Papers

Managing the modern treasury

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Abstract Just like an individual business unit which is responsible for generating a sufficient level of sales and profits, there should be an organisational unit responsible for assuring a corporation's stockholders that the company can meet its liabilities as they come due. Profits may be the 'end game' when it comes time for the markets to value a company, but accounting profits at the end of a period do not pay each day's vendor bills or payroll; only cash can assure vendors, employees and others that the company is an ongoing concern. History is littered with the remains of companies that appeared to generate profits only to fall by the wayside when they either ran out of cash or could no longer access the capital markets, proving that historical measures of financial adequacy are often illusionary and no match for the safety of cash in the bank plus sufficient capital resources — the very definition of liquidity. This paper looks at the role treasury has traditionally assumed within a company and suggests that its role needs to change. The modern treasury needs to conduct less processing and more planning if it is to contribute its fair share toward a corporation's business goals.

KEYWORDS: treasury, liquidity, treasury management, treasury performance

INTRODUCTION

If the old saying that 'cash is king' holds true, does today's treasury know what business it is in? It should be the liquidity business or the business of funding current and future corporate needs at the lowest possible after-tax cost of funds.

Just like an individual business unit which is responsible for generating a sufficient level of sales and profits, someone should be responsible for assuring a corporation's stockholders that the company can meet its liabilities as they come due. Profits may be the 'end game' when it comes time for the markets to value a company, but accounting profits at the end of a period do not pay each day's vendor bills or payroll; only cash can assure vendors, employees and others that the company is an ongoing concern. History is littered with the remains of companies that appeared to generate profits only to fall by the wayside when they either ran out of cash or could no longer access the capital markets, proving that historical measures of financial adequacy are often illusionary and no match for the safety of cash in the bank plus sufficient capital resources — the very definition of liquidity.

This paper looks at the role treasury has traditionally assumed within the company and suggests that its role needs to change. For the modern treasury, there needs to be less processing and more planning if it is to

contribute its fair share toward a corporation's business goals.

THE TRADITIONAL TREASURY

The traditional treasury organisation grew out of a need for the organisational unit to track cash. Tracking cash usually meant accounting for customer receipts or payments to vendors or employees. As most corporations keep their cash in the bank, there was also a need to reconcile the cash balances at the bank (ie treasury cash) with the cash balances on the books of the company (ie book cash). If there was any excess cash available, it got invested; if there was insufficient cash, the treasurer would arrange credit with the bank and borrow under the company's credit facilities up to a prearranged limit. This cash-flow cycle would repeat itself, usually in harmony with a corporation's accounting cycle, typically monthly.

Despite the importance of cash, treasury staffs usually remained small. According to the 'Treasury Issues 2007' survey completed earlier this year, 66 per cent of the 400 US companies participating had no more than five people in their treasury departments.[1] Even among the larger companies (ie sales above $1bn) approximately one-third of those companies still had no more than five staff in their treasury. The small treasury staff size, relative to staff levels in other financial areas, such as the controller's area or a financial planning area, also means that just a few requests for assistance from these larger departments can consume a disproportionate share of treasury resources.

Treasury resources are usually devoted to obtaining data about cash transactions affecting the corporation's many demand deposit or investment accounts at its many financial institutions. Treasury also spends significant resources on processing transactions:

- creating accounting entries for each transaction impacting a bank account;
- executing outgoing payments, especially if they involve electronic funds transfers or different currencies;
- buying or selling short-term investments or currencies;
- borrowing or repaying debt under existing credit facilities;
- maintaining lists of accounts at its financial institutions and who may use them.

The organisational structure and culture of a company can also make the production of a consolidated view of liquidity difficult and time-consuming for the following reasons:

- *Growing importance of global operations:* Cash transactions can be in a different currency from the parent company's functional currency, complicating the reporting of consolidated cash balances.
- *Disagreements over the correct level of cash balances:* Regional or local business units often take a proprietary view of 'their' cash vs the corporation's cash to ensure they have sufficient cash for their own operating needs. Lack of forecasts or different forecasts about the correct level of cash can cause a company to become over-borrowed or under-invested within its global businesses. This lack of forecasts and agreements over cash balance targets can lead to lost opportunities when managing liquidity.
- *Cash reconciliation differences:* The strict definitions of 'book' cash, which includes a given amount of cheques outstanding and receipts in the process of being collected (ie float) or other book entries not shown in the balances at the bank, can produce a much different number compared with treasury cash or cash available to fund disbursements, pay down debt or invest. These reconciliation differences contribute to an under-invested or over-borrowed situation with their attendant costs.
- *Processing leads and lags:* Even in today's wired world, most treasury departments are heavily dependent on multiple general ledgers (GL) and web-based bank systems, spreadsheets and e-mails to calculate and communicate cash, debt, investment and foreign exchange positions among other