Treasury health check-up 2012

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About the survey

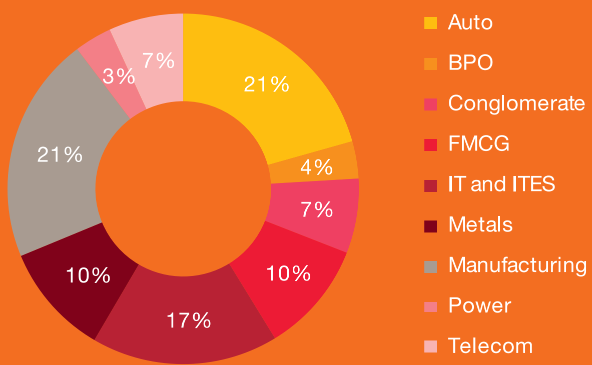
The Treasury Health Check-up 2012, conducted by PwC India across a section of leading corporates in the country, examines the trends, issues and challenges faced by their Treasury functions.

The key areas examined in the survey included:

- Risks involved in running today's treasury operations
- Treasury governance
- Use of technology in treasury
- Integrated risk management practices in treasury
- Foreign exchange and interest rate risk management
- Cash and investment management

Based on the survey findings, we have identified key themes and attempted to provide insights on current treasury management practices and opportunities for improvement.

The survey respondents included organisations spanning nine industry sectors across India.



Note: Not all Figures in some graphs add up to 100%, which is attributed to the rounding of percentages, overlapping responses and to the exclusion of 'neither/nor' and 'not applicable' responses.

Executive summary

Corporate treasurers have to achieve a critical balance between protecting their businesses and achieving value drivers for growth by managing significant risks. As the portfolio of activities to achieve this equilibrium is varied, over-emphasis on a few may mean failure to notice and mitigate others.

In this survey of corporate treasuries, we observed that Indian treasuries are placing prominence on diversifying their funding sources and effectively managing liquidity and foreign exchange risks. Survey results also suggest that there are various areas with significant scope for improvement - use of technology in treasury and managing operational risks. Incidentally, these did not rank as high priority by most respondents; possible reason could be resource constraints, given other business commitments.

In India, while many organisations are embracing new technologies to help manage the increasing flow of data, spreadsheets remain the tool of choice for a majority of respondents as compared to the use of ERP and other integrated treasury systems and tools.

As regards the management of foreign exchange risks, survey results show that forward contracts are the instruments of choice with a majority of the respondents. Survey results indicate an increase in reporting to the board and senior management with a majority of respondents reporting information on risk management (primarily FX and interest rate), treasury operations and funding.

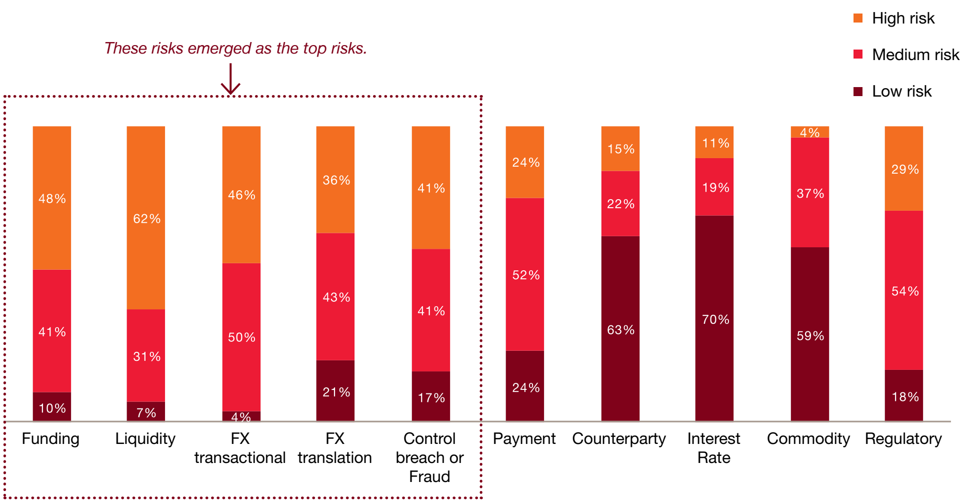
Given the importance of cash management in a treasury function, treasurers see the need to enhance visibility and control of cash and liquidity at an entity level. Respondents, being aware of the challenges of achieving this, rate this as one of the key concern areas.

According to the survey results, treasuries may not be realising the value of complete integrated risk management, as their primary focus today seems to be managing financial risks. Treasuries need to achieve a comprehensive and more integrated understanding (and management)of the risks arising from foreign exchange movements; commodity prices; interest rates; and their people, systems and processes, as their businesses pursue growth.

On the whole, corporate treasuries must effectively integrate treasury initiatives with the overall business objectives as the role of the treasurer continues to evolve.

Key risks on the treasurer's agenda

1. Key risks on top of the treasurer's agenda



With respect to treasury risks, the responses suggest that the focus for treasuries remains on managing liquidity, funding and Foreign Exchange (FX) risks. Nearly 62% of respondents have rated liquidity risk as high. The recent volatility in the FX market has put pressure on companies to manage their FX risks and hedge their exposures. Alongside, recent regulatory changes have also put pressure on the eligible instruments and transactions for managing FX risks. However, more than half of the respondents have rated regulatory risk as medium.

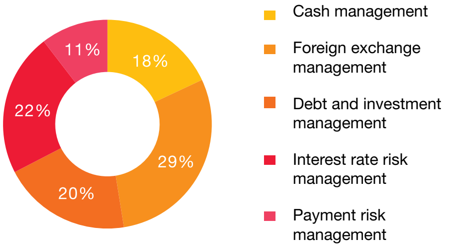
Control breach or fraud is a concern for most treasuries (See Figure 1). Hence, there is a need to strengthen the mechanism to manage fraud. The survey results indicate that out of the 41% respondents who have rated control breach or fraud as high risk, less than half use an independent resource or function for ensuring compliance to treasury policy. Of these 41% respondents, few conduct root cause analysis to address control failure and other incidents that could impact business. Our analysis also indicates that most of these respondents do not have dealing, confirmation or settlement activities automated through a Treasury Management System (TMS).

We observed that respondents with exposure to commodity risks and Interest Rate(IR) risks have given a lower weightage to these as compared to other risks.

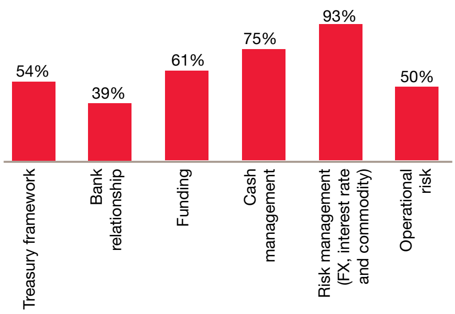
Indian treasuries are placing prominence on diversifying their funding sources and effectively managing liquidity and foreign exchange risks.

Governance in treasury

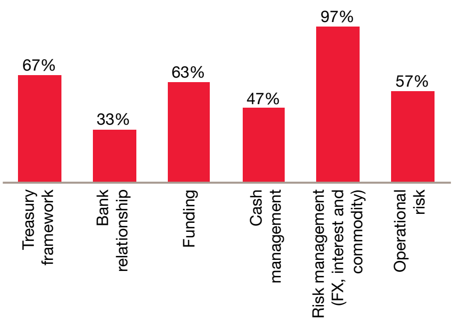
2. Percentage responses for presence of formally documented policies



3. Treasury risk function having KPI



4. Reporting information to the board



5. Time devoted to treasury activities

Treasuries are responding to the risk and uncertainty by establishing a mechanism for measuring, monitoring, controlling and reporting of key risks.

A majority of the respondents have formally documented policies for FX risk management, debt and investment management and cash management(See Figure 2). This is in line with our survey findings as FX risk has been rated high and a majority of respondents have emphasised the importance of cash and investment management as detailed in subsequent sections.

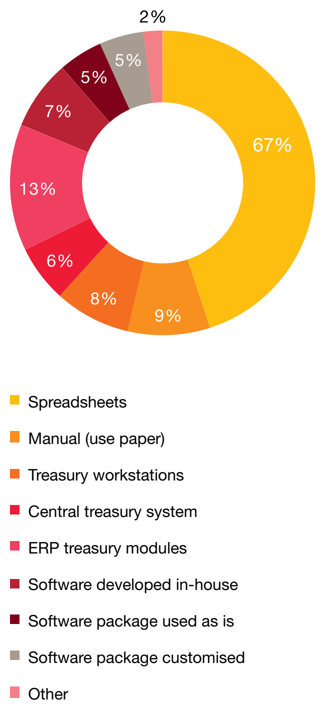
The Key Performance Indicators (KPIs) used by various treasuries also validate the above with a majority of respondents having KPIs defined for risk management (FX and interest rate), cash management and funding (See Figure 3). KPIs for operational risk are used by a smaller proportion of respondents suggesting that treasuries are placing lower emphasis on monitoring operational risk as compared to FX risk, cash management and funding.

Besides, treasuries are ensuring that the board is better informed through better reporting of treasury-related information. Our survey results indicate that 97% of the treasuries emphasise on reporting risk management information (primarily FX and interest rate) while more than half of them report information on the treasury framework and funding to the board (See Figure 4).

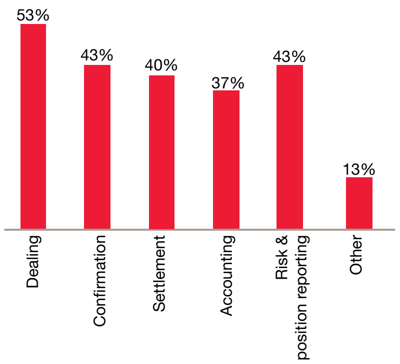
The survey results suggest that treasury staff devotes more time to FX risk management followed by cash, debt and investment management (See Figure 5). This validates the focus of treasuries on FX risk, cash and investment management.

Utilising technology for treasury operations

6. Usage of tools in cash management, hedging, debt and investment management and risk management



7. Activities done within TMS or linked directly to a system



Technology can play a crucial role in making the job of a treasurer less stressful (by having better visibility on risks and liquidity) and more efficient (through process automation and performance improvement).

In India, while many companies are adopting new technologies to help manage the increasing flow of data, spreadsheets remain the tool of choice for 67% of respondents (See Figure 6). These findings raise questions about the pace of progress of technology in this area, with respondents spending more time on consolidating information from multiple systems and locations. Most of the respondents using spreadsheets have, on an average, 60 spot transactions and 20 derivative transactions per month. However, as business grows, the number of transactions would grow, thereby increasing the level of automation in treasury through investments in systems – to efficiently manage the increasing volumes and complexities of treasury operations.

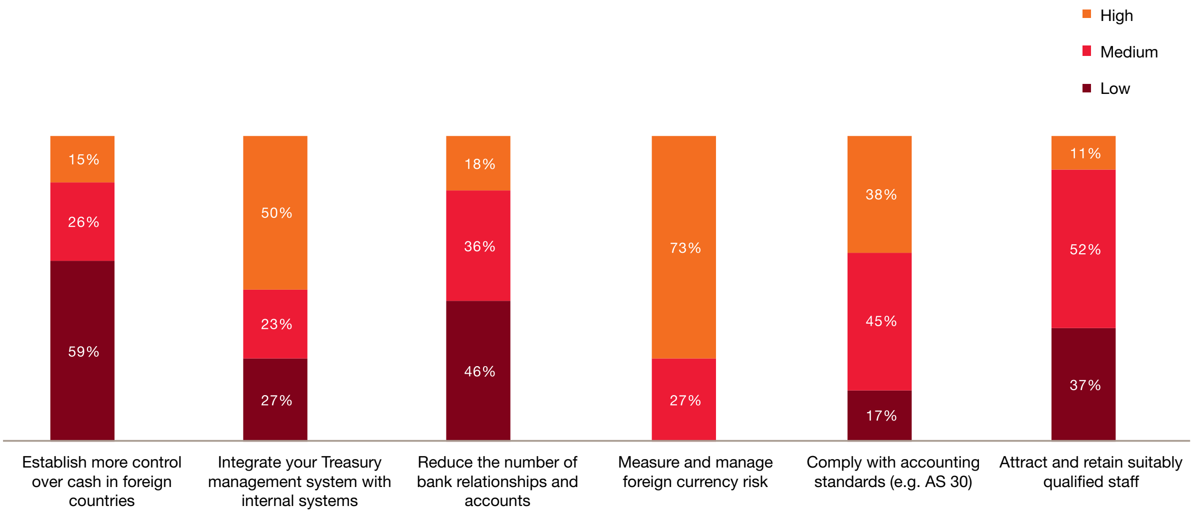
Treasuries with greater manual activity naturally have a higher number of Full-Time Equivalents (FTEs) involved in treasury activities. Survey results suggest that even for large treasuries (companies with annual turnover exceeding 5000 crore INR), the use of technology for managing treasury activities still has a lot of ground to cover. However, on an average among the treasuries that have implemented treasury systems, the a majority have linked dealing, validation and settlement with electronic systems to replace dealing via phone (See Figure 7).

Thus with limited investment available for new systems, treasury functions may find it increasingly difficult to keep up with changing business needs as the volume and complexity of transactions increase in the future.

To reap the benefits of advancements in treasury technology, a shift in mind set and significant investment would be needed.

Integrated risk management practices

8. Initiatives for risk management



According to the survey results, treasuries may not be realising the value of integrated risk management, as the focus is primarily towards managing financial risks. Around 73% of respondents have reported measuring and monitoring FX risk as a high priority initiative (See Figure 8).

The results also suggest that the following are the top three initiatives taken by treasuries around risk management:

1. Managing FX risks
2. Technology enhancement by integrating TMS with internal systems
3. Compliance with accounting standards (e.g. AS 30)

Implementing integrated risk management practices will allow treasuries to enhance their overall control of risk.

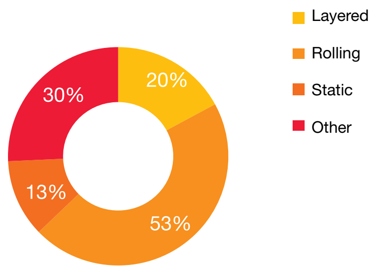
FX risk management

A majority of treasuries are increasingly managing their FX risks by using various approaches (See Figure 9). More than half of the participating treasuries follow rolling approach (first choose a hedge horizon and the percentage of the exposure to hedge in each period on a rolling basis) while only 13% follow static approach.

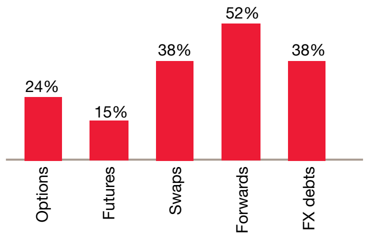
Our analysis suggests that more than half of the respondents rely on forward contracts to manage FX risks. The preference for the use of other instruments including swaps and options for managing FX risks is distributed while only 24% respondents are currently using options to manage FX risk (See Figure 10).

Treasuries are focusing more on budget rate protection and transaction risk management as part of their FX hedging programme (See Figure 11). Minimising earnings volatility is another area of focus that treasuries are trying to address through their hedging programme. This is in line with business expectations, given the volatility in the FX market in recent times. Also, maximising returns and maintaining competitive advantage are areas that treasuries are aspiring to achieve through their FX hedging programme. Presently, this is more aspirational than operational.

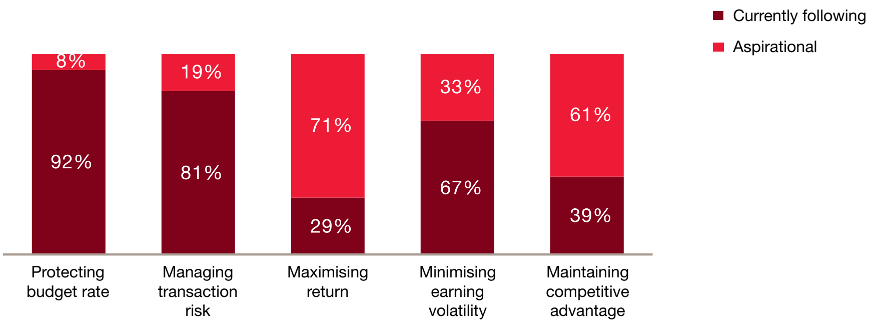
9. Approaches to hedge FX risk



10. Percentage of responses using instruments to manage FX risks



11. FX risk management strategies treasuries are looking to achieve in their FX hedging programme



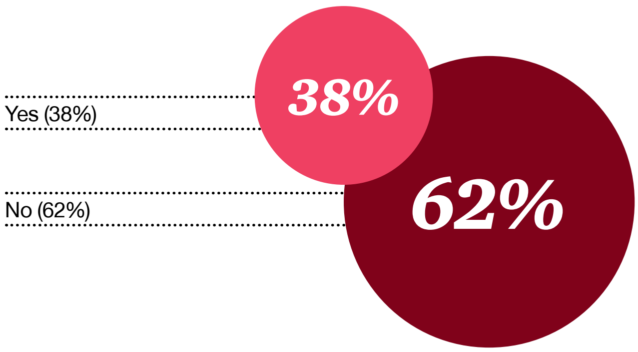
The resurgence of foreign trade — combined with volatility in the USD-INR market — heightens the importance of having a foreign exchange risk management strategy in place.

Interest rate risk management

Treasuries understand that managing Interest Rate (IR) risks can remove a source of financial uncertainty and bring stability to finance costs. Swaps emerge as the instrument of choice for managing IR risks with 58% respondents using them. Other instruments primarily used for managing IR risks include cross-currency swaps.

When asked about the measurement of IR sensitivities, the results suggest that most of the participating treasuries do not measure them (See Figure 12).

12. Do you measure interest rate sensitivities?



Swaps and cross-currency swaps are the major derivative instruments used for managing interest rate risk.

Operational risk management

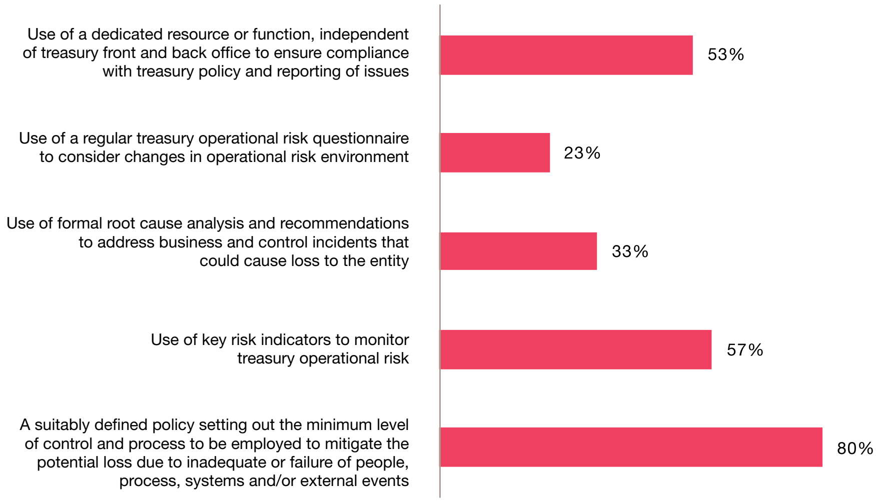
Inadequate operational risk management increases the possibility of fraudulent events and errors that could have significant implications for a company's business. Operational risk management is more important than ever for Indian treasuries as most of them are yet to fully integrate technology in their operations.

Our survey results indicate that 80% of respondents have a policy in place for establishing control over the failure of people, processes and systems. Other mechanisms adopted widely to manage operational risk include the use of Key Risk Indicators (KRIs) and having a dedicated independent resource or function to ensure compliance with the policy (See Figure 13).

Nearly 73% of the treasuries have reported managing FX risk while 50% have reported integrating TMS with internal systems as high-priority initiatives for reducing overall operational risk (See Figure 14).

On a lower priority are initiatives on people, establishing greater control over cash in foreign countries and compliance with accounting standards.

13. Mechanisms adopted to identify, measure, monitor and control operational risks

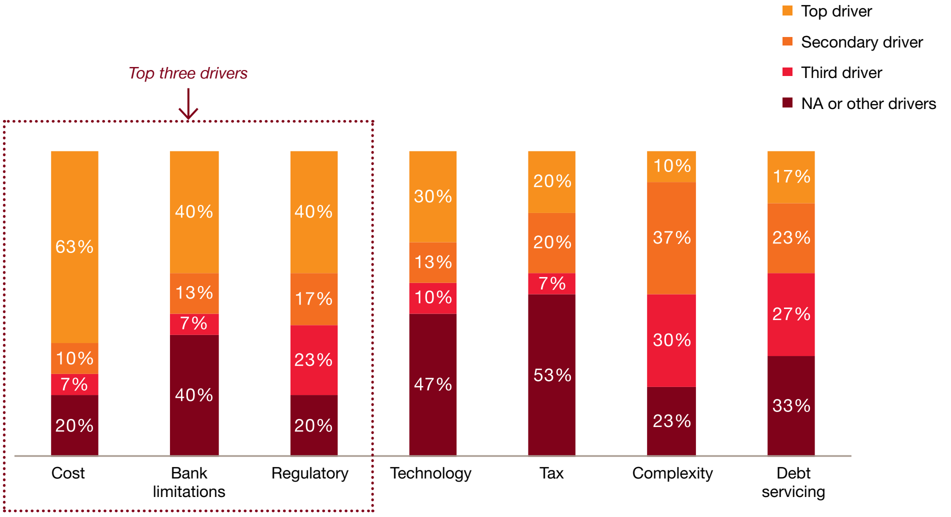


14. Initiatives to reduce operational risk	Priority for treasurers
Measure and manage foreign currency risk	High
Integrate your treasury management system with internal systems	High
Comply with accounting standards (e.g. AS 30)	Medium
Attract and retain suitably qualified staff	Medium
Establish more control over cash in foreign countries	Low
Reduce the number of bank relationships and accounts	Low

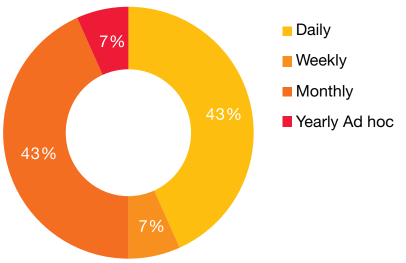
Every organisation needs a policy which sets out the minimum level of processes and controls to be built to mitigate operational risks (failure of people, processes and systems) and increase operational efficiency to improve performance.

Cash and investment management

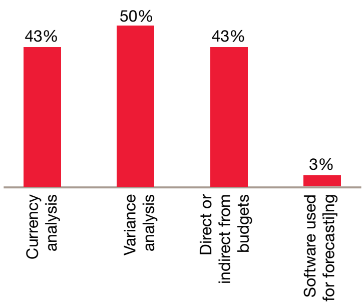
15. Drivers for cash management



16. Cash flow forecasting frequency



17. Percentage response for cash flow forecasting activities



Companies are increasingly focussing on getting a better understanding of their current and future cash positions, decreasing their funding requirements and enabling a more proactive approach to investment management. The survey results suggest that cost, bank limitations and regulatory implications are major drivers for cash management (See Figure 15).

A majority of the respondents reported following daily or monthly cash flow forecasting (See Figure 16) with 50% respondents using variance analysis and 43% using currency analysis for cash flow forecasting (See Figure 17).

One of the key requirements for managing funding risks is having accurate cash forecasts. A majority of the respondents are using this tool well, given the importance they place on cash management and funding.

Cash visibility essentially requires the ability to compile and maintain an accurate cash position and forecast.

Conclusion

Integrated risk management and a robust governance framework will benefit treasuries by enhancing the overall visibility of, and control over enterprise-wide risks. This will also help provide reasonable assurance on internal controls over business operations to internal and external stakeholders.

A treasury management system, rather than operating as a stand-alone system, needs to be well interfaced with the organisation's other systems and platforms. Optimum implementation of technology can help treasuries strengthen risk management through automation of controls, manage fraud risks, enhance reporting and operational efficiency through reduced manual interventions.

With the ever-growing need for effective cash management and funding, treasuries need to maintain a proactive approach to cash management. Accurate cash forecasts will help treasurers make informed decisions concerning optimised funding structures and help them better manage liquidity and foreign currency risk.

As business dynamics change, organisations grow and markets evolve, bringing with them a host of regulatory changes and complex products, the scope of corporate treasuries needs to be widened and more closely aligned to business objectives.

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