Best Practices in International Treasury Management

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Abstract: In this article, Alfonsi dimensions 11 best practices for global treasury management and global treasury centers. In a companion presentation, Alfonsi has benchmark statistics and data points/elements to back up the assertions of these 11 best practices. The article is written for a broad audience, and is applicable to both international corporations, as well as financial institutions. The reader should assess if they possess these characteristics or best practices, and if not, how to implement same.

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"Think Global, Act Local" is a trite axiom. Despite its brevity, it says a lot about the fundamental international operating philosophy of companies that have achieved "best-in-class" status - companies that have made it to the coveted position of first quartile in best-practices databases.

In these days of heightened global competition, all companies are looking for ways to enhance their international treasury processes and achieve best-in-class status.

The Path to Best Practices
Companies that have the lowest degree of risk, the highest quality of output or the lowest ratio of finance-cost-to-revenue-received share 11 common best practices in international treasury and finance.

1. The finance structure is centralized.
Although a central finance structure is indicative of a shared service center approach to finance, it is the way that these shared service activities are performed that results in a best practice.
If the central staff is spending the majority of its time chasing down wire transfers, posting transactions or conducting non-value-added activities, the company is most likely something other than best-in-class.
Best-in-class organizations, with a centralized structure, provide high value-added activities to the business, particularly activities that provide decision support and improved business performance (e.g., forecasting, financial trend analysis, risk and exposure management, and efficiency improvement projects).
Most best-in-class organizations are responsible for the development and administration of policies, guidelines, and controls for the design of information flows and the business reporting process. An excellent example is Hard Rock Café, which is owned by the Rank Group in London.

Hard Rock Café's North American operation, headquartered in Orlando, FL, handles the day-to-day treasury and finance functions for the corporation, and for the 40 corporate-owned cafes and retail stores in the U.S., Canada and the Caribbean. In London, Group Treasury takes responsibility for policy and the macro, or overall design of the corporate treasury and finance architecture. It then relies on the Hard Rock subsidiary to "play the music they have written" - that is, achieve the benefits of the macro design.

> "We have free rein to make things happen operationally," said Chris Knipfing, CCM, Hard Rock's U.S. treasury manager.
>
> "We get all of the money in the system moved and the transactions posted and reconciled. We have complete control over the entire field system. For cash flows that benefit the group, although managed by us, they are subject to the central needs of the parent."

2. Roles and responsibilities are clearly defined, with management reporting focused on consistent format and key performance indicators.

The key here is that management reporting production is an outcome of both thinking through the information needed to make a good decision, and defining the roles and responsibilities of who produces and uses the information. In other words, every team member knows the rules of the game, "plays" his or her position, and is expected to always play like an "all-star."

Dave Montgomery, CCM, treasury manager of The West Companies in Lionville, PA, noted:

> "expectations are clear from the first day you join the company - the local, in-country treasury centers' information must be accurate and on time.
>
> "We have fundamentally the same reporting format no matter the country where we operate," Montgomery explained.

It is this consistent format that enables The West Companies to make effective and timely decisions about repatriating cash, netting/pooling or foreign exchange (FX) purchases. Decisions are made centrally, by Montgomery's manager, because that is the defined role of the function. As treasury manager, Montgomery's responsibility is to make sure the information is accurate, consistent and timely. This is more critical than it first appears. In the four weeks before this article was written, the dollar's value against the yen dropped almost 10 percent. The right information, at the right time, effectively reported, enabled the hedging of the fluctuation's impact. Performance like that gets attention.

3. The finance and treasury cost base (e.g., finance as a percent of revenue) is low.

In the U.S., one of the fundamental tasks of treasury managers is to perform calculations such as the all-in cost of a lockbox item or the all-in cost of credit. The lockbox calculations, however, usually do not consider the full component of finance's time and occupancy costs, as well as all of the comprehensive finance activities involved in actually issuing and collecting the remittance.

Similarly, the all-in cost of credit calculation does not involve the finance staff's service of procuring, analyzing and maintaining the credit facility - it focuses on the raw costs of credit. It's in these types of situations that benchmarking really pays off.

In international trade finance activities (e.g., letters of credit, currency purchases, currency hedges and credit dispositioning), best-in-class companies have reduced their all-in costs primarily by knowing each of their component costs, streamlining operations, negotiating prices, and bundling services for leverage, using a limited number of providers.

4. Reasonable risk factors are identified and mitigated.

Risk management is perhaps the hottest topic today in treasury and finance circles. The usual risk concerns in international treasury (i.e., transaction and translation exposure management) are well managed by best-in-class companies - but not over-managed. Forwards/futures contracts are consolidated and usually placed with one primary and one secondary counterparty.

There is a decided effort among the Fortune 1000 to have, at a minimum, the architectural components of regional treasury centers (RTCs), and to include the risk management function within the RTC. RTCs, which actually perform the netting, pooling, re-invoicing and currency risk management functions, add a layer of cost. However, they do provide an effective interim analysis stop on the way to centralized management decisions.

To determine whether an RTC makes sense, a laser-beam cost/benefit analysis (CBA) is needed - conducted in the absence of other, albeit important, activities (e.g. tax treatment, credit management, vendor relations, etc). An RTC only should be established if the CBA case is overwhelming. Otherwise, central finance and treasury management should conduct the sensitivity analysis and be the keeper of the risk management profile.

5. The time cycle prefers analysis to initiating, and tracking transactions.

This performance characteristic will be tough to maintain as businesses begin operating in "e-speed." In the meantime, one of the benefits of international business is that there is usually time to rationalize delivery mechanisms and payment terms, including payment currency, credit exposure and other risk factors - or at least, a company gains invaluable experience after years of international trading.

The biggest risk - wild fluctuations in traditional currencies in short time horizons - can be managed, but only if it is truly managed. The euro's debut and the recent Asian crisis both point to a new wave of FX risk - a risk that will be inherent in international commerce for some time. Therefore, matched hedging, the safest of all "insurance" plays on currency risk, must be considered as a component of all international transaction costs.

Interestingly, with the relaxation of some trade barriers (yet, within the context of the ongoing "genetic meat" tariff war), there is a movement among multinational companies away from letters of credit (LC) as the primary trade finance vehicle. It is unclear, however, what is replacing the LC, but there has been a noticeable increase in the number of international subsidiary initiatives and in-country captive finance companies.

The only way companies can evaluate and benefit from using LC alternatives is if treasury has the freedom to spend less than 20 percent of its time on the basics (creating, posting, reviewing, approving and reconciling transactions), and spend more than 50 percent of its time on management analysis. This task/time breakout is indicative of best practice performance.

6. Resources (time and money) are spent on information gathering, information management and personal communication.

What is evident the moment one walks into a best-in-class organization is the "buzz." Within these organizations, news is "streaming" all around. For best-in-class performers, quality information tools are not a matter of cost, but a matter of managing media (wire services, Internet, rating agencies, reporting services - even radio & TV). Communication methods are not a function of budget, but a necessity for team performance.

Routine finance reviews are conducted by video teleconference, or at a minimum, audio teleconference. Project reporting is well managed over the Internet, with common, shared software. Site visits are routine, and usually conducted twice a year - in advance of mid-year and annual reporting - with more frequent visits made on an "as needed" basis.

Al Thorp, CFO of Technitrol, revealed,

> "it isn't an easy trip, but there is no substitute for personally interacting with and assessing each of our in-country operations."

Technitrol, with over $500 million USD in annual sales, has subsidiaries and plants with treasury operations in the UK, Ireland, France, Germany, China, Japan, Singapore and Malaysia.

> "There has never been a trip that did not pay for itself," explained Thorp. "It is the financial management team that makes the trip, and that includes those responsible for both treasury and tax."

Technitrol centrally administers its international treasury operation from the U.S. headquarters, with 2.5 full-time equivalents (FTEs) for the management of its domestic and international locations.

Treasury workstations, as a technological resource, are used to manage the detailed banking information in best-in-class companies. Europeans view treasury workstations quite differently from their U.S. counterparts. Price doesn't matter. All reasonable expenses are made to implement and maintain an effective, secure, redundant, 24x7 workstation, and efforts are now under way to combine other information media into the workstation.

7. Active business partnering exists with sales, credit/collections/AR, purchasing and A/P.

Much has been written about managing from the partnership perspective, with CEOs praising treasury for its analytical ability. But, the number one complaint among CEOs is that treasury and finance sometimes act in silos.

It is no accident that best-in-class treasury and finance operations are often seen as "partners" by the company's other business units. There is a direct correlation between the ability to get improvement projects accomplished and the ability to reach out and partner with other components of the business enterprise.

8. Structures are simple.

There is no better example of this than Dow Corning's move to a global payments platform. Dow Corning's corporate treasury department accomplished the goals of globally standardizing the payments process, migrating vendors to electronics and leveraging banking relationships for economies of scale.

While Dow Corning's treasury operations supervisor, Christine Handt, was the first to admit this was "the most rigorous project undertaken by the company," a best practice such as this could only come from establishing a far-reaching vision, but keeping it simple.

Treasury took the lead and made the key decisions on how particular activities could be most efficiently be performed. The company's designs were based on "keeping it simple."

The result: prima-facie evidence of best-in-class thinking and implementation. (See TMA Journal, May-June 1999, pages 52-54, for more information on this project).

9. Tax treatment is a factor, but not the factor.

At the CFO level, tax is a major-league consideration in treasury management. Its international impact can be as much as 14 percent - and that is to the bottom line! In businesses where margins are tight, tax becomes an even more influential player in the financial and treasury decision-making process. However, in best-in-class companies, tax is a team player, not the team manager.

Tax impact gets balanced with liquidity needs. At Technitrol, Thorp said, "the treasury-tax balance is so important that these functions, literally, occupy adjoining office space." The numbers get crunched to arrive at the best course of action for the global company, and everybody wins, both tax and treasury.

10. No rookies work in the department.
The benchmark data reveals that top-performing, centralized treasury and finance organizations employ staff with different levels of experience from a variety of backgrounds. In international treasury and finance, the average employee has a minimum of 11 years' experience and has held at least one other professional, corporate, position in the international arena, usually in funds trading or accounting.

11. Constant improvement is sought.

Electronic trade processes (e.g., Trade Card) and improvement consortia (e.g., the Bolero Association) have made "leap frog" innovations in document handling. Choosing and re-evaluating financial partners is always high on the corporate improvement list. Proposing and evaluating shared service centers, EDI utilizations, Web interfaces and integrated, enterprise wide systems enhancements are also worthy of attention. Best-in-class organizations are always looking for ways to improve, crafting a culture of working smarter and more efficiently.

Getting Off the Dime...or Yen, or Quid!

How does a company undertake an improvement program or re-engineer to achieve first quartile status in international finance and treasury management?
A three-phased approach, involving setting the direction, working out the details, and realizing the benefits, has proven to be most effective. But it works only when the team wants that first quartile status.
The best-practices expedition, like an international exploration, has its highs and lows - and there is no turning back. The journey itself is worth it, and with an important discovery or two, the expedition makes history!

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