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Forward and Upward:

Changing KPIs Force Treasurers to Improve Their Risk Technology

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Ken Monahan is a senior analyst on the Market Structure and Technology team, specializing in electronic trading, regulation and fixed-income markets.

89%
OF TREASURERS REPORT THAT THEIR KPIs HAVE CHANGED IN THE PAST 5 YEARS

26%
OF A TREASURER'S TIME IS NOW SPENT WORKING ON PROJECTS AND NEW INITIATIVES—MORE THAN ANY OTHER USE

Executive Summary

Corporate treasury, the guardian and anchor of the financial health of the corporation, is undergoing significant change. Greenwich Associates has conducted a study of corporate treasurers from major multinational and other corporations and looked at how their roles are changing and how they are adapting. Key performance indicators (KPIs) for the great majority of treasury departments have changed over the past five years. Treasurers are being asked to look further forward into the future and upward to address more strategic concerns. They are seen as centers of analytic excellence and are being asked to play a role in transforming as well as securing the firm.

This is clear from what treasurers say and do. They have been increasingly focused on projects and one-off assignments at the behest of management, rather than the day-to-day management of the treasury department. These projects are driven by strategy, risk or by the need to routinize the processes of treasury in order to free up more time to focus on strategy and risk.

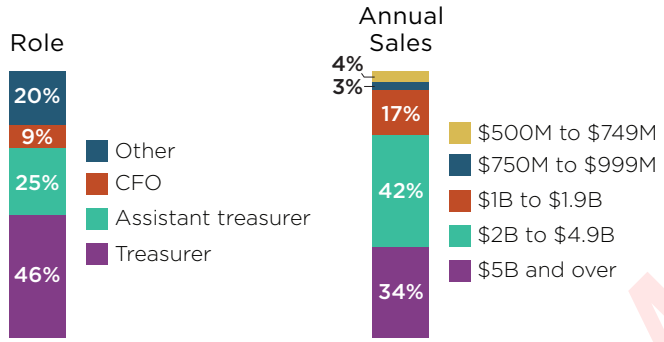
Though managing and measuring risk rank highly among treasurers' priorities, there is little consensus around what constitutes best risk management practice. The nature of risks that firms take on, and how their stakeholders prefer those risks be addressed, varies significantly across firms. Treasury departments are working steadily to improve their risk management techniques as well as the data that drive them.

Technology thus presents both an opportunity and a challenge. Many treasury departments are heavily dependent on spreadsheets. These can be unwieldy and difficult to integrate with data sources. Treasurers must decide how they invest in improving these processes. Properly leveraging technology is becoming a central task for treasurers, from automating routine processes to using third-party tools to enhance internal risk analysis. The fact that there is not a one-size-fits-all solution to the challenges facing treasury departments means that their technology must be increasingly flexible.

METHODOLOGY

Greenwich Associates conducted electronic interviews with 76 corporate treasury executives from large, industry-leading multinationals based in the United States to explore the evolving role of the corporate treasurer. The interviews were conducted in the second half of 2019. Topics covered in the research included how corporate treasurers' objectives are defined, what methods and tools they use to achieve those objectives, and where there may be shortcomings in the tool set. In addition, we conducted several qualitative interviews via in-depth conversations in order to dive more deeply into how specific corporate treasury staff manage their risks. This paper is produced in partnership with Bloomberg.

RESPONDENTS



Note: Based on 76 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Introduction

During the second half of 2019, Greenwich Associates conducted a study examining the role of the corporate treasurer. The study took two forms: first, a wide-ranging questionnaire and second, a series of in-depth interviews conducted with leading treasurers to validate and understand the findings. The companies in the study were among the largest in the U.S., including many household names, and all were leaders in their industries. The sample includes both public and private companies with a variety of corporate structures and risk profiles. We found that corporate treasury departments are increasingly recognized for what they have always been: centers of analytical excellence. Corporations are increasingly looking to leverage the analytical skills of their treasury groups to determine the strategy of the firm.

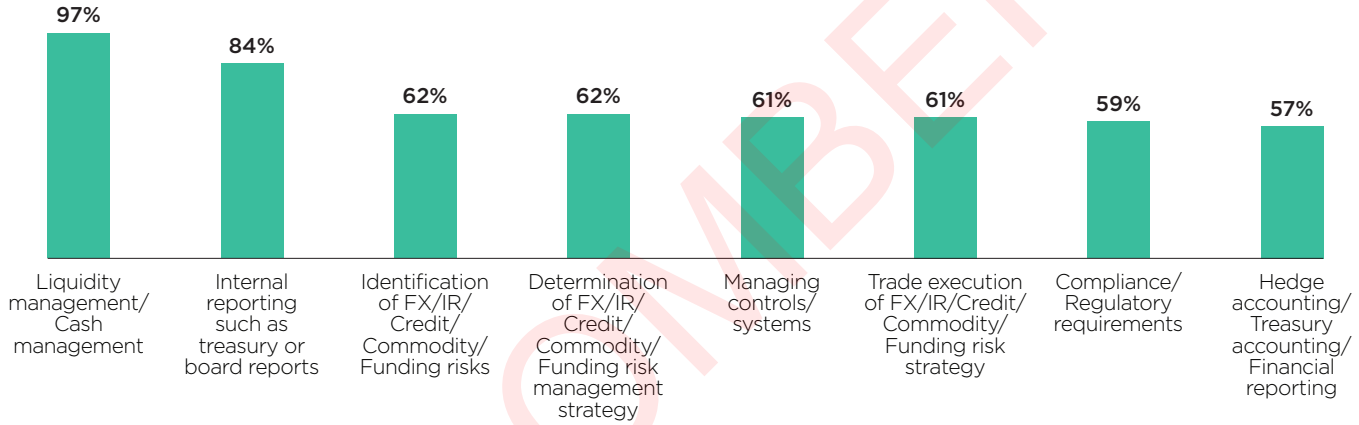
While this is a positive development, it has its challenges. The treasurer is more often focused on strategic-level issues: The day-to-day functions of the treasury group need to be made more efficient. For example, treasurers are frequently asked to focus on risk management, which is both a day-to-day operation and a strategic initiative. It can be difficult for treasurers to gain efficiency in these aspects of their business because their ability to substitute technology is limited by the systems they use and how their technology spend is determined. Nonetheless, these efficiencies must be gained, as the demands on the corporate treasurer expand.

The treasurer is increasingly focused on strategic-level issues: The day-to-day functions of the treasury group need to be made more efficient.

The Day to Day: Responsibilities of Corporate Treasurers

Despite the wide variety of companies in our study, there was a remarkable uniformity in how treasurers perceived their responsibilities. While treasurers were nearly unanimous in naming cash management and internal reporting as among their priorities, the diversity of the sample reasserted itself thereafter. Among other options presented to the treasurers, there was practically a six-way tie for third place, highlighting that the responsibilities of the treasurer depend on the nature of the firm.

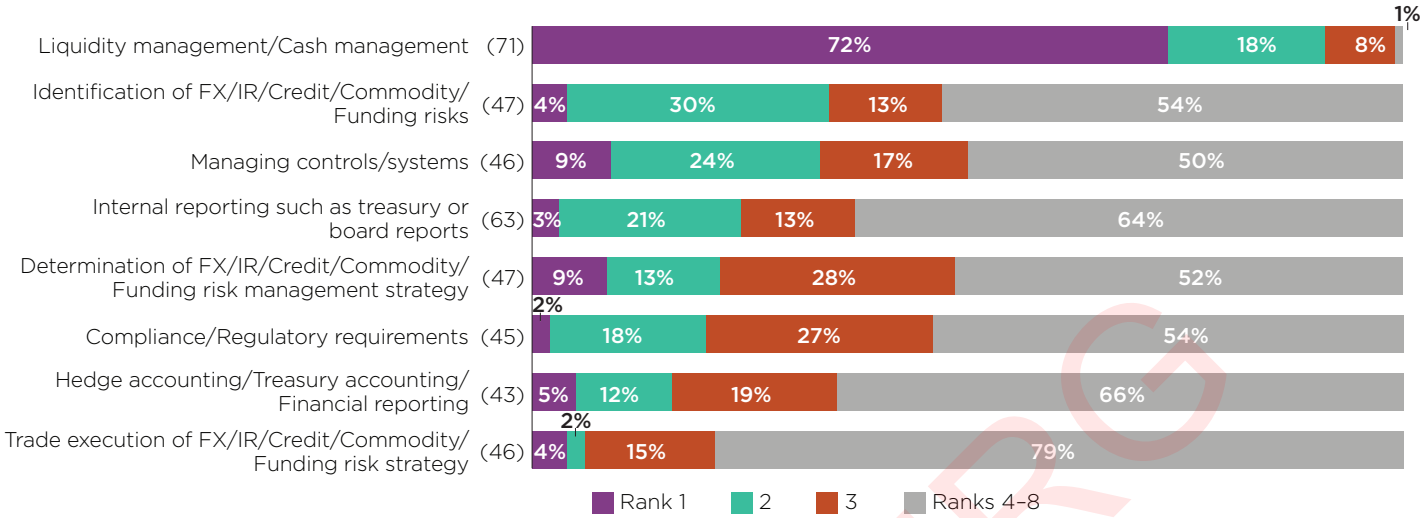
RESPONSIBILITIES OF CORPORATE TREASURERS



Note: Based on 76 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Seeking greater clarity, we asked treasurers to rank order their responsibilities. Cash management again led the pack. However, one level down, another commonality among treasurers' day-to-day responsibilities becomes clear: the focus on risk. The top No. 2 priority was identification of risks, and the top No. 3 priority was the determination of the strategy for managing those risks. Executing the strategy was a low priority, but this speaks to the strategic rather than operational nature of the treasurer role. In contrast with the focus on risk, internal reporting, which was the second most widely reported responsibility, ranked sixth in terms of priority. Just because something is common, does not necessarily mean it is important.

RANK-ORDERED RESPONSIBILITIES OF CORPORATE TREASURERS



Note: Numbers in parentheses represent number of respondents. May not total 100% due to rounding.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Onward and Upward: How Treasury KPIs are Changing

While an in-depth look at treasurers' priorities was illuminating, the degree to which their KPIs were changing was surprising, as was the direction of those changes. Change in treasurer KPIs is very widespread, with 89% of treasury officials interviewed saying their KPIs have changed in the past few years. How precisely the KPIs are changing reflects a wide shift in the philosophy of the corporate treasurer role. The main objective is no longer merely "run the firm." Now it is "change the firm."

Change in treasurer KPIs is very widespread, with 89% of treasury officials interviewed saying their KPIs have changed in the past few years.

CHANGES IN KPIs

Note: Based on 76 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

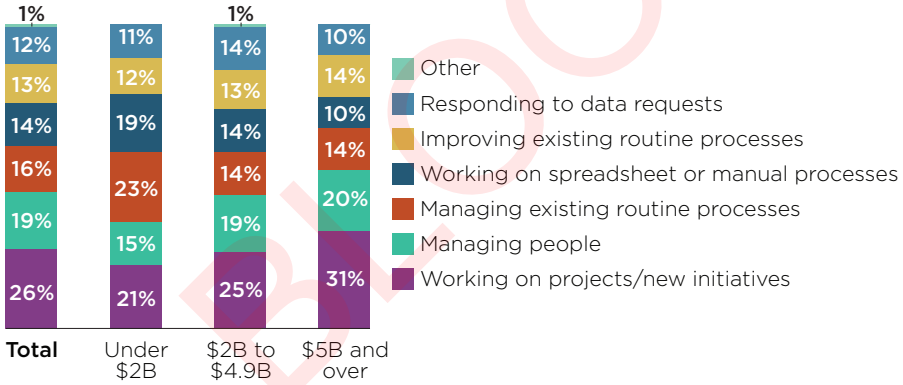
Treasurers reported that their KPIs were being made both more forward- and upward-looking. That is, they were being measured over longer time horizons, stretching their responsibilities into the future. Additionally, many senior management tasks were being devolved onto them from the CFO's office. The third most common change was an increased focus on risk, which is in some ways an extension of the first two. Treasurers are increasingly seen not merely as the custodians of the cash and financing activities of the firm, but as responsible for centers of analytical and quantitative excellence within their companies. They are expected to use these abilities to help direct the firm at a more strategic level, both to manage the threats to the firm and to take advantage of opportunities that lie ahead.

Treasurers reported that their KPIs were being made both more forward and more upward looking. Additionally, many senior management tasks were being devolved onto them from the CFO's office.

As their KPIs have shifted toward a longer-term strategic focus, treasurers have responded. This is most visible in how treasurers spend their time. Across all treasurers, the No. 1 use of time is working on one-off projects. This is not true for the smallest firms in the sample, those with revenues under $2 billion. Their largest use of time is the management of existing routine processes. However, as we look at larger and larger companies, we see that the bigger the business, the greater the focus on projects. There is a corresponding reduction in the amount of time spent on routine and manual processes. Among the largest firms in our study, treasury officials spent more time working on projects than on managing people and working on manual processes combined. The lesson is clear: It is imperative for treasurers to raise the efficiency of their routine processes if they are to meet their new KPIs.

Treasurers must raise the efficiency of their routine processes if they are to meet their new KPIs.

HOW TREASURERS SPEND THEIR TIME



Note: Based on 75 respondents. May not total 100% due to rounding.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Greenwich Associates asked treasurers to list their top three projects in order to understand this more fully. The responses were as diverse as the sample, but generally fell into three categories. The first were projects that focused on the operational efficiency of the treasury department itself. **As we have seen, efficiency enhancements are key to increasing strategic focus.** The second group comprised the strategic projects in line with shift in the KPIs. These included things like forecasting, rationalizing banking relationships, optimizing capital structure, and

executing M&A transactions. The third group was made up of projects focused on risk. These projects included improvement in data collection, improvements in risk methods or selection of counterparties. The focus on risk is a hybrid: an area of increased KPI focus, but also a treasury function that many seek to standardize and routinize to focus on more strategic initiatives.

Risk Management: Best Practices Vary

Risk management is an essential treasury function, but how risk is defined and managed varies significantly from firm to firm. The risks to a firm depend on the nature of its underlying business, its structure and, ultimately, on the preferences of its stakeholders. Public companies often make quarterly or annual public forecasts, and investors hold them accountable to these. The forecasts rest on assumptions that provide a benchmark for the treasurer, who may then manage risk to the forecasts. Private companies can have longer time horizons, but their owners often have different sensitivities to risk. A private firm owned by a financial sponsor primarily focused on return on equity will have entirely different risk preferences from a private firm owned by a founding family primarily concerned with preserving the whole company for future generations.

BEST PRACTICES WITH REGARD TO RISK MANAGEMENT

Note: Based on 72 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Some areas of corporate governance have a clear consensus on best practices that can help to guide managers. Risk is different, and there is little consensus on whether there is a best way to do things. In our study, 29% of respondents felt that there were generally agreed best practices. A vocal minority felt that the variety among firms was so great, it was impossible to establish best practices. Most treasurers split the difference and said that while there may be best practices in concept, these need significant adjustment at the firm level to be useful.

This lack of consensus on how best to address risk management issues bedevils treasurers looking to systematize their operations. It speaks to the complexity of the task, makes it difficult for external partners to develop solutions and often leaves treasurers to their own devices.

In the absence of clear best practices, treasurers must first determine just what risks they face and what they need to manage. Beyond managing liquidity, which all firms face, the risks vary significantly with the nature of the business itself. In a business where high levels of advantage are required to generate competitive returns on equity, interest-rate risks can be the main issue. In others, where margins are high and capital requirements are low, interest rates may not be a risk at all. Firms with concentration risk among their customers, or that have customer profiles with weak credit, must manage their credit risks. Firms in the tradable-goods sector or with international operations find foreign exchange to be a major source of risk.

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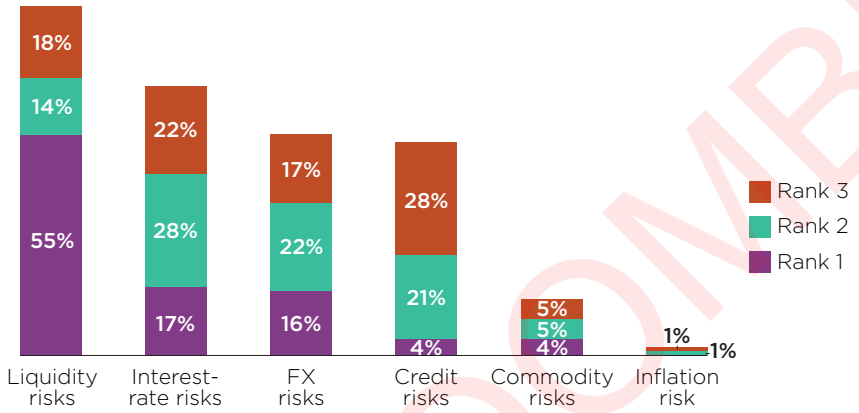
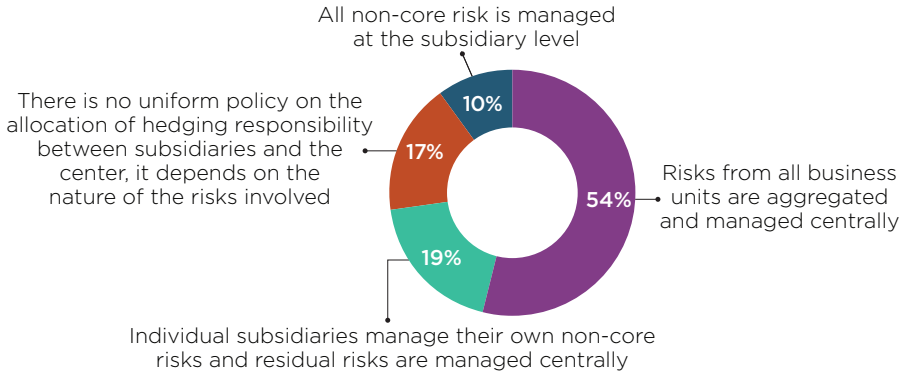
TOP RISKS MANAGED BY TREASURY DEPARTMENTS



Note: Based on 76 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Treasurers also must weigh the structure of the firm when thinking about risk. Many large firms separate their business lines into different operating units or subsidiaries. This can create operational efficiency but also complicate the risk management strategy. The treasurer must decide at what level in the corporate structure to address these risks. Some choose not to have a firm policy, handling risk on a case-by-case basis. This was the case for a surprisingly large 17% of respondents. One in 10 firms managed all their risks at the subsidiary level. This can make sense for conglomerates that have few synergies among operating units. This kind of decentralization can work for some companies, but it is a minority view. Most firms systematize and centralize at least some of their risks.

MONITORING NON-CORE RISKS



Note: Based on 72 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Just under 20% of the treasurers in our sample managed as much risk as possible at the subsidiary level then passed residual risks on to central management. This makes sense because risk management has economies of scale. Risks generated in different parts of the company can offset one another, and firms that aggregate risks can negotiate better terms with their trading counterparties. As a result, a slight majority of firms in our study aggregated their risks and managed them centrally. However, centralization carries its own risks. For example, ensuring that data arrives from the subsidiaries in full and on time can be extremely difficult and, if mismanaged, can lead to error. Firms that seek the scale and control that centralization provides need to devote significant thought and resources to the process of centralization.

Managing Risk in the Absence of Best Practices

The ambiguity about risk management best practices is observable in the risk methodology treasurers chose. For example, 8% of interest-rate hedging and 17% of FX hedging is done using risk models that are developed in house. Think about that. None of the firms in our sample were financial services firms; risk modeling was not a core competency for any of them. Still, they felt the need to go it alone, and did.

To the extent that there is a "best practice" risk methodology, it is either "value at risk" (VaR) or one of its variants—EaR (earnings at risk) or CFaR (cash flow at risk). These are effective but sophisticated risk methodologies that originated in the financial services industry. Firms require a granular knowledge of their exposures and must possess accurate measures of volatilities and correlations in order to utilize it. These are sophisticated requirements, but they permit fairly granular and precise hedging strategies to be carried out. In our sample, just

under a fifth of firms used them. The low uptake of what is elsewhere a standard method demonstrates how ingrained the lack of agreed-to best practices is among treasurers.

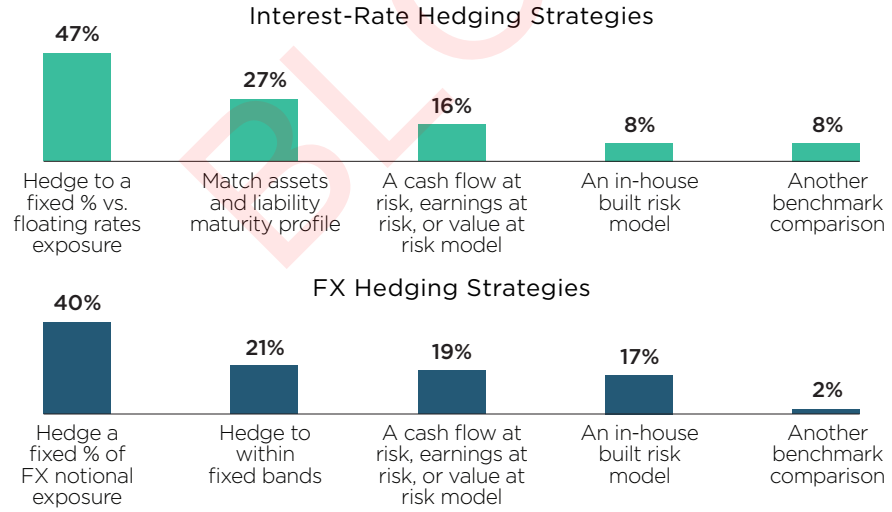
In contrast with the granular sophistication of VaR, the most popular risk methodology by far is hedging to a fixed percentage of notional. This is true in both rates and FX.

At first glance, this is puzzling. After all, if you know what 100% of your notional exposure is, why not hedge fully? Why only a fixed percent? It also seems like a blunt instrument—why choose an arbitrary fraction of the exposure to hedge when you could use something like VaR to more precisely determine the optimal hedge? There are many reasons why hedging to a fixed percentage of notional is appealing, illuminating the challenges treasurers face.

For example, for some treasurers, hedging a percentage of notional is a way to preserve optionality. That is, instead of doing it to take a directional view, they may do it to leave some room for their markets to come their way and then hedge the full amount if markets move away from them.

This can be attractive for public companies that give guidance to analysts. The guidance makes a set of assumptions about both future interest rates and foreign exchange. Firms like this are hedging not necessarily to spot but to the assumptions embedded in their forecast. These firms have an incentive to be conservative in their guidance. Partially hedging their exposures is a way to take some pressure off their operating business by using the hedging strategy to capitalize on the conservatism of the forecast.

HEDGING STRATEGIES USED BY CORPORATE TREASURERS



Note: Based on 51 respondents for interest-rate hedging strategies and 42 respondents for FX hedging strategies.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Perhaps the most important reason that firms hedge fixed percentages of notional is that there is often some ambiguity about what that notional actually is. Sometimes this is driven by the fact that firms hedge to forecasts, which are, by definition, uncertain. For example, one of the companies interviewed hedged its FX exposure out three years in advance. Therefore, it would hedge a fixed percent of its perceived risk out three years using three-year forwards, a larger percentage of its two-year-out risk with two-year forwards, and a still larger percentage of its one-year risk with one-year forwards. With the progress of time, the three-year risk would become two-year risk and the percentage adjusted accordingly. The hedging strategy was determined by a VaR model but implemented over time using fixed percentages because as time went by, the accuracy of the forecast improved.

The other very important factor that treasurers grapple with when determining the risk methodology is data quality. Simply gathering the data across all the elements of the firm is a non-trivial undertaking. When treasurers were asked how confident they were that they were fully capturing and calculating their FX risks, three times as many replied that they were "not at all confident" as replied "totally confident." This lack of certainty increases with the size and complexity of the firm. Put another way, for 17% of respondents, gathering up all the data within their own firm is just as uncertain an exercise as predicting the future. Given that many treasurers can rely on neither their forecasts nor on their data, utilizing a fixed notional hedging strategy makes a lot more sense.

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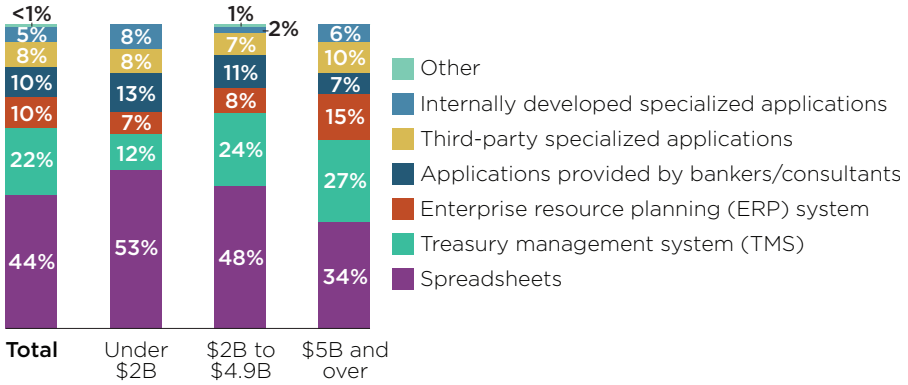
CONFIDENCE IN SYSTEM TO CAPTURE AND CALCULATE FX RISK

Note: Based on 60 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Corporate treasurers then have two parallel technology priorities with regard to risk. The first is ensuring that they are getting quality information. The second is working to standardize and routinize the process enough to free up their time to concentrate on their strategic KPIs. Both of these challenges are substantial. Gathering, aggregating and analyzing data is a complex and specialized procedure. Yet companies of all sizes rely primarily on spreadsheets to manage their operations. As firms grow in size, they increasingly rely on treasury management systems (TMS) as well as enterprise resource planning (ERP) tools—software platforms specifically designed for the purpose. Still, the variability among firms makes it difficult for software vendors to provide complete solutions, thus firms continue to rely heavily on spreadsheets regardless of their scale or sophistication.

TOOLS USED BY CORPORATE TREASURY DEPARTMENTS

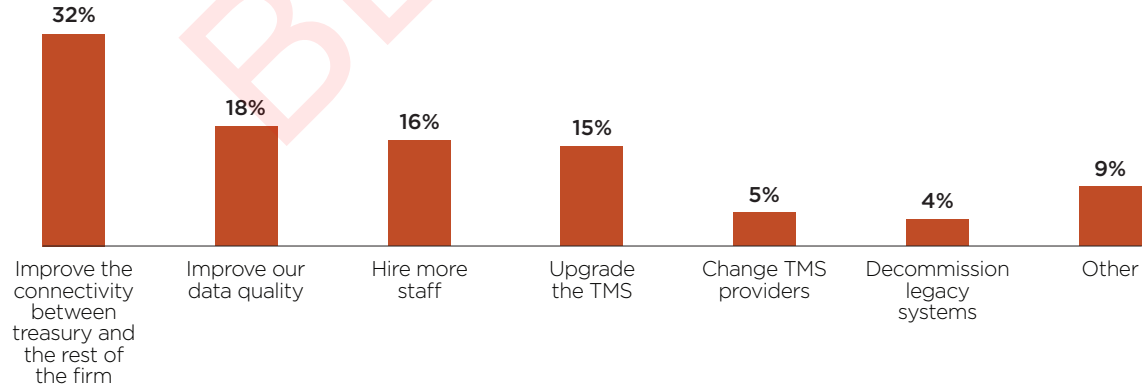


Note: Based on 72 respondents. May not total 100% due to rounding.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Moving Toward the Ideal: What Treasurers Want and How to Get it

It is interesting to note that within the data, as technological sophistication increases with size, there is little change in the risk methodologies that large firms use. Large firms and small firms are equally likely to hedge to a fixed percentage of notional, even though large firms are twice as likely to use treasury management systems (TMS) and enterprise resource planning (ERP) systems. On the other hand, none of the large firms in our sample use in-house risk systems to hedge their FX exposures. Larger firms switch to off-the-shelf risk models as they become more sophisticated. Two things are probably driving the persistent use of the fixed percentage model among corporates of all sizes.

DESIRED CHANGES TO TREASURY DEPARTMENT



Note: Based on 74 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

The first issue is highlighted by what treasurers say they would do if they were given an infinite budget to spend on improving their groups. By far the No. 1 response was improving the connectivity between the treasury department and the rest of the firm. This was almost as popular as the next two options combined. Improving data quality, the No. 2 answer, is likely related to connectivity. This focus on connectivity and data quality is important and speaks to the difficulty of determining the precise risk and so supports the strategy of hedging to a fixed percentage of the calculated notional, because that calculation is made with data that may not be accurate.

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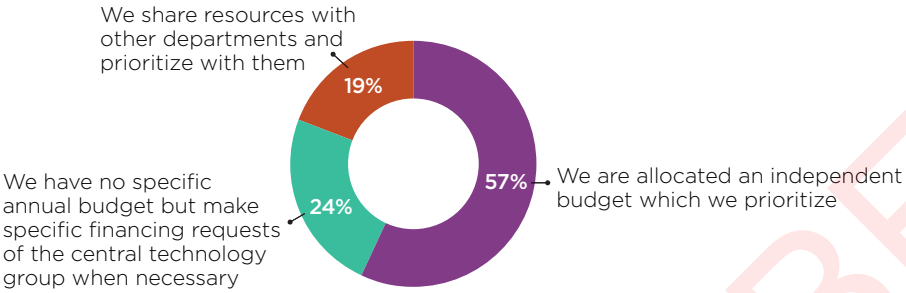
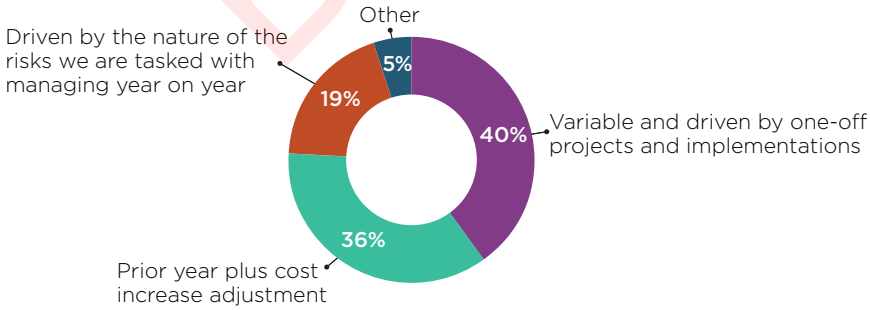
ORGANIZATION OF TREASURY DEPARTMENT'S TECHNOLOGY BUDGET



Note: Based on 75 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

The second and probably the more important issue facing treasurers as they look to improve and streamline their risk management process is the difficulty of optimizing technology resources. This is, in part, due to the complexity of the task, but it also due to budgeting for the kinds of technology spend that are necessary. We asked treasurers how their technology budgets were generated and the results confirmed this theory. Of the firms in our study, 19% shared resources with another group and had to prioritize with them, while just over a quarter had no budget at all but had to make requests on a one-off basis. Treasurers who do not have access to their own funds may struggle to improve or streamline their risk technology stack.

ALLOCATING TREASURY DEPARTMENT'S TECHNOLOGY BUDGET



Note: Based on 42 respondents.
Source: Greenwich Associates 2019 Corporate Treasurer Study

Over half of the firms had their own budgets, which they were free to prioritize. However, of these, only a third had budgets that were predictable year over year. The plurality had a budgeting process driven by one-off projects, which, while it is helpful that the budgeting is project-focused, makes the execution of longer-term strategic improvements difficult. A fifth had budgets that were determined specifically by the risks they were responsible for managing. This validates the thesis that risk management is a central focus for technology spending in treasury departments, which in turn validates the thesis that optimizing and systematizing risk management is a key element of treasurers' efforts to achieve their KPIs.

Conclusion

Treasury departments are increasingly drawn into the role of strategic advisor to the business as a whole. Their financial and analytical acumen is being leveraged to help corporations see further into the future and to address strategic-level challenges. This takes time, and to free up time, treasurers are being asked to automate as much of the routine processes in their groups as possible.

At the same time, the more specialized functions, such as risk management, are increasingly important and demand greater levels of sophistication. Treasury departments are looking to new technologies and third-party providers to help them address both these challenges. This is partially because they are budget constrained but mainly because improved technology helps them to better diagnose their issues and improve their efficiency. Superior diagnoses and efficiencies support treasury departments in their pivot toward being more forward-looking and more strategic in their thinking.

NOTES

The data reported in this document reflect solely the views reported to Greenwich Associates by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and reviews for presentation purposes in order to produce the final results. Unless otherwise indicated, any opinions or market observations made are strictly our own.

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