Five Trends Transforming Global Treasury

The long-awaited transition to globally integrated treasury management is upon us. Take advantage of these five key trends to ensure your treasury operations achieve best in class.

BY STEPHEN BAIRD

FOR THE STRATEGICALLY MINDED treasurer, the idea of a truly global treasury function has been a long and dearly held objective.

After all, the benefits of a globally integrated and controlled treasury are compelling and well understood. This fundamental best practice provides visibility to global cash balances for enhanced control and optimization. Centralization brings greater control of high-risk treasury activities, such as derivatives trading, while creating liquidity pools for enhanced investment yields. It facilitates the appointment of a single global banking partner, leading to opportunities to net intercompany payments and foreign exchange-related transactions. Moreover, with the harmonization of investment, risk management and cash forecasting strategies around the world comes the opportunity to reap maximum benefit from costly technology implementations.

While the case for global treasury may be clear and persuasive, relatively few companies have succeeded in reaching this ideal state. "Domestically centralized, internationally decentralized" is an all-too-familiar description used by corporate practitioners in explaining the structure of their treasury operation.

One striking indicator of the dispersed nature of the typical global treasury operation is the relatively low number of U.S. companies with treasury staff located outside of the United States. In a recent survey of 405 U.S. corporations, Treasury Strategies found that a minority of companies, even among large multinationals, employ treasury staff offshore. (See *Global Treasury: The Exception, Not the Rule*, opposite.) The decentralized structure of international treasury is even more striking among middle-market firms, where over 80 percent of treasury departments are located exclusively in the United States. For these companies, treasury is typically the responsibility of subsidiary controllers who perform cash management functions along with a host of general financial responsibilities.

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A number of factors are to blame for the failure of treasury departments to globally integrate their treasury function. International subsidiaries are often reluctant to relinquish control of their liquidity and banking relationships. At the same time, the need for global or even regional solutions has often gone unmet due to a fragmented banking industry, regulatory restrictions and disconnected technology platforms, among many other challenges.

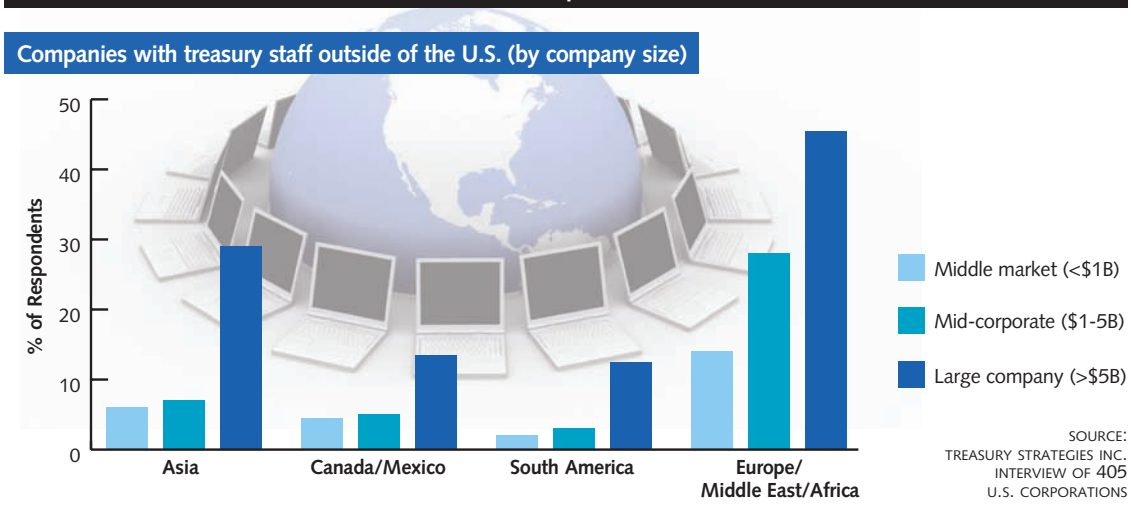
However, the advent of the truly global treasury may be closer than you think. More companies than ever are centralizing key treasury activities at global and regional centers as age-old barriers to treasury globalization are falling away.

THE TRENDS DRIVING GLOBAL TREASURY

It's essential for multinational corporations to capitalize on five key trends that are driving these transformational changes in treasury. Leading-edge treasury departments are actively driving and exploiting these new opportunities to create global, best-in-class treasury operations. Companies that continue to maintain a traditional structure of delegating offshore treasury activities to foreign subsidiaries risk falling to a level of underperformance relative to their peers.

1. SEPA and the coming transformation in payments. When it comes to establishing a truly integrated and streamlined treasury operation, the devil is in the details — and nowhere are the details more critical than in payments. Companies receiving and disbursing payments around the world have faced a disjointed global payments system, with each country operating unique clearing systems. In the area of low-value payments, for example, companies operating globally find that many nations do not provide a clearing system comparable to the automated clearing house (ACH) in

GLOBAL TREASURY: The Exception, Not the Rule



DOMESTICALLY CENTRALIZED, INTERNATIONALLY DECENTRALIZED

Few companies with less than $5 billion in annual revenue have established a global treasury organizational structure with treasury professionals offshore reporting to corporate HQ.

the United States. Where such low-value clearing systems do exist, formats will be unique to each system, requiring a customized set of instructions to initiate the payment.

As a result, many companies have traditionally relied on local subsidiaries to generate payment instructions, often utilizing proprietary communication platforms linked to local clearing systems. These payments must then be locally cleared and reconciled, creating additional costs. The challenges associated with centralizing accounts payable and accounts receivable were evident in a recent Treasury Strategies survey, in which over 50 percent of respondents indicated that local subsidiaries were responsible for these functions — the least centralized of all their treasury activities.

However, a major transformation of global payments is just around the corner. On Jan. 1, 2008, a new era in European payments will begin with the advent of the Single Euro Payments Area (SEPA). While the ultimate goal of SEPA — to create a single European payments area on an operational and legal basis — will take at least until 2010 to achieve, over the next several years banks will be required to introduce pan-European payment instruments that provide consistent pricing and float conventions along with standardized formatting.

For the corporation, this could mean, in theory, the ability to clear all Eurozone payments through one operating account. Additionally, the greater flexibility in payment formats afforded by SEPA will further enable companies to establish centralized payment factories and even centralized collection points.

At the same time, those companies that do not make a priority of assessing and adopting SEPA standards may encounter significant cost increases as banks transition away from supporting local payment formats. For example, under SEPA the Bank Identifier Code (BIC) will be the only bank routing designation accepted by EU-domiciled banks. Payments that do not contain the BIC will need to be repaired by the bank, resulting in additional charges to the company. Unfortunately, many companies do not have BICs in their vendor files and will need to collect this information or implement an automating solution.

Fortunately, the bank-owned cooperative SWIFT is leading several key initiatives that aim to deliver a common platform to support global standards for payments in Europe and globally. The UNIFI (ISO 20022) project, led by SWIFT, is developing global open (XML) payment and collection standards that will meet SEPA rules, including the provision of far richer messaging formats. In addition, ongoing projects to enable direct access by corporations to SWIFT, such as the Standardised CORporate Environment (SCORE) initiative, will enable large global companies to participate directly in SWIFTNet rather than through individual, single-bank linkages. The ongoing harmonization and enrichment of payment formats will serve to drive continuing improvements in straight-through processing rates and the ability to realize just-in-time funding of subsidiaries, outcomes that further bolster the business case for centralized treasury processing.

2. Creating a global master database. A global treasury operation must be able to access accurate and timely global data in order to be effective. Corporate treasury departments have long struggled to create a centralized and coordinated approach to treasury when obtaining key data such as foreign bank balances, cash forecasts and foreign currency exposures. The need for efficient

A NEW REGIME FOR GLOBAL TREASURY

Traditional Challenge	New Regime	Opportunity
Disjointed and inconsistent payment systems	Harmonized and enriched payment standards	Establish payment and receivables factories with single-point clearing.
Fragmented treasury data	Global infrastructure provided through ERP, treasury systems and financial messaging	Push and pull global treasury data at a single point of entry.
Lack of treasury automation	Distributed ASP treasury systems	Implement globally distributed treasury technology.
Need for local banking arrangements	Global banking partners	Streamline the global bank relationship structure.
Regulatory restrictions	Liberalization of capital markets	Expand netting and pooling programs.

access to data becomes even more critical for a company seeking to establish a regional shared services center to process payments.

The need for a common platform that provides access to business intelligence across the enterprise — both in treasury and across other functions — has led companies to implement ERP systems and other financial applications in subsidiaries around the world. The availability of hosted and ASP treasury systems, corporate access to SWIFTNet, and improvements in bank reporting platforms are also making data more accessible on a worldwide basis. While global system rollouts are an ongoing project at many companies, access to worldwide data from a central location has reached an unprecedented level. For corporate treasury departments, this means the opportunity — and the need — to implement centralized tracking of treasury management processes that previously were impractical.

For example, foreign currency risk management has remained relatively decentralized at many companies as a result of the difficulty of obtaining timely exposure data. Following implementation of global sub-ledgers for accounts receivable and accounts payable, however, corporate treasury now has the ability to independently view booked exposure information. Armed with this direct access to data, treasury can more easily take responsibility for trading and administering the derivative portfolio.

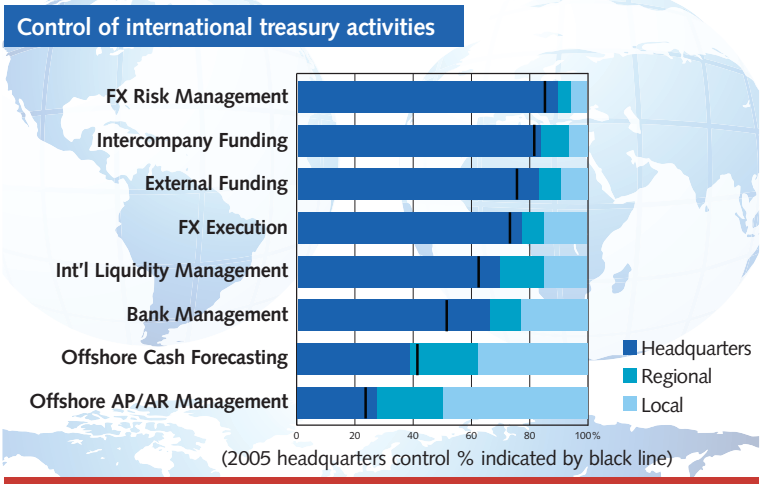
3. Treasury technology: a tool for the global enterprise. The introduction of treasury management systems over a decade ago was a major step forward for treasury departments in their quest to enhance efficiency and reduce risk through process automation. Manual and sometimes error-prone tasks such as debt and investment accrual calculation, bank activity reconciliation and posting, and gathering of cash position data could now be performed automatically rather than by hand. Costly and time-consuming to install, however, these "workstations" were typically limited to the corporate treasury department or perhaps key treasury center locations offshore. With only a select number of users, these applications often failed to receive the IT support needed to realize their full functionality and integration with other company systems. In addition, personnel in foreign subsidiaries were often unable to access and take advantage of these treasury management systems, inhibiting global coordination and the visibility of treasury.

The introduction and rapid adoption in the marketplace of Web-based treasury technology is changing the rules of the game, however. From anywhere in the world, company personnel can now access and utilize their treasury management systems through the Web. Companies now deploy a worldwide platform to capture distributed data across the enterprise. Real-time reporting of the global cash position, for example — long sought by CFO's but too costly for treasury to provide — is now a practical proposition. Furthermore, the cost of licensing and installing the newest breed of hosted and ASP treasury systems is now well within the budget of most midsize companies.

The challenge of creating a global cash forecast illustrates the strength of a global treasury management system. Faced with the difficulty of obtaining and compiling cash forecast spreadsheets from foreign subsidiaries, many companies have simply opted out and are unable to develop a consolidated forecast. With a Web-based treasury system, however, subsidiary staff can now input forecast information through a Web interface. Corporate treasury can utilize robust hierarchy and user-privilege functionality to ensure a consistent forecast methodology and define roles. For example, a particular individual may have the right to input forecast information, while only being able to view data for the local subsidiary.

4. The advent of true global banking. If the corporate treasury function has remained a local affair, so has the banking industry. Homegrown banks dominate their national footprint while

THINKING GLOBALLY, But Still Acting Locally



THE WAY FORWARD

Activities related to offshore accounts payable and accounts receivable are the least centralized globally. Recent innovations in payment systems and technology will finally enable the establishment of truly global receipts and disbursement clearing.

achieving a far more limited presence outside their borders. While a small group of global banks have long claimed a worldwide presence, branch locations and local banking services have frequently been limited in many countries. The need for a local branch network for making deposits and servicing payroll, for example, has led many companies to establish local bank relationships throughout the world. The result: a long list of bank relationships and bank accounts.

Treasury Strategies found, for example, that over 25 percent of U.S. corporations in a recent survey had more than 10 banks globally. Within the United States, the proportion having this number is only 11 percent, reflecting the far greater levels of streamlining that U.S. companies have realized domestically. For these companies, the cost of dispersed bank relationships outside of the United States is high. Bank accounts may be excessive and costly to maintain. Visibility into bank balances and service charges is low. For many larger multinationals, simply cataloging the bank relationships around the world can prove difficult, creating risk and control concerns. Companies are unable to award a lion's share of their wallet to their credit providers.

The rules of the game are changing, however, as an elite group of global banks is emerging with true capabilities to provide regional, and even global, capabilities. Bank consolidation and investment in branch networks are replacing many of the traditional homegrown banks with global brand names. Nowhere is this trend more evident than in Europe, traditionally a stronghold of "balkanized" banking. After years of consolidation, a select group of European banks have attained leading market positions in multiple Eurozone countries. SEPA is certain to reinforce this trend by reducing the cost of cross-border payments and the need for local clearing arrangements.

In other parts of the world, the elite global banks are making major outlays to land leading positions in key developing markets. Three of the Big 4 Chinese banks, for example, have received significant minority interest investments from U.S. and European financial institutions. These investments illustrate the importance to the world's leading banks of providing a global partnership to their corporate clients.

Corporations will need to continually monitor the growing capabilities of these global banks and evaluate the opportunities to establish regional and eventually even global partnership arrangements.

Deregulation: expanding cross-border solutions.

When implementing global, or even regional, treasury centralization solutions, theory often does not translate to reality when it comes to actually applying cross-border techniques around the world. Exception countries are all too common, limiting the effectiveness and scope of such solutions. Foreign exchange and other controls, for example, prohibit netting of payments in key Asian markets such as China and India. In Latin America, tax regimes impede concentrating funds between financial institutions. Even in Western Europe, generally amenable to cross-border cash management solutions, there are exceptions to be dealt with. A recent judicial ruling in Germany, for example, calls into question the ability for subsidiaries located there to participate in notional pooling programs.

5.

Nevertheless, as a result of the long-term trend toward globalization and market liberalization, these restrictions are gradually falling away in many areas. It is critical for treasury practitioners to monitor developments around the world in order to understand when solutions previously considered impractical can and should be implemented. The example of China illustrates the dynamic regulatory environment in many countries, particularly in the developing world. Just in the past year we have seen continuing relaxation of currency controls and branch banking. Brazil, Mexico, and India — traditionally some of the most problematic countries for multinational treasury operations — have been introducing important reforms that eliminate some traditional restrictions.

Treasury management — often described as more evolutionary than revolutionary — is entering a unique period of transformation. Treasurers must establish a strategic vision for their companies that leverages these unique opportunities to create shareholder value. Those companies that continue to rely on traditional organizational structures, technologies and payment processes risk facing an environment of rising costs as solution and financial services providers increasingly cater to a new breed of global treasury operations. BF

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