based conglomerate, for example, woke up his direct reports with a 5:00 AM telephone call announcing a simulated disruption to normal activities and setting in motion a series of tests. These tests helped the function develop operational readiness and the ability to access and transact in markets, with no "leakage." Ideally, treasury operations would appear undisrupted to senior management.

3. Enhance treasury-management systems

The rapid pace of software development over the past 20 years has brought to market a range of sophisticated tools that facilitate the treasury function. The conundrum has been that the earliest tools—spreadsheet programs—have dramatically improved. Some CFOs are not convinced that advanced systems are worth the cost, which can run as high as $1 million or more for integrated treasury-management systems and enterprise-resource-planning (ERP) modules. In our survey, we found that nearly half of the companies with less than $10 billion in revenue still used spreadsheets as their primary treasury system.

Yet cost–benefit analyses are unreliable in this case because it's difficult to measure the value of risk avoidance, a unified database, automation, integration, and enhanced management reporting. Quantifying the value of stronger governance, internal controls, and better analytical tools is a challenge, too. And spreadsheet programs, powerful though they may be, are woefully inadequate for a centralized global treasury. They're seldom well controlled, and few companies audit them closely enough to validate the logic of interconnecting calculations or even the formulas in individual cells. A single error in a single cell can ripple through an entire model, leading managers to borrow instead of invest, to hedge incorrectly, and to forget to fund operating accounts or to make debt payments.

And often there's no integration: we continue to encounter treasurers whose management system includes as many as 50 or 100 distinct spreadsheets, often reflecting different systems used by businesses in different geographies. That approach can lead to unnecessary hedge transactions when managers unintentionally hedge exposures in different regions against each other, instead of aggregating the longs and shorts of currency exposures and then hedging the net position.[2]

Even minor errors can cost a company many times the expense of a more sophisticated treasury-management system. At one North American utility company, for example, a simple spreadsheet error for energy auction bids led managers to enter into nonreversible contracts the company didn't need—a mistake that cost it half of its operating earnings for the quarter. At an agrochemicals company, a simple data entry error led the US treasurer to wire $80 million inadvertently to the wrong payee in the wrong country. By the time managers discovered the error, currency rates had shifted, and returning the cash came at a substantial cost.

4. Increase the accuracy of cash flow forecasting

Treasurers often admit that their global cash flow forecasts are poor or incomplete. The CFO of one international airline, for example, noted that when his company recently ordered new airplanes, it had no cash flow forecast—and no idea if it could pay when the time came. If it couldn't, the airplane manufacturer would stop delivering planes, hobbling the airline's growth. That's an egregious example, to be sure. Yet in our survey, nearly one-half of the treasurers reported that their cash forecasting was less than 80 percent accurate.

Improving the accuracy of forecasts isn't rocket science; it just requires a robust set of activities that companies don't or can't undertake. A company's treasury function should aggressively analyze cash flow forecasts and different cash scenarios, consult with the company's businesses in all global regions on how they might best utilize cash economically, run currency "what if" scenarios, and provide a multinational company with better intelligence for the use of cash.

An effective program also acts as an early-warning system to anticipate potential liquidity gaps, which are a primary source of financial risk, particularly in emerging markets. Liquidity forecasts, measuring liquid assets and credit sources to predict whether a company will be able to pay its debts and obligations, can help it manage cash by

[2]See Bryan Fisher and Ankush Kumar, "The right way to hedge," mckinseyquarterly.com, July 2010.

testing stress scenarios for differing market conditions. The daily, weekly, and monthly monitoring of cash in all business regions helps treasurers keep track of progress; for example, it ensures that they have the information needed to decide which cash pools and funding options they should pursue to avoid a cash shortfall and lets them measure the impact of efforts to improve cash flow performance.

Here again, an advanced treasury system is a powerful tool. But as with all technological solutions, it can't fix variances in global cash flow forecasts or automate the process completely. Cash flow forecasting is a structured and iterative process that requires treasurers to seek input from the field and various business locations.

5. Manage working capital in developing markets

The concept of working capital seems like a simple one: current assets minus current liabilities equals the capital that a company uses in its day-to-day operations.

Yet managing working capital globally is a challenge, especially in developing markets, where the task can be complicated by differences in business culture. Payment terms, for example, may vary markedly—from the 30 days common in many developed markets to as much as 360 days in some South American and African countries. A lack of automated systems to process accounts payable and receivable introduces further complexity.

Moreover, many companies in both developed and developing markets focus too closely on accounting-type measures, such as the cash flow statement or the profit-and-loss statement, without developing discipline in cash and working-capital management. That emphasis misses the real workings of a company and deflects attention from the fundamental principles of optimizing cash. The CFO of a business unit in a global industrial company, for instance, recognized the progress of his treasury's efforts to reduce working capital in accounts payable and receivable. But he also stressed that efforts to improve inventory still needed to encompass the entire cash conversion cycle.

Many executives are surprised to find that their companies hold excessive levels of working capital in regions where they aren't established. Managing working capital is complicated because it requires spending a lot of time with business units in their various regions to understand how they pay their suppliers and figure out customer behavior. It's not an easy task. Yet many treasurers find it a useful way to raise their profile and distinguish themselves as strategic financial advisers to the organization. Indeed, two-thirds of the treasurers in our survey reported seeing working-capital management as an opportunity and would like more involvement in it.

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As companies assign new responsibilities to the corporate treasury function, treasurers must improve it with a global focus and streamline its performance. That may require an up-front investment, but the payback is worth it.

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