Banking and Capital Markets

Understanding the Corporate Treasurer:

Banks need to put themselves in their customers' shoes

Transaction Banking Compass

PricewaterhouseCoopers

Corporate treasurers face a broader range of challenges arising from the credit crunch as well as the ever-greater complexity of increasingly international business. Expressing a desire to create more value for their internal customers, they could often receive better support from their banks. Banks that fully understand a treasurer's needs, and that have effectively responded to those needs by aligning their own goals with their clients' key performance metrics, will provide more effective service and better value. They will also improve the quality of their client relationships and, in turn, create value for themselves.

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Successful banks therefore need to have a clear awareness of the thinking and priorities of their corporate treasurer customers. Today, corporate treasurers view many activities – beyond the boundaries of traditional treasury – as being of critical importance, including:

- working capital management;
- capital structuring;
- customer financing;
- IT integration; and
- improved risk management.

They are also looking to add value and manage risk by integrating their treasury activities more closely with finance function and the wider underlying business.

So what do treasurers consider the most promising areas to add value to their business? The main opportunities, which are very much related to the push for closer integration, are seen as being in-house banking, straight-through processing, payment factories, shared service centres and global banking. Further down the line come areas such as increased knowledge and understanding of risk and innovative financial solutions.

The challenge for banks is to differentiate themselves in a fragmented and heavily supplied market. This is particularly important as the competition from international banks is enabled by new legislation and therefore increases in each local market. Performance measures within banks are limited, and where they do exist, they tend to be poorly aligned with customer needs and their value drivers.

Corporate treasurers' key challenges

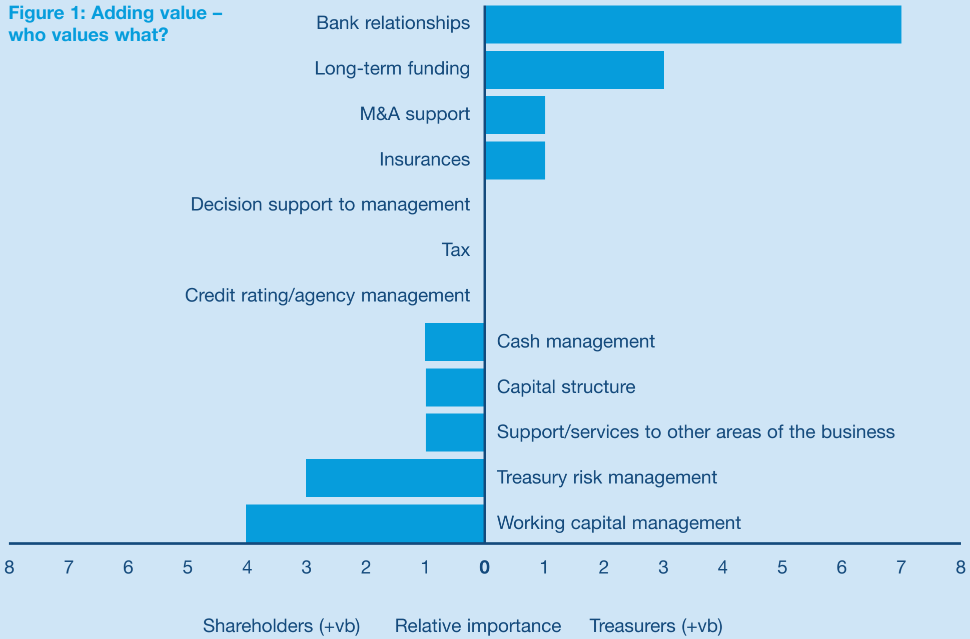
The global credit crunch is the single hottest topic of conversation among treasurers, and they also view it as their greatest challenge in the short and long term. This challenge is not simply defined by difficulty in borrowing and cash management, but by a permanent change in the way financial risk is identified and managed.

Illustrating this change, there has been a major shift in the management of counter-party risk, with a need to offer stronger assurances over security and exposure before obtaining credit. In a similar way, managing foreign-exchange exposure has become more challenging, due to the volatility not just of exotic currencies, but also of the previously more stable US dollar and euro.

The increasingly international nature of business is introducing a range of new regulatory and tax issues. Even in a challenging economic environment, this trend is likely to accelerate. In a recent study of the US market by HSBC,[1] 67% of respondents said they have seen revenue from international operations increase at a greater rate than domestic sales, and 49% plan to increase international revenue objectives should the US economy continue to slow.

In light of the increasing complexity of business models and the credit crunch, efforts are being made to arrange financing well in advance of actual need, even though additional costs are incurred. The pricing and terms of funding are important, but secondary considerations when compared with access. Treasurers are also seeking insurance through increasing their funding options, including new banking relationships or bank lines.

Figure 1: Adding value – who values what?



Source: PricewaterhouseCoopers

This has not been a good experience for treasurers. PricewaterhouseCoopers’[2] Spring 2009 Treasury Market Update found that although the credit crunch is now an accepted fact of life, many treasurers are surprised by the extent to which the market has fallen and by how dramatically and rapidly the position of banks has changed. The collapse of major financial institutions has also increased the sense of insecurity – even fear – as to what might happen next. Treasurers are also disappointed – even hurt – by the apparent evolution of relationship banking. Cash and funding are key treasury priorities, but the banks are appearing less helpful – taking more time to make decisions, applying increased scrutiny, putting additional pressure on margins and attempting to accelerate repricing. Some treasurers feel they are being bullied, others ignored.

Treasury functions are surprised by how slow and difficult even routine actions have become. Given the banks’ capital constraints, funding decisions are being made in the cold hard light of return on investment – relationship managers within the banks are having to risk their own reputations by backing clients, and are therefore demanding more reassurance and negotiating tougher terms.

There is also some suspicion of an emerging credit nationalism, with some treasurers believing banks are more likely to support businesses in their own territories. Such suspicions reinforce the sense of a reduction in the support being offered by the banking sector to its corporate clients. Tougher banking attitudes and responses – real or perceived – have caught treasury functions off-guard after years of relatively easy fundraising. The necessity of change to banking relationships built during those high liquidity days has revealed that some were less robust than was thought. This is leaving some treasurers feeling less empowered to influence their situation.

Pressures brought about by the credit crunch and the increasing complexity of business may actually help treasurers to address the historical challenge of role definition. Beyond the relationship gap the treasurer has with the wider business – 75% want to be a partner of the business, but only 16% have this type of relationship[3] – there is a clear divergence between activities that the treasurer feels add value and the focus that shareholders feel the treasurer should have (see Figure 1).

Measuring bank performance

It should not be surprising that treasurers view bank relationships as their most value-adding activity. They point out that time spent presenting and negotiating with banks helps to achieve better service and, most importantly, lower pricing. As a result, most treasurers who measure the performance of bank relationship management use bank fees as the performance indicator. The significant minority of 25% of treasurers who do not use this yardstick, struggle to measure the performance of bank relationship management.[4]

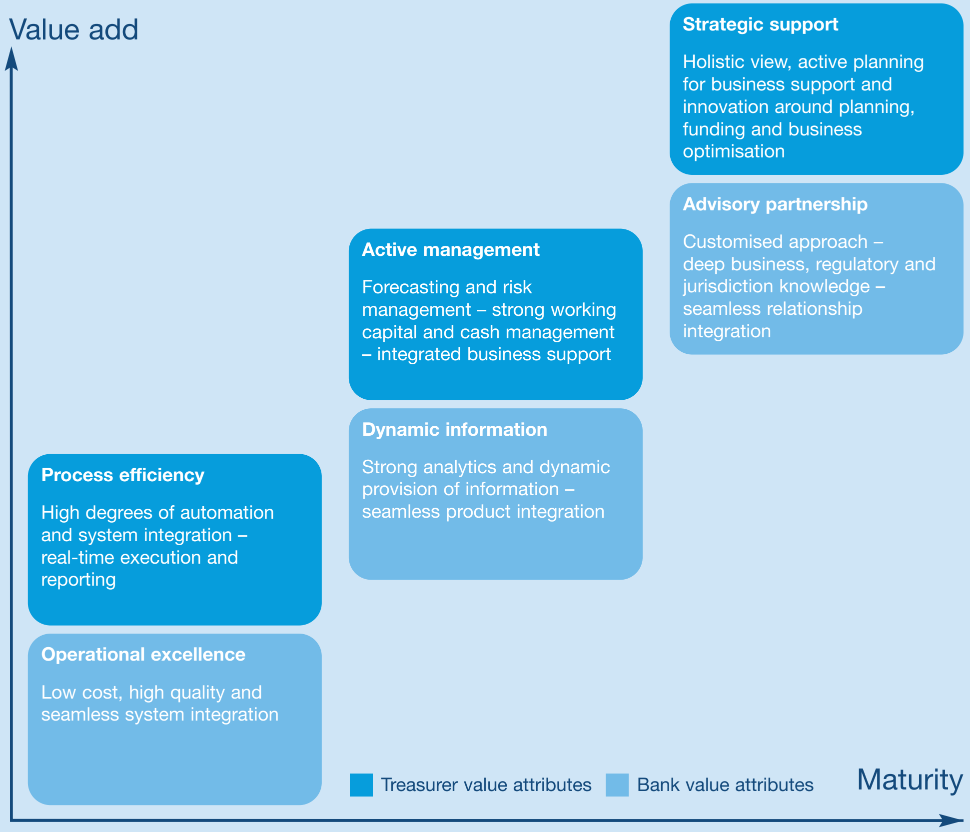
1 Financial and International Needs Survey, HSBC – 07.08.

2 PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

3 The Annual EuroFinance Global Treasury Survey 2007.

4 European Treasury Survey – Measuring Value from Treasury, PricewaterhouseCoopers – 06.

Figure 2: Components of a full treasury service



Source: PricewaterhouseCoopers

Despite the widespread use of enterprise resource planning and electronic banking platforms designed to capture detailed information in a structured manner, many treasurers struggle to demonstrate how they add value. This is particularly noticeable in areas of increasing focus, such as treasury risk management and working capital management. Pressure from the economic environment and increasing attention from the board and executive management are likely to lead to demands for a full range of treasury performance metrics.

Clearly, banks need to understand not only how they can help the treasurer add value to the business, but also how they can contribute to the measurement and communication of that value. Until banks can achieve this, long-term differentiation in the provision of treasury services will remain elusive.

Adding value

Banks need to understand treasurers' basic areas of focus and the ways in which they add value for their customer – the underlying business. Value-adding areas can be broken down into three key components: process efficiency, active management and strategic support[5] (see Figure 2).

Process efficiency continues to be a key priority for treasurers seeking to add value, many of whom do not feel they are obtaining the full anticipated benefit of their investments in technology. Frequently facing a portfolio of systems with multiple manual interfaces, treasurers still very often rely on spreadsheets for their final analyses and 64% remain unsatisfied with their cash-flow forecasting.[6]

Centralising operations is a high priority, along with automating treasury processes. In terms of performance measurement, working capital, cash management and payments-related activities are top of the list. Straight-through processing remains the area of greatest focus for future investment.[7]

After achieving process efficiency, the next step on the value chain for treasurers is to actively manage treasury risk. The impact of hedging activities on the profit and loss statement, average rates achieved, hedging results versus peers and achieved hedging levels versus established benchmarks can all be quantified, allowing the treasurer to demonstrate added value. Other less popular metrics include real-time mark-to-market valuation of financial instruments, cost/benefit analysis and the efficiency of hedging in reducing earnings volatility. Balance-sheet and cash-flow volatility, along with other criteria like risk-adjusted return analysis, are less important performance measurement metrics.

At the top of treasurers' value add spectrum comes the provision of strategic support. Identifying and measuring added value is much more challenging in this area, but treasurers are increasingly involved with funding integration and standardisation, geographical expansion and capital structuring. In general, treasurers want to be more proactive in their relationships with the organisation's businesses and gain a better understanding of their needs. In light of the observations above about real or perceived changes to banks' attitudes to their corporate relationships the need to truly align to the corporate treasurers strategic needs is increasingly important.

5 Based on findings and trends identified in: European Treasury Survey – Measuring Value from Treasury, PricewaterhouseCoopers, 2006, 'The World has changed – The Treasurers agenda', PricewaterhouseCoopers, April 2008 and recent PricewaterhouseCoopers client work.

6 The Annual EuroFinance Global Treasury Survey 2007.

7 European Treasury Survey 2006, Measuring Value from Treasury, PricewaterhouseCoopers – 2006.

As treasurers seek to increase the ways in which they add value, they face a number of hurdles (see Figure 3). Their frequent dislocation from the business, combined with a lack of understanding on the part of the board and senior management, impacts investment levels. The need to implement new technology and meet the requirements of regulators, management and auditors, places pressure on resources, particularly people. Skill shortages in areas such as project management and communications skills are another regularly identified issue.

Banks are well placed to help treasurers address these skill gaps, and to help corporate customers better understand what treasury can achieve beyond its traditional remit. There is an opportunity to educate treasurers in generating and measuring value, and in presenting this to management and the wider business.

A high standard of management reporting and key performance indicators (KPIs) is important for resolving communication, expectation and performance gaps. Management reporting should be aligned with underlying drivers of value, but many treasurers are using KPIs that – while easy to measure – are not necessarily the most appropriate for the business. There is an opportunity for banks to help treasurers to develop systems that can quantify the impact of their activities and demonstrate the value added to internal stakeholders.

Improving alignment

Banks appear to be confident that they are serving corporate treasurers in a client-centric way. Even so, the evidence suggests that there is an opportunity to service customers better and improve banks' alignment with their needs. At present, there is not always close alignment between the balanced scorecard a corporate treasurer might use and that of the head of treasury or cash management in a bank. Banks need to ensure that these scorecards are aligned (see Figure 4) and that they understand the issues preoccupying treasurers. Only then can the banks behave as the strategic partner they aspire to be, and take the right steps to help customers to succeed. Aligning itself to a treasurer's scorecard also allows a bank's own performance to be more easily measured against key customer value drivers, and consequently to strengthen the customer relationship.

For banks, aligning their product and service performance against a corporate treasurer's scorecard would increase their focus on financial criteria such as:

- the average foreign exchange (FX) rate versus the customer's budget or market;
- the trading profit and loss account (P&L);
- the cost of debt;
- the weighted average cost of capital;
- hedging costs;
- the return on monetary assets;
- idle cash at operating companies as a percentage of sales;
- movements in foreign currency net assets and earning; and
- hedge cover periods.

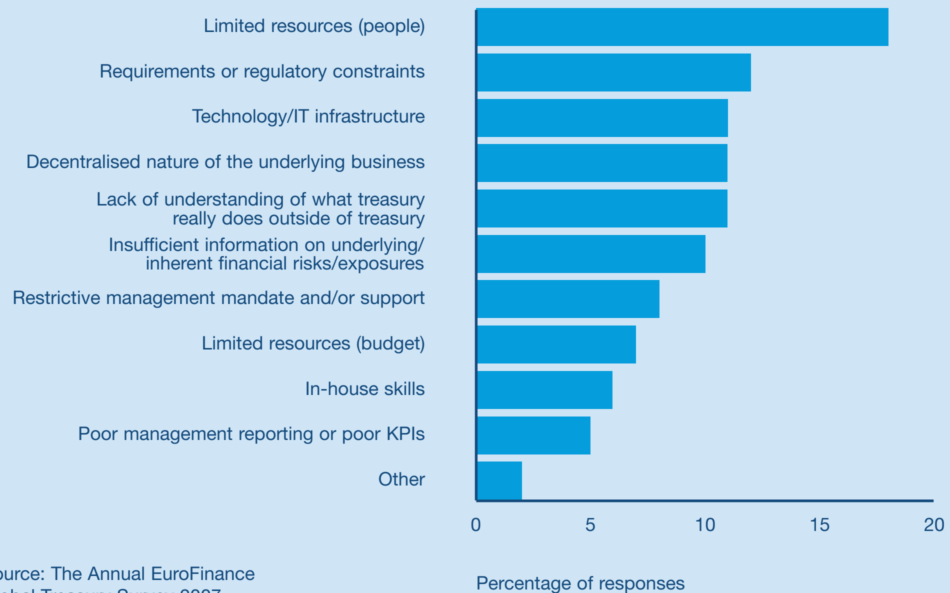
Banks should ask themselves to what extent they are helping their corporate treasurer customers to generate, measure and demonstrate added value against these criteria.

Once a bank better understands its clients' needs, it might decide to set its own scorecard objectives differently. This would allow a bank to segment its clients in a more balanced way, optimising the value of its customer relationships. Banks typically segment their corporate customers by geography, turnover and industry, even though this approach is credit-based. It neither differentiates a bank in terms of the way it looks at its customer, nor does it allow optimal alignment of treasury and transaction banking products.

A more effective method of segmentation would be to focus on a corporate client's capabilities and needs, using a three-dimensional model that assesses:

- the degree of financial sophistication (i.e. the ability to use advanced financial techniques like off-balance-sheet funding, or advanced cash forecasting);
- the operational sophistication of the corporate (e.g. nature of business, structure of treasury, deployment of technology); and

Figure 3: Barriers to driving treasury efficiency



Source: The Annual EuroFinance Global Treasury Survey 2007

- the corporate's credit dependency (how reliant the customer is on the bank's balance sheet for its working capital and funding needs). This approach can not only help banks to align themselves with customer needs, but can also help banks to better structure and manage the different elements of their own service model.

In conclusion, corporate treasurers face some significant challenges, but there is substantial opportunity for banks to help. Just as treasurers are striving to deliver greater value to their own internal customers, banks need to align themselves more closely with corporate treasurer clients to deliver lasting value. As treasurers struggle to adapt to far-reaching changes in their operating environment, banks too, need to change their approach. Those banks able to develop close partnerships with treasury customers based on mutual understanding could create considerable long-term value for both parties.

Figure 4: Understanding and aligning bank services to the corporate treasurer scorecard

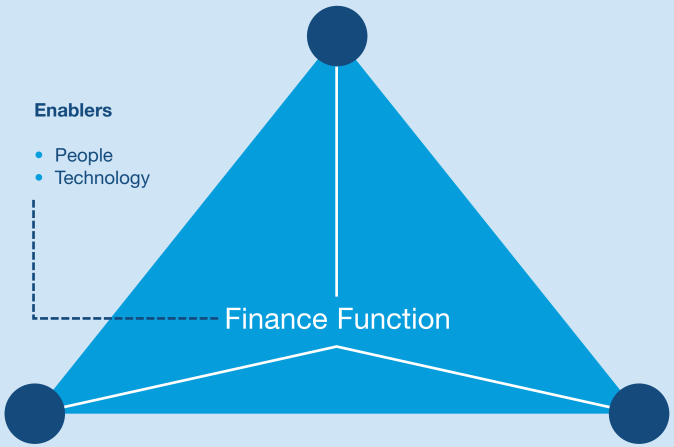
Performance dimensions

Value

- Management information
- Stakeholder management
- Tax and treasury strategy

Enablers

- People
- Technology



Efficiency

- Value for money
- Standardisation
- Automation

Control

- Transparency
- Risk management
- Governance

Treasury scorecard

Financials

- Sensitivity of P&L/balance sheet to rate movements
- Average FX rate vs budget/market
- Trading P&L (if permitted)
- Cost of debt
- Risk management impact on weighted average cost of capital/hedging costs
- ROMA (return on monetary assets)
- Idle cash at operating companies (OpCos) as % of sales
- Hedge cover period

Customers

- OpCo satisfaction (service level agreement rating survey)
- Number of visits to OpCos
- % of time spent on advisory services to OpCos
- Range of quality finance products on offer
- Average FX rate achieved vs budget
- Optimised dividend planning

Process

- Number of bank relationships
- Bank charges per transaction/flow
- Unit transaction processing cost (total)
- Cost of treasury systems
- Internal vs external transactions (netting)
- Number of settlement errors
- % of cash under Group Treasury control
- Compliance with policy/limits

People

- Attrition rate/retention rate
- 360-degree appraisal results
- Employee survey results (Treasury only)
- Training/development hours per full time employee
- Employee costs/unit measure
- % target skill set

Source: PricewaterhouseCoopers

Illustrative

Contacts

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