



Innovation meets technology

Treasury professionals are living up to their potential by adopting flexible and innovative strategies in-house that allow their department to evolve with the unpredictable, volatile environment.



Women in Treasury
Professor Alyson Warhurst
Chief Executive Officer
Maplecroft

The trouble with pensions
Navigating complexity

Sustainable treasury
Paper reduction and much more



The Corporate View
Paul Pomroy
Chief Financial Officer
McDonald's UK and Northern Europe

Operating in the cloud
Enhanced functionality for treasury

Treasury KPIs
Are they useful?



No monkey business

Adam Smith Awards 2013

in association with

Bank of America
Merrill Lynch



Switchboard	+44 (0)13 0462 9000
Publisher	+44 (0)13 0462 9012
Subscriptions	+44 (0)13 0462 9002
Advertising	+44 (0)13 0462 9018
Editorial	+44 (0)13 0462 9004
Production	+44 (0)13 0462 9013
Fax	+44 (0)13 0462 9010

Annual Subscription Rate £285

subscriberservices@treasurytoday.com

© Treasury Today ISSN 1466-4224

Treasury Today is published monthly
(10 issues) by Treasury Today Limited
Courtyard Offices • Harnet Street
Sandwich • CT13 9ES • UK

The entire content of this publication is protected by copyright. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means mechanical, electronic, photocopying, recording or otherwise, without the prior written consent of the copyright holders. Every effort has been made to ensure the accuracy of the information contained in this publication. Treasury Today Limited cannot accept liability for inaccuracies that may occur. Where opinion is expressed it is that of the authors and does not necessarily coincide with the editorial views of the publisher or Treasury Today. All information in this magazine is verified to the best of the author's and the publisher's ability. However, Treasury Today does not accept responsibility for any loss arising from reliance on it. No statement is to be considered as a recommendation or solicitation to buy or sell securities or other instruments, or to provide investment, tax or legal advice. Readers should be aware that this publication is not intended to replace the need to obtain professional advice in relation to any topic discussed. Printed by: Buckland Press.

Treasury Today USFS: (USPS 023-387) is published monthly except August and December by Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES.

The 2012 US annual subscription price is \$588.00. Airfreight and mailing in the USA by agent named Air Business Ltd, c/o Worldnet Shipping Inc., 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA.

Periodicals postage paid at Jamaica NY 11431.

US Postmaster: Send address changes to Treasury Today, Air Business Ltd, c/o Worldnet Shipping Inc., 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA.

Subscription records are maintained at Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES.

Air Business Ltd is acting as our mailing agent.



The great SEPA countdown

The race is on to beat the clock and migrate euro payments to Single Euro Payments Area (SEPA) instruments by the deadline of 1st February 2014. At long last, the Eurozone will give birth to a (relatively) harmonised payments landscape that should be easier and cheaper to navigate, both domestically and cross-border.

The gestation period was a laborious 14 years, beginning with the Lisbon Agenda in 2000. The treaty intended to make the EU 'the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion' by 2010. Despite the deadline slipping a few times and the intervention of the global economic crisis, the SEPA train continued to lurch forward.

However, with less than a year to complete migration, all reports point to the fact that there is still a long way to go. With a persistently low adoption rate thus far (as of December 2012, SEPA Credit Transfers (SCTs) made up just 34.86% of the total volume of credit transfers, while SEPA Direct Debits (SDDs) made up just 1.91%), every transaction bank and SEPA solution vendor in Europe is ratcheting up their marketing and communications machines into overdrive.

For many of us suffering from SEPA fatigue, this is a welcome burst of excitement and one that will hopefully result in tangible gains for corporates – after the pain, that is.

For those corporate treasuries that are sitting outside the Eurozone, thinking that this has nothing to do with them, then it is time to think again. The EU is a major trading partner for most countries around the world and for those that do trade in euros implementing SEPA will mean faster settlement, simplified processing and lower costs for cross-border payments. In addition, for those companies whose treasury is headquartered outside but still have treasury operations within the Eurozone, this is an opportunity to standardise payments and simplify ERP systems to streamline and centralise to gain further efficiencies. There is a lot to play for.

But in order to take advantage of what SEPA offers, you need to get in the game. Clients are typically requiring between six months and a year to prepare themselves for the switch. The biggest concern being voiced by banks and vendors alike is that many corporates will wait to the final quarter of 2013 to start thinking about a migration programme. If this happens, there will be a crushing (and costly) bottleneck because the banks and vendors will not be able to service all their customers.

An important question still hangs over the scheme: what will happen on 2nd February 2014 if a corporate is not compliant? Will its payments be rejected? No one is quite sure – but then again no one really wants to wait and find out.

Our advice? Start now.

INSIGHT & ANALYSIS 16



Treasurers get inventive

Treasurers are under the gun to provide detailed analytics and perspectives on everything they do. Yet resources remain limited. They need to tap their creativity and find innovative solutions in order to establish centres of excellence in FX, liquidity management, banking and risk management.

WOMEN IN TREASURY 6

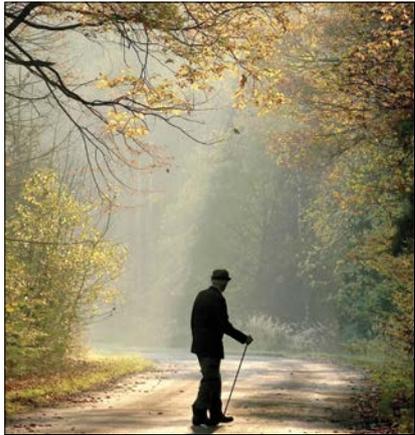


Professor Alyson Warhurst
Chief Executive Officer



Professor Alyson Warhurst stresses the importance of academic training and promotes PhDs, especially for women. She believes that personal success is derived from talent and expertise, luck and a good mentor.

CORPORATE FINANCE 23



The trouble with pensions

While the majority of funded pensions provided by companies for employees are either defined benefit (DB) or defined contribution (DC) schemes, the shift from DB to DC schemes is a noteworthy trend.

BANK PROFILE 19



MMFs in China: the next big trend

China remains a relatively restricted country in terms of cross-border money flows. Today corporates are seeking a short-term, secure home for their excess cash and exploring the budding money market fund (MMF) space for a solution that is consistent with global treasury policies.





TECHNOLOGY 28

A cloudy forecast

A cloud solution can provide IT infrastructure flexibility in a straight through trading, confirmation and payment solution model. Despite persisting security concerns, treasurers are mitigating the risk using layered authentication and other protection mechanisms.



RISK MANAGEMENT 34

The return of FX volatility?

Most treasurers' gut reaction is that hedging FX risk is a good thing, but nothing can be a good thing all of the time. How does a treasurer know when – or if – to hedge?



TREASURY ESSENTIALS

Treasury Insights	4
Question Answered	11
Market View	14
The Bigger Picture	26
Back to Basics	41



31 The Corporate View

Paul Pomroy
Chief Financial Officer, McDonald's UK and Northern Europe



As CFO of McDonald's UK and northern Europe operations, Paul Pomroy has a broad suite of responsibilities, with around £1 billion total annual spend at his disposal for company-owned and franchisee operations. Treasury needs to not only ensure the corporate function has the necessary funding, but also that all its franchisees can afford to get on board immediately with new initiatives.

SUSTAINABILITY 38

Investing in the future

Creating a sustainable treasury goes beyond having the treasury team recycle their plastic water bottles or work on energy efficient computers. What are the key areas where treasurers can really begin to drive change?



These pages contain edited versions of a few of the Treasury Insight pieces written in the last month. The full versions are posted on treasurytoday.com as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at treasurytoday.com

The fog of currency war

Fears of so-called currency wars were sparked last month when Japan's new Prime Minister Shinzo Abe ordered the country's central bank to take action over an appreciating yen (JPY).

The hedging strategies of some corporates were among the first casualties resulting from this latest outbreak of hostilities. Japanese exporters should, of course, be the main beneficiaries of the Bank of Japan's (BoJ) new aggressive monetary easing and fiscal stimulus. However, auto-maker Honda was one company caught off guard by the recent volatility, incurring a ¥54.5 billion loss on currency derivatives in 4Q12.

But it is not only companies with large exposures to the JPY who need to be on their toes. After European Central Bank (ECB) president Mario Draghi's intervention, the prospect of other currencies joining in a "race to the bottom" cannot be ruled out, experts warn. "I think if retaliation does come it will eventually come from the ECB," says Richard Driver, Currency Analyst at Caxton FX. However, the market's reaction immediately after was probably premature, he adds.

While there remains a large degree of uncertainty surrounding the future direction of many of the other major currencies, Driver believes treasurers would be wise to remain cautious when picking their hedges. "You could look at forward contracts and options," he says. "Of course, it depends on the currency pairs, but you wouldn't really want to put a forward on sterling at the moment because it is so weak."

If the currency wars do continue to heat up in the coming months, Dr. Warwick Knowles, Chief Economist for D&B, highlights three specific areas of risk he thinks likely to result: policy uncertainty; currency uncertainty; and disruption to supply chains.

"Because of this global situation we are in at the moment, we are seeing a lot more of these 'beggar-thy-neighbour' policies, many of which are just implemented overnight," he says. "And with uncertainty over policy, comes uncertainty over currency, which is what is creating such a major headache for businesses at the moment."

The final risk is that currency wars often lead to trade wars; retaliation from other countries, he says, may come in the form of protectionist policies. "Because of this supply chains are being threatened and there is yet more uncertainty for cross-border trade and investment," he says.

"Tightening payment terms, diversifying supply chains in order to reduce your reliance on a business or a particular country, and shortening supply chains through product innovation are all high level strategies that can be used to mitigate supply chain risk," Knowles says. With regards to FX, hedging would seem the obvious recourse. This, however, he acknowledges is not always straightforward, particularly in some of the more heavily regulated emerging market economies.

SEPA: time is running out

The Single Euro Payments Area (SEPA) vision is getting ever closer to becoming a reality. But even with the 1st February 2014 deadline fast approaching, some companies are still dragging their feet, indicates a webinar poll of corporates conducted by J.P. Morgan (JPM). The poll, which was conducted on Wednesday 23rd January, found that while a majority of participating companies have set their migration objectives, a significant number have yet to decide upon a budget.

"The risk of non-compliance could be high for any organisation," says Susan Dean, Head of Transaction Services EMEA, JPM Treasury Services. "Apart from disrupting the supply chain and cash flow, it could also have an adverse reputational impact from delayed salary payments, outstanding debts to authorities and strategic alliance disruption."

But are corporates sufficiently informed about what needs to change in order to meet SEPA compliance? How much time should corporations put aside to make the SEPA switch? The answer largely depends on the organisation, the complexity of their business model and operations, and whether they are seeking merely a basic level of compliance or something more.

Nevertheless, JPM said that its clients are typically requiring between six and 12 months to prepare themselves for the switch. So, for corporates who have yet to set migration objectives or to decide on their SEPA budget, the message is clear: time is running out. ■

Longer versions of these articles are available at treasurytoday.com/treasury-insights



Client commitment.

Global solutions.

Total connectivity.

Taking your opportunity further.

That's return on relationship.

**Bank of America
Merrill Lynch**



This much I know

Professor Alyson Warhurst

Chief Executive Officer



What is your career-defining moment?

It was when I recognised that risk can and must be brought to life through mapping and measuring complex issues in challenging geographies.

Which woman in business most inspires you and why?

There are three women that have a broad influence on me: Aung San Suu Kyi, who is an inspiration for standing by her principles, as well as her understanding of the importance of responsible business in rebuilding her country; Hillary Clinton for her understanding of the importance of human rights, especially those affecting women in Africa; and the Body Shop's Founder Anita Roddick for her influential teaching style and product innovation.

What is the biggest challenge you are facing just now?

Running a business as it grows and moves into second-stage growth is very challenging, especially in today's economic climate. It requires hard work and 24/7 engagement.

What couldn't you manage without?

I could not be without a brilliant senior team and the loyal and competent employees and colleagues that have been with us from the beginning.

What is your next major objective?

We are an ambitious business. The next major objective is to realise the goal of becoming the world leader in risk mapping, analysis and political risk advisory services.

What advice would you give to other women in treasury?

There is no substitute for hard work and achievement. Criticisms and obstacles are often put in your way, so it is important not to allow those things to tie you up. There is no substitute for putting your head down, working hard and letting the end results speak for themselves. I am a real believer in building careers one brick at a time, ensuring that you move on to the next brick and keep moving upwards. Finding a good mentor is paramount to guide you through this process.

If there is one thing you could have done differently in your career path so far, what would that be?

If I could have done things differently, I would have written more books. At the pinnacle of my career as a professor, I still had a lot of writing to do which I believe would have had an impact. But I chose to build a business instead and it is difficult to do both at the same time. When I retire from business, I would like to write – but perhaps by then it might be a more creative novel.

“There is no substitute for putting your head down, working hard and letting the end results speak for themselves.”



Professor Alyson Warhurst began her career in academia with a geology and geography degree, moving into political science and international relations and completed a PhD with a large amount of field work in Latin America. “The challenge I set myself was exploring why there had been no success in transforming the mineral wealth of the Andes into economic wealth for the countries it touches (Bolivia, Colombia, Venezuela, Ecuador, Peru and Chile), in the same way that Canada and the US transformed the Rockies from natural to national wealth. This main thesis has been something that has intrigued me throughout my academic career,” she explains.

Warhurst distinguished herself as an academic and became the youngest UK business school professor at the time she was appointed Chair of the Bath School of Management in 1994. Five years later, she was awarded a Chair at Warwick Business School where she set up a corporate citizenship unit. She had fairly large teams of researchers who worked on various types of PhDs to understand business influences in emerging markets and what made for business/government/society success in these areas.

At Warwick she taught an MBA module on business and society, which came first out of 92 different modules that were undertaken at Warwick, something which she is extremely proud of. “I received the outstanding teacher award every year and that really mattered to me,” Warhurst says. However, her teaching experience made her realise that when teaching it is critical to bring words to life and in order to learn students have to be enjoying themselves. “I came up with the concept of mapping risk, which builds on my geography background. The concept is based on using visually compelling ways of presenting data in charts and maps to explain risk and a range of different issues relevant to the complex emerging markets business environment,” she explains. She attributes this insight as her “career-defining moment”.

The concept was also based on many years living and working in China, Myanmar, parts of Africa and virtually every country in Latin America. “Words just don’t do that business environment justice, so I developed a visual alternative,” she says.

When Warhurst reached 50 she took early retirement, so she changed course in 2005 and committed to working with business and life partner, Ed Cole, in developing software and mapping applications. She started working full-time as CEO of Maplecroft from 2009. Since then the company has grown by 40% and now employs 100 people. She believes that the company is successful despite the recession because “everyone wants/needs to understand risk in emerging economies”.

In her day-to-day work, Warhurst has worked hard in the last year to build up a senior team of 12 people. Her three key areas of responsibility are:

1. Business development: she still enjoys travelling and meeting new people to expand the business.
2. Maintain quality and ensure career development; peer reviews; and ensuring talent development across the business with a strong emphasis on research quality.
3. Business strategy; ensuring that the strategic aims of the business are met.

“I don’t have my eyes just on revenue but also on valuation,” she says. “It is about ensuring revenues are high and that they keep growing and are sufficient.” She is very comfortable taking risks so the company is not yet in profit because the revenue is invested in building the business and new areas of research and innovation. “I am a strong believer in R&D and maintaining everything so there isn’t a day that goes by that we are not innovating in one way or another.” Valuation is also important to Warhurst, ensuring that the company has long-term contracts, a good senior team and that the business is on sound ground and has all the right indicators.

She believes academic training is important and promotes PhDs, especially for women. “A PhD is a formidable building block in any career and a great accomplishment,” she says and looks for this when recruiting, as well as often suggesting a PhD when giving career advice. “You have to achieve a certain standard in terms of understanding methodology and innovating with respect to methodology after having spent time out in the field. All the ingredients in producing a successful PhD are the ingredients I look for in employees.”

Warhurst is mindful of gender balance in her company and of ensuring that the support is there across the board, taking into account the special situation that women find themselves when they are building their careers. She believes that personal success is derived from talent and expertise, luck and a good mentor. “You need all three – one on its own is not sufficient,” she says.

Biography

Alyson Warhurst is CEO and Founder of risk analysis and mapping company Maplecroft. Over the past ten years she has built Maplecroft into the leading source of extra-financial risk intelligence for the world’s largest multinational corporations; banks and asset managers; governments and NGOs. Coming from an academic background, she now advises global companies and organisations at board level on issues including: global and political risks, human rights, ethical supply chains, corporate reputation and corporate social responsibility (CSR). Warhurst is a consultant to the World Economic Forum (WEF), where she is also part of the faculty; she is a member of Clinton Global Initiative and on the Board of Trustees at Transparency International UK. From 1999 to 2009 Warhurst was Chair of Strategy and International Development at Warwick Business School, where she won the inaugural Faculty Pioneer ‘Beyond Grey Pinstripes Award’ (called by the FT the “Business School Oscars”), regularly won the ‘Outstanding Teacher Award’ and was made an Honorary Professor in 2010. She is an accomplished speaker at high-level international events and has written several books and more than 100 articles, including a regular column for Business Week. In 2010 Warhurst was a recipient of a Business Insurance Magazine ‘Women to Watch’ award.



1 February 2014
It's time to start the
migration now!

Corporate Banking

Because SEPA is more efficient with Commerzbank!

Profit from comprehensive advice and make the most of all opportunities

From 1 February 2014, you will have to process your payments according to SEPA regulations. Which makes now the perfect time to benefit from Commerzbank's expertise in providing SEPA solutions and our wide practical experience from successful implementation projects.

Working with us will allow you to secure maximum benefits. Because with our individually tailored "SEPA+" package, we help you optimize your Cash & Treasury Management processes and structures – far beyond the borders of SEPA.

If you have to implement SEPA, it pays to do it properly. Speak to your Commerzbank relationship manager or our specialists today. www.commerzbank.com/sepa



COMMERZBANK 
The bank at your side

The Industry Awards

“ There was a time when treasury was hidden away in a room down the back stairs – but no longer. Today, treasury professionals are increasingly in front of the Board, giving strategic advice to steer a safe course for our companies through these tough economic conditions. The prestige of treasury within the business has never been higher – and Merck KGaA treasury is rising to the challenges presented to us.

Winning the Adam Smith Award for Best Cash Management Solution for streamlining our cash pooling structure and also receiving a Highly Commended 'One to Watch' accolade for our group-wide bank guarantee scheme, which resulted in one worldwide bank guarantee facility over €150m valid for all of our 250 subsidiaries, is a truly great honour for us. These Awards illustrate what we have achieved against great competition from quality treasuries across many industries.

Being recognised and rewarded for our motivation, enthusiasm and innovation by industry peers is a powerful tribute. We are looking forward to participating again this year with excellent projects. ”

Jörg Bermüller
Head of Cash and Risk Management
Merck



NOMINATIONS NOW OPEN

treasurytoday.com/adamsmith

Award categories

- Treasury Today's Top Treasury Team 2013
- 'First Class' Bank Relationship Management
- Best Cash/Liquidity Management Solution
- Best Short-Term Investment Strategy
- Best Working Capital Management/Financial Supply Chain/AP/AR Solution
- Best Card Solution
- Best Financing Solution
- Best Risk Management Solution
- Best Process Re-engineering Solution
- Best MME/SME Treasury Solution
- One to Watch
- Best in Class Benchmarking

As well as our established Award categories, we have added three new categories for 2013:

- Best Foreign Exchange Solution
- Asia Pacific Regional Award for Best Practice
- Treasury Today Woman of the Year

Commodity price risk

Tapping our collective knowledge to get better information

“ Should corporate treasury be more concerned with managing commodity price risk? ”

Krishnan Iyengar, Vice President of Global Solutions, Reval:



We're seeing an increasing number of corporate treasury departments institute programmes to manage the risks associated with volatile commodity prices. Historically, commodity price risk management resided in procurement, but because treasury already manages exposures from fluctuations in foreign exchange (FX) and interest rates, bringing commodities into the purview of treasury's holistic approach to risk management makes sense.

Sustained periods of commodity price volatility since 2005 have materially impacted corporate performance. For example, coffee prices fluctuated dramatically between 2011 and 2012, while during the same time metals dropped 68% and then spiked by 172%. This type of volatility has wreaked havoc on profit margins and many companies' ability to price their products. It is natural that treasury, with its mandate to strategically guide the company's financial health, manages risk across all asset classes.

We also have seen a decoupling of price risk from supply chain risk. This decoupling has allowed procurement to concentrate on managing supply chain risk (the risk of procuring commodities and delivering them when they are needed by the organisation), while treasury take ownership of managing the price risk associated with procuring these commodities. The major trigger for this decoupling seems to have been the global financial crisis, which allowed treasury departments to showcase their financial risk management acumen and cast into the spotlight the inherent risks prevalent in physical fixed price contracts.

Prior to the financial crisis, the most common method for procurement departments to use in managing the price risk of commodity purchases was to require suppliers to provide their commodities at fixed prices over a given time horizon. In times of low volatility, this strategy worked well; however in times of extreme volatility, this strategy pre-supposed that the supplier had the appropriate risk management acumen to run its own business. As the global financial crisis made painfully clear, this was not always the case.

The results we have seen from companies taking over the management of commodities indicates that treasury has successfully applied the financial risk management techniques they have always used, including examining natural offsets across the enterprise and the prudent use of derivatives.

Michael Schwartz, SVP, Chief Marketing Officer, Triple Point Technology:



The short answer is yes. Corporate treasurers must make managing commodity price risk a high priority in order to protect profits and remain competitive. Volatile commodity prices cause fluctuations in the cost of ingredients and subcomponents that, if not properly managed, will adversely affect profit margins and ultimately earnings. According to Gartner's Predicts 2012 report, without effective risk management processes, commodity volatility easily translates to a double-digit percentage hit to the bottom line.

Many manufacturing and consumer products companies make the mistake of assuming that price spikes are a temporary thing, and think that they don't need a strategic, long-term strategy for managing volatility. The fact of the matter is that commodity volatility is here to stay and companies that don't take steps to mitigate its effects are in severe danger of being left behind.

In order to be successful in today's environment, organisations must see commodity management as a strategic issue, not just a procurement challenge. They must move away from spreadsheets and embrace technology solutions that are specifically designed to manage commodity risk, such as Triple Point's Commodity XL™. Commodity XL™ enables manufacturers to

manage costs and risk exposures related to the price of raw materials, packaging and energy. It provides full transparency into commodity risk across all categories, divisions and geographies, along with access to real-time data and analytical tools that drive fast, accurate decision making.

Commodity risk exposure is no longer an issue confined to traditional commodity buyers, sellers and traders – it now encompasses companies further down the commodity value chain. Commodity volatility is not going away and the companies that implement a viable long-term strategy to manage volatility that includes leveraging the appropriate technology will secure a large competitive advantage. Those companies that continue to bury their heads in the sand, relying on massive, error-prone spreadsheets to manage commodity exposure, are setting themselves up for failure.

Jeff Wallace, Managing Partner, Greenwich Treasury Advisors:



If commodity risk is a significant factor in the pricing of the company's revenue, then the answer is no treasury should not be concerned. In that case, the company is economically a trader in commodity risk and needs to profitably manage that risk. Trading skills are needed and typically corporate treasury by deliberate design has hedging, risk minimisation skills – not trading, profit-maximisation skills. The two mind-sets are quite different.

However, if commodity risk is a significant factor in the manufacturing input process, then the answer is yes. The alternative is allowing the purchasing department to manage the risk, and purchasing managers typically do not have any training in managing market risk, trading derivatives or hedge accounting, nor do they have the systems infrastructure. However, what they do have is an understanding of the supplier market in which the commodity is purchased, a market which is often quite different than the applicable derivative market.

Since the biggest challenges in any corporate commodity hedging programme is managing the basis risk between the particular purchase index and adder and the derivative index used to hedge it, the purchasing department should be involved as part of the commodity hedging team with treasury, accounting and operating management.

The volatility of this basis risk – which can vary substantially if the physical index is not highly correlated with derivative index and/or there are significant, frequent changes in the adder – can affect the economic and accounting effectiveness of hedge. Purchasing's expertise is needed in negotiating purchase contracts that have indices more highly correlated with the available derivative indices and have adders that are fixed for as long as possible.

However, it is treasury's job to explain to purchasing the contract restructuring alternatives for achieving this better matching. It is also treasury's job to have a good technical understanding of the commodity derivative market, who the major market makers are (which are not always the global banks), buy the derivatives on a competitive basis, manage the counterparty risk and explain how the hedge accounting will work for the accountants.

These are easily transferable skills from treasury's FX hedging. Since the objectives of hedging purchased commodity risk and FX risk – smoothing volatility or to lock in rates – are often the same, the trading tactics treasury uses to manage FX risk are often directly applicable to managing commodity risk. In addition, and equally critically, the systems infrastructure treasury uses to manage FX risk can be quite easily adapted to manage commodity risk. ■

The next question:

“How can treasurers improve the quality of their cash forecasts?”

Please send your comments and responses to qa@treasurytoday.com



“Entering new markets has its challenges. For us, managing our cash and trade isn’t one of them.”

Citi’s Treasury and Trade Solutions delivers local expertise and global capabilities to help drive your business expansion.

Success in new markets requires local insight and experience. At Citi, our on-the-ground experts in over 90 countries have an in-depth understanding of global, regional and local business environments. We partner with you to develop tailored solutions that create operating efficiencies, unlock working capital and improve bottom-line performance. Find out how our global network, next-generation solutions and trusted advisors can give you a competitive edge at treasuryandtrade.transactionservices.citi.com.



Will Germany push the ECB to play its role in the currency wars?

The EMU may be comparable to gold standard, but ...

In some ways the Economic and Monetary Union (EMU), in its current guise, resembles the gold standard between World Wars I and II. Every member state has pegged its (nominal) currency to the euro and cannot print extra money. In theory, this should not pose a problem, provided the economic cycles are in sync. The latter would allow the European Central Bank (ECB) to attune its monetary policy to the EMU as a whole.

In reality, many economic cycles are out of step. And since the introduction of the euro, the imbalances have increased. For example, asset prices and credit supply have barely boomed in several strong EMU countries (particularly in Germany), if at all.

Following the adoption of the single currency, Germany implemented substantial structural reforms (under Chancellor Gerhard Schroeder) in order to improve the growth prospects of the economy. When this process started, the country was known as the 'sick man of Europe' and German interest rates were low in European terms. The country also managed to avoid credit bubbles. Subsequently, Germany reaped the benefits of this restructuring – it became Europe's growth engine.

Divergence within the monetary union

Between the introduction of the euro and the eruption of the credit crisis, economic growth blossomed in what are now identified as the weak Eurozone countries, where asset prices rose as interest rates fell (towards the level of bond yields in Germany). Here, borrowing mushroomed, especially for consumption purposes. One outcome was that trade deficits widened while the economies started to depend more and more on domestic sectors that were not greatly exposed to international competition (for example construction, the public sector and local consumption). High growth meant that the politicians barely saw the need for structural reforms. As labour costs rose, the countries in question lost competitiveness and their trade balance continued to deteriorate.

After the credit crisis broke out, the debt-based growth in the weak countries collapsed. At the same time, a decline in global trade activity undermined the German economy. More recently however, trade has improved around the world. As a result, things are looking up for Germany. Yet the situation in

the peripheral EMU countries is worse than ever. They desperately need to regain competitiveness and can only grow through exports; the domestic economies continue to shrink (due to fiscal consolidation and deleveraging in the private sector).

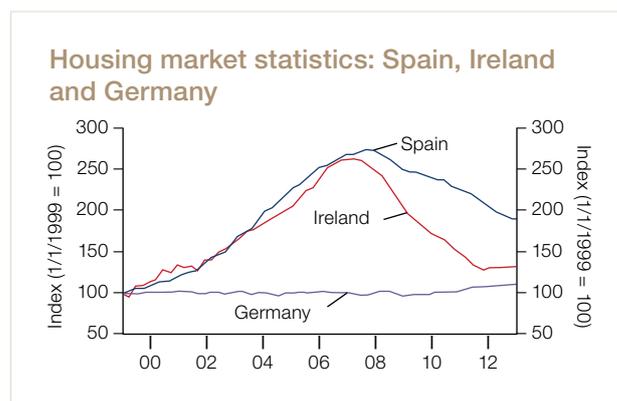
Easy way out or the bitter pill?

Theoretically and from a macroeconomic standpoint, Europe's problem countries can boost competitiveness in two ways. The first option is structural reforms, which underpin productivity and drive down labour costs. The second option would be a looser monetary policy, leading to a cheaper currency.

The struggling Eurozone countries place their hopes on the second option – a looser monetary policy, as this would reduce the need to carry out painful reforms; in addition lower wages make the debt burden more unbearable. An additional problem is that other major countries' central banks are easing their policies. Unless the ECB follows suit, the euro will end up as one of the strongest currencies. This is an anomaly, as the EMU is in an economic quagmire, and it is bad news for competitiveness.

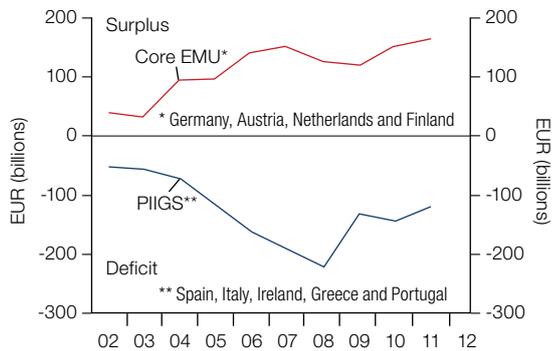
Meanwhile, Germany wants the debt-laden member states to implement structural reforms:

- It knows from experience that these work well.



Source: Thomson Reuters Datastream/ECR

Trade divergence: PIIGS versus strong EMU countries



Source: Thomson Reuters Datastream/ECR

- Germany envisages the EMU as an integrated union in terms of fiscal policy, banking and politics. In addition, Berlin wants the members of such a (future) union to be financially healthy, competitive and self-sufficient.
- Monetary easing is not the solution. On the one hand, it would take away the incentive for the ailing member states to execute the required structural reforms. On top of this, it would expose Germany to higher inflation risks, which is something the country wants to avoid at any cost.

Germany in charge

Germany is Europe's strongest economy and the main capital provider for the peripheral EMU countries. By and large it rules the roost in the EMU. As a result, its 'dependents' meekly swallow the bitter 'German medicine' of cutbacks and structural reforms. Mainly under German pressure, the ECB is pursuing a policy that aims to prevent a liquidity crisis and break-up of the EMU. Unlike the Federal Reserve in the US and the Bank of England (BoE), it is not aiming to boost asset prices and/or growth. Yet it remains to be seen how much longer the ECB can adopt this strategy.

Clearly, the peripheral EMU countries are fighting a losing battle. The German remedy focuses on improved competitiveness. However, this aggravates the economic misery (rising unemployment, an ongoing contraction, more poverty, emigration and so on). At the same time, the intended effect – higher economic growth as a result of higher exports – does not materialise because the euro is too expensive.

Another analogy with the gold standard in the 1930s is that those economies that adhere to the standard the longest (ie pursue the least accommodative monetary policy), will suffer the most. A growth slump in peripheral Europe over a prolonged period means that the populations will be more

inclined to listen to politicians who advocate an exit from the EMU. One consequence would be that the new currency of the country in question will be much cheaper than the euro, while its national central bank can pursue a much looser monetary policy. At first, the economy will be hit hard but there are various examples of countries that found their feet after a devaluation of their domestic currency (such as Iceland).

Will ECB give in to pressure?

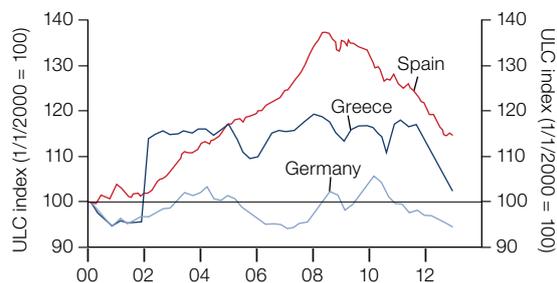
The strong EMU countries, Germany included, do not think this is a desirable scenario. As soon as one country crosses this bridge, investors will expect the other problem countries to follow suit and remove their capital on a massive scale. This will place huge upward pressure on bond yields; many banks will end up in deep trouble. In the first instance, the ECB can take countermeasures. If so, these struggling states could quickly become 'addicted to financial heroin', and it will only be a matter of time before the EMU disintegrates.

This would be very unfortunate. The EMU is much stronger if it acts collectively vis-à-vis the economic blocs that are forming around the US, China and India.

These drawbacks, plus Germany's wish to proceed with a more united Europe, will put pressure on the ECB to pursue a looser monetary policy. The ECB will not need to say aloud that it uses monetary easing as an instrument to drive down the euro. Also because the ongoing recession in peripheral Europe will put downward pressure on inflation (which has largely risen on the back of higher taxes in any case).

If the recession persists in the weak Eurozone countries, deflation will loom larger. Therefore the ECB has every reason to ease its policy. In combination with better growth perspectives for the US economy (see also ECR's recent reports on the Global Financial Markets) this could result in more capital flows from the EMU to the US over the coming quarters, which will put downward pressure on EUR/USD. ■

Unit labour cost indicators: Spain, Greece and Germany



Source: Thomson Reuters Datastream/ECR

ecr research
Economic, Currency & Interest Rate Experts

Unique approach for time
pressed decision makers

ECR's unbiased and thought provoking research on the major currency and interest rate markets is subscribed by thousands of CFOs and treasurers globally. Get your complimentary trial on www.ecresearch.com and experience your new web based research solution!





Treasurers get inventive

It's no revelation that treasurers are currently facing a number of challenges – problems that seem to be increasing and expanding on an almost daily basis. An ever resilient lot, however, these professionals are living up to their potential by adopting flexible and innovative strategies in-house that allow them and their department to evolve with the unpredictable, volatile environment.

The treasury teams of multinational corporations globally continue to be under great scrutiny and pressure as boards and C-level executives grapple with market volatility and economic uncertainty. The ability to bring back value to shareholders despite the turbulence in the marketplace is top of mind for business leaders, notes Carina Ruiz, Partner and National Leader, Treasury and Commodity Risk Management at Deloitte & Touche. “As such, treasurers are under the gun to provide detailed analytics and perspectives on cash flow projections, repatriation strategies to support share buy-back and dividend programmes, and capital structure and funding options to sustain and fuel the business.”

The pressure is on and resources remain limited. Corporates are therefore looking inwards with a critical eye, determination and creativity in order to survive against the myriad challenges that continue to be presented to them.

Alternative thinking

Among the main hurdles that have – and will have – an impact on a corporate's bottom line are the current monetary policies of the governments, according to Sigurd Dahrendorf, Vice President Corporate Treasury at Knorr-Bremse. “For example, the European Central Bank (ECB) is trying to fight against the financial crisis by printing money. This is necessary in the short term, but it could actually be dangerous long term – I think it has a hidden impact on the value of the currency,” he warns.

Although a Europe-based company, Dahrendorf ensures that Knorr Bremsse holds large portions of its cash in currencies other than euro in order to mitigate this potential depression. “Companies need to look at the cash they have on hand on a regular basis and ensure that it is well spread between a number of different currencies, ideally those they are generating cash flows from.”

Stéphane Aubin, Treasury Manager at the European Broadcasting Union (EBU), also cites issues of information – and gaining access to information – as playing a large part in the current global financial difficulties. He foresees this being a challenge for quite some time. “There are numerous challenges around obtaining information, either externally or internally, therefore treasurers need a better source from which to glean an accurate feed.”

As such, Aubin asserts that the solution is to access and compile this data both internally and externally – and on an immediate, real-time basis. “From a treasury perspective, the department always needs to have a transparent, accurate view of company cash and must shorten the time it takes to get a consolidation overview. What was manually done on a daily basis may have been acceptable a few years ago but now needs to be automated where possible.”

While many regional treasuries are still prioritising debt management as available funds are considerably stretched, Bruno Lawaree, Senior Treasury Manager EMEA at Eaton Corporation, reports that there are also a significant amount of companies that are placing their main focus on analysing existing treasury operations and seeking best practice in these processes. Some of these activities include “much more of an emphasis on pooling cash and building strong processes to manage credit risk on our investments. On the foreign exchange (FX) side, treasurers are looking to build robust methodology for the timely assessment of exposures and establish effective consolidation methods, in order to minimise the volume of errors in external trades.”

Centres of excellence

Before the economic downturn several years ago, most treasury organisations were fighting a losing battle when it came to requesting funds from their company Board in order to improve operations through automation and organisational changes, according to Ruiz. “Treasury was purely seen as a cost centre and would typically be subject to cost reduction exercises related to outsourcing activities to shared service centres (SSCs) or downsizing.”

When the financial crisis hit, however, the importance of the role of the treasurer became glaringly apparent and it was realised that the lack of investment in treasury departments left most companies completely unprepared to handle the series of drastic market events that would follow. In this context, the evolution of treasury organisations has been measured, says Ruiz. “The trend has been for treasury groups to first focus on automating manual processes through treasury technology solutions to free up resources. Once completed, they typically turn to moving up the treasury operating maturity model and seek to establish centres of excellence in FX, liquidity management, banking and risk management – that is, components of in-house banks.”

Ruiz adds that a more sophisticated and integrated ERP solution needs to be in place before all aspects of an in-house bank can be implemented, including global liquidity pools, a payment factory and a collections factory. But working on integrating and improving aggregation of all sources (TMS, ERP and non-financial data) is close to the heart of the innovative modern treasurer, says Aubin, who is currently placing a lot of energy into having in-house systems integrated in an efficient manner. “We need to integrate the data from these sources in

such a way that we can extrapolate an accurate forecast. This is again where we need near real-time information.”

The EBU is now working on the implementation of the SWIFT network to allow better access to banks for its subsidiaries, according to Aubin. But regardless of what each company has achieved thus far, the drive to constantly improve processes, systems and infrastructure is clearly apparent across the landscape, borne from a need to survive and adapt in a difficult economic and competitive era. In this respect, Dahrendorf sees the Single Euro Payments Area (SEPA) as a very reasonable and welcome development because it makes the payment exchange in Europe much easier, more convenient and perhaps most importantly, cheaper for companies. “Our own company has almost finished our approach to this – we are prepared and essentially SEPA-ready. But what we are now looking at is what others should also address – the fact that there may be establishments outside the SEPA zone, under our company remit, which are also transacting in euros.”

“If they are handling in euros, they have to fulfil the same requirements as any company in the SEPA zone. The majority of companies are only looking at the subsidiaries that are located within the SEPA zone but if you have a company in China that deals a reasonable part of its business in euro, then they have to ensure that payments still reach the beneficiary effectively after the introduction of SEPA,” he warns.

Strengthening the supply chain

In an effort to optimise internal processes, treasurers are also acutely aware of external influences that must be appropriately addressed and managed. For many companies, the biggest sustainability risks they face are embedded in the supply chain. Tied to this process are various treasury-specific metrics – for example, reduction in working capital and reduction in cost of funds – as well as broader finance goals, such as reduction in the cash conversion cycle and improvement of accounts payable (AP) and accounts receivable (AR) terms, inventory and cyclical cash flow.

Ruiz recognises that maximising working capital is not exactly a new concept but believes that the function has grown and improved. “While the method itself may not be novel, I find that CFOs are trending towards giving treasurers greater responsibility for governance over working capital in general. In response, treasurers are seeking to utilise their own cash flow forecasting process and marry this as much as possible with budget and forecasting models to be able to provide independent views to the CFO on opportunities to improve and reduce working capital overall.”

Indeed, supply chain finance (SCF) is an area in which Knorr-Bremse as a company has focused on for almost six years. Dahrendorf and his team, in partnership with Deutsche Bank in 2008, developed one of the very first finance supply chain (FSC) programmes, an initiative that merited an Adam Smith Award in 2009. This is still such a relevant theme, especially in terms of liquidity, says Dahrendorf. “If you look at the fact that many companies have been newly assessed in terms of their ratings by the banks and as a result are sometimes rated worse than before, their credit facilities may be negatively affected. If that happens with supply chain finance, they may get the opportunity to turn to customers such as ourselves to improve their liquidity by participating in a relevant programme which we can offer them. Since they

are practically selling AR to the bank, we are actually lending our rating to these suppliers.

“Some companies that were extremely reluctant to take part in a supply chain programme initially have suddenly become interested. They realise that this finance structure is basically the same as factoring. The crucial difference to factoring, however, is that some of the cost/risk components of a normal factoring programme are excluded and that makes it very attractive for companies. The extension of SCF solutions is a very important tool – not only now but also for the coming years – to stabilise especially smaller suppliers and optimise our own working capital structure.”

Lawaree too acknowledges a change in tactics across the industry in recent times, a growing understanding that working with treasury at an early stage and being upfront in order to optimise supply chain structures can be hugely beneficial for all concerned. “We have seen over the past years, both in the structure of treasury department and also in the interactions with external operations an evolution, a move towards a much more dynamic and proactive approach in working capital management processes.”

Innovation meets technology

When the treasury function was highlighted as having such a central role to play in the survival and the development of the corporate, the technology providers and banks launched a tsunami of product releases, solutions that would enable the corporate treasurer to do their job better – and more easily.

Companies of all sizes are either implementing or are looking to implement some form of treasury technology solution to

automate tactical treasury processes, according to Ruiz. “Whereas before, companies under \$5 billion in revenues would usually rely on manual processes and a series of banking platforms to operate treasury day-to-day, web-enabled cash management-focused treasury workstation solutions have flourished in this space to offer cost-effective and relatively more easily implementable solutions.”

A rapidly advancing industry, Lawaree says that the choice of available products is a welcome one. “Everything that can help treasury to increase automation and controls is appreciated. New regulations plus the need to absorb more and more data is driving our strategy and projects.”

Eaton Corporation is also looking at options for an in-house system that will incorporate cloud services as it is an area, says Lawaree, which has seen mass adoption – and created great benefits – across the corporate system landscape. Aubin, for instance, uses a TMS in his treasury which is cloud-based and cites many advantages of the platform, not least the fact that his team do not have to rely on IT support. However, he does add: “the bad side is that typically for customisation and integration with other systems, you have to somehow rely on the existing features or it means additional costs. While we enjoy using the application for TMS and cash management and so on, it does have its limitations.”

Nonetheless, ultimately the trend is to essentially tap into creativity and find very innovative solutions in order to make sure that the corporate is always well financed and has enough access to cash, according to Dahrendorf, concluding: “there is no way that one size fits all. Every treasurer has to adjust; with the tool box that is available, they must find a solution that is appropriate for their company.” ■

The regulation wall

Corporates, too, have boundaries – perhaps not to their innovation or creativity – but there are some aspects of the current environment that treasurers may not be able to tackle themselves. The regulatory backlash – that continues to rage on – from the economic slump is one such area. Many market participants believe that a large portion of these rules and guidelines were made in haste and used as a ‘comfort blanket’ to assuage fears of double (or triple) dip with no real consideration for the damage it could have on already suffering corporates.

This is a challenge for medium-sized companies, according to Dahrendorf. “In Germany, for example, are many mid cap companies that are generally not very well equipped with risk management and IT systems to administer their FX deals and so on. But they are also required to do the same thing as the larger corporates if they go beyond the thresholds and for them this is really a challenge.”

Dahrendorf gives us the example of the introduction of European Market Infrastructure Regulation (EMIR) to highlight his point. On 4th July 2012, the regulation on over-the-counter (OTC) derivatives, central counterparties and trade repositories was adopted and it entered into force on 16th August 2012. According to the European Commission, the aim of this legislation is “to ensure that all European derivative transactions will be reported to trade repositories and be accessible to supervisory authorities, including the European Securities and Markets Authority (ESMA), to give policymakers and supervisors a clear overview of what is going on in the markets.”

Dahrendorf accepts that that the fundamental concept of the legislation is relevant enough but cannot fathom why the regulators have decided to extend that small to medium-sized producing companies. “The administrative burden is in no reasonable relation to the risks involved. For banks, it is an acceptable request as it is part of their business model to speculate FX deals; but mid-cap companies, where FX business is just for hedging in order to keep the company cash free from negative currency impacts, are suffering.”

Corporates are not capable of managing this, according to Dahrendorf. They have to implement bigger projects to fulfil the requirements. Also larger companies, such as Knorr-Bremse, have decided to implement projects to deal with these new regulations and facilitate their implementation into their daily business. “Essentially we need the help of consultants for this, as we feel that this is too sophisticated and too complicated with too many traps along the way.”

FOR WHOLESALE/PROFESSIONAL/INSTITUTIONAL CLIENTS ONLY NOT FOR RETAIL CLIENTS' USE OR DISTRIBUTION

Chinese AAA MMFs: an ideal solution

As cash pools grow in China, treasurers are looking for secure, highly liquid investment solutions in line with corporate policy. The CIFM RMB Money Market Fund¹, pioneered by JPMAM, goes one step further.

In China, a country still relatively restricted in terms of cross-border money flows, multinational corporations (MNCs) seeking a short-term, more secure home for their excess cash have few options open to them. The traditional response has been to play safe and opt for bank deposits; however, their yields and tenors are regulated by the country's central bank, People's Bank of China (PBoC), making them less flexible than international bank deposits.

For a treasurer seeking more security, liquidity and optimal returns on their cash, there is a means of gaining packaged access into the underlying fixed income markets in China, which generally are much higher-yielding than regulated deposits. And there is one solution that has considerably more provenance than any other in China.

The China International Fund Management (CIFM) RMB Money Market Fund (CIFM RMB MMF), pioneered by J.P. Morgan Asset Management (JPMAM) through its joint venture company, CIFM, was the first – and is the largest² – AAA-rated fund in China³ and has become one of the most popular investment choices for treasurers in China.

In the beginning...

The history of MMFs in China stretches back to 2003 when the China Securities Regulatory Commission (CSRC) first published MMF guidelines. In 2004, CIFM was created as a joint venture between JPMAM, itself the largest institutional AAA-rated MMF provider globally (with more than \$506 billion under management as of 31st December 2012⁴) and the non-bank financial institution, Shanghai International Trust Co (SITCo). The CIFM RMB MMF was launched in May 2005, leveraging on the product and investment expertise of JPMAM. JPMAM continues to be in direct communication with CIFM in regards to the investment process for this fund.

The CSRC guidelines are much broader than what we see in the existing international setting, comments Travis Spence, Head of Global Liquidity, Asia Pacific for JPMAM. The weighted average maturity guideline, for example, is 180 days in China, which is three times longer than typically allowed in the international context at 60 days. Having the appearance more of a short bond fund than a MMF, Spence says JPMAM saw the strategic opportunity to create a AAA-rated fund which would not only be more consistent with the guidelines understood and accepted by its global clients operating in China, but also better serve the needs of rapidly expanding local corporates who share the same investment objectives for their excess operating and reserve cash.



The rating is an additional level of comfort for treasurers, which is also often a requirement of investment policies. "We worked with the rating agencies to develop a rating structure for AAA MMFs in China," Spence explains. The CIFM RMB MMF's rating is provided by both Fitch and Moody's local unit, which is a joint venture with CCXI, the first nationwide domestic credit rating agency created with the approval of the PBoC.

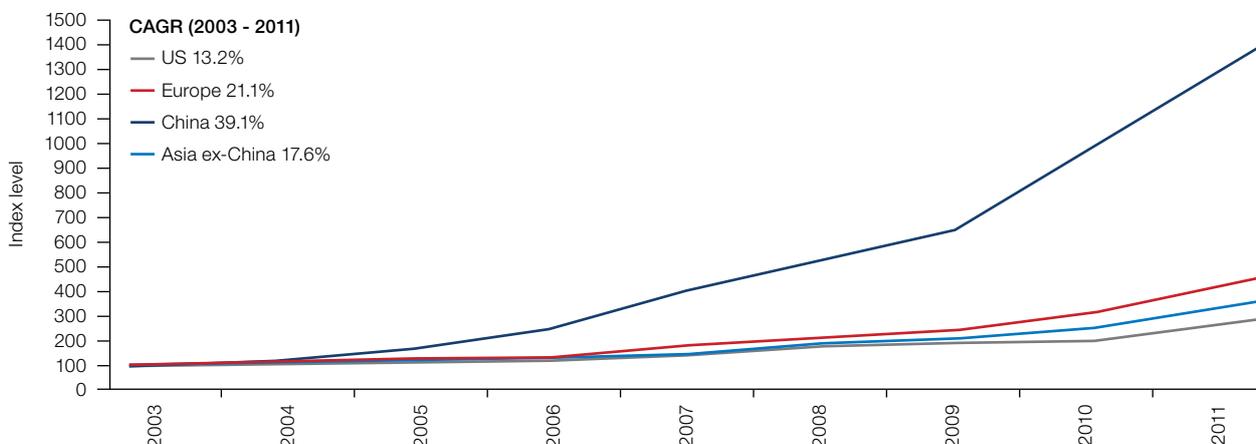
Cash balances are growing faster in China than other developed markets and this has fuelled a quest for better alternatives.

The publication of CSRC's guidelines was a timely intervention and, as a pioneer in this space, the CIFM RMB MMF was proactively designed to fit neatly into most global investment policies while satisfying the burgeoning needs for better diversification, liquidity and yield optimisation. The CIFM RMB MMF's T+1 liquidity gives it more flexibility than regulated call deposits, while typically out-performing the rates prescribed by PBoC.

As the concept becomes more familiar, increasing numbers of both local and MNCs are choosing to invest in MMFs in China. The CIFM RMB MMF in China, Spence adds, has doubled in size in the past five quarters, with RMB 21.99 billion (\$3.5 billion) in assets under management as of 31st December 2012⁵, and rose another 10% during January 2013 – there are more than 250 institutional investors using the fund, giving it a highly stable client base⁷.

Chart 1: Cash in Asia is growing even faster than other regions⁵

Historical normalised* comparison



Source: Bloomberg

The launch of the RMB fund was part of a long-term strategy in Asia to serve JPMAM's global clients and develop new local currency solutions for domestic institutional investors, notes Spence. Since then JPMAM has developed its footprint in Asia with the addition of AAA-rated MMFs in Japanese yen (JPY) in 2007, Singapore dollar (SGD) in 2007 and Australian dollar (AUD) in 2010.

Taking it to the region

In taking this trail-blazing approach, JPMAM becomes the only provider with a consistent MMF strategy across the region, added to which it brings the benefits of its wider global investment experience. Despite its ongoing series of 'firsts' in this space, Spence feels JPMAM is still at an early stage of development of its regional solutions. This is not false modesty, he explains, but "part of our long-term strategy to build a

complete platform of short-term solutions across key markets in Asia, and grow with the markets." It has, he opines, "certainly been a very successful beginning. However, it is important that we continue to innovate in the largest markets like China and Japan, which is why we launched our second MMF in Japan in October 2012, the JPY Government Liquidity Fund, which became the first ever T+0 institutional MMF in the domestic market limited to government risk in the underlying portfolio."

Indeed, in January 2013, total assets under management (AUM) for JPMAM's Asian local currency MMFs exceeded \$11 billion⁹, along the way securing its status as the largest institutional MMF provider in Japan¹⁰ (and only AAA MMF), the largest AAA MMF in China and the largest and only AAA-rated MMF in Singapore dollars¹¹.

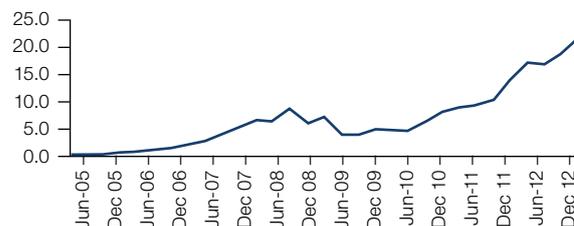
The CIFM RMB MMF was the fastest-growing MMF of the Asian platform for JPMAM during 2012, rising by about RMB 8 billion (\$1.2 billion)¹². "What we are experiencing is corporate demand driving growth of short-term fixed income markets in Asia, represented by the MMFs we manage," comments Spence. "This will continue to allow us to create new and innovative solutions for our clients."

What the treasurer wants

Treasurers generically look for five key attributes when evaluating new investment products, explains Spence:

1. Security of principal.
2. Liquidity, without hidden costs or penalties.
3. Diversification.
4. Transparency, with easy to understand structures.
5. Relative yield.

"The CIFM RMB MMF in China is successful because it hits all of these attributes and it is consistent with global treasury policies," he states, adding that even the push for yield, which is typically the last in the list of demands, is satisfied. "The unique thing about

Chart 2: CIFM RMB MMF size since inception (RMB billion)⁸Source: Wind data as at 31st December 2012

China is that the regulations are still demanding: bank deposits, for example, are controlled by both tenor and yield. However, there is a deep and growing fixed income market that operates based on market yields.”

But the fixed income markets are not the easiest for a treasurer to gain direct access to, comments Spence. MMFs – especially the AAA-rated fund, which invests in the highest rated instruments available onshore (primarily treasury bills and other government-backed instruments, and repos) – provide a neatly packaged solution for those seeking to access the fixed income markets to achieve both diversification and higher yields than traditional bank deposits. For example, during January 2013, the seven-day repo market (the deepest most liquid market in China) provided yields averaging 3%, whereas a regulated seven-day PBoC deposit offered 1.35%¹³.

Besides improved yield, there is an additional advantage for treasurers. Dividends from mutual funds in general, which would include MMF's are tax-exempt. With corporate tax in China up to 25%, this is potentially a material difference to other taxable investment options, including deposits and direct securities¹⁶.

In this context, if the prospect of MMFs in China sounds too good to be true, Spence refers back to the generally broader guidelines issued by CSRC. Of the 62 MMFs¹⁷ in the market today, most follow the broader set of guidelines. Investment practices, he notes, will therefore naturally differ from one fund to another and he urges investors to fully understand the investment processes and risks of the funds they are considering, as well as the experience of the manager, adding that due diligence has always been an important part of investment decisions.

The guidelines of the CIFM RMB MMF creates a unique appeal to prudent corporate and institutional investors in China. Indeed, with the demand in China increasing for alternative investment solutions beyond using simple bank deposits, the CIFM RMB MMF is seen by Spence as “a great first step” for companies to take.

The next big trends in China

JPMAM's experience suggests that trapped cash will still exist, despite new programmes from the Chinese government designed to liberalise cross-border capital flows. For example, pilot schemes around RMB and foreign currency movements are underway, under the guidance of China's State Administration of Foreign Exchange (SAFE), in consultation with PBoC. For now, these pilots are deliberately limited in their reach (around five banks and thirteen corporates to date).

While the pilots will offer some companies more flexibility in managing excess cash balances in China, Spence notes that there are also companies that are intentionally holding back annual dividends for future growth. “For many companies, there is much more potential to grow inside China than outside,” he notes, adding that local cash in the meantime could earn an average of 3-4% in China as opposed to “near-zero” in developed markets, with the opportunity also for currency appreciation.

As these reserve cash pools grow, treasurers are increasingly looking to segment cash in China, as many already do globally. More intensive cash flow forecasting processes will deliver more balanced decisions between the need for liquidity versus longer investment horizons. Currently the options available further out on the curve are “very limited – almost non-existent”, says Spence. So, as companies in China consider what to do with their cash reserves, he says discretionary investment portfolios, or separate accounts, are becoming “very interesting”.

CIFM, using the same investment process as the RMB MMF and in conjunction with JPMAM, launched the first short-term fixed income separate account in June 2012¹⁸. Such solutions will play an increasingly important part of its solutions mix going forward. Companies will normally maintain diversification limits in individual mutual funds, thus restricting how much can be placed in a single MMF. The “almost unlimited” scale and diversification that can be achieved in a separate account will thus provide the ideal vehicle for the corporate treasurer with cash reserves that have a longer investment horizon.

Despite the obvious success of the CIFM RMB MMF, surprisingly it is only in the last 18 months that a small band of competitors has seen fit to enter the market. Whilst there are some natural barriers to entry, the most obvious being foreign fund managers' requirement to operate through a joint venture (one of the reasons why JPMAM partnered with SITCo to create CIFM), Spence admits that he anticipated competitors would appear “much earlier on”.

Regardless of the how and when other players make their entrance, Spence welcomes these incursions into what has become JPMAM's own high ground. “It will help to grow the overall market and provide some alternatives,” he comments. But then he can perhaps afford the easy acceptance of competition: with an eight-year track record in the market, it gives JPMAM a distinct advantage in terms of market knowledge and scale within its funds. “I think that is going to continue to differentiate JPMAM and CIFM for years to come.”

Common Market Yields in China PBoC Deposit Rates ¹⁴ (as of 31 st January 2013)	Rates
Current	0.35
One-day call	0.80
Contract savings	1.15
Seven-day call	1.35
Three month	2.60
Six month	2.80
One year	3.00
Yield Comparison ¹⁵ (as of 31 st January 2013)	Rates
O/N repo	2.185
Seven-day repo	3.315
3M PBoC bill	2.67
CIFM RMB MMF (seven-day average)	2.725
CIFM RMB MMF (30-day average)	2.94

MMFs – A brief guide

Money market funds (MMFs) are short-term debt securities, forming a part of the fixed income market. There is no central exchange or trading floor and trades are executed via the dealer market only, which is to say transactions are made through the dealer's own account; money markets rarely offer direct access for investors and so mutual funds tend to be the way in. Instruments traded are numerous but the main ones typically used in the international setting are treasury bills, certificates of deposit (CDs), commercial paper (CP), Eurodollar deposits, asset-backed securities and repurchase agreements (repos). MMFs tend to be rather conservative in their approach and therefore relatively low-yielding, but they are highly liquid, making them attractive to treasurers seeking a home for their excess cash.

FOR WHOLESALE/PROFESSIONAL/INSTITUTIONAL CLIENTS ONLY NOT FOR RETAIL CLIENTS' USE OR DISTRIBUTION.

For non-US Investors. Please note that this document is for professional, institutional or wholesale investors' use only. It is not for public distribution and the information contained herein must not be distributed to, or used by the public.

The material and communication contained herein is intended as a general market commentary for distribution to investment professionals only. The above information does not constitute investment advice, or an offer to sell, or a solicitation of an offer to buy any security, investment product or service nor a distribution of information for any such purpose. Opinions, estimates, forecasts, and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. The information provided herein should not be assumed to be accurate or complete. The views and strategies described may not be suitable for all investors. These materials are not intended to constitute legal, tax, or accounting advice.

The value of investments and the income from them may fall as well as rise and you may not get back the full amount invested.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited which is regulated by the Financial Services Authority; in other EU jurisdictions by JPMorgan Asset Management (Europe) S.à r.l., Issued in Switzerland by J.P. Morgan (Suisse) SA, which is regulated by the Swiss Financial Market Supervisory Authority FINMA; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, all of which are regulated by the Securities and Futures Commission; in India by JPMorgan Asset Management India Private Limited which is regulated by the Securities & Exchange Board of India; in Singapore by JPMorgan Asset Management (Singapore) Limited which is regulated by the Monetary Authority of Singapore; in Japan by JPMorgan Securities Japan Limited which is regulated by the Financial Services Agency; and in Australia by JPMorgan Asset Management (Australia) Limited which is regulated by the Australian Securities and Investments Commission; in Brazil by Banco J.P. Morgan S.A. (Brazil) which is regulated by The Brazilian Securities and Exchange Commission (CVM) and Brazilian Central Bank (Bacen); and JPMorgan Asset Management (Canada) Inc. is a registered Portfolio Manager and Exempt Market Dealer in Canada (including Ontario). In addition, it is registered as an Investment Fund Manager in British Columbia. In the United States by J.P. Morgan Investment Management Inc. which is regulated by the Securities and Exchange Commission. For U.S. registered mutual funds, J.P. Morgan Institutional Investments Inc., member FINRA/SIPC. Accordingly this document should not be circulated or presented to persons other than to professional, institutional or wholesale investors as defined in the relevant local regulations. The value of investments and the income from them may fall as well as rise and investors may not get back the full amount invested.

© 2013 JPMorgan Chase & Co.

¹The CIFM RMB Money Market Fund (the "Fund") is a fund managed by China International Fund Management Co. Ltd. which is a joint venture between Shanghai International Trust Ltd and J.P. Morgan Asset Management (UK) Ltd. This Fund is not being offered through J.P. Morgan Funds (Asia) Limited. The information contained herein is for informational purposes. Shares of the Fund may be offered and sold only in China to: (i) individuals who are Chinese citizens and residents; (ii) institutions legally organised in China and permitted by Chinese law and regulation to invest in open-end investment funds; and (iii) entities with "Qualified Foreign Institutional Investor" status in China.

²Source: Wind data, as at 31st December 2012.

³Source: China Cheng Xin International Rating Co. Ltd. (CCXI), with technical assistance provided by Moody's Investors Service, Inc. Moody's, assigned a MMF national scale rating of Aaa to the CIFM RMB MMF. This level of credit quality qualifies for the highest fund rating on a national scale basis.

⁴Source: iMoneyNet, selected AUM for the Asset Management (JPMAM PCS, PB) division of J.P. Morgan Chase & Co. and CIFM internal report, all data as at 31st December 2012.

⁵Source: Bloomberg, as of 15th December 2013. Analysis done by looking at the cash and cash equivalents of the top 100 listed companies in each country/region for each respective fiscal year. Asia includes China, Japan, Singapore, Hong Kong, Taiwan, Korea, India and Australia.

*Rebased to index level of 100.

⁶Source: Wind data as at 31st December 2012 and 30th September 2013.

⁷Source: CIFM internal reporting 31st January 2013.

⁸Source: Wind data as at 31st December 2012.

⁹Source: JPMAM internal reporting including selected AUM for the Asset Management (JPMAM PCS, PB) division of J.P. Morgan Chase & Co. and CIFM internal report, data as at 31st December 2012.

¹⁰Source: JPMorgan and The Investment Trusts Association, Japan (JITA), as of 31st January 2013

¹¹Source: Bloomberg as at 31st January 2013.

¹²Source: Wind data, as at 31st December 2012 and 31st September 2011.

¹³Source: Bloomberg and PBoC website as at 31st January 2013.

¹⁴Source: Bloomberg and PBoC website as at 31st January 2013.

¹⁵Source: Bloomberg and PBoC website as at 31st January 2013.

¹⁶Investors are advised to take, in advance, all necessary legal, regulatory and tax advice on the consequences of an investment.

¹⁷Source: Wind data as of 31st December 2012.

¹⁸Source: JPMAM internal reporting and CIFM internal report, data as at 31st January 2013.



Demystifying corporate pensions

The basic concept of a pension fund is simple, but there are many pressures applied to the different scheme-types and these make it a far more complex matter than most would care to tackle. What are the issues?

Roger Daltrey of the rock band, The Who, sang the legendary words “hope I die before I get old” back in 1965. He is now well into pensionable age (69 at the time of writing) but few would say he’s old per se; life expectancy (from birth) in developed countries with state-funded healthcare systems (such as Japan, Canada and the UK) is now more than 80, with lifespan (the figure calculated for individuals making it into early adulthood) increasingly seeing people live into their 90s.

With such a proportion of life spent in retirement, making financial provision for the later years of life becomes an increasingly important part of working life for many – rock stars included. One of the most common ways of approaching this is through a pension scheme.

Most pensions provided by companies throughout the world are funded schemes. These operate as funds established by the company and will be built up by regular contributions from both the company and its employees. A fund is normally structured as a trust (and thus managed by a trustee), so the assets are kept separate from those of the sponsor company.

Defined benefit or defined contribution

The majority of funded pensions provided by companies for employees are either defined benefit (DB) or defined contribution (DC) schemes.

DB schemes pay members a pre-defined pension on retirement. The amount is worked out as a proportion either of

the average or the final salary of a member, the latter being the most common model. A member leaving a company will often find it administratively difficult to take the pension benefits they have accrued with them; but DB schemes remove the risk related to investment performance. Employers operating a DB scheme can, in lean times, find themselves with a serious funding shortfall: the deficit in UK pension schemes hit a record high of £312.1 billion in mid-2012.

In the last decade, many DB schemes have closed to new members: latest figures in the UK from the National Association of Pension Funds (NAPF) show just 13% of private sector DB schemes are open to new members (in 2005 it was 46%). DB obligations must still be met and NAPF figures show that more than two million workers are still members and the schemes pay out to over four million pensioners.

Most companies started offering DC schemes as a way of mitigating the risk of future pension scheme insolvency. The aim of the DC pension scheme is to give a lump sum on retirement. This is used to purchase an annuity which pays out on a regular basis for the rest of the member's life. The value of the lump sum is worked out according to the employee's contributions (personally and those made by the employer on their behalf) and by the performance of the pension fund as a whole, passing the risk of poor performance onto the members. But employers must commit to a defined level of contribution which must be paid irrespective of the financial health of the company.

Accrued assets for each member are easier to transfer should the member leave the company, but DC schemes typically require more effort (and more expense) on the part of the company in terms of administration than DB because each member has a tailored pension according to their individual circumstances.

Trustees

All schemes must remain solvent and must comply with the relevant regulations. This is one of the main tasks of the trustees of the scheme. According to the Association of Corporate Treasurers (ACT), citing IAS19 accounting regulations, "the overriding duty of the trustee is to act in the best interests of scheme members and to be seen to do so". In remaining at arms length from business decisions, trustees can influence the outcome of major commercial activities.

In July 2004, the trustees of the pension funds attached to UK-based retailer, WHSmith, forced private equity firm, Permira, to drop its plans to acquire the firm after failing to come to an agreement about how to fill the £250m gap in its pension fund. Trustees have been notably vocal in other M&A deals, including Kraft's takeover of Cadbury (Cadbury's scheme had a deficit of £500m), the failed takeover of Marks & Spencer by Philip Green (rumours of another attempt abound) and British Airways' merger with Iberia (the BA pension scheme bearing an estimated £3.7 billion deficit at the time of the merger). In 2007, UK-based high street chemist Boots was acquired by private equity firm KKR, it was reported that there were 'protracted and heated negotiations' with the trustees to protect the pension fund.

Let it grow

The investment strategy of the fund is directed by the trustees. In their duty to maintain solvency and comply with regulations, trustees are required to mitigate risk by creating a

broad investment portfolio. In taking the safe route, they often achieve relatively poor yield. Some firms took action against such low returns. In October 2001, the aforementioned Boots switched its £2.3 billion fund from equities to AAA/Aaa long dated sterling bonds, including 25% index-linked. In 2002 it increased its 25% index-linked content to 50%, executed through a series of interest rate swaps. That same year, the Financial Times ran the headline: "Bonds switch yields £700m gain for Boots".

On the rocks

Liabilities have outstripped assets in DB schemes for a number of reasons, not least measures to aid the economy, such as quantitative easing (QE).

QE rounds, first applied in 2009, were intended to kick-start the economy. In the UK, more than £325 billion worth of gilts were bought, forcing down gilt yields and long-term interest rates. Whilst this was intended to drive investors seeking higher yield into riskier securities, it had the unintended consequence of hitting naturally conservative pension funds right where it hurts. "Businesses running final salary pensions are being clouded by QE," said Joanne Segars, CEO of NAPF, in a statement. "Deficits that were already big now look even bigger because of its artificial distortions." In the UK alone, NAPF estimates it has cost schemes more than £90 billion.

Even in better times, measures were taken that may not have been as generally helpful as intended. In 1997 the UK's Advance Corporation Tax relief was scrapped. This meant pension funds were no longer able to reclaim tax on their dividend income, effectively lowering pension returns and reducing the incentive for corporates to put large contributions into their schemes.

The finger of accusation has also been pointed at actuarial miscalculations dating back to the 1980s and 1990s. Acting in tandem with existing regulations on producing valuations, actuaries seemingly took an overly optimistic view on the likely growth of pension investments – spurred on by buoyant stock markets – creating the impression amongst sponsoring companies that their liabilities were all taken care of. Many took 'contribution holidays' thinking they would simply catch up later. Boots, for example, had resumed contributions in 1999 after a long holiday, having adopted a market-based actuarial valuation of its fund.

In the UK, the government decided to tax pension fund surpluses in the late 1980s. According to Dr. Ros Altmann, Director General of the over-50s holidays and insurance specialist, Saga Group, these surpluses had built up not just because equities were fruitful, but also because there were more people contributing than retiring. The surplus, she wrote, should have been left to accumulate in order to take care of leaner times and to counter the point when the number of people retiring started rising.

Indeed, there is now a demographic shift to contend with. Where once people may have been expected to live another 15 to 20 years after retirement, now it is more like 25 to 30 years. Pension funds will struggle to cope.

The age of receipt of state pension can be raised to match changes of longevity, as it has in many countries including the UK and France, and the US is currently debating the issue. Plans are also afoot to bring private sector pensions in line by adjusting the benefit structure and UK retailer, Tesco, is noted for linking its scheme for new members to longevity.

Pension fund legislation update

In recent years there has been a general tightening of regulations governing pensions, with several new pieces of legislation being introduced covering areas such as mandatory indexation, re-valuation and spouse benefits, which together have increased sponsor liabilities (some NAPF members report increases of up to 30%).

IAS 19

In the preparation of accounts, International Accounting Standards (IAS) 19 covers employee benefits such as wages and salaries as well as pensions. It requires the assets and liabilities of a scheme to be noted on the balance sheet. DC accounting is relatively simple in that contributions and pay outs are recorded as they take place. DB accounting is more demanding as the value of the fund's future liabilities are, at best, an estimate. IAS specifies the use of actuarial calculation methods to arrive at an appropriate figure.

As such, IAS 19 asks for DB assets and liabilities to be recorded at 'fair value'. In terms of assets, market-based assumptions are most commonly used. Liabilities are more complex as they are calculated by discounting anticipated future outgoings of the scheme by the current return on high quality (normally AA-rated) corporate bonds.

Solvency II

Solvency II, due to go live in January 2014, is intended to standardise EU insurance regulation. It covers the level of capital that insurance companies need to hold to reduce the risk of insolvency. Imposing insurance standards onto DB schemes could have a negative effect on the liquidity and credit profiles of those still running these schemes.

Another component of Solvency II for pension funds is the deployment of the 'holistic balance sheet' (HBS). HBS is intended to iron out the differences across schemes in Europe and offer easier insight into, and comparison of, a fund's long-term financial position. The goal is to itemise and account for all the fund's assets and its liabilities.

Reasons not to be cheerful

According to the NAPF, the EU's assessment of Solvency II-type rules for pension funds (under the auspices of the European Insurance and Occupational Pensions Authority and its Quantitative Impact Study), is "seriously flawed". NAPF's Seggars has commented that HBS is not a sound analytical framework for assessing the strength of pension schemes because it does not take adequate account of the "complex structures of many large, multinational companies and their pension schemes".

Whilst it might be appropriate for insurance firms, Mel Duffield, Head of Research and Strategic Policy for NAPF, argues that most occupational pension schemes are already backed by an employer covenant indicating an ability to fund the scheme and underwrite investment risk. There is, she adds, also a compulsory insurance system (the Pension Protection Fund) which is funded by risk-based levies on all UK-based DB schemes. Adding strict requirements around what discount rates have to be used and what assets have to be held could see DB schemes facing an extra £300-£400 billion hit, she comments. As Solvency II rolls out over the next ten to 15 years, she feels it will "go against the government's growth agenda", as

corporates needing to hold the extra funding will do so in safe but low yield assets such as fixed income and gilts, in order to be seen to be sufficiently de-risked. "When there's a drop in gilt yields an employer can be looking at millions of pounds being added to their deficit overnight. If you're forcing the corporate to put more cash into the pension scheme in the short term that is obviously cash not being invested elsewhere."

Not only that, notes Duffield, but the legacy of DB may take another 60 years before all the benefits accrued in those schemes are paid out. In the meantime, corporates will probably be looking at managing "a whole series of pension offerings". When auto-enrolment was introduced by the UK government in October 2012 (to ensure most people have access to a pension plan), some firms will have to create additional schemes on top of their existing DB and DC schemes to cater for the new influx of members. This could create "significant levels of administration" for companies.

An observed effect of this is that DC schemes can often become "a bit of an afterthought", simply because they do not carry the same risk for the employer as DB, in which trustee time tends to be absorbed by the funding issues and the required level of interaction with the regulators.

One of the main challenges, therefore, is to reduce time taken in dealing with those issues. Tom Wood, Head of Professional Services Industry at Barclays, believes that it is essential for a trustee to grasp as soon as possible what is going on in the markets in terms of regulation and key risks, and to consider the resources needed to manage these changes. "Because of the extra challenges trustees have to deal with, our aim is to provide them with slicker systems and processes to carry out their day-to-day tasks, to give them time back," he says. The bank's insight puts trustees in a position to stop fire-fighting and start taking "a more considered approach".

Creating a high level awareness of impending issues and pointing the way to the appropriate specialist advisors is a vital part of the role for Wood's team of directors. Discussion may, for example, concern how regulations will impact upon the way in which funds are reported at the P&L level, or provide commentary on how volatility in the Eurozone will pan out. However, he says, there is "a real challenge in predicting what the potential shortfall would look like in any DB scheme", and so direct bank-led finance solutions are an option, such as a letter of credit (LC).

Dealing with investment strategy is difficult because much of the regulatory pressure centres on fund de-risking, but at the same time the fund needs to get the best return. NAPF's Duffield notes that in the past few years there has been "a big shift away from equities into fixed income", and where speculation that the bond bubble "might be about to burst", some funds have been looking for other growth assets (stopping short of a shift back to equities).

In terms of the shift from DB to DC schemes, the trend will continue, says Wood. As the general level of awareness of the important issues necessarily increases, so some trustees are becoming "a little more sophisticated" in the management of their funds. By putting in place "early warning" trigger points which reflect market changes, he believes they are better able to foresee the risk of those changes and to take appropriate action. ■

David Ricardo

The economist John Maynard Keynes once said of David Ricardo that he had “conquered England more completely than the Holy Inquisition conquered Spain”.

Today, David Ricardo is remembered primarily for what he contributed to our understanding of economic growth and income distribution. As an economist, his theoretical works included explaining what causes economies to grow and decline, and how the three components of wealth – rent, wages and profits – are divided up within societies. Ricardo wrote from a staunchly free trade perspective, more so even than the man credited as founding father of classical economics and liberal capitalism, Adam Smith. International free trade, according to Ricardian theory, is an absolute must in order for nations to grow and prosper; protectionism, on the other hand, was a policy which always damages growth. In Ricardian economics, the introduction of tariffs almost always precipitates economic decline.

Early life

Ricardo was born on 18th April 1772 in London. He was the third child of Abraham Israel Ricardo, a Spanish Jew who had formerly worked as a stockbroker at the Amsterdam Stock Exchange. At the age of 11 he was sent to live in Amsterdam with his uncle – also a trader – to educate and prepare him for following his father into the world of trade and finance.

Upon returning to England, Ricardo took up work at his father’s office. He proved very capable, eventually earned himself such a reputation that London’s banks provided him with credit to establish his own office. The fact that Ricardo was able to establish himself as a trader so swiftly was fortunate because he was soon to become estranged from his father, a result of his disapproval over the young Ricardo’s romance and later, marriage to a woman from the Quaker religion.

Now working independently as a broker on the London Stock Exchange, Ricardo was able to amass a huge personal fortune through his knowledge and understanding of stocks, bonds and real estate investments. Having secured significant personal wealth while still in his 20s, Ricardo took the decision to dedicate the rest of his life in pursuit of his various intellectual and scientific interests – mineralogy, geology, mathematics and chemistry.

Ricardo the economist

Ultimately Ricardo would become renowned for his writings on economics. His career as an economist began after he came across a copy of Smith’s ‘The Wealth of Nations’ while on vacation in Bath. The text had a profound influence on Ricardo, even though the approach to economics he later developed would differ markedly. After reading Smith, he became inspired to study economics and would meet frequently for friendly debates with a group of other eminent intellectuals of the day, including the likes of James Mill, Jeremy Bentham and Thomas Robert Malthus.

Like many of the other classical economists before him, Ricardo immersed himself in the study of economic theory for a particular purpose – to develop practical solutions to the various economic and financial questions facing the UK in the first two decades of the 19th Century. In 1819, he purchased a seat in the House of Commons and served briefly as an MP for the Irish borough of Portarlington. His reputation within the legislature as an expert on financial and economic matters was quickly cemented, and he became known for often taking contentious positions on some of the important issues of the day including tariffs, taxation and agricultural trade.

In most economic textbooks today, the main references to Ricardo are to his theory of comparative advantage. Over two centuries on, Ricardo’s analysis on this matter is still used as the justification used by most economists against protectionist tariffs and in favour of free trade. But Ricardo did make at least three other important contributions to economic thought. His theories helped to explain the distribution of national income between profit, rent and wages and how that distribution changes over time. He also developed the labour theory of value which, somewhat paradoxically considering Ricardo’s liberal credentials, provided a framework later used by Karl Marx.

Why free trade can work for everyone

Smith’s ‘Wealth of Nations’ was the starting point for Ricardo’s analysis of international trade. Smith believed that if a given country was more efficient at producing certain goods than another country, then it would naturally endeavour to export those goods to the other country. This is what is referred to by Smith as “absolute advantage”. For example, a country with an absolute advantage in the production of food, clothes and cars will export those items to other countries. As a result, those other countries will begin to run up trade deficits.

But from Ricardo’s perspective it was comparative – not absolute – advantage that was the critical factor in international trade. It did not matter if one country was less efficient at producing all goods, he argued. It was relative efficiency that was decisive.

Ricardo observed that countries tended to export goods that they were relatively more efficient, or relatively less inefficient at producing. Therefore, the key to understanding comparative advantage is “opportunity cost” – that is the value of what is given up. In his 1817 book, ‘On the Principles of Political Economy and Taxation’, he used the example of Portugal and England to illustrate the point.

In Portugal, economic conditions meant that it was possible to produce both wine and cloth using less labour than it does for England to produce the same quantities. Portugal had, in the words of Smith, an absolute advantage in the

production of both products. However, in this example it was the relative costs of producing the two goods that really mattered. In England, the natural environment is not particularly conducive for wine production; but producing cloth, by comparison, is not such an impossible challenge. So while it proves cheaper to produce cloth in Portugal, the opportunity cost is such that there is more incentive for Portugal to produce excess wine in order to trade of English cloth.

The conclusion Ricardo draws is still considered to be one of the cornerstones of the doctrine of international free trade. By specialising in a good where it has comparative advantage, cross-border trade can be beneficial for both, and, indeed all nations.

Rent, profit and wages: a theory of income distribution

Ricardo's second important contribution to the science of economics was a theory explaining how income is distributed between workers, landlords and capitalists. There are three elements to the model that Ricardo devised – a theory of rent, a theory of profits and a theory of wages. The conclusion he reached was that profits are inversely related to wages, which in turn fluctuate on account of the rise and fall of the price of food staples. As populations grow, the rents on land also increase owing to the increasing costs of producing larger quantities of food for the expanding populace. However, unlike his good friend and intellectual rival Thomas Malthus, Ricardo did not see much tendency towards unemployment. He did consider, however, that a rising population might adversely affect the incomes of workers, pushing wages down to a subsistence level.

Ricardian economics for the 21st Century?

Ricardo, along with the other classical economists, is often cited for the historical importance of their work. But do the writings of an economist who lived two centuries ago still hold relevance today? What insights can today's policymakers draw from the theories that Ricardo is known for?

In any economics textbook today, if you come across any mention of Ricardo, a majority of them will be in reference to his theory of comparative advantage in international trade. For that reason, agricultural protectionism is likely to be the ideal starting point for any discussion of the classical economist's 'legacy'. Dr. Terry Peach, Professor of Economics at Manchester University, argues that Ricardo will continue to hold some relevance to economics for as long as governments continue to play politics with trade and give in to pressure for protectionist policies.

"What you've got from Ricardo, far more than with Smith," he reasons, "is what amounts to an extreme free trade position. There is barely any role for government at all." Today this position would clearly put Ricardo at odds with some current laws on the statute books – the EU's Common Agricultural Policy (CAP) being one which immediately springs to mind. "Ricardo would find the idea of agricultural protection completely abhorrent," Dr. Peach adds. "In his view, there should be no restrictions on trade activity – this should all be left to the market."

We can also draw some insight from Ricardo on that perennial issue in financial markets over the past few years: sovereign debt. Again, Ricardo would almost certainly have taken a dim view of the budgetary deficits racked up by Western governments in recent history, even if some of that debt was the product of nations acting to rescue the free markets he so cherished. He was once reported to have said that the UK would be the happiest nation on earth if it only "got rid of two great evils – the national debt and the Corn Laws". Had his advice been heeded by government, according to Dr. Peach, the past several centuries may not have been quite as bloody.

"In the case of the national debt he argued that it should be paid off in a two year period. It was astonishing," Dr. Peach says. In a proposal that echoes some current debates within the UK's coalition government, Ricardo suggested that the debt be paid off through the imposition of a property tax. Then, once paid off, governments should run a balanced budget and steer clear of the capital markets, particularly with regards to funding costly foreign conflicts.

"His argument was that war should always be financed out of current taxation, never by government borrowing," explains Dr. Peach. "The logic follows that if you finance it through government borrowing, then governments would be far more likely to engage in these adventures. On the other hand, if the position was that any foreign adventure had to be financed by current taxation then there would be far more public hostility."

Ricardo would almost certainly have had something to say on the subject of recent trends in monetary policy too. Asked what Ricardo would have thought about the Federal Reserve's quantitative easing (QE) and recent reports about countries engaging in competitive currency devaluations, Dr. Peach is unequivocal. "Ricardo was very much in favour of independent central banks," he says. "His last publication was promoting the idea of a national bank which he would set up in place of the Bank of England (BoE), for which he had no time for whatsoever. The commissioners of the bank would be appointed by the government, but could only be dismissed by a vote of both houses of Parliament, not on the decision of a Chancellor alone."

Crucially, Dr. Peach says, this central bank would have one objective: control of the money supply in order to maintain price stability. "Interestingly, the last Labour government moved in that direction, but then subsequently rowed back."

It is safe to assume that Ricardo probably wouldn't have been much of an admirer of fiat currencies either. One could imagine the economist being rather bemused by the mounting tensions resulting from attempts by governments to manage the exchange values of their currencies to ensure export competitiveness. Would he side with the liberal clique arguing in favour of a return to the gold standard? Probably.

"His view was that exchange rates should be fixed – at that time that meant gold prices. Once that was done, he didn't think there would be any need for further intervention adjustments because disequilibria would be resolved through price changes internally, with an attendant period of unemployment during that adjustment," says Dr. Peach. But in his view, Ricardo was not a pessimist, as some other scholars have claimed. "His position was that these adjustments would be generally frictionless. They would occur for a very short period of time." ■

Heads in the cloud

Cloud computing offers treasurers the chance to revolutionise their workflow. The more technical aspects of the job can be outsourced and a treasurer can be sure they are always running the latest software version. But as with any new technology, there are plenty of questions that should be asked when selecting a vendor.

When it comes to buzzwords in technology, 'the cloud' is a popular recent addition. But while it may be a relatively new term, the cloud is not actually a new concept. It represents computing remotely rather than locally, with vendors offering technology solutions that are managed, serviced and hosted remotely, outside the treasury organisation. A software-as-a-service (SaaS) solution is a perfect example of a cloud solution.

As with any new terminology, definition is vital. Some vendors will claim that they offer a solution that is cloud-based because some components are run remotely; or they offer an older technology using an application service provider (ASP) model and call it cloud-based. This can lead to confusion in the marketplace.

When looking at cloud-based solutions, treasurers should ensure they are investing in new technology that they can trust will be expanded upon in the future. The benefit of treasury services in the cloud is that the treasurer does not have to worry about managing the technical infrastructure. Instead, they simply order a service.

With a web-based cloud service, there is nothing to install and no implementation programme to work through. The corporate's in-house IT department is busy enough with their internal systems, so the more that can be pushed out of house to the software experts, the better it is for both the corporate's business and IT functions. If something does not work, the treasurer simply calls their supplier who will then take care of the issue. In the payments arena this is a huge value proposition for corporates.

"The cloud computing story should be interesting to treasurers because of the level of innovation that they can receive via these services," says Joerg Wiemer, CEO, Treasury Intelligence Solutions (TIS). "Every customer is always running on the newest version of the software, which is a big difference compared with the way things used to work."

Enhanced functionality for treasury

Cloud-based solutions are available for a large number of treasury functions, such as the headline areas of cash management, payments processing and working capital transactions. Today they can also go deeper into functions such as risk management, derivative trading and tracking, and accounting services for the treasury and accounting groups.

Take payments as an example. The way that the treasurer manages their payments business with a relationship bank can be simpler, faster, cheaper and at a lower risk when using remote rather than local solutions.

From a relationship perspective, the treasurer maintains the direct relationship with their bank representatives. Where the supplier becomes involved is with the technical connectivity between the treasurer's treasury management system (TMS) and/or enterprise resource planning (ERP) systems and the bank systems.

Using a cloud-based service for this makes sense for the banks as well, as the core competence of many banks generally lies outside the area of systems integration and connectivity. Rather, their core competency in the transaction space is to execute and manage payments originating in different systems. From a bank perspective, if their corporate customer approaches them with a cloud service supplier, they know that the implementation projects connecting the customer to the bank's technological infrastructure will be quick and reduce the effort on their side.

"The cloud computing story should be interesting to treasurers because of the level of innovation that they can receive via these services."

Joerg Wiemer, CEO, Treasury Intelligence Solutions (TIS)

The quality of the data that the bank receives from a cloud platform can be higher than that directly from a corporate via different accounting or ERP systems in the front end. Many suppliers will check some customer data before sending it to the bank. They can carry out format mapping of the data, for example from the SAP payment format IDoc into a bank-specific format or the Single Euro Payments Area (SEPA) ISO 20022 XML format. This means that the error rate should be significantly reduced.

"A benefit of cloud computing is that a single solution can bring you visibility through your whole treasury function and workflow," explains Phil Pettinato, Chief Technology Officer (CTO) at Reval. "This means that you can consolidate this data and get value-added business process optimisation to aid your strategic decision making. There is a push by many treasurers to move out of the local processing of data in disparate systems, which is where a single cloud-based solution comes in."

Following the 2008 global financial crisis, treasury has become much more strategic within the corporate organisation. The treasurer requires the right solutions,

analytic tools and technology in order to provide that strategic level of value back to the organisation. Running on legacy TMS that was primarily designed to track cash and payments may not be the most efficient option available today. The type of sophisticated analytics that the treasurer requires include elements such as:

- Valuation.
- Risk management.
- Cash flow at risk.
- Stress testing of portfolios.
- Bank account management, where accounts are globally and how they feed back in to foreign exchange (FX) hedging and exposure management for different currencies.

Manufacturers also need to understand the procurement risk on their commodities side and exposures to fluctuating commodities prices. All of this data needs to be packaged together into information that allows the treasurer to make the right decisions. If you are trying to do this using disparate legacy systems, by the time all of the data has been organised and analysed it is already old information. On the other hand, investment in cloud-based solutions all feeds into the latest version of the software.

“Cloud solution providers can keep up with market trends and compliance changes, ensuring that all service users remain up-to-date,” explains Reval’s Pettinato. “For example, if a currency was to be split out from the euro, the provider can change the software accordingly, roll it out in the next maintenance release and ensure that all clients are running the new version.” You can’t do that in an ASP/client server environment with multiple versions in the market.

A changing landscape

The shift to cloud computing for treasury is part evolution, part revolution. On the evolutionary side, when systems that the treasury hosts in-house have fallen behind current industry best practice due to either market or regulatory changes, they become due for an upgrade.

At this point, the cost of upgrading the system, which might be several versions back from the current version, can be problematic for the budget. There are also the issues of internal IT cost and the distraction to the business function as the new version of the same solution is tested and rolled out.

As previously mentioned, if the treasurer goes for a cloud-based solution instead, they will join the single version of software that they share with the community of other users, and won’t be left behind in terms of the software they are using. This is currently one of the main drivers behind the adoption of cloud computing for treasury.

“I think there is also some revolution at work with cloud computing, as web-based technology is where the focus of technological advancement is,” says Reval’s Pettinato. “Everyone is realising that in order to get the benefit of, for example, global access to software in a real-time perspective so that subsidiaries and central treasury can all see their exposures, hedges and cash positions, you really need to have this technology. The availability of this technology in the market place is causing this change of mindset.”

For most corporates with an IT budget, when looking for a new system to invest in they are looking to new technologies. Investment in a legacy-type product is not an appealing option.

The IT support provided by cloud solution vendors is another driver for adoption among treasurers. If a problem is encountered with a payments batch, for example, this can be solved quickly on the vendor side, without the treasurer having to arrange a long project. Removing any worries on the technical side of operations leaves the treasurer free to focus on the more strategic elements of the job that add more value to the organisation. TIS’s Wiemer provides an example:

“I recently spoke with a CFO who had a new treasurer joining the company. They discovered that the PC-based station the company used to execute payments had broken down on several occasions. There were problems with their salary payments and suppliers were asking about overdue payments. In turn this created rumours in the market that the company had liquidity problems. The CFO knew that this problem needed to be resolved very quickly.

“Therefore, before the new treasurer could focus on the strategic business partner role of the job, he had to clear up the existing problems. This would not happen with a cloud service, as the provider would have identified and eliminated the problem much earlier.”

The global picture

Globally, North American adoption of cloud-based treasury solutions has led the way. Today, Europe and Asia are catching up quickly, with request for information (RFI) and request for proposals (RFPs) for treasury systems increasingly showing a preference for the cloud.

“I have spent some time in Asia over the past few months, in places such as Mumbai, Singapore and Shanghai, to find out more about customer requirements,” says Wiemer. “What I see is that the acceptance of cloud-based services is significantly increasing in all parts of the world.”

“Cloud solution providers can keep up with market trends and compliance changes, ensuring that all service users remain up-to-date.”

Phil Pettinato, Chief Technology Officer (CTO), Reval

“We have many clients across the Asia Pacific region in places such as Australia, New Zealand, Hong Kong and Singapore,” says Reval’s Pettinato. “Companies in Asia realise that there are technology trends from outside of their region that they can benefit from, and they are focussed on accepting those technologies they can take advantage of.”

For those whose business touches Europe, SEPA can be a driver for the shift to the cloud. Currently treasurers have a systems issues related to SEPA, with the need to produce the SEPA XML format in the TMS/ERP in time for the looming SEPA migration deadline of 1st February 2014.

There are two basic options available to achieve this. The first option is to bring in an external consultant to configure the

system to make sure that it is SEPA-compliant. Such a project can be time consuming, but perhaps a larger problem at the moment is that it is very difficult to hire such a format specialist consultant as they are likely to be fully booked.

The second option is to outsource this to a cloud provider that can deliver a SEPA out-of-the-box service. This takes the strain for the treasurer and can ensure compliance by the time the SEPA migration end date arrives.

Data security

With any remotely hosted technology, there are important questions to ask about where the data is and how secure it is.

1. A secure data mindset

The world is trending towards cloud-based solutions, so where data specifically resides is not necessarily going to be as transparent to everyone. The most important thing is that it is maintained in a secure fashion. Evaluate the company you are contracting with and what their security services are around providing these services.

2. Treasury experience

If you are a treasurer and want to shift into the cloud, be sure that the service has a good quality of management. Quality means experience in treasury – do they really understand your needs? Look for both experiences in developing solutions that fulfil your needs, as well as in operating these solutions.

3. ISO certification

When evaluating the data security available from cloud solution providers, treasurers should also look for ISO security certifications. This is a quality seal and shows that your supplier has done their homework. Does an ERP provider certify the solutions? Are they SAP-certified? It is important to know this information before making any purchase.

A cloudy forecast

The application of cloud computing is part of a transformation that is currently occurring in the traditional treasury technology space. With an increasing focus on risk management, treasurers are looking for sophisticated software that can match their ambition. A shift to the cloud is one way to achieve this. ■

Treasury talk: cloud computing

Treasury Today recently spoke off-the-record to the Treasurer of an international beverage company headquartered in North America and the Group Treasurer of a global sportswear manufacturer headquartered in Europe, to hear their take on cloud computing.

Treasury Today: *How long have you been using treasury cloud services?*

North American Treasurer (NA): We are relatively new to this type of service, having been using it for less than a year.

European Group Treasurer (EU): It is similar for us, we've been using cloud solutions for just over one year.

TT: *Which areas of your treasury use cloud computing solutions?*

EU: Our treasury uses a cloud solution for bank account management.

NA: We use one cloud-based TMS provider for all traditional treasury areas, including front office trading and back office confirmations, cash positioning, straight through processing (STP) of payments/settlements, short-term cash forecasting, and the general ledger interface of treasury activity to our ERP system.

TT: *What benefits do you feel that you receive from using treasury cloud services?*

NA: The cloud solution allows for maximum IT infrastructure flexibility in a straight through trading, confirmation and payment solution model. In addition, unlimited licensed users allow treasury to further roll out forecasting, reporting, and the inter-company netting process to business users outside of treasury.

EU: Yes it is similar from our perspective, the ability to run one global standard platform is key.

TT: *Do you have any concerns about using treasury cloud services?*

EU: Confidentiality would be our biggest concern.

NA: Yes, security concerns will always exist. We try to mitigate this risk with several layers of authentication and other methods of protection. The cloud service eliminates the concern of a long-term commitment versus the previous server installed investment model. Given the flurry of consolidation in the industry that we have seen of late, we weigh these concerns against the ability to maintain flexibility to participate in future technology improvements.

TT: *Are there other treasury functions in your department that you would like to move to the cloud in the future?*

NA: We would like to see additional back office paper for bank signatories, bank account documentation and bank invoice volumes and fees migrated to an all-in-one cloud service.



A bigger serving

Paul Pomroy

Chief Financial Officer, McDonald's UK and Northern Europe



Promoted in November 2012 to CFO of the UK and northern Europe division, Paul Pomroy, a 16-year veteran of McDonald's, has the kind of breadth and depth of experience that entirely warrants his ascent to a leading financial role for this globally recognised brand.

McDonald's needs little in the way of introduction; it is simply one of the world's largest and most recognisable fast food brands. In the midst of global economic meltdown, it has still managed to drive a 2% gain on full-year revenues for 2012, hitting \$27.6 billion. Since 2006 it has adhered to its high-level strategic 'Plan to Win', in which it defines the continual optimisation of various operational aspects of its business. The 'Plan to Win' for 2013 will see McDonald's invest some \$3.2 billion worldwide in new restaurants and its continued 're-imaging' programme, in which it delivers new signage, new eco-friendly and health-conscious food and drink products, and even free wi-fi to existing restaurants. The corporation's financial team is under no illusion that its position is unassailable: according to the 2012 annual statement, it fully expects global bottom-line growth to remain "pressured".

Having qualified as an accountant in summer 1996, Pomroy "jumped ship" towards the end of that year, joining the McDonald's crew. He proceeded to progress up through the ranks of finance, but notably spent the period between late 2002 and mid-2005 in the business strategy department, alongside marketing and food development. Armed with

first-hand knowledge of how the business works, promotion to the UK executive team in February 2008 saw Pomroy assume the role of Financial Vice President. Here he took responsibility for commercial and corporate finance, including tax and treasury, with his remit extending to pricing, profitability and financial projections.

Following the move of long-term Finance Director, Brian Mullens, to McDonald's Oak Brook, Illinois head office, Pomroy took the helm of the company's north London-based regional HQ, assuming the title of CFO, a role that gave him the additional remit of supply chain and real estate management. This broader sweep of responsibilities puts at his disposal a total annual spend for company-owned and franchisee operations of around £1 billion (about £700m on supply-chain and up to £300m on capital spend).

Despite the high-power position and the constant cut and thrust of business life, "what really keeps me at McDonald's is the people," states Pomroy. It is, and always has been, a melting pot of individuals from all walks; from the crew in the dining area to the senior executives, to the equally diverse mix of franchisees (a smattering of ex-bankers and accountants amongst their number).

Taking it to the streets

The franchise model is a big part of the UK operation, making up around 70% of the business. It brings with it some interesting challenges for a finance department. The best way to describe it to those who have not worked in this environment is to liken it to giving your shareholders a permanent hot line to your desk, says Pomroy. "They have a vested interest in the business because they have a 20-year contract with us for each restaurant that they run, with their own equity invested, and they are very heavily involved in the planning process and working with us to move the business forward."

The franchisees are represented through a leadership team which has direct access to McDonald's senior executives with a remit to discuss any major issues that affect the running of their businesses. Such a close partnership can indeed be challenging in terms of "getting everyone on the same page", but McDonald's would not have it any other way because the franchisees are close to their customers. "On a day-to-day basis, we have 170 franchisees that can give us instant feedback from the high streets on how customers are feeling and reacting," explains Pomroy. Their input helps the whole business to constantly move forward which, he says, is one of the reasons why McDonald's has survived the worst of the recession. His work with the franchisees also gives Pomroy the opportunity to step back from international corporation issues, enabling him to remain grounded; a new one-restaurant business may have a different set of concerns but these must nonetheless be met with equal professionalism.

Cash is king

McDonald's is not an overly complex business and it still uses spreadsheets to manage its cash position. The oft-quoted commercial notion that 'cash is king' is certainly well-founded here. Around 70% of its takings are in cash, the rest is by card, with contactless payments (enabled in all restaurants) gathering momentum. Handling the volume has never been an issue and the typical till-to-bank delay is no more than three days. Treasury is connected to each of its UK banks (RBS, NatWest, Barclays and HSBC) electronically, using bank proprietary platforms. Most payments out are made using electronic data interchange (EDI) and there is an electronic invoicing (e-invoicing) system in place too.

When it comes to those outgoing payments, even with a number of overseas suppliers, only around 10% of McDonald's UK's transactions involve foreign currency (and

then only in euro or US dollar). The reason is simple: it does not buy any of its produce; suppliers purchase raw product and sell the finished article to McDonald's.

Because major suppliers are taking the initial procurement risk, it is absolutely in the interests of supply chain continuity that each one makes the best investment decisions. In terms of hedging policy, McDonald's treasury will work with all of them to help them formulate (but not impose) best practice. This may not necessarily see them take the cheapest route as the over-arching aim is to deliver cost-certainty for McDonald's, something that is particularly important for the franchisees. In this respect, suppliers can hedge currency with consultation between treasury and supply chain. As part of the supplier and McDonald's relationship, Pomroy chairs a quarterly phone-in for them in which the US and UK treasury teams, alongside economists from Barclays and RBS, discuss currency movements.

The nature of McDonald's business means it does not have the same financial challenges faced by companies selling on credit. This means it can pass on the benefits of its cash flow with supplier payments typically executed in less than 30 days and many of the main contractors being paid weekly. "If we sit on a lot of cash, we won't earn much interest on a weekly basis, but to our suppliers that cash is really valuable," comments Pomroy. But even when yields were higher, the same approach applied: the quicker McDonald's passes the cash down through the supply chain system, the more assured that supply chain is. Without that assurance, none of the businesses can function effectively – it is that simple.

All pull together

Although the global corporate business is guided by headquarters, with "a very strong treasury function in the US", it is not centrally-ruled, instead following the cues of each local market to form corporate policy. "We all learn from each other, and Oak Brook pulls the best of what is going on around the world and shares that with all of us," states Pomroy.

It's a big part of treasury's job in the UK not only to make sure the corporate function has the necessary funding, but also that all its franchisees can afford to get on board immediately with new initiatives. There are no half-measures where consistency of the McDonald's experience is concerned. If a capital-intensive initiative is proposed requiring these businesses to have funding, the treasury team will already have been talking to the banks to ensure they have it.

The concerted effort of McDonald's to revamp its branding across both UK company-owned and franchised businesses is a lesson learnt from a rather testing period up to about 2005, when it had focused too heavily on new openings and not enough on brand consistency. Following a period of introspection, the planning process that now involves franchisees and the senior executives (and a lot of real-world experience) saw a change of tack.

Under the banner of the 'Plan to Win', the heading was re-set in 2006, casting off with a £300m total re-imaging programme. The new strategic direction may have coincided more or less with the onset of financial crisis, but it has yielded notable results. The process, based on a 12-month cycle of constant renewal, has seen 96% of the UK chain upgraded, bringing with it brand and experience consistency and a number of new products and incentives for customers. This has kept trade "solid" throughout the worst of the recession. Indeed, says Pomroy, over the past

five years, the UK business has seen its most successful period ever, growing like-for-like sales every year.

No treasury island

McDonald's treasury manages a cash pooling structure within its global wholly owned subsidiaries. This allows the US central treasury team to manage the corporation's liquidity and associated counterparty risks and facilitate inter-company loans. When it is required, debt is typically longer term (and currently rated A2 by Moody's and A by S&P), and is only issued by the US office.

As McDonald's is cash rich, typically about a third of funds is used to pay down debt, another third goes on re-imaging and development and the remainder is returned to shareholders. This is not set in stone and in early 2009, in response to the financial crisis, the brakes were gently applied to the pooling process in the UK to give the cash management processes of its banks some stability.

"We approach our banks in a slightly different way than most other retail businesses," says Pomroy. By treating them the same as any of its suppliers, McDonald's has created a "three legged stool" model in which the company, the franchisees and the suppliers all have to be equal to ensure stability. This means all have to be fully involved and working together.

The listening banks

With the view that its banks are its partners, banking representatives join with auditors, franchisees, major suppliers and the senior executive team (including US treasury) at the AGM where plans for the coming year are unveiled. The finance team also meets on a quarterly basis with the banks to discuss how those plans are progressing. "It's a unique situation having competing banks sitting around the boardroom table," notes Pomroy. He is obviously aware that they also finance McDonald's direct competition, but he is insistent that there has to be trust and openness between all partners. "Our banks don't have any surprises; they know our strategy, they know the tactical execution and when it's going to happen. We also have some significant planning tools for the franchisees with which the banks are very familiar."

McDonald's corporation has a revolving credit facility with global banks and works with them on placing corporate debt. But the level of corporate business is only given on the understanding that the bank also works with the franchisees. "We don't allow them to cherry-pick; if a bank in the UK wants to take the corporate debt they can pitch for it, but they also have to pitch for the business of our one-store operators."

Whilst corporate McDonald's remains at arms length in the financial relationship between bank and franchisee – it doesn't underwrite any debts for example – through its deliberate sharing of planning information with all parties, it really can build up that solid level of trust, explains Pomroy. "We have a good track record of doing what we say we are going to do and the franchisees have a very healthy appetite to paying down their debt in the UK and we embrace our banks as partners in the business."

Keeping up to scratch

Armed as they may be with as much information as they could possibly need to do the job properly, there is no room for

complacency amongst the banking panel. As with all of McDonald's suppliers, performance review is ongoing, with a well-established set of key performance indicators (KPIs) covering all aspects of the business, banks included. "We fill in an annual report on each bank, meeting with the relationship directors in the UK before the report is submitted to Oak Brook," says Pomroy. If there are any concerns US treasury will meet with senior representatives from each institution to iron out the issues. This has only happened twice in the past six years.

"It comes down to relationships," Pomroy says of the success to date. Franchisees need access to affordable credit so they can get on with running the business and the bank-as-partner arrangement helps. Pre-crisis, the funding process could take as little as 24 hours, but in the current climate franchisees can typically get an agreement in around seven to ten days, which is still relatively favourable – and there have been no credit refusals for franchisees in the past few years. "I think our relationship with our banks has actually got stronger during the recession," states Pomroy.

Crisis? What crisis?

In his role as CFO, much of Pomroy's work is in deciphering the multitude of views on what may or may not happen espoused by the world's economists. But he feels it is also important in the current climate to be able to understand his suppliers' businesses (banks included) sufficiently well to be able to empathise with the conditions they are facing – and to know when they may be pushing it too far.

That level of understanding must extend to the McDonald's customer base too. The last quarter of 2012 was a tough time for all retailers in the UK. "We must stay close to our core customers and always understand how they are feeling," he says. "As the austerity measures reach further, we need to ensure that we keep changing the experience to meet their expectations."

McDonald's is fortunate in that it has got itself into a place where it need not worry about next week's cash position. But Pomroy knows it has to keep working hard to stay ahead of the game. The austerity measures that are clearly hitting many other retailers have not affected the number of franchisees coming forward. "We've actually seen an up-tick," he reports, adding that communication of the message concerning supply chain and financial support, amongst other aspects, has given potential franchisees confidence to take on this long-term partnership. With the four main lending banks attending presentation days, this is surely one place where they are willingly supporting the smaller enterprise.

Armed with experience

Having risen up through the finance ranks, Pomroy is thankful for his experience in the business strategy department which, by bringing him up close and personal with the various allied functions, he gained a wealth of experience that is now serving him well as CFO. Armed with a level of general business knowledge and empathy that some finance professionals lack, the first six months of his new role have seen him immersed in supply chain and real estate matters, getting out and about, meeting suppliers and franchisees and promoting new initiatives. All the while, of course, he has been working on the 'Plan to Win' for 2014 and finding new ways of serving the constantly shifting needs of McDonald's customers. ■



Hedging your bets

The JPY's 20% depreciation since November has stoked fears of increased FX volatility in 2013 and potentially a new era of currency wars. What tools can be used to protect companies from FX fluctuations? Is hedging always the answer?

Japan has been the first major economy to blink in the game of currency valuation. Due to new Prime Minister Shinzo Abe's aggressive monetary policy, such as a higher 2% target for Japanese inflation, the yen (JPY) has experienced a 20% fall since November. The depreciation has also been a primary driver of the longest weekly run of gains for the Nikkei index since 1959, according to Reuters.

The action is clearly a calculated attempt to wrench Japan out of its 20-year plus stagnation pattern. The idea is that as the JPY weakens, Japanese exporters will become more competitive at the expense of other Asian exporters. A weak currency also increases the cost of imports, thus making domestic producers more competitive in the national economy, again driving growth. (However, the negative side is that it drives up the costs of imports, for example oil, and runs the risk of encouraging inflation.)

This has fuelled fear of a new round of 'currency wars', as other countries respond in kind and simultaneously weaken their own

currencies in order to stay competitive. The other G7 nations – the US, UK, Canada, Italy, Germany and France – were quick to condemn, using economic policy to target exchange rates; however, the G20 meeting in Moscow, following close after the G7 statement, only called for a "commitment to refrain from competitive devaluations" and stated that "monetary policy would be directed only at price stability and growth".

Japan responded by leaving the door open for outright purchases of foreign bonds to weaken the JPY further, a move that could put it on a collision course with the US and Europe.

FX volatility: possible rise in 2013?

In 2012 FX volatility – both on an implied and actual level – had fallen back from the elevated levels created in the aftermath of the financial crisis in 2007/8, which had affected even 'safe' currencies such as the US dollar (USD), the euro (EUR) and sterling (GBP). For example, one-year implied volatility for the EUR versus the USD slipped below 9% on 20th November, the

lowest since February 2008. On the same day, JPMorgan Chase & Co.'s G7 Volatility Index declined to the lowest since 2007.

A low volatility environment persisted in spite of the fact that many macroeconomic risks, such as the Eurozone crisis, the US debt crisis and the central bank's unconventional monetary interventions, remained to a large extent unresolved. This puzzled many industry analysts over the course of the year.

However, it was the knock-on effect of these unconventional activities – whether direct, such as the active suppression of volatility in the case of the Swiss franc (CHF), or indirect, such as keeping the interest rates low – which helped to dampen volatility, effectively sinking the carry trade. Carry trade is the practice of obtaining funds in a country with low borrowing costs and investing in those nations with higher interest rates. According to Kevin Lester, Director of Risk Management and Treasury Services at Validus Risk Management: “killing off the carry trade effectively kills off a lot of market activity and, in turn, volatility.”

In addition, Lester believes that a retreat in corporate hedging programmes contributed to a low volatility environment. This pull-back happened for a variety of reasons. “One reason is that the global macro uncertainty made corporate's cash flow forecasting much less certain and therefore made them more unwilling to hedge,” he explains. “In addition, the cost of hedging is going up with new Basel III regime coming in. As we all know, as the cost goes up, the incentive to do it goes down. These factors, among others, came together last year to bring volatility right back down to – and in some cases below – the long-term average.”

Although much of the FX fluctuation seen early in 2013 has been a by-product of JPY developments, it can also be seen as a result of a resurgence in the carry trade, which had its best start to the year since 2007. “If we see – and that is a big if – a return of carry trade activity by the speculative side of the market, then that will be a catalyst for volatility,” Lester says.

Another reason why the FX market is experiencing increased volatility is because of uncertainties surrounding the end game of unconventional central bank actions. “We knew this was coming from the day that quantitative easing (QE) was initiated, but it can take a long time to play out,” says Lester. He highlights Financier and Philanthropist George Soros' statement at Davos indicating that interest rates will spike this year on the back of inflation. “Even though most people wouldn't necessarily agree that it will happen this year, it is a sign that people are starting to factor in what the effects of unwinding QE will be and how we can put the genie back in the bottle, so to speak. That will be a source of volatility in the FX market without a doubt.”

A Financial Risk Manager at a large cruise liner company, who asked not to be named, agrees with Lester's general assessment of the state-of-play. “I think that volatility will increase this year due to the likelihood of government action – no one knows what to expect, so government announcements and central bank actions cause a great deal of activity in the FX market,” she says.

Treasury tools for quantifying FX risk

When measuring and predicting FX risk, the more advanced treasury group usually employs value-at-risk (VaR) and/or cash-flow-at-risk (CFaR); some even use Monte Carlo simulation to quantify their risk. For non-financial corporates, CFaR is the more appropriate tool, according to Rey Sermonia,

ex-Treasurer turned Treasury Advisor, for it gives a probability distribution or range of values of a company's operating cash flow over a specific time horizon, based on information available today. VaR, on the other hand, focuses on asset values and is usually used for shorter time horizons, such as a day or a week.

The Financial Risk Manager's approach to assessing FX risk is to look at exposures to each currency and historical and implied volatility to see what the company's range of outcomes could be from FX revenues/expenses and commitments. She also tries to assess whether the company's exposure to currencies has any natural offsets (for example fuel) before implementing any hedging. But she admits that there are some disadvantages to using these inputs. “There is no guarantee that historical relationships will continue to hold, nor is there any guarantee that FX will be within its implied range, so we could be relying on information that will bear no resemblance to what actually happens,” she explains.

This is an important point to make, particularly at a time when many are expecting volatility to return to the market. According to Validus' Lester, treasurers need to be careful about relying too heavily on probabilistic analysis tools because a bias can be “baked” into the analysis and they need to be cognisant of this. “When using these tools treasurers will plug in a volatility number, which would be a relatively low number according to 2012's market conditions. As a result, treasurers will see their risk reducing and also the value of hedging coming down – but in reality that is a dangerous mistake. It highlights a big flaw in this type of risk analysis tool, which is plugging in a constant for volatility – which is anything but constant.”

Sermonia believes that one could also use the Monte Carlo method. “If I were doing it today, I would use Monte Carlo simulation,” he says. “Monte Carlo is a computerised mathematical technique using algorithms which gives you a range of possible outcomes and the probabilities that they will occur for any choice of action, for example what happens if you hedge versus what happens if you don't.”

Fundamentals: making the hedging call

Most treasurers' gut reaction is that hedging is a good thing, but nothing can be a good thing all of the time. For example, Honda Motor Co. Ltd was one Japanese company caught out by the recent JPY depreciation. According to Reuters, Honda's CFO Fumihiko Ike reported that the company hedged currency trades three month out (a common practice among Japanese exporters) which meant its fourth quarter sales were booked at JPY levels near a record high.

But how does a treasurer know when – or if – to hedge? Sermonia believes that treasurers shouldn't be hedging if they can't identify where the value is coming from. Jonathan Binke, Global Head of FX Products at SuperDerivatives, adds that a company also needs to be clear as to its risk appetite and target levels. “You also need to have an informed opinion about your expectations for the future path of each market you are exposed to. In light of the answers to these questions, you can start to consider the relevant pros and cons of each strategy, and then focus on those strategies that best meet both your targets and expectations for the future.”

The Financial Risk Manager agrees that determining risk tolerance, balanced against liquidity constraints, will help to determine which products to use, as well as how much exposure to hedge.

“Treasury needs to understand the company’s risk tolerance, tolerance for earnings volatility, and whether paying option premiums would be considered, and then determine whether hedging should be done to take some risk off the table.”

Lester identifies three fundamental questions that will help in determining whether hedging is in the company’s best interest:

1. How does FX hedging relate to the internal business? For example, if the business has a lot of pricing capacity and capability, it might not need to hedge.
2. What is the objective of hedging? Is the company trying to stabilise cash flows, prevent a violation of a lending covenant or improve ability to forecast future cash flows?
3. How is the FX hedging programme integrated with the underlying business?

“Many companies miss the third point,” says Lester. “It is useful to step back and ask where exposures come from – and if they are managed differently, what is the knock on effect to business? It is all about integrating risk management with the underlying commercial objectives of the business.”

Returning to his earlier point, Lester emphasises that low volatility is a dangerous indicator as to whether to hedge or not. “When volatility, and therefore the cost of hedging, is coming down, then it makes sense to hedge more – but intuitively we take the opposite stance based on the expectation that low volatility will continue into the future. But history tells us that a period of calm is followed by a period of volatility. Currently volatility is low and hedging is quite affordable, so all things equal you should be hedging more.”

Robert Wade, Head of Corporate Electronic FX Sales at Deutsche Bank, agrees. “Our view would be that treasurers should use this opportunity, when it is more cost efficient to hedge, to better position their company for the extreme events.”

The Financial Risk Manager adds: “there is no guarantee that FX rates will mean-revert, so not hedging in anticipation of a particular rate returning to more of a historical norm is just increasing exposure. Having said that, I don’t think that companies should rush to hedge when rates get away from them. A measured approach to hedging, with the opportunity to increase hedging if rates become more attractive, is prudent.” ■

The gold ticket

A recent report from the World Gold Council promotes the use of gold as a valuable option in hedging currency risk in emerging markets.

According to the World Gold Council’s report, entitled ‘Gold and currencies: hedging foreign exchange risk’, gold is a much overlooked yet valuable option for hedging FX risk in emerging market currencies. Although gold is not a substitute for an FX hedging programme, it can supplement the strategy in a positive way.

The report argues that there are certain things that work in gold’s favour as part of a hedging strategy:

1. Gold has a negative correlation to developed market currencies, in particular the US dollar, but also applies to other currencies such as sterling and euro, especially during periods of systemic risk.
2. It is positively correlated to emerging markets growth cycle, as a significant demand comes from emerging markets. For example, India and China have made up about 50% of the world’s demand over the past few years.
3. Gold has a lower cost of borrowing than emerging market currencies. To put up a position in India rupee, Brazilian real or Russian rouble would mean borrowing at the country’s (sometimes offshore) interest rate, which is what makes hedges expensive. If a company included a gold overlay, it could borrow cash directly at its local cost of borrowing, which is currently extremely low.
4. It offers tail risk protection. Therefore, if there is a systemic risk within the financial system that creates a flight to quality, then gold is going to benefit. In this way it can be used to hedge away a tail event within an FX exposure.

“One thing that stands out – and will always be present – is that gold offers tail-risk protection to investors with or without foreign currency exposure,” says Juan Carlos Artigas, Global Head of Investment Research at the World Gold Council. “But the other three factors also need to be present for gold to be useful as an emerging market currency hedging strategy.”

Key findings of the report include:

- Over eight periods of crisis conditions examined in the report, including gold in currency hedging strategies in an emerging market portfolio offered cumulative outperformance of 2.4% above an un-hedged portfolio and over 1% above a currency-hedged portfolio.
- Adding a gold overlay to emerging market assets reduced portfolio peak-to-trough declines over the past decade, on average, to 9.2% from a 12.5% decline in currency-hedged portfolios and a 13.1% decline in unhedged portfolios.
- The average costs of hedging a basket of emerging market currencies is currently over 4% compared to less than 50 basis points on borrowing costs for a gold overlay.

“Over the past few years, gold has become more widely accepted as a source of collateral and a high quality liquid asset,” says Artigas. “Therefore, more corporates are coming to understand the value of gold as one tool in their arsenal to hedge currency risk.” He believes that it is first a matter of “awareness, knowledge and implementation” before it becomes widespread practice among corporates.



SCHWABE, LEY & GREINER

TIP Treasury Information Platform

—

Your figures at a glance



You won't miss a thing with TIP. Whether it be the financial situation, credit lines or aval portfolio – you have all the relevant financial items for the entire company at your fingertips. It is just as easy to check banking fees, perform cash flow forecasting and draw up customised financial reports. 12,000 users across 100 companies rely on TIP.

For more information, please refer to the section entitled "Treasury Reporting" on our website: www.slg.co.at

Building a sustainable treasury function

It might require change, but embedding sustainability into the day-to-day running of the treasury department doesn't have to be a chore. So keep an open mind and embrace the possibilities.

For some functions within the corporate entity, embracing sustainability is quite straightforward, or at least there are obvious initiatives to implement. IT can focus on low-hanging fruit, such as energy efficiency and the product development team could look at using recyclable materials, or building 'eco' versions of existing concepts.

But just having the treasury team recycle their plastic water bottles or work on energy efficient computers isn't going to cut it in this day and age, especially since sustainability goes much deeper than just being environmentally friendly – it's about mining for valuable information too. What this means is that treasurers must take a long hard look at their operations and policies to identify areas that could become more sustainable.

Fortunately, Treasury Today has done a lot of the groundwork for you. By speaking to award-winning treasurers and sustainability experts from across the globe, we have outlined key areas where treasurers can really begin to drive change. Unsurprisingly, the first of these is by getting rid of paper.

Saving trees, shedding costs

Still printing documents like its 1999? Well, the vast majority of office workers are, according to a survey released in December last year by Nitro, a company that delivers products to help people work smarter with digital documents. In fact, the survey results reveal that a mere 1% of us always – without fail – review documents electronically, rather than on paper. Like their legal counterparts, many treasurers are all too familiar with a paper-intensive workflow.

"When you're operating in a company that has hundreds of bank accounts and thousands of customers, paper is most definitely the enemy of efficiency," says the Treasury Manager of a manufacturing company, who wished to remain anonymous. "Getting rid of paper and going 'green' in the process has to be the way forward for treasury functions of any size. And it's not just about the impact on the planet, or the bottom line improvements. Think about the quality of your employees' work life. Do they really want to spend their days photocopying, filing and manually reconciling?"

A relatively early-mover in the space, Kellogg began a company-wide 'Go Green' initiative in 2005. The aim was to reduce the company's impact on the environment and the communities surrounding its operational centres. As part of these efforts, the company's treasury function identified an excellent opportunity to reduce the amount of paper flowing in and out of the department on a daily basis.

Almost 10,000 pieces of paper being handled each month and the equivalent of one full-time employee was dealing solely with manual reconciliation of receivables. With assistance from J.P. Morgan, the company underwent an electronic transformation.

✓ Paper reduction: a checklist for treasurers

- ❑ **Make the most of your bank's online offering.** Logging into your bank's online platform to view bank accounts will surely be much quicker than digging out the relevant file. It also provides added security controls and keeps an easily accessible record of reviewing and approval processes.
- ❑ **Embrace e-invoicing.** In addition to the cost benefits that have been so widely reported, e-invoicing leads to greater consistency and standardisation, which in turn helps to reduce organisational complexity.
- ❑ **Say goodbye to cheques.** Using electronic payments instruments improves visibility, reduces the risk of fraud and can significantly reduce costs. Consider wire payments, cards programmes and mobile solutions. Where customers persist in paying you by cheque, discount incentives for signing up to direct debit may be useful.
- ❑ **Consider electronic bank account management (eBAM).** Do away with paper-intensive account opening and maintenance procedures to really improve efficiency and control.
- ❑ **Set up digital treasury workspaces.** Whether in a secure cloud environment, or protected on your work server, archive reports and other documentation electronically. The search functionalities this provides can prove invaluable.
- ❑ **Printer etiquette.** If you or your team really do have to print, make sure it's double-sided and on recycled paper. Any non-confidential documents should be put in a recycling bin after use and a sustainable confidential document destruction programme implemented.

Best practice solutions were rolled out to allow the company to view a significant amount of its bank statements online. For receivables reconciliation, customer remittance information was also moved online. Not only did this electronic solution get rid of paper, it also made automated reconciliation far more achievable, and reduced the company's days sales outstanding (DSO).

In addition, Fifth Third Bank implemented an electronic remote cheque capture and deposit system for Kellogg. This meant that the company no longer had to use an armoured vehicle to transport cheques, thereby reducing cost and risk, as well as its carbon footprint. All this suggests that going paperless is the most obvious and wide-reaching way of embedding sustainability right at the heart of the treasury function.

The next link in the chain

Moving on from paperless treasury, the next area of sustainability investigation is supplier management. While the physical supply chain and the company's choice of suppliers may not fall squarely into the treasurer's camp, the bond between the physical and financial chains does make it their business. Even more so where the company is actively financing suppliers through supply chain finance (SCF) programmes, for example. What is more, having responsible suppliers can improve relationships and also reduce risk in both physical and financial supply chains.

Increasingly, companies are using matrices and questionnaires to measure the sustainability of their suppliers. Philips is a best practice leader in this space with a programme that stretches far beyond merely assessment to help suppliers to become more sustainable. The company's Supplier Sustainability Involvement Programme is built on five core pillars, see table below.

During stage one, the supplier sustainability declaration is made based on an assessment of suppliers across five key checkpoints: labour; health and safety; environment; management systems; and ethics. There are also general considerations such as the suppliers' compliance with laws and regulations. Suppliers can self-assess their compliance using an online Excel-based questionnaire on the company's website.

Business is only awarded to the suppliers that live up to the company's high expectations, but Philips also works with suppliers that need to improve their sustainability, as it sees this as a joint responsibility. Some companies do not have quite such rigorous supply chain standards in place, and many large food and beverage chains have been accused by the global press of simply chasing 'ecolabels' to bolster consumer sentiment. Nevertheless, it is widely accepted today that supply chain sustainability is not just the right thing to do from a PR and corporate social responsibility (CSR) point of view, but also from a company viability standpoint.

A step beyond

Aside from supplier assessment, there are a handful of other tools and techniques that come under the heading of supply chain sustainability. Supplier finance is one of these – by providing suppliers with access to credit at a lower cost than they would typically be used to and not squeezing them on payment terms, buyers are taking a responsible attitude towards supplier management. Ultimately, this builds a more robust and sustainable supply chain.

Elsewhere, reverse logistics is an interesting angle to consider. Sometimes referred to as the reverse supply chain, this is an often neglected part of the working capital management process – and sustainability initiatives. In a nutshell, it involves the flow of goods from the point of consumption back to the point of origin. While this may sound like the domain of logistics managers, there are good reasons for treasury to get involved, not least the fact that an inefficient reverse supply chain process can end up costing companies anywhere between two to four times the amount paid for the original item.

And just the transport alone of these returned goods has a far from inconsequential impact on the company's carbon footprint, but centralised 'take-back' processing plants can assist. Sometimes though, it makes better financial and environmental sense to simply replace a faulty product without asking for it to be sent back – the end consumer can recycle it locally where appropriate. Nevertheless, it should be noted that in the EU, disposal of the waste of electrical and electronic equipment (WEEE) is now the producer's responsibility, not the consumer, under the European WEEE directive.

Employees on the frontline

If a treasury function is determined to set about demonstrating best practice in sustainability, then it is only right that it upholds high standards in all aspects of the day-to-day running of the department. Naturally, this should include employee welfare. This is not just about corporate social responsibility and making sure you are operating an ethical, diverse workplace, but also engaging employees to make sustainability a reality.

A few practical ideas to improve the treasury department's sustainability credentials by engaging employees might include:

- Setting performance targets that include reducing the amount of printed documents in the department.
- Arranging flexible working, to reduce commuting where appropriate.
- Increased use of video conferencing rather than physical travel.
- Incentives for walking, cycling or taking public transport to work.

1. Create commitment	2. Build understanding	3. Monitor identified risk suppliers	4. Manage risk	5. Work with stakeholders
<ul style="list-style-type: none"> ● Supplier sustainability declaration. ● Regulated substances list. 	<ul style="list-style-type: none"> ● Training and capability building. 	<ul style="list-style-type: none"> ● Philips risk assessment. ● Electronic Industry Citizenship Coalition audit tool. 	<ul style="list-style-type: none"> ● Follow up. ● Consequence management. ● Repeat audit cycle every three years. 	<ul style="list-style-type: none"> ● Transparency. ● Constructive dialogue.

Source: Philips Supplier Sustainability Involvement Programme

You may also want to set achievable targets for recycling within the department, as easy-wins can help to drive employee engagement. There are also new technologies that companies can leverage to assist, such as CloudApps SuMo (short for sustainability momentum). SuMo is in many ways a modern equivalent of the 'star chart'. It combines social networking, gaming and sustainability, to help employees connect with sustainability goals and aims, whether departmental or enterprise-wide. Treasury managers should not underestimate the power of such engagement when it comes to employee satisfaction and retention.

Investing in the future

Sustainable investment is another area of focus for sustainability-aware treasurers. It's a topic that we'll be covering in the next article in this six-part series, but it certainly deserves a mention here.

Inevitably, companies won't invest in sustainable instruments purely out of good will; the main incentive will be performance – but this does not negate the fact that sustainable investing can help to ensure that future commitments are not compromised by meeting short-term goals. There are a number of institutions that offer sustainable investment services for corporates, so speak to your bank or asset manager to find out more. Alternatively, you could follow the example of carbon-neutral Google and invest directly in green energy projects. The tech giant committed \$915m to renewable energy projects in 2011.

There is another side to sustainable investment to consider as well – investing in the company, as opposed to the markets. Honeywell's corporate finance team, for example, recently undertook a project to raise \$8m in cash and \$4.5m in net after-tax benefits to save an ageing production facility that was facing imminent closure – as it specialised in producing substances such as CFC refrigerants, which are being eliminated globally. Not only was the plant saved, but the local community also got to keep a valuable employer.

Reporting for duty

Finally, we come to the treasurer's role in sustainability reporting – and how sustainability initiatives can provide valuable information and insight.

According to Alan McGill, a Partner in PwC's Sustainability and Climate Change practice: "non-financial sustainability information can help an organisation to have a far better understanding of what might put their business at risk, such as resource scarcity. It also helps to assess the ability of your supply chain to deliver the goods you require, so that you can continue to manufacture." In other words, the critical driver for companies to have sustainability information available is the ability to continue to deliver the financial returns that they have historically.

There are various sustainability reporting frameworks that exist in the marketplace, says McGill. "The most widely used and globally accepted is the Global Reporting Initiative (GRI), which provides companies with a solid idea of what kind of information they can report, what disclosures would be required and so on. At the same time, there are some global standards that do exist, and the most widely referred to of these is the Greenhouse Gas Protocol for carbon reporting."

Arguably what's going to happen, as it did with financial reporting, says McGill, "is that over the next five to ten years, we will see a maturing of the measurements and the standards for reporting non-financial sustainability information. This will be part of the broader move in corporate reporting towards what is called 'integrated reporting'. Historically, most corporate reporting has had a single issue focus around the financial performance of the business, but there is a lot more information that can support companies. So, reporting needs to become more reflective of that – particularly around the impact the business is having from an economic, social, environmental and financial perspective."

Paving the way

In the future, this means that the finance department and key actors within that world, such as the CFO and treasurer will become far more engaged in the provision of information – both financial and non-financial. "The fact that the information has tonnes of carbon, or metres cubed at the end of it, is irrelevant. Companies need to start thinking about these measures as the equivalent of different currency symbols, so instead of a dollar, pound or euro sign at the beginning, you have CO2 at the end of it, for example."

And it's true. Sustainability can have many tangible benefits, but one of the biggest barriers to it is totally intangible: mind-set. Is it time to change your way of thinking? ■

Reporting requirements: a global snapshot

In the UK, the coalition government is introducing mandatory carbon reporting for listed organisations this year. There is also a requirement in the UK on directors, when preparing their annual reports and accounts, to consider and report on the material social and environmental issues that concern the company.

Outside of the UK, there are legal requirements for sustainability reporting in countries such as Sweden and Denmark. And in France, Grenelle 2 requires French companies to include a variety of social and environmental factors as part of their annual reporting.

Certain stock exchanges, such as Hong Kong, India, Brazil and South Africa, also have listing requirements around social and environmental issues that need to be reported. In South Africa, there is a government code called King 3 (named after Mervyn King who led the review into government reporting) which is entitled 'Integrated Reporting'. It requires companies listed on the Johannesburg Stock Exchange to include all the social, environmental and economic aspects of their business, alongside financial performance.

But critically, adds McGill, integrated reporting "isn't about asking companies just to report more information – which would put huge reporting burdens on companies. It's about putting out better information. So it's redefining corporate reporting as we know it."



How useful are treasury KPIs?

"If you cannot measure it, you cannot improve it," the great mathematical physicist Lord Kelvin, William Thomson, once quipped. In corporate treasury measuring performance has become even more important since the financial crisis. Sophisticated financial KPIs are now commonplace within treasury and also increasingly expected at the executive level. This article looks at what KPIs are, how they can be used and some of the problems which arise when attempting to implement relevant KPIs for treasury.

What is a KPI?

A key performance indicator (KPI) is a metric used by organisations to gauge or compare performance in terms of meeting strategic and operational goals. There are two main approaches organisations use for measuring performance – qualitative and quantitative.

1. Quantitative KPIs are typically based upon financial targets – ie costs as a percentage of total revenue.

2. Qualitative KPIs can alternatively be used as a complimentary measure of non-quantitative targets, such as employee satisfaction. These are often measured using more subjective methods such as surveys or questionnaires.

Some types of organisation are likely to reap more benefits from KPIs than others. For large global organisations incremental improvements in efficiency are likely to have a much greater impact than smaller businesses. But this does

Treasury discipline	No 1 KPI	No 2 KPI	No 3 KPI
Overall treasury efficiency	Cash visibility	Cash pooling structure	Costs as percentage of total treasury costs or revenue
Core cash management efficiency	Cash flow forecasting accuracy	Cash pooling structures	Balance transaction reporting
Working capital management	Days sales outstanding (DSO)	Days payables outstanding (DPO)	Days inventory outstanding (DIO)
Liquidity management	Cash flow forecasting	Short-term investments	Short-term funding
Risk management	Mark-to-market	Hedging effectiveness	Value-at-risk (VaR)
Funding/balance sheet management	Net debt/EBITDA	Net interest expense	Weighted average cost of capital (WACC)

Source: Treasury Today European Corporate Treasury Benchmarking Study 2012

not mean that the treasury department of smaller organisations will not benefit at all from frequent performance measurement and improving upon processes.

Choosing which aspects of the department's performance to measure can itself be a complicated task. KPIs will often vary considerably between treasuries, reflecting differences in policies and objectives. In some organisations there may be a greater focus on external performance – the degree of success in its dealings with external entities. In other organisations there may be a greater emphasis upon internal performance metrics, such as transaction rates, and compliance with set limits.

The table above shows a number of KPIs currently being used to measure treasury performance, in order of their perceived importance. According to Treasury Today's 2012 European Corporate Treasury Benchmarking Study, 55% of respondents used cash visibility as their prime KPI to measure overall treasury efficiency, with a further 45% monitoring cash pooling structures.

Why measure treasury performance?

Treasurers are not salesmen; their performance cannot always be measured in tangible achievements. Furthermore, treasurers have many demands placed on them at the present time – managing dwindling liquidity, new regulations in the form of Basel III and Dodd-Frank, and also the migration to the Single Euro Payments Area (SEPA). With time resources so constrained, why should a treasurer bother making the effort to measure performance? Do they not have more important things to do than calculate the value of some abstract indicator?

Below we have outlined some of the reasons why, to the contrary, measuring treasury performance is very important:

- Control**
 Treasury KPIs can be a useful method for exerting control over treasury operations. By regularly assessing the various treasury metrics, management can be assured that all team members are operating as effectively as possible and, equally, any areas of concern will also be highlighted.
- Risk awareness and mitigation**
 The treasury function has assumed increasing responsibility for the management of financial risks in recent years. Keeping a close check on risk management KPIs can help the treasurer understand where the company's main exposures reside and evaluate hedging effectiveness.
- Illustrating value**
 In the past, the treasury departments have sometimes had difficulty demonstrating the value they contribute to

the organisation. As a consequence, there has sometimes been a downward pressure on resources. By regularly collecting KPI data, treasurers can overcome these doubts, providing senior management with conclusive evidence of the contribution made by treasury to the organisations bottom line.

- Improving treasury processes**

KPIs are a great tool for evaluating the efficiency of specific treasury processes. Once treasurers have a snapshot of all the various inputs and outputs of a process, then they can consider ways in which the process can be altered and, if necessary, improved.

“The role of treasury has changed significantly in the past three or four years. Now it is seen as a very strategic unit within an organisation. There is a lot more emphasis placed within the treasury on helping the business achieve its overall objectives and helping with the strategic direction that the corporate wishes to take.”

Jiten Arora, Global Head of Sales, Transaction Banking at Standard Chartered

Are KPIs applicable to treasury?

Treasury has always been regarded as a cost centre within a corporate – that is a department which adds to operational cost but contributes only indirectly to the bottom line. But a consequence of this was that treasurers often found themselves on the margins of corporations, away from the attention of senior management, and frequently under pressure to minimise expenses and manage with increasingly diminishing resources. In such a setting, measuring treasury performance made little sense – KPIs were far more common in sales departments, where measuring achievement is, for obvious reasons, far more straightforward.

In addition, corporate treasury is largely perceived to be a 'black box' within an organisation – isolated from the rest of the business and, for the most part, impenetrable. Few outside of treasury know which KPIs to assign to them.

But this perception as to the usefulness of KPIs for treasury was to be swept away as events began to unfold in 2008. In the

post-crisis setting, treasury tasks which before were considered to be routine, such as cash and risk management, quickly became recognised to be of critical importance to the profitability and even survival of a corporation. Treasury is no longer viewed as a functional unit within a corporation that simply ensured that the basics were competently administrated. It has been transformed into a centre of greater strategic importance, more closely integrated into the core business and this provided much more scope for the integration of sophisticated KPIs reflecting the businesses overall strategic objectives.

“The role of treasury has changed significantly in the past three or four years,” says Jiten Arora, Global Head of Sales, Transaction Banking at Standard Chartered. “Now it is seen as a very strategic unit within an organisation. There is a lot more emphasis placed within the treasury on helping the business achieve its overall objectives and helping with the strategic direction that the corporate wishes to take.”

In this context, Arora believes that the measurement of treasury performance has become increasingly vital. An optimally functioning treasury, he says, can be a big advantage to companies as they attempt to navigate through an increasingly testing economic climate. “In this changing environment we absolutely think that organisations should measure treasury performance. Probably the key component for treasury performance is working capital. If you look at how trade is becoming more expensive and banks’ balance sheets are shrinking with Basel III, it is important that corporates look at their long-term aspirations and derive a lot more from their working capital.”

Risk management KPIs are also very important, according to Arora. As companies grow and begin to move into new markets, particularly in emerging markets, they will be taking on more risk than before when operating in more established economies. “New suppliers, new buyers and being in heavily regulated environments in which they are facing issues such as trapped liquidity and heightened FX risk – all these are critical parameters which make it important for treasuries to look at their performance with respect to risk management.”

The most obvious metrics for risk management are hedging effectiveness and funding costs. But Arora says that another important dimension of risk that needs to be considered is found in the supply chain. This is particularly true for companies in the process of expanding and taking on new suppliers and buyers. But how can organisations measure the level of risk that they are taking on from new counterparties? By analysing their cash to conversion ratio across the supply chain, he says. “Corporates ought to be looking at new suppliers and buyers that they have been taking on, and measuring the counterparty risk. Are they making sure that they partner with banks that are able to mitigate some of those risks that come with the new business partners?”

Selecting the right KPIs

In recent years, performance measurement has become increasingly integrated into the treasurer’s day-to-day workflows. However, a consensus on which KPIs are most helpful or indeed relevant is still some way off within the treasury community. Martin Bellin, CEO of BELLIN, a German treasury management system (TMS) provider, believes there are several reasons why measuring treasury performance remains problematic for some organisations. “When you talk about KPIs, you are talking about something that you can

achieve, something you can reach,” he says. “When you work within a sales department, for example, you have to perform to a certain level and that is measured by KPIs – so the number of new contracts won and the number of deals signed.”

“Treasury is often hidden in the background, sometimes operating out of view – and that has to change. If it is to change then performance indicators are definitely something which can help to demonstrate to the management the work which treasury is doing, and how the department is contributing their power and knowledge to the company’s bottom line.”

Martin Bellin, CEO of BELLIN

“But treasury is different. The treasury department remains a cost centre or, as some see it, a service centre. So the treasury’s performance is very often driven by third-party requirements. Of course, it is important to define targets, but in the context of a cost centre I think that the term ‘KPI’ can be a little misleading.”

Measuring performance is important for treasuries, he acknowledges, as it is for other departments. It is just that the department’s unique role within a corporation demands that performance be measured differently than it is in other areas of the company. And getting this right, he says, can be very difficult – particularly when the setting of targets is undertaken exclusively by senior management without the involvement of treasurers themselves.

“It really depends who defines the performance indicator,” he explains. “They are normally set by senior management, but it is often the case that senior management is not as concerned about the detail of treasury operations as they should be – either they do not understand or are simply not interested.”

“However, when KPIs are set it is critical to have management on board. When you ask a CEO of a large company about their sales division, they will be able to tell you what they expect should be delivered. For KPIs to be effective, management needs to reach that same level of understanding with treasury. But if the treasury department cannot get a clear answer, then what is the point of KPIs?”

But having the right targets in place can certainly be beneficial for treasurers. Beyond providing treasurers with a means to review and benchmark their performance against their industry peers, KPIs are also useful for illustrating the value of the services provided to the rest of the business. In the past, Bellin adds, treasuries have sometimes been under resourced as a result of their failure to effectively demonstrate their value to the organisation. KPIs, Bellin believes, may be just the solution.

“Treasury is often hidden in the background, sometimes operating out of view – and that has to change. If it is to change then performance indicators are definitely something which can help to demonstrate to the management the work which treasury is doing, and how the department is contributing their power and knowledge to the company’s bottom line.” ■



INSIGHT AND ANALYSIS

Evolving investment priorities

The first step in developing an investment strategy is to understand the three core objectives – security, liquidity and yield – and the interrelationships between them. Is it possible to optimise all three objectives at the same time? If not, what considerations should be top of mind?



CASH MANAGEMENT

SWIFT for Corporates: an update

SWIFT's offering for corporates has ramped up during the recent past, including Alliance Lite 2, electronic bank account management (eBAM), Trade for Corporates, Trade Services Utility (TSU), electronic invoicing (e-invoicing) and SWIFT Secure Signature Key (3SKey). What's coming next?



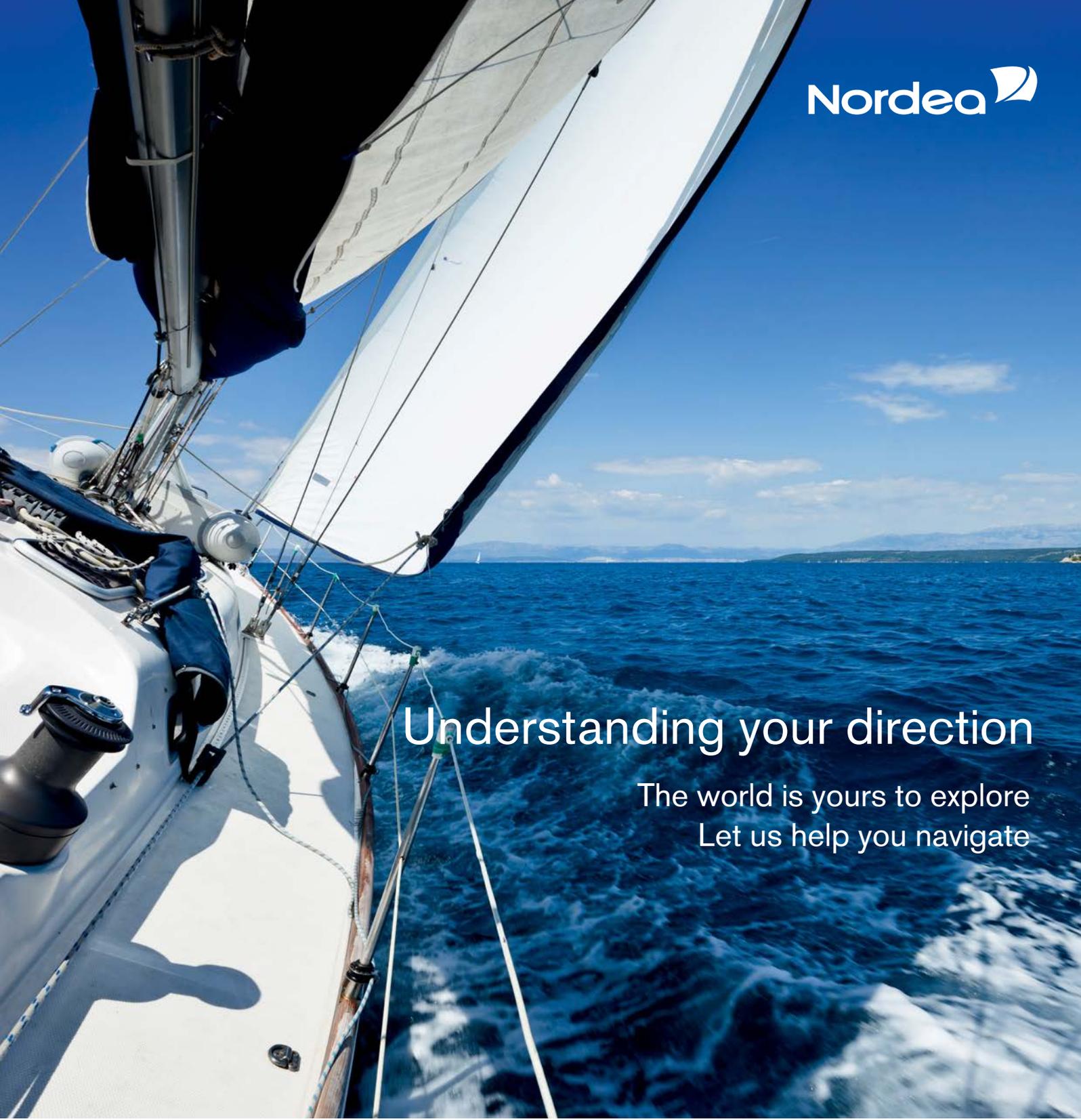
BACK TO BASICS

Putting together an RFP

When the time is right to introduce or establish a major new banking relationship, the selection process can be daunting. What does putting together a request for proposal (RFP) entail? Are there any short-cuts to take advantage of? A number of treasury consultants offer their insight and experience.

We always speak to a number of industry figures for background research on our articles. Among them this month:

Jiten Arora, Global Head of Sales, Transaction Banking, Standard Chartered; **Juan Carlos Artigas**, Global Head of Investment Research, World Gold Council; **Stéphane Aubin**, Treasury Manager, European Broadcasting Union (EBU); **Martin Bellin**, CEO, BELLIN; **Jonathan Binke**, Global Head of FX Products, SuperDerivatives; **Sigurd Dahrendorf**, Vice President Corporate Treasury, Knorr-Bremse; **Susan Dean**, Head of Transaction Services EMEA, J.P. Morgan Treasury Services; **Richard Driver**, Currency Analyst at Caxton FX; **Mel Duffield**, Head of Research and Strategic Policy, National Association of Pension Funds (NAPF); **Krishnan Iyengar**, Vice President of Global Solutions, Reval; **Dr. Warwick Knowles**, Chief Economist, D&B; **Bruno Lawaree**, Senior Treasury Manager EMEA, Eaton Corporation; **Kevin Lester**, Director of Risk Management and Treasury Services, Validus Risk Management; **Alan McGill**, Partner, PwC; **Dr. Terry Peach**, Professor of Economics, Manchester University; **Phil Pettinato**, CTO, Reval; **Paul Pomroy**, CFO, McDonald's UK and Northern Europe; **Carina Ruiz**, Partner and National Leader, Treasury and Commodity Risk Management, Deloitte & Touche; **Michael Schwartz**, SVP, Chief Marketing Officer, Triple Point Technology; **Joanne Segars**, CEO, NAPF; **Rey Sermonia**, Treasury Advisor; **Travis Spence**, Head of Global Liquidity, Asia Pacific for J.P. Morgan Asset Management; **Robert Wade**, Head of Corporate Electronic FX Sales, Deutsche Bank; **Jeff Wallace**, Managing Partner, Greenwich Treasury Advisors; **Professor Alyson Warhurst**, CEO, Maplecroft; **Joerg Wiemer**, CEO, Treasury Intelligence Solutions (TIS); **Tom Wood**, Head of Professional Services Industry, Barclays.

A high-angle, close-up photograph of a sailboat's deck and rigging. The white sails are partially unfurled, and the boat is moving through deep blue water, leaving a white wake. The sky is clear and blue, with distant land visible on the horizon.

Understanding your direction

The world is yours to explore
Let us help you navigate

A Great European Bank

Nordea is the largest financial group in Northern Europe and with AA credit ratings* one of the world's most stable banks. With nearly 200 years of experience behind us, and the most extensive network across the Nordic and Baltic Sea region – we know our home market like no other bank.

We are proud to be a bank built on values and cross-border diversity, where relationships are valued and great customer experiences are delivered.



We believe you can never look too closely.

At J.P. Morgan Global Liquidity, we are known for our relentless focus on credit backed by our conservative investment culture. Our strong credit process benefits from original quantitative and qualitative research, and teams of tenured credit analysts who bring invaluable sector-focused expertise to the process. The result? High-quality money market funds for your short-term investing.

To learn more about the vision we bring to your investments, call your J.P. Morgan Global Liquidity representative.

Visit www.jpmgloballiquidity.com

J.P.Morgan
Asset Management

Any forecasts, opinions and statements are J. P. Morgan Asset Management's at the date of this document and may be subject to change without notice. Research in this document has been obtained and may have been acted upon by J. P. Morgan Asset Management for its own purpose. The value of investments and the income from them may fall as well as rise and investors may not get back the full amount invested. J. P. Morgan Asset Management makes no representation or warranty regarding the accuracy or completeness of the information herein.

Issued in Continental Europe by JPMorgan Asset Management (Europe) Société à responsabilité limitée, European Bank & Business Centre, 6 route de Trèves, L-2633 Senningerberg, Grand Duchy of Luxembourg, R.C.S. Luxembourg B27900, corporate capital EUR 10.000.000.

In Switzerland, J.P. Morgan (Suisse) SA, 8, rue de la Confédération, PO Box 5507, 1211 Geneva 11, Switzerland, has been authorised by the Swiss Financial Market Supervisory Authority FINMA as Swiss representative and as paying agent of the funds.

Issued in the UK by JPMorgan Asset Management (UK) Limited which is authorised and regulated by the Financial Services Authority. Registered in England No. 01161446. Registered address: 25 Bank St, Canary Wharf, London E14 5JP, United Kingdom.