
The bulletproof treasury operation: How best practices produce quantifiable results

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Abstract Careful attention to best practices creates a best-in-class treasury with defining characteristics such as a clear vision, appropriate staffing, wise use of technology, robust systems, effective management control of banking relationships and sound oversight of the company's cash. The research in this paper shows how those implementing these best practices will see quantifiable results in the form of cost reductions, compliance and improved yields.

KEYWORDS: treasury operations, quantifiable results, financial crises, evaluation, planning, policies, processes

INTRODUCTION

If it's not too painful, ponder the current financial crisis and consider how corporate treasurers have managed through events up to this point. What actions and management strategies were considered as the subprime mortgage crisis created uncertainty around many investment instruments and later fuelled a credit crisis that toppled investment and commercial banking giants?

Has your treasury team been able to manage its day-to-day activities and still concentrate on dealing thoughtfully with the crisis at hand? Could they turn to established policies and processes to guide them through the unprecedented difficulties? Or did they flounder and just make it up on the fly? Could they make rapid choices between taking care of operational details and putting out fires?

At Treasury Strategies, those working with corporate treasurers have seen both extremes. But what differentiated those who reacted thoughtfully and strategically from those who

spun into confusion and uncertainty? It was not talent, or exposure, or even sheer leadership. It was *readiness*. It was the corporate treasury version of the old Boy Scout motto: *be prepared*.

Being prepared is a lot like a farmer who can sleep through a stormy night. The farmer does not have to check the roof, fence or livestock, as he has done his job ahead of time and can sleep through the storm.

The companies that have fared well through this crisis were prepared because they too had done their job ahead of time and 'bulletproofed' their operations. Companies that bulletproof treasury proactively engage in a periodical, comprehensive evaluation and planning process. By doing so, when the inevitable but unplanned crisis happens, they can weather the storm and continue to manage core operations responsibly while maintaining their focus on strategic-level issues.

Treasury operations are typically leanly staffed, so the challenge for most is how to

allocate time. Many find they cannot spend sufficient time on strategic-level issues because they have insufficient people or inadequate processes, technologies and policies to ensure productive and effective operations under normal conditions. As a result, they must devote excessive time and effort to tactical activities, diverting them from strategic matters.

In the bulletproof treasury, the pyramid of activities is inverted (Figure 1). Operational concerns and problems that can be minimised by policies, technology or process consume less time and attention. Value-added, strategic initiatives dominate.

THE BIG NINE

There are nine principal areas of treasury that can profit by incorporating best practices. The balance of this paper describes the typical issues that arise in each of these, as well as proprietary research results and some best practices that have proven to deliver profitable results to practitioners.

Treasury organisation

To be truly effective, treasury needs to be structured and staffed correctly for the full scope of its responsibilities:

- *Centralised structure:* There is no one absolute organisational design to recommend, but the

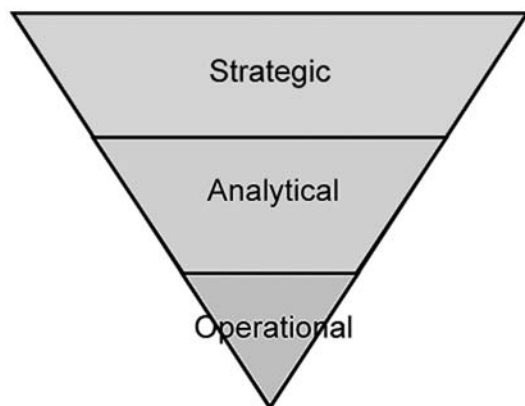


Figure 1: The allocation of time within a bulletproof treasury function

most effective treasury organisations provide for a strong measure of centralised control and management.

- *Correct staffing:* While having the right number of staff is vital, extra attention should be paid to making sure the positions are filled with people who have the right mix of talent, knowledge, experience and training.
- *Training and cross-training:* Bulletproof treasuries have formal, thorough training programmes for each position. One frequently overlooked area, even in well-staffed organisations, is the need for robust cross-training so that when crises arise, people can quickly fill in for others using thorough, up-to-date procedures.

It is not unusual to find that many treasury organisations are understaffed — sometimes significantly — for their stated responsibilities. Understaffing is sometimes not apparent because the existing staff may have, out of necessity, taken to shortcutting certain tasks or executing them infrequently.

A common example of a responsibility that can fall by the wayside in understaffed companies is the examination of bank fees. Research by Treasury Strategies shows that actually adding a person for that purpose — regular, rigorous examination of bank invoices — can save money to the tune of 5 to 10 per cent. The savings come in the form of identifying idle accounts that could be closed, fees that have crept higher, and errors that go uncaught. If a company's bank fees run to about \$120,000 a month and it is not regularly examining its bank invoices, it may well be sitting on a \$6,000–\$12,000 savings opportunity.

- *Policies:* When it comes to smooth operations, there simply is no substitute for careful consideration of the policies that govern each treasury activity. They should be documented, approved by the board of directors, and reviewed annually. Otherwise, *ad hoc* activities flourish in a crisis, and efficiency and control suffer precisely when they are at a premium (Figure 2).

It is common to find that clients have

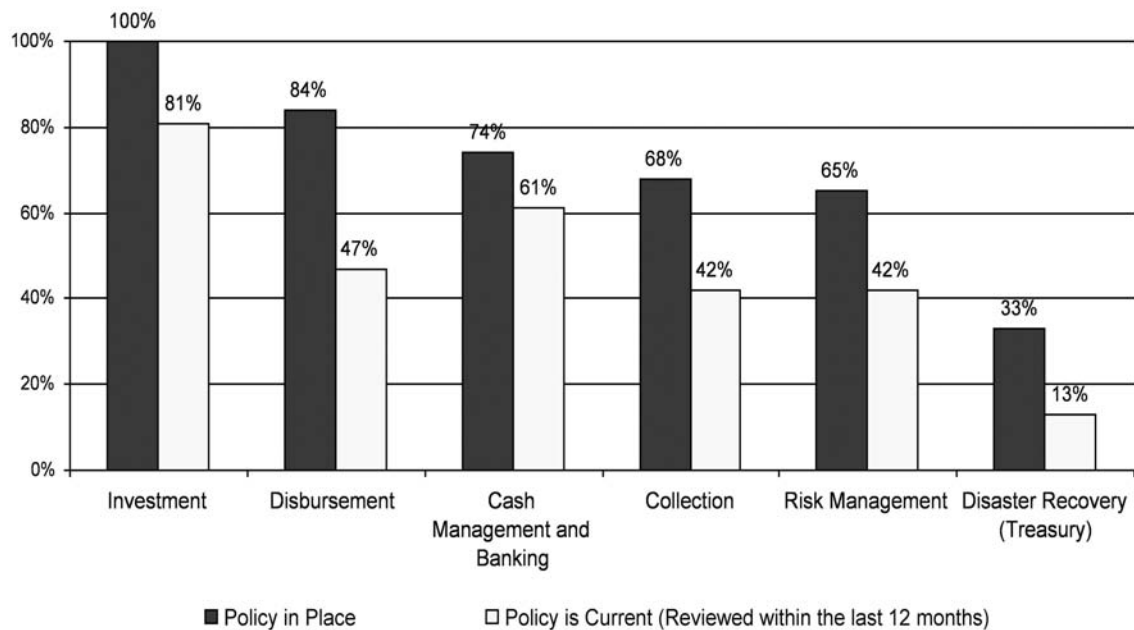


Figure 2: Treasury policies

done a good job of documenting traditional policies but have overlooked two key vulnerabilities. One, they may not have kept policies up to date with changing circumstances. Two, new technologies, relationships and exposures call for a concurrent review of existing policies in addition to the standard annual review.

Bulletproof policies should have clear, written descriptions for every treasury responsibility. Such policies should define and document the necessary authorities and procedures, mandate a regular schedule for annual review and modifications, and ensure access to documentation as appropriate — usually via intranet and hard-copy.

- *Contiguous functions:* Research suggests a steady expansion of treasury's purview and organisational impact. Today, treasury increasingly supports and serves many more activities that carry a sizeable risk component, such as capital markets, cash forecasting, trade finance and risk management. Bulletproof treasuries have the staff to support adequately these responsibilities, board-approved policies, and

their own carefully crafted disaster recovery plan.

- *Staff size:* Simply put, staffing levels should allow treasury to plan, execute and measure its performance, as well as provide for adequate control and backup as needed (see Figure 3).

Bank structure and administration

The best practice for bank account structure is to minimise the number of banks and accounts:

- *Zero-balance accounts (ZBAs):* One practice that almost invariably produces quantifiable results is the ZBA. For example, Treasury Strategies worked with a retail industry client with ten locations. Each location had a separate bank account, and the client was making a daily transfer out of each account, not only devoting considerable time to managing the accounts, but paying transfer fees on each account every day. Letting the bank do the work via ZBA saved the company hundreds of dollars each month in account fees and transfer fees, as well as staff time.

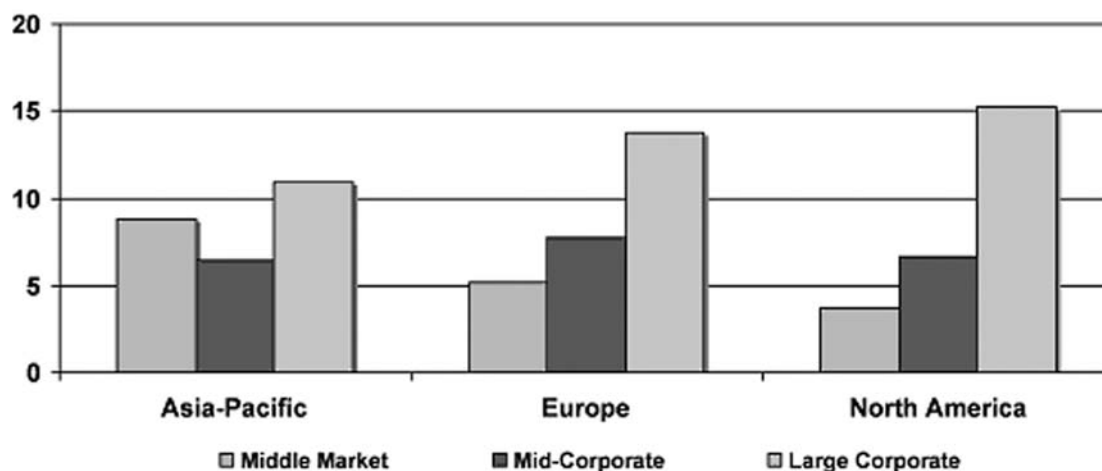


Figure 3: Median worldwide treasury FTE

Best practices in bank administration typically involve three areas: managing the relationships with the company's banks, managing the services they provide, and managing the fees they charge:

- *Banking relationships:* Treasurers should hold a formal review meeting with their banking partners to discuss challenges, additional activities that could bring greater value to the relationship, and external trends that could affect their banking activities.
- *Regular rebidding:* A formal process that puts bank services out for bid every three to five years is recommended. Rebidding helps ensure that banking partners are closely focused on providing value for the company and that potential value from new relationships receives consideration. Research by Treasury Strategies shows that by simply asking banks periodically to compete for the business, companies can reduce their banking fees by as much as 5–10 per cent.
- *Invoice/fee review:* One process that often breaks down is controlling banking fees. Considering that companies can easily spend millions of dollars on bank services, alarm bells should ring when bank invoices are paid without scrutiny, particularly when such tools as baseline reporting and

comparative metrics are easily deployed and can highlight potential problems.

Collections

The purpose of best practices in collections is simple — focus on fast and efficient ways to bring the company's cash into investable balances as quickly as possible. Many longstanding services are offered for this purpose and new services are evolving. When engaging in a comprehensive review of collections, it is important to keep in mind that while cheques are still a large component of payments, electronic payments are experiencing rapid growth. Such a review should assess which of the following services bring value to treasury:

- *Lockbox:* The more cheques can be collected through a lockbox, the better. Even better is if the lockbox provides a direct transmission to accounts receivable, as this reduces manual keying of data, increases accuracy, and reduces exceptions processing.
- *Remote deposit capture:* This should be considered if cheques come into the company's branches and other remote locations. Newer applications now allow corporate cheques to be processed as images, while consumer cheques are processed by automatic clearinghouses (ACHs).

- *Float/availability monitoring*: Regardless of the collection method involved, float and availability should be carefully monitored and managed.
- *Return cheques*: To manage insufficient-funds expense, treasuries should consider using RCK, which allows bounced cheques to be submitted via ACH to increase the chance of collection. This method is preferred as ACH items will be settled ahead of paper items and can be presented three times — instead of twice for cheques.
- *Accounts receivable cheque conversion*: A treasury operation dealing with high volumes of consumer cheques coming into multiple locations should consider this method to accelerate lockbox payments by presenting them via ACH.
- *Back office conversion*: Rather than slowing down checkout lines by converting payments at the point of purchase, some retailers are finding it profitable to convert them in the back office.
- *Recurring credit card payments*: Companies that have a large number of recurring payments, such as insurance companies, find that by drafting their customers' credit cards they can substantially increase renewal rates.
- *Credit card compliance*: No review of collections best practices would be complete without a concentrated focus on protecting consumer data. Mistakes in this area can be costly in terms of fines and loss of customer confidence.
- *Payment/data integration*: An under-utilised best practice is straight-through processing that updates accounts receivable as the payment is keyed. This process of 'moving the data with the cash' provides for many residual benefits beyond the collection value.

The payoff for following best practices in collections can be powerful. One service sector client reported realising a significantly better interchange rate and settling transactions faster by implementing credit card best practices. The same company put its merchant card processing out for bid and the following year reaped

\$1.4m in reduced interchange and processing fees — a 20 per cent reduction.

Disbursements

The objective of disbursement best practices is generally two-fold: minimise the expense involved in making payments; and ensure adequate control over disbursement activities. Best practices include:

- *Consolidated payables processing/centralised disbursement*: Bringing together payables activities and disbursing them from a central location creates opportunities for productivity improvements and lower processing costs. It also minimises the number of bank accounts required.
- *Segregation of duties*: Segregation of duties for initiating, authorising and releasing payments is a basic requirement in accounts payable. However, when companies have many facilities and high turnover, it frequently becomes an area of vulnerability. An important best practice is to require remote facilities to update regularly the central location on precisely who is authorised in each case. A further best practice is to establish dollar limits by function, location and individual.
- *Payment method protocols*: Low-cost electronic methods should have the highest priority. When possible, use P-Cards (purchasing cards that deliver a rebate) and make sure employees use the P-Card for as many of their necessary payments as possible. If customers do not accept P-Cards, consider ACH, because this method minimises transaction expense and risk. Further down the hierarchy would be paper cheques and finally wire transfers. After many years of slowing growth, paper cheque payments are now in decline as electronic alternatives have increased. Today, fully two-thirds of payments are made electronically.
- *Payroll direct deposit*: Direct deposit of payroll eliminates the cost of cheques. It should be paired with electronic pay stubs that eliminate paper and postage.

- *Controlled disbursement:* For companies still issuing a large number of cheques or large-dollar cheques, controlled disbursement lets them maximise investable cash by informing them precisely when they need to fund cheques issued, rather than leaving funds on the table for an extra day or more.
- *Positive pay:* Taking advantage of banks' positive pay offerings is an inexpensive and robust fraud prevention mechanism, because the banks know in advance which cheques presented are indeed legitimate.

Here again, the value of these best practices can be substantial. By deploying a P-Card policy and encouraging its use throughout the organisation, one client reaped a \$1m rebate in the first year. The client also saved a substantial amount in cheque costs.

Concentration and cash forecasting

Bulletproof treasury operations are scrupulous about monitoring bank accounts each morning, obtaining visibility of their cash positions, and rapidly investing any excess funds. Part of this capability is having a reliable cash forecasting capability. The objective is to manage and mobilise cash as needed by the company.

- *Cash concentration:* A best practice for cash concentration is to have a single concentration bank and often a single concentration account as well. Funds should be quickly moved into this account through ZBAs, sweep accounts or other low-effort mechanisms. Even with this structure in place, it is still critical to examine regularly the process surrounding cash forecasting. While performing a best practices review for a client with a rather robust cash concentration function, Treasury Strategies was surprised to discover a large, daily build-up of cash in one collection account. On examining the process, it was found that they had indeed created and were following a procedure for their lockbox banks, which required them to wire the collection bank about collected funds on a daily basis.

However, embedded in the process was a small miscommunication about the timing of the wire and the moving of investable cash. Once they changed the timing, they were able to free up millions of dollars of investable balances each day. Consequently, it is best practice to examine the structural linkages between the collection bank and the supporting activities.

- *Cash forecasting:* Balance management must be supplemented by effective cash forecasting so that treasury knows the organisation's cash needs at a granular level and is able to utilise funds and maintain balances at a minimum level. Best practices for cash forecasting involve forecasting technology, which includes a mechanism for collecting the information needed for forecasting, the right methodology for predicting the company's cash flows, and execution of the forecast as the basis for liquidity decisions.

Another cash forecasting best practice is variance analysis. Treasuries that regularly assess any difference between the forecast and the actual invariably learn from that assessment and continually refine their forecasting capability for better results. Research by Treasury Strategies shows that companies with formally documented investment policies make better cash investment decisions and reap better earnings accordingly — 24–65 basis points better than those without such policies (Figure 4). The research further shows that companies using a formal forecasting process to make investment decisions achieve higher returns — 10–38 basis points better than those that do not (Figure 5).

Debt and investments

Effective debt and investment best practices incorporate many of the same elements as cash concentration and cash forecasting:

- *Centralisation:* Bulletproofing the borrowing and investment function should begin with centralising activities in order to maximise

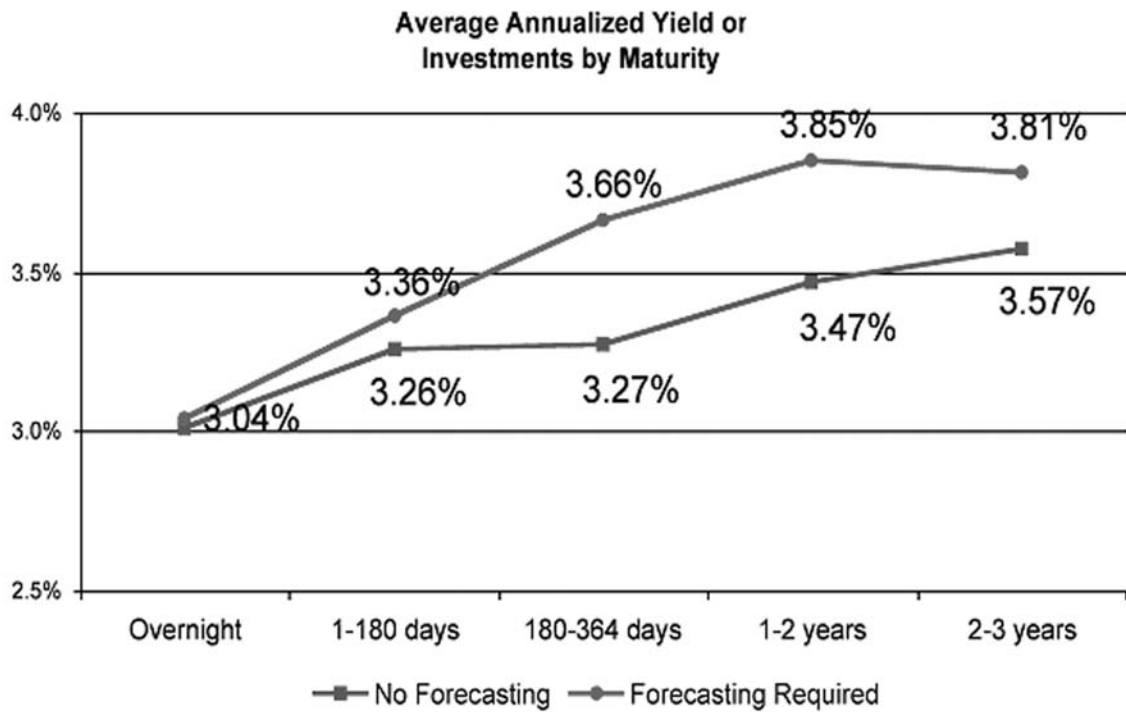


Figure 4: Differential investment yields — those who forecast vs those who do not

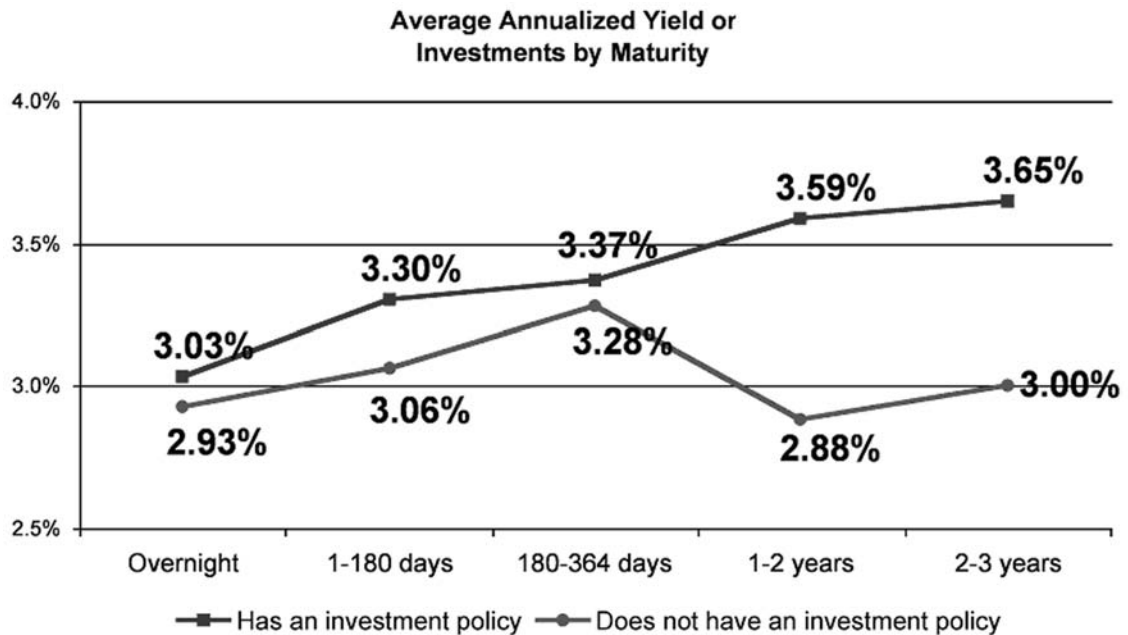


Figure 5: Differential investment yields — those who have policies vs those who do not

control and leverage corporate-wide activity levels for favourable rates and pricing.

- *Automation:* Technology best practices include tracking all debt facilities and short-term investments as well as tightly integrating related payments with cash forecasting tools.
- *Policy review:* Debt covenants and investment policies should be regularly reviewed in light of any changes in organisational objectives and market conditions. In recent months, it has not been unusual to see companies encounter significant investment pitfalls that are often due to outdated authorities granted by their existing policies. In light of new regulatory changes being enacted, it is wise to improve upon the annual review of policies by conducting more frequent and thorough reviews in order to ensure full compliance.
- *Portfolio benchmarking:* Treasurers should establish comparative benchmarks for measuring the performance of their investment and debt portfolios. Research by Treasury Strategies shows that companies using such benchmarks routinely achieve materially higher yields — including benefits of up to 33 basis points.

Foreign exchange

In the increasingly globalised world of business, foreign exchange offers numerous opportunities for increased visibility of exposure and better hedging of the risk:

- *Centralisation:* A centralised foreign exchange operation supports better compliance with FAS 133, and provides a central point for measuring exposure and hedging the associated risk.
- *Competitive bidding:* For large-value foreign exchange transactions (over \$100,000), treasurers are advised to establish a competitive bidding system with large bank partners. It is not unusual for clients who solicit competitive bids to realise improved yields of 5–10 basis points on each transaction.

- *Currency netting:* To reduce foreign exchange transaction costs, Treasury Strategies recommends currency netting, offsetting currency receipts and payments against one another to arrive at the company's net short or long position in each currency.
- *Automation:* Technology plays a critical role in the bulletproof foreign exchange operation, measuring exposure and supporting a programme to hedge the risk. The technology can be deployed to extract foreign exchange information from accounts payable and receivable. For more timely information, it can also draw from the purchasing and sales departments to refine the exposure calculations further. Finally, it can be integrated with the general ledger system to update automatically.

Cash accounting

Cash accounting is a critical focus for best practices, demanding timeliness and accuracy. The sheer volume of cash flowing in and out of the company and its bank accounts makes the matter a fundamental priority.

Treasury's role in cash accounting can vary significantly from company to company, but a larger role is to be encouraged for several reasons. Treasury is likely to be familiar with most transactions flowing in and out of the bank accounts. When it comes to sophisticated transactions such as swaps or certain debt instruments, treasury will frequently have been active in their execution and familiar with the details. Treasury is responsible for the banking systems and services as well as the technology involved in the postings throughout the process.

One area where one often finds gaps is escheatment — the process of turning abandoned property or accounts over to the government. This is a complex process, prevalent in the USA and in certain other regions. The process is governed by a complex set of guidelines, defined by each governmental body. These guidelines place stringent demands on holders of the abandoned properties as to how the related properties are tracked,

recorded, reported and ultimately dispositioned with the related government entity. In all cases, these guidelines demand timely and accurate reporting and processing relating to the property and levy costly fines on parties deviating from these defined procedures.

Policies for every aspect of cash accounting, including escheatment, should be revisited regularly. Special attention should be directed towards those processes, such as escheatment, which carry with them costly ramifications for non-compliance.

Technology

If the goal of treasury best practices is to 'invert the pyramid' and shift the balance of effort from tactical to strategic, technology is essential. Experience suggests that if a treasury group is spending more than 30 per cent of its time gathering, rekeying and manipulating data, then it is not maximising technology's value.

Certainly, the traditional benefits of technology are the ability to reduce administrative and repetitive operational procedures, thereby freeing time for strategic, value-added analysis. Additional benefits include embedded access controls and fraud prevention as well as error reduction. Other more qualitative benefits include risk mitigation and improved visibility and access to liquidity.

It is worth taking a broad view of technology in order to obtain global visibility to cash, manage counterparty risk, execute payments efficiently and provide expanded reporting. Digital dashboard reporting can be an important channel for senior management overview of treasury activities.

Technology can also deliver increased capacity in other company functions supported by treasury. Recent corporate access to SWIFT is now expanding to include additional alternatives for directly accessing bank information. Treasury is also playing a lead role in expanding payment activities to include payment factories which maximise the use of low-cost payment methods and direct file delivery to banks. Technology is the centrepiece of a bulletproof treasury operation.

Two critical best practices for any treasury group today are to assess current technology in light of changing needs and to understand the range and value of technology solutions available in the marketplace:

- *Online banking platforms:* For many companies, functionality developed by banks and offered online at low cost serve their purposes well. While treasurers have long been able to check balances and execute payments online, some banks have increased functionality for cash positioning, forecasting and ledger interfaces. This can often be sufficient functionality for small to middle-market companies for which those processes involve rekeying data and the use of spreadsheets. These platforms provide improved and earlier visibility to available cash during the day. A company with a large number of accounts or highly sophisticated financial transactions may find it less productive to use such functionality in an online application.
- *Treasury workstations:* These are standalone, 'best of breed' treasury management systems which offer a high degree of functionality across a number of treasury functions. Not only do they provide automated access to cash positions and payment execution, they also support debt, foreign exchange, investment and risk management activities. A drawback is that in order to maximise their use, treasury workstations need to be integrated with other company systems, requiring a greater implementation effort to interface applicable systems in order to provide a comprehensive view.
- *Enterprise resource planning (ERP):* Here, this refers to the treasury modules of companywide systems like SAP and Oracle. These treasury modules are often well integrated into other company systems, such that management has a comprehensive view of the organisation. The drawback is that these modules are typically not highly customisable to treasury's needs and lack some of the more sophisticated features

found in best-of-breed systems. However, that functionality may not be required by all treasury groups. As one CIO client said, 'If I'm buying a best-of-breed treasury workstation, I expect it to support 95 per cent of my critical treasury system requirements. But if I'm going with an ERP module, I'm satisfied if I get 80 per cent and bolt on specific applications if I find I need them'.

- *Specialised systems:* In addition to the basic treasury management systems described above, some companies should consider alternative technology platforms based on the scope of their involvement in speciality activities. A specialised system would assist treasury to manage their processes more effectively and ensure compliance. These would include online trading portals for foreign exchange and investments, bank-to-book reconciliation, risk management, multilateral netting, and bank account administration systems.

SUMMARY

Careful attention to best practices creates a best-in-class treasury with the following defining characteristics:

- a clear vision and mission statement defining the role and mandate of treasury;
- appropriate staffing with sufficient resources to meet all company requirements;
- wise use of technology — less than 30 per cent of time spent on low-level activities;
- a robust system of internal controls;
- actionable metrics and reporting;
- effective management and control of banking relationships;
- sound oversight of the company's cash and liquidity.

Year after year, research from Treasury Strategies suggests that firms that implement these best practices will see quantifiable results in the form of cost reductions, compliance and improved yields.