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Corporate Treasury Vol 1

The ever evolving landscape of treasury in India

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Introduction

Treasury management or treasury operations is a common term in banking parlance. With the growth of large corporate houses, treasury departments have created a place for themselves in sectors other than banking. In essence, treasury management is all about handling funding requirements for the business and management of financial risk, which primarily involves raising and managing money, commodities, interest rates and, in some organisations, the related areas of insurance, pension, property and taxation.

The function of the department is now dynamic and it is responsible for identifying risks associated with this activity and for controlling the risks that could erode financial strength, using mitigation and hedging techniques and encouraging a culture of sound financial practice. This translates into a need to ensure that the company, at all times, has the liquidity and cash to meet its obligations as they become due, arranging funding through equity or debt capital market activities, bank borrowings, through to day-to-day cash management and investment.

The treasury function is an integral part of every business, although in small firms it may be part of a department that's responsible for other functions, such as accounting. In larger organisations, it is likely to be a separate department reporting to the chief financial officer, but it needs to communicate well with the rest of the organisation if it is to provide effective services. This treasury function may be a centralised or decentralised function depending on the size and nature of business activities.

Treasury management represents one of the two main aspects of financial management, the other being financial control. The treasury is concerned with the relationship between the entity and its financial stakeholders, who include shareholders, fund lenders and tax authorities. Financial control, on the other hand, is concerned with the relationship between the entity and stakeholders such as customers, suppliers and employees.

Introduction

Evolution of the treasury function

In the early stages, the treasury function was undertaken by banks, which managed the inflow and outflow of cash. As economies grew complex, the regulators rolled out guidelines for the management of funds. The role of the treasury in banks was then enhanced but still restricted to dealing in permissible securities and managing the funds flow. Over a period of time, the role of the treasury in Indian banks has evolved from just being the cash manager to the risk manager. The departments have now assumed a strategic role and undertake profit-making activities within the stipulated risk framework so as to reduce the cost of funds. Typically, a bank treasury would be organised into:

- Money market desk
- Forex desk
- Capital market desk
- Asset liability management desk
- Risk management desk
- Transfer pricing desk

The desire to reduce the cost has led to mammoth growth of the corporate treasury in large and mid-sized corporates. A corporate treasury department can be viewed as an in-house solution for managing the funds of the business house. The corporate treasury performs functions such as cash management, liquidity planning, procuring finance and managing risk for the business. The turbulent and unstable global economic environment is a contributing factor in the growth of the corporate treasury in India. Companies now aim at preserving wealth along with riskless profit making.

The corporate treasury can be viewed as an in-house bank, providing services to various departments of the organisation. However, the scale of operations is much larger for banks. Corporate treasurers are continuously battling with issues such as cash visibility, exposure recognition as well as the absence of a long-term treasury strategy. This is where the debate on whether the treasury department should be considered a cost centre or a profit centre stems from.

Return of the profit centre

The treasury plays a pivotal role in any organisation. It is therefore imperative to decide the position of the department as a cost centre or a profit centre. Treating the treasury department as a cost centre would mean that the entire cost of operations will be allocated to the various other revenue-generating units. Cost centre treasuries focus on providing a service to the business units, much like a client-supplier relationship. Rather than working to a profit goal, a number of metrics are used that vary based on the organisation and its focus on analysing the effectiveness of the treasury. The treasury then reports on the costs of cash management, the net hedging and interest expenses and so on.

On the other hand, if the treasury is positioned as a profit centre, it needs to generate profits to absorb its own cost. While a few companies may define their treasuries in terms of the classic profit centre model of the late 1980s and 1990s, some are now self-defining as profit centres with a completely different profit model.

A) 1980s – the rise of the profit centre

From a global perspective, the treasury department was viewed as a profit centre in this decade. With the goal of reducing transaction costs, combined with the necessity of handling trade and hedging for other core treasury functions, these companies began allocating capital to the treasury to bring in a profit from trading activities. Many of these companies looked more like banks than corporates when it came to finance and treasury, with some even seeing more profit from trading activities than from core businesses.

B) ’90s crisis and the shift towards the cost centre

The ’90s can be termed as the decade of crisis as the European crisis in 1992–93 was swiftly followed by the Latin crisis in 1994–95, and the Asian crisis followed that in 1997. After a number of treasuries ran into difficulties with trades going bad, the profit centre treasury model became less attractive. As the cost of capital gradually increased, there was a rise in the internal competition for capital allocation between different business units. Companies actually began focusing on core competencies and resources were first allocated to those competencies seen as core.

With all that happened during and after the crises—corporate scandals, the advent of Sarbanes-Oxley and tightening reporting standards around the globe—a few corporate treasurers or finance managers don’t wish to have anything to do with the world of speculation and, hence, the approach of treating the treasury as a profit centre took a backseat.

The role of the treasurer reverted to helping to protect the interests of the company and reducing risk wherever possible rather than seeking profits. The cost centre model—with no specific profit goals and no trading except for cash management purposes—became the popular approach.

Return of the profit centre

C) The revised profit centre model and the way forward

Based on this discussion, one can ask what the way forward for corporate treasuries might be. Recently, there has been a resurgence of interest in the idea of a profit centre treasury. But what exactly this means has completely changed. Rather than being allocated funds and having a profit goal, the new profit centre treasury is all about adding value through process efficiency and improved working capital management through the following ways:

- By combining the banking needs of all business units, this model allows savings through economies of scale.
- Putting in place cash centralisation structures, such as cash pools.
- Margins, and thus treasury profits, can also be created by better managing banking relationships. This would involve demanding competitive bids and requiring credit from those banks that wish to benefit from a share of the cash management business.
- The treasury can use its skills in risk management in order to help push forward corporate strategy while still bringing in profit.

Hence, though the treasury function was traditionally viewed as a profit centre and a cost centre, the trend in recent years has been emphasising the need for the conversion of the treasury function into a value creation centre by treating it as a hybrid of both the cost centre and profit centre.

Centralisation and decentralisation of treasury

Today, every cash manager must look not only to keep things running smoothly but also efficiently. Companies around the globe are looking for ways to streamline their operations and pull out cash tied up as a result of business process inefficiencies. With the advent of global business, corporates need to decide whether to position the treasury as a centralised department or a decentralised department.

In a centralised set-up, the key decisions and functions shall be taken by a single team on behalf of all the group companies located elsewhere. In such cases, risk management and fund management for the entire group is handled centrally. In contrast to this set-up, the decentralised set-up vests the decision-making power in the smaller unit, which may be located geographically apart, and cash management is done locally. Only reporting could be centralised for the purpose of group consolidation.

Companies benefit from decentralised control when it comes to their treasury operations, because handing over the control and management to local people helps to reap the benefits of familiarity with the business, customs, language, and the culture. However, the advantages of centralised operations outshine those of the decentralised set-up. The greatest benefit of pooling operations at a centralised location is the reduction in the costs for services, increased professional treasury knowledge, and increase in buying power.

Although a fully centralised environment may appear to be the most suitable structure for multinational corporations, in reality, this may not be the case. Many companies end up with a hybrid or decentralised arrangement, simply because it is impractical to operate in any other way. The better idea is to have a hybrid state of management and reap the benefits of both set-ups. In larger firms, the treasury is usually centralised at the head office and provides services to all parts of the business. This allows it to achieve economies of scale—for example, by obtaining better borrowing rates. The financial control function is often delegated to individual units, where it can respond more easily to customers and suppliers and relate more specifically to the units' competitors. As a result, the treasury and financial control tend to be separated by location as well as responsibility.

What the industry has to say

PwC's Global Corporate Treasury Benchmarking Survey 2017 revealed that 83% of the 220 corporates who participated have a dedicated central treasury department. However, on average, only 35% of the full-time equivalent (FTE) involved in treasury processes are employed in treasury departments.

Treasury processes involve not only local finance managers for forecasting but also shared services for accounting and payment factories. With 65% of the FTE involved in treasury processes distributed across the enterprise, treasurers have to manage what is, in fact, a virtual treasury organisation. The treasury can be considered more of a range of services and process than a department.

FTEs involved in treasury processes do not differ vastly across the world. However, European companies tend to be slightly more centralised and to involve shared service centres more often than their peers in other parts of the world.

The treasury is widely seen as a value-adding shared service, with 92% run as a cost or cost saving centre. Further, 64% of the respondents say their treasury operates as the central counterparty or the group in-house bank.

Almost two-thirds of the respondents indicate that their treasury budget will be flat or cut somewhat next year, while 30% indicate that it will increase somewhat.

Average treasury FTEs by geography and location

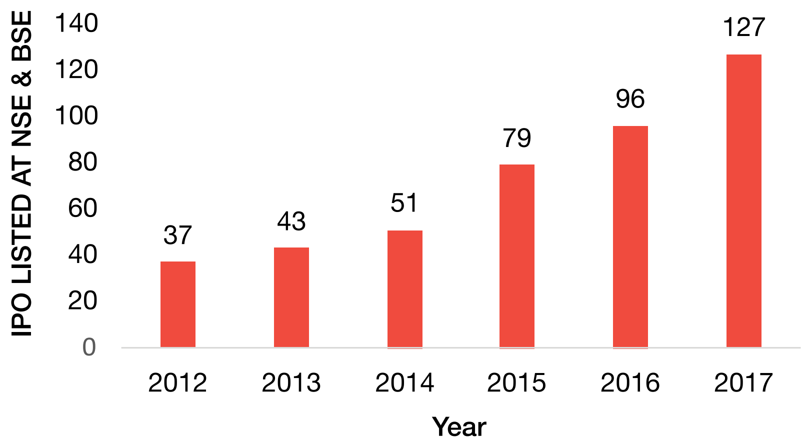
	Central treasury centre	Regional treasury centre(s)	Local treasury	In-house bank	In-company shared services	Outsourced shared services	Total staffing (average)
Asia Pacific	3.3	2.1	11.1	1.0	0.0	0.0	19.4
Africa and Middle East	9.6	2.2	6.5	0.0	50.8	0.0	49.4
Southern Europe	5.7	1.8	3.9	4.0	5.0	6.0	17.2
Northern Europe	6.9	4.5	1.3	0.0	7.5	0.0	16.8
Western, Central and Eastern Europe	7.4	2.0	3.3	4.2	5.6	2.0	16.3
Latin America	9.0	0.0	2.0	0.0	0.0	0.0	11.0
North America	4.9	5.8	5.1	1.5	0.0	0.0	11.9
Average number of FTEs	**6.6**	**1.7**	**5.9**	**0.6**	**3.9**	**0.2**	**18.9**
Percentage of organisations using this structure	**83%**	**30%**	**49%**	**15%**	**20%**	**4%**	**100%**

Source: Global Corporate Treasury Benchmarking Survey 2017 (https://www.pwc.com/gx/en/services/audit-assurance/publications/corporate-treasury-benchmarking-survey.html)
Treasury Today (http://treasurytoday.com)

Indian landscape

Considering the above, the treasury function in India is evolving. Organisations are regrouping in order to raise themselves and meet the global best practices. In the context of Indian corporates, along with a move towards centralisation of decision making, there are emerging trends that demonstrate the use of complex ecosystems (FinTech, hedging platforms, etc.) and a seamless interface for managing transactions and associated reporting. The influx of funds needs to be handled with utmost diligence so as to maximise the returns with the minimum cost while ensuring compliance with the regulatory framework.

There is a huge capital inflow in the Indian economy, both from domestic and foreign sources. If we look at the volume of initial public offerings (IPOs) listed on NSE and BSE, a consistent emerging trend can be observed across the last 5 years.



This means that with the increased flow of capital in the companies, there is an increased demand for managing the funds efficiently and in a cost-saving method. The corporate treasury needs to buckle up to face the upcoming challenges.

The best approach would be to adopt a hybrid system by centralising risk management and decentralising cash management. Each decentralised unit could be a cost centre, thereby minimising their profit maximisation motives. The centralised units can be assigned as profit centres and undertake profit-making activities which shall be under central supervision.

While deciding the approach, we should also be mindful of the regulatory scenario and the complex treasury products available in the market. A treasury can perform efficiently if it deals in the correct products as per its requirements.

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